The Chartered Institute of Management Accountants

MANAGEMENT CASE STUDY May 2018 EXAM ANSWERS

Variant 4

The May 2018 exam can be viewed at

https://connect.cimaglobal.com/system/files/resource/MCS%20Variant%204%20Qs%20May%202018.pdf

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Training costs

Understanding training costs is complicated by the fact that some of the variables that affect training are largely outside of Menta's control. Knowing how much we will have to spend is complicated because of problems such as the need to comply with changing legal requirements, and we may even pre-empt changes to minimise future disruption. We have very little discretion over training because drivers must be adequately trained and licensed.

Even if training costs can be linked to specific factors such as the recruitment of drivers, it may not be clear why a particular driver is being trained and so there could be some ambiguity as to whether a cost should be charged to replacing departed drivers or to expansion. There will also be issues arising from the fact that training costs can be driven by appointment decisions rather than the loss of drivers. Replacing a departing driver with a licensed driver who simply requires induction training will cost very little compared to the cost of training a new driver.

Understanding the issues that determine training costs may be difficult or expensive. For example, it would be useful to know why Menta is losing trained staff, but gathering that information would require time and effort to be invested in exit interviews and even that may not give a complete picture if drivers choose not to disclose their reasons for leaving. The cost of this data collection may outweigh the advantages.

There is a further complication arising from measuring the benefits of discretionary training. Menta would not be permitted to operate services if its drivers were not properly qualified, but those mandatory costs account for just over half of the total cost of training. The remainder is discretionary expenditure that hopefully adds value to the company, but the implications of reducing that investment can only be seen if we stop spending. That uncertainty affects training costs because we do not know how much revenue we would lose if we decided to spend less on discretionary training.

Competitive advantage

Menta competes at a local level by offering a combination of cost leadership and differentiation. Menta aims to offer the cheapest fares in each of the towns where it operates and also has a strategy of providing "safe, reliable, customer-centred transport services". Better trained drivers may reduce the running costs of buses through more economical driving and better maintenance procedures, which would be a measurable saving. Training will also allow for better customer service by teaching drivers to engage with customers and offer excellent customer service, which could be evaluated by regular customer surveys.

The extent to which Menta can derive competitive advantage from this training depends on whether other bus companies can replicate that advantage for themselves. With the possible exception of Dawlbus, most of Menta's competitors are small companies who could not afford to replicate Menta's training scheme. They can, however, derive much of the benefit by recruiting drivers from Menta, perhaps by offering slightly better pay and conditions. Matching such offers, so that drivers are not tempted to leave, may offset some of Menta's cost advantage and so staff turnover should be monitored .

There is also the question of whether bus passengers are prepared to pay for all of the benefits offered by this training. The fact that drivers receive training in customer service does not necessarily motivate them to treat passengers any differently. It is also possible that the training makes it slightly more pleasant to travel with Menta, but it is debateable whether passengers will necessarily travel by Menta because of that. The engagement with the driver is such a very small aspect of the service compared to, say, the frequency of service, that it is doubtful whether Menta derives a great deal of advantage.

Section 2

Transfer pricing

The training centre is, presumably, a cost-effective alternative to the third party training that it will be replacing. If transfer prices are to be left to the internal market within Menta then the lowest price that the training centre's managers will accept is the total cost divided by the centre's capacity**.** If they accept less than the training centre will run at a loss, which could make them appear inefficient**.** The most that the subsidiaries will pay to use the centre is the amount presently paid to their local third party trainers. Paying more will increase their training costs and reduce their profits**.**

The simplest way to optimise the use of the training centre would be to rank the subsidiaries in decreasing order by the unit cost that they pay for training each of their drivers. We should show their typical annual training needs in terms of driver numbers**.** We could take a cumulative total of training needs until we reach the maximum capacity of the centre and set the transfer price at the rate that is paid to third parties by the marginal subsidiary**.** That transfer price should leave the training centre with a reasonable margin and most of the subsidiaries will enjoy a saving**.**

Switching to the training centre will require those subsidiaries who are outside of reasonable travelling distance to use the residential facilities**.** Charging separately for the residential facilities, even at cost, will disrupt the internal market, so the training centre should set a fixed cost per driver, regardless of whether residential facilities are used or not **.** If that means that the training centre cannot make a profit then there will be no financial benefit to establishing the centre in any case.

The induction training and discretionary ongoing training will all be facilitated by the training centre. There is no specific need to optimise transfer pricing if it is simply company policy that the training centre be used for this function, although it will improve the relationship between the training company and the subsidiaries if we set a basis that benefits both parties**.** We might start by reviewing the daily rates charged by the third party training companies used for induction and discretionary training. It would be ideal if we could set the daily rate charged by the training centre staff at the lowest external rate and still have the training centre make a profit on this training**.** That would mean that the subsidiaries are not paying any more than they did before, except for having to pay for induction training that was previously conducted by depot managers**.**

Impairment review

If the buses are likely to be written down in a forthcoming impairment review then their book value exceeds their recoverable amounts, which means that both their realisable values and their net present values are less than book values**.**

Transferring the buses to the training centre will not affect their realisable values. That means that the buses will still be impaired after the transfer unless their NPVs increase because of the move to the training centre.

It may be that moving the buses between subsidiaries will mean that the need for an impairment review will be overlooked. The training centre will record the incoming buses at their transfer price and it may be taken for granted that impairment will not be an issue for assets that have only just been acquired. If part of the motive for making this transfer is to conceal the need for an impairment review then this is a breach of the concept of integrity, which requires us to be straightforward, honest and truthful.

IAS 36 Impairment of assets sets out a clear requirement to consider the need for an impairment review and to conduct such a review as and when it seems likely that an asset could be impaired. These buses had already been deemed to be in that category and it seems unlikely that transferring them to the training centre will significantly reduce that likelihood. Failure to comply with such a clear accounting requirement would put Menta in breach of the principle of professional behaviour, which requires compliance with relevant regulations.

The fact that Robert has accepted the advice that no impairment review would be necessary does not alter the fundamental facts of this case. As finance director, Shuaib has a duty to decide for himself as to whether it is necessary to conduct an impairment review and to insist that the financial statements reflect any impairment if one is discovered. To do otherwise would be a breach of the concept of objectivity, which says that professional judgement should not be overridden by influence from others.

Section 3

Risk of losing drivers

Arguably, the primary motivator for competing bus companies to attract Menta's drivers will always be that it is quicker and cheaper to employ a licensed driver than to train an unlicensed recruit. Competing bus companies will not find themselves in greater need of drivers just because Menta's training has improved and so any increase in pressure to lure drivers may be incremental. At worst, competitors may make a point of targeting Menta when looking for additional drivers to replace their own losses.

If competitors do decide that Menta's drivers are more attractive because of the training centre, then it will be relatively easy to target them. Bus stops and public bus stations usually have advertising space and it would be a simple matter to use those to advertise driver vacancies. They need not specifically advertise for drivers who have trained with Menta, they could simply prioritise applicants from that background when selecting shortlists for interview.

Menta should respond to this threat by being aware of the local market for drivers. There is no need for every subsidiary to offer its drivers exactly the same terms and conditions because they are all operating in different towns. Menta should ensure that it is aware of what its local competitors are offering their drivers, with a view to matching and even slightly exceeding the benefits offered by the competition.

If competitors do start to encroach on Menta for any reason, then Menta should respond by recruiting aggressively. If Menta uses its size and reputation to start recruiting competitors' drivers aggressively then it will send a very clear message that this competition is unwelcome and will be self-defeating. Menta can also make a point of promoting or otherwise encouraging any drivers who say that they are thinking of leaving for a competitor.

Reducing the number of dismissals

The ultimate aim of an effective disciplinary procedure is to bring about a change in an employee's behaviour. Treating dismissal as a very last resort gives Menta the opportunity to address any problems and to retain that employee's services. Menta could adopt a zero-tolerance policy relating to driving-related offences and the loss of licences. That would send a very clear message to all drivers and also to customers that safe driving is mandatory. Less serious matters can be dealt with through a range of sanctions that are clearly understood and proportionate.

It is important that Menta retains the possibility of dismissal, otherwise drivers may feel that they do not have to comply with Menta's rules and regulations. The threat of dismissal offers a deterrent against serious or repeated breaches and underlines Menta's authority to discipline its drivers as necessary. Failure to dismiss a driver for a serious offence could also send a very clear message to others that it is acceptable to breach the rules.

Incorporating the number of dismissals into the evaluation of HR is only realistic if HR is given the ability to influence and guide the whole disciplinary process. If HR is not involved in disciplinary matters until they have reached a point where dismissal is under consideration, then it is debateable whether the HR department can be held responsible for reducing the number of dismissals. In practice, most disciplinary issues will be dealt with in the first instance by line managers and it would be demotivating to hold HR responsible for decisions taken by others.

If HR is to be held responsible for reducing the number of dismissals, then Menta should require all line managers to be trained in managing staff and in implementing the company disciplinary procedures. Line managers should also notify HR of any disciplinary action taken, even at an informal level through verbal warnings, so that HR can see the possibility of problems arising. HR can only be held responsible for disciplinary decisions if it can influence and monitor the whole process from beginning to end.

Section 4

Abandonment

The incremental cash flows of completing the project should be considered**.** Work on the training centre started on the basis that this is a positive NPV project and so completing it is likely to remain so**.** The only concern would be that the cost of clearing the site and the delay in commencing operations would make completion a negative NPV project, which seems unlikely**.**

The market value of the land and the work done to date might be a consideration**.** It may be that the site could be sold as it stands to one or more buyers who would be interested in completing the construction work to their own requirements and who did not need to build anything in the habitat in the short term**.** The land could be worth more because of the initial clearance and the infrastructure that has been put in place**.**

The possibility of an alternative site being found is also a consideration**.** If Menta could sell the present site, then it could build a similar design elsewhere that offers scope for creating a variety of driving conditions**.** That would be quicker and possibly even more cost-effective than clearing the present site**.**

The final consideration is that Menta's training needs are already being taken care of by third-party training companies**.** A delay in completing the training centre will be unwelcome, but it will not hold back Menta's operations unduly**.** The subsidiaries can simply continue with their existing arrangements until such time as the training centre becomes available**.**

WACC and scenario planning

WACC is a weighted average of the costs of debt and equity. The impact of abandonment on the cost of debt will depend on the impact of this on Menta's cash flows and the value of the land**.** If Menta is forced to abandon the project in a manner that disrupts cash flows, then it may be at greater risk of default on its debt. That would push down the market value and increase the cost of debt, and so WACC Similarly, if the land loses value then Menta's lenders will have less collateral available to them in the event that they are forced to foreclose. Again, that will push up the cost of debt and WACC

The cost of equity is related to expectations of growth in future dividend payments. If the shareholders had expected the training centre to lead to additional growth in their dividends, then abandonment will disappoint them**.** The share price will fall and so the cost of equity, and WACC, will increase**.** There could be further increases in the cost of equity if the shareholders lose confidence in Menta's management**.**

The managers of a complex project should develop a range of scenarios that might have an impact on the project's progress and should, ideally, have a response in place**.** In this case, it would appear that the problem would have been difficult to foresee because the mammal is rare**.**

Creating a response for this eventuality would also have been virtually impossible because the law prevents any further work from being carried out until the creatures have been removed**.** The only response would have been to have identified an alternative site in the event that work was interrupted on the primary site, which would hardly have been realistic**.** This setback is such an unexpected problem that it would be unfair to hold the managers responsible for failing to foresee it.