

CGMA CASE STUDY AUGUST 2019 EXAM ANSWERS

Variant 1

These answers have been provided by CIMA for information purposes only. The answers created are indicative of a response that could be given by a good candidate. They are not to be considered exhaustive, and other appropriate relevant responses would receive credit.

CIMA will not accept challenges to these answers on the basis of academic judgement.

Section 1

Requirement 1: Planning and controlling costs using RFID data

At present, Cruisealm has relatively little scope for measuring the extent to which passengers actually use facilities aboard ship and so it is not always clear whether costs are driven by passenger demand. If, for example, passengers spend relatively little time in the swimming pools aboard ship, then it may be possible to either reduce costs by removing the pools or to invest more effectively by replacing them with an alternative. It would be difficult to keep track of the number of passengers using the pools at any given time. Doing so would be highly labour-intensive. The RFID tags would also give insights that would be virtually impossible to obtain manually, such as whether the pool is used frequently by a small number of passengers or infrequently by many.

Some costs may be driven by inefficiencies because, Cruisealm cannot accurately track passenger movements accurately. For example, mealtimes that coincide with shore visits will make it difficult for restaurant staff to know how much food to prepare because they will be unsure how many passengers will remain aboard or will return to eat. That is likely to result in food being wasted because the catering staff will have to make conservative estimates to avoid running out of food. The RFID system will make it possible for the catering staff to be able to track passenger movements in real time, thereby making it easier to prepare batches of food to meet expected demand.

Being able to track the use that passengers' make of services will enable Cruisealm to consider cutting costs on the basis that there is little demand for them. For example, if the data suggests that passengers spend less time ashore towards the end of their cruises then there could be an argument that there are too many stops and that passengers are becoming tired or bored. In that case, Cruisealm could justify spending more time at sea, thereby reducing the port charges associated with docking. Any such apparent reduction in service could be justified on the basis that the company is being responsive to passenger feedback and that could be an aspect of the marketing and promotion. The ability to track activities would also show which activities were being used a lot and this would enable us to ensure we are providing what the customers value.

Requirement 2: Revolutionary change

The use of this technology is revolutionary in the sense that it will transform the manner in which Cruisealm engages with its passengers, through the ability to track their movements and the manner in which they make use of their time aboard ship. It is also, necessarily, a "big bang"

change because there would be little point in introducing the technology in an incremental manner.

Mitchell is responsible for Hotel Operations and so has a duty to be aware of any developments that could improve the quality of Cruisecalm's products. The existence of the technology is a prerequisite to Mitchell's proposal, but that is hardly a reason to criticise him. A negative response from Hotel Operations staff is to be expected because this has the capacity to make their jobs more demanding. For example, housekeeping staff may have to walk greater distances during their shifts if they are expected to clean only unoccupied cabins rather than, say, starting at one end of a passageway and cleaning each cabin in turn.

The impact of this technology on passengers' enjoyment of their cruises will be difficult to predict without conducting a trial and seeking feedback. Passengers may not find it disturbing to have their cabins cleaned during the day and so might not notice any benefit in the housekeeping staff visiting while they are elsewhere on the ship. Some passengers may find having their whereabouts tracked constantly while they are aboard ship intrusive and a breach of privacy. Others may be concerned about the security implications of using this technology to handle payments.

Arguably, these bracelets will offer relatively little direct benefit to most passengers in the short term because they are unlikely to have an immediate impact on their time aboard ship. There could, however, be longer-term benefits for Cruisecalm passengers on future cruises. For example, passenger flow data may suggest that some areas of the ship become busy at certain times and the reasons for that could be investigated in the hope of reducing queues and improving passenger satisfaction in the process. There could also be bigger issues, such as the discovery that certain facilities are not used to any great extent. There could be an opportunity to repurpose areas that passengers are not using. If a new attraction is fitted to just one ship, then the RFID data could track the extent to which it is used by passengers before it is rolled out across the fleet.

Section 2

Requirement 1: Big Data analytics

The first advantage is that Big Data analytics would enable Cruisecalm to draw inferences from the whole set of data that it holds. There could, for example, be relationships between answers to specific questions on the customer satisfaction surveys that influence the likelihood of a repeat booking. Studying the responses in isolation of booking files might not enable the company to see the relative importance of satisfaction in particular areas of the passenger experience. It may be, for example, that passengers will make a repeat booking provided the ship was clean or provided they found the crew friendly.

Once the model has been constructed, Cruisecalm will be able to run it repeatedly in order to establish whether any of the factors have changed in importance. For example, whether changes to the restaurant menus have had an impact on overall passenger satisfaction. Apart from anything else, that would give Cruisecalm a basis for checking the impact that any changes made in response to previous feedback have had. Hopefully, there will be signs of increased passenger satisfaction and an increase in the number of repeat bookings.

Big Data analytics could have a number of disadvantages. For example, the underlying data might not be particularly helpful, because it is not always fully representative. One obvious issue is that the customer satisfaction surveys are completed by only 30% of passengers, which could create a significant problem because of non-response bias. If, say, unhappy passengers are more likely to take the trouble to complete the survey, then Cruisecalm could be tempted to make changes to its cruises that take no account of the views of the passengers who enjoyed themselves, but who choose not to take the time to complete the survey .

Big Data analytics do not necessarily develop a causal model and could produce misleading results. For example, passengers' experiences could have been affected by bad weather during their cruise, which meant that they did not enjoy themselves. If Cruisecalm had not taken account of such external factors then it could draw incorrect conclusions from the results of its analysis of the data that it has collected internally. It may also be difficult to measure key variables, such as the proportion of passengers who go on to make repeat bookings. Many passengers will not book their next holiday for several months after their return and so that data will not be available unless Cruisecalm revisits the historical responses some time later .

Requirement 2: Revenue recognition

Cruisecalm enjoys two sources of revenue from its passengers, namely the fare for the cruise itself and the on-board extras that passengers are likely to buy once aboard ship. Cruisecalm could argue that the booking constitutes a binding agreement with respect to the cruise fare and that the completion of the booking process commits the passenger to making payment in full . The fact that the passenger is required to pay a substantial deposit further supports the argument that the passenger's fare could be regarded as a receivable at the time of booking.

The revenues from other on-board items is less clear cut, but an argument could be made. Cruisecalm's data indicates that there is a clear expectation that the vast majority of passengers will make purchases while on board and so it could be argued that those expectations can be expected to arise from the date of booking.

The arguments relating to the recognition of cruise fares can be best evaluated against the requirements of IFRS 15 *Revenue from Contracts with Customers*. The booking falls within the requirements of IFRS 15 and meets some of the criteria for recognition. For example, Cruisecalm is capable of identifying the rights and obligations of both parties and can identify the payment

terms, which also applies because the booking will specify the cruise and the due dates for payment. It must be also be probable that Cruisecalm will collect the consideration to which it will be entitled. In this case, the customer must pay a 10% non-returnable deposit, which constitutes a significant commitment to honour the contract in full, including making final payment.

Unfortunately, the IFRS does not permit the revenue to be recognised until Cruisecalm transfers the promised service to the customer. In other words, the fact that the booking commits the customer to pay for the cruise does not permit Cruisecalm to recognise any of the revenue from that booking. The only real debate is whether the revenue can be recognised in full when the passenger boards the ship, with the fuel and provisions ready to fulfil the obligation. Even then, it could be argued that Cruisecalm should not recognise revenues until the service has actually been provided because of the possibility that it will have to reimburse the passengers if, for example, the ship had to put into port because of mechanical problems or some other emergency

IFRS 15 does not apply to the on-board extras. The fact that passengers are likely to buy these goods and services does not create revenues that can be recognised at the time of booking. Income is characterised by an increase in assets. Assets require control that has arisen from past events. The sale of these extras may be considered likely to occur, but their occurrence is dependent on a future event, so no increase in assets can be justified at the time of booking.

Section 3

Requirement 1: Bundling products

The most immediate problem is that some passengers will be put off by being confronted by the total cost of the cruise, inclusive of excursions and upgrades. At present, Cruisecalm's website appears to focus on a relatively low "basic" cost for a cruise, in the hope of attracting passengers. Passengers can then add to that to tailor their cruises to match their personal budgets, allowing for any upgrades that they wish to purchase.

Removing the flexibility associated with tailoring cruise packages could deter experienced passengers who know what they require and are unwilling to pay more for a package that includes features that they do not wish to pay for. That suggests that Cruisecalm would have to offer the ability to modify the bundles, which could add to the confusion. It might be possible to overcome this by having two links on the bookings home page, one offering a simple bundle and the other offering tailor-made packages.

Bundles could cost Cruisecalm revenue if the included upgrades are relatively modest. The whole point of this process is to simplify booking and so passengers may select the basic package without further exploring the additional upgrades that could be purchased. Those passengers may then be dissatisfied with their cruise if they find themselves making significant additional purchases during their holiday.

Bundles are often associated with discounts, with the bundle being sold for less than the total cost of the individual parts of the offer. If Cruisecalm discounts its prices then it may confuse some more experienced passengers who realise that tailoring a cruise could prove more expensive than buying a bundle. Again, it could prove cheaper to lose some bookings in order to charge the full price for the basic cruise plus optional extras.

Requirement 2: Competitive advantage

Cruisecalm's passenger data could be a major resource in encouraging passengers to make repeat bookings, rather than, having them book with other cruise lines or on other types of holiday. For example, Cruisecalm knows when passengers booked their most recent cruise, so they could send an email at that same time of year, or a little earlier. That should hopefully coincide with the time that passengers book their annual holiday. The reminder could be personalised to refer to the name of the ship and the route booked last year and recommending similar cruises on which there is availability.

Passenger feedback could also be used to inform regular updates that might be put on a blog, with links emailed regularly to passengers. The updates could be written in a positive manner, but could make subtle references to improvements that have been made. If, for example, the entertainment was not well received on a particular ship then the blog or messages could introduce the new acts that have been booked for the forthcoming season.

The fact that some bookings are made through travel agents could reduce Cruisecalm's ability to capitalise on its ability to contact previous passengers. The travel agents will not release confidential details to other cruise lines, but they will be keen to sell holidays to past customers, including those who have previously sailed with Cruisecalm. They might, for example, email former passengers with details of special offers on cruises offered by Wavelyne or Saildine.

The nature of the cruise industry suggests that cruise lines need to be innovative and forward looking in order to retain passengers and the analysis of passenger data may be essentially backward looking. For example, competing cruise lines might add new features to their ships that

attract passengers away from Cruisecalm. Cruisecalm could attempt to pre-empt that by adding features to its ships, but passenger data might not help them with that. Passengers may not be particularly good at suggesting such features because they may not appreciate what is actually possible.

Section 4

Requirement 1: Validity of comparison

Polony operates in a different market from Cruisecalm Inclusive because cruise passengers are frequently drawn to cruise lines that are based in their home countries. The expectations of passengers from Werrland may differ from those from Norland because of cultural differences, which could affect operating costs. Cruisecalm Inclusive may not, for example, be able to sustain food costs that are as low as Polony's. Polony also has experience of the routes and destinations that are attractive to passengers who are looking for less expensive cruise holidays.

The manner in which Cruisecalm Inclusive came into existence could also affect the comparison of figures. For example, costs such as marketing and running a booking system will be shared with the rest of the Cruisecalm Group, which could inflate profit in comparison with Polony. In the short to medium term, Cruisecalm Inclusive will offer passengers cabins that were designed with the needs of conventional passengers in mind. A low-cost line such as Polony may have smaller and more efficient cabins and so any comparison based on operating profit could be misleading because Cruisecalm's advantage in this sector is not sustainable.

The accounting judgements made by both companies could easily cause material differences between the figures without either company knowingly or deliberately intending to provide misleading figures. For example, Polony has just six ships and Cruisecalm Inclusive just two. That means that individual ships have to be depreciated over expected useful lives that could involve highly subjective estimates that could differ. The lives of ships can be as much about their owners' intentions regarding repairs and refurbishments as about the physical life expectancy of the ships themselves.

Associated with that, we have the question of the manner in which the ships transferred to Cruisecalm Inclusive were valued, whether at book value to the group or fair value. That decision would have implications for the equity shown in Cruisecalm Inclusive's statement of financial position and so would affect the company's return on capital employed. Transferring older ships at a low net book value would have the effect of understating equity and would make the company appear to be far more profitable than Polony.

Requirement 2: Behavioural issues and HRM

Presumably, the management team will be drawn from Cruisecalm's existing managers, who will be concerned about the basis on which the budget was prepared. The new management team may be reluctant to accept the budget targets as because this is a new venture and its champions may have been tempted to set high expectations in order to obtain approval. The biggest behavioural concern is that the management team may be demotivated and could simply give up altogether.

There could also be a concern that the management team indulges in dysfunctional behaviour in order to avoid criticism from the Board. They could aim to sell places on cruises by, say, discounting prices excessively in order to demonstrate that they have filled capacity. They could also be tempted to underspend on costs such as maintenance in order to meet overall profit targets, even though that is damaging to the company overall.

The HRM challenges arise because Cruisecalm has put a new team in charge of a new venture. That makes it difficult to tell whether the success or failure of Cruisecalm Inclusive has been due to the management team or has simply been due to the inherent nature of the business. The evaluation of those managers will require some sensitivity, otherwise they may feel that they are

being criticised unfairly if they are blamed for any problems because the venture has suffered from teething problems.

Another concern is that the new management team may view being moved to Cruisealm Inclusive as a subtle form of demotion. If the new venture fails then the management team may fear that it will be closed down and they might be made redundant, rather than being brought back into their previous roles within the group. Any feedback and evaluation should indicate their career progression within the Group as a whole and should ensure that there is no unnecessary uncertainty about their job security.