Answers

1 To Board of LLA
From A Accountant
Date December 2012
Subject **Performance measurement and management at LLA**

This report will address a number of questions raised at the recent board meeting regarding performance management at LLA. It will assess the performance of each of the regional offices and consider the appropriate way of measuring performance, given the concerns expressed about responsibility accounting. Finally, the report evaluates the current remuneration policies at the offices and suggests improvements.

(i) Regional Office Performance

Fundamentally, all three offices are doing well.

	North	East	West
	$m	$m	$m
Net Income	20	65	80
Net cash flow in year	24	86	46

They have all delivered profits at its most basic level (net income) and positive cash flows. In addition, there have only been positive residual incomes and returns on capital employed of over 50%. However, these are not effective performance measures for a service company such as LLA. The intangible nature of many of the assets and services provided will make traditional measures based on capital employed less reliable. A more thorough analysis of performance would require data on customer satisfaction and retention.

However, the offices do show differences in their growth and liquidity prospects.

1. The North office has seen a decline in revenues over the three periods (by 1·9% in the most recent year). As a result, net income has fallen by 4·8% in the last year. The office has the lowest operating margins.
2. The East office has stable revenues growing slightly (although it would help to gain a clearer perspective on this figure by benchmarking against the wider market for advertising). The East office has managed to hold down cost of sales and this has driven a strong increase in net income (by 12·1% over 2011).
3. The West office has seen the highest growth in revenues (by 8·9% over 2011). But this has led to strains in working capital as receivable days has risen to 93 days (well above the 54–59 day range for the North and East offices). This, and a higher level of capital expenditure, helps to explain why West is seeing a fall in cashflows generated while driving its profits higher. It should be noted that West is obtaining significantly higher operating margins than North or East as well. This may be as a result of the large capital expenditure that seems to be going into that office.

(ii) Suitable performance measures at LLA

Net income is not wholly the responsibility of the regional management as head office costs are allocated outside of their control. Therefore, measures based on operating profit are more appropriate for the regional managers at LLA. However, even using operating profit, residual income and return on capital employed are less meaningful for a service-based business, since the business will not use a great deal of tangible assets compared to a manufacturing business. More meaningful measures would be revenue growth and, in cost terms, the ratio of staff costs to revenue. If residual income were to be used, it may be more appropriate to use different notional interest rates for the different offices. This is justified as it seems that West may be in a different environment and with its higher capital spend, it may be taking more risks, for example, by investing in technology to aid the creative design process.

Specifically, at present, the following performance metrics match to the issues at each office:

1. At North, the need is to turn around the decline in revenue and so revenue growth would be set as a target. However, this must not encourage the ‘buying’ of revenue by slashing prices and so an operating margin measure would be an appropriate additional control.
2. At East, the business appears stable and therefore efficiencies should be sought. East should focus on staff costs as it is paying 37% of revenue to its staff compared to as little as 31% at West. There may be economic reasons for this – the East office may be in the richest and most expensive part of Veeland and so it costs more to attract good employees to work there. The East office could pass on to the other offices how it has driven such high gross margins (72% as opposed to 66% at West).
3. At West, the business needs to continue its growth at the best operating margins but it must maintain control of working capital and so turn profit into cash. Therefore, debtor days or current assets should be targeted.

It would assist decision-making if suitable benchmarks internal (office to office) and external (competitors) to LLA were also found and included in performance reporting. A further suitable external measure may be the market share that each office holds in its region.

Therefore, it is recommended that operating profit is a more appropriate general measure for the offices at LLA with revenue growth and staff costs ratio as subsidiary indicators of performance. There are additional detailed indicators noted above to address each office's specific problems.

(iii) Remuneration packages

Generally, using industry norms as a basic benchmark will help to ensure that staff are kept broadly happy, although it will not motivate them to outperform their peers.

Taking each of the staff levels in turn:

Senior management
Their basic salary reflects historic norms and the bonus should motivate performance. It is notable that no account is taken of the different economic conditions that each office may find itself in and so there may be resentment from those in offices where the general economy is doing poorly to those who are in a region with good performance and so profits are growing easily. It may be worthwhile trying to benchmark the performance of each office against its regional competitors, although it can be hard to obtain such detailed information.

Creative staff
The creatives' packages are set when recruited. This could lead to a loss of motivation, especially for those who get only a fixed salary. If a bonus is paid, then it is currently based on revenue and not profits and so there is no mechanism to control costs on projects with these employees. There will be tension between the need for imaginative ideas and cost efficient ones. Overall, it is likely that each staff member should have a personalised package with a performance element that would be based on the assessment of a superior manager. In order to maintain some sense of objectivity, the criteria that the manager might use to judge performance should be agreed across the firm and could include, primarily, winning new business in tender competitions and, secondarily, winning industry awards.

Buying staff
The packages for the buying staff appear to be based on appropriate performance, although the setting of such targets depends heavily on the expertise of the finance team and, as they are based in the East office, they may lack the local knowledge to set the budget accurately. It may be wise to maintain the bulk of the buyers' remuneration as a fixed salary element as a result.

Account management staff
It is surprising that this group of client-facing staff are not paid on performance. It would seem that their performance could be directly measured by client retention and new business won, so it would be common for such staff to have a high percentage of their remuneration based on performance and not be wholly fixed. Measures such as numbers of clients and total client revenues would be appropriate for these posts.

Administration staff
This is a common method of remuneration for these types of jobs and in line with the general market. A small bonus based on the overall performance of the firm may help to create a culture of loyalty throughout the business. It is unlikely to be efficient to set individual targets for such employees, given that there will probably be a large number of them.

In conclusion, the main finding of this report is the encouraging performance of the offices although further work needs to be undertaken to ensure that West can continue to grow while turning its profits into cash efficiently. The main performance measure (net income) is not suitable as it is not a true measure of solely the regional management's efforts. Measures using operating profit would be more appropriate and recommendations have been made about each office individually.

2 **(a)** The current method of budgeting at all divisions is incremental budgeting. The advantages of incremental budgeting are that it is simple and easy; therefore, it does not take up much time and resources in the finance department, which is constrained by the new information system implementation. It is suitable in organisations where the business is stable and so historic figures represent a solid base from which to consider small changes. The problems associated with incremental budgeting are that it consolidates existing practices into the targets and so tends to stifle innovation. As a result, inefficient and uneconomic activities will not be challenged and opportunity for cost savings may be missed. Also, managers may deliberately spend up to their budget limits in order to ensure that they get an increment from the highest possible base figure in the next budget.

At the different divisions
As S and H are stable businesses, it makes sense to continue to use incremental budgeting at these divisions. Change at these divisions may not seem necessary as it would create resistance from the divisional managers. However, incremental budgeting is not consistent with continuous improvement which may be required to reduce costs and improve profit margins in these divisions.

At F, the incremental budgets will be rapidly out of date in such a growing business. The current problems of management dissatisfaction and poor quality control may be resulting from divisional management trying to meet their targets with a budget that is not suitable for the growth occurring. They may be cutting corners to meet budget and so buying poorer materials or failing to increase capacity and so not making deliveries.

At M, incremental budgeting is intensifying complaints from the other divisions, who already see M as an unnecessary expense. Incremental budgeting is insufficiently critical of the existing spending and it can lead to unjustified increases.

(b) A rolling budget is one where the budget is kept up to date by adding another accounting period when the most recent one expires. The budget is then rerun using the new actual data as a basis. At Drinks Group, with its quarterly forecasting, this would work by adding another quarter to the budget and then rebudgeting for the next four quarters.

Rolling budgets are suitable when the business environment is changing rapidly or when the business unit needs to be tightly controlled.

The new budget at F would be:

	Current year Q1 $'000	Q2 $'000	Q3 $'000	Q4 $'000	Total $'000	Next year Q1 $'000
Revenue	17,932	18,470	19,024	19,595	75,021	20,183
Cost of sales	9,863	10,159	10,464	10,778	41,264	11,101
Gross profit	8,069	8,311	8,560	8,817	33,757	9,082
Distribution costs	1,614	1,662	1,712	1,764	6,752	1,817
Administration costs	4,214	4,214	4,214	4,214	16,856	4,214
Operating profit	2,241	2,435	2,634	2,839	10,149	3,051

Based on the assumptions that cost of sales and distribution costs increase in line with sales and that administration costs are fixed as in the original budget.

The budget now reflects the rapid growth of the division. Using rolling budgets like this will avoid the problem of managers trying to control costs using too small a budget and as a result, choking off the growth of the business. The rolling budgets will require additional resources as they now have to be done each quarter rather than annually but the benefits of giving management a clearer picture and more realistic targets more than outweigh this.

However, it may also be worth considering going beyond budgeting altogether in order to avoid this constraint problem.

(c) At M, as noted in part (a), incremental budgeting may not be a suitable choice of budget method. A more appropriate budgeting system for such a project-based function is zero-based budgeting (ZBB). Marketing operates around campaigns that often run for fixed periods of time and do not fit neatly into accounting periods which further undermines the use of incremental budgeting. It can be seen as a series of projects. This type of operation is best controlled by having individual budgets for each campaign that the divisional managers must justify to senior management at the start. ZBB requires each cost element to be justified, otherwise no resources are allocated. This approach would please the manufacturing divisional managers, as they will see tight control. It will not hobble M as there are few fixed overheads in marketing as it mainly involves human capital. ZBB is often used where spending is discretionary in areas such as marketing and research and development.

(d) The management style currently used at DG is top-down, budget-based with some degree of participation by divisional managers. Given the irritation being expressed by the divisional managers, the senior management could consider making the control process more participatory. This would involve shifting to more bottom-up setting of control targets. This could involve the divisions preparing budgets or else dropping budgeting altogether.

Bottom-up control involves the divisional managers at DG having an opportunity to participate in the setting of their budgets/targets. It is also known as participative control for that reason. It has the advantages of improving motivation of the divisional managers by creating a greater sense of ownership in the budget/targets. It increases the manager's understanding, which has additional benefits if personal targets are then set from the budget. Bottom-up processing frees up senior management resource as the divisional managers do more of the work. It can also improve the quality of decision making and budgeting as divisional managers are closer to their product markets.

Bottom-up control can be contrasted with top-down budgeting. A top-down budget is one that is imposed on the budget holder by the senior management. It is controlled by senior management and avoids budgets that are not in line with overall corporate objectives or that are too easily achieved.

At DG, the current approach does have involvement from the budget holders and so is participatory. This is important as the managers are set targets based on budgets, although the finance department involvement should help to avoid the issues of lack of strategic focus and slack that are noted above. The introduction of rolling budgets could be delegated to the F managers as they will be happy to take on the solution to their constraint problems. It would be wise to keep some involvement by senior finance staff in reviewing the budget – particularly, the key growth assumptions. The introduction of ZBB at M will require the involvement of budget holders as they will prepare the original proposal. These suggestions will have the advantage of encouraging innovation although it will loosen central control. Senior management will need to assess whether the managers of the stable divisions (H and S) can be relied on to drive down costs without the close oversight of the head office that is provided by a top-down approach.

Thus, some level of bottom-up budgeting fits well with both the current and future plans for financial control at Drinks Group. Although, the senior management will have to decide on the different level of central control to exercise, based on the skills of the divisional management and the degree of latitude that they require in order to improve their operations.

3 (a) Stillwater Services

Economic Value Added

	$m	
Operating profit	68·0	
Add back		
Non cash-items	7	
Accounting depreciation	59	
Doubtful debts	2	
Research and Development	12	
Less		
Economic depreciation	83	
Tax – Cash paid	9·0	
Lost tax relief on interest	5·75	= $23m x 25%
NOPAT	50·25	
Capital employed		
At 2012 start	637	
Add back:		
Provision for doubtful debt (at 2012 start)	2·5	= year end less increase in year
Other non-cash items (incurred in 2011)	6	
Adjusted year-start figure	645·5	

WACC = (40% x 16%) + (60% x 5% x (1 – 25%))
= 8·7%

EVA™ = NOPAT – (WACC x Capital employed)
= –5·9

The company is currently destroying value as it is failing to meet the economic cost of its own capital. This is an unsustainable position in the long term and will lead to shareholder dissatisfaction. The problem could lie in a high cost of equity for such a heavily regulated industry. The risk of investing should be low, given that 80% of the services that SS provides are vital to the economy and so demand is nearly guaranteed. Alternatively, the company needs to either drive up its Net Operating Profit After Tax (NOPAT) as it requires a NOPAT of $56·2m in order to break even on economic value added or reduce its capital base by selling under-utilised assets.

[**Tutor note:** *The technical article 'Economic value added versus profit-based measures of performance' by Nick Ryan covers the reasoning behind the adjustments in the EVA™ calculation.*]

(b) Regulatory ROCE

Target 6%

SS $\frac{\text{Operating profit}}{\text{Capital employed}} = \frac{46 \cdot 0}{779 \cdot 0} =$ 5·90%

Operating margins

Regulated services	16·7%
Non-regulated services	31·9%

The company is within the allowed return on capital employed by the regulator. There is only a minimal scope for increase in the profitability of this aspect of the business as the maximum operating profit that the regulator would allow on $779m of capital employed is $46·7m.

The company should seek to increase its non-regulated activities as these are generating much higher operating profit margins – 32% compared to 17% (regulated). It could use the regulated activities as a reliable source of cash profit to reinvest in expansion of the more profitable non-regulated areas.

The implications for performance management are the need to control costs within regulated activities as then the regulator cannot argue that the company is overcharging its customers in order to drive profit growth. This can be done through tight observance of budgets and seeking cost savings through efficiency improvements. Targets based on minimising variances and innovation in cost cutting would be appropriate.

Within the non-regulated areas, a more entrepreneurial approach can be taken. Performance management in these areas will focus more on growing revenues by expanding markets (taking a larger share of the national market) and improving profit margins. As already noted, growth by acquisition of suitable unregulated businesses using the cash generated by the regulated activities would be a possible course of action. Targets based on revenue growth and innovating in new business areas with high profit margins would be appropriate.

4 **(a)** The current measures of performance at CCNH are based on profits. These are often insufficient to grasp issues to do with the survival of the business, both in the long and the short term. In the short term, liquidity covers the degree to which there are readily available funds in order to meet immediately payable liabilities, for example, the cash to pay suppliers. In the long term, gearing measures risk. This could be financial risk or it could be operational risk. Gearing indicates the size of the fixed regular liabilities of the company compared to the cash generators that will cover them. So, financial gearing is measured by the ratio of debt to equity – debt being the fixed liability and equity the capital equivalent that generates funds to cover this liability. If the ratio is high, then there are large fixed liabilities to cover with only a small equity investment and so the business is at financial risk. (The ability to cover the annual payments needed on the loans is often measured by the interest cover which is the ratio of profit before interest to interest payable.) Operational gearing compares the ratio of fixed costs to variable costs (or sometimes the ratio of contribution to the operating profits). If it is high, then the business is more risky as the fixed costs are a large part of the overall costs of the business and so if revenue falls the variable costs fall but the fixed ones do not.

Liquidity at CCNH is difficult to measure in detail as we are only given the current assets figure. However, we can compare the current assets and liabilities in the current ratio and we get 0·62. Therefore, CCNH does not have readily available assets to pay its creditors.

There is no breakdown into receivables, inventory and cash which might aid a detailed understanding of the maturities of the different items. However, we do know that there is no cash on deposit and since CCNH is a service company, it is unlikely that there is much value in inventory. Therefore, the bulk of current assets must be receivables. So we can deduce that SC has difficulty collecting its receivables compared to GC, as it has much higher receivables on lower revenues. It may be helpful to use receivables days which measures the time taken to collect receivables as a key performance indicator for SC and also for SC to compare its collection procedures with those at GC in order to identify possible improvements. (Currently, SC has 68 receivables days compared to 9 at GC, assuming all current assets are receivables.)

Financial gearing at CCNH is fairly low with a debt to equity ratio of 54%. There is, however, a financial risk as the interest payments are barely covered by profits in the most recent year and this could jeopardise the relationship with the bank which has recently proved so valuable in getting the overdraft extension.

Operational gearing at CCNH is probably what the director was referring to when speaking to the CEO. From the income statement, it can be clearly seen that rents, which are a fixed payment, are a large percentage of revenues (27%). Given that central and home staff costs will probably also be fairly fixed this means that CCNH has a high operational gearing which means that any fall in revenues is not matched by a fall in costs and so the company moves quickly into loss as seems to be the case in the most recent period. (Operational gearing [measured as fixed costs to variable costs] at CCNH is 7·6 which is very high.)

There are few simple ways to change the nature of the costs in the business. However, using more temporary staff would mean that home staff costs would become more variable, although this may compromise the quality of the service provided. Also, it may be possible to renegotiate the terms of the leases on the homes so that the landlord accepts part of the risk by taking a lower rent combined with a percentage of revenue that the home generates. However, landlords are notoriously risk averse and it will have to be an attractive deal to obtain such a renegotiation.

(b) Qualitative models of business failure such as Argenti use a variety of qualitative and some non-accounting factors to predict corporate failure. The types of factors included are management experience, dependence on one or a few customers or suppliers, a history of qualified audit opinions and the business environment including the industry sector and the general economic situation.

The Argenti model is a qualitative model used to predict corporate failure which is based on non-accounting or qualitative variables. The model suggests that there are three connected areas that indicate likely failure: defects, mistakes made and symptoms of failure. Each of these areas is divided further and an assessor gives scores under each of these headings. A score of more than 25 is considered to indicate that the company is at risk of failing. The scores in the three areas themselves are also of interest as high scores in mistakes made indicate poor management. Failing companies often score highly, around 60.

The Argenti score has, therefore, attempted to quantify the causes and symptoms associated with failure. Its predictive value has not been adequately tested, but a misclassification rate of 5% has been suggested.

Defects are divided into management defects and accounting defects. Management defects are to do with the characters and strengths of senior management. Facts that would cause concern are a dominant CEO, the failure to separate role of chairman and CEO, a passive board of directors, poor skills and experience in the management team and a poor record of responding to change in the business environment. Here, the recent loss of senior management at CCNH would be a black mark. Examples of accounting defects are lack of budgetary control, lacks of cash flow planning and costing systems. The one defect that we have evidence of at CCNH is the lack of cash flow planning which has resulted in the near failure to pay the landlords.

If a company's management and accounting systems are weak, then it is suggested that this will lead to mistakes being made. The mistakes are scored too under three headings: high gearing; overtrading and the failure of a large project. There may be evidence of some overtrading at the Special Care division, where rapid growth has led to a failure of credit control and so high receivables which are straining the working capital of the business.

Finally, the model suggests that the weaknesses noted above will lead to specific symptoms of failure where the prospect of corporate collapse becomes more publicly clear. The symptoms are financial such as poor ratios in the financial statements;

the use of creative accounting to window dress the financial statements; and non-financial signs such as frozen salaries, delayed investment projects, falling market share, high staff turnover. A glance at the financial statements of CCNH indicates problems with no profits generated, high operational gearing (831/110 = 7·6) and low interest cover (5/5 = 1). The difficulty in paying creditors such as the landlords is often an indication that failure is close at hand. The other public signs of weakness at CCNH are the need to extend the overdraft, the directors' resignations and the police investigation of theft.

Overall, the picture at CCNH is bleak and will require immediate and possibly drastic action in order to avoid insolvency.

[**Tutor note:** *The model solution has included some comments about the actual scores although these were not necessary for a good answer. They are included here for teaching purposes. The Argenti model has been used as the basis for the answer but suitable credit will be given for any reasoned approach. Further detail on failure prediction models can be found in Michael Pogue's technical article 'Business Failure'.*]

5 (a) Overview

Burns and Scapens have studied changes in management accounting and noted how it has changed focus from financial control to business support. So the management accountant has become more of a generalist within the business providing an internal consulting service for managers. They have named this new role a hybrid accountant. Traditionally, it was thought that accountants needed to be independent from operational managers in order to allow them to objectively judge and report their accounting information to senior management. Burns and Scapens also report that many accountants believe that there is an element of a current fashion in the need for change.

Burns and Scapens state that there are three main forces for change: technology, management structure and competition. Taking technology first, a significant change has occurred over the past 20 years in the quality and quantity of information technology. In the past, the accountant was one of the few people in the organisation who had access to the IT system and the information generated, as the outputs from the IT system were used to prepare highly sensitive financial reports to management. Data input was strictly controlled. Now, however, management information systems (MIS) allow users across the organisation to input data and run reports giving the type of analysis once only provided by the management accountant. So, the management accountant now just acts as another user of the system. This force is present at HS as it has seen the SBU managers gain more access to information via the new MIS.

Secondly, changes in management structure have forced change on the accountant. For example, responsibility for budgeting has often moved from the head office to operational management. This force is illustrated at HS where the increased autonomy of SBUs has driven the SBU managers to take more of the decisions that would have been reserved for the head office management accountant. These managers will be using financial and non-financial indicators and they will be producing forecasts. The management accountant will be providing reports alongside the SBU reports, often trying to provide a link between the operational reports, the financial consequences and the strategic outcomes desired by the board.

Finally, the competitive environment also drives change in the role of the management accountant. Over the last 20 years, there has been a move in organisations to a more strategic focus with the need for competitive advantage being emphasised. As a result, the traditional accountant's focus on the final profit figure has been seen as short term and this has led organisations to focus on a range of measures to try to capture the longer-term trends in their performance. This is evident at HS as it is a family firm focused on providing wealth and management opportunities to the family and not being driven by short-term outside shareholder demands. HS also faces global competition from expanding large brands that will try to enter and dominate its markets using their scale to competitive advantage. Therefore, HS will have to be flexible and innovative in response.

Benefits

All of the factors requiring the changes in the role of the management accountant are present at HS. It will be of particular benefit that the management accountant can take a supporting role to assist the SBU managers in getting the most from the new MIS. This will entail the accountant understanding the needs of the particular manager and then working with them to extract valuable reports from the MIS. It may also require the development of different performance measures beyond the traditional measure of profit.

From the organisation's perspective, the accountant will be a guide to the SBU manager to ensure that strategic goals are reflected in their performance management.

(b) Brand identity quickly conveys an image of quality and price that helps customers to identify the products and so helps to create customer loyalty to the brand. Loyalty results in repurchase and continued use of the products. Brand awareness is an indicator of the strength of a product's/organisation's place in the customers' minds.

From the customer perspective, at HS, the brand is part of the competitive advantage of the business. The history and quality of the products justify the high margins that are charged for such luxury goods. The customer will want to see the family story behind the company maintained and this will require a large annual marketing budget. The company will want to promote itself in places that match with that brand story, so sponsorship of public events may be large. Controlling such a budget will be difficult and the management accountant will want to regularly test the usefulness of the marketing spend against sales growth in order to identify the most effective marketing channels to use. HS will have to be sensitive to the needs and attitudes of the different markets in which it operates. The testing of the marketing will have to be appropriately segmented (geographically, by age, by gender, by income) as a result. This spending will be both regular, to maintain the general brand and its position, and irregular, to match specific product launches or marketing opportunities.

From the internal process perspective at HS, quality control is of great importance. This is true in both the production and retailing SBUs. In production SBUs, the spending on prevention of faults and the appraisal of products on the production line and their repair will all indicate the importance of quality at HS. In the retail SBU, service staff training will be high in order to give a high quality of experience to customers in the company's shops. There will also be a need for high capital costs in order to fit out the retail premises to the standard expected of a premium brand such as HS.

Measuring brand awareness can be done crudely through the revenue and market share that HS enjoys. In more detail, consumers can be tested on the marketing of HS products in order to see if they recall the brand that is associated with HS' logos and products. Again, this will need to be done in each of the different markets that HS operates.

Measuring brand loyalty can be done through customer retention and repeat purchase rates. The elasticity of demand to price will also indicate customer loyalty. The ability of a brand to be able to push through price increases with little loss of demand is a key benefit of brand loyalty. It can also be measured by considering the profit margins that HS enjoys and comparing these to other companies that make similar products but without such a strong brand.

1	**(i)**	Discuss overall performance	up to 1
		Evaluate measures calculated and offer suggested improvements	up to 2
		Discuss performance of each office	up to 8
		Max 10 marks	
	(ii)	1 mark per point up to a maximum of 10 marks (To obtain a good mark a candidate must address the issue of controllability and responsibility)	
	(iii)	1 mark per point up to a max of 10 marks	
	Professional presentation: up to 4 marks		
	Total 34 marks		
2	**(a)**	Incremental budgeting – generally	up to 5
		Recommendation for S and H	up to 3
		Discussion of F	up to 3
		Discussion of M	up to 3
		Max 8 marks	
	(b)	Explain rolling budget process	up to 2
		Calculations:	
		Use of 'Actual' figures	1
		Revenue	1
		Cost of sales	1
		Distribution costs	1
		Administration costs	1
		Operating profit	1
		Next year Q1	1
		Max 6 marks for calculations	
		Comments on process at F: 1 mark per point up to 3 marks	
		Max 8 marks	
	(c)	1 mark per point up to 4 marks	
		Max 4 marks	
	(d)	Explain bottom-up control	up to 2
		Evaluate use at DG and impact on current processes	up to 6
		Max 6 marks	
	Total 26 marks		

3	**(a)**	NOPAT	
		Non-cash items	0·5
		Accounting depreciation	1
		Doubtful debts	1
		Research and development	1
		Interest	0·5
		Tax	2
		Capital employed	
		Year start figure	0·5
		Doubtful debt	1
		Other non-cash items	1
		WACC	1
		EVA	1
		Max 10 marks for calculation	
		Comments:	
		1 mark per point up to 3 marks	
		Max 13 marks	
	(b)	Calculations:	
		Regulatory ROCE	1
		Operating margins	1
		Maximum regulated operating profit	1
		Other	1
		Commentary:	
		On calculations	up to 2
		On performance management	
		Regulated areas	up to 2
		Unregulated areas	up to 2
		Max 7 marks	
	Total 20 marks		
4	**(a)**	Explain liquidity, financial and operational gearing	up to 4
		Illustrate each at CCNH	
		Liquidity	up to 4
		Financial gearing	up to 2
		Operational gearing	up to 4
		Max 11 marks	
	(b)	Describe qualitative models (possibly use Argenti as an example) (includes examples of possible failure indications)	max of 5 marks
		Identify weaknesses at CCNH	
		Culture of fraud in previous management	1
		Lack of senior management	1
		Poor cash flow planning	1
		Overtrading at SC	1
		Weak financial ratios noted	1
		Inability to pay landlords/Seeking emergency funding from the bank	1
		Max 9 marks	
	Total 20 marks		

5	**(a)**	Describe Burns and Scapens' view of the overall change	up to 2
		Identify the three factors driving change and illustrate at HS (up to 3 marks per factor)	up to 9
		Benefits of the change at HS	up to 3
		Max 12 marks	
	(b)	Describe brand loyalty and awareness	up to 2
		Impact of brand loyalty and awareness Customer perspective and internal process perspective	up to 6
		Evaluate measures of brand loyalty and awareness	up to 4
		Max 8 marks	

Total 20 marks