

Management level integrated case study – Examiner’s report**May 2016 exam session**

This document should be read in conjunction with the examiner’s suggested answers and marking guidance.

General comments

This paper was based on a pre-seen scenario which described a company in the optical industry. The scenario was made available in advance of the exam and five variant papers were set, each presenting additional scenario-based information and setting four tasks to be completed. Each task was split into two or three specific elements.

Information on this industry and on the sale of spectacles and eye tests is widely available.

Overall, the standard of answers presented was similar to the February 2016 case study; there were many very short and incomplete solutions. As with the February case study, the strongest answers were properly applied to the scenario.

There were some very short answers to the case study and some candidates did not seem to know much about the industry or the company. Given that the pre-seen material had been available for several weeks prior to the exam, this was disappointing. There were also answers which appeared to have been learnt in advance and reproduced in response to tasks where they were not relevant.

Some candidates demonstrated an alarmingly poor understanding of several syllabus areas, including material that is clearly ‘core’, such as the accounting standards, ethics and WACC. This was clearly very disappointing. There were also some very good solutions where candidates were well-prepared and made excellent attempts at answering what was asked.

Summary

The standard of scripts varied more widely than usual in this session. There were some good scripts submitted by candidates who had clearly prepared well, made good use of the pre-seen material and were technically competent. Once again, these candidates also tended to structure their work using headings and subheadings related to the requirements. At the other end of the spectrum were some very poor papers, where candidates had written very little and did not always demonstrate understanding of the requirements. Some weaker candidates had clearly revised specific topics and were determined to work them into their answers despite the fact that they were really not relevant. Generally the least well attempted tasks were those requiring knowledge of financial reporting and ethics.

Variant 1

	Designed to test ability to:	Competency:	Syllabus lead learning outcome:
Task 1	Discuss management of project.	Technical	E2 (D2) – discuss the concepts involved in managing projects.
	Discuss risk management.	Business	P2 (D2) – discuss management's responsibilities with regard to risk.
Task 2	Selection of team members.	People	E2 (C1) – discuss the effectiveness of organisational relationships.
	Evaluating team's performance.	Leadership	P2 (B2) – discuss issues arising from the use of performance measures and budgets for control.
Task 3	Discuss findings obtained from pilot study.	Business	P2 (C1) – evaluate information to support project appraisal.
	Discuss suitability of WACC in calculating NPV and relevance of NPV to final decision.	Technical	F2 (A2) – calculate a weighted average cost of capital (WACC) for an incorporated entity.
Task 4	Discuss financial reporting implications of acquiring subsidiary.	Technical	F2 (B2) – demonstrate the impact on the preparation of the consolidated financial statements of certain complex group scenarios.
	Discuss assimilation of staff from new subsidiary.	People	E2 (C1) – discuss the effectiveness of organisational relationships.

Comments on performance

Task 1

For the first part of this task, candidates were asked to focus on problems estimating revenues and for many weaker candidates this proved quite a challenge, who often simply commented about the fact that it would be difficult without explaining why.

Most candidates provided a good discussion of quality control.

Candidates were then asked to discuss risks and their mitigation. The weakest candidates did little more than state the risks of estimating revenue and quality, for which marks were credited to part (a); they found it very difficult to think of any of their own different risks. Weaker candidates also often did not attempt to mitigate the risks at all, or if they did just quoted TARA and said risks should either be insured or the one-day service should not be provided. The best technique for this part was for candidates to explain a risk and then mitigate it before moving on to the next risk as this ensured that maximum marks were achieved for each point made.

Task 2

The first part of this requirement asked candidates to discuss how a team should be set up to manage the pilot scheme. While there were some very good answers that covered cross departments, different skills and personalities with reference to Tuckman and Belbin, answers tended to focus on this from the company's viewpoint; there was usually nothing from the employee's viewpoint. There were also other poor answers that just discussed the role of a project manager.

The second part of this requirement asked the candidates to consider performance measures and whether the team should select them. Most candidates mentioned the need for a balanced scorecard and then discussed the theory of KPIs. Weaker candidates didn't consider all perspectives and some just gave examples of financial KPIs – so these answers were too narrow in their focus. Better answers included both positive and negative points of teams setting their own measures along with a conclusion – usually that everyone involved should participate.

Task 3

There were some very good answers here where candidates carefully reviewed the data in the tables provided and mentioned that the budget was fixed each month, and that the actual sales were lower at the start than budgeted so they had additional areas to criticise. Weaker candidates didn't look at this level of detail; instead they focused on the overall sales increase of 123 lenses and 611 customers paying for the same-day service, which were figures provided to them rather than them having to interpret the table.

Then candidates were asked to consider if an NPV was necessary and the use of WACC. Most answers were biased in focussing on NPV and not WACC, indicating some possible gaps in candidates' learning. In terms of the NPV most candidates stated that it

should be done but the weaker candidates didn't say why; they just launched into a description of how NPV calculations work. There were a few very good answers for WACC but they were not common.

Task 4

The first part of this task required candidates to discuss the financial reporting implications of the acquisition and the FV adjustments. Many weaker candidates hadn't absorbed the reference in the requirement that this was a takeover. Once candidates discussed subsidiaries they usually discussed control, what the control meant and consolidation, so some high marks were achieved. The answers on fair value were more variable, with very poor descriptions given by weak candidates.

Many candidates discussed the problem of staff fearing redundancies (even though no indication was given that this would happen). These discussions then moved into the importance of communication to keep staff informed and how it should be quick to avoid gossip etc. Only the best candidates discussed the need to align the contract terms between the two sets of staff or things like career paths.

Variant 2

	Designed to test ability to:	Competency:	Syllabus lead learning outcome:
Task 1	Apply relevant accounting standards.	Technical	F2 (B1) – produce primary consolidated financial statements, incorporating accounting transactions and adjustments, in accordance with relevant international accounting standards, in an ethical manner.
	Recommend system for performance measurement and motivation.	People Leadership	P2 (B2) – discuss issues arising from the use of performance measures and budgets for control.
Task 2	Discuss risks associated with permitting buyout.	Business	E2 (A1) – discuss developments in strategic management.
	Discuss commercial and cash flow implications of buyout.	Technical	P2 (C1) – evaluate information to support project appraisal.
Task 3	Discuss valuation of intellectual property.	Technical Business Leadership	F2 (B1) – produce primary consolidated financial statements, incorporating accounting transactions and adjustments, in accordance with relevant international accounting standards, in an ethical manner.
	Discuss ethical and practical aspects of manipulating selling price.	People Leadership	P2 (D1) – analyse information to assess its impact on long-term decisions.
Task 4	Discuss consolidation adjustments	Technical Business	F2 (B2) – demonstrate the impact on the preparation of the consolidated financial statements of certain complex group scenarios.
	Discuss change management	People	E2 (D1) – advise on important elements in the change process.

Comments on performance

Task 1

This task began by informing the candidate of the reaction of staff at IC Optical's research and development facility to a poster asking if they were "an expense or an asset". Candidates were asked how best to explain to the research and development staff why their research efforts must be written off as expenses in the statement of profit or loss.

Whilst better candidates performed well in this section, demonstrating knowledge of IAS 38 and relating the reporting requirements to the specifics of the case study, many omitted any discussion of the reporting requirements and only touched on the motivational aspects.

Candidates were then asked to suggest an alternative performance measurement system and explain how their proposed method would motivate the research and development staff and inform the board of IC Optical.

This was generally better attempted than the first requirement; many candidates made reasonable suggestions for alternative systems but relatively few discussed the requirement to inform the board of IC Optical, again focussing only on motivating the staff.

Task 2

In the second section candidates were told that the manager of the research and development facility had proposed a buyout. Candidates were asked to discuss the risks to IC Optical of the proposed arrangement. Many candidates combined a discussion of risks, commercial and cash flow implications, which was acceptable, although often there was little focus on cash flows.

Some candidates misinterpreted the question and discussed the risks to the buyout team, although the requirement was very clearly stated. This demonstrates the importance of reading the question very carefully.

Candidates were then asked to focus on the commercial and cash flow implications of the proposal. Better candidates demonstrated good awareness of the potential commercial impact of the new arrangement.

Task 3

In task 3 the proposed buyout was progressing and the candidate was asked to comment on how the intellectual property could be valued, as there was some suspicion that the buyout team had undervalued it. There was a range of answers to this section; better candidates showed understanding of the practical difficulties of valuing intellectual property and made sensible suggestions as to how this could be done.

In the second section of this task, an alternative proposal was made that IC Optical could overstate the estimated value of the work they would commission from the new entity in order to increase the price and overcome the undervaluation problem. Candidates were asked to discuss whether this was a practical and ethical response.

Once again, the ethical aspects were generally not well addressed. Many candidates did not attempt this task at all. Some stated that there were no ethical implications, which showed a worrying lack of knowledge and understanding.

Task 4

In the final task, candidates were first asked to explain the impact on IC Optical's consolidated financial statements of the sale of the research facility, both in the year of disposal and the longer term. This was done reasonably well.

The financial reporting was less well addressed, and some candidates did not attempt this requirement. Better candidates attempted this well and showed good technical knowledge.

In the second part of this task, candidates were asked to explain the change management issues to be faced both by IC Optical and also the people working for IC Research. This requirement was generally attempted quite well although many candidates omitted the change management issues for IC Research and only discussed IC Optical.

Variant 3

	Designed to test ability to:	Competency:	Syllabus lead learning outcome:
Task 1	Advise on commercial implications.	Leadership Business	E2 (A1) – discuss developments in strategic management.
	Advise on ethical issues.	People Business	P2 (D2) – discuss management's responsibilities with regard to risk.
Task 2	Advise on predicting cash flows.	Technical Business	P2 (C1) – evaluate information to support project appraisal.
	Accounting statements and interpretation.	Technical Business	F2 (C1) – evaluate the financial performance, financial position and financial adaptability of an incorporated entity.
Task 3	Discuss implications of funding by debt.	Technical	F2 (A1) – discuss types and sources of long-term finance for an incorporated entity.
	Discuss implications of funding by retained earnings.	Leadership People	E2 (C2) – discuss management tools and techniques in managing organisational relationships.
Task 4	Advise on business risks.	People	P2 (D2) – discuss management's responsibilities with regard to risk.
	Discuss implications of excluding entity.	Technical	F2 (B1) – produce primary consolidated financial statements, incorporating accounting transactions and adjustments, in accordance with relevant international accounting standards, in an ethical manner.

Comments on performance

Task 1

Candidates generally saw the dilemma created by the opportunity of laser eye surgery. In the short term it could generate significant contribution but it might then leave customers requiring no further purchases in subsequent years. Most candidates made sensible suggestions, with the most popular being that competitors will offer this service, thereby reducing long-term demand for spectacles in any case. Arguments relating to the second requirement were a little more mixed in quality. The most obvious point, that IC Optical could recruit suitably qualified surgeons to perform the procedure, was generally well made. Better answers demonstrated wider thinking and addressed the associated issues, such as the need to train the opticians who would be required to evaluate the needs of customers and the suitability of this procedure before referring them to the laser clinic.

Task 2

The first requirement addressed one of the more significant problems associated with project appraisal, namely the forecasting of cash flows. There is very little point in understanding the various models that can be used in evaluating a project if the underlying predictions are unreliable. Arguably, a net present value analysis can be biased through either optimism or pessimism in the forecasting of cash flows. Many candidates simply described techniques such as NPV, IRR and payback, with no attempt made to answer the question.

Answers to the second part of this task were better. Most candidates were able to identify the impact of this transaction on the financial statements themselves. Most candidates were also able to identify accounting ratios that would be affected. The two main areas in which the quality of answers diverged was over the justification for including a particular ratio. Arguably, any major project will increase capital employed almost immediately, while the associated returns may take longer to appear. That means that a successful project could diminish, say, return on capital employed in the short term but offer an increase in the longer term when profits start to accrue.

Task 3

Answers to the first requirement were generally good. Candidates were able to demonstrate an understanding of the impact of borrowing on the overall cost of capital. Good arguments teased out the fact that borrowing tends to be relatively inexpensive compared to equity, but increasing borrowing makes the entity more highly geared and so the overall impact on WACC can be complicated. Relatively few candidates addressed the question of future flexibility, the point being that most entities have a limited borrowing capacity and exhausting that will make it more difficult to raise further debt in the future.

Task 4

The discussion of risk was often too heavily biased towards the medical risks arising from the laser procedure itself. While that was undoubtedly a valid line of argument, it represented only one of several other lines of argument that could arise. Better scripts tended to address both upside and downside risks across the whole range of business risks. Candidates were often good at identifying risks, but less capable of offering a relevant mitigation.

The second requirement tended to be answered either very well or very badly. At its most basic, this requirement asked candidates to reflect on the merits of attempting to exclude a group member from the consolidated financial statements. Better answers identified the fact that the proposal involved creating an artificial management structure for Laser and addressed the relevant IFRS requirements that would, hopefully, prevent its exclusion.

Variant 4

	Designed to test ability to:	Competency:	Syllabus lead learning outcome:
Task 1	Discuss business implications of new development.	Business	E2 (A1) – discuss developments in strategic management.
	Discuss basis for setting rental.	Technical	P2 (C1) – evaluate information to support project appraisal.
Task 2	Advise on motivating staff.	People	E2 (D1) – advise on important elements in the change process.
	Problems associated with profit-related bonuses.	Leadership People	P2 (B2) – discuss issues arising from the use of performance measures and budgets for control.
Task 3	Advise on accounting issues relating to intangibles.	Technical	F2 (B1) – produce primary consolidated financial statements, incorporating accounting transactions and adjustments, in accordance with relevant international accounting standards, in an ethical manner.
	Advise on corporate culture.	Business	E2 (B2) – discuss the hard and soft aspects of people and organisational performance.
Task 4	Advise on status as associate.	Technical	F2 (B1) – produce primary consolidated financial statements, incorporating accounting transactions and adjustments, in accordance with relevant international accounting standards, in an ethical manner.
	Advise on risks of giving a seat on board.	People Leadership	P2 (D1) – analyse information to assess its impact on long-term decisions. P2 (D2) – discuss management's responsibilities with regard to risk.

Comments on performance

Task 1

This requirement tested the ability to link a business decision to the underlying business strategy. A good answer should have considered both the possibility that the venture with LowPrice will prove an exciting opportunity to expand the company's trading capacity and a threat that the new shops will simply compete with the existing shops, while threatening a loss of goodwill due to slower service on busy days. Candidates made some good points and discussed some of these issues very well. In general, points about consumer confidence were not picked up by many candidates. Another point that was really not mentioned by many candidates was the convenience of having more branches for consumers.

The second part of this task asked for a discussion of a set of figures offered as part of a negotiation. It is hardly surprising that the figures appear to favour the party who prepared them. A good answer should have identified ways in which the figures may be distorted by IC Optical's prospective business partner. Candidates should have addressed this concern by considering the logic underlying the figures.

Task 2

The first part of this task required candidates to think about the most appropriate response to a perception created by a documentary. IC Optical's staff may now be reluctant to relocate to the new shops because of concerns expressed by LowPrice's staff while on camera. The validity of the documentary may be open to question and the extent to which the IC Optical staff might be confronted by those issues are both worth addressing. The key issue is that these employees will continue to work for IC Optical, albeit in a setting provided by LowPrice. Many candidates answered this requirement very badly and could find little to say about the two shops.

Good answers to the second part of the task should have recognised that a financial incentive, particularly in the form of a profit-related bonus, is missing the point of the staff uncertainty. Few candidates discussed this issue which was disappointing. The employees are being asked to work in a setting that may prove unpleasant. It may be possible to address that through a small financial incentive, but linking it to shop profit means that the reward is not being linked to the source of the concern. Apart from failing to address the concerns of the staff working at LowPrice, the bonus may lead to resentment on the part of the other employees. Again very few of these points were made by candidates.

Task 3

The first part of this task was on brand recognition and brand impairment. This raises two issues: the accounting choices and the shareholder response. The accounting choice depends on the application of the criteria relating to the recognition of assets. The criteria themselves offer sufficient discretion to enable IC Optical to justify either writing the cost off or capitalising it.

In principle, the choice of accounting treatment will have little impact on the future cash flows. The shareholders could, however, decide that the decision indicates an element of confidence in the investment, with capitalisation implying that the directors anticipate significant future benefits and expensing implying that they do not. This was very badly answered with few candidates having the knowledge of brand accounting required to answer the question.

The second part of the task asked candidates to consider the potential impact of permitting LowPrice to supervise the IC Optical shops that will be situated on their premises. There could be an argument that any such supervision will be unlikely to hamper IC Optical's operations. If it did then LowPrice would make smaller profits from the joint venture. Conversely, there could be motivational issues associated with the supervision of professionally-qualified staff by LowPrice's local managers. Any undue interference could even have an impact on the quality of the care provided to customers and could compromise IC Optical's reputation. Few candidates discussed the two shops in enough detail and did not gain high marks.

Task 4

The decision to classify IC Optical as an associate will have no immediate impact on IC Optical. The questions that will have to be addressed by LowPrice are, at best, only indirectly relevant to IC Optical. Candidates should have been able to explain how the treatment of this investment would affect LowPrice's financial statements. The criteria for the classification should reflect the information given in the scenario. The first part was about associates and unfortunately this was badly answered by many candidates. Candidates demonstrated little knowledge and application of accounting standards in their answers. This area of the syllabus must be revised before a resit attempt is made.

The second part of the task required candidates to consider two issues relating to placing a LowPrice director on IC Optical's board. The first issue is the possibility that this will prove disruptive. That director will have a significant interest in the company, which will lead to votes being cast and discussions pushed in the direction of LowPrice's needs. The second issue is the question of the ethical implications of permitting LowPrice to place a director. There were a wide range of arguments that could be put forward. In general, this part of the task was answered very badly. Some candidates missed this part out and others had no idea at all on the ethical implications. This was very disappointing.

Variant 5

	Designed to test ability to:	Competency:	Syllabus lead learning outcome:
Task 1	Discuss an investment proposal.	Technical	P2 (C1) – evaluate information to support project appraisal.
	Resolve conflict between board members.	People	E2 (C2) – discuss management tools and techniques in managing organisational relationships.
Task 2	Identify financial and non-financial criteria for closure of branches.	Business People	P2 (B2) – discuss issues arising from the use of performance measures and budgets for control.
	Recommend criteria for staff selection.	People Leadership	E2 (B1) – discuss the concepts associated with managing through people.
Task 3	Discuss cost of equity.	Technical	F2 (A2) – calculate a weighted average cost of capital (WACC) for an incorporated entity.
	Discuss shareholder expectations with respect to directors' performance.	Business Leadership	E2 (B2) – discuss the hard and soft aspects of people and organisational performance.
Task 4	Advise on calculation of goodwill on acquisition.	Technical	F2 (B1) – produce primary consolidated financial statements, incorporating accounting transactions and adjustments, in accordance with relevant international accounting standards, in an ethical manner.
	Discuss risks.	Business	P2 (D2) – discuss management's responsibilities with regard to risk.

Comments on performance

Task 1

This requirement tests understanding of the logic underlying a project evaluation. It requires an evaluation of some arguments that have been put forward in order to justify a decision that a manager has made for other reasons. A good answer will demonstrate an understanding of the principles of NPV.

Generally most candidates were reasonably good on the first section with some very complete answers amongst them. Most highlighted significant shortcomings in the evaluation although very few actually picked up on any contribution element that these stores were making, or the potential difficulties in selling the stores or redeploying the equipment. Many picked up on the opportunity to give competition a free ride in those areas where stores were closing. Few considered the overall cash flow problems which could emerge from the combination of cessation of contribution, plus new investment, plus redundancy.

The second part of this task asked for recommendations as to how to deal with conflicting positions adopted by board members. Arguably, it is inevitable and even healthy that such disputes will arise, but the board has to take care that a final decision is reached and that all parties can continue to work together effectively. In this case, there may be a suspicion that one directors is working to protect her departmental interests, in which case she should be encouraged to focus on the company's needs. This part of the task was far less well answered than the first; only 20% or so gave good answers or answers of any length here with quite a large percentage showing very scant answers, often combined with very full answers to the first part.

Task 2

This first part of this task asked for an understanding of both the financial and non-financial aspects of selecting a shop for closure. While they overlap, candidates should also recognise that they are also distinctive. The financial issues reflect the potential loss of a contribution. The non-financial affect the wider presence of IC Optical in this market. There is no specific list of acceptable factors. A good answer will demonstrate some logic in the selection and justification.

There were many good answers here. Certainly financial factors were well covered via a discussion of various profitability ratios and the application thereof to the data provided on the four shops. It would have been good if more candidates had mentioned that all the shops detailed were profitable so that there was some confusion regarding the term 'underperforming'. Non-financial factors were not covered nearly as well with many candidates vaguely referring to areas where there may be two or more stores, rather than setting out any hard non-financial criteria.

The second part of the task asked candidates about criteria for selection of staff for retention. Good retail staff will have skills that can maximise the contribution from any given sale. The key variables here will be whether customers can be persuaded to buy more

expensive frames and lenses, thereby making the most from every transaction. This is important because shop staff may be unable to do much to attract additional customers into their shop. There are also major opportunities to sell high-margin coatings and tints. These appear to be cheap and easy to provide, but they are sold at a significant margin.

The other issue is the ethical dilemma associated with transferring staff to shops that have been identified as due for closure. A good answer would have recognised that this is a complicated issue because the shop has to make some staff redundant and it does have a legitimate interest in selecting the better staff for retention. Answers to this section were often brief. Many candidates had little idea of the relevant ethical issues involved and were thus unable to apply them to the case study. When ethics were covered only the ethical principle of integrity was covered to a satisfactory level.

Task 3

The first part of this task asked about calculation of the cost of equity. Candidates should focus here on the fact that the share price is set by market forces and that the board cannot make the shareholders accept a lower cost of equity. At best, the company can report positive news with a view to encouraging the share price to increase. On the whole this question was very poorly answered. NPV was often discussed in a general context without any discussion on the cost of equity.

Crucial to answering the second part of this task was recognising that the markets may not set explicit rates of return as targets, in dealing with their companies. The share price rises and falls in line with market sentiments and it may be possible to infer a required rate of return using mathematical models that reveal the estimates that might be made by the market.

As regards the fairness of expected returns most candidates agreed that 415 was unreasonably high but failed to explain why, with many saying with similar vagueness that 21% was OK. Not many had any clarity on this. Quite a few discussions extended to WACC without consideration of the cost of equity.

Task 4

This task focussed on the acquisition of SmartSight, an online retailer. Candidates should have been aware of goodwill and other issues relating to consolidation because that is a prominent aspect of F2. Answers should have addressed the specific problems in the scenario rather than simply describing the goodwill figure, although some marks were given for generic answers.

The suggested answer focuses on the separable net assets, but marks were also awarded for a sensible discussion of the purchase consideration. Generally the first part of this task was answered badly. A majority of candidates had little knowledge of the relevant accounting standards and were thus unable to give advice on how to calculate goodwill on acquisition. Advice was given on how to consolidate SmartSight's results, which was not really relevant. Some of the definitions of goodwill demonstrated little comprehension of the makeup of this intangible asset. Some revision of this area is required before a resit.

In the second part of this task, candidates were free to discuss any sensible issues arising from the fact that IC Optical owns only a controlling interest in this important subsidiary and that the NCI shareholders may take a close interest in their management of the company. In this part very few candidates mentioned the minority shareholder element and possible conflicts on vested interests, however most dealt reasonably well with the online sales risks.

Tips for future candidates

There are a number of key points to take into account when preparing for future management level case study examinations, as follows:

Candidates must make better use of the opportunity to gain familiarity with the pre-seen material. It is not necessary to memorise the material or to become an expert in the industry, but candidates should develop an understanding of the business.

Questions give explicit instructions as to what is required and marks will not be awarded for anything that has not been requested. In particular, essays on the theory underlying the problem at hand are unlikely to score well if the question asks for a response to a particular issue arising from a scenario.

Candidates should remember that all sections of tasks are equally weighted.

With the time constraints in place, candidates can only spend a limited amount of time on each task. Therefore it is essential that candidates focus on making the points that they are most confident of before they run out of time.