ADVANCED LEVEL CASE STUDY EXAMINATION
JULY 2021
(4 HOURS)

ICAEW PARTNER IN LEARNING

ACA MASTERS

Case Study: Mock Exam 1

Guidance:

To obtain maximum benefit, this mock exam should be sat under full exam conditions using the Case Study CBE software which is available from the ICAEW website. You should use the exam technique taught during the ‘How to Ace the ACA Case Study’ class.

Once you have completed the exam, you should use the marking grids provided to calculate whether you have scored enough passing grades for each section.

In order to improve your grade, you should carefully analyse how the report has been structured and written in the prize-winner model answer.

EXHIBIT 15

EMAIL

From: Amanda Ellis
To: Jules Wingate
Subject: House Pride: Draft management accounts and business developments
Date: 21 July 2021

There have been several significant developments. I am attaching the following:

- House Pride's draft management accounts for the year ended 30 June 2021 **(Exhibit 16)**
- Information relating to House Pride's draft management accounts for the year ended 30 June 2021 **(Exhibit 17)**
- An email from Hans Ritz to me about Phase 2 of the Enterprise Resource Planning (ERP) project **(Exhibit 18a)**, together with media coverage **(Exhibit 18b)**
- An email from Wei Li to me about joining a buying group **(Exhibit 19a)**, together with media coverage **(Exhibit 19b)**

I would like you to draft a report from me to the House Pride board. This should comprise the following.

1. A review of House Pride's draft management accounts for the year ended 30 June 2021 in comparison with the year ended 30 June 2020.

Your review should be based on the draft management accounts as set out in **Exhibit 16**. It should cover revenue; gross profit and operating profit. Please include comments on both divisions and the overall business. In your review you should refer to the additional information provided in **Exhibit 17**. You should also address the product issue (**Exhibit 17**).

2. An evaluation of the proposal for Phase 2 of the ERP project, as set out in **Exhibit 18a**.

Using the information in **Exhibit 18a** and **Exhibit 18b**, you should evaluate the quotes from the Phase 1 supplier, Grossmark, and the potential new supplier, Transit. For each supplier, you should calculate the total expected incremental operating profits. You should assess the adequacy of the assumptions and advise on the commercial, ethical and business trust issues that House Pride should evaluate when deciding which quote to accept. You should provide a justified recommendation for the way forward.

3. An evaluation of the approach from the buying group (**Exhibit 19a**).

You should evaluate the financial, operational, strategic, ethical and business trust issues, including those arising from **Exhibit 19b**. You should advise, with reasons, whether House Pride should join the buying group.

EXHIBIT 16

HP: Draft management accounts for the year ended 30 June 2021

Statement of profit and loss for year ended 30 June 2021

	£000
Revenue (Note 1)	34,551
Cost of sales (Note 1)	(27,883)
Gross profit (Note 1)	**6,668**
Distribution costs	(2,556)
Administrative expenses (Note 2)	(3,506)
Operating profit	**606**
Net finance income / (expense)	(15)
Profit before taxation	**591**
Income tax	(112)
Profit for the year	**479**

Statement of financial position as at 30 June 2021

	£000
Non-current assets	
Property, plant and equipment (PPE) (Note 3)	4,265
	4,265
Current assets	
Inventories (Note 4)	2,413
Trade and other receivables (Note 5)	3,618
Cash and cash equivalents	796
	6,827
TOTAL ASSETS	**11,092**
Equity	
Ordinary shares	90
Retained earnings	5,920
	6,010
Current liabilities	
Trade and other payables (Note 6)	4,970
Taxation	112
	5,082
TOTAL EQUITY AND LIABILITIES	**11,092**

Statement of cash flows for year ended 30 June 2021

	£000
Cash flows from operating activities	
Profit before taxation	591
Adjustments for:	
Depreciation	522
Loss on disposal of PPE	7
Finance (income)/expense	15
	1,135
Change in inventories	(393)
Change in trade and other receivables	(275)
Change in trade and other payables	620
	1,087
Income tax paid	(51)
Net cash generated from operating activities	**1,036**
Cash flows from investing activities	
Acquisition of PPE	(460)
Proceeds from disposal of PPE	8
Interest received/(paid)	(15)
Net cash generated from investing activities	**(467)**
Cash flows from financing activities	**-**
Net change in cash and cash equivalents	569
Cash and cash equivalents at start of period	227
Cash and cash equivalents at end of period	**796**

Notes to the management accounts

Note 1: Revenue, cost of sales and gross profit

	£000
Revenue	
RH	
Branch	17,524
Online	9,092
	26,616
BCT	
Branch	5,221
Online	2,714
	7,935
Total	
Branch	22,745
Online	11,806
	34,551
Cost of sales	
RH	22,632
BCT	5,251
	27,883
Gross profit	
RH	3,984
BCT	2,684
	6,668

Cost of sales comprises:

Goods and materials	23,438
Wages and salaries	4,445
	27,883

'Goods and materials' includes impairment allowances against inventories (see note 4). Wages and salaries relate to customer-facing staff, based in branches, the warehouse and e-commerce operations.

Note 2: Administrative expenses

	£000
Personnel	1,483
IT, premises, depreciation and other	1,715
Marketing and advertising	308
	3,506

'Personnel' includes the directors' salaries and related costs: £703,000. 'Other' includes impairment allowances against trade receivables (see note 5)

Note 3 Property, plant and equipment (PPE)

	Land, buildings, plant, machinery, fixtures, fittings and equipment	Motor vehicles	**Total**
	£000	£000	**£000**
Cost			
At 1 July 2020	4,649	2,306	**6,955**
Additions	298	162	**460**
Disposals		(25)	**(25)**
At 30 June 2021	**4,947**	**2,443**	**7,390**
Depreciation			
At 1 July 2020	1,356	1,257	**2,613**
On disposals		(10)	**(10)**
Charge for year	280	242	**522**
At 30 June 2021	**1,636**	**1,489**	**3,125**
Carrying amount at 30 June 2021	**3,311**	**954**	**4,265**

Note 4 Inventories

Inventory is carried at the lower of cost and net realisable value. Where necessary, an allowance is made for obsolescence and slow-moving items. Allowances have been recognised as part of goods and materials within cost of sales as follows: £98,000.

Note 5 Trade and other receivables

	£000
Trade receivables	3,280
Other receivables and prepayments	338
	3,618

Trade receivables are stated after impairments for amounts considered irrecoverable. Impairment charges recognised in administrative expenses are: £47,000.

Note 6 Trade and other payables

	£000
Bank overdraft	-
Trade payables	4,086
Other payables and accruals	884
	4,970

EXHIBIT 17

Additional information relating to the draft management accounts

I have set out below some information that should assist in the analysis of House Pride's revenue, gross profit and operating profit for the year ended 30 June 2021.

- Despite severe disruption in other sectors of the economy, construction has continued to remain relatively unaffected.
- The past 12 months has seen a surge in activity in the housing market as housebuilders try to keep up with growing demand for new houses. In addition, existing homeowners have increased expenditure on home refurbishments.
- We did not open or close any branches during the year, except for closing Wigan and Bolton in January 2021 for upgrades.
- Elevant was awarded several large contracts in September 2020 which resulted in an additional £500k of revenue.
- We estimate that we lost around £450,000 of revenue in the year due to online systems issues.
- Revenue from each branch was as follows:

	£000
Warrington	3,127
Preston	2,609
Bury	-
Blackburn	3,593
Burnley	3,123
Wigan	2,014
Bolton	2,531
Manchester	3,128
Liverpool	2,620
	22,745

- Almost all our suppliers increased their prices in the year, citing the rising cost of inputs. These increased costs were unexpected and sudden.

Product issue

In May, we started to receive numerous complaints from customers relating to a York flooring product. We need to decide what to do about this.

Customers say that the flooring does not hold in place. When our inventory team tested the product, they confirmed that there is a problem with the product not holding in place.

At 30 June 2021, we have 5,000 units of the product which cost of £70 per unit. The current retail price is £90 per unit. Ross Connor has advised me that there is a market for slightly defective products and expects that the items could be sold for £42 per unit.

We need to decide (a) what adjustments, if any, we should make to the draft June 2021 management accounts and (b) the actions House Pride should take to deal with the issue.

EXHIBIT 18a

EMAIL

From: Hans Ritz
To: Amanda Ellis
Subject: Enterprise Resource Planning Project Phase 2
Date: 21 July 2021

The next phase of the Enterprise Resource Planning (ERP) project is scheduled to start 1 October 2021. Phase 2 will require the design, implementation and maintenance of a new website and automated e-commerce facility. This will greatly improve the experience of our online customers, reduce costs and help generate more revenue.

Following the success of Phase 1, and the persistent outages which continue to impact our e-commerce activity, I am keen for Phase 2 to be completed as soon as possible. We have already begun the decision-making process and have two quotes from potential suppliers.

We need your help calculating the incremental operating profits.

I have set out the key terms proposed by each supplier below.

	Transit £000	**Grossmark £000**
• Supplier quote: capital costs (hardware and software)	300	450
• Supplier quote: annual maintenance and IT support costs	50	95
• Payment terms: capital costs	1 October 2021: 50% 30 June 2022: 50%	1 August 2021: 75% 30 June 2022: 25%
• Payment terms: annual maintenance and IT support costs	Monthly in arrears	Start of each year
• HP estimate: additional annual revenue		
○ Year 1	400	600
○ Year 2	650	900
○ Year 3	900	1,200
○ Year 4	1,150	1,500
• HP estimate: saving in other annual operating costs (each of Years 1-4)	75	125

Other information and assumptions

1. The planned launch date in both cases is 1 October 2021.

2. The website and e-commerce facility will last around four years, at which point it is likely that new technologies will require us to undertake a full replacement.

3. I have estimated the additional annual revenue and cost savings based on my experience of similar projects.

4. Please use a 20% gross profit margin and approximate delivery costs to be 6% of revenue so that it is consistent with the Phase 1 calculations.

5. Transit claims to be able to offer the best online chat facility as they have developed one of the most technologically advanced chat robots in the industry. It also comes with unlimited support.

6. Grossmark have advised that due to the success of Phase 1 and their familiarity with House Pride's systems, a parallel run will not be required for Stage 2. This will help save time and costs for Grossmark and House Pride. These savings have been included in the estimated cost savings.

7. My preference is to use Grossmark again. Phase 1 went well, and I have built a good rapport with the Managing Director, Keith Pitt. On several occasions, we have needed help beyond the scope of the project and Keith has had one of his team assist us. The expectation is that we will award Grossmark the Phase 2 work and I hope we would then get some sort of a discount on the Phase 3 work.

EXHIBIT 18b

RECENT MEDIA COVERAGE

Nobody's job is safe (Business Week, May 2021)

The use of automation and robotics is expected to dramatically change the workplace over the next decade.

Many industries have already seen dramatic changes, with work of a routine nature now being performed by robots. Whilst this may liberate some employees from repetitive tasks and help reduce costs, it raises the question about what will happen to the workers who are no longer needed.

An online-only builders' merchant recently made all its web support staff redundant following the implementation of state-of-the-art e-commerce platform. Customer queries which were previously handled by support staff and now dealt with by a chat bot. The CEO of cementonline.com defended the decision on the basis that the company is committed to reducing overheads so that it can offer lower prices to customers.

EXHIBIT 19a

EMAIL

From: Wei Li
To: Amanda Ellis
Subject: Buying Group
Date: 21 July 2021

MiNW, a buying group comprised of builders' merchants in the north-west of England, have approached us with a proposal for House Pride to become a member of the buying group. The group aims to reduce the cost of supplies for members by combining purchases to place large orders with suppliers. MiNW needs our decision on whether to join the buying group by 31 August 2021.

All House Pride's suppliers have increased their prices in the last 3 years and we are unable to resist such increases due to our limited size. I am concerned that House Pride is exposed to further increases and we need to do something to mitigate the risk.

MiNW have said that they have resisted all attempts by suppliers to increase prices during the last year. They say that future attempts to increase prices are inevitable because of cost inflation and House Pride will be unable to prevent such increases if it does not join the buying group. To help protect margins further, the group plans to get member agreement about what can be done on the price side.

The proposal

1. The buying group is made up of separate product teams and each product team sources supplies from a range of UK and international companies.
2. Each member company has at least one representative on each product team.
3. New members do not have representation for the first 6 months.
4. The buying group will purchase from the supplier which has the lowest cost per unit.
5. Orders from suppliers will be placed once per week.
6. Members are required to submit their quantity requests 3 days before the order is placed.
7. Members are required to collect goods from the buying group's storage facility.
8. All members of the buying group will pay the same per unit price for each item.
9. Payment is due 48 hours before collection of the goods.
10. House Pride will purchase all goods and materials through the buying group.
11. House Pride will not engage with any suppliers directly.

In addition to the above points, my team have gathered the following information. I have added some comments below:

- Due to the economies of scale obtained by purchasing large quantities, cost savings will be 10%.

  My comments: 10% seems high, I think 4% would be more likely. Please use both in the calculations for comparison purposes.

- As the business continues to grow, our purchases will increase significantly.

  My comments: For the purposes of decision making, let's assume that sales and purchases continue at 2021 levels.

EXHIBIT 19b

RECENT MEDIA COVERAGE

Quality over quantity (Materials Monthly, May 2021)

Tradespeople have been left unimpressed by the new product ranges at Harpers Timber and Building Supplies, which has left the company's social media pages flooded with complaints and angry comments.

Until recently, Harpers had been renowned in the industry for providing quality across a wide range of products. Although more expensive than some other merchants, particularly online ones, many tradespeople were prepared to pay that little bit extra for the assurance of quality and access to a wide product range.

Following recent marketing campaigns advertising a price cut, tradespeople were eager to get to their nearest Harpers branch. However, their initial feeling of having secured a bargain was soon overcome with frustration when they used the materials for projects as there have been several reports of quality issues and even safety concerns. In addition, the range of products on offer is not as wide as it previously was.

Harpers have since issued a statement on their website. "We apologise to all our customers who have experienced issues with our products and are unhappy with the choice available. The issue has arisen due to a change in supplier and we are working hard to revert to our previous suppliers. We thank you for your patience and understanding whilst we resolve the matter."

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Mock Exam 1 Marking Key

OVERALL ASSESSMENT CRITERIA	EXECUTIVE SUMMARY **R1 - Review of financial performance**
• Appropriate layout: headings AND paragraphs/sentences • No disclaimer AND from Amanda Ellis • Suitable language: formal AND tactful AND ethical • Reasonable spelling and grammar	• Revenue: qualitative comment on HP/RH/BCT with fig • GP/GP%: qualitative comment with fig • OP/OP%: qualitative comment with fig • Concludes on product issue and impact on accounts with fig
NA ID IC SC CC	**NA ID IC SC CC**
	• BCT: online increase causing GPM increase • RH: investigate reasons for GPM decline • Other commercial recommendations • Appropriate summary of report section
NA ID IC SC CC	**NA ID IC SC CC**

R2 - Evaluation of ERP Phase 2 proposal	R3 - Evaluation of buying group proposal
• Gives incremental profit Grossmark AND Transit (figs) • Evaluates/questions assumptions • GM depends on uncertain savings/revenue growth • Concludes on way forward	• Calculates cost for 10% AND 4% change • Potential stockouts/lost revenue could negate GP benefit • Concludes on main operational/strategic issue • Proposal not acceptable in current format
NA ID IC SC CC	**NA ID IC SC CC**
• Concludes on commercial issues • Concludes on ethics/business trust issues • Other commercial recommendations • Appropriate summary of report section	• Less control/flexibility over product supply • Business trust: should not engage in price discussions • Other commercial recommendations • Appropriate summary of report section
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 1 – Review of financial performance

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 1 • Presents 2021 figures • Presents 2020 figures • Analysis of RH and BCT figures: revenue and GP • Analysis per branch / average branch revenue	**Financial analysis: revenue (report)** • Revenue growth: higher than last year v 6.5% > • RH: Elevant £500k / construction continued unaffected > • BCT: homeowner refurbishments > • Mix: RH 77.0% v 78.4% / BCT 23.0% v 21.6% • Wigan/Bolton: decline due to refurbishments > • Rev per branch: up £242.0k v £238.1k >
NA ID IC SC CC	**NA ID IC SC CC**
AI/CS Exam info (report/appendix) • Overall revenue: up £4,997k / up 16.9% • RH revenue: up £3,448k / up 14.9% AND BCT revenue: up £1,549k / up 24.3% • Overall GP: up £1,009k / 17.8% **OR** GP%: 19.3% v 19.1% • OP: up £343k / 130% **OR** OP%: up 1.8% v 0.9%	**Financial analysis: GP/OP (report)** • RH: up £3,139k/16.1% / BCT up £849k/19.3% > • Goods: up £3,676k /18.6% / wages: up £312k/7.5% > • Distribution up £486k/23.5% due to online sales increase • Admin up £180k/5.4% • Distribution 7.4% of revenue / Admin 10.1% of revenue
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • Regional growth/home buyer incentives/weather • Goal to reduce distribution/admin as % of revenue • Sales increasingly take place online • Products cost increasing / CMPI / 70% of revenue • £450k lost due to online system issues	**Product Issue** • Customer complaints re York flooring > • Other customers may have purchased product > • Impairment £140k > • Impairment will impact GP/GPM/OP/OPM with fig • Can reclaim from manufacturer if production fault • Complaints may impact HP's good reputation for quality >
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 1 – Review of financial performance

<table>
<tr><th>APPLYING JUDGEMENT</th><th>CONCLUSIONS AND RECOMMENDATIONS</th></tr>
<tr><td>Evaluation of revenue analysis
• Strong performance in booming industry / exceeds £30m
• RH: continued shift towards online/online growth rate slowing
• BCT: branch revenue still below 2019 level
• BCT: dramatic online increase / online/branch mix same as RH
• Blackburn largest / refurbishments effective and well managed
• Small/slowing increase / no closures except refurbishments</td><td>Draws conclusions (under a heading)
• Revenue: qualitative comment with fig
• GP/GP%: qualitative comment with fig
• OP/OP%: qualitative comment with fig
• Concludes on inventory issue</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Evaluation of GP/OP
• Goods and materials: costs increasing / compares to revenue
• % of revenue: goods 67.8% v 66.9% / wages 12.9% v 14.0%
• RH/BTC revenue mix: positive impact on GP/GPM OR Branch/online revenue mix: positive impact on GP/GPM
• RH GPM continues concerning decline
• OP/OPM: nearly recovered to 2019 levels / admin well controlled</td><td>Makes recommendations
• Further analysis by division / further cost analysis
• Seek alternative suppliers / join buying group
• Focus on online sales
• Investigate reasons for RH GPM decline
• Other commercial recommendations</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Evaluation / recs on product issue
• Only appears to affect single product from one supplier
• Consider need for product recall
• Refund from supplier should be possible / contingent asset
• Contact York to see if other complaints / discuss way forward
• Identify and contact other affected customers
• Offer all customers immediate refund</td><td></td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
</table>

REQUIREMENT 2 – Evaluation of ERP Phase 2 Proposal

<table>
<tr><th>ASSIMILATING & USING INFORMATION</th><th>STRUCTURING PROBLEMS & SOLUTIONS</th></tr>
<tr><td>Appendix 2
• Numbers labelled AND clearly derived
• Calculation of Transit proposed contract
• Calculation of Grossmark proposed contract
• Considers additional costs/flexes numbers</td><td>Calc of revenue and profit (appx or report)
• Transit GP: £80k, £130k, £180k AND £230k / £620k
• Grossmark GP: £120k, £180k, £240k AND £300k / £840k
• Transit OP: £6k, £41k, £76k AND £111k / £234k
• Grossmark OP: £1.5k, £43.5k, £85.5k AND £127.5k / £258k</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>AI/CSE information (report/appendix)
• Capital costs: £75k AND £112.5k per annum
• Annual costs: £50k AND £95k per annum
• Cost savings: £75k AND £125k per annum
• Delivery costs: uses 6% or own 2021 fig</td><td>Assumptions
• Revenue increases based on estimated figures >
• Transit revenue increase appears low >
• GPM may be lower/higher >
• Cost savings are uncertain / could be higher/lower >
• Delivery costs will increase if more sales online >
• Not clear what is meant by “unlimited” support</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Business issues / wider context
• Impact of COVID-19 on the business
• E-commerce needs updating for online growth
• Yorath & Co: no parallel run / problems
• Persistent outages / online chat adds value
• Transit: website specialists / Greg & Sons
• HP cash balance £796k</td><td>Comments on ethical / business trust issues
• Revenue and cost estimates provided by Hans Ritz >
• Reckless to suggest no parallel run >
• Transit claims “best online chat” function >
• Automation results in redundancies >
• Cost reduction on phase 3 not guaranteed</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
</table>

REQUIREMENT 2 – Evaluation of ERP Phase 2 Proposal

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of commercial issues • Changes in assumptions will impact calculations • GM: capital cost and ongoing cost higher • GM: payment terms less favourable • GM: benefit depends on uncertain savings/revenue growth • Benefits could continue to occur beyond forecast period	**Draws conclusions (under a heading)** • Gives incremental profit Grossmark AND Transit (figs) • Evaluates/questions assumptions • Concludes on ethics/business trust issues • Concludes on way forward
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation of assumptions • Compare with prior experience e.g. £450k v £600k (2020) • Compare with Greg & Sons / £450k lost revenue in 2021 • Compare GPM with 2021 / future impact of online shift • Compare with prior experience e.g. 2020 higher • 6% delivery costs lower than 2021 • GM: problems with maintenance / timeframes short	**Makes recommendations** • Negotiate with Grossmark / Transit • Further research on likely revenue benefit • Due diligence on Transit / customer feedback • Obtain third quote for comparison • Communicate plan to staff and stakeholders • Other commercial recommendations
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation/recs: ethical/business trust • Hans Ritz has developed close relationship with GM / bias • Must ensure disruption kept to a minimum • Request demonstration / inspect other merchant websites • Normal consequence of technological advance • Decision should not be made on price alone	
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 3 – Evaluation of buying group proposal

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Workings / report • Numbers labelled AND clearly derived • Calculations for 10% AND 4% cost reduction • Calculates GP for HP • Considers flexing numbers eg lost revenue / admin costs	**Financial calculations (appx or report)** • Goods and materials: £21,094k AND £22,500k • Calculates cost % of revenue: 61.1% AND 65.1% • GP: £9,012k AND £7,606k • Calculates GP% AND compares to HP (19.3%) • Inventory impairment: states ignored/uses own fig
NA ID IC SC CC	**NA ID IC SC CC**
AI/CSE information (report/workings) • 2021 revenue: £34,551k • 2021 goods and materials: £23,438k • 2021 wages: £4,445k • 2021 GP: £6,668k	**Operational and strategic issues** • Less diversification if all supplies via buying group >
 • Being part of group will take up management time > • Focus seems to be exclusively on cost > • HP will have less flexibility and control over purchases > • No representative member in first 6m > • HP only uses UK suppliers >
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • Cost of goods and materials increased in 2021 / CMPI • Risk 5: HP critically dependent on certain product lines • NiNW: 20 merchants / members control / lobbying • HP product portfolio: wide range of items • Harper: supplier change / disruption / reputation	**Comments on ethical/bus trust issues** • NiNW has access to commercially sensitive information > • Suggestion of pricing agreement among members > • HP has robust supplier procedures > • Lower product quality has caused H&S issues > • Deadline puts pressure on HP > • Working with competitors >
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 3 – Evaluation of buying group proposal

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of financial issues • Any changes in assumptions will impact calculations • Potential stockouts/ lost revenue could negate GP benefit • Compares cost % of revenue to industry (70%) • Additional costs e.g. transport, storage • Benefit will increase as HP grows • Earlier payments will have negative impact on cash	**Draws conclusions (under a heading)** • Calculates cost for 10% AND 4% change • Concludes on main operational/strategic issue • Concludes on ethics / business trust issues • Proposal not acceptable in current format
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation: operational/strategic issues • Could be difficult to go back to old suppliers • Could be disagreement/conflict with other members • HP prides itself on selling quality products • Could prevent HP being able to compete effectively • Questions why HP will have no representation • Longer lead times/quality issues/additional costs e.g. FX	**Makes recommendations** • Negotiate with buying group • Further research on likely cost savings • Discuss reduced product range with sample of customers • Due diligence on NiNW • Inspect products of existing members • Other commercial recommendations
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation/recs: ethical/business trust • Identify how HP information will be kept confidential • HP must not engage in any price discussions • Unclear how monitoring of suppliers will work • Verify facts as media report may not be accurate • Decision should not be rushed • Competitors have same products at same cost	
NA ID IC SC CC	**NA ID IC SC CC**

ADVANCED LEVEL CASE STUDY EXAMINATION
JULY 2021

ICAEW PARTNER IN LEARNING

ACA MASTERS

Mock Exam 1 Model Answer

A report on House Pride Limited

TO: Directors of House Pride Limited

FROM: Amanda Ellis (Finance Director)

DATE: 21 July 2021

Executive Summary

REVIEW OF FINANCIAL PERFORMANCE FOR YEAR ENDED 30 JUNE 2021

Overall revenue has increased impressively by £4,997k (16.9%) to £34,551k which is a strong performance in a thriving industry. Revenue is now considerably higher than the 30 June 2020 target of £30m.

RH revenue has increased significantly by £3,448k (14.9%) to £26,616k due to increased construction activity. BCT revenue has increased impressively by £1,549k (24.3%) to £7,935k due to increased spending on home improvements. BCT online revenue increased dramatically by 88.2%, resulting in online now accounting for 34.2% (2020: 22.6%) of BCT revenue which is the same proportion as RH.

Average branch revenue per month increased slightly by 1.6% to £242.0k from £238.1k.

Goods and materials increased substantially by £3,676k (18.6%) due to suppliers unexpectedly increasing prices. Goods and materials now account for 67.8% (2020: 66.9%) of revenue.

Overall GP increased impressively by £1,009k (17.8%) to £6,668k, with a GPM increase to 19.3% from 19.1% due to a revenue mix shift towards the higher margin BCT division. RH GPM declined from 15.9% to 15.0%, due to cost of sales (16.1%) increasing faster than revenue (14.9%). RH GPM continues its concerning decline (2019: 16.1%). BCT GPM increased to 33.8% from 31.1%, due to a revenue mix shift towards higher margin online sales.

OP has increased by a dramatic £343k (130%) to £606k, with OPM restored to 1.8% (2020: 0.9%), which is similar to years period to the unusual 2020.

Inventory is measured at lower of cost and NRV, so an impairment of £140k will be needed if NRV is only £42 per unit. This would decrease GP and OP by £140k and would cause GPM to be 18.9% and OPM to be 1.3%. However, HP should be able to claim a full refund from York if it is due to a production fault so could recognise a contingent asset if refund is virtually certain.

RECOMMENDATIONS

Discuss with York whether product recall needed.
Join buying group to mitigate price increases.
Investigate reasons for RH GPM decline.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

FINANCIAL EVALUATION OF ERP PROPOSAL

If Transit is selected, the total incremental operating profits will be £234k. If Grossmark is selected, the total incremental operating profits will be £258k.

The higher profit under Grossmark is due to the expected higher revenue and cost savings. These are not guaranteed, whereas the higher costs will be incurred.

Grossmark payment terms for both capital and ongoing costs are less favourable than Transit which will have a negative impact on cash.

The revenue growth assumptions may be inaccurate as they were in Phase 1 when additional revenue in year 1 was only £450k despite being forecast as £600k. £600k in year 1 has been used again for Grossmark.

Delivery costs are likely to be higher than 6% of revenue. In 2021, they were 7.4% of revenue and will increase as a result of increased online sales due to the new website.

Using Transit's online chat facility could enable HP to offer the best online sales platform in the industry. It has also been reported that online chat adds value for customers.

Grossmark have suggested not using a parallel run to save costs. Not using a parallel run caused significant disruption, security breaches and reputational damage for Yorath & Co and this should be avoided to protect HP's reputation.

Hans Ritz appears to have developed a close relationship with Grossmark which may be influencing his estimation of the benefits of using Grossmark and possibly understating the benefits of using Transit.

HP was reluctant to lose staff during Phase 1 and the automation of e-commerce is likely to result in redundancies of HP staff. This could potentially cause reputational damage for HP. However, such changes are a normal consequence of new technologies and HP must enhance its online facilities to stay competitive.

HP should proceed with Grossmark once the future revenue projections have been verified.

RECOMMENDATIONS

Discuss basis for assumptions with Hans Ritz.
Negotiate fee reduction with Grossmark.
Obtain third quote for comparison.

EVALUATION OF BUYING GROUP PROPOSAL

If costs of goods and materials reduce by 10%, gross profit will increase by £2,344k to £9,012k. GPM will increase to 26.1% from 19.3%.

If costs of goods and materials reduce by 4%, gross profit will increase by £938k to £7,606k. GPM will increase to 22.0% from 19.3%.

The calculation does not factor in revenue which will be lost due to having a reduced product range, potential stockouts due to ordering restrictions and potentially lower quality goods. This will reduce additional GP and GPM improvements.

Payment terms are much less favourable than existing suppliers so will have an adverse cash impact.

HP will have no representation in the group which means it will have no control or influence over matters regarding the products it purchases. This severely limits HP's strategic flexibility.

The buying policy appears to be entirely based on price and no consideration of quality. HP has a reputation for quality, so this is not consistent with HP's strategy.

HP may require orders more frequently than once per week and may not be able to identify quantities needed three days in advance. This appears very restrictive.

The group plans to get member agreement about pricing and this would very likely lead to action from the CMA. This could result in fines and reputational damage for HP.

There is no mention of due diligence over suppliers. Currently, HP undertakes substantial due diligence to ensure product quality, sustainability and employee welfare. Using unethical suppliers would compromise HP's ethos.

HP should not join the group because the conditions are too restrictive and there appear to be inadequate controls over suppliers.

RECOMMENDATIONS

Due diligence on NiNW.
Find alternative buying groups for comparison.
HP should not engage in any discussions on pricing.

APPENDIX 1: Analysis of Management Accounts 30 June 2021

	2021 (£k)	2020 (£k)	Change (£k)	%
Revenue				
RH				
Branch	17,524	15,535	1,989	12.8%
Online	9,092	7,633	1,459	19.1%
Total	26,616	23,168	3,448	14.9%
Mix:				
Branch	65.8%	67.1%		
Online	34.2%	32.9%		
BCT				
Branch	5,221	4,944	277	5.6%
Online	2,714	1,442	1,272	88.2%
Total	7,935	6,386	1,549	24.3%
Mix:				
Branch	65.8%	77.4%		
Online	34.2%	22.6%		
Total				
Branch	22,745	20,479	2,266	11.1%
Online	11,806	9,075	2,731	30.1%
Total	34,551	29,554	4,997	16.9%
Mix:				
Branch	65.8%	69.3%		
Online	34.2%	30.7%		
Mix:				
RH	77.0%	78.4%		
BCT	23.0%	21.6%		
Branches				
Warrington	3,127	2,970	157	5.3%
Preston	2,609	2,457	152	6.2%
Blackburn	3,593	3,168	425	13.4%
Burnley	3,123	2,860	263	9.2%
Wigan	2,014	2,101	- 87	-4.1%
Bolton	2,531	2,565	- 34	-1.3%
Manchester	3,128	2,513	615	24.4%
Liverpool	2,620	1,845	775	42.0%
	22,745	20,479	2,265	11.1%

Average branch revenue per month	**2021 (£k)**	**2020 (£k)**	**Change (£k)**	**%**
Branch revenue	22,745	20,479		
No. of branches (no refurb)	6	6		
Months open	12	11		
	72	**66**		
No. of branches (refurb)	2	2		
Months open	11	10		
	22	**20**		
Months open total	**94**	**86**		
	242.0	238.1	3.9	1.6%

	2021 (£k)	2020 (£k)	Change (£k)	%
CoS				
RH	22,632	19,493	3,139	16.1%
BCT	5,251	4,402	849	19.3%
	27,883	23,895	3,988	16.7%
Goods and materials	23,438	19,762	3,676	18.6%
Wages	4,445	4,133	312	7.5%
	27,883	23,895	3,988	16.7%
% of revenue				
Goods and materials	67.8%	66.9%		
Wages	12.9%	14.0%		
GP				
RH	3,984	3,675	309	8.4%
BCT	2,684	1,984	700	35.3%
TOTAL	6,668	5,659	1,009	17.8%
GPM				
RH	15.0%	15.9%		
BCT	33.8%	31.1%		
TOTAL	19.3%	19.1%		
Distribution	2,556	2,070	486	23.5%
% of revenue	7.4%	7.0%		
Admin				
Personnel	1,483	1,418	65	4.6%
IT, premises, depreciation and other	1,715	1,619	96	5.9%
Marketing and advertising	308	289	19	6.6%
	3,506	3,326	180	5.4%
% of revenue	10.1%	11.3%		
OP				
Total	606	263	343	130%
OPM	1.8%	0.9%		

Inventory			
	£	Units	
Cost	70	5,000	£350,000
NRV	42	5,000	£210,000
Impairment			£140,000
	£k		
GP before	6,668		
impairment	-140		
GP after	6,528		
GPM after	18.9%		
OP before	606		
impairment	-140		
OP after	466		
	1.3%		

REVIEW OF FINANCIAL PERFORMANCE FOR YEAR ENDED 30 JUNE 2021

REVENUE

Overall revenue has increased impressively by £4,997k (16.9%) to £34,551k which is a strong performance in a thriving industry. The rate of growth is increasing (2020: 6.5%), although 2020 was impacted by temporary factors. Revenue is now considerably higher than the 30 June 2020 target of £30m. Both divisions and both channels have grown.

RH revenue has increased significantly by £3,448k (14.9%) to £26,616k due to increased construction activity and an additional £500k of revenue from Elevant. Branch revenue increased 12.8% and online revenue increased 19.1%, resulting in online now accounting for 34.2% of RH revenue (2020: 32.9%). The whole industry has seen a shift towards online sales.

BCT revenue has increased impressively by £1,549k (24.3%) to £7,935k due to increased spending on home improvements. Branch revenue increased by a modest 5.6% and online revenue increased dramatically by 88.2%, resulting in online now accounting for 34.2% (2020: 22.6%) of BCT revenue which is the same proportion as RH. COVID-19 has caused people to spend more on housing improvements due to more time being spent at home.

RH now accounts for 77.0% (2020: 78.4%) of HP revenue with BCT accounting for 23.0% (2020: 21.6%), showing the increasing importance of BCT. Online sales now account for 34.2% of revenue (2020: 30.7%) despite £450k of revenue being lost due to online system issues.

Average branch revenue per month increased slightly by 1.6% to £242.0k from £238.1k. Whilst branch revenue increased by 11.1%, the branches were open for months in the 2021 compared with 2020 (94 months v 86 months) as there were no closures in 2021 expect for the two refurbishments.

GROSS PROFIT

Goods and materials increased substantially by £3,676k (18.6%) due to suppliers unexpectedly increasing prices. Goods and materials are now 67.8% (2020: 66.9%) of revenue. Whilst this is still below the typically industry figure of 70%, it is increasing. The CMPIs have increased in most of the last five years and prices were expected to increase in 2020/21.

RH GP increased by £309k (8.4%), with a GPM decline from 15.9% to 15.0%, due to cost of sales (16.1%) increasing faster than revenue (14.9%). RH GPM continues its concerning decline (2019: 16.1%).

BCT GP increased incredibly by £700k (35.3%), with a GPM increase to 33.8% from 31.1%, due to a revenue mix shift towards higher margin online sales.

Overall GP increased impressively by £1,009k (17.8%) to £6,668k, with a GPM increase to 19.3% from 19.1% due to a revenue mix shift towards the higher margin BCT division. BCT has a higher GPM due to a lower customer discount (5% v 10%).

OPERATING PROFIT

Distribution costs increased significantly by £486k (23.5%) due to increased online activity. They are now 7.4% (2020: 7.0%) of revenue despite the goal to reduce this ratio.

OP has increased by a dramatic £343k (130%) to £606k, with OPM restored to 1.8% (2020: 0.9%), which is similar to years prior to the unusual 2020.

PRODUCT ISSUE

Inventory is measured at lower of cost and NRV so an impairment of £140k will be needed if NRV is only £42 per unit.

This would decrease GP and OP by £140k and would cause GPM to be 18.9% and OPM to be 1.3%

This would cause GPM to fall below 2020 GPM.

However, HP should be able to claim a full refund from York if it is due to a production fault so could recognise a contingent asset if refund is virtually certain.

HP reputation for quality products could be damaged as a result. Although the issue appears to be isolated to a single product from a single supplier.

Recommendations
Identify and contact other customers who have purchased the product.
Discuss with York whether product recall needed.
Seek legal advice on right to claim refund from York.

CONCLUSIONS

Overall revenue has increased impressively by £4,997k (16.9%) to £34,551k which is a strong performance in a thriving industry. RH revenue has increased significantly by £3,448k (14.9%) to £26,616k due to increased construction activity. BCT revenue has increased impressively by £1,549k (24.3%) to £7,935k due to increased spending on home improvements.

Overall GP increased impressively by £1,009k (17.8%) to £6,668k, with a GPM increase to 19.3% from 19.1% due to a revenue mix shift towards the higher margin BCT division.

OP has increased by a dramatic £343k (130%) to £606k, with OPM restored to 1.8% (2020: 0.9%).

Inventory is measured at lower of cost and NRV so an impairment of £140k will be needed if NRV is only £42 per unit.

RECOMMENDATIONS

Further analysis by division / profit analysis by branch.
Continue refurbishment programme to increase branch revenue.
Join buying group to mitigate price increases.
Investigate reasons for RH GPM decline.
Increase charge for online delivery.

APPENDIX 2: ERP Proposal

	Transit	**£k**	**£k**	**£k**	**£k**	**£k**
		Year 1	**Year 2**	**Year 3**	**Year 4**	**TOTAL**
	Revenue	400	650	900	1150	3100
20%	GP	80	130	180	230	620
	Admin					
300	Capital costs	-75	-75	-75	-75	-300
50	Annual costs	-50	-50	-50	-50	-200
75	Cost savings	75	75	75	75	300
6%	Delivery costs	-24	-39	-54	-69	-186
	OP	6	41	76	111	**234**
						7.5%
	Grossmark					
		Year 1	**Year 2**	**Year 3**	**Year 4**	**TOTAL**
	Revenue	600	900	1200	1500	4200
20%	GP	120	180	240	300	840
	Admin					
450	Capital costs	-112.5	-112.5	-112.5	-112.5	-450
95	Annual costs	-95	-95	-95	-95	-380
125	Cost savings	125	125	125	125	500
6%	Delivery costs	-36	-54	-72	-90	-252
	OP	1.5	43.5	85.5	127.5	**258**
						6.1%
Revenue	£k					
2021	34,551					
T	400	1.2%				
GM	600	1.7%				

FINANCIAL EVALUATION OF ERP PROPOSAL

CONTEXT

As a result of COVID-19, it is likely that more business activity will take place online in the future. HP needs to capitalise on this by having a leading e-commerce function.

HP has suffered from persistent IT outages which have predominately impacted e-commerce and caused a loss of sales. This project will help resolve these issues and is a key part of the strategic plan.

HP revenue is increasingly online (2021: 34.2%) so it is crucial that there the right supplier is used and that there is no disruption.

RESULTS AND FINANCIAL ANALYSIS

If Transit is selected, the total incremental operating profits will be £234k. If Grossmark is selected, the total incremental operating profits will be £258k.

Under either supplier, the project will add a small but increasing amount of revenue to HP. Transit will add 1.2% in year 1, Grossmark will add 1.7% in year 1.

Grossmark has a higher capital and ongoing cost compared with Transit.

The higher profit under Grossmark is due to the expected higher revenue and cost savings. These are not guaranteed whereas the higher costs will be incurred.

Both proposals will result in an improvement to the existing OPM (1.8%). The incremental OPM under Transit proposal is 7.5% and under Grossmark it is 6.1%.

Grossmark payment terms for both capital and ongoing costs are less favourable than Transit which will have a negative impact on cash.

HP has sufficient cash (£796k) for either proposal.

ASSUMPTIONS

The calculation is based on various assumptions and the results will change if the assumptions change.

The revenue growth assumptions may be inaccurate as they were in Phase 1 when additional revenue in year 1 was only £450k despite being forecast as £600k. £600k in year 1 has been used again for Grossmark.

Transit revenue appears low for year 1 given that online systems issues resulted in £450k of lost revenue in 2021 and Greg & Sons added 10% to revenue when they worked with Transit.

GPM may be higher or lower than 20%. It was 19.3% in 2021 but could increase in future years if more higher margin online sales take place due to the new website.

The cost savings estimate for Grossmark is much higher than Transit and the reason for this is not clear.

The cost savings could be higher as they were in 2020 following Phase 1.

Delivery costs are likely to be higher than 6% of revenue. In 2021, they were 7.4% of revenue and will increase as a result of increased online sales due to the new website.

The revenue and cost savings assumptions have been provided by Hans Ritz who could be bias as he is keen for the work to be awarded to Grossmark.

As the work is due to start 1 October 2021, the timeframes are challenging.

COMMERCIAL

Using Transit's online chat facility could enable HP to offer the best online sales platform in the industry. It has also been reported that online chat adds value for customers.

Grossmark have suggested not using a parallel run to save costs. Not using a parallel run caused significant disruption, security breaches and reputational damage for Yorath & Co and this should be avoided to protect HP's reputation.

Hans Ritz has experience working with Grossmark so this should enable the project to run smoothly.

There could be a discount on Phase 3 if Grossmark is selected, although there does not appear to be an actual agreement about this.

There have been problems with maintenance as Grossmark not always able to attend within 2-hour window so need to ensure existing issue resolved before using Grossmark again.

ETHICS AND BUSINESS TRUST

Hans Ritz appears to have developed a close relationship with Grossmark which may be influencing his estimation of the benefits of using Grossmark and possibly understating the benefits of using Transit. Hans Ritz should present objective, unbiased forecasts. It could potentially cause HP to overpay for the project and have an inferior service. However, Hans Ritz may have a sound basis for his assumptions and may simply be favouring Grossmark because of the success of Phase 1.

HP was reluctant to lose staff during Phase 1 and the automation of e-commerce is likely to result in redundancies of HP staff. This could potentially cause reputational damage for HP. However, such changes are a normal consequence of new technologies and HP must enhance its online facilities to stay competitive.

Recommendations

Discuss basis for assumptions with Hans Ritz.
Train staff for other roles.

CONCLUSIONS

If Transit is selected, the total incremental operating profits will be £234k. If Grossmark is selected, the total incremental operating profits will be £258k.

The revenue growth assumptions may be inaccurate as they were in Phase 1 when additional revenue in year 1 was only £450k despite being forecast as £600k. £600k in year 1 has been used again for Grossmark.

Delivery costs are likely to be higher than 6% of revenue. In 2021, they were 7.4% of revenue and will increase as a result of increased online sales due to the new website.

Using Transit's online chat facility could enable HP to offer the best online sales platform in the industry. It has also been reported that online chat adds value for customers.

Hans Ritz appears to have developed a close relationship with Grossmark which may be influencing his estimation of the benefits of using Grossmark and possibly understating the benefits of using Transit.

HP should proceed with Grossmark once the future revenue projections have been verified.

RECOMMENDATIONS

Negotiate fee reduction with Grossmark.
Further research on revenue and cost benefit.

Due diligence on Transit.
Customer feedback on Transit.
Obtain third quote for comparison.
Communicate plans to staff.

APPENDIX 3: Buying Group Proposal

	£k	£k		£k	
	2021	**10% cheaper**		**4% cheaper**	
Revenue	£34,551	£34,551		£34,551	
Lost revenue		?		?	
Goods and materials	£23,438	£21,094	90%	£22,500	96%
Wages	£4,445	£4,445		£4,445	
	£27,883	£25,539		£26,945	
% of revenue	67.8%	61.1%		65.1%	
GP	£6,668	£9,012	£2,344k	£7,606	£938k
	19.3%	26.1%		22.0%	
Admin increase		?		?	
OP		?		?	

CONTEXT

The cost of goods and materials have been increasing, causing downward pressure on margins. The CMPI has risen in most of the last 5 years so HP needs to address this issue.

COVID-19 is likely to result in price increases as suppliers have reduced capacity and supply chains are restricted, therefore HP is likely to face further cost pressures.

NiNW are a buying group of 20 merchants who are involved with lobbying so joining could enable HP to influence matters affecting the industry.

The tracker identifies that HP is critically dependant on a few product lines so care must be taken not to disrupt the supply of these items.

RESULTS AND FINANCIAL ANALYSIS

If costs of goods and materials reduce by 10%, gross profit will increase by £2,344k to £9,012k. GPM will increase to 26.1% from 19.3%.

Goods and materials will only be 61.1% of revenue which is well below the typical industry average of 70%.

If costs of goods and materials reduce by 4%, gross profit will increase by £938k to £7,606k. GPM will increase to 22.0% from 19.3%.

Goods and materials will be 65.1% of revenue which is still below the typical industry 70%.

Payment terms are much less favourable than existing suppliers so will have an adverse cash impact.

Calculation is based on various assumptions and the result will change if the assumptions change.

The calculation does not factor in revenue which will be lost due to having a reduced product range, potential stockouts due to ordering restrictions and potentially lower quality goods. This will reduce GP and GPM improvements.

There are also likely to be additional costs for transporting the goods from the buying group's warehouse.

STRATEGIC

HP needs to decide by 31 August 2021 so timeframes are very tight.

HP will continue to lose competitiveness if costs keep increasing.

HP will have no representation in the group which means it will have no control or influence over matters regarding the products it purchases. This severely limits HP's strategic flexibility.

The buying policy appears to be entirely based on price and no consideration of quality. HP has a reputation for quality so this is not consistent with HP's strategy.

HP is unable to purchase goods from other suppliers making it entirely dependant on the buying group. It will lose relationships with suppliers it has used for many years.

OPERATIONAL

HP currently only uses UK suppliers and changing to international suppliers could cause longer lead times and FX risk.

HP may require orders more frequently than once per week and may not be able to identify quantities needed three days in advance. This appears very restrictive.

Staff and management time will be taken up by the changes and dealing with the buying group.

ETHICS

The group plans to get member agreement about pricing and this would very likely lead to action from the CMA. This could result in fines and reputational damage for HP.

The buying group will have access to the quantities and products ordered by HP. This would be valuable information for competitors who are also part of the group and it could be used to gain a competitive advantage over HP.

There is no mention of due diligence over suppliers. Currently, HP undertakes substantial due diligence to ensure product quality, sustainability and employee welfare. Using unethical suppliers would compromise HP's ethos.

Products from Harper's supplier posed a health and safety risk. It is not clear whether these were sourced via a buying group. Also, it was reported in the media so need to verify the facts.

Recommendations

Discuss how HP information will be kept confidential.
HP should not engage in any discussions on pricing.
HP should consider disclosing issue to CMA.
Request details of supplier due diligence.

CONCLUSIONS

If costs of goods and materials reduce by 10%, gross profit will increase by £2,344k to £9,012k. GPM will increase to 26.1% from 19.3%.

If costs of goods and materials reduce by 4%, gross profit will increase by £938k to £7,606k. GPM will increase to 22.0% from 19.3%.

The calculation does not factor in revenue which will be lost due to having a reduced product range, potential stockouts due to ordering restrictions and potentially lower quality goods. This will reduce additional GP and GPM improvements.

HP will have no representation in the group which means it will have no control or influence over matters regarding the products it purchases. This severely limits HP's strategic flexibility.

HP may require orders more frequently than once per week and may not be able to identify quantities needed three days in advance. This appears very restrictive.

The group plans to get member agreement about pricing and this would very likely lead to action from the CMA. This could result in fines and reputational damage for HP.

HP should not join the group because the conditions are too restrictive and there appear to be inadequate controls over suppliers.

RECOMMENDATIONS

Due diligence on NiNW.
Negotiate with NiNW.
Research on likely cost savings.
Inspect and test product quality.
Find alternative buying groups for comparison.

ADVANCED LEVEL CASE STUDY EXAMINATION
JULY 2021
(4 HOURS)

ICAEW PARTNER IN LEARNING

ACA MASTERS

Case Study: Mock Exam 2

Guidance:

To obtain maximum benefit, this mock exam should be sat under full exam conditions using the Case Study CBE software which is available from the ICAEW website. You should use the exam technique taught during the 'How to Ace the ACA Case Study' class.

Once you have completed the exam, you should use the marking grids provided to calculate whether you have scored enough passing grades for each section.

In order to improve your grade, you should carefully analyse how the report has been structured and written in the prize-winner model answer.

EXHIBIT 15

EMAIL

From: Amanda Ellis
To: Jules Wingate
Subject: House Pride: Draft management accounts and business developments
Date: 21 July 2021

There have been several significant developments. I am attaching the following:

- House Pride's draft management accounts for the year ended 30 June 2021 **(Exhibit 16)**
- Information relating to House Pride's draft management accounts for the year ended 30 June 2021 **(Exhibit 17)**
- An email from Ross Connor to me about a proposal for House Pride to be a key supplier for Orko's new development **(Exhibit 18a)**, together with media coverage **(Exhibit 18b)**
- An email about the proposal for House Pride to acquire a new warehouse **(Exhibit 19a)**, together with media coverage **(Exhibit 19b)**

I would like you to draft a report from me to the House Pride board. This should comprise the following:

1. A review of House Pride's draft management accounts for the year ended 30 June 2021 in comparison with the year ended 30 June 2020.

Your review should be based on the draft management accounts as set out in **Exhibit 16** and the additional information in **Exhibit 17**. It should cover, both overall and separately, for each of the two divisions: revenue, cost of sales and gross profit. Please also include comments on individual branch performance.

2. An evaluation of the proposal for House Pride to be a key supplier for Orko's new development, as set out in **Exhibit 18a**.

Using the information in **Exhibit 18a** and **Exhibit 18b**, you should evaluate the proposal from Orko. You should calculate House Pride's expected operating profit, assess the adequacy of the assumptions and advise on the ethical and business trust issues that House Pride should evaluate when deciding whether to proceed. You should provide a justified recommendation for the way forward.

3. An evaluation of the proposal for House Pride to acquire a warehouse in Blackburn (**Exhibit 19a**).

You should evaluate the financial, operational, strategic, ethical and business trust issues, including those arising from **Exhibit 19b**. You should advise, with reasons, whether House Pride should acquire the warehouse.

EXHIBIT 16

HP: Draft management accounts for the year ended 30 June 2021

Statement of profit and loss for year ended 30 June 2021

	£000
Revenue (Note 1)	35,174
Cost of sales (Note 1)	(28,401)
Gross profit (Note 1)	**6,773**
Distribution costs	(2,533)
Administrative expenses (Note 2)	(3,560)
Operating profit	**680**
Net finance income / (expense)	5
Profit before taxation	**685**
Income tax	(130)
Profit for the year	**555**

Statement of financial position as at 30 June 2021

	£000
Non-current assets	
Property, plant and equipment (PPE) (Note 3)	4,265
	4,265
Current assets	
Inventories (Note 4)	2,393
Trade and other receivables (Note 5)	3,816
Cash and cash equivalents	962
	7,171
TOTAL ASSETS	**11,436**
Equity	
Ordinary shares	90
Retained earnings	5,996
	6,086
Current liabilities	
Trade and other payables (Note 6)	5,220
Taxation	130
	5,350
TOTAL EQUITY AND LIABILITIES	**11,436**

Statement of cash flows for year ended 30 June 2021

	£000
Cash flows from operating activities	
Profit before taxation	685
Adjustments for:	
Depreciation	522
Loss on disposal of PPE	7
Finance (income)/expense	(5)
	1,209
Change in inventories	(373)
Change in trade and other receivables	(473)
Change in trade and other payables	870
	1,233
Income tax paid	(51)
Net cash generated from operating activities	**1,182**
Cash flows from investing activities	
Acquisition of PPE	(460)
Proceeds from disposal of PPE	8
Interest received/(paid)	5
Net cash generated from investing activities	**(447)**
Cash flows from financing activities	**-**
Net change in cash and cash equivalents	735
Cash and cash equivalents at start of period	227
Cash and cash equivalents at end of period	**962**

Notes to the management accounts

Note 1: Revenue, cost of sales and gross profit

	£000
Revenue	
RH	
Branch	17,860
Online	10,014
	27,874
BCT	
Branch	5,512
Online	1,788
	7,300
Total	
Branch	23,372
Online	11,802
	35,174
Cost of sales	
RH	23,350
BCT	5,051
	28,401
Gross profit	
RH	4,524
BCT	2,249
	6,773

Cost of sales comprises:

Goods and materials	23,060
Wages and salaries	5,341
	28,401

'Goods and materials' includes impairment allowances against inventories (see note 4). Wages and salaries relate to customer-facing staff, based in branches, the warehouse and e-commerce operations.

Note 2: Administrative expenses

	£000
Personnel	1,498
IT, premises, depreciation and other	1,755
Marketing and advertising	307
	3,560

'Personnel' includes the directors' salaries and related costs: £712,000. 'Other' includes impairment allowances against trade receivables (see note 5).

Note 3: Property, plant and equipment (PPE)

	Land, buildings, plant, machinery, fixtures, fittings and equipment	Motor vehicles	**Total**
	£000	£000	**£000**
Cost			
At 1 July 2020	4,649	2,306	**6,955**
Additions	298	162	**460**
Disposals		(25)	**(25)**
At 30 June 2021	**4,947**	**2,443**	**7,390**
Depreciation			
At 1 July 2020	1,356	1,257	**2,613**
On disposals		(10)	**(10)**
Charge for year	280	242	**522**
At 30 June 2021	**1,636**	**1,489**	**3,125**
Carrying amount at 30 June 2021	**3,311**	**954**	**4,265**

Note 4: Inventories

Inventory is carried at the lower of cost and net realisable value. Where necessary, an allowance is made for obsolescence and slow-moving items. Allowances have been recognised as part of goods and materials within cost of sales as follows: £86,000.

Note 5: Trade and other receivables

	£000
Trade receivables	3,452
Other receivables and prepayments	364
	3,816

Trade receivables are stated after impairments for amounts considered irrecoverable. Impairment charges recognised in administrative expenses are: £37,000.

Note 6: Trade and other payables

	£000
Bank overdraft	-
Trade payables	4,255
Other payables and accruals	965
	5,220

EXHIBIT 17

Additional information relating to the draft management accounts

I have set out some information below that should assist in the analysis of House Pride's revenue and gross profit for the year ended 30 June 2021.

- UK government incentives for housebuilders and home buyers stimulated activity in the housing market. However, the increase in working from home resulted in a significant decline in activity in the non-residential market.
- Due to some of House Pride's competitors having supply issues in July 2020, three regional housebuilders selected House Pride as one of their replacement suppliers. This added around £3.5 million of revenue.
- From September 2020, we noticed a significant decline in revenue from Wrights. We estimate that the total impact was lost revenue of £500,000.
- Heightened activity in the housing market saw an increase in renovation works being carried out. In addition, due to increased amounts of time spent at home, other homeowners brought forward refurbishment projects.
- Between October 2020 and June 2021, we introduced a temporary trade discount for Members of NWFT (North-West Federated Tradespeople). This entitled members to pay 'trade prices' on all purchases. This proved very popular among NWFT members.
- House Pride continued to reap the benefits of the new inventory management systems. We estimate that with fewer stockouts, this added £750,000 to revenue.
- Despite the increase in the number of deliveries, 96% of delivers were made on time.
- In December 2020, we took the decision to permanently close the Bolton branch from 1 January 2021. Notice of closure was given and customers were advised to use either the Wigan or Blackburn branch. Staff were redeployed to e-commerce roles where possible, although some staff were made redundant with generous redundancy payments. Inventories were transferred to other branches or sold in December at a 40% discount.
- In February 2021, following increased customer usage of click-and-collect facilities at other branches, we closed the Manchester and Liverpool branches so that click-and-collect facilities could be added. Both branches were closed for one month.
- Due to increased purchase volumes, we were able to negotiate more favourable terms with suppliers. These terms applied to purchases from March onwards.
- Revenue from each branch was as follows:

	£000
Warrington	3,652
Preston	2,948
Bury	-
Blackburn	4,169
Burnley	3,643
Wigan	3,009
Bolton	983
Manchester	2,901
Liverpool	2,067
	23,372

EXHIBIT 18a

EMAIL

From: Ross Connor
To: Amanda Ellis
Subject: Orko Proposal
Date: 19 July 2021

We have been invited by our customer Orko to become a key supplier for their new retirement village development in the Lake District. The village is located approximately 125 kilometres from our Warrington warehouse. Following Orko's acquisition of Dolphino, this is the first stage of Orko's plan to build several retirement villages across the north-west of England.

Information about the proposal is set out below.

1. The village will comprise 75 properties located in a rural setting.

2. Orko have provided a detailed breakdown of the products they are likely to require from HP for the project, including quantities. My team and I have reviewed the products Orko require and we currently offer all the products in our product range.

3. The total price for the products, based on the prices advertised on House Pride's website and Orko's stated quantities, is £5,250,000.

4. The cost to House Pride of purchasing the products will be £3,650,000.

5. Orko have stated that they expect to receive a 20% discount on all advertised prices due to the size of the project. However, they have made it clear that this discount should not be contingent on Orko purchasing certain quantities from House Pride.

6. The project will begin on 18 February 2022 and must be completed by 30 June 2022. Orko acknowledges that this is an ambitious timeframe, which is part of the reason they only want to use trusted suppliers, such as House Pride.

7. Orko will be using a range of building merchants and specialist suppliers, including cementonline.com, who recently expanded and starting supplying regional housebuilders. Having visited cementonline.com, I can see that they could supply the required products for £4,050,000.

8. Due to the volume of the orders, we will require additional branch, warehouse and e-commerce staff. My estimate is that this will cost £250,000.

9. There will be no charge for delivery.

10. As most deliveries will be very large, distribution costs are expected to be 5% of revenue.

11. Orko will make payment for each delivery 45 days after the delivery date.

EXHIBIT 18b

RECENT MEDIA COVERAGE

High leverage, high risk (Finance Journal, April 2021)

With increasing demand, government incentives and rock bottom interest rates, property developers appear to be operating in near perfect market conditions.

The demand for almost all types of property, ranging from starter family homes to retirement housing, is rising. Prices are rising too, and when combined with generous government incentives, developers are being encouraged to build, build, build.

With interest rates at record lows, developers are funding large projects with high levels of debt. In fact, a new retirement village approved for the Lake District is being funded almost entirely via bank loans.

Whilst such cheap finance is attractive, it does not come without risk. Any delay in selling the properties could cause the developer to miss loan repayments, which in turn could result in the bank forcing the developer into liquidation.

Care homes not fit for purpose (Golden Years, February 2021)

Homes in five different retirement villages across the north west of England have been found to have structural defects. The consequences are wide ranging: inefficient energy use, drafts, damp and health and safety hazards. There is concern that the issue could be more widespread, so a local authority investigation is due to launch in the coming months.

Three of the retirement villages have been traced back to a developer called Dolphino. We understand that this developer has been involved in other projects, so we expect that these villages will be the first place that the authorities look.

EXHIBIT 19a

EMAIL

From: Amanda Ellis
To: Jules Wingate
Subject: Warehouse
Date: 21 July 2021

House Pride has entered discussions about acquiring a warehouse in Blackburn.

Currently, inventory is taken from the Warrington warehouse for all online sales, including click-and-click collect. The last 18 months has seen a significant increase in the proportion of House Pride's sales which are made online and this trend is expected to continue. In addition, the geographical spread of House Pride's customers is increasing, meaning that drivers are now travelling further.

In order to adapt to these changes, the board have agreed that House Pride should acquire another warehouse. This will be in addition to the existing warehouse in Warrington which will continue in operation.

Blackburn has been identified as a suitable location because it will enable faster delivery to customer premises and construction sites to the north of Manchester, as well as for click-and-collect orders to be collected from the Preston, Blackburn and Burnley branches.

The Warrington warehouse will be used for deliveries to customer premises and construction sites to the south of Manchester, as well as for click-and-collect orders to be collected from the Warrington, Wigan, Manchester and Liverpool branches.

As a result of these changes, House Pride will be able to offer delivery within 12 hours of order. This will be the fastest delivery time of all UK building merchants.

House Pride will implement a new delivery charge as follows:

Order Value	Delivery Charge
Below £100	£60
£100 - £499	£50
£500 - £4,999	£40
£5,000 - £9,999	£30
Over £10,000	Free

Further information
- The warehouse is located close to major motorways, as well as residential areas and a local nature reserve.
- Negotiations are ongoing but the warehouse is expected to cost around £1 million and will be in use for 25 years.
- Forklift trucks, fixtures and fittings and other equipment are expected to cost £120,000. These will need replacing every 10 years.
- Additional vehicles will be required. The initial suggestion was to purchase a range of new energy-efficient hybrid vehicles for £60,000. The vehicles would come fitted with tracking devices and cabin cameras so that we can monitor drivers at all times. Whilst such vehicles would last at least 10 years, it has been suggested that older diesel vehicles should be purchased for around £15,000 in order to save costs.

- Revenue will increase by £210,000 due to the new delivery charge and the attraction of fast delivery.
- Despite the increase in sales volume, overall distribution costs will reduce by £100,000 due to the shorter distances being travelled for deliveries to the north of Manchester.
- As part of Phase 3 of the ERP project, algorithms will be used to allocate orders to workers in the warehouse, group deliveries and plan routes. This will help maximise efficiency.
- A detailed analysis of product lines has been undertaken and the product range will be rationalised to remove slow moving items and items which earn a lower profit margin.

EXHIBIT 19b

RECENT MEDIA COVERAGE

21st Century Jobs (Business Insider, May 2021)

The rise of e-commerce might have created a substantial number of new jobs, but the quality of those jobs should be of serious concern.

E-commerce often requires large numbers of workers to manage the ever-growing warehouse and storage facilities of these popular internet businesses. The working environment is demoralising: a lack of natural daylight, restricted breaks, constant monitoring by bosses and monotonous work.

A worker who spent two weeks at the warehouse of the world's biggest online retailer was recently quoted as saying: "They treat you as if you are just an expendable part of equipment. Even a robot would get depressed doing a job like that."

ADVANCED LEVEL CASE STUDY EXAMINATION
JULY 2021
(4 HOURS)

ICAEW PARTNER IN LEARNING

ACA MASTERS

Mock Exam 2 Marking Key

OVERALL ASSESSMENT CRITERIA	EXECUTIVE SUMMARY R1 - Review of financial performance
• Appropriate layout: headings AND paragraphs/sentences • No disclaimer AND from Amanda Ellis • Suitable language: formal AND tactful AND ethical • Reasonable spelling and grammar	• Revenue: qualitative comment on RH and BTC (fig) • Revenue: qualitative comment on branch (fig) • COS: qualitative comment on an individual cost (fig) • GP/GP%: qualitative comment with fig
NA ID IC SC CC	**NA ID IC SC CC**
	• BCT: discount causing GP% decline • Branches: Bolton revenue transferred to other branches • Other commercial recommendations • Appropriate summary of report section
NA ID IC SC CC	**NA ID IC SC CC**

R2 - Evaluation of Orko proposal	R3 - Evaluation of warehouse proposal
• Gives operating profit figure • Evaluates/questions assumptions • Concludes/recommends on ethics/business trust issues • Identifies cash flow/working capital risk	• Calculates financial benefit (revenue/profit) • Concludes on main operational/strategic issue • Concludes/recommends on ethics/business trust issues • Concludes on way forward
NA ID IC SC CC	**NA ID IC SC CC**
• Concludes on way forward • Identifies potential capacity issues (March-June) • Negotiate payment terms • Appropriate summary of report section	• Additional finance will be required • Identifies missing costs • Other commercial recommendations • Appropriate summary of report section
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 1 – Review of financial performance

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 1 • Presents 2021 figures • Presents 2020 figures • Analysis of RH and BCT figures: revenue and GP • Analysis per branch / average branch revenue	**Financial analysis: revenue (report)** • Revenue growth: higher than last year v 6.5% >| • RH: new customers £3,500k (July) > • RH: Wrights lost £500k revenue (September) > • BCT: home refurbishments brought forward > • BCT: NWFT 10% discount (October) > • Increase in deliveries on time >
NA ID IC SC CC	**NA ID IC SC CC**
AI/CS Exam info (report/appendix) • Overall revenue: up £5,260k / up 19.0% • RH revenue: up £4,706k / up 20.3% AND BCT revenue: up £914k / up 14.3% • Overall GP/GP%: up £1,114k/19.7% / 19.3% v 19.1% • RH GP: up £849k/23.1% / 16.2% v 15.9% AND BCT GP: up £265k/13.4% / 30.8% v 31.1%	**Financial analysis: Branch revenue (report)** • Average branch revenue per month: £265.6k > • Bolton: down £1,582k/61.7% > • Blackburn: up £1,001k/31.6% / Wigan: up £908k/43.2% > • Manc up: £388k/15.4% Liverpool: up £222k/12.0% > • Burnley up due to 2020 refurbishment
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • Government incentives for builders / home buyers • Decline in non-residential sectors • Growth in both divisions / channels • Product cost increasing / CMPIs / 70% of revenue • Good overall performance / exceeds £30m	**Financial analysis: COS/GP** • RH COS: up £3,857k/19.8% / BCT up £649k/14.7% > • Good and materials: up £3,298k /16.7% > • Wages: up £1,208k/29.2% > • RH GP% increase due to online shift • BCT GP%: decrease due to discount
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 1 – Review of financial performance

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of revenue analysis • Growth due to volume (not price) / stockout benefit £750k • Significant addition / accounts for majority of growth • Bigger impact next year as full-year effect • Could reduce next year as demand brought forward • NWFT 50% of sales so significant • Fewer refunds / v target (95%)	**Draws conclusions (under a heading)** • Revenue: qualitative comment on RH and BTC (fig) • Revenue: qualitative comment on branch with fig • COS: qualitative comment on an individual cost (fig) • GP/GP%: qualitative comment with fig
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation of branch revenue analysis • Increase in branch revenue and months open / v £238.1k • Closure in January / 40% discount in December • Customers transferred from Bolton / offsets Bolton decline • Due to one month closure / refurbishment improves performance • Wigan best performing / Blackburn largest / all up except Bolton	**Makes recommendations** • Profit analysis by branch / further cost analysis • Reduce NWFT discount • Increase delivery charge • Consider closing more branches • Other commercial recommendations
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation of COS/GP analysis • RH/BCT: compares to revenue growth • Goods and materials: economies of scale / 65.6% of revenue • Wages: redundancies / 15.2% of revenue • HP GP%: one-off costs: redundancies/closure costs/40% disc • HP GP%: online/branch mix / RH/BCT mix impact on GP%	
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 2 – Evaluation of Orko proposal

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 2 • Numbers labelled AND clearly derived • Calculation of revenue • Calculation of operating profit • Considers additional costs/flexes numbers	**Calc of revenue and profit (appx or report)** • GP: £300k / GPM: 7.1% • OP: £90k / OPM: 2.1% • Flexes calculation for 10%/15% discount / distribution costs • Justifies basis for flexed calculation • Calculates revised GP/GPM/OP/OPM
NA ID IC SC CC	**NA ID IC SC CC**
AI/CSE information (report/appendix) • Advertised prices: £5,250k • 20% discount: £4,200k • Costs: £3,650k AND £250k • Distribution costs: uses 5% or own fig	**Assumptions** • Quantities provided by Orko > • 20% discount higher than usually offered > • Considers achievability of timescale > • Cost of materials could be lower/higher > • Delivery likely to be higher > • Not clear what is meant by "one of our key suppliers"
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • HP won Supplier of The Year from Orko • Properties for the elderly: growing sector • Antoine: delays / pressure on suppliers / 15% discount • Orko approach for HP to supply materials for project • HP cash balance £962k / risk tracker: risk 3	**Comments on ethical / business trust issues** • Dolphino villages with structural defects > • Would become largest customer / risk tracker: risk 4 > • HP unable to compete on price with COL > • Orko may pressure HP to match COL price > • Orko financial pressure / may delay payment to HP >
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 2 – Evaluation of Orko proposal

<table>
<tr><th>APPLYING JUDGEMENT</th><th>CONCLUSIONS AND RECOMMENDATIONS</th></tr>
<tr><td>Evaluation of proposal
• Changes in assumptions will impact calculations
• Significant addition to revenue / calcs relative size
• Compares GP%/OP% with 2021 GP%/OP%
• Payment terms less favourable than current / v 30 days
• Potential for additional work / growth area</td><td>Draws conclusions (under a heading)
• Gives operating profit figure
• Evaluates/questions assumptions
• Concludes on ethics/business trust issues
• Concludes on way forward</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Evaluation of assumptions
• Figures may be overstated to obtain discount
• Larger project may require higher discount / v 10%/15%
• 50% of sales typically in March-June / capacity / supply
• Potential economies of scale / costs increasing
• Travelling further distances will increase costs
• Other costs e.g. staff, admin, account manager/director time</td><td>Makes recommendations
• Negotiate with Orko
• Further research on costs
• Determine if sufficient capacity / suppliers
• Estimate likely benefit of future work
• Other commercial recommendations</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Evaluation/recs: ethical/business trust
• Verify facts / speak with Orko / HP sustainability ethos
• More than 5% of revenue / monitor credit status
• Price of £4,050k would result in a loss for HP
• Emphasis on quality/reliability/favoured supplier
• Contract clauses / penalties / arrange finance with HP bank
• Media reports may not relate to Orko</td><td></td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
</table>

REQUIREMENT 3 – Evaluation of warehouse proposal

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Workings / report • Numbers labelled AND clearly derived • Calculation for additional revenue / reduced costs • Calculates capital expenditure • Calculation for additional profit	**Financial calculations (appx or report)** • Applies GP% to revenue (2021/20%/own fig) • Includes distribution costs saved • Calculates deprecation on capital expenditure • Identifies missing numbers: Late delivery refunds / holding costs saved / admin costs / other staff costs / overheads / IT / security
NA ID IC SC CC	**NA ID IC SC CC**
AI/CSE information (report/workings) • Warehouse: £1,000k • Other capex: £120k and £60k • Revenue: £210k • Blackburn is located north of Manchester	**Operational and strategic issues** • 12-hour delivery would make HP market leader > • Relies on dependable supply chain > • Better inventory management through rationalisation > • Distribution route planning required > • Training and recruitment needed / costs > • Reduced transport time for click-and-collect
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • Sales increasingly online / increased click-and-collect sales • Delivery time key factor for customers • Inventory for online sales taken from Warrington • Greg & Sons branch conversion / COL new warehouses • Some competitors use sliding scale for delivery charges	**Comments on ethical/bus trust issues** • Employee welfare a concern in warehouses > • Warehouse close to houses and nature reserve > • Vehicle emissions will be higher for diesel cars > • Security is essential consideration > • Tracking drivers may be invasive > • Short delivery time will require constant working >
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 3 – Evaluation of warehouse proposal

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of financial issues • Any changes in assumptions will impact calculations • Increased fixed costs / operating gearing • Delivery pricing will deter smaller orders • Financing needed as cash balance insufficient • IT and security costs could be substantial • Higher GPM from online sales	**Draws conclusions (under a heading)** • Calculates financial benefit (revenue/profit) • Concludes on main operational/strategic issue • Concludes on ethics / business trust issues • Concludes on way forward
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation: operational/strategic issues • Significant improvement from 48 hours • Shortages in underlying components / long lead times • Reduced holding cost / fewer impairments • Will require additional drivers / ERP Phase 3 • Potential automation in future / use of algorithms • C&C growing / ERP Phase 2 will increase demand	**Makes recommendations** • Negotiate with vendor • Further research on additional revenue / other costs • Find alternative sites for comparison • Identify funding sources / arrange meeting with bank • Other commercial recommendations
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation/recs: ethical/business trust • Staff are key / sufficient breaks / consult with HR • Community consultation required • HP ethos / HP emissions policy / use hybrid • Disruption would have significant impact on delivery times • Consult with drivers before implementing • Many businesses operate on a 24hr basis	
NA ID IC SC CC	**NA ID IC SC CC**

ADVANCED LEVEL CASE STUDY EXAMINATION
JULY 2021

ICAEW PARTNER IN LEARNING

ACA MASTERS

Mock Exam 2 Model Answer

A report on House Pride Limited.

TO: Directors of House Pride Limited

FROM: Amanda Ellis (Finance Director)

DATE: 21 July 2021

Executive Summary

REVIEW OF FINANCIAL PERFORMANCE FOR YEAR ENDED 30 JUNE 2021

Overall revenue has increased impressively by £5,620k (19.0%) to £35,174k which is a strong performance in a thriving industry. Revenue is now considerably higher than the 30 June 2020 target of £30m.

RH revenue has increased significantly by £4,706k (20.3%) to £27,874k due to £3,500k generated from new customers. BCT revenue has increased impressively by £914k (14.3%) to £7,300k due to renovations and homeowners bringing forward refurbishment projects and the discount for NWFT members who account for 50% of BCT revenue. As the increase in revenue is partly due to brought forward demand, growth is likely to taper off.

Average branch revenue per month has increased significantly by 11.5% to £265.6k from £238.1k. Bolton revenue decreased £1,582k (61.7%) due to being closed on 1 January. Customers have used Blackburn and Wigan instead and these branches have seen revenue increase by 31.6% and 43.2% respectively.
Goods and materials have increased by £3,298k (16.7%), which is lower than the revenue increase due to HP benefiting from economies of scale from March onwards.

RH GP increased by £849k (23.1%), with a GPM improvement from 15.9% to 16.2%, due to a revenue mix shift towards higher margin online sales. BCT GP increased by £265k (13.4%), with GPM decreasing disappointingly to 30.8% from 31.1%, due to the 10% discount offered to NWFT members which is significantly more than the 5% usually offered to BCT customers. Overall GP increased impressively by £1,114k (19.7%) to £6,773k, with a GPM increase to 19.3% from 19.1% due to the GPM improvement in RH which accounts for the majority of revenue.

RECOMMENDATIONS
Reduce NWFT discount to 7%.
Consider consolidating more branches.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

EVALUATION OF ORKO PROPOSAL

Applying the 20% discount, the revenue will be £4,200k, gross profit will be £300k and operating profit will be £90k. This will add a significant 11.9% to HP revenue. The GPM of 7.1% is below the GPM earned in 2021 by HP (19.3%) and RH (16.2%) due to the 20% discount. The payment terms of 45 days are less favourable than existing terms of 30 days so will have a negative impact on cash. HP only has £962k of cash so may require additional finance for the project.

The quantities are provided by Orko who may have inflated them for HP to agree to the 20% discount. The timeframe is ambitious and coincides with HP's busy period (50% of sales occur in March to June). HP may not have sufficient capacity to satisfy all demand.

The project will enable HP to establish a foothold in the elderly care accommodation market which is growing.

If Orko is unable to complete the project on time or sell the houses then the bank may pressure Orko, who in turn could delay payment to HP. Such a large project could cause HP to suffer severe working capital issues and go out of business.

HP will become increasingly dependent on Orko as this project alone will account for more than 5% of revenue. The loss of such a major customer was identified as a key risk and as mitigation HP previously ensured that no customer accounted for more than 5% of revenue. This risk is increased because Orko has high debt finance.

HP should proceed with the project after negotiating better payment terms so that cash flow risk is reduced.

RECOMMENDATIONS

Negotiate better payment terms.
Impose penalties for late payment.
Negotiate lower discount.

EVALUATION OF WAREHOUSE PROPOSAL

The new warehouse will result in additional operating profit of £82.5k per annum.

There is a significant upfront cash outlay of £1,180k and HP does not have the cash reserves (£962k) to fund this so will require additional finance.

The calculation does not include the overheads for the warehouse, additional admin, IT or security costs.

It is a big commitment and would be difficult to exit if sales were to decline and the warehouse were to be underutilised.

HP will have a competitive advantage by having the fastest delivery time. The new delivery charge will likely result in a loss of customers who place small orders as the £60 delivery charge for orders less than £100 seems high. HP should consider if this is an intended strategy.

Blackburn's geographical position makes it a good choice for a new warehouse. HP will need to ensure that suppliers can supply products in time. Longer lead times from suppliers was previously identified as a concern.

The suggestion to use older diesel vehicles will result in more pollution. HP aims to use energy-efficient processes across its sites so this would contradict that aim. However, the emissions may be considered 'satisfactory'.

The warehouse is close to residential areas and a nature reserve. As the warehouse will be in constant operation, it could create conflict with the community.

If HP can obtain suitable finance, then it should proceed so that it can gain a competitive advantage by offering the fastest delivery.

RECOMMENDATIONS

Purchase the new energy-efficient vehicles
Further research on additional costs e.g. security.
Discuss financing with the bank.

APPENDIX 1: Analysis of Management Accounts 30 June 2021

	2021 (£k)	2020 (£k)	Change (£k)	%
Revenue				
RH				
Branch	17,860	15,535	2,325	15.0%
Online	10,014	7,633	2,381	31.2%
Total	27,874	23,168	4,706	20.3%
Mix:				
Branch	64.1%	67.1%		
Online	35.9%	32.9%		
BCT				
Branch	5,512	4,944	568	11.5%
Online	1,788	1,442	346	24.0%
Total	7,300	6,386	914	14.3%
Mix:				
Branch	75.5%	77.4%		
Online	24.5%	22.6%		
Total				
Branch	23,372	20,479	2,893	14.1%
Online	11,802	9,075	2,727	30.0%
Total	35,174	29,554	5,620	19.0%
Mix:				
Branch	66.4%	69.3%		
Online	33.6%	30.7%		
Mix				
RH	79.2%	78.4%		
BCT	20.8%	21.6%		

Branches				
Warrington	3,652	2,970	682	23.0%
Preston	2,948	2,457	491	20.0%
Blackburn	4,169	3,168	1,001	31.6%
Burnley	3,643	2,860	783	27.4%
Wigan	3,009	2,101	908	43.2%
Bolton	983	2,565	(1,582)	(61.7%)
Manchester	2,901	2,513	388	15.4%
Liverpool	2,067	1,845	222	12.0%
	23,372	20,479	2,893	14.1%
Mix				
Warrington	15.6%	14.5%		
Preston	12.6%	12.0%		
Blackburn	17.8%	15.5%		
Burnley	15.6%	14.0%		
Wigan	12.9%	10.3%		
Bolton	4.2%	12.5%		
Manchester	12.4%	12.3%		
Liverpool	8.8%	9.0%		
	100%	100%		
Average branch revenue per month				
Branch revenue	£23,372	£20,479		
No of branches	5	6		
Months open	12	11		
	60	**66**		
No of branches	2	2		
Months open	11	10		
	22	**20**		
No of branches	1			
Months open	6			
	6			

	88	**86**		
	£265.6k	£238.1k	£27.5k	11.5%
CoS				
RH	23,350	19,493	£3,857	19.8%
BCT	5,051	4,402	£649	14.7%
	28,401	23,895	£4,506	18.9%
Goods and materials	23,060	19,762	£3,298	16.7%
Wages	5,341	4,133	£1,208	29.2%
	28,401	23,895	£4,506	18.9%
Mix				
Goods and materials	81.2%	82.7%		
Wages	18.8%	17.3%		
% of revenue				
Goods and materials	65.6%	66.9%		
Wages	15.2%	14.0%		
GP				
RH	4,524	3,675	£849	23.1%
BCT	2,249	1,984	£265	13.4%
TOTAL	6,773	5,659	£1,114	19.7%
	6,773	5,659		
GPM				
RH	16.2%	15.9%		
BCT	30.8%	31.1%		
TOTAL	19.3%	19.1%		

REVIEW OF FINANCIAL PERFORMANCE FOR YEAR ENDED 30 JUNE 2021

REVENUE

Overall revenue has increased impressively by £5,620k (19.0%) to £35,174k which is a strong performance in a thriving industry. The rate of growth is increasing (2020: 6.5%), although 2020 was impacted by temporary factors. Revenue is now considerably higher than the 30 June 2020 target of £30m. Both divisions and both channels have grown and benefited £750k due to the new inventory management system, as well as lower refunds due to 96% of deliveries being on time (the target of 95% has been exceeded).

RH revenue has increased significantly by £4,706k (20.3%) to £27,874k due to £3,500k generated from new customers more than offsetting the £500k of lost revenue from Wrights. Branch revenue increased 15.0% and online revenue increased 31.2%, resulting in online now accounting for 35.9% of RH revenue (2020: 32.9%). The new customers account for most of the growth. Demand is being stimulated by government incentives.

BCT revenue has increased impressively by £914k (14.3%) to £7,300k due to renovations and homeowners bringing forward refurbishment projects and the discount for NWFT members who account for 50% of BCT revenue. Branch revenue increased by a significant 11.5% and online revenue increased by an impressive 24.0%, resulting in online now accounting for 24.5% (2020: 22.6%). As the increase in revenue is partly due to brought forward demand, growth is likely to taper off. COVID-19 has caused people to spend more on housing improvements due to more time being spent at home.

RH now accounts for 79.2% (2020: 78.4%) of HP revenue with BCT accounting for 20.8% (2020: 21.6%), showing the increasing importance of RH. Online sales now account for 33.6% of revenue (2020: 30.7%). There is a shift to online sales in the industry.

Average branch revenue per month increased significantly by 11.5% to £265.6k from £238.1k. Whilst branch revenue increased by 14.1%, the branches were open for more months in 2021 compared with 2020 (88 months v 86 months) as there were no temporary closures in 2021 except for the two refurbishments. The growth rate is increasing (2020: 2.3%).

Bolton revenue decreased by £1,582k (61.7%) due to being closed on 1 January (6 months of year) and selling some products at a 40% discount. Customers have used Blackburn and Wigan instead and these branches have seen revenue increase by 31.6% and 43.2% respectively.

Liverpool saw the smallest increase of £222k (12.0%) due to being closed for one month, along with Manchester which had growth of £388k (15.4%).

Wigan was the best performing branch (43.2% growth). Blackburn accounts for the largest share of revenue (17.8%). The refurbishment programme appears to be a success as performance appears to improve after refurbishment. All branches (except Bolton) have seen an increase/decrease in revenue.

COST OF SALES AND GROSS PROFIT

Goods and materials increased by £3,298k (16.7%) which is lower than the revenue increase due to HP benefiting from economies of scale from March. Goods and materials are now 65.6% (2020: 66.9%) of revenue. This is still below the typical industry figure of 70%. The CMPIs have increased in most of the last five years and prices were expected to increase in 2020/21.

Wages increased by £1,208k (29.2%) due to redundancy payments. Wages are now 15.2% (2020: 14.0%) of revenue and above the typical industry figure of 15.0%.

RH GP increased by £849k (23.1%), with a GPM improvement from 15.9% to 16.2%, due to a revenue mix shift towards higher margin online sales.

BCT GP increased by £265k (13.4%), with GPM decreasing disappointingly to 30.8% from 31.1%, due to the 10% discount offered to NWFT members which is significantly more than the 5% usually offered to BCT customers.

Overall GP increased impressively by £1,114k (19.7%) to £6,773k, with a GPM increase to 19.3% from 19.1% due to the GPM improvement in RH which accounts for the majority of revenue.

CONCLUSIONS

Overall revenue has increased impressively by £5,620k (19.0%) to £35,174k which is a strong performance in a thriving industry. RH revenue has increased significantly by £4,706k (20.3%) to £27,874k due to £3,500k generated from new customers. BCT revenue has increased impressively by £914k (14.3%) to £7,300k due to renovations and homeowners bringing forward refurbishment projects and the discount for NWFT. Average branch revenue per month increased significantly by 11.5% to £265.6k from £238.1k.

Goods and materials increased by £3,298k (16.7%) which is lower than the revenue increase due to HP benefiting from economies of scale from March onwards.

RH GP increased by £849k (23.1%), with a GPM improvement from 15.9% to 16.2%, due to a revenue mix shift towards higher margin online sales. BCT GP increased by £265k (13.4%), with GPM decreasing disappointingly to 30.8% from 31.1%, due to the 10% discount offered to NWFT members. Overall GP increased impressively by £1,114k (19.7%) to £6,773k, with a GPM increase to 19.3% from 19.1% due to the GPM improvement in RH which accounts for the majority of revenue.

RECOMMENDATIONS

Further analysis by division / profit analysis by branch.
Continue refurbishment programme to increase branch revenue.
Reduce NWFT discount to 7%.
Consider consolidating more branches.
Increase charge for online delivery.

APPENDIX 2: Orko Proposal

	20% discount		10% discount 7.2% distribution
	£k		£k
Revenue (W1)	4,200		4,725
Goods and materials	- 3,650		- 3,650
Wages and salaries	- 250		- 250
	- 3,900		- 3,900
GP	300		825
GPM	7.1%		17.5%
Distribution	- 210		- 340
Admin	?		?
OP	90		485
OPM	2.1%		10.3%
Revenue (W1)			
Advertised price	5,250		5,250
20%	- 1,050	10%	- 525
80%	4,200	90%	4,725
Costs as % of revenue			
Goods	86.9%		77.2%
Wages	6.0%		5.3%
Distribution	5.0%		7.2%
% of 2021 Revenue	11.9%		13.4%
	35,174		35,174

FINANCIAL EVALUATION OF ORKO PROPOSAL

CONTEXT
HP won Supplier of The Year from Orko so this is an opportunity to for HP to benefit from the goodwill between the two companies.

Antoine, another retirement village developer, suffered delays which resulted in the bank putting pressure on Antoine to delay payments to suppliers. The same could happen with Orko which would have a severe impact on HP and cash flow is already on the risk tracker.

Disruption from COVID-19 could cause a delay in construction projects or sales which would have an adverse impact on Orko and HP.

RESULTS AND FINANCIAL ANALYSIS
The revenue will be £4,200k, gross profit will be £300k and operating profit will be £90k.

This will add a significant 11.9% to HP revenue.

There is the potential for additional work because Orko plans to build several more retirement villages and care for the elderly was previously identified by HP as a growing market.

The GPM of 7.1% is below the GPM earned in 2021 by HP (19.3%) and RH (16.2%) due to the 20% discount.

The incremental OPM on the project is 2.1% which is slightly above the 2021 OPM of 1.9% but the project has not included any admin costs.

The payment terms of 45 days are less favourable than existing terms of 30 days so will have a negative impact on cash. HP only has £962k of cash so may require additional finance for the project.

If HP offers the normal 10% discount and distribution costs are increased to 7.2% as was the case in 2021, revenue will be £4,725k, GP will be £825k (GPM: 17.5%) and OP will be £485k (OPM: 10.3%)

ASSUMPTIONS
This calculation is based on various assumptions and the results will change if the assumptions change.

The quantities are provided by Orko who may have inflated them for HP to agree to the 20% discount.

The 20% discount is more than the 15% which is typical for projects of a similar size.

Cost of materials may be lower as HP should be able to negotiate a bulk purchase discount with suppliers.

Staff costs could be higher as other admin staff may be required. In addition, there will be training and recruitment costs, as well as management time.

Distribution costs are likely to be higher than 5% because they were 7.2% in 2021.

The timeframe is ambitious and coincides with HP’s busy period (50% of sales occur in March to June). HP may not have sufficient capacity to satisfy all demand so there could be lost sales elsewhere.

OTHER FACTORS

The project will enable HP to establish a foothold in the elderly care accommodation market which is growing.

The project enables HP to develop its relationship with Orko, who appears to be growing.

Cementonline.com can offer the same materials at a considerably lower price. HP would make a loss at these prices so HP will need to compete on its quality and past reliability to Orko.

Suppliers may not be able to supply the quantities required, particularly as there have been issues with lead times.

ETHICS AND BUSINESS TRUST

If Orko is unable to complete the project on time or sell the houses then the bank may pressure Orko who in turn could delay payment to HP. Such a large project could cause HP to suffer severe working capital issues and go out of business.

HP will become increasingly dependent on Orko as this project alone will account for more than 5% of revenue. The loss of such a major customer was identified as a key risk and as mitigation HP previously ensured that no customer accounted for more than 5% of revenue. This risk is increased because Orko has high debt finance.

Media reports suggest that Dolphino retirement village projects have been poor quality. This could cause reputational damage for Orko and in turn HP. HP should avoid being associated with such negative publicity. However, Orko has only recently acquired Dolphino so is unlikely to have been involved in the old projects.

Recommendations

Negotiate better payment terms.
Impose penalties for late payment.
Reduce size of project by only supplying a limited amount to Orko on credit.
Speak with Orko to gain reassurance that new project will be high quality.

CONCLUSIONS

Apply the 20% discount, the revenue will be £4,200k, gross profit will be £300k and operating profit will be £90k.

The quantities are provided by Orko who may have inflated them for HP to agree to the 20% discount.

The project will enable HP to establish a foothold in the elderly care accommodation market which is growing.

If Orko is unable to complete the project on time or sell the houses then the bank may pressure Orko who in turn could delay payment to HP. Such a large project could cause HP to suffer severe working capital issues and go out of business.

HP should proceed with the project after negotiating better payment terms so that cash flow risk is reduced.

RECOMMENDATIONS

Negotiate lower discount.
Further research on costs.

Find out likely size of future projects.
Enhanced due diligence on Orko.

APPENDIX 3: New Warehouse

		£k		
	Revenue increase	210		
19.3%	GP%	40.5		
	Distribution costs saved	100		
	Holding costs saved	?		
	Depr (W1)	-58		
	Admin	?		
	Overheads	?		
	OP increase pa	82.5		
	CAPEX (W1)	**Cost**	**UEL**	**Depr PA**
	Warehouse	1000	25	40
	F&F / Equipment	120	10	12
	Vehicles	60	10	6
		1180		**58**
	2021 OP	680		
		82.5		
		12.1%		
	2021 Revenue	34551		
		210.0		
		0.6%		

EVALUATION OF NEW WAREHOUSE PROPOSAL

CONTEXT

COVID-19 has caused a shift towards online activity and if this trend continues, HP will require more capacity to process online sales.

Delivery time is a key factor for customers so decreasing delivery time should help increase HP's revenue.

Currently, all online sales are fulfilled from the Warrington warehouse which is a substantial distance from some of the branches and customer locations. A new warehouse would reduce this transfer time and improve efficiencies.

RESULTS AND FINANCIAL ANALYSIS

The new warehouse will result in additional operating profit of £82.5k per annum.

It only adds a small amount of £210k (0.6%) to existing revenue but this could increase in the future.

It will add a significant amount to OP (12.1%).

The GPM will likely increase from 19.3% as online sales have higher GPM due to fewer staff costs.

Having an additional warehouse will significantly increase the operating gearing (and risk) of the business.

It is a big commitment and would be difficult to exit if sales were to decline and the warehouse were to be underutilised.

There is a significant upfront cash outlay of £1,180k and HP does not have the cash reserves (£962k) to fund this so will require additional finance.

The calculation is based on various assumptions and the result will change if the assumptions change.

The calculation does not include the overheads for the warehouse, additional admin, IT or security costs.

STRATEGIC

HP will have a competitive advantage by having the fastest delivery time. Delivery in 12 hours is a significant increase from the current 48 hours.

There is increased risk of deliveries being late due to shortened delivery times and this could result in the delivery charge plus 5% of the order value being refunded.

The new delivery charge will likely result in a loss of customers who place small orders as the £60 delivery charge for orders less than £100 seems high. HP should consider if this is an intended strategy.

HP will have a sliding scale delivery charge like some of HP's competitors.

OPERATIONAL

Blackburn's geographical position makes it a good choice for a new warehouse.

Vehicle running costs will be lower if the energy-efficient vehicles are selected.

Further efficiencies will arise when Phase 3 of the ERP project takes place. This will reduce costs and enhance margins further.

Inventory holding costs will reduce due to the product range rationalisation. This will also reduce costs and increase margins.

HP will need to ensure that suppliers can supply products in time. Longer lead times from suppliers was previously identified as a concern.

HP needs to ensure that there is sufficient staff availability and that they have the skills for the warehouse work.

ETHICS

Monitoring drivers at all times could be an invasion of privacy. This could result in demotivation of drivers.

The suggestion to use older diesel vehicles will result in more pollution. HP aims to use energy-efficient processes across its sites so this would contradict that aim. However, the emissions may be considered 'satisfactory' by HP.

The warehouse is close to residential areas and a nature reserve. As the warehouse will be in constant operation, it could create conflict with the local community.

Warehouse staff have complained about how they are treated by employers. This could cause HP staff to become demotivated and as they are a key part of HP's operations, HP should avoid this. The article is not about HP staff so is not a representation of how HP treats its staff.

Recommendations

Discuss need for monitoring with drivers and agree on how to implement.
Purchase the energy-efficient vehicles.
HP should discuss its plans with the local community.
Ensure staff how good working conditions.

CONCLUSIONS

The new warehouse will result in additional operating profit of £82.5k per annum.

There is a significant upfront cash outlay of £1,180k and HP does not have the cash reserves (£962k) to fund this so will require additional finance.

HP will have a competitive advantage by having the fastest delivery time.

Blackburn's geographical position makes it a good choice for a new warehouse.

The suggestion to use older diesel vehicles will result in more pollution. HP aims to use energy-efficient processes across its sites so this would contradict that aim. However, the emissions may be considered 'satisfactory'.

If HP can obtain suitable finance, then it should proceed so that it can gain a competitive advantage by offering the fastest delivery.

RECOMMENDATIONS

Negotiate with vendor.
Further research on additional costs e.g. security.
Discuss financing with the bank.
Find alternative premises for comparison.
Consult with suppliers to ensure supply will be frequent enough to meet delivery times.

ADVANCED LEVEL CASE STUDY EXAMINATION
JULY 2021
(4 HOURS)

ICAEW PARTNER IN LEARNING

ACA MASTERS

Case Study: Mock Exam 3

Guidance:

To obtain maximum benefit, this mock exam should be sat under full exam conditions using the Case Study CBE software which is available from the ICAEW website. You should use the exam technique taught during the 'How to Ace the ACA Case Study' class.

Once you have completed the exam, you should use the marking grids provided to calculate whether you have scored enough passing grades for each section.

In order to improve your grade, you should carefully analyse how the report has been structured and written in the prize-winner model answer.

EXHIBIT 15

EMAIL

From: Amanda Ellis
To: Jules Wingate
Subject: House Pride: Draft management accounts and business developments
Date: 21 July 2021

There have been several significant developments. I am attaching the following:

- House Pride's draft management accounts for the year ended 30 June 2021 **(Exhibit 16)**
- Information relating to House Pride's draft management accounts for the year ended 30 June 2021 **(Exhibit 17)**
- An email from Emily Hanwell to me about a proposal for House Pride to open a new branch in either Blackpool or Stockport **(Exhibit 18a)**, together with media coverage **(Exhibit 18b)**
- An email from Hans Ritz to me about Phase 2 of the Enterprise Resource Planning (ERP) project (**Exhibit 19a**), together with media coverage (**Exhibit 19b**)

I would like you to draft a report from me to the House Pride board. This should comprise the following.

1. A review of House Pride's draft management accounts for the year ended 30 June 2021 in comparison with the year ended 30 June 2020.

Your review should be based on the draft management accounts as set out in **Exhibit 16** and the additional information in **Exhibit 17**. It should cover revenue and gross profit for each of the two divisions and operating profit for the overall business. Please comment on average branch revenue per month. You should include advice on the IT issue.

2. An evaluation of the proposal for House Pride to open a new branch in either Blackpool or Stockport, as set out in **Exhibit 18a**.

Using the information in **Exhibit 18a** and **Exhibit 18b**, you should evaluate the proposal from Emily Hanwell. You should calculate the expected first year operating profit for each potential site. Please assess the adequacy of the assumptions and advise on the ethical and business trust issues that House Pride should evaluate when deciding whether to proceed. You should provide a justified recommendation for the way forward.

3. An evaluation of the supplier quotes for Phase 2 of the ERP project, as set out in **Exhibit 19a**.

Using the information in **Exhibit 19a** and **Exhibit 19b**, you should calculate the expected incremental profits using each supplier. You should evaluate the financial, non-financial, ethical and business trust issues that House Pride should consider when choosing the Phase 2 supplier. You should advise, with reasons, which supplier House Pride should choose.

EXHIBIT 16

HP: Draft management accounts for the year ended 30 June 2021

Statement of profit and loss for year ended 30 June 2021

	£000
Revenue (Note 1)	35,673
Cost of sales (Note 1)	(28,926)
Gross profit (Note 1)	**6,747**
Distribution costs	(2,872)
Administrative expenses (Note 2)	(3,641)
Operating profit	**234**
Net finance income / (expense)	5
Profit before taxation	**239**
Income tax	(45)
Profit for the year	**194**

Statement of financial position as at 30 June 2021

	£000
Non-current assets	
Property, plant and equipment (PPE) (Note 3)	4,265
	4,265
Current assets	
Inventories (Note 4)	2,424
Trade and other receivables (Note 5)	3,716
Cash and cash equivalents	663
	6,803
TOTAL ASSETS	**11,068**
Equity	
Ordinary shares	90
Retained earnings	5,635
	5,725
Current liabilities	
Trade and other payables (Note 6)	5,298
Taxation	45
	5,343
TOTAL EQUITY AND LIABILITIES	**11,068**

Statement of cash flows for year ended 30 June 2021

	£000
Cash flows from operating activities	
Profit before taxation	239
Adjustments for:	
Depreciation	522
Loss on disposal of PPE	7
Finance (income)/expense	(5)
	763
Change in inventories	(404)
Change in trade and other receivables	(373)
Change in trade and other payables	948
	934
Income tax paid	(51)
Net cash generated from operating activities	**883**
Cash flows from investing activities	
Acquisition of PPE	(460)
Proceeds from disposal of PPE	8
Interest received/(paid)	5
Net cash generated from investing activities	**(447)**
Cash flows from financing activities	**-**
Net change in cash and cash equivalents	436
Cash and cash equivalents at start of period	227
Cash and cash equivalents at end of period	**663**

Notes to the management accounts

Note 1: Revenue, cost of sales and gross profit

	£000
Revenue	
RH	
Branch	17,860
Online	10,290
	28,150
BCT	
Branch	5,635
Online	1,888
	7,523
Total	
Branch	23,495
Online	12,178
	35,673
Cost of sales	
RH	23,725
BCT	5,201
	28,926
Gross profit	
RH	4,425
BCT	2,322
	6,747

Cost of sales comprises:

Goods and materials	23,899
Wages and salaries	5,027
	28,926

Note 2: Administrative expenses

	£000
Personnel	1,489
IT, premises, depreciation and other	1,722
Marketing and advertising	430
	3,641

'Personnel' includes the directors' salaries and related costs: £700,000.

Note 3 Property, plant and equipment (PPE)

	Land, buildings, plant, machinery, fixtures, fittings and equipment	Motor vehicles	**Total**
	£000	£000	**£000**
Cost			
At 1 July 2020	4,649	2,306	**6,955**
Additions	298	162	**460**
Disposals		(25)	**(25)**
At 30 June 2021	**4,947**	**2,443**	**7,390**
Depreciation			
At 1 July 2020	1,356	1,257	**2,613**
On disposals		(10)	**(10)**
Charge for year	280	242	**522**
At 30 June 2021	**1,636**	**1,489**	**3,125**
Carrying amount at 30 June 2021	**3,311**	**954**	**4,265**

Note 4 Inventories

Inventory is carried at the lower of cost and net realisable value. Where necessary, an allowance is made for obsolescence and slow-moving items. Allowances have been recognised as part of goods and materials within cost of sales as follows: £220,000.

Note 5 Trade and other receivables

	£000
Trade receivables	3,352
Other receivables and prepayments	364
	3,716

Trade receivables are stated after impairments for amounts considered irrecoverable. Impairment charges recognised in administrative expenses are: £52,000.

Note 6 Trade and other payables

	£000
Bank overdraft	-
Trade payables	4,333
Other payables and accruals	965
	5,298

EXHIBIT 17

Additional information relating to the draft management accounts

I have set out below some information that should assist in the analysis of House Pride's revenue, gross profit and operating profit for the year ended 30 June 2021.

- From November 2020, prompted by government incentives, we noticed a significant increase in revenue from Elevant. The total impact was additional revenue of £3,250,000 in the year to 30 June 2021. Some of the government incentives started to reduce from 30 June 2021.
- The housing market saw an increase in renovation works being carried out due to increased amounts of time spent at home. This increased demand is expected to peak in 2021.
- One of House Pride's online competitors joined a buying group from August 2020 and offered large discounts. This resulted in a decline in sales volumes to BCT customers.
- In response, House Pride ran an online marketing campaign in September 2020 targeting BCT customers. The cost of the campaign was £150,000. House Pride also temporarily reduced all advertised prices by 10% in March 2021. The reduction applied before the usual discount arrangements.
- The proportion of deliveries made on time in the year was 93%.
- The number of IT outages increased in the year and we estimate that House Pride lost around £870,000 of revenue as a result.
- House Pride did not open any new branches in the year. Wigan and Bolton were closed in January 2021 for refurbishment. It was anticipated that it would take one month but ended up taking two months. Liverpool and Manchester were closed for one month for the installation of click-and-collect facilities.
- Supplier prices remained stable. Other than the March 2021 discount, House Pride maintained most product lines at 2020 prices.

Revenue from each branch was as follows:

	£000
Warrington	3,290
Preston	2,775
Bury	-
Blackburn	4,177
Burnley	3,638
Wigan	2,037
Bolton	2,772
Manchester	2,789
Liverpool	2,017
	23,495

IT Issue

In May 2021, Hans informed the other directors that there were 303 IT outages in the 10 months to April 2021. Around 60% of the outages were e-commerce related. Whilst most outages were minor, others were more substantial and caused the House Pride website to be offline for several hours.

Hans claims that customers have become increasingly annoyed by these persistent issues with House Pride's website. Many have turned to social media to express their dissatisfaction.

Furthermore, House Pride's IT staff are frustrated with some of the current hardware and applications as having to deal with unpredictable outages causes a lot of stress and added workloads. Several staff members have used the appraisal process to express their dissatisfaction whilst others have resorted to leaving House Pride altogether.

Hans has requested approval to hire additional resource in order to deal with the outages.

EXHIBIT 18a

EMAIL

From: Emily Hanwell
To: Amanda Ellis
Subject: New Branch
Date: 20 July 2021

It has been over two years since we last opened a branch and I am keen to expand our coverage in the north-west. Two different sites have been proposed, one is in Blackpool and the other is in Stockport. Each site is in an industrial park and located very close to a major competitor that has a strong market position in the local area. I view this as a good opportunity to win greater market share.

I have based my initial calculations on my own analysis of the management accounts, as well as retrieving various supplier quotes and discussions with other directors. I have set out my various assumptions below.

<u>Blackpool site</u>

1. The site is currently in disrepair due a recent flood and therefore I estimate that we can acquire the property at a below market price of £575,000. I recall reading in a local newspaper that the flood was a one-off event caused by drainage issue and is unlikely to reoccur. I anticipate the renovation costs will be £135,000. The branch would be a similar size to existing branches.

2. Revenue will be £2,500,000 in the first year.

3. The inventory required for the opening of the branch will cost £95,000.

4. Additional distribution costs of £100,000 will be incurred in the first year. I am expecting to utilise current capacity as much as possible.

5. We will need to employ and train a new workforce. I expect that wages and salaries will be £250,000 in the first year, split 70:30 between cost of sales and administrative expenses.

6. To help stimulate interest in the new site, we will offer an additional discount in the first month after opening.

<u>Stockport site</u>

1. The site should cost us around £825,000 and would be our largest site. I anticipate renovation costs will be £125,000.

2. Revenue will be £2,750,000 the first year.

3. Due to the proximity to Manchester, we can move any surplus inventory to the new site. I expect inventory to be purchased for the opening of the branch will cost £85,000.

4. Additional distribution costs of £55,000 will be incurred in the first year. I. Again, I am expecting to utilise current capacity as much as possible.

5. I expect wages and salaries to be £300,000 in the first year, split 70:30 between cost of sales and administrative expenses.

6. It is not necessary to offer an additional discount in the first month at this site due to its proximity to Manchester where House Pride already has an established reputation.

Assumptions for both sites

1. I expect the costs of goods and materials to be 65% of revenue.

2. Click-and-collect services will not be added to the site initially as this would delay the opening.

3. Our strong brand awareness in the region means no additional marketing and advertising costs will be incurred.

4. No significant additional admin costs need to be accounted for as I am confident that we can use our current teams efficiently, especially with the level of remote working now taking place.

5. The costs for either site will be financed through long-term loans as our current cash reserves are quite low.

6. I expect that closing inventory at the end of the first year will be the same as opening inventory.

7. Each site will have a useful economic life of 15 years and the renovation costs will have a useful economic life of 10 years.

8. I am keen to reduce costs where we can on either site and have approached Varian, an established building firm, to carry out the renovation works. Varian is a well-known building firm in the north-west but House Pride has never worked with Varian before.

9. I am keen to open the new branch by 30 September 2021 which Varian have agreed is achievable.

EXHIBIT 18b

RECENT MEDIA COVERAGE

Social media shows its worth for employees (Construction Today, April 2021)

A group of 54 employees of local building firm Varian have written an open letter to their CEO Scott Morris and published this across various social media channels. They have expressed concerns about working practices and safety issues of completed work.

The employees have stated that to maximise revenue there is a culture of neglecting safety standards and procedures in order to complete jobs on or before quoted completion dates. They allege that Varian's wage and bonus structure incentivises employees to complete jobs as quickly as possible.

The employees claim that accidents are common, as are follow ups to correct dangerous work. One employee said that he was working on a warehouse renovation and due to the extreme pressure from his manager to get the job completed, they overlooked a seriously cracked supporting beam. Three weeks later the supporting beam collapsed and part of the warehouse roof collapsed too. Thankfully, the warehouse was empty at the time so no one was harmed. Varian were recalled and are currently finishing the work but the cause remains disputed.

Varian has also been accused by a former operations manager of neglecting their duty to mitigate the impact on the environment by using polluting machinery and materials sourced purely on price with no consideration for environmental impacts. The employee claims that they were dismissed for pursuing an agenda of environmental awareness and more sustainable practices at Varian.

Delivery time crucial for home builders (Home Builders Weekly, February 2021)

In a recent survey conducted by our members, 94% stated delivery of goods on time was more important that cheaper prices, whilst 82% stated if a single delivery was late then they would be extremely unlikely to use the same supplier again. In the same survey, 96% of subscribers said environmental considerations and sustainability were becoming increasingly important to their businesses and supply chains.

EXHIBIT 19a

EMAIL

From: Hans Ritz
To: Amanda Ellis
Subject: Enterprise Resource Planning Project (ERP) Phase 2
Date: 19 July 2021

I am concerned by the recent outages and want to address this problem immediately. I believe Phase 2 of the ERP project will eliminate most major outages.

Phase 2 will see a much-needed upgrade to House Pride's website and e-commerce infrastructure. It was scheduled to be completed by 30 June 2022 but due to my concerns I want it completed by 1 January 2022 at the very latest. Phase 2 will greatly improve the experience of our online customers and I believe it will give us the best functioning website in our industry.

I have held preliminary discussions with Grossmark, Albion and ADV IT. I need your help evaluating the proposals and calculating the incremental operating profits. Their quotes are based on a completion date of 1 January 2022.

I have set out some notes below, along with the key terms proposed by each supplier.

1. Regardless of supplier, I expect the website and e-commerce infrastructure to be in use for 6 years before it needs replacing or upgrading.

2. Please use 19% as an approximation of gross profit margin and 7% of revenue as an approximation of delivery costs.

3. Grossmark were successfully used for Phase 1 and have a good working relationship with our IT team. Grossmark claim their familiarity with House Pride will lead to greater cost savings and allow them to comfortably meet the 1 January 2022 deadline. I think it may be easier to use Grossmark again for Phase 2 so we can build on previous successes.

4. ADV IT are a relatively new IT firm specialising in website design. They have quickly established themselves as an industry leader in their home country of Estonia. This would be the first time they have worked for a company outside of Estonia. They have stated remote working should not affect their work or ability to deliver the new website, however they will need House Pride to give them unrestricted remote access to all information held on the old website and current systems, including customer details.

5. A close friend of mine, Tom Wright, has recently been appointed CEO of Albion and assures me they have recovered from their previous financial difficulties and are now in a strong position. Whilst their expertise was not suited to Phase 1, Tom assures me they specialise in website design and e-commerce solutions.

6. Due to the deadline of 1 January 2022, all suppliers for Phase 2 have stated a parallel run is not feasible and ADV IT and Grossmark have added a premium to their usual charges.

7. All suppliers have stated that any unexpected costs incurred to meet the deadline will be charged in full to House Pride.

	ADV IT £000	Grossmark £000	Albion £000
Supplier quote: capital costs (hardware and software)	360	480	450
Supplier quote: annual maintenance and IT support costs	60	110	85
Premium for 1 January 2022 deadline	3%	2%	None
HP estimate: additional annual revenue			
Year 1	700	900	800
Year 2	900	1100	1200
HP estimate: operating costs saved (each year)	80	125	105
Payment terms: capital costs	1 August 2021	1 June 2022	1 January 2022

EXHIBIT 19b

RECENT MEDIA COVERAGE

What do companies do with your data? (Cyber Insight, May 2021)

With nearly all industries moving to more online activity, the amount of data and information companies obtain from their customers is rising. Creating accounts on websites to store information and payment details is becoming increasingly common.

Last week, an online only builders' merchant (cementonline.com) was exposed for transferring sensitive customer data to a third-party company overseas. Customers were angered as they claimed that they did not agree to this. One customer said "who knows who has access to my information. It is making me wary about creating online accounts and I'm considering cancelling my payment cards just to be safe. I certainty won't be purchasing goods from them again!"

The CEO of cementonline.com discussed this issue in an open letter published on their website. She claimed all customers had agreed to their terms and conditions on creation of accounts or completion of purchases. She said it was a clear in point 12.8 of the terms and conditions that customer data would be passed on to external parties for analysis and marking purposes. She added it is a shame that customers clearly did not take the time to read these terms in full.

Mock Exam 3 Mark Scheme

OVERALL ASSESSMENT CRITERIA	EXECUTIVE SUMMARY **R1 - Review of financial performance**
• Appropriate layout: headings AND paragraphs/sentences • No disclaimer AND from Amanda Ellis • Suitable language: formal AND tactful AND ethical • Reasonable spelling and grammar	• Revenue: qualitative comment on RH and BTC (fig) • GP/GP%: qualitative comment on RH and BCT (fig) • OP/OP%: qualitative comment (fig) • Average branch revenue per month
NA ID IC SC CC	**NA ID IC SC CC**
	• Factors causing growth are temporary • Conclusion on IT outages • Other commercial recommendations • Appropriate summary of report section
NA ID IC SC CC	**NA ID IC SC CC**

R2 - Evaluation of new branch proposal	R3 - Evaluation of ERP Phase 2 quotes
• Gives operating profit for Blackpool and Stockport • Evaluates/questions assumptions • Concludes/recommends on ethics/business trust issues • Concludes on way forward	• Gives incremental OP for each supplier • Concludes on financial / non-financial considerations • Concludes on ethics / business trust issues • Concludes on way forward (Grossmark best option)
NA ID IC SC CC	**NA ID IC SC CC**
• 30 September 2021 opening appears unrealistic • Raises concern over Varian • Other commercial recommendations • Appropriate summary of report section	• HP must not share customer data without permission • Urgent need to address outages • Other commercial recommendations • Appropriate summary of report section
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 1 – Review of financial performance

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 1 • Presents 2021 figures • Presents 2020 figures • Analysis of RH and BCT figures: revenue and GP • Average branch revenue per month	**Financial analysis: revenue (report)** • Revenue growth: higher than last year v 6.5% > • RH: Elevant added £3.25m but temporary (November) > • BCT: lost revenue due to online competition > • BCT: home refurbishments increased revenue > • Average branch revenue per month up 9.6% v 14.7% > • Revenue mix: online increasing 34.1% v 30.7% >
NA ID IC SC CC	**NA ID IC SC CC**
AI/CS Exam info (report/appendix) • Overall revenue: up £6,119k / up 20.7% AND Average branch revenue per month £261.1k • RH revenue: up £4,982k / up 21.5% AND BCT revenue: up £1,137k / up 17.8% • Overall GP/GP%: up £1,088k/19.2% OR 18.9% v 19.1% • OP/OP%: down £29k /11% OR 0.7% v 0.9%	**Financial analysis: GP/OP** • RH GP: up £750k/20.4% / BCT up £338k/17.0% > • Goods and materials: up £4,137k / 20.9% > • Marketing and advertising costs up £141k / 48.8% > • Distribution costs up £802k / 38.7% > • OP/OP%: decline is a concern >
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • North-west construction growth/government incentives • Online sales growth / increased competition • Growth in both divisions / channels • Products cost increasing / CMPIs / 70% of revenue • Good overall performance / exceeds £30m target	**IT outages issue** • Outages have increased to 303 (10m) from 273 (12m) > • 60% e-commerce related > • Hardware/applications causing outages > • Staff frustrated / stressed / leaving > • Adverse social media will impact revenue/reputation > • Time spent on outages is a waste of resource >
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 1 – Review of financial performance

<table>
<tr><th>APPLYING JUDGEMENT</th><th>CONCLUSIONS AND RECOMMENDATIONS</th></tr>
<tr><td>Evaluation of revenue analysis
• Growth due to volume (not price) / delivery refunds / 93% v 95%
• Accounts for majority of growth / could reduce next year / v £1m
• Marketing campaign may have offset decline / growth still strong
• Could reduce next year as demand will peak in 2021 / temporary
• Branch revenue and months open up/ Blackburn best performer/ largest / Wigan worst performer/smallest/down due to closure
• Despite IT outages resulting in lost revenue (£870k)</td><td>Draws conclusions (under a heading)
• Revenue: qualitative comment on RH and BTC (fig)
• GP/GP%: qualitative comment with fig
• OP/OP%: qualitative comment with fig
• Average branch revenue per month
• Conclusion on IT outages</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Evaluation of GP/OP analysis
• Compares to revenue growth / GP% fall due to price reduction
• Prices stable / 67.0% of revenue
• Due to marketing campaign (£150k) / Admin 10.2% of revenue
• Significant increase / 8.1% of revenue
• OP/OP% would be higher than 2020 without marketing campaign</td><td>Makes recommendations
• Profit analysis by branch / further cost analysis
• Analysis of effectiveness of online marketing campaign
• Increase delivery charge
• Evaluate price reduction decision
• Other commercial recommendations</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Evaluation of IT outages issue
• Lost revenue has increased (£870k v £600k)
• Outages relating to e-commerce are increasing
• Dated applications / ERP project will help resolve IT issues
• HP seeks to provide happy work environment / retention key
• Consider accelerating ERP timetable
• IT security is essential / Hans seeking additional resource</td><td></td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
</table>

REQUIREMENT 2 – Evaluation of new branch proposal

<table>
<tr><th>ASSIMILATING & USING INFORMATION</th><th>STRUCTURING PROBLEMS & SOLUTIONS</th></tr>
<tr><td>Appendix 2
• Numbers labelled AND clearly derived
• Calculation of Blackpool operating profit
• Calculation of Stockport operating profit
• Considers flexing numbers in calculation</td><td>Calc of revenue and profit (appx or report)
• GP: £700k & 753k / GPM: 28.0% and 27.4%
• OP: £473k & £540k / OPM: 18.9% and 19.6%
• Wages: £175k and £75k / £210k and £90k
• Depreciation: £52k and £68k
• Calculates a flexed GP/GPM/OP/OPM</td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>AI/CSE information (report/appendix)
• Revenue: £2,500k and £2,750K
• Cost of goods and materials: 65%
• Wages and salaries: £250k and £300k and 70:30 split
• Distribution: £100k and £55k
• Calculates depreciation on site/renovation costs</td><td>Assumptions
• Revenue high for a first year >
• Cost of sales appears low/questions 65% >
• Wages for customer-facing staff appears low >
• Renovation costs appear low >
• Distribution costs low/personnel costs low/UEL could differ
• Discounts at Blackpool not included in calculation ></td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
<tr><td>Business issues / wider context
• Impact of COVID-19 on the business
• HP requirement for branches to be in industrial parks
• Delivery time important for customers
• E-commerce growth reduces need for large branches
• No prior experience working with Varian</td><td>Comments on ethics/other issues
• Varian reputation for poor quality/safety concerns >
• HP's sustainability reputation at risk from association with Varian >
• HP may be unable to meet delivery targets >
• New workforce requires training/additional cost >
• Click-and-collect facilities missing >
• Blackpool flood risk ></td></tr>
<tr><td>NA ID IC SC CC</td><td>NA ID IC SC CC</td></tr>
</table>

REQUIREMENT 2 – Evaluation of new branch proposal

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of proposal • Changes in assumptions will impact calculations • Significant addition to revenue / calcs relative size • Compares GP%/OP% with 2021 GP%/OP% • Either proposal requires financing / additional finance costs • Potential for new branch to be unsuccessful / missing costs e.g. marketing, admin, training	**Draws conclusions (under a heading)** • Gives operating profit for Blackpool and Stockport • Evaluates/questions assumptions • Concludes on ethics/business trust issues • Concludes on way forward
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation of assumptions • Compares with prior experience e.g. Liverpool/Manchester • Compares with 2021 fig / industry 70% / scale economies • Compares with 2021 fig / industry 15% / staff numbers • Compares with existing branch refurbishment costs • 50% of sales typically in March-June/opening in quiet time • Will reduce revenue/GP/OP / timeframes challenging	**Makes recommendations** • Negotiate lower price for premises purchase • Further research on costs / configuration / location • Contact bank to discuss financing • Research competitors/pricing strategy of competitors • Estimate benefit/cost of adding click and collect • Other commercial recommendations
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation/recs: ethics/other issues • Verify facts / speak with Varian / due diligence • Inspect Varian recent work to check quality / investigate working practices used by Varian • Success of HP linked to ability to deliver goods on time • Training staff will add costs to HP • Click-and-collect a vital addition / will result in missed sales • Future remediation costs / insurance required / customer safety	
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 3 – Evaluation of ERP Phase 2 quotes

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Workings / report • Numbers labelled AND clearly derived • Includes costs savings • Calculates incremental OP • Considers flexing numbers / performs sensitivity analysis	**Financial calculations (appx or report)** • ADV IT OP: £44k and £68k / £112k • Grossmark OP: £43k and £67k / £110k • Albion OP: £41k and £89k / £130k • GP%: applies 19% or own 2021 fig • Revenue and costs higher than Phase 1
NA ID IC SC CC	**NA ID IC SC CC**
AI/CSE information (report/workings) • Capital cost: £360k / £480k / £450k • Maintenance and support: £60k / £110k / £85k • Cost savings: £80k / £125k / £105k • Delivery costs: uses 7% (or own reasonable fig)	**Financial considerations** • ADV IT: lowest costs / lowest cost saved / lowest revenue / payment up front > • Grossmark: highest costs / highest costs saved / lowest profit / best payment terms > • Albion: highest profit / no premium / financial difficulties / highest year 2 revenue > • Only 2 years of additional revenue in forecast > • No parallel run could cause disruption/lost revenue >
NA ID IC SC CC	**NA ID IC SC CC**
Business issues / wider context • Impact of COVID-19 on the business • E-commerce needs updating for online growth • Increased outages in 2021 (303 in 10m) • ADV IT: new IT firm / Estonian / unknown to HP • Yorath & Co: no parallel run / problems • HP cash balance £663k	**Comments on ethical/bus trust issues** • Using ADV IT requires remote access to data > • Unclear what unexpected costs would be > • Albion proposal based on Tom's assurances > • Demanding deadline adds stress/pressure > • Grossmark has close working relationship with HP > • Revenue / costs savings likely to differ >
NA ID IC SC CC	**NA ID IC SC CC**

REQUIREMENT 3 – Evaluation of ERP Phase 2 quotes

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of financial impact • Any changes in assumptions will impact calculations • Revenue achievability: compares v Phase 1 / year 2 looks optimistic / compares v outages (£870k) • Cost saving achievability: could be higher/lower / unclear how savings are made / potential redundancies • Significant addition to OP/revenue (with fig) • Sufficient cash for capital costs / overdraft could be required again / maintenance payment terms unknown	**Draws conclusions (under a heading)** • Gives incremental OP for each supplier • Concludes on financial considerations • Concludes on non-financial considerations • Concludes on ethics / business trust issues • Concludes on way forward (Grossmark best option)
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation of non-financial considerations • Risk of non-completion / culture issues / remote working / logistical difficulties / higher risk / market leader • Flexibility / prior proposal accuracy / known to HP / maintenance problems / staffing issues • Website/e-commerce specialists / expertise uncertain • Forecast period too short / need 6 years • High risk / staff pressure / outside busy period (Mar-Jun)	**Makes recommendations** • Negotiate with suppliers • Further info on items included / day-to-day support • Due diligence on suppliers • Ensure parallel run included • Communicate new launch date with staff • Other commercial recommendations
NA ID IC SC CC	**NA ID IC SC CC**
Evaluation/recs: ethical/business trust • Remote access needs to be secure / inform customers / do not share data • Hidden costs / agree what can be charged / consider cap • Verify facts / do not allow friendship to impact decision • Discuss with all stakeholders / create timetable / internal project team • Ensure proposal assessed objectively / most accurate • Decision should be based on more than profitability	
NA ID IC SC CC	**NA ID IC SC CC**

Mock Exam 3 Model Answer

A report on House Pride Limited

TO: Directors of House Pride Limited

FROM: Amanda Ellis (Finance Director)

DATE: 21 July 2021

Executive Summary

REVIEW OF FINANCIAL PERFORMANCE FOR YEAR ENDED 30 JUNE 2021

Overall revenue has increased impressively by £6,119k (20.7%) to £35,673 which is a good performance in a currently prosperous industry.

RH revenue increased significantly by £4,982k (21.5%) to £28,150k due to £3,250k generated from increased sales to Elevant. BCT revenue has increased impressively by £1,137k (17.8%) to £7,523k due to more time spent at home creating additional demand for home improvements. Demand is being stimulated by temporary factors so may be lower in 2022.

Average branch revenue per month increased significantly by 9.6% to £261.1k from £238.1k.

RH GP increased by £750k (20.4%), with GPM decreasing from 15.9% to 15.7%, due to the price reduction and refunds resulting from late deliveries offsetting the benefit of a shift towards online sales. BCT GP increased by £338k (17.0%), with GPM decreasing disappointingly to 30.9% from 31.1%. Overall GP increased by £1,088k (19.2%) to £6,747k, but overall GPM decreased to 18.9% from 19.1% due to a GPM decline in both divisions and revenue mix shifting towards the lower margin RH division.

Overall OP decreased disappointingly by £29k to £234k, OPM fell to 0.7% from 0.9% due to the fall in GPM and distribution costs increasing at a faster rate than revenue. Distribution costs now account for 8.1% (2020: 7.0%) of revenue which is not in line with the goal to reduce this ratio.

IT outages have increased again as there were 303 outages in the 10 months to 30 April 2021 and there were 273 in the year to 30 June 2020. This has resulted in a higher amount of revenue being lost as £870k was lost in 2021 compared with £600k in 2020.

HP has a responsibility for staff wellbeing and the outages are causing additional stress. Staff could be absent on sick leave and suffer health issues if the problems persist.

RECOMMENDATIONS

Analysis to determine if marketing/discount campaign was successful.
Increase charge for online delivery.
Engage with staff to identify key issues.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

EVALUATION OF NEW BRANCH

The Blackpool site will result in OP of £473.2k with an OPM of 18.9%. This will increase HP's overall OP significantly as in 2021 OP was only £234k. The Stockport site will result in OP of £540k with an OPM of 19.6%. Again, this will increase HP's overall OP significantly as in 2021 OP was only £234k.

The new site will help increase future revenue growth as it will expand HP's market share in the region. However, investment could be better used elsewhere, such as investing in the growing online channel.

Revenue estimates appear high for the first year because Manchester only generated £2,000k of revenue in its first year and Liverpool was similar. Goods and materials are likely to be higher than 65% of revenue because they were 67% in 2021 and are typically 70% in the industry. The proposed opening date of 30 September appears very challenging in the current climate.

The survey suggests delivery times are crucial for HP customers, so HP need to ensure that the new site works logistically to ensure that delivery times are met.

HP has a reputation for high quality and has received awards in the past. Varian has been accused of prioritising speed over quality which has resulted in poor work and dangerous outcomes. Working with Varian could be damaging to HP's reputation and pose a risk to HP employees Varian has also been accused of having unsustainable practices and damaging the environment. HP has a policy of assessing the social and environmental impact of any new branches as well as adopting sustainable approaches to operations.

Once the revenue forecasts have been verified, HP should proceed with the Blackpool site as it offers a better geographical spread and is a smaller investment.

RECOMMENDATIONS
Negotiate with vendor.
Contact bank to discuss financing.
Due diligence on Varian.

**highlighted* *text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

EVALUATION OF ERP PHASE 2 QUOTES

Using ADV IT will result in incremental operating profits of £44k in year 1 and £68k in year 2, which gives £112k across two years. Using Grossmark will result in incremental operating profits of £43k in year 1 and £67k in year 2, which gives £110k across two years. Using Albion will result in incremental operating profits of £41k in year 1 and £89k in year 2, which gives £130k across two years.

The project will eliminate outages which resulted in £870k of lost revenue in 2021. On this basis, the year 1 revenue estimates look reasonable and maybe even slightly low. The proposals will add between 17.5%-18.8% to operating profits so this is a significant addition.

Grossmark has the highest cost savings due to their familiarity with HP. They also have the most favourable payment terms which is beneficial for cash. However, Grossmark have the highest costs and these will be incurred regardless of whether the revenue benefits are achieved, and so represents a greater financial risk for HP. Grossmark also have the lowest profit, although this was also the case in Phase 1.

Albion specialise in website design and e-commerce so appear well suited to the project. However, these claims need to be verified as they are from the CEO.

Not using a parallel run caused significant disruption, security breaches and reputational damage for Yorath & Co and this should be avoided to protect HP's reputation and prevent lost revenue.

ADV IT requires remote access to all HP information, including customer data. There is a risk of a data breach, associated reputational damage and loss of customer goodwill, similar to what happened to cementonline.com. This could be illegal if customers have not given permission for their data to be shared.

The nature and amount of unexpected costs is unclear. There is a risk that suppliers could add additional amounts and HP would appear to have no control over this.

HP should proceed with Grossmark because Phase 1 was successful and costs were as per the quote.

RECOMMENDATIONS

Ensure parallel run included.
Communicate accelerated timetable with staff.
Do not share data without explicit permission.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

APPENDIX 1: Analysis of Management Accounts 30 June 2021

	2021 (£k)	2020 (£k)	Change (£k)	%
Revenue				
RH				
Branch	17,860	15,535	2,325	15.0%
Online	10,290	7,633	2,657	34.8%
Total	28,150	23,168	4,982	21.5%
Mix:				
Branch	63.4%	67.1%		
Online	36.6%	32.9%		
BCT				
Branch	5,635	4,944	691	14.0%
Online	1,888	1,442	446	30.9%
Total	7,523	6,386	1,137	17.8%
Mix:				
Branch	74.9%	77.4%		
Online	25.1%	22.6%		
Total				
Branch	23,495	20,479	3,016	14.7%
Online	12,178	9,075	3,103	34.2%
Total	35,673	29,554	6,119	20.7%
Mix:				
Branch	65.9%	69.3%		
Online	34.1%	30.7%		
Mix				
RH	78.9%	78.4%		
BCT	21.1%	21.6%		

Branches				
Warrington	3,290	2,970	320	10.8%
Preston	2,775	2,457	318	12.9%
Blackburn	4,177	3,168	1,009	31.8%
Burnley	3,638	2,860	778	27.2%
Wigan	2,037	2,101	-64	-3.0%
Bolton	2,772	2,565	207	8.1%
Manchester	2,789	2,513	276	11.0%
Liverpool	2,017	1,845	172	9.3%
	23,495	20,479	3,016	14.7%
Mix				
Warrington	14.0%	14.5%		
Preston	11.8%	12.0%		
Blackburn	17.8%	15.5%		
Burnley	15.5%	14.0%		
Wigan	8.7%	10.3%		
Bolton	11.8%	12.5%		
Manchester	11.9%	12.3%		
Liverpool	8.6%	9.0%		
	100%	100%		
Average branch revenue per month				
Branch revenue	£23,495	£20,479		
No. of branches	4	6		
Months open	12	11		
	48	**66**		
No. of branches	2	2		
Months open	10	10		
	20	**20**		
No. of branches	2			
Months open	11			
	22			
	90	**86**		
	£261.1	£238.1	£22.9	9.6%

CoS				
RH	23,725	19,493	£4,232	21.7%
BCT	5,201	4,402	£799	18.2%
	28,926	23,895	£5,031	21.1%
Goods and materials	23,899	19,762	£4,137	20.9%
Wages	5,027	4,133	£894	21.6%
	28,926	23,895	£5,031	21.1%
Mix				
Goods and materials	82.6%	82.7%		
Wages	17.4%	17.3%		
% of revenue				
Goods and materials	67.0%	66.9%		
Wages	14.1%	14.0%		
GP				
RH	4,425	3,675	£750	20.4%
BCT	2,322	1,984	£338	17.0%
TOTAL	6,747	5,659	£1,088	19.2%
	6,747	5,659		
GPM				
RH	15.7%	15.9%		
BCT	30.9%	31.1%		
TOTAL	18.9%	19.1%		
Distribution	2,872	2,070	£802	38.7%
% of revenue	8.1%	7.0%		
Admin				
Personnel	1,489	1,418	£71	5.0%
IT, premises, depreciation and other	1,722	1,619	£103	6.4%
Marketing and advertising	430	289	£141	48.8%
	3,641	3,326	£315	9.5%
% of revenue	10.2%	11.3%		
OP	£234	£263	-£29	-11.0%
OPM	0.7%	0.9%		

REVIEW OF FINANCIAL PERFORMANCE FOR YEAR ENDED 30 JUNE 2021

REVENUE

Overall revenue has increased impressively by £6,119k (20.7%) to £35,673 which is a good performance in a currently prosperous industry. The rate of growth is increasing (2020: 6.5%), although 2020 was impacted by temporary factors. Total revenue has now exceeded the 30 June 2020 target of £30m. Both divisions and both channels have grown. There were more refunds due to 93% (2020: 94%) of deliveries being on time and the target of 95% has not been met.

RH revenue increased significantly by £4,982k (21.5%) to £28,150k due to £3,250k generated from increased sales to Elevant prompted by temporary government incentives. Branch revenue increased 15.0% and online revenue increased 34.8%, resulting in online now accounting for 36.6% of RH revenue (2020: 32.9%). The demand is being stimulated by government incentives which have reduced so growth may be lower in 2022.

BCT revenue has increased impressively by £1,137k (17.8%) to £7,523k due to more time spent at home creating additional demand for home improvements. However, performance would have been higher had it not been for HP having to temporarily reduce prices by 10% in response to online price competition. Branch revenue increased by a significant 14.0% and online revenue increased by an impressive 30.9%, resulting in online now accounting for 25.1% (2020: 22.6%). COVID-19 has caused people to spend more on housing improvements due to more time being spent at home and may reflect a temporary rise in demand.

RH now accounts for 78.9% (2020: 78.4%) of HP revenue with BCT accounting for 21.1% (2020: 21.6%), showing the increasing importance of RH. Online sales now account for 34.1% of revenue (2020: 30.7%) despite £870k of revenue being lost due to online system issues.

Average branch revenue per month increased significantly by 9.6% to £261.1k from £238.1k. Whilst branch revenue increased by 14.7%, the branches were open for more months in 2021 compared with 2020 (90 months v 86 months) as there were no temporary closures in 2021 except for the two refurbishments and installation of click-and-collect at Liverpool and Manchester. The growth rate is increasing (2020: 2.3%).

GROSS PROFIT

Goods and materials increased by £4,137k (20.9%) which is only slightly higher than revenue because supplier prices remained stable. Goods and materials are now 67.0% (2020: 66.9%) of revenue. This remains below the typical industry figure of 70% and is stable. The CMPIs increased in most of the last five years and prices were expected to increase in 2020/21.

RH GP increased by £750k (20.4%), with GPM decreasing from 15.9% to 15.7%, due to the price reduction and refunds resulting from late deliveries offsetting the benefit of a shift towards online sales.

BCT GP increased by £338k (17.0%), with GPM decreasing disappointingly to 30.9% from 31.1%, again this is due to price reductions and delivery refunds.

Overall GP increased by £1,088k (19.2%) to £6,747k, but overall GPM decreased to 18.9% from 19.1% due to a GPM decline in both divisions and revenue mix shifting towards the lower margin RH division. BCT has a higher GPM due to less favourable customer discounts (5%) compared with RH (10%).

OPERATING PROFIT

Distribution costs increased by £802k (38.7%) due to increased online sales. They now account for 8.1% (2020: 7.0%) of revenue which is not in line with the goal to reduce this ratio.

Admin costs increased by £315k (9.5%) which is mainly due to a £141k (48.8%) rise in marketing and advertising as a result of the £150k marketing campaign. They now account for 10.2% (2020: 11.3%) of revenue which is in line with the goal to reduce this ratio.

Overall OP decreased disappointingly by £29k to £234k, OPM fell to 0.7% from 0.9% due to the fall in GPM and distribution costs increasing at a faster rate than revenue.

IT OUTAGES

IT outages have increased again as there were 303 outages in the 10 months to 30 April 2021 and there were 273 in the year to 30 June 2020.

The number of outages relating to e-commerce has increased to 60% from 50%.

This has resulted in a higher amount of revenue being lost as £870k was lost in 2021 compared with £600k in 2020.

The negative publicity on social media will cause even more lost revenue and reputational damage.

HP has a responsibility for staff wellbeing and the outages are causing additional stress. Staff could be absent on sick leave and suffer health issues if the problems persist. However, some of the issues may be resolved following the ERP project.

Staff retention is key so losing staff is a major issue.

Hans Ritz could be exaggerating the issue to obtain additional resource.

Recommendations

Accelerate ERP project timings.
Recruit more staff to help with issue.
Engage with staff to identify key issues.

CONCLUSIONS

Overall revenue has increased impressively by £6,119k (20.7%) to £35,673 which is a good performance in a currently prosperous industry. RH revenue increased significantly by £4,982k (21.5%) to £28,150k due to £3,250k generated from increased sales to Elevant. BCT revenue has increased impressively by £1,137k (17.8%) to £7,523k due to more time spent at home creating additional demand for home improvements.

Average branch revenue per month increased significantly by 9.6% to £261.1k from £238.1k.

RH GP increased by £750k (20.4%), with GPM decreasing from 15.9% to 15.7%, due to the price reduction and refunds resulting from late deliveries. BCT GP increased by £338k (17.0%), with GPM decreasing disappointingly to 30.9% from 31.1%. Overall GP increased by £1,088k (19.2%) to £6,747k, but overall GPM decreased to 18.9% from 19.1%.

Overall OP decreased disappointingly by £29k to £234k, OPM fell to 0.7% from 0.9% due to the fall in GPM and distribution costs increasing at a faster rate than revenue.

HP has a responsibility for staff wellbeing and the outages are causing additional stress. Staff could be absent on sick leave and suffer health issues if the problems persist.

RECOMMENDATIONS

Further analysis by division.
Profit analysis by branch.
Analysis to determine if marketing and discount campaign was successful.
Increase charge for online delivery.
Investigate delivery route efficiency.
Evaluate price reduction decision.

APPENDIX 2: New Branch Proposal

		Blackpool		Stockport
		£000		**£000**
	Revenue	2500		2750
	Discount	?		
	COS			
	Opening inventory	95		85
65%	Goods and materials	1625		1787.5
70%	Wages and salaries	175		210
	Closing inventory	-95		-85
	Total COS	1800		1997.5
	GP	**700**		**752.5**
	GPM	**28.0%**		**27.4%**
	DISTRIBUTION	100		55
	ADMIN			
30%	Wages	75		90
	Depreciation (W1)	51.8		67.5
	Marketing	0		0
	OP	**473.2**		**540.0**
	OPM	**18.9%**		**19.6%**
	Total Branch revenue 2021			
	23,495			
	Blackpool:		Stockport:	
	10.6%		11.7%	
	Wages as % of revenue	7.0%		7.6%
	Distribution as % of revenue	4.0%		2.0%
	Depreciation (W1)			
	Premises	575		825
	Renovation	135		125
15	Depr	38.3		55.0
10	Depr	13.5		12.5
	Total	**51.8**		**67.5**

FINANCIAL EVALUATION OF NEW BRANCH PROPOSAL

CONTEXT

Covid-19 has caused widespread disruption and the issues and challenges posed by Covid-19 may make opening a new branch difficult, particularly recruiting and training a new workforce.

Both sites are located on industrial sites which satisfies HP's internal requirements.

HP has no prior experience of working with Varian so there is a risk that Varian may not be a reliable partner.

HP previously identified the possibility of reducing branch size if the shift to online continued. This proposal is contrary to that.

RESULTS AND FINANCIAL ANALYSIS

The Blackpool site will result in OP of £473.2k with an OPM of 18.9%. This will increase HP's overall OP significantly as 2021 OP was only £234k.

The Stockport site will result in OP of £540k with an OPM of 19.6%. Again, this will increase HP's overall OP significantly as 2021 OP was only £234k.

The Blackpool site will add 10.6% to existing branch revenue and the Stockport site will add 11.7%.

The new site will help increase future revenue growth as it will expand HP's market share in the region.

HP may be able to obtain economies of scale when purchasing from suppliers as HP will be purchasing larger volumes.

Investment could be better used elsewhere, such as investing in the growing online channel.

Additional finance will be required and this will result in additional interest costs.

Working capital requirements will also have an impact on cash.

ASSUMPTIONS

The calculation is based on various assumptions and the results will change if the assumptions change.

Revenue estimates appear high for the first year because Manchester only generated £2,000k of revenue in its first year and Liverpool was similar.

The opening inventory figures used appear to be low compared to the normal inventory levels held by HP for the overall business.

Goods and materials are likely to be higher than 65% of revenue because they were 67% in 2021 and are typically 70% in the industry.

Wages for customer facing staff are likely to be higher because they only account for 7% and 7.6% of revenue and were 14.1% of revenue in 2021 and are typically 15% in the industry.

Also, the split between cost of sales and operating costs for wages is not in line with 2021 where it was 77:23 not 70:30.

Distribution costs are likely to be higher because they are only 4% and 2% of revenue are were 8.1% in 2021.

The initial capital costs may be higher because they are both estimates.

For Blackpool, the renovation works to fix the flood damage seem low as they are only £10k higher than Stockport which has no flood damage.

The Stockport renovation costs looks reasonable as the combined cost for the refurbishment of two existing branches in 2020 was £120k.

The proposed opening date of 30 September appears very challenging in the current climate.

The forecast period is too short for an investment of this size.

FACTORS TO CONSIDER

The survey suggests delivery times are crucial for HP customers, so HP needs to ensure that the new site works logistically to ensure that delivery times are met.

Blackpool will enable HP to achieve a bigger geographical spread and coverage as it is further from exiting branches.

HP will need to recruit and train around 15 new members of staff. This will result in additional costs.

Neither proposal includes click-and-collect facilities despite this having been a success at other branches.

HP will need to spent time consulting with local communities and this will result in additional management time.

ETHICS AND BUSINESS TRUST ISSUES

HP has a reputation for high quality and has received awards in the past. Varian has been accused of prioritising speed over quality which has resulted in poor work and dangerous outcomes. Working with Varian could be damaging to HP's reputation and pose a risk to HP employees and customers.

Varian has also been accused of having unsustainable practices and damaging the environment. HP has a policy of assessing the social and environmental impact of any new branches as well as adopting sustainable approaches to operations. Engaging Varian could harm HP's good work in this area and sustainability appears to be high on the agenda for HP's customers.

The Blackpool site appears to be at risk of flood. This could result in additional costs and potentially threaten staff and customer safety.

Recommendations

Ask Varian about their environmental policies/working practices for quality control.
Due diligence on Varian.
Seek an alternative building firm for the renovations.
Engage surveyor and obtain insurance quotes.

CONCLUSIONS

The Blackpool site will result in OP of £473.2k with an OPM of 18.9%. This will increase HP's overall OP significantly as 2021 OP was only £234k.

The Stockport site will result in OP of £540k with an OPM of 19.6%. Again, this will increase HP's overall OP significantly as 2021 OP was only £234k.

Revenue estimates appear high for the first year because Manchester only generated £2,000k of revenue in its first year and Liverpool was similar.

The survey suggests delivery times are crucial for HP customers, so HP need to ensure that the new site works logistically to ensure that delivery times are met.

HP has a reputation for high quality and has received awards in the past. Varian has been accused of prioritising speed over quality which has resulted in poor work and dangerous outcomes. Working with Varian could be damaging to HP's reputation and pose a risk to HP employees and customers.

Once the revenue forecasts have been verified, HP should proceed with the Blackpool site as it offers a better geographical spread and is a smaller investment.

RECOMMENDATIONS

Further research on revenue and costs.
Negotiate with site vendor.
Ask an estate agent for an official price of either site.
Contact bank to discuss financing.
Include click-and-collect facilities.
Find alternatives to Varian.

APPENDIX 3: ERP Proposal

	ADV IT				
		Year 1	**Year 2**	**TOTAL**	
	Revenue	700	900	1600	
19%	GP	133	171	304	19%
	Admin				
360	Capital costs	-60	-60	-120	
60	Annual costs	-60	-60	-120	
80	Cost savings	80	80	160	
7%	Delivery costs	-49	-63	-112	
	OP	44	68	**112**	
				7.0%	
	Grossmark				
		Year 1	**Year 2**	**TOTAL**	
	Revenue	900	1100	2000	
19%	GP	171	209	380	19%
	Admin				
480	Capital costs	-80	-80	-160	
110	Annual costs	-110	-110	-220	
125	Cost savings	125	125	250	
7%	Delivery costs	-63	-77	-140	
	OP	43	67	**110**	
				5.5%	
	Albion				
		Year 1	**Year 2**	**TOTAL**	
	Revenue	800	1200	2000	
19%	GP	152	228	380	19%
	Admin				
450	Capital costs	-75	-75	-150	
85	Annual costs	-85	-85	-170	
105	Cost savings	105	105	210	
7%	Delivery costs	-56	-84	-140	
	OP	41	89	**130**	
				6.5%	

Current OP	£234k
ADV (Yr1 add)	18.8%
GM (Yr1 add)	18.4%
Alb (Yr1 add)	17.5%

EVALUATION OF ERP PHASE 2 QUOTES

CONTEXT

Covid-19 has resulted in more commerce activity taking place online, so HP needs to capitalise on this by having a state-of-the-art website.

There were 203 outages in the 10 months to 30 April 2021. The number has increased and needs addressing as HP lost £870k in 2021.

Albion were rejected because they wanted 90% of payment upfront, were reported to have financial difficulties, might not have been able to offer required day-to-day support and included items HP did not require.

ADV IT is a market leader in Estonia but has no experience with UK companies and is unknown to HP.

RESULTS AND FINANCIAL ANALYSIS

Using ADV IT will result in incremental operating profits of £44k in year 1 and £68k in year 2, which gives £112k across two years.

Using Grossmark will result in incremental operating profits of £43k in year 1 and £67k in year 2, which gives £110k across two years.

Using Albion will result in incremental operating profits of £41k in year 1 and £89k in year 2, which gives £130k across two years.

The project will eliminate outages which resulted in £870k of lost revenue in 2021. On this basis, the year 1 revenue estimates look reasonable and maybe even slightly low.

The project will add between 17.5%-18.8% to operating profits so this is a significant addition.

HP currently has a cash balance of £663k which is sufficient for the initial capital costs.

The calculation is based on various assumptions and the results will change if the assumptions change.

The revenue forecast only includes two years even though the website will last for six years, so the additional years are needed in order to make a full assessment.

The cost savings could be higher and revenue estimates lower, as they were in Phase 1.

FINANCIAL CONSIDERATIONS

ADV IT has the lowest capital and annual costs so has the lowest investment required.

However, ADV IT wants payment of capital costs up front which is a major risk for HP as it will have less leverage if the work is unsatisfactory or late.

Grossmark has the highest cost savings due to their familiarity with HP. They also have the most favourable payment terms which is beneficial for cash.

However, Grossmark have the highest costs and these will be incurred regardless of whether the revenue benefits are achieved and so represents a greater financial risk for HP. Grossmark also have the lowest profit, although this was also the case in Phase 1.

Albion will result in the highest profit and they have not charged a premium.

However, Albion were previously in financial difficulties so their position needs to be verified before they are considered.

NON-FINANCIAL CONSIDERATIONS

ADV IT are based in Estonia so there could be language and cultural barriers to overcome. Also, completing the whole project remotely may not be feasible.

Grossmark are known to HP and have proved to be reliable in the past as Phase 1 went well and costs were as per the quote. However, there were some problems with maintenance.

Albion specialise in website design and e-commerce so appear well suited to the project. However, these claims need to be verified as they are from the CEO who is keen to win the work.

Not using a parallel run caused significant disruption, security breaches and reputational damage for Yorath & Co and this should be avoided to protect HP's reputation and prevent lost revenue.

Accelerating the completion date to 1 January 2022 from 30 June 2022 may prove challenging and add further pressure to staff.

ETHICS AND BUSINESS TRUST ISSUES

ADV IT requires remote access to all HP information, including customer data. There is a risk of a data breach, associated reputational damage and loss of customer goodwill, similar to what happened to cementonline.com. This could also be illegal if customers have not given permission for their data to be shared.

Hans Ritz is a close friend of Albion's CEO so this could influence his decision making and cause him to select Albion even if they are not the best supplier for HP.

The nature and amount of unexpected costs is unclear. There is a risk that suppliers could add additional amounts and HP would appear to have no control over this.

Recommendations

Do not share data without explicit permission.
Inform customers if their data will be shared.
Seek legal advice on data sharing.
Do not let friendship influence decision.
Ensure a cap for unexpected costs is included in the contract.

CONCLUSIONS

Using ADV IT will result in incremental operating profits of £44k in year 1 and £68k in year 2, which gives £112k across two years.

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ADV IT requires remote access to all HP information, including customer data. There is a risk of a data breach, associated reputational damage and loss of customer goodwill, similar to what happened to cementonline.com. This could also be illegal if customers have not given permission for their data to be shared.

HP should proceed with Grossmark because Phase 1 was successful and costs were as per the quote.

<u>RECOMMENDATIONS</u>

Negotiate lower costs with Grossmark.
Verify cost savings / revenue estimates.
Discuss maintenance issues.
Ensure parallel run included.
Communicate accelerated timetable with staff.
Perform cash flow forecast to determine if financing will be required.