

November 2020 and February 2021
CIMA Management and Gateway Case Study
2019 CIMA Professional Qualification
Full post exam support materials

Below is the full post-exam supporting material for the Management/Gateway case study exam.

Pre-seen material

November 2020/February 2021 pre-seen can be found [here](#)

Examiner's report

The November 2020/February 2021 examiner's report can be found [here](#)

Exam variants

- Variant 1 can be accessed [here](#)
- Variant 2 can be accessed [here](#)
- Variant 3 can be accessed [here](#)
- Variant 4 can be accessed [here](#)
- Variant 5 can be accessed [here](#)
- Variant 6 can be accessed [here](#)

Suggested solutions

- Suggested solutions for variant 1 can be accessed [here](#)
- Suggested solutions for variant 2 can be accessed [here](#)
- Suggested solutions for variant 3 can be accessed [here](#)
- Suggested solutions for variant 4 can be accessed [here](#)
- Suggested solutions for variant 5 can be accessed [here](#)
- Suggested solutions for variant 6 can be accessed [here](#)

Marking Guidance

- Marking guidance for variant 1 can be accessed [here](#)
- Marking guidance for variant 2 can be accessed [here](#)
- Marking guidance for variant 3 can be accessed [here](#)
- Marking guidance for variant 4 can be accessed [here](#)
- Marking guidance for variant 5 can be accessed [here](#)
- Marking guidance for variant 6 can be accessed [here](#)

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November 2020 & February 2021 Management Case Study Examination

Pre-seen material



Contents	Page
The History of plastic construction toys	3
Prybloxx	4
Prybloxx product ranges	6
Pricing issues	7
The manufacturing process	8
Sales	9
Consumers	10
Management structure	11
Business Model	13
Costing information	14
Extracts from Prybloxx's annual report	15
Extract from Ckonstro's annual report	18
News reports	21

Prybloxx is a quoted company that manufactures a range of plastic bricks that are sold globally as toys and educational products. Prybloxx is based in Central City in Varanda.

Varanda has a developed economy with relatively high wage rates, which means that citizens can afford a good standard of living.

Varanda's currency is the V\$. Varandan company law requires companies to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS).

You are a financial manager at Prybloxx's Head Office. Your primary responsibilities are associated with management accounting and you report to Alex McDonald, the Senior Financial Manager, who reports directly to the Finance Director.

The history of plastic construction toys

Prybloxx manufactures construction toy sets that are based primarily on plastic bricks. These bricks come in different shapes, designs and colours, but the majority have studs on top and tubes on the inside. This arrangement makes it possible to clip the bricks together to create toys and models that are strong enough to be played with. Afterwards, the bricks can be easily unclipped and used to make something else or be stored in a box or a bag.



This style of construction toy was launched in the 1930s by a competing brand. This brand remains the market leader for this type of toy. The design proved popular with children because it permitted them to use their imagination in play. Parents were attracted by the educational value associated with the design and construction process. The company grew steadily until it became one of the world's largest toy makers.

Competing brands of bricks started to be marketed during the 1960s. These were deliberately designed so that they were compatible with the industry leader and so could be used interchangeably with its bricks. The design of the bricks could not be patented, so there was nothing to prevent competitors from entering the market, provided they did not abuse registered trademarks such as the company name or the names of products and product ranges.

The initial aim of the competitors was to compete on the basis of retail price. Making their bricks compatible with those of the leading brand enabled them to compete directly on price. Some manufacturers actively promoted them as a means of adding to a child's collection of the leading brand of bricks.

Until the 1970s, all manufacturers sold generic sets of building blocks, with the bricks being supplied in a small range of different colours. Over time, the range of parts had expanded slightly to include items, such as wheels that could be clipped into special bricks that had internal tubes, that allowed axles to rotate. A child might build a toy house one day and a toy car the next.



turntable ladder that came only with this kit, along with bricks that had been screen-printed with signs and logos that signified “Fire Department”.

By the late 1980s, the leading brand’s manufacturer decided to change its direction by adding “model kits” for sale alongside the sets of generic building blocks. These model kits included a printed sheet of instructions and specific bricks that enabled the child to build a specific item or items. For example, a kit might be intended to build a toy fire engine. The distinguishing characteristic of those kits was that they included custom parts that were not otherwise available in the generic sets. For example, the fire engine kit included a



Over time, the sophistication of model kits has grown, with greater emphasis on custom parts and printing to make the models more realistic. The custom parts include small figures that have moveable arms and legs that are designed to complement the models and enhance play value.

There has also been a move towards technology. It is now possible to purchase various electronic components that add functions ranging from flashing lights through to remote-controlled motors that can be operated with a smartphone.

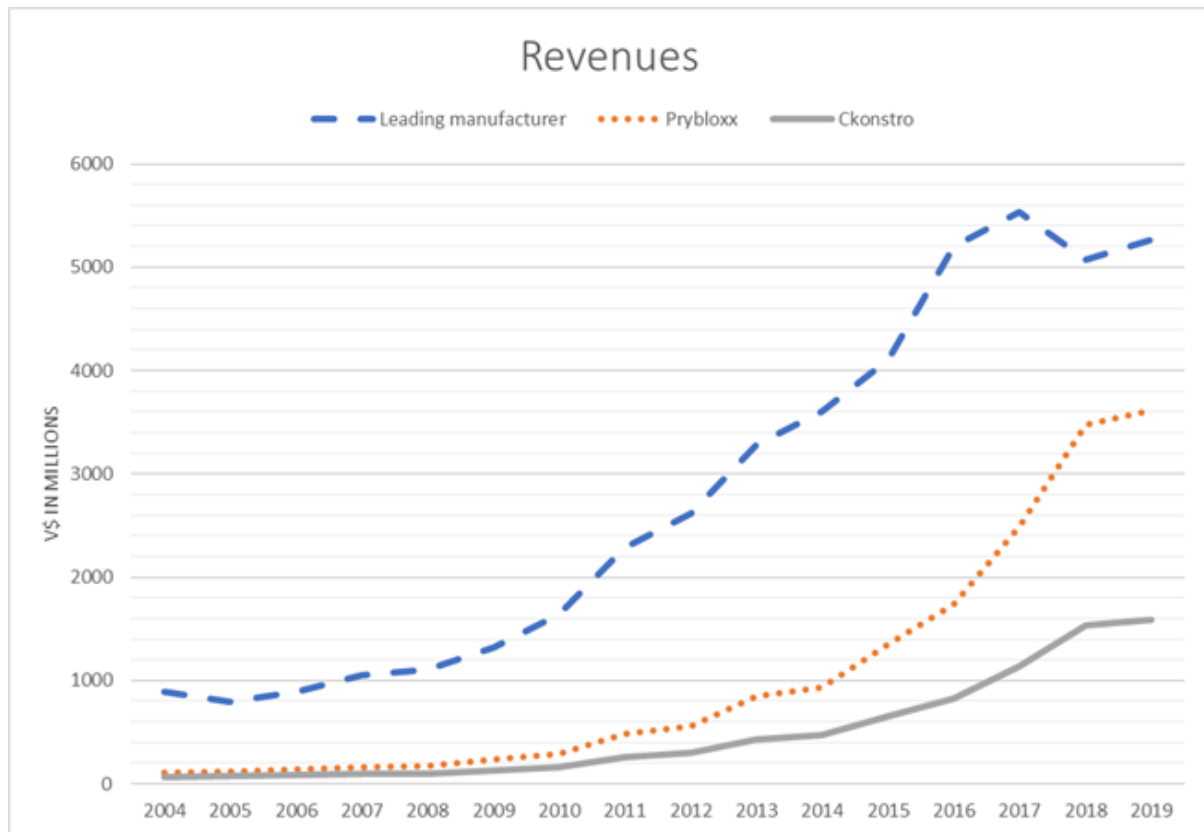
Prybloxx

Prybloxx was founded in 2004 by Brendan Lee, an entrepreneur who wished to imitate the continuing success of the leading brand’s sales of sets and model kits. Mr Lee developed a range of generic bricks that were compatible with those of the leading brand. These were sold by weight in order to stress the value for money that Prybloxx was offering. Selling bricks in one and two kilogramme boxes also made packaging and distribution cheaper and easier. Prybloxx bricks were also manufactured to very fine tolerances so that they fitted together well. Many cheaper brands had a reputation for being difficult to attach to one another and the resulting models could also be fragile. Prybloxx has always aimed to match the leading brand in terms of product quality.

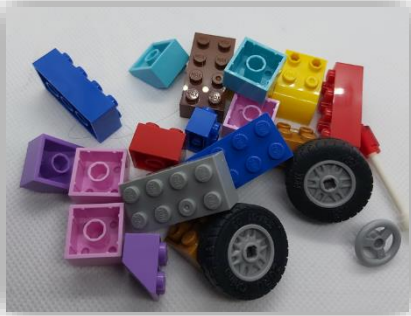


Once Prybloxx was established as a brand that was synonymous with value for money and good quality, it started to develop its own ranges of model kits. These proved highly successful and, as a result, Prybloxx grew rapidly.

Prybloxx was quoted on the Varandan Stock Exchange in 2010. At that time, Brendan Lee retired from the company and sold all of his equity.

Prybloxx is now the world’s second largest manufacturer of construction toys, ranking behind the leading brand. The third largest company is Ckonstro, which has a very similar business model to that of Prybloxx. It offers a very similar model range based on building blocks that are compatible with those of the leading brand.



Prybloxx offers the following product ranges:

Basic Prybloxx	 <p>Basic Prybloxx sets comprise generic bricks and associated items, such as wheels, doors and windows, that are sold as boxes of mixed sizes and colours. They are used to encourage children to express their creativity by building items from the bricks and other components that are available to them.</p> <p>Schools often use Basic Prybloxx in the classroom because they are ideal for helping young children to understand basic mathematical concepts, such as shapes and arithmetic.</p>
Prybloxx Kits	 <p>The Prybloxx Kits range comprises sets of bricks that are designed to build a specific model. They are supplied with building instructions, which enable children to build the item pictured on the box lid.</p> <p>The bricks contained in one of these sets could be used in conjunction with other bricks to make a larger model, but children generally keep the model as a toy or as part of a collection and do not dismantle them once built.</p> <p>Prybloxx Kits usually contain some custom parts that are not generally available in Basic Prybloxx sets.</p> <p>Kits are often linked to themes. For example, Prybloxx City Kits include buildings and vehicles and Prybloxx Rail Kits include locomotives, wagons and carriages.</p>
Prybloxx Character Kits	 <p>The Prybloxx Character Kits build into models that are based on a character, a vehicle or a building from a film or television programme. Prybloxx pays a royalty which grants a licence to use copyrighted images and trademarked names.</p> <p>The design and manufacture of Prybloxx Character Kits is virtually the same as for Prybloxx Kits, except that the owners of the intellectual property that is being licensed insist on seeing and approving the designs before the products are launched.</p>

Prybloxx sets its recommended retail prices at a slightly lower level than the leading brand's to allow for superior brand recognition, but the difference is rarely more than 5-10%.

Prybloxx's bricks are of good quality and moulded to the same fine tolerances as the leading brand's. Its Kits and Character sets are of similar quality and are designed to a high standard. Prybloxx has a large Design Department comprising 150 staff, who are responsible for designing new products and updating existing parts. The design process is complicated by the need to minimise manufacturing costs while creating something that is new and exciting. That can require compromise, such as using an existing blue brick to create a police car kit rather than using a slightly more accurate colour that would require a separate production run to create blue bricks in a slightly different shade that better matches the colour of a real police car.

Prybloxx constantly refreshes its product ranges, particularly with regard to Kits and Character Kit ranges. Products that are declining in popularity are quietly withdrawn from sale. Likewise, new products are generally introduced with relatively little publicity, because customers are generally willing to browse the company's website and the displays provided by both online and traditional retailers.

The Design Department has to work closely with the Production Department over design issues that overlap with production constraints. The injection moulding process requires designs to take account of the need to shape parts so that the mould fills quickly and evenly, with minimal distortion when separating the moulded parts from the mould itself. Designs often require compromise to allow for the constraints associated with the manufacturing process.

Pricing issues

Basic Prybloxx	<p>Trade selling prices allow Prybloxx to recover manufacturing costs and make a realistic contribution, with scope for the retailer to earn a further contribution from the final sale. The relationship between manufacturing cost and recommended retail price is not linear. For example, the Basic Builder Kit contains 153 parts and retails for V\$44.99. The Master Builder Kit has twice as many parts, but it retails for V\$71.00, which is only 60% more. Prybloxx wishes to demonstrate that larger kits offer customers better value for money.</p> <p>Some prices are based on perceived added value rather than cost to Prybloxx. For example, the Motor Builder Kit contains the same number of moulded parts as Basic Builder, but it also includes an electric motor. The Motor Builder Kit costs an additional V\$2.74 to manufacture, but it retails for an additional V\$15.00 because the motor offers much greater play value. Prybloxx also has limited capacity to produce those "added value" parts, especially motors and lights.</p>
Prybloxx Kits	<p>The Prybloxx Kits generally retail for roughly 90% more than a Basic Prybloxx Kit containing the same number of parts and features. That is mainly due to the greater perceived play value of the Kits. Kits generally include a few special parts, which cost a little more than generic parts to make because of low production volumes, but those parts rarely add more than V\$1.50 to the total cost.</p>
Prybloxx Character Kits	<p>Prybloxx Character Kits generally retail for 15% more than a Prybloxx Kit with the same number of parts. Again, that reflects the additional perceived play value arising from the link to popular characters. The royalties add V\$0.15 to V\$0.35 per unit.</p>

The manufacturing process

The basic building blocks are manufactured in a highly automated process called injection moulding. Pellets of a very hard plastic called ABS are melted and forced into a large metal mould using an injection-moulding machine.



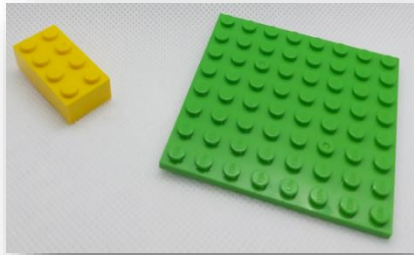
The moulds used in these machines are made out of metal and cost roughly V\$50,000 to produce. The moulds have finite lives, eventually losing their precise shape. The bricks have to be manufactured to a very precise tolerance, otherwise they will not fit together properly. Prybloxx minimises the numbers of moulds required by aiming for long production runs of each given part.

The colour of the brick is determined by the colour of the plastic pellets being fed into the machine. The cheapest and easiest way to change colours is simply to start feeding a new colour of pellets into the machine, discarding the initial outflow while the remainder of the previous colour of plastic is forced through the machine.

Some components are made out of materials other than ABS. For example, clear and translucent components are moulded from polycarbonate plastic. Other plastics are used for parts that require greater flexibility than ABS and polycarbonate can provide.

The cost savings associated with long production runs for each part mean that Prybloxx often makes specialised parts in a single batch, with a view to discontinuing the associated kit once that part runs out. For example, the Namer Ford figure, which is included as part of a Prybloxx Character Kit wears a hat that is unique to that kit. Prybloxx moulded 500,000 hats in a single production run when the kit was launched. That particular kit may be discontinued when the inventory of hats, and any other items that are unique to it, run low. That decision will depend on the continuing popularity of the kit at the time.

Large inventories of parts that are no longer required, because they were intended for kits that are no longer popular, are sometimes repurposed. For example, the wheels that were designed for the Wanda's Carriage Character Kit were subsequently incorporated into the design of the Rider McColl Chuck Wagon Kit. Parts that cannot be repurposed can usually be melted down and brought back into the production process, provided there is no need to dismantle them first in order to separate different colours and materials.



The vast majority of the parts manufactured by Prybloxx are generic bricks and base plates that are unlikely ever to become obsolete. Those parts are manufactured in large quantities and inventories are replenished in economical production runs whenever necessary. These items are generally described in terms of their colour and the number of studs on their upper surfaces. For example, a yellow 4x2 brick or a green 8x8 base plate.



Basic components are ready for packaging once they leave the mould, but others require further assembly before they are sent for packing. For example, some parts are stamped or screen printed to create a texture, a logo or some other form of design feature. Other parts must be assembled from individual components. For example, windows and windscreens usually comprise a frame made from ABS and a clear pane of plastic that is clipped into place. There is also a range of Prybloxx Figures, each of which comprises several small components that are assembled in the factory. All of these processes are automated.

The packaging process is also largely automated. Plastic bags are carried along a filling line, which has been programmed to insert the required number of bricks of each type for the kit that is being manufactured. The bags are then placed in boxes, which are closed and stacked by shipping staff.

Prybloxx has a single large factory that is located on the outskirts of Central City in Varanda. All manufacturing operations are located there. There is a large distribution centre at the factory, but Prybloxx also has a further seven distribution centres located in different countries to facilitate export sales.

Sales

Most of Prybloxx's sales are made through third parties. Products are sold in 110 different countries, most of which offer the following types of retail environment for toys:

Online	<p>A significant proportion of toy sales are made through online retailers, some of which operate internationally.</p> <p>Prybloxx has a strong relationship with the leading online retailer that serves Varanda and several other developed countries.</p>
Catalogue retailers	<p>Catalogue retailers offer a mix of physical and online sales.</p> <p>Physical sales require customers to go to a store and select and pay for an item. The store staff then obtain the item from a stock room for immediate collection by the customer.</p> <p>In Varanda and many other countries, catalogue retailers dominate the physical retail market for toys.</p>

	Catalogue retailers also make their catalogues available through their websites. Customers can select items for collection from their local store or they can order online for delivery.
Major toy chains	Traditional toyshops struggle to compete with online and catalogue retailers, but many countries have at least one major chain of toy retailers.
Wholesalers	Prybloxx requires minimum orders before it will sell directly to any particular customer. Wholesalers generally buy in bulk from Prybloxx in order to resell products to small, independent retailers who could not meet the minimum order requirement.

Prybloxx sets trade prices for sales to retailers. Quantity discounts are offered to customers who buy in greater quantity. Trade prices are sufficient to ensure that Prybloxx makes a satisfactory profit on every sale, even after allowing for quantity discounts.

Prybloxx sets a recommended retail price for every product, which it communicates to its commercial customers. Competition law prevents manufacturers from forcing retailers to sell at the recommended retail price. Some retailers choose to sell at that price, while others sell at a discount and some sell at a higher price.

Consumers

The vast majority of kits are purchased as children's toys. Prybloxx claims that its bricks are suitable for children from the age of three years onwards. There are ranges of kits that are aimed at children in different age groups, up to young teenager. The intended age for each kit is printed on its box. Kits aimed at older children are generally more challenging to build, with larger numbers of small parts. Character Kits are themed to allow for the popularity of film and television characters to different age groups.

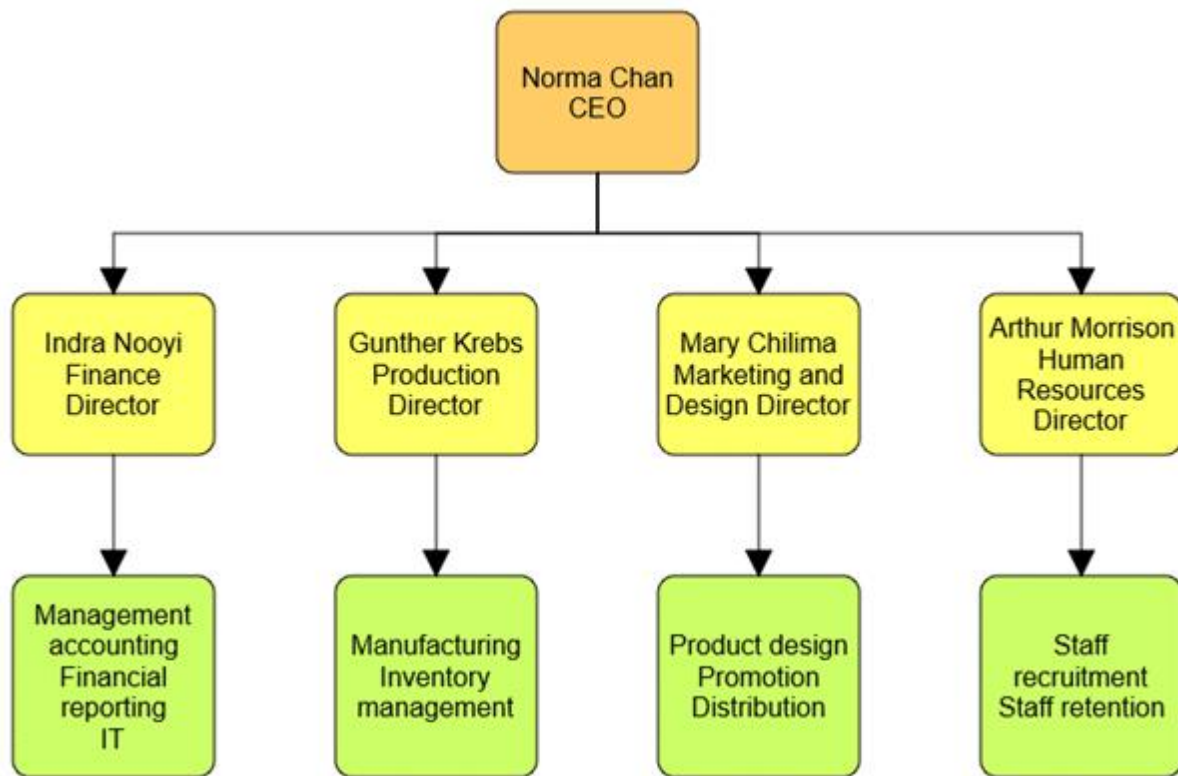
A significant proportion of sales are made to schools. Encouraging younger children to play with building blocks teaches them to understand the relationships between shapes and numbers. Some schools have specifically incorporated building blocks into the curriculum for that purpose. Plastic bricks are also used with older children to build basic apparatus for science experiments. The bricks allow for educational flexibility and can be quickly repurposed, which makes them cost-effective and easier to store than more rigid dedicated equipment.

There is a small but significant market for adult hobbyists. Some enjoy collecting kits and participating in online blogs where the latest models are discussed. Others have practical needs and use bricks for hobby or other practical purposes, possibly in conjunction with parts made from conventional building materials. For example, it is possible to download plans to construct a 3D printer chassis out of Prybloxx bricks. A hobbyist can then build the functional parts of the printer into that chassis and create a working device more cheaply than buying a readymade printer.

Engineers sometimes use plastic bricks to build initial prototypes. The bricks might be used to fabricate, say, an arm for an industrial robot in order to test the effectiveness of a control unit and its associated software. That could be preferable to building an expensive working model before the concept has been proven.

Management structure

Executive directors



Each of the executive directors, other than the CEO, oversees a number of functional areas. Each functional area has its own management team that reports directly to its respective director. The functions are all broken down into responsibility centres, most of which are cost centres. Some of the promotional activities overseen by Mary Chilima are also managed as revenue centres.

The key responsibility centres are as follows:

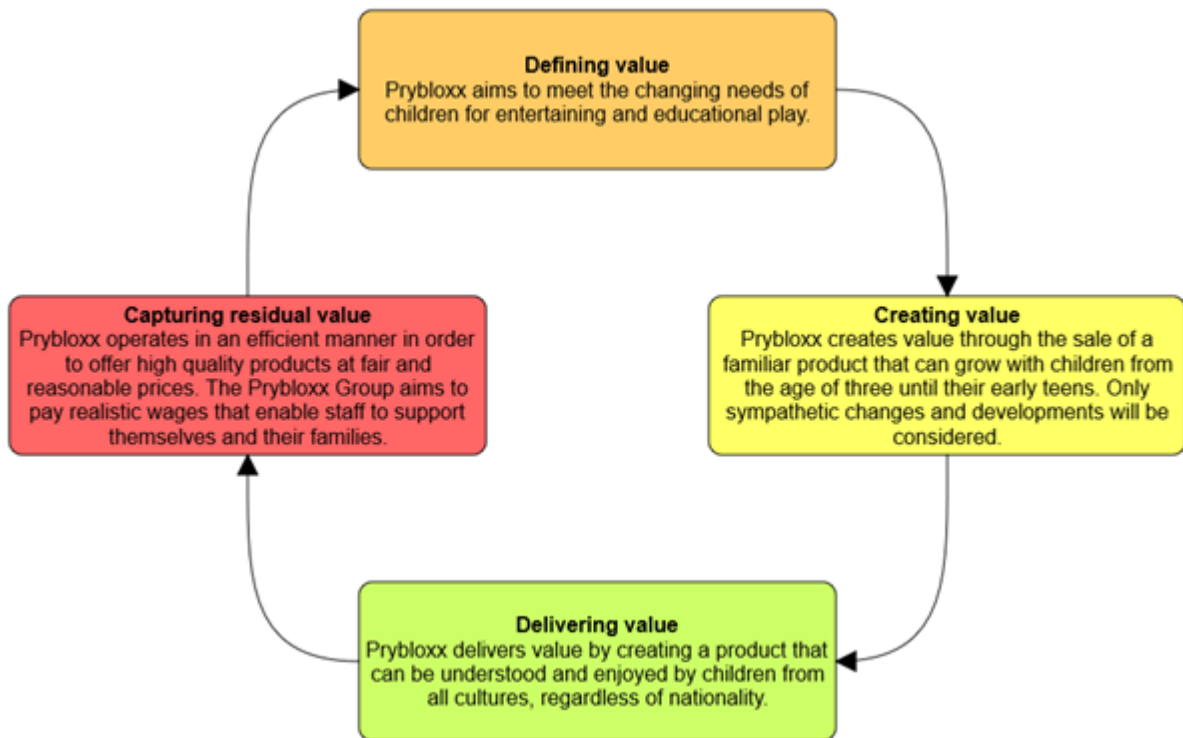
Report to	
Finance Director	<ul style="list-style-type: none"> Accounting and Finance Department – which includes Payroll Information Technology Department
Production Director	<ul style="list-style-type: none"> Production Department – which comprises manufacturing and inventory management
Marketing and Design Director	<ul style="list-style-type: none"> Design Department – which is responsible for the design of new bricks, the development of kits and liaison with the Production Department Sales, Advertising and Promotion Department Fulfilment Department – which is responsible for distribution Product Managers – each product range has a team of Product Managers, each having responsibility for particular product lines. The managers monitor the need for product development, feeding back to the Design Department and to the Advertising and Promotion Department. <p>Product Managers are also held responsible for monitoring sales volumes for their lines. Product Managers are expected to liaise with</p>

	major retail customers and to conduct market research with consumers.
Human Resources Director	<ul style="list-style-type: none"> Human Resources Department

In addition, Prybloxx has a non-executive chairperson and four non-executive directors:

- Mohd Nasarudin Saian – Non-executive Chairperson
- Geraldine Wallace – Non-executive Director
- Johan De Tavernier – Non-executive Director
- Justus Nwaoga – Non-executive Director
- Martine Collins – Non-executive Director

Business model



Prybloxx itself has existed for a little more than a single generation of children aged from three years until early teens. The Prybloxx brand has established its own reputation during that period, while also benefitting from the much longer history of the products that are sold by the leading brand in plastic brick construction toys.

The product range has been designed so that children will learn to play with a basic kit of Prybloxx bricks, which will be supplemented by more advanced and model kits that will stimulate play throughout their childhoods.

Prybloxx avoids direct cultural references in its products. All instructions are in the form of pictograms, so there is no need to offer multiple translations and the company can easily expand into new markets. Model kits use logos in place of text for identification purposes. For example, Prybloxx fire engines use bricks that are screen-printed with a picture of a flame rather than the word “Fire”, or equivalent, in the local language.

The company aims to refresh and update its product range on a constant basis, but it aims to do so without departing from the fundamental brand image of wholesome and educational play.

Prybloxx operates around the world. Most of its staff are employed at its factory in Varanda, but the Group has distribution centres in several other countries. Varanda has a concept of a “living wage”, which is sufficient for an employee to achieve an acceptable standard of living and is higher than the statutory minimum wage. Prybloxx has committed itself to pay at least the living wage, even though it is not compulsory to do so. Overseas workers are also paid sufficient to live comfortably.

Costing information

Prybloxx has a relatively straightforward costing system.

The manufacturing cost for each size and style of brick depends partly on the brick's size and the number of units that are required. Each mould for the injection-moulding process costs approximately V\$50,000 to make and lasts for up to one million impressions before it starts to lose its precision. Moulds for smaller bricks can have multiple chambers that enable several identical bricks to be moulded in each cycle. Larger items, such as base plates, are moulded individually.

The overall cost of each kit includes costs other than the bricks:

- Packaging is expensive because kits are sold in good quality cardboard boxes that are printed in full colour.
- Distribution is expensive because the most cost-effective way to manufacture Prybloxx's large product range is to make each kit in bulk and then store it until it is sold. When the kits are finally shipped they are not particularly heavy, but they do occupy a great deal of volume.
- Character Kits require the payment of a royalty at the time of manufacture.

Extracts from Prybloxx's annual report

Prybloxx Group		
Consolidated statement of profit or loss		
For the year ended 31 December		
	2019	2018
	V\$ million	V\$ million
Revenue	3,612	3,474
Cost of revenues	(1,011)	(997)
Gross profit	2,601	2,477
Administrative expenses	(433)	(425)
Selling and marketing expenses	(621)	(636)
Distribution expenses	(354)	(302)
Operating profit	1,193	1,114
Finance costs	(63)	(70)
Profit before tax	1,130	1,044
Tax	(260)	(252)
Profit for year	870	792

Prybloxx Group		
Consolidated statement of financial position		
As at 31 December		
	2019	2018
	V\$ million	V\$ million
Non-current assets		
Property, plant and equipment	1,163	1,126
Goodwill	897	897
Intangible assets	45	31
	2,105	2,054
Current assets		
Inventories	256	244
Trade receivables	672	658
Bank	109	97
	1,037	999
Total assets	3,142	3,053
Equity		
Share capital and share premium	1,000	1,000
Foreign currency reserve	(466)	(498)
Retained earnings	1,006	880
	1,540	1,382
Non-current liabilities		
Borrowings	900	1,000
Deferred tax	123	113
	1,023	1,113
Current liabilities		
Trade payables	318	307
Tax	261	251
	579	558
	3,142	3,053

Prybloxx Group				
Consolidated statement of changes in equity				
	Share capital and premium	Foreign currency reserve	Retained earnings	Total
	V\$ million	V\$ million	V\$ million	V\$ million
Balance at 31 December 2018	1,000	(498)	880	1,382
Exchange gains/(losses) for year		32		32
Profit for the year			870	870
Dividends			(744)	(744)
Balance at 31 December 2019	1,000	(466)	1,006	1,540

Extract from Kkonstro's annual report

Kkonstro is Prybloxx's closest rival. It manufactures plastic bricks that are compatible with the market leader's and with Prybloxx's. Kkonstro does not have quite as much brand appeal as Prybloxx and its products are often described as being of slightly inferior quality when they are reviewed.

Kkonstro competes directly with Prybloxx with its Kkonstruction Bricks and Kkonstruction Kits, but it also sells ranges that Prybloxx does not:

- Kkonstruction Baby bricks are much larger than traditional bricks, which means that they can be played with by young children under the age of three. The larger bricks are easier to handle for small hands and none of the bricks are small enough for a toddler to swallow.
- Kkonstruction Engineering sets include a range of parts that enable the construction of more complicated mechanical models. They include cogs, gears and drive belts that make it possible to drive moving parts with an electric motor.

Kkonstro Group		
Consolidated statement of profit or loss		
For the year ended 31 December		
	2019	2018
	V\$ million	V\$ million
Revenue	1,592	1,537
Cost of revenues	(459)	(470)
Gross profit	1,133	1,067
Administrative expenses	(207)	(208)
Selling and marketing expenses	(142)	(154)
Distribution expenses	(288)	(261)
Operating profit	496	444
Finance costs	(35)	(49)
Profit before tax	461	395
Tax	(106)	(103)
Profit for year	355	292

Ckonstro Group		
Consolidated statement of financial position		
As at 31 December		
	2019	2018
	V\$ million	V\$ million
Non-current assets		
Property, plant and equipment	554	593
Goodwill	427	427
Intangible assets	40	36
	1,021	1,056
Current assets		
Inventories	116	119
Trade receivables	286	346
Bank	52	40
	454	505
Total assets	1,475	1,561
Equity		
Share capital and share premium	400	400
Foreign currency reserve	(256)	(241)
Retained earnings	520	408
	664	567
Non-current liabilities		
Borrowings	500	700
Deferred tax	53	48
	553	748
Current liabilities		
Trade payables	156	140
Tax	102	106
	258	246
	1,475	1,561

Ckonstro Group				
Consolidated statement of changes in equity				
	Share capital and premium	Foreign currency reserve	Retained earnings	Total
	V\$ million	V\$ million	V\$ million	V\$ million
Balance at 31 December 2018	400	(241)	408	567
Exchange gains/(losses) for year		(15)		(15)
Profit for the year			355	355
Dividends			(243)	(243)
Balance at 31 December 2019	400	(256)	520	664

News reports

Happy Comic

Readers' questions

Question: I received several Prybloxx sets and kits for my birthday. Each one came in a cardboard box. Each box contained several plastic bags full of bricks. Why couldn't Prybloxx just put the bricks in the box itself? Also, isn't it bad for the environment to use lots of little bags instead of one big bag?

Josie, age 11



Answer: The Prybloxx factory makes millions of bricks every day. The bricks are stored in huge bins, with a different bin for each type of brick. Imagine a bin the size of a truck full of green 8x8 base plates. The factory has lots of tracks that carry plastic bags and follow different routes past different bins. Suppose the factory is making a batch of Cheery Tractor Kits today, the track that runs under the bin holding green 8x8 base plates will pause while the machinery counts the correct number of plates into each bag. Then the bag will be carried on, not stopping until it reaches a

different part needed for Cheery Tractor. Other tracks go under different bins and so the tractor's wheels and the parts for its grey canopy go into a different bag.

At the end of each track, the bags are sealed ready to be packed into their cardboard boxes, ready to go to the shops. It would be too complicated to put all of the parts for a kit in the same bag.

Prybloxx uses bags made out of corn starch that is friendly to the environment. It is biodegradable and does no harm when it decomposes.

Varanda Business Daily

Traditional toyshops struggle

Figures released by the Varandan Toy Retail Association (VTRA) show that only one of the country's ten largest toy retailers has a traditional chain of toyshops. Unsurprisingly, the top spot is occupied by Vretail, the major internet retailer that sells everything from pet food to household appliances.



A spokesperson for the VTRA commented that it was hardly surprising that toys sell well online. Children are generally influenced by advertising and by word of mouth endorsements by their friends. Parents find it easier and cheaper to place their orders online than to visit a shop.

The VTRA's figures also revealed that plastic brick construction kits remain the largest category of toys, measured by revenue.

Varanda Daily News

Check your toybox for valuables



Garden Town couple Roy and Betty Lee were celebrating a large windfall last night after they had auctioned a plastic model kit that had been lost in the back of a cupboard for 11 years. They had bought the kit, a Prybloxx Star Manatee, as a birthday gift for their grandson. It was a popular kit at the time and was difficult to obtain. Unfortunately, their son also managed to buy a copy of the same kit, which forced them to buy a last-minute replacement gift. Their spare Star Manatee

went to the back of a cupboard without ever being played with.

They remembered their purchase when an item on the popular television show *Antique Shock* covered the growing demand for rare plastic building kits amongst collectors. They took the kit to their local auction house for appraisal and it was subsequently sold at auction for V\$8,000.

A leading collector told the *Varanda Daily News* that it was unlikely that many toyboxes would yield anything of such value. In this case, the kit had been scarce, which increased its rarity value. Also, this particular kit was still in its box, which had never been opened, and the bricks were in perfect condition. A typical used Star Manatee, without its box and bearing traces of wear and tear, would normally sell for V\$100 at most.

The most sought-after model kit of all is the Prybloxx Newt King Castle. Very few of those kits were ever sold because the figure of the Newt King proved difficult to mould accurately and because of quality control problems. It is believed that an unopened boxed kit would fetch V\$100,000 at auction. Sadly, there is no way to tell whether such a copy even exists. The chances are that all of the kits that were sold have been played with, damaging the box and potentially losing key parts such as the Newt King figure and the banner that flew above the castle. They were, after all, sold as toys.

Varanda Business Daily

Engineers relive their childhoods

Laboratory technicians in engineering laboratories are placing increasing emphasis on their skills with construction toys when they update their CVs. Despite the growing versatility of advanced technologies such as 3D printers, the quickest and cheapest way to build a prototype often involves the same kits that can be found in children's toy cupboards.



There has always been a use for such toys in engineering design workshops. Plastic bricks can be clipped together in a wide variety of configurations. Working models are generally robust, but they can be glued together if greater strength is required.

Toy manufacturers have worked to sell their products to older children by making them more sophisticated and that has led to the launch of various ranges of engineering kits that include gears, pulleys and other mechanical devices. They can be integrated with one another by using bricks that are designed to place free-spinning axles wherever required. Engineers have discovered that those toys are ideally suited to prototyping their own designs.

Social media sites frequented by design engineers often discuss the relative merits of different model kits. The Ckonstro Giga Crane is generally regarded as offering the best value in terms of providing gears, versatile bricks and motors. The sets cost V\$150 each, but engineering companies often buy dozens of sets at a time in order to ensure that they do not run out of the parts that they need to test their designs.



Management Case Study Exam

Maximum Time Allowed: 3 Hours

Welcome, Candidate Name

If this is not your name, please let your administrator know.



Click **Next** to start the test.

This examination is structured as follows:

Section number	Time for section (minutes)	Number of tasks	Number of sub-task/s	% time to spend on each sub-task
1	45	1	2	(a) 60% (b) 40%
2	45	1	2	(a) 60% (b) 40%
3	45	1	3	(a) 33% (b) 34% (c) 33%
4	45	1	2	(a) 60% (b) 40%

Each section (task) has a number of sub-tasks. An indication of how much of the time available for the section that you should allocate to planning and writing your answer is shown against each sub-task in the text of the question (and summarised in the table above).

This information will be available for you to access during the examination by clicking on the Pre-seen button.

 Reference Material Pre-seen

Alex McDonald, Prybloxx's Senior Financial Manager, stops by your workspace and hands you a document.

"I have just come from a meeting of senior managers that was called to discuss a potential new product line, which is to be called My Prybloxx. I have printed an extract from the proposal document for you.

I have been asked to brief Indra Nooyi, Prybloxx's Finance Director. I need you to prepare the following to include in my briefing:

- Firstly, evaluate the impact that the new product range will have on Prybloxx's business model.
- Secondly, explain the issues we need to consider when determining the cost of each My Prybloxx Kit."

[sub-task (a) = 60%]

[sub-task (b) = 40%]

The proposal extract can be found by clicking on the Reference Material button above.

Proposal for “My Prybloxx” bespoke model kits**Executive summary****Prepared by Juan Pedro Irigoin, Marketing and Design**

Sales of Basic Prybloxx have been declining. It appears that children prefer Prybloxx Kits and Prybloxx Character Kits. Our investigations show that children love the intricacy and features of these advanced kits. However, they either do not have the ability or are not prepared to spend time to work out for themselves how to construct the advanced features. Instead, they prefer to follow instructions.

We have developed software that allows children to design their own kits. This will enable customers to design their own models online and purchase the necessary parts, which will be supplied in a customised box with assembly instructions.

For example, it would be possible for a customer to design a pick-up truck that has two pick-up arms on the back and two winches on the front. This would be a custom design by that particular user but using our existing inventory of bricks and parts.

The only customisation for us would be packing the bricks and instructions in a specially printed box.

This software, which would be accessed through our website, has been viewed as disruptive because the resulting product range (My Prybloxx Kit) would change how we do business.

The price of each My Prybloxx Kit could be determined by software that tracks the number and variety of bricks and components needed for each kit. These kits would only be available through our website and we would distribute them directly to customers.

Reference Material

Pre-seen

Write your response to Alex in the box below:

Rich text editor toolbar with icons for:

- Document, Cut, Copy, Paste, Undo, Redo, Bold, Italic, Underline, Strikethrough, Subscript, Superscript, Link, Paragraph, Table, Bulleted List, Numbered List, Indent Left, Indent Right.

Large text area for writing the response.

Reference Material

Pre-seen

Two weeks have passed. You have been asked to represent Finance at a meeting of managers:

Martin Weiss – Marketing and Design (<i>in Chair</i>)	The purpose of this meeting is to discuss some of the implementation issues arising from the decisions that the Board has made concerning the new My Prybloxx product and the “Fulfilment Centre” that it will require. I have provided each of you with a brief summary of those decisions.
Yudi Pranoto - Production	<p>We need to establish the new Fulfilment Centre and there are two approaches we could take. We could either acquire a logistics company as a going concern and adapt it by equipping it with any additional equipment that is required, or we could create a new company and buy the premises and equipment that it requires.</p> <p>How would our approach to establishing the Centre affect the financial statements of the My Prybloxx subsidiary and the consolidated financial statements of the Prybloxx Group?</p>
Martin Weiss (<i>turning to you</i>)	<p>Please answer Yudi’s question, stating the assumptions that you need to make.</p> <p>[sub task (a) = 60%]</p>
Kristan Tetens – Human Resources	We need to consider how to monitor the financial performance of the My Prybloxx subsidiary when it is operational. At this stage I would like to focus specifically on the new Fulfilment Centre.
Martin Weiss (<i>turning to you</i>)	<p>Another question for you. Please recommend, giving reasons, the type of responsibility centre you think would be most appropriate for monitoring the financial performance of the Fulfilment Centre when it is operational.</p> <p>[sub task (b) = 40%]</p>

The Summary of Board decisions can be found by clicking on the Reference Material button above.

Summary of Board decisions

Prybloxx will proceed with the launch of the My Prybloxx product, which will enable customers to design their own models online and purchase the necessary parts, which will be supplied in a customised box with customised assembly instructions.



Initially, the new product will be sold only in Varanda, but it may be extended to other markets if there is sufficient demand.

The product will be promoted primarily through Prybloxx's website. There will be a prominent link from the front page to the My Prybloxx site, which will also be the location for the software used to design and order models.










Prybloxx will require a separate "Fulfilment Centre" for this product, to pick and package parts, to print boxes and instructions and to prepare the resulting packages for despatch.










Prybloxx's existing factory will continue to be the sole location for manufacturing bricks and other parts. The My Prybloxx Fulfilment Centre will hold inventories of parts and those will be replenished regularly by the factory.

A new 100% subsidiary company will either be acquired or created in order to own and operate the Fulfilment Centre.

 Reference Material Pre-seen

Write your response to Martin's requests in the box below:

       **B** *I* U  x_2 x^2 

Paragraph         

Reference Material

Pre-seen

A further month has passed. You receive the following email:

To: Financial Manager
From: Alex McDonald, Senior Financial Manager
Subject: Pricing My Prybloxx

Hi

I have attached a briefing prepared by our Marketing and Design Director that explains our approach to pricing our existing product ranges.

We have decided that My Prybloxx will be established as a profit centre. Its management team will be held accountable for revenues and operating costs associated with My Prybloxx. My Prybloxx will obtain all bricks and other components from Prybloxx's Production Department, which is a cost centre.

I have decided that transfers made from the Production Department to My Prybloxx are made at marginal cost rather than full production cost.

I need you to draft a paper for me that covers the following:

- Firstly, evaluate the possibility that transferring parts from the Production Department to My Prybloxx at marginal cost would prevent suboptimal behaviour.

[sub-task (a) = 33%]

- Secondly, explain how the choice of retail pricing strategy will affect the key accounting ratios based on the Prybloxx Group's consolidated financial statements.

[sub-task (b) = 34%]

- Thirdly, recommend a retail pricing strategy for My Prybloxx, with a justification that takes account of the nature of the product. Remember that the My Prybloxx software will restrict the selection of parts to generic items, including "added value" parts such as motors and lights.

[sub-task (c) = 33%]

Alex

The Briefing Summary prepared by Mary Chilima can be found by clicking on the Reference Material button above.

Retail pricing issues arising from existing product ranges

Executive summary of the briefing



prepared by Mary Chilima, Marketing and Design Director

Clearly, we price our products so that our costs are recovered, but the pricing requires a more sophisticated understanding of our customers' interests if we are to maximise profit.

For example, Basic Builder is the smallest of our Basic Prybloxx sets. It contains 153 parts and retails for V\$44.99. The Master Builder set has twice as many parts, but it retails for V\$71.00, which is only 60% more. We wish to demonstrate that larger sets offer customers better value for money.

Some prices are based on perceived added value rather than the cost to Prybloxx. For example, the Motor Builder set contains the same number of moulded parts as Basic Builder, but it also includes an electric motor. The Motor Builder set costs an additional V\$2.74 to manufacture, but it retails for an additional V\$15.00 because the motor offers much greater play value. Prybloxx also has limited capacity to produce those "added value" parts, especially motors and lights.

Prybloxx Kits generally retail for roughly 90% more than a Basic Prybloxx set containing the same number of parts and features. That is mainly due to the greater perceived play value of the kits. Kits generally include a few special parts, which cost a little more than generic parts to make because of low production volumes, but those parts rarely add more than V\$1.50 to the total cost.

 Reference Material Pre-seen



Write your response to Alex's requests in the box below:

To: Alex McDonald, Senior Financial Manager

From: Financial Manager

Subject: Re: Pricing My Prybloxx



 Reference Material Pre-seen

A month later, Alex McDonald invites you into his office:

"I need your help in the planning of the project to deliver the My Prybloxx Fulfilment Centre.

I have an extract of the project plan for you.

As you know, we have four executive directors in addition to the CEO: Finance, Production, Marketing and Design and Human Resources. Each has nominated a manager to serve on the project. All four directors are arguing that it is their manager who should be designated as a project manager.

I need you to draft a briefing that I can submit to the Board that covers two matters:

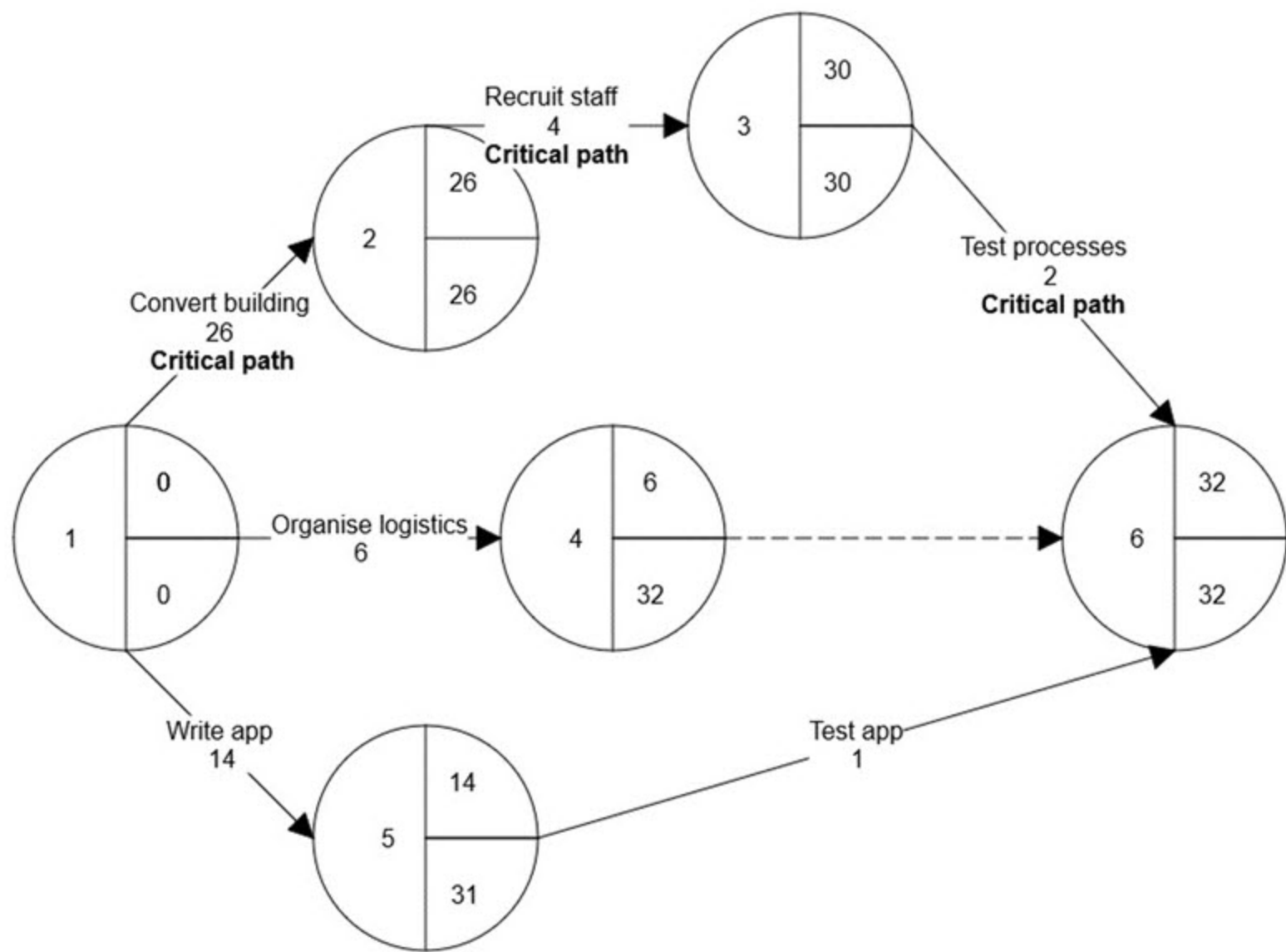
- Firstly, discuss the problems that will arise if the directors do not reach an agreement on the management of this project and recommend, with reasons, the director whose manager should be the designated project leader.

[sub-task (a) = 60%]

- Secondly, identify the key operational risks that could arise after the launch and recommend the manner in which the project team should manage them during the implementation."

[sub-task (b) = 40%]

The project plan extract can be found by clicking on the Reference Material button above.



Notes:

The building that will house the My Prybloxx Fulfilment Centre has been acquired, but it requires some conversion work before it will be ready for operation. The equipment will be installed during the conversion process.

Staff will have to be recruited and trained to operate the system.

The system will have to be tested to ensure that the picking equipment is operating correctly and that staff understand the procedures for operations and maintenance.















Contracts will have to be negotiated for the logistical issues associated with supplying the Fulfilment Centre with parts and with the prompt delivery of kits to customers.











Prybloxx's IT staff, who report to the Finance Director, will have to develop the app and test it before the product can be launched.

Reference Material

Pre-seen

Write your response as requested by Alex in the box below:



Paragraph 



Thank you for completing the Management Case Study Exam.

Before you leave, don't forget to collect your printed confirmation of attendance.

Please click the End Exam (E) button before leaving the testing room quietly.



Management Case Study Exam

Maximum Time Allowed: 3 Hours

Welcome, Candidate Name

If this is not your name, please let your administrator know.



Click **Next** to start the test.

This examination is structured as follows:

Section number	Time for section (minutes)	Number of tasks	Number of sub-task/s	% time to spend on each sub-task
1	45	1	2	(a) 60% (b) 40%
2	45	1	2	(a) 60% (b) 40%
3	45	1	2	(a) 40% (b) 60%
4	45	1	3	(a) 33% (b) 33% (c) 34%

Each section (task) has a number of sub-tasks. An indication of how much of the time available for the section that you should allocate to planning and writing your answer is shown against each sub-task in the text of the question (and summarised in the table above).

This information will be available for you to access during the examination by clicking on the Pre-seen button.

 Reference Material Pre-seen

Alex McDonald, Prybloxx's Senior Financial Manager, stops by your workspace and hands you an extract from Ckonstro's segmental report.

"Prybloxx's Board is considering developing a new brand of engineering sets that will sell under the Prybloxx Gear brand. This will compete with Ckonstro's Ckonstruction Engineering range.

Indra Nooyi, our Finance Director, has asked me to prepare a briefing for further discussion and I need you to draft the following sections:

- Firstly, identify and evaluate the challenges associated with predicting costs and revenues for this new range.

[sub-task (a) = 60%]

- Secondly, evaluate the usefulness of Ckonstro's segmental report as a basis for addressing those challenges."

[sub-task (b) = 40%]

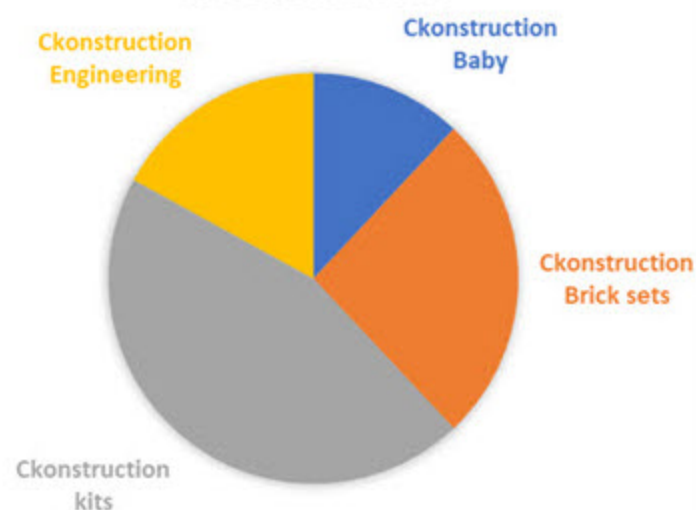
The extract referred to by Alex can be found by clicking on the Reference Material button above.

Extract from Ckonstro annual report - Segmental analysis of performance

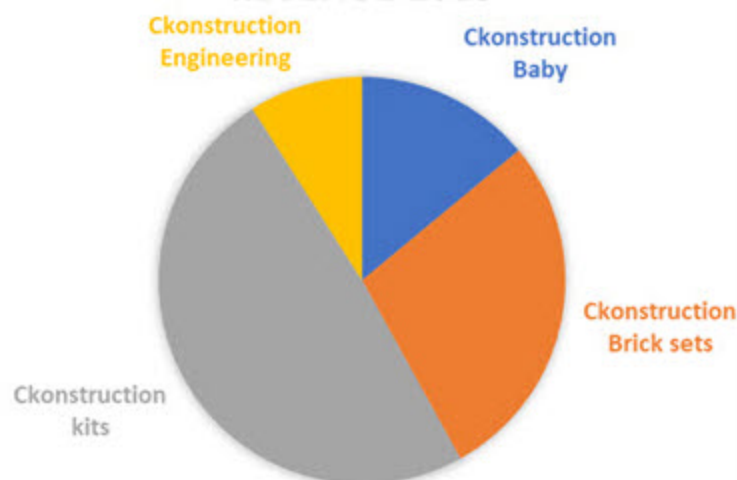
	Year ended 31 December	
	2019	2018
	V\$ millions	V\$ millions
Revenue		
Ckonstruction Baby	191	215
Ckonstruction Brick sets	414	430
Ckonstruction Kits	716	753
Ckonstruction Engineering	271	139
	<u>1,592</u>	<u>1,537</u>

Operating profit		
Ckonstruction Baby	74	71
Ckonstruction Brick sets	154	147
Ckonstruction Kits	208	209
Ckonstruction Engineering	60	17
	<u>496</u>	<u>444</u>

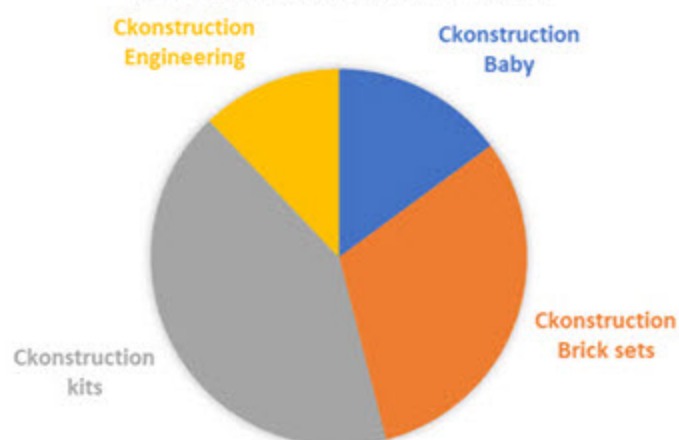
REVENUE 2019



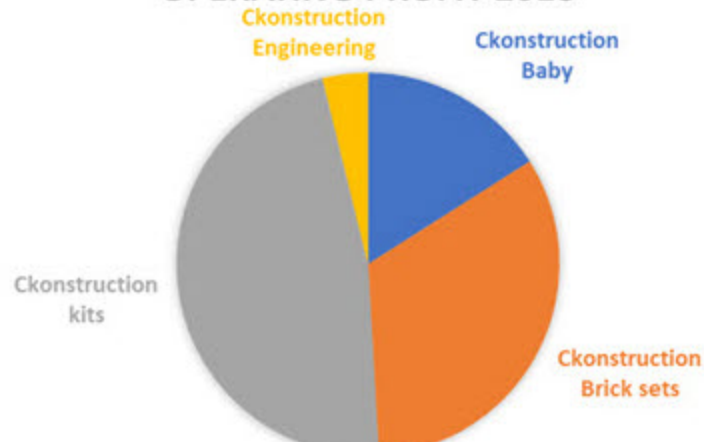
REVENUE 2018





OPERATING PROFIT 2019

















OPERATING PROFIT 2018























 Reference Material Pre-seen



Provide your response to Alex's requests in the box below:



Paragraph ▾

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 Reference Material Pre-seen

A month has passed. Prybloxx's Board has decided to proceed with the development of the Prybloxx Gear range of kits. You receive the following email:

To: Financial Manager

From: Alex McDonald, Senior Financial Manager

Subject: Prybloxx Gear brand

I have attached a copy of a Board minute. I need two things from you:

- Recommend, with reasons, the ways in which we might improve the design team's engagement with the development of this range of products.

[sub-task (a) = 60%]

- Identify the challenges associated with setting a suitable transfer price for the time spent by Production Department staff assisting the Design Department and recommend, with reasons, how those challenges might be overcome.

[sub-task (b) = 40%]

Alex

Copy of the Board minute can be found by clicking on the Reference Material button above.

Extract from Board minutePrybloxx Gear

Mary Chilima, Marketing and Design Director, was invited to report on progress relating to the Prybloxx Gear brand of kits. She brought the following matters to the Board's attention:



- Designers selected from Prybloxx's Design Department to work on this project have proved reluctant to focus on the technical aspects of the designs. Most of the designers enjoy the artistic challenges of creating models that are attractive to look at and are fun to play with, but they are less interested in technical matters such as determining the optimal size of gear wheels and the number of teeth that the gears should have.

Ms Chilima believes that the members of the Design Department have the necessary technical expertise to address this sort of issue, but they lack the necessary interest to concentrate on the whole task.

- The Head of the Design Department has been struggling to obtain the necessary cooperation from the Head of Production. The Design Department requires the expertise of the Production Department to help identify and solve problems associated with manufacturing Prybloxx Gear. For example, injection moulding toothed gear wheels creates very different problems from making conventional wheels.
- The Head of Production has complained that the Design Department is making too many requests for assistance and he has told his staff to ignore any further questions relating to Prybloxx Gear until an acceptable transfer price for Production Department staff time can be put in place.

At present, the Production Department is only permitted to charge the Design Department for the salary costs associated with the time spent on providing advice. The Head of Production believes that the Design Department finds it cheap and convenient to pass all problems along to Production instead of dealing with simple matters internally. There are also concerns about the effectiveness of the Production Department caused by this distraction from their own work.

Gunther Krebs, Production Director, has suggested that the Design Department should engage an engineering consultancy firm to advise on the injection moulding issues associated with Prybloxx Gear.

 Reference Material Pre-seen

Provide respond to Alex's requests in the box below:

To: Alex McDonald, Senior Financial Manager

From: Financial Manager

Subject: Prybloxx Gear brand



Reference Material

Pre-seen

A month has passed. Prybloxx's Board has resolved the problems that threatened to delay the design of the new Prybloxx Gear brand.

You receive the following email:

To: Financial Manager
From: Alex McDonald, Senior Financial Manager
Subject: Prybloxx Gear brand

Hi

I have forwarded an email that I received from Indra Nooyi.

Indra requires a response from me. I need your help with the following:

- Firstly, please identify and evaluate the factors associated with debt and equity that are relevant to Prybloxx's decision concerning the financing of the new moulds and moulding equipment and the inventory. Your evaluation should take Prybloxx's current financial position into account.

[sub-task (a) = 40%]

- Secondly, identify the impact that the new range will have on our integrated reporting capitals: Financial, Manufactured, Intellectual, Human, Social and Relationship, and Natural.

[sub-task (b) = 60%]

Alex

The email referred to by Alex can be found by clicking on the Reference Material button above.

To: Alex McDonald, Senior Financial Manager

From: Indra Nooyi, Finance Director

Fwd: Prybloxx Gear brand



Hi Alex

The initial design work on the Prybloxx Gear brand has been completed. It is clear that we will need to invest in some new moulds and additional injection moulding equipment to cope with the increased capacity that we will require. The new equipment will also give us the ability to mould the harder plastics that are used to make this range of products.

Gunther Krebs, our Production Director, estimates that the new moulds and equipment will require an investment of V\$300 million. We will also require a further V\$50 million for the additional inventory of Gear parts and kits awaiting sale.

You should also be aware that the Board has decided to adopt integrated reporting in our next annual report. As you know, that will require some consideration of six capitals: Financial, Manufactured, Intellectual, Human, Social and Relationship, and Natural.

Indra

 Reference Material Pre-seen

Draft the response to Alex's email in the box below:

To: Alex McDonald, Senior Financial Manager

From: Financial Manager

Subject: Re: Prybloxx Gear brand



A large, empty text area for drafting the response to Alex's email.

Reference Material

Pre-seen

Two weeks later, Alex McDonald stops by your workspace. He places a document on your desk.

"Our Design Department has overcome its initial problems with regard to Prybloxx Gear. We still have to make some important decisions about this product range. At the moment, the designers are working on preliminary matters such as the size of basic components, including gear wheels and electric motors, that will be used across the entire range. Once they are finished, they will start to develop individual kits.

I have brought you a review that was published six months ago when Ckonstro, our closest rivals, launched their new Giga Crane kit. It remains their largest and most expensive kit. It still retails at V\$150 and seems to be selling well. We understand that many of the kits have been sold to colleges and to engineering companies for use in training and in building prototypes.

I have to brief Indra Nooyi on several issues before the next Board meeting. I need you to draft a paper for me that covers the following:

- Firstly, our Board has still not made a final decision on whether to emphasise consumers, colleges or corporate customers in developing the Prybloxx Gear range. I need you to explain how that decision will affect the management of the project to design and launch the range.

[sub-task (a) = 33%]

- Secondly, recommend, with reasons, the approach that we should take to setting recommended retail prices for Prybloxx Gear.

[sub-task (b) = 33%]

- Thirdly, identify the key product and product reputation risks associated with developing this range, justifying your selection."

[sub-task (c) = 34%]

The review referred to by Alex can be found by clicking on the Reference Material button above.

Gadgets and Things

Open the Box

This month's column looks at the Ckonstro Giga Crane





Ckonstro's latest model is the Giga Crane, which has been launched as part of their Ckonstruction Engineering range. It is the most expensive kit that Ckonstro produces, selling at a retail price of V\$150, but you do get a lot of interesting parts for your money.










The kit includes three electric motors and a Bluetooth circuit board that enables the finished model to be controlled by a smartphone app. One interesting new item is the pair of hydraulic arms used to extend the reach of the crane. This is the first time that we have











seen such a component and it will prove attractive to the hobbyists who wish to design their own models.

The kit also includes plenty of the cogs and gears and engineering bricks that we have come to expect from this manufacturer. The build quality was slightly better than we have come to expect from Ckonstro. Overall, this is a good buy.

 Reference Material Pre-seen

Provide your reply to Alex in the box below:

       **B** *I* U  x_2 x^2 

Paragraph          



Thank you for completing the Management Case Study Exam.

Before you leave, don't forget to collect your printed confirmation of attendance.

Please click the End Exam (E) button before leaving the testing room quietly.



Management Case Study Exam

Maximum Time Allowed: 3 Hours

Welcome, Candidate Name

If this is not your name, please let your administrator know.



Click **Next** to start the test.

This examination is structured as follows:

Section number	Time for section (minutes)	Number of tasks	Number of sub-task/s	% time to spend on each sub-task
1	45	1	2	(a) 60% (b) 40%
2	45	1	2	(a) 50% (b) 50%
3	45	1	2	(a) 60% (b) 40%
4	45	1	2	(a) 60% (b) 40%

Each section (task) has a number of sub-tasks. An indication of how much of the time available for the section that you should allocate to planning and writing your answer is shown against each sub-task in the text of the question (and summarised in the table above).

This information will be available for you to access during the examination by clicking on the Pre-seen button.

 Reference Material Pre-seen

Alex McDonald, Prybloxx's Senior Financial Manager, stops by your workspace and hands you a document.

"The Board has made a strategic decision to introduce some new and more exciting sets and kits into Prybloxx's existing ranges. The proposal that I have brought you is one possibility that is being considered as part of the implementation of that decision.

I am preparing to brief Indra Nooyi, Prybloxx's Finance Director, and I need you to draft a paper that covers both of the following:

- Firstly, discuss the suggestion that adding Toyz's electronic components will be consistent with Prybloxx's business model.

[sub task (a) = 60%]

- Secondly, identify and evaluate the significance of the challenges associated with negotiating the potential acquisition of Toyz with the company's present owners."

[sub task (b) = 40%]

The document referred to by Alex can be found by clicking on the Reference Material button above.



**Potential acquisition – executive summary****Prepared by Mary Chilima, Marketing and Design Director**

Prybloxx offers a very limited range of electrical and electronic components in its various kits and sets. Some kits include battery-powered electric motors that have no controls other than the on/off switch. Our most advanced components are flashing lights that are operated by very simple electronics.










I have held some initial discussions with the owners of Bluetooth Toyz ("Toyz"), a company that manufactures plastic toys that are equipped with battery-powered motors, lights, speakers and even cameras. Their toys are all fitted with electronic boards that enable the user to control the toys using Bluetooth connections. Users download an app to their tablets or smartphones from Toyz's website and then pair their phones to their toys.










I have spoken with Toyz's design engineers and they are confident that it would be possible to redesign the company's electronic components so that they could be incorporated into Prybloxx model kits. That would make it possible to sell kits that can be constructed as, say, a remote-controlled police car with full steering, flashing lights and a siren.



Toyz's owners are prepared to sell their company, subject to the satisfactory negotiation of terms and conditions.

 Reference Material Pre-seen

Provide your response to Alex's request in the box below:

       **B** *I* U  x_2 x^2 

Paragraph         

 Reference Material Pre-seen

A month later, Prybloxx has decided to proceed with the acquisition of Toyz. You receive the following email:

To: Financial Manager
From: Alex McDonald, Senior Financial Manager
Subject: Acquisition of Toyz

I have attached a schedule listing some of Toyz's assets. I need two things from you:

- Explain the problems associated with determining the value of Toyz's property, patents and trademarks and inventory for the purpose of valuing goodwill on the acquisition.
[sub-task (a) = 50%]
- Identify the problems associated with applying IAS 38 Intangible Assets to Toyz's post-acquisition expenditure on the adaptation of its electronics to make them compatible with Prybloxx's bricks and recommend appropriate responses to those problems.
[sub-task (b) = 50%]

Alex

The schedule referred to by Alex can be found by clicking on the Reference Material button above.



Toyz – non-current assets

The following assets have been identified as requiring some consideration as part of the calculation of goodwill on acquisition of Toyz by Prybloxx.

It should be noted that Toyz will cease production of its existing product range after the takeover and will assemble electronic and electrical components for sole use in Prybloxx sets and kits.

Property	Toyz operates from a single location that comprises a factory and an office building on the outskirts of Central City. The property was purchased 18 years ago and is valued at cost less accumulated depreciation.
Patents and trademarks	Toyz owns several patents and trademarks, all of which were internally generated. Once the takeover is completed, these will be reviewed to determine whether they are of value to the Prybloxx Group.
Inventory	Toyz will hold inventory costing V\$22 million at the date of acquisition. Under normal circumstances, that inventory would be sold for V\$40 million, but it is likely to realise only V\$30 million when these lines go out of production.

After the acquisition, Toyz's design staff will work closely with their counterparts at Prybloxx in order to adapt their designs to make them compatible with Prybloxx parts. This is expected to prove complicated and there may be some unsuccessful attempts to finalise designs. Toyz's existing components are designed to be secured permanently to the inside of models. Prybloxx, on the other hand, requires parts that will be temporarily clipped into place.

 Reference Material Pre-seen



Provide your response to Alex's request in the box below:

To: Alex McDonald, Senior Financial Manager

From: Financial Manager

Subject: Re: Acquisition of Toyz



 Reference Material Pre-seen

A month has passed. Prybloxx has completed its acquisition of Toyz.

Alex McDonald asks you into his office. He hands you a document.

"Our Design Department prepared this document as a first step in developing new products that incorporate the electronic components produced by Toyz. They purchased an electronic kit manufactured by Ckonstro, our closest rival, and estimated the cost of creating a similar kit from parts made by Prybloxx and Toyz.

As you can see, it would cost too much to manufacture similar kits to Ckonstro's if we are to match our rival's retail price and maintain our margins.

I need you to draft a paper on the following matters so that I can be prepared to brief Indra Nooyi:

- Firstly, evaluate the potential usefulness of target costing in developing these new products.

[sub-task (a) = 60%]

- Secondly, discuss the problems that we will face in choosing a pricing approach to setting a recommended retail price for these electronically enhanced sets and kits and recommend, with reasons, the approach that we should adopt."

[sub-task (b) = 40%]

The document referred to by Alex can be found by clicking on the Reference Material button above.

Analysis of Ckonstro Speedlord Supercar kit

Prybloxx's Design Department purchased a copy of a competitor's kit, which retails for V\$199. The parts used have been analysed as follows:

Item	Description	Unit cost (V\$)	Total cost (V\$)
Electrical components	Motors (one each for propulsion and steering)	2.74	5.48
	Working headlights	0.78	1.56
	Working taillights	0.68	1.36
	Working brake lights that illuminate when the car slows down	0.85	1.70
	Battery box	0.97	0.97
Electronic components	Circuit board with integrated Bluetooth	2.67	2.67
	Speaker with software to emulate engine and braking noises	1.08	1.08
Wheels	4x special wheels, with separate rubber tyres, modelled on those fitted to the real car	0.68	2.72
	<i>Possible alternative</i> Generic performance car wheels from inventory with rubber tyres	0.34	
Specialised bricks	18 shaped bricks to create a realistic car body	0.46	8.28
	Moulded rear spoiler to match real car	0.23	0.23
Basic bricks	314 bricks	0.09	28.26
Packaging	High quality box in heavy duty cardboard	7.84	7.84
	<i>Possible alternative</i> Box in standard cardboard	4.24	
Total (ignoring alternatives)			62.15

In order to match our competitor's retail price, Prybloxx would have to sell it to retailers at a trade price of V\$180. That would require the manufacturing costs to be reduced to V\$48.64 in order to ensure that all non-manufacturing costs are covered.

Reference Material

Pre-seen

Draft the response to Alex's requests in the box below:

Rich text editor toolbar with icons for:

- Insert new document
- Cut
- Copy
- Paste
- Undo
- Redo
- Table
- Text formatting: Bold (B), Italic (I), Underline (U), Strikethrough (ABC)
- Equation: x_2 , x^2 , I_x
- Paragraph style dropdown (Paragraph)
- Table grid icon
- Text alignment: Left, Center, Right, Justify
- Bulleted list
- Numbered list
- Decrease indent
- Increase indent

Large empty text area for drafting the response.

Reference Material

Pre-seen

A week later, you receive the following email:

To: Financial Manager
From: Alex McDonald, Senior Financial Manager
Subject: Business risks

Hi

I have attached a Board minute.

Two alternative approaches have been suggested for the launch of Prybloxx's remote-control feature:

- The first kit will be released for sale as soon as it is ready, which is expected to be three months from now. Promotional activities would be restricted to a press release, accompanied by details on Prybloxx's online catalogue. Or
- A full range of remote-control kits will be released for sale in seven months' time. Prybloxx would invest heavily in promoting this new remote-control feature.

I need you to draft a briefing paper that covers the following:

- Firstly, discuss the challenges of evaluating the respective product reputation and operating risks associated with choosing between the two launch approaches described above. Recommend, with justification, responses to those challenges. **[sub-task (a) = 60%]**
- Secondly, explain the implications for Prybloxx of the possibility that the remote-control feature could become "disruptive technology".

[sub-task (b) = 40%]

Alex

The Board minute referred to by Alex can be found by clicking on the Reference Material button above.



**Extract from Board minute**

Mary Chilima, Marketing and Design Director, briefed the Board on progress towards launching remote-controlled products using the technology obtained from the acquisition of Toyz. The modifications to Toyz's circuit board with integrated Bluetooth receiver have been completed. The circuit board will be sealed inside a Prybloxx plastic brick that will add a remote-control function into almost any model that includes lights, motors or other electrical components. An app will make it possible to use a tablet or a smartphone as a controller.

Very little investment will be necessary in order to put the new circuit board into production. The unit price for manufacturing it in bulk will be less than V\$3.00.

Ms Chilima warned the Board that Prybloxx's competitors had already launched their own versions of this remote-control technology. Ckonstro started selling its version of the remote-control function several months ago and the leading brand is due to launch its version within the next few weeks. Prybloxx's first remote-control kit will be ready to ship in three months, with several more kits expected to be ready over the following four months after that.



 Reference Material Pre-seen

Provide your reply to Alex's email in the box below:

To: Alex McDonald, Senior Financial Manager

From: Financial Manager

Subject: Re: Business risks





Thank you for completing the Management Case Study Exam.

Before you leave, don't forget to collect your printed confirmation of attendance.

Please click the End Exam (E) button before leaving the testing room quietly.



Management Case Study Exam

Maximum Time Allowed: 3 Hours

Welcome, Candidate Name

If this is not your name, please let your administrator know.



Click **Next** to start the test.

This examination is structured as follows:

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2	45	1	2	(a) 50% (b) 50%
3	45	1	3	(a) 34% (b) 33% (c) 33%
4	45	1	3	(a) 34% (b) 33% (c) 33%

Each section (task) has a number of sub-tasks. An indication of how much of the time available for the section that you should allocate to planning and writing your answer is shown against each sub-task in the text of the question (and summarised in the table above).

This information will be available for you to access during the examination by clicking on the Pre-seen button.

 Reference Material Pre-seen

You receive the following email:

To: Financial Manager
From: Alex McDonald, Senior Financial Manager
Subject: Online retailers

Hi

I have attached a summary of a report that is causing significant concern. Our largest competitor appears to have influenced a major online retailer into giving its products more prominence when customers make generic searches using phrases such as "plastic bricks" or "construction toys".

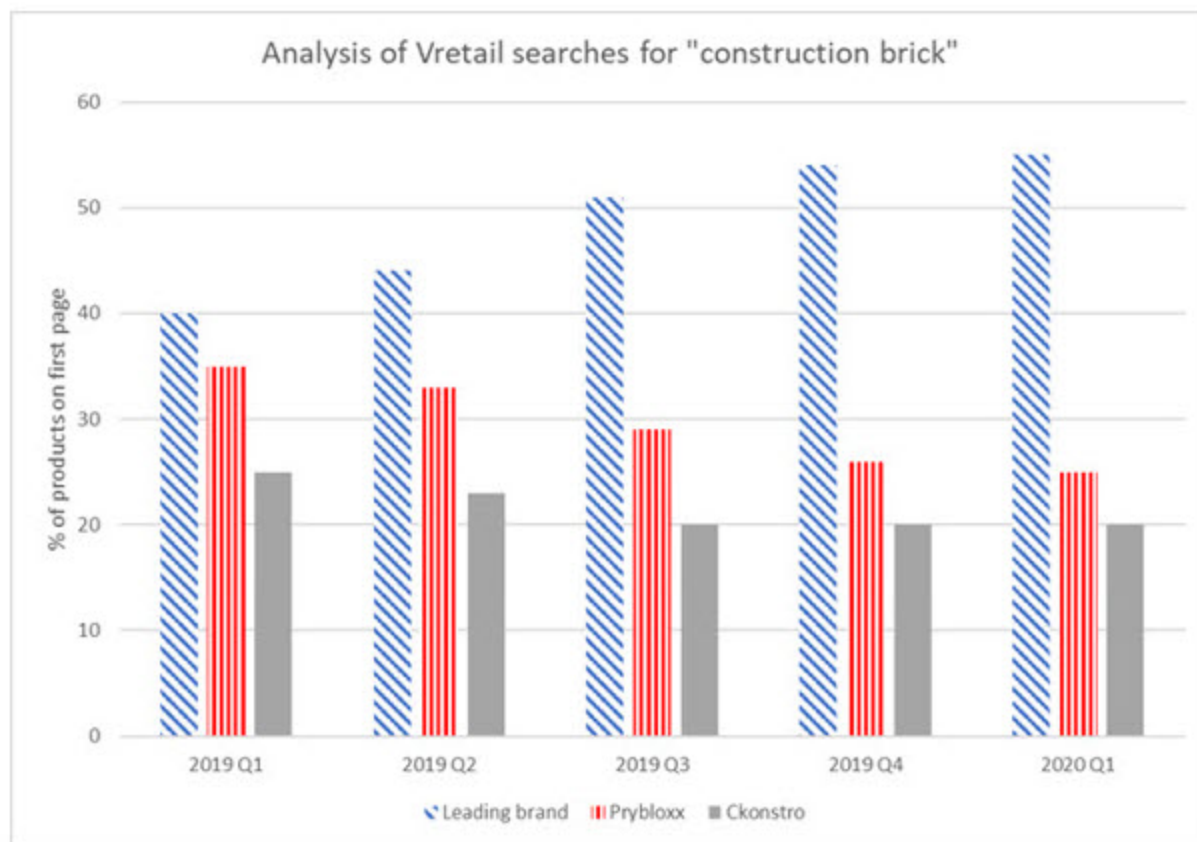
Needless to say, most of our Board is blaming Mary Chilima, the Marketing and Design Director, for our being outmanoeuvred in this way. She, in turn, is blaming the others for having lost sight of Prybloxx's value chain and has suggested that the senior management team should hold regular formal discussions to discuss it.

I need you to draft a report that covers the following:

- Firstly, discuss the implications of the report's findings for Prybloxx's business model.
[sub-task (a) = 50%]
- Secondly, evaluate Mary's suggestion that the report findings indicate that the senior management team should pay closer attention to Prybloxx's value chain.
[sub-task (b) = 50%]

Alex

The report summary referred to by Alex can be found by clicking on the Reference Material button above.





Comments

Vretail is the largest online retailer serving Varanda. It sells a wide range of goods online, including toys, and is the country's largest toy retailer. Vretail is also the largest buyer of Prybloxx products.










Prybloxx's Marketing and Design staff routinely input relevant searches into major online retailer's websites and record the distribution of results that occur on the first page of the results. Customers are more likely to order an item that appears on the first page unless they are searching for a very specific product.










It is clear that the leading brand's visibility on the first page of the results has been growing steadily over the past five quarters. In the first quarter of 2019, roughly 40% of the products listed on the first page were from the leading brand. By the first quarter of 2020 that share had increased to roughly 55%. Both Prybloxx and Ckonstro's share of the first page hits declined over the same period.



These results would have no impact on specific searches for, say, "Prybloxx", "Prybloxx Cheery Tractor" or "Ckonstro Giga Crane".

 Reference Material Pre-seen

Write your response to Alex's requests in the box below:

       **B** *I* U  x_2 x^2 

Paragraph ▾  ▾        

 Reference Material Pre-seen

A month has passed. Alex McDonald stops by your workspace and hands you a document:

"Mary Chilima, our Marketing and Design Director, has argued that Prybloxx needs to be more proactive with regard to our existing customers. That is best illustrated by Vretail, our largest customer, favouring a major competitor over us in the operation of its online search engine.

Mary has proposed the creation of an Account Management Department. This document explains the department's role. She has explained that her managers and staff are focused on developing advertising and promotion to increase consumer demand and on establishing relationships with new retail outlets. They are too busy to add account management to their existing workload and they do not necessarily have the skills.

Indra Nooyi, our Finance Director, has requested a briefing and I need you to draft the following sections:

- Firstly, recommend with reasons whether the new Account Management Department should be established as a cost centre, a revenue centre or a profit centre.

[sub-task (a) = 50%]

- Secondly, recommend the approach that the new department should take to negotiating with Vretail to improve the visibility of Prybloxx's products when customers search for generic items such as "building bricks" or "construction toys".

[sub-task (b) = 50%]

The document referred to by Alex can be found by clicking on the Reference Material button above.

Senior Account Manager job description

Prybloxx seeks an experienced senior account manager to take responsibility for managing ongoing relationships with existing customers.

The successful applicant will take charge of a new Account Management Department. This will be a newly established service department that will support Prybloxx's existing teams of Product Managers, who will continue to ensure that customers are satisfied with Prybloxx's product lines. The Account Management Department will be responsible for maintaining and enhancing Prybloxx's relationships with the retailers and wholesalers who buy our products.

Duties:















- Maximise sales to existing customers.
- Act as the designated point of contact for existing customers.
- Develop and maintain long-term relationships with customers.
- Ensure that customer orders are completed in a timely manner.
- Communicate customer needs and wishes to relevant decision-makers within Prybloxx, including Product Managers and relevant Board members.
- Identify opportunities to develop business with existing customers.
- Maintain detailed records of interactions with customers.
- Undertake specific tasks as required by the Senior Product Manager.












This is a new role for Prybloxx and the successful applicant will be expected to assist in the recruitment and development of Account Management staff.

Reference Material

Pre-seen

Draft your notes to Alex's requests in the box below:



Paragraph 

Reference Material

Pre-seen

Three months have passed. Prybloxx has established its Account Management Department.

Alex McDonald asks you to join him in his office:

"Our Account Management Department has just negotiated a contract with Vretail, our largest customer. I have printed a copy of the contract terms for you.

This is a major contract for Prybloxx. We usually make annual sales of V\$350 million to Vretail.

Prybloxx has purchased the rights to use the intellectual property associated with the Newton Sound cartoon characters with Kidmation, the owner of those rights.

Kits 1–3 will be manufactured and sold to Vretail during the year ended 31 December 2021. Kits 4–6 will be manufactured and sold to Vretail during the year ended 31 December 2022. Prybloxx's Board wishes to recognise the V\$300 million revenue and V\$200 million profit from all six kits during the year ended 31 December 2021.

Prybloxx's Board also wishes to recognise all of the contracted minimum sales of other products totalling V\$1,000 million, with profit totalling approximately V\$700 million, when the contract is signed in 2021.

I need you to draft a briefing that covers the following:

- Firstly, advise the Board, stating reasons, on the correct recognition of the revenues and profits from the contract with Vretail.
[sub-task (a) = 34%]
- Secondly, explain how the contract with Vretail will affect Prybloxx's weighted average cost of capital (WACC) at the date of announcement and throughout the contract's duration.
[sub-task (b) = 33%]
- Thirdly, this contract will require Prybloxx to invest V\$250 million in inventory. Recommend, with reasons, how that investment should be funded."
[sub-task (c) = 33%]

The copy of contract terms referred to by Alex can be found by clicking on the Reference Material button above.



Maurice Challa,
Head of Toys,
Vretail.

Dear Maurice

Memorandum of understanding – Vretail exclusive lines

I am pleased to confirm the matters that we discussed during our recent meeting:



- Prybloxx will develop an exclusive range of construction kits that will be available only through the Vretail website. That range will be based on Kidmation's popular Newton Sound cartoon characters.
- Prybloxx will have kits 1–3 ready to ship within 6 months. Kits 4–6 will be ready to ship in 12 months. The development of further kits will be discussed after the launch of kits 4–6.
- Vretail agrees to purchase V\$50 million of each kit. Deliveries will be scheduled in accordance with Vretail's instructions, but all deliveries must be completed within 4 months of each kit's initial availability.
- Prybloxx will invoice Vretail V\$50 million on the date of each kit's initial availability, but Vretail will make payment on the basis of delivered kits, with payment falling due 30 days after each delivery.
- Vretail will order at least V\$500 million of Prybloxx's other products during each of the years ended 31 December 2021 and 2022.

I will have our lawyers draft a formal contract on the basis of the above terms.










Yours sincerely










Giovanni Di Nicola

Account Management Executive.

 Reference Material Pre-seen

Draft your briefing notes for Alex in the box below:

       **B** *I* U  x_2 x^2 

Paragraph ▾  ▾        

Reference Material

Pre-seen

Two months have passed. You receive the following email:

From: Alex McDonald, Senior Financial Manager

To: Financial Manager

Subject: Vretail contract

Hi

I have forwarded an extract from a Board minute relating to the Vretail contract. Our contract with Vretail requires us to deliver the first three kits within 8 weeks from today. Kidmation will be entitled to cancel our licence if we do not commence production of Newton Sound kits within 12 weeks from today.

I need you to draft a paper for me that covers the following:

- Firstly, evaluate the argument that Prybloxx's Board was reckless in signing the contract with Kidmation, given the terms referred to by Indra Nooyi.

[sub-task (a) = 34%]

- Secondly, discuss the operating risks for Prybloxx of disappointing Vretail by permitting the contract to lapse.

[sub-task (b) = 33%]

- Thirdly, recommend an approach that could be taken to resolve the conflict between Kidmation and Vretail over their different wishes for the style of Newton Sound kits.

[sub-task (c) = 33%]

Alex

The Board minutes can be found by clicking on the Reference Material button above.



**Extract from Board minutes****Vretail contract for kits based on Kidmation's Newton Sound cartoon show**

Mary Chilima, Marketing and Design Director, reported on the progress of the Vretail contract. Her designers are currently working to design six model kits, based on the Newton Sound cartoon programme. Unfortunately, the model's kits must be approved by both Kidmation (who is licensing the image rights to Prybloxx) and Vretail (who will be buying the kits). So far, the design team has submitted 15 designs, of which only two have been accepted by both companies.

Kidmation wishes Prybloxx's range of Newton Sound kits to focus on the humorous aspects of the cartoon show, while Vretail wishes a greater emphasis on the show's action elements. The two kits that have been approved so far have combined elements of both, but the designers have struggled to repeat that in other designs.

Gunther Krebs, Prybloxx's Production Director, reminded the Board that any specialised parts required for these kits would have to be designed and manufactured, the artwork for the packaging would have to be designed and printed and the kits themselves packed and prepared for delivery.

Indra Nooyi, Prybloxx's Finance Director, reminded the Board that Prybloxx had made a substantial payment to Kidmation for the right to use Newton Sound images. Prybloxx is not entitled to a refund in the event of any breach of contract on our part, including a delay in bringing the product to market.

 Reference Material Pre-seen

Write your responses as requested by Alex in the box below:

From: Financial Manager

To: Alex McDonald, Senior Financial Manager

Subject: Re: Vretail contract



A large, empty rectangular text area for writing the response.



Thank you for completing the Management Case Study Exam.

Before you leave, don't forget to collect your printed confirmation of attendance.

Please click the End Exam (E) button before leaving the testing room quietly.



Management Case Study Exam

Maximum Time Allowed: 3 Hours

Welcome, Candidate Name

If this is not your name, please let your administrator know.

Click **Next** to start the test.

This examination is structured as follows:

Section number	Time for section (minutes)	Number of tasks	Number of sub-task/s	% time to spend on each sub-task
1	45	1	3	(a) 33% (b) 33% (c) 34%
2	45	1	2	(a) 50% (b) 50%
3	45	1	3	(a) 34% (b) 33% (c) 33%
4	45	1	2	(a) 60% (b) 40%

Each section (task) has a number of sub-tasks. An indication of how much of the time available for the section that you should allocate to planning and writing your answer is shown against each sub-task in the text of the question (and summarised in the table above).

This information will be available for you to access during the examination by clicking on the Pre-seen button

Reference Material

Pre-seen

You receive the following email:

From: Alex McDonald, Senior Financial Manager
To: Financial Manager
Subject: Product recall

Hi

I have attached a product recall notice that Prybloxx issued this morning relating to its Purple Plater Kit. It has been posted prominently on our website, published in major newspapers and circulated to retailers.

We issued the recall because of complaints from three consumers, one of whom required medical attention after standing on a sliver of plastic from a shattered brick.

Prybloxx manufactured 800,000 copies of this kit in 2018. We ceased production after using all of the purple bricks that were a feature of the kit. We have analysed the bricks returned by the consumers who raised the complaints and have discovered that the purple pigment used to make the bricks makes the plastic become brittle after approximately 2 years.

All of our inventory of this model has been sold. We have no way to tell whether any retailers still have this model in stock. The kit's retail value was V\$20.00. We expect that we will be unable to resolve this matter until the next financial year.

I am writing a report for the Board and I require you to draft a paper for me that covers the following:

- Firstly, advise the Board, stating your assumptions, on whether we should make provisions in our financial statements in respect of the hazards associated with splinters from bricks and in respect of the cost of reimbursing customers.
[sub-task (a) = 33%]
- Secondly, advise the Board on the likely impact that this recall will have on Prybloxx's weighted average cost of capital (WACC).
[sub-task (b) = 33%]
- Thirdly, evaluate the concern expressed by some Board members that the manufacture and subsequent recall of the purple bricks is evidence of quality failures within Prybloxx.
[sub-task (c) = 34%]

Alex



The product recall notice can be found by clicking on the Reference Material button above.

Product recall notice – Prybloxx Purple Plater










It has come to our notice that the purple bricks contained in the Prybloxx Purple Plater construction kit are liable to become brittle and to shatter into sharp fragments if they are dropped onto a hard surface. This notice applies only to the purple bricks that were contained in the kit, which was shipped during 2018.











If you have a Purple Plater kit in your possession, then you should remove the purple bricks immediately and store them securely out of the reach of children. You should then use the link on the Prybloxx customer service page to request a prepaid envelope that will enable you to return the bricks to Prybloxx for safe disposal. You will receive a full refund of the kit's recommended retail price.





 Reference Material Pre-seen

Write your response to Alex in the box below:

       **B** *I* U  x_2 x^2 

Paragraph          

 Reference Material Pre-seen

A week has passed. Alex McDonald stops by your workspace and hands you a document:

"I have brought you an extract from the minutes of a Board meeting that was held this morning. Indra Nooyi, our Finance Director, has asked me to prepare a briefing and I need you to write a paper that covers two matters:

- Firstly, advise the Board on the factors that need to be considered to ensure that the project team has suitable terms of reference.

[sub-task (a) = 50%]

- Secondly, recommend, with reasons, four performance measures that could be used to monitor the progress of the project team."

[sub-task (b) = 50%]

The extract referred to by Alex can be found by clicking on the Reference Material button above.

Extract from Board Minutes**Product recall**

The Board discussed the recently issued product recall. It was noted that Prybloxx has never found it necessary to recall a product in the past.















After considerable discussion, it was agreed that the implementation of the product recall should be managed by a project team drawn from across the management team.

Further discussion followed, but no decisions were made. Norma Chan, CEO, expressed disappointment that the other directors appeared to be more concerned with protecting their individual areas of interest than in resolving the crisis. It was agreed that a further meeting would be held within 48 hours.

Reference Material











Pre-seen

Write your response to Alex's requests in the box below:



Paragraph ▾

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Reference Material

Pre-seen

A further two months have passed. You receive the following email:

From: Alex McDonald, Senior Financial Manager

To: Financial Manager

Subject: Coloured bricks

Hi

I have attached a report that the Board has circulated to senior management.

As you can see, our Research and Development Team believes that it can offer a new process for producing bricks in very specific colours. Such a process would be extremely helpful in developing bricks to match specific items for Prybloxx Character Kits. For example, a character's house could be made from bricks that are an unusual shade of blue. Apart from helping us to expand our range of kits, the bricks produced by this process will not deteriorate over time and so will prevent a recurrence of our recent product recall.

The Board has asked me to recommend whether it is worth incurring the additional costs that are required to complete testing and to put the process into operation. In order to do that I need your help on three matters:

- Firstly, identify the challenges associated with determining the net present value of the project.
- Secondly, identify the main operating risks associated with the commercial exploitation of this process.
- Thirdly, how the costs described in the report will be accounted for in Prybloxx's financial statements.

[sub-task (a) = 34%]

[sub-task (b) = 33%]

[sub-task (c) = 33%]

Alex

The report from the Board can be found by clicking on the Reference Material button above.



Prybloxx Research and Development Team**Plastic pigmentation study****Executive summary**

For the past 3 years, Prybloxx's Research and Development Team has been working on a new process that should enable us to create plastic for moulding in any colour, quickly and at a reasonable cost and with no risk of the chemical instability that led to our recent product recall.

Our process is essentially a digital one that will permit us to combine the pigments that we use to colour our basic bricks in very precise combinations so that we achieve any colour that we wish. We can select any colour using software or by scanning an object. A mechanical process then mixes a batch of plastic that is sufficient for cost-effective moulding. Further batches can be made at any time and they will be identical in colour.

Research and Development have spent V\$5 million on the investigation of this process in previous financial years. A further V\$2 million was spent during the present financial year on prototyping and testing the process. Following that work, we were reasonably confident about the technical feasibility and commercial viability of the process. In order to complete the project, as detailed in the original specification, we would have to spend V\$39 million and this comprises: V\$8 million to complete testing, V\$25 million for equipment and V\$6 million to be spent on staff training and calibration of equipment. However, we could abandon the project now.



 Reference Material Pre-seen

Write a response to the email from Alex in the box below:

From: Financial Manager

To: Alex McDonald, Senior Financial Manager

Subject: Re: Coloured bricks



Reference Material

Pre-seen

Three months have passed. Alex McDonald stops by your workspace and hands you a newspaper article.

"As you can see, the Board acquired Plazchrom instead of developing a new process for making new colours of plastics. Plazchrom is now a 100% subsidiary of the Prybloxx Group. We will continue to manufacture our generic bricks here in Varanda as before, but we are already using Plazchrom to supply the plastic for small batches of bricks in specific colours for specialised models. Plazchrom is evaluated as a profit centre.

The Board is excited. It had already announced the creation of a new subsidiary that will be called Prybloxx Short Run. This will produce kits in small quantities for specialised purposes and will need specific colour matches.

All of Plazchrom's output is shipped to our Production Department, which uses the special colours of plastic to make bricks that have to be made in a particular colour. That includes specific parts for Prybloxx Character Kits and parts required by our Prybloxx Short Run subsidiary.

The Eastovian Tax Authorities have expressed concern about the possibility that Prybloxx is manipulating the transfer prices on sales from Plazchrom to Prybloxx Group companies in Varanda in order to underpay tax in Eastovia.

A dispute has arisen between the managers in charge of Prybloxx Short Run and the Production Department. The managers in charge of Prybloxx Short Run are complaining that the cost of the colour-matched bricks that it needs in most of its model kits is excessive. They claim that because Prybloxx Short Run is a profit centre it must cover those costs and is in danger of losing sales because of the resulting need to set high sales prices. The Production Department, which is a cost centre, acknowledges that the average charge per colour-matched brick to Prybloxx Short Run is high and stated it is because the colour-matched bricks are ordered in small volumes.

I need you to draft a paper that covers the following:

- Firstly, identify the problems associated with determining an appropriate transfer price for the supply of colour-matched bricks from the Production Department to Prybloxx Short Run and ensure that you include the impacts of transfer prices on the profits of Prybloxx Short Run and of the Prybloxx Group.
[sub-task (a) = 60%]
- Secondly, recommend the approach that Prybloxx should take in negotiating with the Eastovian Tax Authorities in order to reassure them that we are not using transfer pricing to manipulate the tax that we must pay in their country."
[sub-task (b) = 40%]

The newspaper article can be found by clicking on the Reference Material button above.

Varanda Business Daily

Prybloxx acquires overseas subsidiary

The Prybloxx Group has acquired Plazchrom, a plastics manufacturer based in the country of Eastovia. It is understood that Plazchrom has developed and patented processes that enable it to manufacture plastics in any colour. Prybloxx is understood to have acquired the company in order to obtain the rights to use this process, which will be valuable in its ongoing development of models based on cartoon characters.

Norma Chan, Prybloxx's CEO, welcomed the acquisition of Plazchrom and confirmed that Prybloxx had no intention of closing the factory or of relocating any of its operations to Varanda. She stated that Plazchrom had a superb workforce and that the Eastovian business environment provided an excellent base for this newly acquired subsidiary.















Industry analysts have pointed out that the acquisition of Plazchrom will enhance the new Prybloxx Short Run product line, which is aimed at commercial customers rather than consumers. Prybloxx Short Run makes kits in small quantities to order. For example, a car manufacturer might wish to buy 1,000 models of a newly launched car, colour-matched to the real thing, that it can use as gifts to motoring journalists or car dealers.













Reference Material

Pre-seen

Write a draft paper as requested by Alex in the box below:



Paragraph 



Thank you for completing the Management Case Study Exam.

Before you leave, don't forget to collect your printed confirmation of attendance.

Please click the End Exam (E) button before leaving the testing room quietly.



Management Case Study Exam

Maximum Time Allowed: 3 Hours

Welcome, Candidate Name

If this is not your name, please let your administrator know.



Click **Next** to start the test.

This examination is structured as follows:

Section number	Time for section (minutes)	Number of tasks	Number of sub-task/s	% time to spend on each sub-task
1	45	1	3	(a) 40% (b) 30% (c) 30%
2	45	1	2	(a) 50% (b) 50%
3	45	1	3	(a) 30% (b) 30% (c) 40%
4	45	1	2	(a) 50% (b) 50%

Each section (task) has a number of sub-tasks. An indication of how much of the time available for the section that you should allocate to planning and writing your answer is shown against each sub-task in the text of the question (and summarised in the table above).

This information will be available for you to access during the examination by clicking on the Pre-seen button.

 Reference Material Pre-seen

You receive the following email:

From: Alex McDonald, Senior Financial Manager

To: Financial Manager

Subject: Acquisitions

Hi

I have attached an extract from this morning's Board meeting.

I need you to write a paper that covers the following:

- Firstly, advise the Board, stating reasons, whether the proposed acquisition of these companies is compatible with Prybloxx's existing business model.

[sub-task (a) = 40%]

- Secondly, advise the Board of the factors that would have to be considered in determining the goodwill on the acquisition of the four subsidiaries.

[sub-task (b) = 30%]

- Thirdly, advise the Board on the implications of the goodwill on acquisition for the interpretation of the Prybloxx Group's consolidated financial statements.

[sub-task (c) = 30%]

Alex



The Board meeting extract can be found by clicking on the Reference Material button above.

**Extract from Board minutes**










The Board discussed concerns about growth being restricted by production capacity. Gunther Krebs, Production Director, confirmed that the factory in Varanda was close to reaching full capacity and that there was insufficient space on the site to allow for expansion.










Norma Chan, CEO, announced that she had been quietly investigating the possibility of acquiring competing brick manufacturers as going concerns, with a view to having them rebrand their output as Prybloxx. She has identified four potential acquisition targets, three of which are based in Varanda and the fourth in Westonia, where Prybloxx already has its largest distribution centre outside of Varanda. The Westonian distribution centre presently imports kits from Varanda and handles the logistics of getting them to retailers in that country.



Each of the four companies is significantly smaller than Prybloxx, but each is well established as a desirable brand in the market for construction bricks. The Board agreed that the implementation issues associated with acquiring the four companies as 100% subsidiaries should be investigated.

 Reference Material Pre-seen

Write your response to Alex in the box below:

       **B** *I* U  x_2 x^2 

Paragraph ▾  ▾        

 Reference Material Pre-seen

A month has passed. Alex McDonald stops by your workspace and hands you a news article:

"This article went online this morning. Hobrix is one of the companies that Prybloxx is considering acquiring in order to increase our production capacity. They have a reputation for quality and their bricks are directly compatible with ours.

Our CEO has already met with Hobrix's founders and they have indicated that they would be prepared to consider exchanging 100% of Hobrix's shares for some shares in Prybloxx, with the number of our shares still to be negotiated.

I have to brief the Board before discussions with Hobrix proceed any further. I need you to write a paper that covers the following:

- Firstly, identify the challenges associated with determining the present value of the cash flows arising from an investment in Hobrix and recommend how those challenges might be overcome.

[sub-task (a) = 50%]

- Secondly, advise the Board on the approach that should be taken to negotiating the exchange of Prybloxx's shares for 100% of Hobrix."

[sub-task (b) = 50%]

Alex

The news article can be found by clicking on the Reference Material button above.



Varanda Business Daily

Hobrix buys cartoon rights

Hobrix, the manufacturer of generic plastic construction bricks, has made its first venture into the market for licensed character kits with the purchase of the rights to manufacture models based on characters and vehicles based on the Rittles and Bob cartoon programme.















Hobrix is just one of several manufacturers of plastic bricks. It has previously focused on the sale of sets of bricks that enable children to design and build their own models. In common with its competitors, Hobrix's bricks are interchangeable with those produced by the market leader. While that market may appear to be somewhat crowded, it should be noted that building bricks are by far the largest segment in the lucrative toy market.

Hobrix was founded in 2012 by brothers Harry and Morgan Hobbes. The brothers retain joint ownership of the company's equity.

Reference Material










Pre-seen



Write your response as requested by Alex in the box below:



Paragraph ▾

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 Reference Material Pre-seen

Two months have passed. You receive the following email:

From: Alex McDonald, Senior Financial Manager

To: Financial Manager

Subject: First acquisition

Hi

We have reached an agreement to acquire Hobrix. Our Production Director is already thinking ahead to the things that need to be organised and I am attaching a summary of the report that he submitted to the Board.

I need you to draft a paper that covers the following:

- Firstly, identify the key risks and uncertainties that could impact on the operational compatibility of Hobrix and Prybloxx, and recommend how they could be managed.

[sub-task (a) = 30%]

- Secondly, recommend the composition of the project implementation team for putting Gunther Krebs' arrangements into effect.

[sub-task (b) = 30%]

- Thirdly, evaluate the possibility that establishing the Hobrix factory as a responsibility centre could lead to dysfunctional behaviour and recommend, stating reasons, the type of responsibility centre that should be used in order to discourage dysfunctional behaviour.

[sub-task (c) = 40%]

Alex

The report summary submitted to the Board can be found by clicking on the Reference Material button above.

Manufacturing arrangements following Hobrix acquisition**Executive summary**

Gunther Krebs – Production Director

Hobrix's factory is located 10 kilometres from Prybloxx's. We intend to use their factory to increase total production capacity for the Prybloxx Group. Hobrix's factory is roughly one-sixth the size of Prybloxx's.















Incorporating Hobrix will include the following:

- Hobrix will have to switch to Prybloxx's supplier of plastic pellets to ensure that bricks made at their factory are identical to ours in terms of colour, texture and fit.
- We will have to replace the moulds at the Hobrix factory so that the bricks made there carry the Prybloxx logo.
- The location of manufacture will have to be decided. Ideally, we wish to minimise the duplication of parts manufactured at both factories, although it will not be possible to eliminate such duplication altogether. The Board has decided that we will not ship bricks between factories. Each factory will make its own parts and packaging and will ship completed sets and kits.
- We may decide to manufacture most Prybloxx Character sets at Hobrix, with the Prybloxx factory concentrating on Basic Prybloxx.
- Hobrix staff will have to be inducted into the Prybloxx Group, avoiding differences between group members over terms and conditions of employment.

Reference Material













Pre-seen



Draft your notes as requested by Alex in the box below:



Paragraph ▾

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 Reference Material Pre-seen

Two months have passed. Prybloxx has completed its acquisition of Hobrix.

Alex McDonald asks you to join him in his office. He hands you a newspaper article.

"Some of the Board members have asked Indra to explain some of the matters arising from our ongoing expansion through acquisition. In particular, it has been proposed that we should make greater use of Activity-Based Management (ABM) and cost transformation methodology.

- Firstly, evaluate the potential benefits of introducing ABM and cost transformation techniques across the Prybloxx Group.
[sub-task (a) = 50%]
- Secondly, evaluate the problems associated with conducting an impairment review on the goodwill arising on the acquisition of Hobrix and recommend a response to those challenges."
[sub-task (b) = 50%]

The newspaper article can be found by clicking on the Reference Material button above.

Varanda Business Daily

Prybloxx investors nervous















Prybloxx is due to release its financial statements shortly. These will reflect the acquisition of Hobrix, which was completed by means of a major exchange of V\$200 million worth of newly issued Prybloxx shares in exchange for 100% of Hobrix's equity in November 2020, just over a month before the 31 December 2020 year end. Analysts are warning shareholders not to panic over the figures.

The next year could prove challenging for investors. It is rumoured that the acquisition of Hobrix was the first of several planned acquisitions by the Prybloxx Board. It is anticipated that Prybloxx will acquire at least one further subsidiary during the year ended 31 December 2021. It is understood that Prybloxx wishes to acquire these companies in order to expand its production capacity. The Hobrix factory is already operating at full capacity making Prybloxx-branded kits and sets.

Reference Material










Pre-seen

Write your responses as requested by Alex in the box below:



Paragraph ▾

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Thank you for completing the Management Case Study Exam.

Before you leave, don't forget to collect your printed confirmation of attendance.

Please click the End Exam (E) button before leaving the testing room quietly.

MANAGEMENT/CIMA GATEWAY CASE STUDY
NOVEMBER 2020 & FEBRUARY 2021
EXAM ANSWERS

Variant 1

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SECTION 1

Business model

The “My Prybloxx” product is probably more of an evolutionary step in the ongoing development of plastic construction toys, rather than a fundamental change. The initial concept behind the product was that children would use their imaginations to construct simple models from a basic set of bricks. They would then dismantle those models and reuse the bricks to build something else. Consumer tastes have changed over time and model and character kits have become more popular. My Prybloxx effectively extends the concept of the model kits by permitting customers to use their imaginations in designing their own bespoke kits.

Arguably, the expectation is that My Prybloxx will sell alongside the existing range of kits and sets. A truly disruptive technology would lead to a more dramatic reduction in the sale of existing products. The real question is whether selling My Prybloxx alongside Prybloxx Kits and Prybloxx Character sets will displace sales of Basic Prybloxx to the extent that Basic is withdrawn altogether or whether it might reawaken interest in designing models and so boost sales of Basic. It may be that children will enjoy creating models online to such an extent that they return to the idea of building toys from scratch with basic bricks.

Prybloxx’s business model defines value in terms of entertaining and educating children. It could be argued that My Prybloxx is consistent with that because it encourages greater use of the internet and online applications in response to a realistic task. There are significant transferrable skills associated with My Prybloxx. The product will also offer challenges such as enabling children to understand the relationship between their design and the cost of the bricks that they will require. They will have to interact with their parents over design elements and the amount that they are permitted to spend.

Prybloxx claims that it creates value by offering children a familiar product that grows with them. It could be argued that My Prybloxx is inconsistent with that value proposition. For example, it would imply that an older child could be expected to have collected a good variety of bricks and so to be able to build almost any desired model from that collection. There is also the question of whether purchases made using My Prybloxx will contribute to a growing collection of bricks and parts or whether the model will be built according to the instructions and retained intact.

The business model delivers value by creating a product that can be understood and enjoyed regardless of culture or nationality. That is clearly implicit in the My Prybloxx product because children are free to base their designs on their personal observations and experience. Plastic construction bricks are themselves a global product that is sold worldwide and so the My Prybloxx product will reinforce that concept.

The final element of the business model is that Prybloxx operates in an efficient manner. The nature of the My Prybloxx product is that it is inherently inefficient because it requires the creation of individual kits, each of which will be boxed and shipped independently. This will undoubtedly be a relatively expensive product to manufacture and so it could lead to problems for Prybloxx staff, whose jobs may be jeopardised if they are employed on this line and the company is forced to withdraw it.

Determining cost

The most obvious response associated with this new product would be to price it on a cost-plus basis, with a mark-up added to the production cost. Unfortunately, that could have a negative impact on sales because there will be significant fixed costs associated with every unit sold. Each model will require bricks to be picked, a box to be custom-printed and a courier or postage charge. Customers are free to design their own models and so it may be difficult to ensure that each model is profitable, unless a separate charge is made for those costs. Adding a significant charge for postage and packing could make My Prybloxx seem unacceptably expensive in comparison to traditional kits.

The costing approach should be designed to focus customers' attention on the total cost of their model, rather than on making separate charges for costs that would not be incurred separately when buying a traditional kit, such as picking, printing and postage. Prybloxx could present customers with a "base" price for a model of, say, V\$20.00 for a bespoke model. That base price would cover the initial selection of parts. The total price would then start to increase once the customer's design had exceeded that initial allowance. This approach would avoid the possible psychological impact of charging customers for items that might be perceived as adding little value. Packaging is the second most expensive item on traditional kits, even though the boxes are printed in bulk.

Customers may be attracted to parts that would have a high opportunity cost to Prybloxx. That would include basic parts that are running low, but are not scheduled to be replenished immediately, because that might interfere with the ongoing production of normal kits and sets. There could also be problems if the

customer designs a model that could be built at a lower retail price by using the parts from an existing Basic Prybloxx set or Prybloxx kit. It would create negative publicity if the customer is charged more for a smaller set of parts than could be purchased as a standard set. There could be similar concerns if customers are permitted to make inefficient design decisions. For example, it might be cheaper to create a row of two 4x2 bricks rather than four 2x2 bricks.

Section 2

Financial statements

Acquiring a logistics company as a going concern would mean that the My Prybloxx subsidiary would start with the acquired company's assets and liabilities, which would already have book values for accounting purposes. The acquisition would require the fair value of those balances to be determined for consolidation purposes, although there would be no need to reflect them in the subsidiary's financial statements. Presumably, the fulfilment centre would require some reorganisation and re-equipping, which would mean the sale of some existing assets with the potential for gains or losses on disposal.

Acquiring the company as a going concern would mean that Prybloxx would have to purchase the equity from the subsidiary's existing owners. The acquisition could be paid for with cash or by exchanging Prybloxx shares for those of the subsidiary. If shares were issued, then the cost of the acquisition would be determined in terms of the market value of the shares that had been issued on the date of acquisition. The fair value of the identifiable assets and liabilities would have to be established for consolidation purposes and compared to the cost of acquisition for the sake of calculating goodwill. The goodwill figure would then appear in the Prybloxx Group consolidated financial statements as an asset.

If Prybloxx creates a new company, then it will probably inject some equity by buying shares in the new company. The equity will be valued at the amount of cash injected, split between the par value and the share premium. The new company will then have the necessary funding to acquire the assets that it requires to act as a fulfilment centre. The costs incurred in doing so will appear in the subsidiary's statement of financial position. It is extremely unlikely that these costs will have to be restated to reflect fair values unless there is reason to believe an overpayment was made and that a newly acquired asset has been impaired. The newly created company will probably require many assets to be purchased as new and so the overall cost may be higher than the assets that might be reflected in the statement of financial position for a company that is acquired as a going concern.

A newly-created company will not require the recognition of goodwill on acquisition in the consolidated statement of financial position. That may help to reduce the value of the group's consolidated net assets and so enhance return on capital employed. The group equity will reflect the value of the shares issued to create the subsidiary, which may have a further effect on gearing and performance ratios. The lack of goodwill could be important because the goodwill in any acquired business is unlikely to be of any direct value to Prybloxx and so it may have to be written off as impaired, which would reduce reported profit.

Performance

The performance of this subsidiary will require careful management because it is a newly established venture that will create complementary responsibilities for management and decision making. The Prybloxx Board will be making a significant investment in the venture and the success or failure of that investment

will have to be tracked, if only in order to determine whether further expansion might be justified or whether the fulfilment centre should be repurposed or disposed of. The Board should reflect on the overall performance of My Prybloxx on a regular basis, perhaps annually, in order to determine whether the opportunity costs of maintaining this subsidiary are justified.

It may not be appropriate to manage My Prybloxx as a profit centre because it would not necessarily be in the Group's strategic interests to maximise sales of this product. For example, the fulfilment centre will have limited capacity and it may not be economically viable to expand that capacity in the event that the subsidiary management team reaches that level of sales. The Group's relationship with retailers could also be impaired if there are concerns that the My Prybloxx product, which is sold direct to consumers, is displacing a significant proportion of traditional retail sales.

It would clearly be desirable to encourage the My Prybloxx management team to manage costs at the fulfilment centre and so a cost centre would be an appropriate arrangement. The costs of producing parts will be the responsibility of Production Management, but the My Prybloxx management team can be made responsible for the costs incurred within the fulfilment centre. The team can be evaluated on the basis of factors that are within its control, such as the average monthly cost of fulfilling an order, so that there is an incentive to manage the processes as efficiently as possible.

Section 3

Pricing

Prybloxx's existing pricing strategy for its Prybloxx Kit and Prybloxx Character products is based on premium pricing and so it would be logical to continue to adopt that for the My Prybloxx product. The market is already paying a premium for the ability to buy a set that makes a specific model and so it is reasonable to expect it to pay even more for the ability to design a model online and have a bespoke kit shipped directly to the customer. Apart from anything else, it would be foolish to permit My Prybloxx to undercut Prybloxx Kit and Prybloxx Character on price because customers could simply design models that were similar to the sets that they wished to buy and have their replicas shipped to them at a discount. The market is also prepared to pay a premium for additional perceived value and My Prybloxx offers scope for significant perceived value for creating personalised gifts.

Prybloxx will have to take care in setting prices in case it overdoes the premium aspect and attracts competition into the market. The entry barriers to this product's market are low because several other companies make and sell compatible construction bricks. Competitors are not held back by intellectual property considerations in the manner that they are with Prybloxx Kit and Prybloxx Character and so they could develop their own design software and infrastructure for packaging and delivery. Prybloxx will also have to take care not to overprice My Prybloxx in the first instance because it may lose the initial interest that the launch will create in the product.

Accounting ratios

The impact on accounting ratios will depend, in part, on the price-elasticity of demand for My Prybloxx. Return on capital employed is the most important accounting ratio relating to performance and that will be affected by pricing. The key here is how the pricing strategy affects total contribution and, so, profit because the higher the profit the higher the return on capital employed. The pricing strategy is unlikely to have any impact on capital employed, so the denominator of the ratio will remain unaffected. The numerator is likely to be affected because it will impact total contribution, although the problem in this case is that it is not necessarily clear how changes to selling price will affect profit.

In the same way, pricing will affect other performance ratios such as asset turnover and gross profit %, with both being affected by the extent of the price elasticity. It seems reasonable to expect sales volume to decrease if prices increase, but this market will probably sustain quite a high selling price and so a high price will probably create an attractive performance ratio.

The pricing may also have an impact on other ratios, particularly those relating to activity and liquidity. For example, if demand is stimulated by a lower selling price then the average time that parts spend in inventory will decrease and so the inventory turnover ratio will be faster. Increased sales will also increase both cash and trade receivables, depending on whether customers pay by debit or

credit card. That will lead to an overall increase in current assets, which will increase liquidity ratios.

Transfer pricing

Transferring at cost would be consistent with the fact that the Production Department operates as a cost centre and so has little direct incentive to support My Prybloxx. The Production Department could be reluctant to support and encourage My Prybloxx because of the need to pick and transfer small quantities of bricks, which might increase the Production Department's operating costs. My Prybloxx might be unwilling to accept a "cost" figure that is higher than the production cost. Any disputes could lead to time being wasted by unnecessary disagreements and debates between the management teams.

Optimal transfer pricing strategies generally allow for the opportunity costs of internal transfers. Clearly, if My Prybloxx can make a higher margin from the sale of any given component then it will do its best to encourage customers to buy that component. It will not necessarily benefit the Prybloxx Group to sell large quantities of scarce parts as components of My Prybloxx kits because that could make it difficult to schedule the manufacture of batches of more traditional sets. For example, motors are high-margin parts that should be used to satisfy demand for traditional kits.

Section 4

Project management

The project comprises three separate elements: the conversion and establishment of the fulfilment centre, the organisation of the logistics and the development and testing of the app. Each of the four directors can claim that the project overlaps with their area of responsibility, which would give each a claim to take overall charge. The director in charge will determine the emphasis placed on the management of the project, if only because his or her expertise will influence the priority given to issues arising from reports. For example, the Finance Director will focus on cash flows and the management of the IT aspects of the project because those are the areas that she focuses on in her area of responsibility for strategic management of the Group.

It is important that the directors agree on a clearly designated project lead, but that they all work towards the successful completion of the project as a priority for Prybloxx as a whole. Any lack of cooperation could lead to resentment and dysfunctional behaviour. For example, the layout of the building and the mechanical processes associated with picking and packaging bricks could have implications for the design of the app. Ideally, there will be active cooperation between the managers responsible for the mechanical aspects and those responsible for IT. If such cooperation cannot be encouraged then the CEO will have to impose a project management structure on the Board, designating the project lead and insisting on regular feedback to ensure that the lead receives the full support of colleagues from other disciplines.

Production is the most logical function to take overall charge of this project because the result will be a production facility that relies on Production for the sourcing of parts and will exist to facilitate orders using mechanical production processes. Giving the Production Director overall responsibility will ensure that the efficient design and organisation of the facility is the priority when, say, decisions have to be given to architects and engineers. The facility will also have to be designed to maximise the synergy with the existing factory and inventory management. The Production Director's staff are the ones who best understand the existing logistics of the manufacture and storage of bricks and so their knowledge will minimise the disruption associated with supplying My Prybloxx.

Coincidentally, the project's critical path falls largely within the Production Director's remit and so it would be logical to give the Production Director the overall responsibility for completion. The conversion of the building and installation of the equipment is the single-largest step in the project, and it is the one that would require the greatest input from the Production Director even if another functional area had the lead. There is significant slack in the other paths through the project and so the Production Director can legitimately focus on the conversion in order to ensure that it is not compromised. The other directors can then negotiate whatever inputs they are required to make in order to avoid delaying the project as a whole.

The Board might also pay attention to the skills, experiences and other personal attributes of the managers who are available to serve as project leads. It might

be preferable to place the project under the leadership of a manager from a different department if none of the candidates from, say, Production were suitable.

Operational risks

Operational risks are essentially losses that might arise from business processes. The most significant concern will be that My Prybloxx will receive bad publicity because of problems with kits or because of late deliveries. The app could be a source of risk because it is essentially a new piece of software that will be making unique products using a newly designed automated process. If it fails, then it will be impossible to make sales of this line.

There could also be significant inventory management issues arising from this line because customers could deplete significant parts through their designs. That could lead to production scheduling difficulties, with Prybloxx being forced to manufacture parts sooner than expected, and so perhaps incurring additional costs in the process.

The risk of problems with the app could be addressed in part by writing the software as quickly as possible so that it can be tested thoroughly. The test could involve laboratory tests that check the relationship between the design on the screen and the associated picking list that will be generated for the equipment in the fulfilment centre. It would be ideal if the operation of the fulfilment centre could be based on equipment and software that is already in use in making up kits in the main factory so that the risk of software problems is minimised.

The inventory management problems could be more difficult to predict because one of the selling points of My Prybloxx is that customers can select their own parts and so it might take some time to identify popular parts. It would be ideal if Prybloxx could seek feedback from potential customers about the types of models they might make, so that unforeseen demand for, say, green bricks can be identified before the logistics system is put in place. Once the new product is launched, the fulfilment centre should track demand for each individual part in real time in order to identify items that are likely to run out at an earlier stage.

MANAGEMENT/CIMA GATEWAY CASE STUDY
NOVEMBER 2020 & FEBRUARY 2021
EXAM ANSWERS

Variant 2

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SECTION 1

Challenges in predicting costs and revenues

The first challenge relating to cost is that engineering parts may create difficult problems associated with estimating manufacturing costs. The nature of the parts may require different grades of plastic in order to enable them to cope with the stresses and strains of operating cogs and other moving parts. There may also be issues associated with the life expectancy of moulds for these parts if the process causes more wear or requires greater precision, which shortens the life expectancy of the moulds. The fact that Ckonstro has already got a similar product on sale may help overcome this problem because the design team could undertake some reverse engineering, in particular with the analysis of the plastic being used.

The new line may also significantly increase costs associated with inventory management. Prybloxx Gear will comprise mainly, or even exclusively, new parts that will have to be stored and will require a new array of storage bins and picking lines in order to make these sets. There will also be the question of the rate of inventory turnover for finished kits that will be manufactured in batches and stored until sale. The inventory costs associated with new parts will pose fewer problems than estimating the holding costs for finished kits.

The fact that this is a new product line will complicate Prybloxx's ability to predict revenues. The existing ranges have some educational and practical value, but they are primarily toys, whereas Prybloxx Gear will be more of an educational product that might appeal to an older age group than the present ranges. One difficulty is that the potential appeal of this range will be linked to the extent of Prybloxx's investment and the range of parts that will be offered. Unfortunately, the investment decision will be affected by expected revenue. There may also be a risk that Prybloxx Gear will simply displace sales of existing product ranges, which will undermine the commercial logic of bringing this to market.

The fact that Prybloxx is coming to this market after its closest competitor has already become established may create further difficulties in estimating future revenue. The bricks in Prybloxx's existing ranges are mainly generic and interchangeable with those of competitors, but that may not necessarily be the case with Prybloxx Gear. Even if the parts in Gear are of a standard design, the market may regard Ckonstro as the leading brand and Prybloxx may have to compete on price in order to gain market share.

Usefulness of competitor's segmental report

The fact that Ckonstro breaks its revenues down between the four product ranges is interesting because it indicates how revenues and profit are broken down for internal management purposes. Sales of Ckonstruction Engineering are clearly a significant part of the group's total income. The fact that the figures are analysed between the four ranges is helpful because it implies that Ckonstro's management believes that each has its own distinctive characteristics in terms of commercial risk. That analysis clearly offers Prybloxx a clear indication of the sales revenues for Ckonstruction Engineering, including the fact that sales almost doubled since 2018.

The figures for operating profit are less valuable because it is not necessarily clear to Prybloxx how Ckonstro breaks down its operating costs between product ranges. The fact that operating profit almost quadrupled over a period in which revenues doubled implied that there have been significant fixed costs attached to Ckonstruction Engineering. The manner in which those costs have been determined is not disclosed, which means that it is difficult for Prybloxx to predict the costs that it will incur in developing and selling Prybloxx Gear. The figure for operating profit may also exclude the design costs that Ckonstro had to incur that have yet to be borne by Prybloxx.

Ckonstro's segmental report implies something about the potential demand for engineering construction kits, but using the report requires several major assumptions that could prove invalid. For example, the fact that Ckonstro's sales are equivalent to 17% of its total revenues does not necessarily mean that there is a significant unmet demand for these kits. It is possible that this is a small niche market and that the launch of Prybloxx Gear will simply lead to operating losses by both Ckonstro and Prybloxx.

Section 2

Design team engagement

The first step in improving engagement would be to establish why the team lacks engagement in the first place in order to establish whether there is a need to offer support. If, for example, the members of the design team lack confidence in their ability to design this product then they would benefit from additional support in order to address their concerns. For example, a more specific design brief might be developed, based on market research, that would more clearly establish exactly what customers would need from the use of this product. That would leave the design team briefed and equipped to make a start on the creation of the product range, without having to make decisions such as the need to include cogs of different sizes or similar.

A strict deadline for the design work on Prybloxx Gear would improve focus. Presumably, the design team has a range of projects that require attention and it is natural for individuals to concentrate on the tasks that they enjoy more. Mary Chilima should intervene by asking the Head of Design to identify the projects that are underway and by establishing a ranking that ensures that Prybloxx Gear has sufficient priority. It would also be sensible to seek interim progress reports that enable the Board to see that work on Gear has commenced and is making satisfactory progress.

The staffing of this project should also be investigated in order to ensure that it does not suffer because of poor motivation. It is possible that individual designers are reluctant to display too much enthusiasm for Prybloxx Gear, for fear of being allocated additional work on it. The Head of Design should be tasked with allocating specific design duties to individual designers, ensuring that the selected designers have the required ability and experience to discharge their responsibilities. The Head of Design should be asked to furnish Mary Chilima with a list of designers, if only to indicate to the design team that she is taking an active interest in their work.

If all else fails, the members of the design department might be asked whether they would feel more comfortable with outsourcing this design project to an external consultancy. That would put the designers under a certain degree of pressure to take a more proactive and involved approach to Prybloxx Gear because outsourcing would imply a lack of confidence on their part. They might also view the prospect of outsourcing as a subtle threat to their jobs because Prybloxx might then consider making greater use of consultants and downsizing its design team in the future. At the very least, the threat to outsource would give a clearer indication of whether any excuses for a lack of progress to date were genuine because those excuses will be withdrawn if the designers feel threatened.

Transfer price

The basic challenge is that either manager could indulge in dysfunctional behaviour without it necessarily being obvious that they are doing so. The Head of Design could be tempted to make excessive use of Production staff time in

order to free Design staff for other duties, while the Head of Production could encourage staff to feign ignorance or take shortcuts in developing responses to queries from Design. It would not necessarily be obvious that such behaviour was occurring and so it would be difficult for the Prybloxx Board to simply instruct the two department heads to cooperate. Furthermore, the Production Department is a cost centre and as such is evaluated on the efficient and effective use of resources. There is not a recognisable 'production' output that would be recognised for the work done for the Design Department.

It would be ideal if the question of cooperation could be resolved by economic forces, so that neither department had an incentive to behave in a dysfunctional manner. Generally, opportunity costs offer the most satisfactory basis for effective models that optimise internal trading, although those might be difficult to measure in this case. The difficulty is that there will not be an objective way to measure the value of the time being requested to either department.

One response to the problem might be to permit the Head of Production to make an internal charge that is equal to the hourly overtime rate paid to staff. If necessary, the Production Department could then afford to pay overtime to managers to make up for time spent dealing with Design Department queries. The charge should have an upper limit that was less than the hourly rate that would have to be paid for external consultants: and this should discourage the Design Department from using external providers. The imposition of charges would create a disincentive for Design to make excessive use of Production staff time.

Section 3

Debt and equity

The immediate costs of raising finance will always be an issue in selecting between different sources. There is generally a significant fixed cost associated with raising equity, which makes it uneconomic to raise small amounts by equity rather than debt. In this case, the investment would require an increase of $V\$350m/V\$1,540m = 23\%$, which suggests that it would be viable to issue either equity or debt.

Gearing is an important accounting ratio and so the impact of new funding should be considered. Prybloxx's gearing is presently $V\$1,023m/(V\$1,023m + 1,540m) = 40\%$. Borrowing a further $V\$350m$ would increase that to $V\$1,373/(V\$1,373 + 1,540m) = 47\%$. Issuing equity would reduce gearing to $V\$1,023/(V\$1,023 + 2,913) = 35\%$. That would create a significant argument for equity over debt in this case because the gearing would start to look excessive otherwise.

It would be possible to tailor debt to match the life of the assets that are being financed. In this case, there will be a significant investment in moulds that have relatively short lives and also in inventory that will hopefully be sold very quickly. In this case, though, the hope would be to create a new product line and so the investment in relatively short-lived moulds and inventory would continue into perpetuity with cash flows from revenues from Prybloxx Gear being used in part to replace these assets.

Capitals

Financial capital is essentially the funding that will appear in the Prybloxx Group's statement of financial position that would be reported as a matter of routine in the traditional financial statements. The funding raised for that expansion will simply be reported as normal in equity or non-current liabilities.

Manufactured capital will essentially be the investment in the moulds and other production equipment that will appear in the Group statement of financial position. Again, it will simply be reflected as an increase on non-current assets in the financial statements.

Intellectual capital will reflect any intangibles that Prybloxx creates as a result of this new range of products. It will not be necessary to attach a monetary value to those assets; it will be sufficient to describe them in sufficient detail to inform stakeholders about the intellectual property that Prybloxx has created. In this case, the knowledge relates to the creation of generic parts, so it is not unique to Prybloxx, but that is not a particular issue. It is sufficient that Prybloxx has developed designs and processes that enable it to expand the range of products that it sells.

Human capital will reflect any new competencies or capabilities that will be created for any of Prybloxx's staff. This range will require Prybloxx's design staff to develop new skills with regard to designing moulds that can fabricate parts out of hard plastic. Those skills may be of value in extending the Prybloxx Gear range

or in developing parts that will give additional features to other ranges of kits or sets.

Social or relationship capital arises from relationships and also the ability to create collective wellbeing. Prybloxx Gear will create a new direction for the various companies that manufacture these compatible bricks and so it will enhance the overall marketability to the industry as a whole. It will also create a new type of experience that could have significant potential to enhance engineering and other skills that will be of value to children as they prepare for adulthood.

Natural capital reflects the impact that Prybloxx has on scarce resources. In this case, there is no reason to believe that Prybloxx is working to minimise or even reduce the consumption of scarce resources and so there may be no positive disclosures that might be made.

Section 4

Project management

Identifying the primary customer group will affect the manner in which the project should be managed and so it could affect the selection of the most suitable project manager. For example, if Prybloxx Gear is to be sold primarily to consumers then the focus on design and marketing should really be the play value that might be obtained from sets, which suggests that marketing should take the lead. The new Gear kits should be designed to be visually appealing and the promotional activities should be designed to appeal to parents and children. The selection of parts lists will be influenced by the need to allow for exciting working features and moving sections in finished kits, which could mean that there ought to be a bias towards smaller parts.

More technical users, such as colleges and engineers, will be more interested in Prybloxx Gear for teaching or prototyping purposes. In both cases, they are likely to be interested in the product's ability to create working models that apply the basic rules of engineering and mechanics. The ideal project leader might come more from a design background and the design process might focus more on talking to college lecturers or corporate design engineers in order to establish what types of features their working models might benefit from and how best they can be supplied.

In either case, care will have to be taken to ensure that Prybloxx Gear appeals to all key customer groups, otherwise there may be a loss of revenue. The success of Ckonstro Giga Crane shows that corporate buyers are prepared to buy kits that may be primarily designed for children.

Pricing

The nature of this product would lend itself to a price skimming strategy, provided Prybloxx takes care to differentiate its product slightly from Ckonstro's equivalent range. Colleges and design laboratories are likely to be interested in using Prybloxx Gear to extend their collections of engineering parts that can be used in laboratory demonstrations and in prototyping, so they will undoubtedly pay a premium for parts that are compatible with those from other manufacturers but unique to Prybloxx. Demand from those markets will enable Prybloxx to generate some revenue while establishing and developing brand recognition for Gear. If demand is satisfactory then Prybloxx may discover that it can sustain that high pricing into the medium-term future.

In time, Prybloxx should probably aim for a premium pricing approach for Prybloxx Gear because consumers may be prepared to pay more for the educational value of the product. Parents may appreciate the fact that the parts will enable children to understand various mathematical and mechanical principles and so they may be prepared to pay well for it. There is also the fact that Prybloxx's other products are positioned as relatively high-price and high-quality items. Consumers are used to paying more for Prybloxx compared to, say, a Ckonstro equivalent.

Product and product reputation risks

The most obvious risk that might arise from this new product is that the anticipated demand might not materialise and so the product might fail. The fact that Ckonstro has already established itself and has attracted positive reviews for its most expensive product could mean that Prybloxx will find it difficult to enter this particular market niche and attract market share. The fact that Prybloxx has been successful in the past with its other products does not necessarily matter because this is a new range that is aimed at a different market.

There could be unforeseen problems arising from the manufacturing processes that are being used with this new range, which could disrupt the launch and damage the product reputation. Prybloxx Gear uses different grades of plastic and the parts will engage with one another in a different way from existing bricks. The finished kits may not have the necessary precision or robustness to cope with the stresses associated with building working engineering models.

Other manufacturers may decide to follow both Ckonstro and Prybloxx into this market and they may decide to compete heavily on price. That could lead to longer term problems with the profitability of the Gear range, even if it takes some time to materialise. That risk will be enhanced by the continuation and extension of Prybloxx's premium pricing policy into this new range.

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Variant 3

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SECTION 1

Business model

This development is consistent with Prybloxx's approach to defining value because it extends the play value of the company's products. Children are becoming increasingly accustomed to working with sophisticated electronics, including smartphones and remote-control toys such as drones. Their expectations are changing and so they may become reluctant to continue to play with construction sets that build into inert and passive models. These electronic components will be more consistent with their existing engagement with electronics and video games.

This is also consistent with the concept of creating value through making sympathetic changes that retain the sense of a familiar product that can grow with customers throughout their childhoods. Younger children who would find advanced electronics too advanced can continue to play with traditional Prybloxx bricks until they are old enough to appreciate these new elements. Older children may be attracted back into playing with Prybloxx if they are given a set or kit that contains these parts. In either case, the fundamental nature of the product remains unchanged. Even with the addition of motors and lights, the toy will basically help children to use their imaginations and to learn through play.

These parts will continue to deliver value through offering children toys that can be understood and enjoyed from any culture. The bricks themselves are sold globally and are well understood across national and cultural borders. The electronic components add functions that will be equally universal and will appeal to all children. Basing control on Bluetooth-capable apps will enable children to exploit the familiar electronic interfaces that they have become accustomed to.

The question of whether Prybloxx will be capturing residual value in a manner consistent with its business model remains to be seen. Presumably, buying these parts in quantity from an established supplier would be a relatively efficient and

cost-effective way to acquire them. These components should permit Prybloxx to add significant value to a new range of kits and so it should enhance overall profits and benefit the Group and its shareholders. Prybloxx's model also allows for maintaining acceptable wages for its employees. Buying in components from third parties will do nothing directly to enhance wages, but it might enable Prybloxx to secure jobs by making more profit. If Prybloxx acquires Toyz then its employees will expand the Prybloxx Group's workforce and so it will be possible to maintain the terms and conditions of the new staff.

Negotiation

The most immediate problem from Prybloxx's point of view is that Toyz's present owners do not appear to be under any particular pressure to sell their company. That puts Prybloxx at a disadvantage in terms of negotiating a win-win agreement because Toyz's owners are unlikely to sell unless Prybloxx can pay more than the company's market value. That may still be a positive NPV investment for Prybloxx, but it will undoubtedly be necessary for Prybloxx to negotiate on the basis that it is prepared to pay a generous price for this company.

Alerting Toyz's owners to Prybloxx's interest could leave Prybloxx exposed to Toyz's owners seeking counteroffers from other brick manufacturers. If the electronic parts are potentially compatible with Prybloxx's products then they will work equally well with those from other manufacturers, who may be prepared to outbid Prybloxx in order to compete more effectively in this market. There would be no particular reason for Toyz to favour a smaller bid from Prybloxx if a competitor decides to offer more.

There is no previous relationship between Toyz and Prybloxx, meaning that Toyz's owners may not take Prybloxx's proposal seriously and may refuse to negotiate for fear of wasting time. That challenge may not be serious because Prybloxx could make Toyz its preferred supplier of advanced electronic components, thereby demonstrating that it has a legitimate business interest. Once that relationship has been established and the two companies are doing good business together then Toyz will be more open to negotiation.

Section 2

Goodwill

IFRS 3 *Business combinations* requires that all these assets should be valued at their fair value as at the date of acquisition. Fair value is defined in terms of the amount that would be received from a transaction between market participants in an orderly market and that definition is further supported by IFRS 13 *Fair value measurement*.

The fair value of this property is basically the market value of the land and buildings at the acquisition date. It would be ideal if Prybloxx could observe relevant prices for sales and purchases of similar properties in that area, although it is clearly unlikely that the market will be so liquid that there will be sufficient transactions to make this possible. Prybloxx may be forced to determine approximations, using indicators such as price paid per square metre of floor space for offices and factories sold in the recent past in that area.

Clearly, there will be no observable market price for patents and trademarks acquired from Toyz because such assets are unlikely to be freely traded. It may be possible to estimate the fair value in terms of Prybloxx's expectations with regard to the commercial exploitation of the assets, although that will be highly subjective and open to debate. It may be possible to add some credibility to those estimates by reflecting on the information provided by Toyz during the negotiation process and taking some account of the deliberations by Prybloxx's Board over the amount that it was prepared to pay for Toyz, including its intangibles.

The value of the inventory raises some interesting questions because it could be attributed a fair value of either V\$40m or V\$30m depending on the interpretation of "fair value". The definition requires some consideration of what is meant by orderly markets and the manner in which those apply to this transaction. It could be argued that the lower valuation reflects the value to Prybloxx because that is the best use to which it could put the inventory. Even if a manufacturer of electronic parts could sell the inventory for V\$40m, that would be a very theoretical price. For example, Toyz's previous customers might not be prepared to pay the full wholesale price for inventory that was affectively being remaindered.

Intangibles

The key accounting issue is whether the cost associated with this work should be capitalised as an intangible asset or whether it should be written off as an expense. IAS 38 *Intangible assets* sets out some criteria that will help determine how those costs should be accounted for. Essentially, there are several criteria that would require the costs to be capitalised if they were all met. If one or more do not apply, then the costs must be written off.

The most significant challenge is in determining whether the work being done is going to result in a workable addition to Prybloxx's product range. If there is a realistic possibility that the project will have to be abandoned because it proves impossible to integrate Toyz's parts into Prybloxx's construction sets then the costs will have to be written off as they are incurred. That challenge would be

best addressed by asking Prybloxx's designers, who have experience of developing new products and integrating more basic electrical products, to identify the challenges and to indicate their seriousness. Hopefully, they will be able to reassure the Board that this project will succeed.

There is a related challenge associated with the commercial value of this project. If there is a risk that the project will not prove commercially viable then the costs will have to be written off. It cannot be taken for granted that this will be a successful product just because it was the basis for the acquisition of the company. For example, a competitor might launch its own set of electronic products and Prybloxx might decide not to compete. The Board might be asked to reflect on their overall confidence in the commercial success of this product and also on whether there are any realistic matters that might lead to its cancellation.

The costs have to be determined reliably, which may prove complicated if the design department is engaged on a range of different projects. There is a further complication arising from the fact that some of the project is experimental and that some of those experiments are expected to fail, which raises a question about whether failed experiments should be regarded as an element of the overall project. Once a decision has been taken about the failed experiments, Prybloxx will have to ensure that it maintains detailed records of staff time and resources consumed so that they can legitimately claim to know exactly how much is being spent on the project.

Section 3

Target costing

Target costing requires Prybloxx to determine the selling price at which it wishes to position its products in order to generate satisfactory revenues in order to obtain an acceptable contribution. The fact that Ckonstro has already launched a product line offers some insight into what is acceptable to the market, although that may be complicated to some extent by the fact that Prybloxx generally competes against Ckonstro on quality rather than on price. In this case, Prybloxx's starting point has been the reverse engineering of a Ckonstro kit that is similar to the products that Prybloxx wishes to create. It appears that Prybloxx will be unable to match Ckonstro on features and quality in this market without risking being significantly undercut on price. Given that this is a new market for Prybloxx and that Ckonstro has the advantage of being established here, it is possible that the target costing exercise suggests that Prybloxx will be unable to enter into this market.

The detailed costing gives Prybloxx's designers the ability to consider the impact on cost of making changes to the specification of the model. For example, a significant saving could be obtained by removing the working brake lights or by specifying a simpler type of packaging for the model. Unfortunately, the costing document does not offer the designers the ability to evaluate the implications of removing such features from the product. It may be that replacing, say, the shaped bricks with ordinary bricks would have a significant impact on cost but would also make the model far less appealing to consumers. Presumably, there is little scope for using cheaper packaging because that might detract from the perceived value of such a high-end product.

It may be that Prybloxx should conduct a fresh target costing exercise, estimating the price of a totally new product that is significantly better than Ckonstro's in terms of features and build quality. Prybloxx's designers could be set the challenge of adding value to its initial offering of kits by adding additional features that make them superior to competitors' offerings, so that the market is prepared to pay more. For example, adding a camera to the kit so that the car can be driven with a "driver's eye" view from the user's phone or tablet would increase costs but might add significant play value. Prybloxx could then aim to determine whether customers would be prepared to pay more for this additional value, perhaps using market research to establish how much consumers would pay.

The fact that Prybloxx operates with a very high margin might also raise questions about the validity of target costing in this case. Matching the competitor's selling price would require an overall reduction of $V\$62.15 - 48.64 = V\13.51 or 22% of the present cost. Arguably, Prybloxx could consider making a smaller saving and could still achieve a satisfactory selling price by reducing its margin. If that proves to be impractical in practice, then the price could always be raised.

Pricing

The most immediate challenge is in deciding whether consumers will be attracted to this product. It could be argued that it offers a significant update to Prybloxx's product range and so consumers will be willing to pay a steep price. Equally, the market may not be particularly interested in adding a digital element to an old and familiar analogue product. It is possible that consumers will be unimpressed by the addition of remote control and realistic lights and sounds because they can create significantly more exciting experiences in the digital world. Consumers may be unclear as to the amount that they would pay for this new element when responding to Prybloxx's market research.

Prybloxx must also bear in mind that it sells an essentially generic product and so it must take care to avoid giving competitors any advantage in responding to the launch of this new line. The final selling price will have an impact on the responses of competitors. The fact that Ckonstro is already in this market is a consideration because Prybloxx's pricing may also have an impact on continuing sales of Ckonstro's kit. The fact that electronics develop quickly will mean that competitors will undoubtedly be able to add new features to make them technically superior to Prybloxx's range.

Despite the risks, it would make sense for Prybloxx to continue with its premium pricing strategy for this new range. The company has developed a reputation for selling high quality products that are better than those of its competitors, even if they use parts that are essentially interchangeable with those from other manufacturers. Prybloxx's premium charging policy appears to have helped reinforce the perception that its products are superior to those of, say, Ckonstro and so it would be possible to reinforce that perception by charging slightly more for its electronic products.

Section 4

Product reputation and operating risks

The low-key launch restricts the possible loss if this product proves to be unpopular and so avoids the downside risk of wasting money on fruitless promotional activities, thereby mitigating the product reputation risk. Unfortunately, the low-key approach will also offer a smaller upside risk because there will only be one product available in this new range and so consumers will not be able to buy more and there will be insufficient investment in promotion to stimulate demand. The conflict between the upside and downside of risks means that neither approach is necessarily superior. The Board will have to evaluate the different risks and make a subjective decision. It could be argued that Prybloxx's management should have sufficient understanding of its market to be able to predict expected demand with some confidence and so a low-key launch motivated by insecurity is unacceptable.

The fact that the circuit boards have not gone into production yet also complicates the operating risks. The Board cannot be certain that the mass-produced components will operate as effectively as the prototypes did in laboratory settings. If Prybloxx books a major advertising campaign and manufactures significant stocks of different models, then any delays due to manufacturing or quality issues could prove disastrous. The danger is that the more risk-averse launch of a single product with little publicity might appear to be unduly cautious. Stakeholders might expect the Board to be able to manage a more upscale product launch without major problems.

Rather than simply accept the product reputation risks, the Board should conduct further market research into the likely popularity of these kits. It is, for example, possible that the market will not be attracted to a digital enhancement to a physical toy that focusses on creativity. For example, the potential success of the more ambitious launch could be evaluated by collecting more information about consumer reaction to the range and their willingness to pay for these models. Market research would help the Board to better understand whether there is a risk that consumer demand will not be forthcoming. The risks could also be mitigated by incorporating other features of Prybloxx sets into the advertising so that the launch promotes features across the whole company's product range and not just the electronic components that are being added.

The manufacturing issues might be addressed by seeking assurances from Toyz that the parts will be ready in time and will work to specification. Prybloxx's Board might, for example, seek a clear explanation of the steps that must be taken prior to the launch of a reliable and robust product and have the software and electronic engineers explain the problems that might arise and how those problems would be addressed if they did. Prybloxx should certainly demand a substantial advance delivery of a batch of mass-produced parts so that they can be tested as soon as possible before the launch date, with a view to being able to rectify any problems in time to meet the launch.

Disruptive technology

This new range will mark the creation of a disruptive technology if it significantly changes the way in which Prybloxx, its customers and its competitors operate. It will only be the case that this is a disruptive technology if consumer tastes switch to electronic kits to such a marked extent that production of traditional brick sets and model kits decline drastically in favour of electronics. The fact that the circuit board that permits remote control costs only V\$3.00 means that it will not necessarily prove unduly expensive to incorporate this technology across all of Prybloxx's ranges.

If this technology does truly become disruptive then Prybloxx may have to start thinking of itself as a manufacturer of electronic toys rather than a manufacturer of plastic construction bricks. The play experience that Prybloxx will be offering might be seen as providing a platform that facilitates the design and construction of electronic systems within a plastic shell that happens to be made of plastic bricks. The design team will probably have to be expanded, with electronics experts being recruited.

Electronics will add a significant new dimension to the design process because consumers will be providing the most sophisticated component of all, in the form of their smartphones and tablets. Prybloxx will have to aim to exploit the facilities that will be created by that technology, without losing sight of the factors that drove sales of its toys in the past. For example, it would still be possible for Prybloxx to manufacture kits based on cartoon characters, but those could now create models that offered interactive features driven by phone apps, such as the ability to synthesise voices.

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Variant 4

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SECTION 1

Prybloxx's business model defines value in terms of meeting the changing needs of children. The problem that arises from these results is that children (or their parents) will not necessarily be able to see new products launched by Prybloxx in response to those changes. Prybloxx's approach to doing business is partly to capitalise on the continuing demand for plastic construction bricks and so a shift away from manufacturers of compatible bricks can only harm the company's business. The fact that general searches are increasingly likely to present potential buyers with products created by the leading brand is clearly going to reduce the likelihood of any new products launched by Prybloxx being promoted.

The creation of value through the creation of a familiar product that will grow with children is also at risk because of this. If searches on online retailers' sites favour the leading brand, then children may lose sight of Prybloxx. The fact that the bricks are compatible means that the leading brand could actually take advantage of the familiarity enjoyed by Prybloxx's customers, persuading them to make their collections grow by adding sets and kits from the leading brand. The growing emphasis on online retailing means that customers no longer have the opportunity to browse different kits in toyshops and pick up familiar brands, they may not realise that online searches are biased.

Prybloxx delivers value by creating a product that can be understood and enjoyed by children from all cultures. The drift in results from internet searches creates problems because children from different cultures might not fully understand the approach that has to be taken in order to find Prybloxx products online. Potential customers may not appreciate that there are different brands and that they have to take particular care to find alternatives to the leading brand. Prybloxx could, however, enjoy an advantage in retaining customers in countries where toys are purchased from traditional toy shops.

Prybloxx aims to capture residual value by operating in an efficient manner. Again, that may not necessarily benefit the company because any failure to appear on a website search engine will cost the company the opportunity to benefit from its price positioning against the leading brand. The growth of online retailing could make it difficult for companies selling compatible construction bricks to compete against the leading brand in any form, unless they can motivate the online retailers to favour them over the leading brand. Online retail could invalidate much of the hard work that Prybloxx has invested in creating a respected and popular brand.

Value chain

The fact that the value chain activities need to be carefully coordinated in order to ensure efficient and effective operations would suggest that senior management should be careful to avoid making too many major changes. Changing any one aspect of the value chain will require other aspects to be updated in response to the value, which may prove disruptive to the staff having to implement those changes. It should be possible to encompass most ongoing changes in the business environment without having to adapt the value chain.

If senior managers meet with the express purpose of discussing the value chain, then they may feel that they need to agree to changes in order to give those discussions some purpose. The very fact that the meetings are being held could bring about unnecessary changes, which could then demotivate staff because they are constantly being forced to make changes. Any developments that are sufficiently significant to require a change to the value chain will probably be relatively obvious and so the need for a meeting can be identified.

The Vretail findings do indicate that there is a need for senior management to meet whenever a major issue arises so that there is a coordinated response to factors that could have an impact on the value chain. There is a need to hold a meeting because such events could require several changes. For example, the concern about the sustainability of sales being made through this major online retailer should be addressed directly but correcting it could require changes to outbound logistics in case a different sales strategy is required. The change may also require adjustments to Prybloxx's IT approach in order to enhance the company's online presence and protect brand awareness.

Establishing a principle that such events will result in a formal meeting of senior managers from all backgrounds would prevent problems from being recognised and addressed on a piecemeal basis. That would prevent the risk of, say, the marketing managers taking ownership of this problem and attempting to manage it in isolation. Giving senior managers from all functional areas the opportunity to decide for themselves whether they need to involve themselves will result in a far more efficient and effective response.

Section 2

Account management

It would make most sense to establish Account Management as a revenue centre, making the account managers responsible for the delivery of sales to their existing customers. The whole point of having this department is to retain customers and maximise the business that Prybloxx does with them. If Account Management is a revenue centre, then its managers and staff will be evaluated on the consistency of sales made to existing customers and so the Board will have an insight into how the Department is functioning. The only concern will be that Prybloxx's sales will be driven both by retailers' purchasing decisions and demand from consumers and so it may be difficult to distinguish the effects of the work done by Account Management from that of Marketing and Design. It may be necessary to develop performance measures that reflect activity by Account Management rather than simply focussing on total revenue. For example, the number of customer contacts and the results in terms of orders obtained through those contacts.

It could be unhelpful to establish Account Management as a cost centre because that could be a potential distraction to the newly appointed senior account manager in the first instance. Initially, the Board should permit the new manager to develop a plan for the implementation of an account management function and to be available to discuss the likely advantages and disadvantages of different levels of investment in staffing and other resources. Cost will have to be considered as part of this process, but the important issue is the determination of what account management can do to enhance overall performance. Forcing the senior account manager to focus on costs in the first instance could lead to dysfunctional behaviour and might even discourage good applicants from accepting the post if they feel that Prybloxx lacks commitment to this function.

It would make very little sense to establish Account Management as a profit centre because it would be extremely difficult to measure the departmental profit in a meaningful way and attempting to do so could result in dysfunctional behaviour. Account Management is essentially about augmenting the efforts of other functions in the company. For example, the account manager should maintain contact with customers and should reinforce positive messages such as excellence in product design and manufacturing quality. It will always be difficult to tell whether orders placed through an account manager were earned because of the manager's work or whether the customer would have ordered anyway because of previous positive experience of working with Prybloxx. If Account Management is given the credit for repeat business with existing customers, then the production and distribution staff will have little incentive to meet customer needs.

Negotiation approach

Prybloxx needs to start by understanding Vretail's interest in this matter. It is logical to expect that a major online retailer who sells a wide range of products will have a search engine that enables consumers to find items that are of interest. It would be ideal if Prybloxx could obtain some understanding of the

algorithms that drive Vretail's search engine because that is undoubtedly the factor that is driving the decline in Prybloxx's prominence on the site. It is possible that the algorithms are driven purely by data from previous transactions. If, for example, previous customers who have searched for "building bricks" have tended to buy products manufactured by the leading brand then it would be logical for the algorithm to take that into account in ranking the results of searches through Vretail's website. It is also possible that the algorithm takes account of direct inputs from Vretail, with a deliberate bias towards more profitable items in order to maximise contribution.

If Vretail's algorithm is purely driven by data, then it is unlikely that the retailer will be open to making changes that result in any benefit to Prybloxx because it might simply result in customers abandoning their searches if they do not see an item that attracts them. Making an active change could also damage Vretail's relationship with the leading brand, without creating any benefit to Vretail. Prybloxx should probably invest in some market research to ask consumers about their experiences of making online purchases and the factors that drove them to choose a particular brand. The information obtained may be sufficient to change the products so that online customers are drawn to Prybloxx, without Prybloxx having to seek Vretail's support. Or Prybloxx might start negotiation on the basis that changes are being made that might benefit Vretail's revenues if it favours Prybloxx.

If Vretail is deliberately biasing its search engine to favour the leading brand, then Prybloxx should explore ways in which it could encourage the retailer to adjust its algorithm. Prybloxx's products are recognised as being of high quality and are compatible with the leading brand, so there is no doubt that consumers are willing to purchase them. If the leading brand is favoured because of margin, it would be simple to undercut the leading brand on price. Unfortunately, such an approach might not result in a sustainable agreement because the leading brand might retaliate by reducing its prices and Vretail could only benefit in the short term from a price war. Prybloxx should consider whether there are alternatives to cutting prices in order to reach a win-win resolution, such as specially branded kits that might be offered exclusively to Vretail and so enhance its competitive position against other toy retailers.

Section 3

Revenue recognition

This is a major contract, worth $6 \times \text{V\$}50\text{m} = \text{V\$}300\text{m}$ for the special kits and $\text{V\$}500\text{m}$ for other products, or $\text{V\$}800$ million in total. The basic question is whether that revenue and associated profit can be recognised when the contract is signed or whether there are any other recognition criteria that must be met. The rules relating to revenue recognition from this agreement are set out in *IFRS 15 Revenue recognition*. The most important issue raised by *IFRS 15* in this case is that of the performance obligations associated with the contract because Prybloxx cannot recognise any revenue from this contract unless the revenue has been earned. The standard sets out other criteria, including having a clear transaction price, which are essentially all satisfied for the recognition.

In this case, Prybloxx must create six kits in order to earn the agreed $\text{V\$}300\text{m}$ from this contract. While the memorandum of understanding does not say so explicitly, the six kits will almost certainly have to be finalised and deemed acceptable to both Kidmation and Prybloxx. Furthermore, the kits have to be manufactured and delivered before any cash must be paid, which further confirms that the revenue has not been earned and so cannot be recognised until delivery. There is a similar issue with the minimum order of $\text{V\$}500$ over two years. Firstly, that condition only becomes binding once the conditions relating to the kits have been satisfied and so it cannot be recognised before then. Secondly, the orders have to be placed and the goods delivered before the revenue has been earned. The contract terms would probably be difficult to enforce if the orders did not materialise.

WACC

The contract will increase Prybloxx's revenues and profit considerably, without necessarily leading to an increase in dividends. In that case, the dividend valuation model would suggest that the cost of equity would decrease because of the increase in share price. The fact that the revenue is in the form of a large contract with a major retailer should lower the risk associated with Prybloxx's shares because future profits will be more certain and so this should further increase the share price.

Lenders might also be prepared to charge Prybloxx a lower rate of interest because of the enhanced expectations about future cash flows. The additional business will enhance Prybloxx's ability to manage its debt, which should make it cheaper to borrow further in the future. The cost of existing debt will, however, be left unaffected if calculated on the basis of book values.

WACC is a weighted average of both the cost of debt and the cost of equity, so the fact that both will decline should reduce overall WACC. The fact that Prybloxx is financed largely by equity means that any decrease in the cost of equity should have a more pronounced impact on the overall WACC figure than any decrease in debt.

Funding inventory

It could be argued that funding should match the life of the asset, which might imply that short-term debt in the form of trade credit might be appropriate. It might be difficult to persuade suppliers to advance that amount of additional credit, and the materials that will be purchased could take too long to process, sell and obtain payment.

Long-term debt would have the advantage of being cheaper than equity. It might be difficult to raise the loan without offering existing assets as security because raw materials are unlikely to be acceptable as collateral. Prybloxx's debt is roughly 40% of the total of debt and equity, which might leave room for further borrowing.

Equity would be a permanent source of funding, which might actually be desirable if this increase in activity levels will be maintained. The hope is that Prybloxx will continue to trade with Vretail into the long-term future and that the "permanent" injection of equity will be justified by the need for the ongoing replenishment of inventory to meet these sales. It is also to be hoped that the profits from that business will make the trade with Vretail self-funding through retentions.

Section 4

Decision to enter into contract

The contract appears to offer a significant upside to Prybloxx. The Kits will be based on popular cartoon characters and so there could be strong demand. The Kits will be offered exclusively through a major online retailer, which will give that retailer a significant incentive to push the product and ensure that it has a high profile when customers search. The deal creates an opportunity to develop a better relationship with two potentially valuable business contacts.

Unfortunately, Prybloxx signed the contract despite the fact that meeting its conditions is partly the responsibility of a third party. Prybloxx has agreed to make kits that are acceptable to Vretail as well as to Kidmation. In theory, that means that it cannot control the acceptance of the kits. It was reckless to agree to specific contract terms that gave a third party such control over performance because there was no guarantee that any dispute will ever be resolved, as is proving to be the case.

It is dangerous to argue that accepting a risk was reckless when one has the benefit of hindsight. It could be argued that both Kidmation and Vretail have an incentive to accept any potentially attractive designs because both would benefit from Prybloxx's expertise in that area. It is debatable whether this outcome could have been reasonably foreseen.

Business risks

The first risk is that Prybloxx could lose credibility with this major retailer. Vretail has been working on the basis that it will receive an exclusive range of kits, but Prybloxx will be in a position in which it did not deliver on that commitment. That could leave scope for competing brands of construction bricks to strengthen their relationship with Vretail and so cost Prybloxx revenue in the longer term too.

Similarly, Prybloxx would lose credibility with Kidmation by delaying production until the last minute and then offering limited sales because the products are deemed unacceptable by the largest toy retailer. Kidmation may refuse to agree to permit Prybloxx to use its characters again in the future, which could give other brick manufacturers an advantage in innovating. This failure to offer suitable designs will undermine Kidmation's confidence in Prybloxx's design team.

Failure to reach agreement will have an adverse impact on the design team's morale. These designers are a key source of competitive advantage for Prybloxx and so it is important that they do not start to feel untrusted or undervalued.

Conflict resolution

The two parties appear to be communicating directly with Prybloxx, but not necessarily with each other, which will undoubtedly complicate the resolution of this problem. It would be ideal to create a forum in which the two parties could enter into a dialogue over potential designs, in the hope that either or both might relax their constraints. Ultimately, both companies have a mutual interest in

developing a design that will generate profit for both. Neither will benefit unless they can agree.

Prybloxx should seek clarification from both parties as to why their wishes are so different, with a view to both understanding their concerns and determining their strength of feeling. It may be that one or other of the companies has a clear commercial reason for its position. For example, Kidmation may be keen to ensure that younger viewers are not alarmed by launching merchandise that has an action element. If one side has a view that is entrenched, then that enables Prybloxx to concentrate on persuading the other.

It may be possible to reach a compromise by including a choice of parts within each kit, so that children can decide on the “mood” of the kit. The fact that sales will be made exclusively online via Vretail’s website means that it would be possible to give each equal prominence in the retail environment.

MANAGEMENT/CIMA GATEWAY CASE STUDY
NOVEMBER 2020 & FEBRUARY 2021
EXAM ANSWERS

Variant 5

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SECTION 1

Provision

The accounting treatment for this matter will have to be considered in terms of the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The recall could lead to payments to owners who have suffered personal injury or property damage because of the splintering of the bricks. Injured parties will be alerted to the possibility of making such a claim by the recall. It is unlikely that a provision could be justified because there are three criteria and at least two of them do not apply. Firstly, it is unclear whether it is probable that Prybloxx will have to make any payment because the question of responsibility may be defended, and the courts may find in Prybloxx's favour. Secondly, it is also debatable whether there could be a reliable estimate of the cost because many potential claimants could have attributed the splintering to bad luck and could have cleared up and disposed of the shattered bricks, thereby destroying the evidence.

There is a stronger case for a provision with regard to the cost of reimbursing customers who return their bricks for disposal because the recall creates a constructive obligation to make payment. The fact that Prybloxx knows how many kits were manufactured helps develop an estimate of the total payable, although an estimate will have to be made of the number of owners who have already discarded their kit or who choose not to seek a refund. If Prybloxx is confident in the accuracy of its estimates of the total payable, then it should create a provision for the cost of reimbursing owners and also for the cost of safe disposal for the bricks. If it cannot be satisfied that it has a realistic estimate, then it should create a contingent liability by indicating the facts in a note to the financial statements.

WACC

The cost of equity is determined by the stock market. It reflects the relationship between expected dividends and the share price. The product recall is likely to unsettle the stock market and create the impression of increased risk in the short term. It is clear that Prybloxx will be faced with an unknown cost arising from this recall and there may be other products that will create similar problems. The share price will fall, implying that the stock market is increasing the cost of equity and thereby reducing the present value of expected dividends.

In the longer term, the cost of equity may recover, depending on how quickly Prybloxx can resolve the issues associated with the recall and reassure the stock market that the problems with the purple bricks were very much an isolated issue. Once the costs associated with the recall have been settled, predictions concerning future dividends will probably revert to previous long-term expectations and the cost of equity will return to its previous level. If there are any lingering concerns about further recalls, then the cost of equity will remain higher than it was before. It will not necessarily revert unless the stock market can be reassured.

WACC is also affected by the cost of debt, which is unlikely to be affected by the recall because it seems unlikely to be sufficiently serious to bring about an increase in the risks borne by lenders. The fact that WACC is the weighted average of the costs of debt and equity means that the overall impact of the rising cost of equity will be reduced by the effects of the cost of debt remaining unchanged.

Quality failure

Quality is crucially important to Prybloxx because it sells what amounts to a generic product that is interchangeable with similar products produced by competitors. Any failure could encourage a switch of brands. Also, these bricks are sold as toys and so any quality problems could result in injuries to children. Prybloxx should have an ongoing commitment to quality because dealing with the consequences of shipping products that are of poor quality will raise significant reputational damage.

This defect would have been difficult to prevent or detect because the pigment used in the purple bricks took some time to cause the breakages. Presumably, the checks and tests that Prybloxx conducted at the time revealed nothing because the bricks were strong and met all relevant quality and safety checks when they were first manufactured. The only way this could have been classified as a failure would have been if the problems associated with purple pigment could have been known and predicted at the time of manufacture.

This recall cannot be viewed as evidence of internal failure unless Prybloxx wishes to restrict itself to using tried and tested pigments for its bricks and refrains from introducing new colours. The Character kits require special parts that have to be coloured to match the items that appear in the programme and so avoiding the creation of new colours would seriously restrict that product range. One of the company's selling points is that children should keep their

bricks and add to them over time. It is possible that a similar long-term deterioration could occur with almost any of the colours sold by Prybloxx.

Section 2

Project team

The most important factor is that the Board must have a very clear understanding of what the project team is expected to achieve. Before the team can be briefed, the Board must identify the issues that must be addressed and the importance of each should be determined. The recall will have several objectives and there will undoubtedly be a conflict between those, which could prove confusing for the individual team members because they will have a natural tendency for each to concentrate on those most closely related to their departmental duties. The Board can reduce the risk of conflict within the team by setting a priority for each of the objectives. For example, the Board should make it clear whether the team should focus more on managing costs than on managing the reputational issues associated with the recall. Both are important, but they could clearly be in conflict.

The Board should avoid expanding on the information that has already been provided in respect of the recall, otherwise there will be little scope for the project team to make any decisions. As things stand, the public has been made aware of the dangers associated with these bricks and of the fact that they can be returned for a refund. The project team should be left to decide on further details, otherwise there is little point in having a team. The team should be free to make decisions on the ongoing management of this crisis, including the approach that might be taken to following up the initial recall. If the Board wishes to reserve any particular decisions, then those should be identified specifically in the briefing given to the project team.

The team members should be briefed to ensure that they fully understand that the cross-departmental membership reflects the need to bring different skills to solving this problem. It must be made clear that they are not there to protect the interests of their respective departments. The team leader should be selected on the basis of skill in the area that is regarded as the most important, say marketing, but it should be made clear that this is not a marketing project. The Board should identify the outcome that it wishes from this project and that should be communicated when briefing the team, emphasising the need for all to work with Prybloxx's best interests in mind. The briefing might also remind team members that they are all part of a high-profile project and that their contribution to the outcome may well play a significant part in their future evaluation as members of the management team.

Performance measures

Prybloxx knows how many purple bricks it manufactured and sold and so the proportion of those bricks that is recovered can be measured and used as a performance indicator. Setting a target of 100% will motivate the team to develop ways to contact as many buyers as possible and encourage them to return their purple bricks. If the company can recover and safely destroy all of the bricks that were sold then it will protect itself from criticism and future claims, so this performance measure would align the team's motivation with the company's interests.

The time taken to reach a conclusion for the recall should be measured and should, ideally, be as short as possible. Continuing to seek the return of purple

bricks will be reinforcing the negative message that Prybloxx sold a dangerous product and so it will create additional damage to the company's reputation for delivering quality. Ideally, the project team will oversee a rapid recovery of a large proportion of these bricks and so be able to draw the recall to its earliest possible conclusion.

The number of positive posts on social media might be measured and used to reflect on the impact of the team's external communications with the public. Ideally, it should be possible to concentrate the message on positive aspects, such as the risk being very small and that Prybloxx's recall is a precautionary act by a responsible company. The comments made on social media offer a basis for measuring the impact that the recall is having on the company's reputation and the team should aim to send out a positive message by highlighting, for example, the fact that the problem could not have been foreseen when the kits were sold but that the company remains keen to address the risks.

Feedback from retailers should also be monitored, with particular emphasis on whether the level of repeat orders is being maintained. The project team has to maintain the confidence of retailers, if only through reassuring them that consumers remain satisfied that Prybloxx is a safe and reliable brand. The project team should develop a mechanism for informing retailers of the steps that are being taken to manage the recall so that future sales are not impaired. It may be that the team should collaborate with Marketing in order to ensure that there is a consistent and relevant message to retailers.

Section 3

Net present value

The testing has not yet been completed which means that there must be some doubt about the technical feasibility of the process. It seems highly likely that this investment will succeed, but there may be additional costs that have not been incorporated into the estimates. One response would be to ask the development team for a definitive list of the steps that have to be taken in order to create a working system and to identify any areas that rely on estimates or assumptions, with a view to determining the upper limit to the final implementation cost.

The testing costs incurred over the previous few years will be irrelevant. But the V\$39 million is all relevant cost.

It will be difficult to predict the additional revenues that will arise from the ability to extend the colour palette for Prybloxx's bricks. Presumably, this will have some impact on the creation of Character kits, although children may not be more inclined to buy a toy just because it is a perfect colour match for the on-screen version in their favourite programme. Prybloxx's Board will have to seek advice from the Marketing and Design Department as to the expectations relating to future revenues and the realism of the underlying assumptions.

The hope is that the new process will reduce the reputational and operational costs associated with future product recalls. Predicting the savings from that will be almost impossible because this is a very rare occurrence, although it involves a significant cost when a recall is required. Perhaps the most effective way to take account of this is to set a slightly lower required rate of return than would usually be the case, in order to offset the risk reductions associated with unsafe products against the initial investment.

The net present value will require the Board to determine an appropriate required rate of return for this project, taking account of the risks associated with future cash flows. The starting point is often the weighted average cost of capital (WACC) because that reflects the cost of funding the business as a whole and so it would be a reasonable cost of capital for the evaluation of any expansion. Prybloxx's Board should consider whether this new process reflects an expansion of the main business or whether it requires separate consideration with its own cost of capital.

Operating risks

This investment could create operational risks in the forms of unexpected inefficiencies arising from the new process. One possibility is that the ability to create a much wider range of colours will lead to Prybloxx holding a larger range of coloured bricks than it does at present. In the worst possible case, there will be greater amount of cash tied up in inventory of different coloured bricks and additional operating costs arising from inefficiencies in storage and access to bricks required for kits.

The new process might lead to product risks, with consumers being unwilling to buy existing products because they seem dull in comparison with the new models that will be offered. Prybloxx might find itself faced with the need to withdraw existing products and replace them with new lines, possibly having to incur costs

in scrapping inventories of existing models and bulk stores of bricks. There could be a loss of revenue if initial production cannot keep up with demand for new products.

This could be a bad time for Prybloxx to be selling new colours of bricks, even if the pigments have been proven to be safe. The recent recall and concerns arising from the specially manufactured purple bricks could lead to a product reputation risks associated with the new colours. Customers might be unwilling to accept assurances, given that it took some time for the risks associated with the purple bricks to emerge.

Financial reporting

The accounting treatment of any development costs should be determined in relation to IAS 38 *Intangible Assets*. The IAS sets out both the definition of an intangible asset and the recognition criteria that must be met. If the costs fall within the definition and meet the criteria then they have to be recognised as an intangible asset, otherwise they must be written off as expenses.

The V\$5 million spent in previous years would not have been capitalised because of the uncertainty that would have existed at that time with regard to the successful completion of the development project. The same argument applies to the ongoing research this year because further testing is required, so there is still some uncertainty as to the successful implementation of this process.

The V\$25 million that will be spent on new equipment will be accounted for under the requirements of IAS 16 *Property, Plant and Equipment*. The equipment will be capitalised and depreciated over its expected useful life, just like any other investment in tangible assets.

The final costs arising from the implementation and training will be written off because IAS 38 specifically states that they cannot be capitalised. The Board may regard those as having some longer term value to the company for internal decision making purposes, but that is not relevant for financial reporting.

Section 4

Transfer price

There is a risk that Prybloxx Short Run will indulge in dysfunctional behaviour by using generic bricks from inventory rather than commissioning a better match from Plazchrom. Doing so would increase profits in the short term, but could lead to dissatisfied customers, who feel that the models they are buying are not the perfect match that they had hoped for and so they may be less inclined to place repeat orders. The fact that Prybloxx Short Run can specify generic bricks, albeit that they are not a perfect colour-match, could lead to an underutilisation of the Plazchrom's capacity, which have an adverse effect on Group profits.

Plazchrom may also have an incentive to indulge in dysfunctional behaviour because it can sell plastic pellets to other members of the Prybloxx Group. It would be preferable to make bulk sales to manufacture Character kits. That could lead to a situation in which Plazchrom charges Prybloxx Short Run excessive prices for plastic, which might lead to customers rejecting quotes for bespoke kits because the final price is too high. If Plazchrom's management team believes that Prybloxx Short Run is buying generic bricks unless a special colour match is absolutely necessary, then it may be tempting to further increase selling prices in order to replace lost revenues.

If Prybloxx Short Run can trade with other subsidiaries within the Group, then it might start to encourage subsidiaries to buy a wider range of colours for kits that will then be available for bespoke products. That could lead to further dysfunctional behaviour, with subsidiaries building up inventories in order to trade with Prybloxx Short Run.

It seems unlikely that a high price will have a significant impact on sales volume. Prybloxx Short Run is offering a unique product that is aimed primarily at business customers who are keen to buy gifts for corporate promotion and hospitality. That suggests that a high retail price would be tolerated because the intention appears to be to create prestigious products for customers' business contacts. Customers will be prepared to pay more and might, indeed, prefer to retain an air of exclusivity if these bespoke and colour-matched kits are relatively unusual.

Making specially coloured bricks will be relatively expensive for very short runs in any case because these will need to be moulded, which requires the colour being run through the machinery to be cleared. It would always have been necessary to charge high prices for those very short runs because of the need to recover these high manufacturing costs. Prybloxx Short Run can offer quantity discounts that take account of any declining unit costs associated with larger quantities in the event that a customer wishes to order a large quantity of colour-matched kits.

The Production Department will see transfers from Plazchrom as a cost and will include such costs in the work that it does for Prybloxx Short Run. The Production Department is a cost centre and therefore its only concern will be output being a measure of efficiency. Any element of mark-up and profit in any of the transfer prices between Plazchrom, the Production Department and Prybloxx Short Run clouds the true view of Group profit and could lead to a lack of goal congruence.

Negotiation

The starting point would be to determine the relative tax rates between Varanda and Eastovia. The tax authorities in Eastovia will be more inclined to suspect Prybloxx if it could save tax by declaring profits in Varanda rather than Eastovia. If Eastovia has a higher tax rate, then the Board should aim to be transparent about transfer pricing arrangements and other factors that might lead to lower profits in that country. If Varanda has a higher tax rate, then the Board will still have to be alert to factors such as a reduced tax charge in Eastovia in case the tax authorities suspect that Varanda is offering tax concessions.

Prybloxx should attempt to be a good corporate citizen in Eastovia because the tax authorities may be open to influence from other government agencies. For example, if Eastovia contributes to the local economy through investment and by maintaining staff numbers then there may be pressure from Central Government to refrain from upsetting Prybloxx. Ideally, Prybloxx might develop ways to expand its presence in Eastovia in order to protect its interests there.

Prybloxx should engage in an active dialogue with the tax authorities to ensure that there are no unexpected disputes about the treatment of contentious items that might affect tax liabilities. For example, there could be questions about whether a particular cost should be allowed as an expense for tax purposes and it would probably be less confrontational to seek the tax inspector's advice rather than attempting to impose the treatment. Prybloxx should avoid conflict by agreeing to the tax inspector's opinion unless there is a very strong argument to the contrary.

MANAGEMENT/CIMA GATEWAY CASE STUDY
NOVEMBER 2020 & FEBRUARY 2021
EXAM ANSWERS

Variant 6

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Section 1

Business model

Prybloxx's business model defines value in terms of meeting the changing needs of children. The acquisitions will expand production capacity, which will enable the Group to meet demand. The acquisitions will not interfere and so they are not directly inconsistent with the definition of value.

The expansion will be consistent with the approach taken to the creation of value. The new subsidiaries will extend the Group's ability to meet demand for a familiar product that can grow with children. The fact that the companies all produce essentially the same compatible product means that it will simply be a matter of replacing or modifying moulds to imprint a new logo.

Prybloxx's delivery of value allows for the fact that its products can cross cultures and be understood and enjoyed by customers regardless of culture. One of the subsidiaries is based overseas in a country that appears to be a major market for existing products. Manufacturing bricks in Westonia will help to demonstrate that Prybloxx is aiming for a global market and that it should not be regarded as a Varandan company. Expanding the Group's presence in a major overseas market will also create the opportunity to learn more about foreign customers' interests in the product range.

The one major concern is that Prybloxx aims to capture residual value through the efficient operation of manufacturing and distribution. Having four additional factories in addition to the one that it uses at present could lead to inefficiencies in the form of maintaining duplicate inventories and scheduling production. There will be new logistical challenges associated with creating kits and sets at multiple locations. That may be addressed in part by making a specific range of kits at each location, although that will probably do little more than reduce the

duplication of inventory. Even that would then create further logistical issues with retailers requiring a range of products having to be supplied for more than a single location.

Goodwill

Prybloxx will have to determine goodwill in accordance with the requirements of IFRS 3 *Business Combinations*. Prybloxx will have to determine the fair value of the identifiable net assets that it is acquiring.

One factor that will have to be considered is the fair value of the intangible assets that are an element of the consideration. The four companies will all have established brand names that will become Prybloxx's property, even if it has no particular reason to use them. The purchase price will have to reflect the value of those brands, even if they have little value to Prybloxx. That may lead to an immediate impairment adjustment if the brands are to be discontinued, rather than being sold or licensed.

The goodwill figures could also be complicated by the values attributed to the plant and equipment at each of the four new subsidiaries. These may be valued differently because of negotiations being conducted with different sellers. That could lead to inconsistent valuations for goodwill because the tangible assets are likely to be a major element of the acquisition prices for these companies.

Interpretation

The recognition of goodwill increases assets, which in turn increases equity. That could lead to a decrease in return on capital employed, making the entity appear less profitable. The shareholders might hold the Board responsible for earning a return from the funds that have been invested in goodwill and so they may be disappointed by any reduction in ROCE because of goodwill.

The goodwill figure cannot be increased to reflect any appreciation in value, but it is necessary to conduct an annual review for impairment. That means that there is a risk that impairment losses will have to be recognised in the statement of profit or loss, which could significantly reduce reported earnings.

Goodwill has the effect of increasing equity without affecting debt and so the gearing ratio might decrease. Reducing gearing will make the Group appear less risky.

Some shareholders choose to ignore goodwill when they are calculating accounting ratios. The fact that the asset cannot be sold separately means that it does not provide the same reassurance that is provided by the ownership of assets that can be sold in order to address problems with cash flow.

Section 2

Determining PV

The operating cash flows arising from the acquisition of Hobrix will require decisions to be made about the organisation of production in order to establish how Hobrix will contribute to the overall production capacity and profitability of the Prybloxx Group. Even at this early stage, Prybloxx's management will need an understanding of the equipment and layout of Hobrix's factory, costings of different processes and staffing. That information is unlikely to be readily available unless Hobrix's directors agree to release it because it could affect Hobrix's ability to compete in this market if the acquisition does not go through.

One response to this challenge would be for Prybloxx to conduct a preliminary investigation based upon information that is either publicly available or that Hobrix can release without compromise. That would at least demonstrate a genuine interest in the acquisition, which might persuade Hobrix that it would be desirable to make further information available for the sake of having meaningful discussions about price. This might require Prybloxx to release facts and figures of its own in order to ensure consistency, which would further encourage Hobrix to recognise that this is a serious proposal.

Hobrix's acquisition of the rights to make kits related to a popular television show will also affect NPV. Presumably, the present owners of the company will wish to see that reflected in the company's selling price. The value of those rights to the Prybloxx Group will depend on whether the rights are worth exercising and whether the acquisition will interfere with the ability to exercise. Hobrix may also have signed a contract that gives the show's producers some control over the production and distribution of kits.

Prybloxx will require a copy of the contract granting the rights to use these images and the contract will have to be reviewed by a lawyer to establish whether the rights would be transferrable to the Prybloxx Group. The lawyers would also have to check that Prybloxx would not be in breach of any existing contract terms that forbid the distribution of products based on rival studios' designs. Prybloxx's Marketing and Design Department will have to evaluate the manufacture of the proposed kits, bearing in mind that they may be competing directly with existing products.

Negotiation

As always, the key to any successful negotiation is to establish what both sides wish to accomplish, so that common ground can be found. Prybloxx wishes to acquire 100% of Hobrix without issuing more shares than are necessary because the existing shareholders will not wish their ownership to be diluted. Hobrix's founders will be keen to receive as many shares as possible because that will give them a larger share of the Group's profits. They may also wish to obtain a large enough interest to be able to exercise some influence over the ongoing management of the Group.

Prybloxx should start by attempting to establish a realistic price for Hobrix, based on the founders' interests. It is unlikely that the founders will accept less than the market value of their company and so it would be foolish for Prybloxx's Board to seek to pay less than the shares are worth. It may be possible to determine a valuation based on a suitable comparative company that has an observable market price. For example, if Prybloxx is ten times the size of Hobrix in terms of earnings then it might be realistic to argue that Hobrix is worth one tenth the value of Prybloxx's market capitalisation. Hobrix's founders may counter that they believe that a higher offer is necessary because their company will add a much higher NPV to the Group, but at least Prybloxx will have made a realistic opening bid.

If the founders decide to insist on a larger shareholding in order to retain some influence over the Prybloxx Group, then it may be possible to counter that with a mutually acceptable alternative. The founders may be reluctant to grant full control of Hobrix, only to see the workforce made redundant or suffer a loss of benefits. Prybloxx might offer to provide assurances to the contrary in the purchase agreement, so that the founders could accept a smaller share with a clear conscience. They might also be offered management positions within the Hobrix subsidiary so that they can monitor and influence the management of their former company and protect stakeholder interests.

Section 3

Risks

The injection moulding machines owned and operated by Hobrix may not be wholly compatible with the plastic pellets specified by Prybloxx. That could lead to quality problems, with poorly fitting bricks. Prybloxx should fit some of its moulds to Hobrix's machines as a temporary measure and should run the machines with plastic pellets drawn from Prybloxx's inventory. That will reveal any serious shortcomings with quality and will permit a decision to be taken before any significant costs are incurred.

It might prove difficult to rationalise manufacturing between Hobrix and Prybloxx without creating unforeseen inefficiencies that have a significant impact on price. Having Hobrix make nothing but Character kits, with all bricks being made on site, could lead to some very short runs for the generic bricks that are required. The solution to this concern may be as simple as reviewing the decision not to transport bricks between factories. It may prove more cost-effective to supply Hobrix with small quantities of generic bricks made at the main factory.

Staff may be unhappy at the rationalisation of employment conditions across the group, with demotivated staff considering leaving or striking. Ideally, the contract terms might be rationalised in such a way that any differences are resolved by taking the more favourable approach in every case, although that may be uneconomic if, say, one company pays more to compensate for less favourable conditions. The issues associated with this change must be identified as quickly as possible and negotiations should be started with the workers' representatives.

Project team

The team should consist of managers recruited from both Hobrix and Prybloxx. That will ensure that there is clarity about what is required to rationalise operations across the group. Including managers from both teams will also reduce the likelihood of motivational problems, particularly with Hobrix staff feeling that unrealistic expectations are being imposed on them. The managers from both companies should be matched in terms of seniority, so that neither side feels itself to be at a disadvantage to the other.

The project should be led by a manager from Prybloxx's Production Department, with a deputy from Hobrix's closest equivalent because the key issues associated with this project are the rationalisation of manufacturing and inventory management across the Group. The whole point of this project has been to increase manufacturing capacity and so it is logical to have it led by managers from a production background. The success of this project will hinge on the company's ability to integrate manufacturing and distribution so that it can continue to provide retailers with a steady supply of high-quality products.

The project should also include representation from Human Resources, given the need to rationalise terms and conditions of employment across the Group. It is important that the staff at both companies are reassured that the acquisition of Hobrix is not going to undermine their job security or lead to a deterioration in their conditions. The transition will require staff to be motivated and keen to ensure that the integration is a success and so HR should work closely with the Production staff to ensure that HR negotiations do not interfere with the smooth operation of changes in the factories.

Responsibility centre

The management team at Hobrix may feel that they are at a disadvantage to the remainder of the Prybloxx Group because their factory is significantly smaller than the main factory. Furthermore, they may feel that they are at risk of rationalisation because the operation of the two factories is causing logistical problems with matters such as inventory control. Hobrix's management team could abuse any latitude that they are given in decision-making in order to reduce the risk of, say, their factory equipment being relocated to the main factory and jobs being shed at Hobrix in the process.

Hobrix should not be established as an investment centre because the local management team might be inclined to invest as heavily in property, plant and equipment as possible in order to make it less attractive for the Prybloxx Board to relocate them. Even though the costs of any such investment will be sunk, that would make it less attractive to relocate the Hobrix factory because of the need to write off more assets.

Similarly, it would be unrealistic to hold Hobrix responsible for revenues, either as a revenue or a profit centre because the subsidiary is responsible only for manufacturing products that will be sold by the Prybloxx Marketing and Design Department. The Character kits are likely to have a high margin, which could lead to the main factory's management and staff being demoralised by lower reported margins from their shift to generic brick sets.

It would be ideal to make Hobrix a cost centre so that its management team is held responsible for ensuring that costs are kept under control. The Board should take care to allow for the fact that the nature of the products has changed and so there should be some allowance for staff training and inefficiencies during the transition. That should reduce the risk of dysfunctional behaviour, such as reducing costs by taking risks with product quality.

Section 4

ABM and cost transformation

Prybloxx is well established and has been manufacturing what is effectively the same product range since its foundation. That could have led to complacency over the operating costs that are being incurred. ABM and cost transformation techniques would focus attention on the reasons for incurring costs and whether those costs could be reduced or even avoided. It should be borne in mind that Prybloxx manufactures a very large range of different parts, some of which are stored in inventory for a significant period before being sold and so there could be significant potential for saving costs in manufacturing and inventory management.

The fact that Prybloxx is going through a period of expansion because of acquisition suggests that this would be an excellent time to introduce ABM information systems. The integration of Hobrix into the Group creates an opportunity to reflect on how best to manage different performance centres across the entire group, including the new subsidiary. Comparing practices between the existing Group and Hobrix would be a quick means of identifying areas that might be fruitful areas for investigation.

A cost transformation model would encourage managers throughout the group to understand the importance of managing costs. That may require a change of culture, depending on whether the Group has been sufficiently conscious of costs in the past, but even if the Group already has a healthy culture, the review process associated with adopting the model will reinforce the benefits. The model also encourages staff to be aware of risks and so there is less likelihood of dysfunctional behaviours that might arise from a simple cost-reduction exercise.

Cost transformation requires managers to understand costs and so helps to align cost management with the company's best interests. It recognises that some costs should be viewed as delivering potential benefits that outweigh the downside, such as the creation of new products. Again, the fact that Prybloxx is going through a period of expansion suggests that this would be an ideal time to address questions of what constitutes a sustainable approach to cost management.

Impairment review

Impairment reviews require a comparison between the book value of an asset and the higher of the asset's fair value and its net present value. In the case of goodwill on acquisition, that book value reflects the amount paid over the fair value of the subsidiary's net assets at the date of acquisition. That suggests that the impairment of goodwill is likely to be an issue only if the fair value of the subsidiary itself has declined or the expected cash flows from future operations are in doubt. These figures are generally difficult to determine because there are no observable market values for subsidiaries and the value in use would be difficult to determine.

Hobrix has only been a subsidiary for a matter of a few weeks and so it is difficult to imagine why the value of the subsidiary might have decreased to the extent that an impairment review is required. The shareholders are likely to interpret any such adjustment as a clear admission that Prybloxx's Board made a reckless investment worth V\$200 million, which would seriously undermine the Board's credibility. The only realistic justification would be for Prybloxx to argue that it purchased Hobrix in order to acquire its assets and that the goodwill has no value to the Group.

Parent companies are required to conduct annual impairment reviews and so the need for such an adjustment must always be considered. In this case, the Board might revisit the reasoning behind its decision to pay V\$200 million for Hobrix. If the Board believes that it should have paid significantly less for the acquisition then the reason for that belief should be explored, focussing on whether the overpayment was due to paying too much for the assets or for the company as a whole. Given the brief period since Hobrix was acquired, it is almost certain that the Board could justify carrying goodwill at cost, with no impairment adjustment.

If the Board reflects on the acquisition and concludes that it overpaid for the subsidiary, then the simplest response might be to write goodwill on acquisition off entirely. That would have the effect of avoiding revisiting the need for an impairment adjustment in future years and so would avoid creating further concern over the Group's future through the recognition of further losses. It might also be easier to justify a full write-off to the shareholders on the grounds that a precise valuation is difficult to justify and so it is logical to write the value down to zero.

This document covers both Management Case Study and the CIMA Gateway exam. It should be read in conjunction with the examiner's suggested answers and marking guidance.

General comments

The Management Case Study (MCS) and CIMA Gateway examinations for November and February 2021 were based on a pre-seen scenario which described Prybloxx, a quoted company that manufactures a range of plastic bricks that are sold globally as toys and educational products. The pre-seen indicated that Prybloxx's products are used across a wide range of ages, with simple construction toys being used by pre-school children and sophisticated construction kits being aimed at young teenagers. The bricks also have educational and practical applications, including use as teaching aids and as flexible prototyping materials for use in design and other engineering applications.

Six variants were set on Prybloxx:

- Variant 1: Prybloxx is considering the introduction of personalised construction kits that will be designed by customers.
- Variant 2: Prybloxx is developing a new product range that will offer engineering components that will enhance educational play and also practical applications in design work.
- Variant 3: Prybloxx is considering the addition of electronic components that will add exciting new play opportunities to kits.
- Variant 4: Prybloxx is facing problems because a major online retailer appears to be favouring competitors' products when customers conduct searches on the retailer's website.
- Variant 5: Prybloxx faces product liability issues because a particular colour of brick has been found to become unsafe over time.
- Variant 6: Prybloxx is exploring the implementation issues associated with expanding production capacity by acquiring a competitor.

Each of the six variants complied with the published blueprint and covered the core activities in the prescribed weightings. Each variant consisted of four sections and each of these sections was further subdivided into two or three separate tasks. The weighting attached to each requirement was stated and candidates were advised to allocate the time available for each requirement on the basis of those weightings. Markers were instructed to adopt a holistic approach to marking, which meant that the answer to each requirement was read and judged on its merits. Markers were provided with detailed marking guidance with the characteristics of level 1, level 2 and level 3 answers for each separate task. The total mark available for each task was split into three levels: level 1, level 2 and level 3. It was also possible to achieve a score of zero for a trait if there was no rewardable material.

From the candidate's perspective, the key to scoring well is to read and then answer the questions. The expectation is that candidates will be familiar with the context of the company and its industry from their prior study of the pre-seen. It is important that they then address the question requirements in accordance with the specific requirements. Higher marks are awarded to fuller answers that are both relevant and correct. Relevance and correctness are frequently judged in the context of the scenario, taking account of the nature of the business and the specific issues raised by the new information provided in the variant itself and the tasks set by the requirements.

A level 3 score generally requires a combination of good technical understanding and good application to the issues arising from the scenario. Level 3 scores also require clear and comprehensive discussion and frequently seek an explanation or justification for the candidate's recommendations or arguments. Candidates should always bear in mind that the MCS and Gateway exam is essentially a simulation of a series of work-based tasks that represent the professional competence appropriate to this level.

Level 1 scores tended to be awarded to answers that demonstrated some or all of the following:

- failure to address the requirement in the task.
- limited technical understanding of the syllabus content.
- unsupported assertions that had little or no justification.
- illogical or unrealistic application to the issues arising from the scenario.

Variant 1

Section 1

Section 1 described a proposal to introduce a new product line, called My Prybloxx, in response to declining sales of basic Prybloxx. Newly developed software would allow customers to design their own kits, they could design a model and purchase the necessary parts online which would be supplied with assembly instructions. The customisation would require Prybloxx to pick and pack the bricks and instructions in a specially printed box. Candidates were told that this could be viewed as disruptive because the new product range would change the way in which Prybloxx does business.

The first task asked candidates to evaluate the impact the new product range will have on Prybloxx's business model.

A level 3 response to this task would have clearly evaluated the ways in which the new product range was consistent with the existing business model, as well as explaining the ways in which the new product would cause significant changes. For example, it would be appropriate to consider whether the new range would be truly disruptive given that it would be sold alongside the existing product lines. On the other hand, one element of the business model is that Prybloxx operates efficiently and the new product will be less efficient to produce as each kit will need to be created, boxed and shipped individually. Level 2 responses were more superficial but showed understanding of Prybloxx's business model and some of the likely changes which will be caused by the new products. Low level 2 and level 1 responses often did not demonstrate an understanding of the new product line and the changes its introduction would require. Some candidates did not fully consider the business model, instead discussing whether or not the proposal should go ahead, which was not the question asked in this requirement.

The second task asked for an explanation of the issues that should be considered when determining the cost of each My Prybloxx kit.

Level 3 responses considered the impact of the new product on costs, for example considering the likely difficulties associated with ensuring that each model designed is profitable without them being prohibitively expensive, as well as the possibility that a customer could inadvertently design a model which could be built more cheaply from existing standard kits. Better candidates provided thoughtful responses which clearly applied their knowledge to the costing problems presented by the new product line and linked this to pricing and customer demand. Level 2 responses showed less focussed understanding of the costing issues and some did not fully connect these to pricing and customer demand. Level 1 responses were less well thought through, with candidates making general, theoretical comments about costing rather than applying their knowledge to the specific issues arising from this scenario. Weak scripts often did not consider the link between costing and pricing or the potential impact on customer demand.

Some candidates wrote little in response to the costing requirement, possibly due to time management issues.

Section 2

In section 2, the decision has been made to proceed with the launch of My Prybloxx. This will require a separate Fulfilment Centre for the new product line where parts will be picked and packaged and boxes and instructions printed. Bricks and other parts will continue to be manufactured in the existing Prybloxx factory. The Fulfilment Centre will be owned and operated by a new subsidiary company.

The first task of the question addressed the choice between buying an existing logistics company as a going concern and adapting it for the specific requirements of My Prybloxx, or setting up a new company and buying the premises and equipment needed. Candidates were asked what the impact of the chosen approach would be on the financial statements of the new subsidiary and the Prybloxx Group's consolidated results.

Level 3 responses provided a full discussion of both the subsidiary and group results, addressing issues such as recognition of goodwill and the fair value of assets and liabilities if buying a going concern and the costs of setting up a new company. Level 2 answers often did not differentiate discussion of subsidiary and group statements, or fully explore the different impact of buying a company or setting up from scratch. Level one and lower level 2 responses often did not address the impact on the financial statements, instead focussing on how a consolidation should be carried out, often giving detailed step-by-step instructions for this but not really addressing the requirement to consider the reporting issues.

The second task asked what type of responsibility centre would be most appropriate for monitoring the financial performance of the Fulfilment Centre.

Level 3 responses addressed this well, considering a range of relevant factors and setting out the advantages and disadvantages of evaluating the Fulfilment Centre team as an investment centre, a profit centre, or a cost centre, making a clear and well-supported recommendation. Issues such as the importance of considering which factors can be controlled by the Centre management and the need to consider the interests of the Group as a whole were evaluated. Level 2 answers often made little use of the information presented in the case study and provided only theoretical points about different types of responsibility centres without application to the specific details of the Fulfilment Centre. Whilst these answers might give accurate descriptions of the types of responsibility centres, they did not include sufficient analysis to support a recommendation. Level 1 responses often explained that monitoring performance is important and made recommendations such as the adoption of Balanced Scorecard, but did not address the requirement to consider the type of responsibility centre which would be most appropriate for the Fulfilment Centre.

Section 3

In section 3, the Marketing and Design Director has provided a briefing explaining the approach to pricing Prybloxx's existing products. It has been decided that My Prybloxx will be established as a profit centre, obtaining bricks and other components from Prybloxx's Production Department which is run as a cost centre.

The first task asked for an evaluation of the possibility that transferring parts from the Production Department to My Prybloxx at marginal cost would prevent suboptimal behaviour.

Level 3 responses addressed this requirement well, exploring transfer pricing issues in the context of the information provided and demonstrating an understanding of dysfunctional behaviour. Discussion recognised that whilst transferring at cost would be consistent with the fact that the Production Department operates as a cost centre, it could be reluctant to support My Prybloxx. The need to pick and transfer small quantities of bricks may increase costs and My Prybloxx might be unwilling to accept a cost figure higher than production cost. Level 1 answers showed less understanding of transfer pricing and often drew a conclusion as to whether or not marginal cost was an appropriate choice without any justification.

The second task asked for an explanation of how the choice of retail pricing strategy will affect key accounting ratios based on the Prybloxx Group's consolidated financial statements.

Level 3 answers explored the impact of pricing, and price-elasticity of demand, on specific ratios such as asset turnover and inventory turnover, as well as profit percentages. Level 1 answers again lacked depth and many did not link pricing strategies to accounting ratios.

The final task asked for a recommended retail pricing strategy for My Prybloxx, with a justification taking account of the nature of the product and remembering that the My Prybloxx software will restrict the selection of parts to generic items.

Level 3 responses explored the existing pricing strategy and whether it would be appropriate to adopt this for My Prybloxx. Relevant considerations included the potential reaction of competitors and the need to ensure that My Prybloxx prices do not undercut Prybloxx. Recommendations were clear and supported. Many level 1 responses made recommendations as to which strategy should be adopted without any justification.

Section 4

Section 4 addressed planning the project to deliver the My Prybloxx Fulfilment Centre. Candidates were provided with a critical path for the project and some details of the project requirements. Each of the executive directors had nominated a manager to work on the project and each believed that their manager should be project manager.

The first task was to explain the problems which would arise if the directors could not reach agreement on who should be the project manager, and also to recommend which manager would be the most appropriate.

Level 3 responses discussed the need for the project team to cooperate in order to achieve a good outcome and explored each of the director's functions in turn, looking at how central they would be to project success. Some level 3 answers focussed on the skills and experience needed to be an effective project leader. Most gave a clear and well-supported recommendation. Level 2 answers were often less well developed and many focussed on theoretical arguments about how a team should be created and developed, rather than applying this knowledge to the scenario. Many level 1 responses did not address the question requirement, for example explaining Tuckman's Team Building Theory without any application to the scenario.

The final task was to identify the key operational risks that could arise after the launch and recommend how the project team should manage them during project implementation.

Level 3 responses identified risks such as production scheduling difficulties, problems with the app and bad publicity arising because of problems with kits or late deliveries. They also made appropriate suggestions for responses to those risks. Level 2 answers often identified a smaller range of risks and provided less well-developed suggestions for appropriate responses to them. Level 1 explained what risks are but did not relate this to the specific scenario.

Variant 2

Section 1

This section introduced a proposal that Prybloxx would introduce a new range of products that would compete directly with a similar range offered by a direct competitor. This range will continue to focus on interchangeable building blocks, but it will add engineering components, which will raise both manufacturing issues and marketing issues.

The first task asked for the identification and evaluation of the challenges associated with predicting costs and revenues for this new range. Most candidates were able to identify at least some challenges. Level 1 answers tended to amount to lists of problems associated with predicting costs and offered little more than a brief explanation of their relevance. Level 3 answers generally addressed both the identification and the evaluation issues, as required by the task. A level 3 answer required an explanation of the seriousness of the challenge and the extent to which it might be overcome.

The second task asked for an evaluation of the usefulness of a competitor's segmental report for predicting costs and revenues from this new range. The exhibit provided breakdowns of revenue and operating profit by product range. Level 1 answers tended to make descriptive observations, such as the fact that engineering sets had increased in terms of shares or revenue and operating profit. That was clearly a relevant argument but there were further arguments that could be made on the basis of that information. Level 2 answers focussed on the usefulness of the report rather than simply offering a descriptive interpretation of it. Level 3 answers generally brought out a clear explanation of the limitations of the segmental analysis as well as its relevance.

Section 2

This section dealt with implementation issues associated with the development and launch of the new product range.

The first task dealt with the fact that the designers from the Design Department are not interested in working on the technical aspects of this project, such as designing cogs and gears for engineering applications, because they prefer to work on toys and models that create artistic challenges. The requirement asked how the design team's engagement might be improved. Level 1 answers tended to simply expand on the problems that would arise from a lack of engagement and to expand on the fact that this attitude could threaten the launch of the product range. Level 2 answers offered more realistic responses, usually with some justification for the recommendations being made. Level 3 answers focussed on the requirement and provided full responses that would improve matters. Many of these better answers demonstrated that the candidates had thought about the problem and how it might be overcome. As always, any relevant argument was marked on its merits.

The second task dealt with the difficulties associated with the Design Department obtaining the support that it requires from the Production Department. The Head of Production is reluctant to release staff to advise the Design Department on the production constraints associated with this new product. The requirement asked about the challenges associated with setting a suitable transfer price for Production Department time that would address the suboptimal behaviour arising from the inability to ensure satisfactory cooperation between departments. Level 1 answers tended to ignore the requirement and offer a list of different transfer pricing strategies, often without drawing a clear conclusion as to which would address the challenges. Level 3 answers focussed on the requirement and identified realistic challenges that could arise. Generally, level 3 answers identified concerns associated with determining opportunity costs and also with the attitudes of the departmental managers.

Section 3

The implementation issues associated with the new product range continue.

The first task dealt with the need to finance the acquisition of new moulds and manufacturing equipment that can deal with the new product range. The requirement asked about the factors associated with debt and equity that affected their suitability for funding this specific investment. Level 1 answers generally demonstrated little or no discussion of the factors and their relevance. Answers at this level tended to describe debt and equity, with little attempt to identify the factors. Some candidates went into detail on specific financial instruments, with little or no attempt to address the requirement. Level 3 answers tended to start by identifying the features of the investment, such as the potential stability of future cashflows and the suitability of the assets to serve as collateral. They also discussed Prybloxx's present financial position, which is also relevant to the evaluation of the factors associated with debt and equity.

The second task dealt with the impact that the new product range would have on the integrated reporting capitals, which were listed in the task. Level 1 answers tended to define and describe the features of the different capitals, with little or no discussion of how those capitals would be affected by the introduction of the new product range. Level 3 answers offered opinions as to how the new product would affect each of the capitals. Each of the capitals permits some scope for interpretation and so answers were marked on their merits, allowing for the fact that candidates might have their own views on how the product should be reflected. Level 2 answers tended to be inconsistent in their approach, with a good discussion of some capitals and a weaker discussion of others.

Section 4

The final task dealt with three further implementation issues.

The first task identified three potential markets for the new range and asked how the selection of the key market would affect the design and launch of the new range. Level 1 answers tended to offer descriptive accounts of the interests of the three potential markets, with

little real insight into the implications of that choice. Level 3 answers tended to offer more of an overview of the issues that would arise from the selection. For example, different markets will have different needs and interests and that would affect the composition of the kits.

The second task asked about the pricing of the new range. Level 1 answers tended to simply describe the strategies that are available, with little or no attempt to offer a properly supported recommendation. Level 3 answers reflected the information that was available from the scenario, including details of the competitor's product and pricing. That resulted in a recommendation that had a clear commercial logic. Level 2 answers generally consisted of recommendations but with room for improvement in terms of the extent of the justification offered.

The third task asked about the product and product reputation risks associated with the development of the new range. Level 1 answers tended to talk in very general terms about risk, with little real application to the scenario and the requirement. Level 3 answers offered clear and relevant identifications of the specific risks in the scenario and demonstrated an understanding of the concept.

Variant 3

Section 1

Section 1 provided a proposal identifying a company “Toyz” that manufactured electronic components that could be incorporated into Prybloxx’s model kits. The proposal also stated that the owners of Toyz would be prepared to sell their company.

The first task asked candidates to discuss the suggestion that adding Toyz’s electronic components would be consistent with Prybloxx’s business model.

It was expected that candidates would refer to Prybloxx’s business model in the pre-seen document and use this as the structure for their answers. However, this was not always the case with some candidates not referring to it at all or just discussing one of the elements.

A level 3 response would have considered all 4 elements making up the business model, offering a good discussion of the relevance and consistency of the proposal to the business model. Most candidates did use the business model definitions from the pre-seen and the level 3 candidates were able to adapt the details from the proposal into the business model and could clearly demonstrate whether each element would be met. The level 3 candidates were able to provide a balanced discussion by not only suggesting where the model could be met (which is what most candidates tried to show) but also instances where it might not be met. Level 1 answers often only provided a repeat of the pre-seen definitions of each element of the business model and they could not demonstrate whether the proposal would be consistent with the model.

The second task asked candidates to identify and evaluate the significance of the challenges associated with negotiating the potential acquisition of Toyz with the company’s present owners.

This part was generally not well responded to as candidates did not discuss the challenges relating to the negotiation. Instead, they described the negotiation process thus limiting the number of marks that could be awarded.

A level 3 answer to this task was expected to identify and discuss the challenges relating to negotiation with good justification of their significance. Unfortunately, most candidates did not seem to understand what was required of them and, instead of discussing the challenges associated with negotiating the potential acquisition, they discussed the steps involved in a negotiation process so answers covered the four steps of preparation, opening, bargaining and closing. Level 1 answers just outlined the negotiation process from a purely theoretical view and were not able to bring in any relevant detail from the scenario

Section 2

In section 2, candidates were informed that Prybloxx had decided to proceed with the acquisition of Toyz. A schedule was provided which listed some of Toyz's assets: property, patents and trademarks and inventory.

The first task asked candidates to explain the problems associated with determining the value of Toyz's property, patents and trademarks and inventory for the purpose of valuing goodwill on the acquisition. The task was generally not answered well as candidates often did not know what to do with the assets other than to state that the asset needed to be recorded at fair value which might be a problem to ascertain but without explaining what the problem was or how it could be addressed.

A level 3 response required candidates to discuss what the issues were with determining the fair value of the assets for the purpose of determining goodwill on acquisition with the explanation extending into methods of overcoming the issues. For the property, level 3 responses would appreciate that the fair value would equate to the market value at acquisition date and suggest that an external valuer, or a review of similar properties in the area for sale, could be used to assess the market value. A level 1 response tended to just reproduce the details from the question. For the property, the level 1 candidates could only repeat that the land and buildings were purchased 18 years ago and were valued at cost less accumulated depreciation so no credit could be given as candidates need to do more than just reproduce the exam material.

The second task asked candidates to identify the problems with applying IAS38 Intangible Assets to Toyz's post-acquisition expenditure to make the electronics compatible with Prybloxx's bricks and to recommend appropriate responses to those problems.

Overall, most candidates could demonstrate a reasonable level of technical knowledge relating to IAS38 but many had difficulties in applying the information in the scenario to the Standard.

A level 3 response would demonstrate good technical knowledge of IAS38 and good application to the scenario to address the problems with meeting the Accounting Standard. These candidates were able to provide a thorough explanation of the conditions that needed to be satisfied and provide a good discussion of whether they could be met, especially where the scenario indicated that there may be unsuccessful attempts to finalise the designs. Level 1 candidates were unable to discuss the aspects of the scenario in relation to meeting IAS38, with many showing poor technical knowledge of IAS38.

Section 3

Section 3 informed candidates that Prybloxx had acquired Toyz and was starting to develop new products that incorporated the electronic components. They had purchased an electronic kit manufactured by a rival and attempted to estimate the cost of creating a similar kit. A schedule of the estimated costs was provided.

The first task asked candidates to evaluate the potential usefulness of target costing in developing the new products.

Overall, candidates could provide a basic definition of target costing but many candidates did not explain why it would be useful to use in the current market, or the fact that Prybloxx traditionally competed against this rival on quality rather than price. After providing the definition of target costing, candidates usually then moved the answer into a generic one of controlling costs and applying value analysis, value engineering and functional analysis

A level 3 answer was able to go beyond just providing a basic definition of target costing, bringing in relevant parts of the scenario such as competition in the marketplace so explaining why target costing would be useful. In addition, they were able to utilise the schedule of costs that had been provided to show where there may be possibilities of savings and the impact this would have on the overall costs and the ability to meet the target cost. The level 1 answers just gave a basic definition of target costing without explaining its usefulness and were unable to bring in details from the scenario or pre-seen to enhance their discussion.

The second task asked for a discussion of the problems faced in choosing a pricing approach to set a recommended retail price for the new kits and to recommend with reasons the approach that should be adopted. Again, candidates showed a good general knowledge of pricing strategies but, while this was a good starting point for the requirement, a level 3 answer was expected to discuss implications of pricing decisions in relation to the scenario and to recommend a pricing strategy with good justification. These candidates were able to adapt their knowledge of pricing strategies well to the scenario bringing in details such as there is already competition in the market, and that it would be difficult to know how much customers would be prepared to pay for the new product. Level 1 answers usually gave a definition of just a couple of pricing strategies with no link to the scenario and often no overall recommendation of which would be suitable.

Section 4

Section 4 informed candidates that the new kit was ready and that two alternative launches were suggested. One suggestion was that the first kit would be launched as soon as it was ready in three months' time with restricted press release and online catalogue. The other option was to release a full range of kits in seven months' time that would be heavily promoted.

The first task asked candidates to discuss the challenges of evaluating the product reputation and operating risks associated with choosing between the two launch approaches and to recommend responses to the challenges.

Many answers here were far too brief. Many candidates didn't include enough risks and usually just focused on the fact that competitors had already released their models and presented the same discussion for both the 3-month launch and the 7-month launch making the answers very narrow in content. A level 3 answer identified the challenges associated with evaluating the risks and provided good responses to the challenges with justification. A level 3 answer was usually split into a discussion of the 3-month launch then a

discussion of the 7-month launch, with an overall summary and recommendation at the end. These candidates could suggest a variety of risks, but more importantly they could respond to the challenges to provide ways of overcoming the risks. A level 1 answer typically only included one or two downside risks and they were usually identical for the two launches. The answers were too brief and no response was given to the identified risk.

The second task asked candidates to explain the implications for Prybloxx of the possibility that the remote-control feature could become 'disruptive technology'. Many candidates struggled with this question as they did not seem to know enough about 'disruptive technology' to provide a discussion. Some candidates could give a brief description and a sentence about Uber as an example of disruptive technology but then seemed to be unable to expand the details or make them relevant to Prybloxx.

A level 3 response was expected to define disruptive technology and then provide a good explanation of the implications of this for Prybloxx. The level 3 candidates were able to bring into their answers discussions on the current business model and how it would have to change, implications for staffing and investment, what customers wanted from their products, competitors and their resulting actions and the effects on the traditional business. It was rare to see these answers. A level 1 answer typically could do no more than provide a basic definition or example of disruptive technology but then could not discuss any impacts this would have on Prybloxx. Instead answers typically just discussed whether adding the technology to the kits was a good idea.

Variant 4

Section 1

Prybloxx is concerned because a major online retailer's search engine is favouring a competing brand.

The first task asked about the implications of the discovery for Prybloxx's business model. Most candidates framed their answer in terms of the formal description of the business model as provided in the pre-seen. Level 1 answers tended to summarise and describe the business model, with little or no discussion of the fact that Prybloxx appears to be struggling to promote its products through this particular retailer. Level 3 answers generally focussed on the issue in the scenario and linked that to the different aspects of value as described in the business model. Level 2 answers tended to fall between by offering some relevant discussion that was more limited than the more comprehensive discussion required for Level 3.

The second task asked whether the concerns about the visibility of Prybloxx's products on this website suggests that insufficient attention has been paid to the company's value chain. Level 1 answers tended to overlook the requirement and describe the value chain. Level 3 answers generally offered a relevant discussion that focussed on the requirement. Those answers often addressed both sides of the argument, while drawing an overall conclusion that pulled together the stronger argument. It was encouraging to see that a number of candidates were able to develop an argument about the relevance of managing the value chain in this context.

Section 2

A new Account Management Department is to be established to manage sales to existing major customers.

The first task dealt with the manner in which the new department should be established as a responsibility centre. Level 1 answers tended to focus on the description of the different types of responsibility centre that are available. Such answers failed to offer a clear recommendation or, if they did, it was left unsupported. Some level 1 answers demonstrated a very weak grasp of the distinction between the different types of responsibility centre. Level 3 answers generally demonstrated an awareness that the selection of a suitable type of responsibility centre depended upon the duties of the department's managers and the matters that are under their control. Level 3 answers generally earned most credit from the justification for their recommendations rather than for necessarily selecting one particular type of responsibility centre.

The second task sought an approach to entering into negotiations with the retailer in order to persuade it to modify its search engine with a view to making Prybloxx more visible when customers input generic searches for items that it sells. Level 3 answers tended to demonstrate a commercial logic that reflected the relative bargaining positions of Prybloxx and Vretail. Such answers seem to have a realistic prospect of succeeding. Level 1 answers tended to describe a generic approach to managing a negotiation. Level 2 answers suggested an approach but offered less detail on ways in which Vretail might be prepared to favour Prybloxx over competing brands.

Section 3

Prybloxx has entered into a contract with Vretail that commits the retailer to significant purchases over the next two years.

The first task asked about the recognition of the revenues from this contract during the two-year period. Most candidates were aware of the need to comply with the requirements of IFRS 15 in this case. The quality of answers depended on candidates' ability to offer an argument concerning the recognition criteria set out in the IFRS. Level 1 answers generally referred to the fact that recognition criteria existed and had to be met, but made little or no attempt to apply that logic to the scenario. Level 2 answers said a little more about the performance obligations set out in the contract and so were able to offer some explanation of when the revenue could be recognised. Level 3 answers provided a full explanation of the performance criteria.

The second task asked how the contract would affect Prybloxx's WACC. Candidates were generally aware of the concept of WACC and of the factors that might affect it. Marks varied according to the explanation of the concept in the context of the scenario. Level 3 answers generally addressed the complex interactions that might be created by this contract. These included the impact of the contract on profits and cash flows, which led on to an explanation of the effects on the risks associated with equity and debt. This requirement was answered well, with level 3 answers demonstrating an appreciation of the impact of the contract on both equity and debt. Level 2 answers generally focussed exclusively on debt or equity and so missed the opportunity to develop their arguments. Level 1 answers tended to offer an explanation of WACC and its calculation, with little direct discussion of the requirement.

The third task asked about the manner in which a major investment in inventory should be financed. Answers varied in quality, depending on the extent to which candidates addressed the issues raised in the scenario. Level 1 answers generally described the differences between debt and equity, with little or no discussion of the relevance of those differences to the company's needs. It is, for example, unlikely that a rights issue will be a suitable response to raising this amount in the time available. Level 3 answers highlighted the factors in a manner that reflected the asset and the timing.

Section 4

Prybloxx has purchased a licence to make kits that represent a popular television show and has agreed to give Vretail exclusive rights to sell those kits. Unfortunately, the copyright owner and the retailer are in dispute over the development of the kits.

The first task asked whether it was reckless of Prybloxx to have entered into a contract that required agreement with two independent third parties. Answers varied in quality. Level 1 answers generally overlooked the fact that the outcome of the decision to sign did not necessarily mean that Prybloxx had been reckless. Level 3 answers offered an argument based on what was likely to have been known at the time of signature and what could have been reasonably foreseen.

The second task asked about the operating risks associated with permitting the contract to lapse. This requirement was answered well, with most candidates achieving a level 2 or 3. Level 2 answers identified the basic reputational issues that could be expected if Prybloxx disappoints a major retailer by failing to honour a commitment. Level 3 answers made very similar arguments, but offered greater development.

The third task asked for a recommendation for the resolution of the conflict between the third parties involved in these kits. Level 1 answers tended to describe generic conflict resolution strategies in some detail, with little or no direct application to the scenario. Level 3 answers focussed on the reasons for the lack of agreement and proposed a realistic strategy for its resolution.

Variant 5

Section 1

Following a small number of complaints, including a physical injury, Prybloxx have carried out an investigation and have discovered that a certain feature element of a now discontinued kit tends to become brittle after approximately 2 years and may shatter under pressure.

Prybloxx have issued a product recall for 800,000 units distributed and sold but need to understand the implications, for provisions in the financial statement, the likely impact on WACC and the evidence of quality failures within Prybloxx.

The first task asks for advice to the Board on whether we should make provisions in the financial statements in respect of the hazards associated with splinters from bricks and in respect of the cost of reimbursing customers.

The vast majority of candidates dealt with identifying the costs associated with the reimbursement process for the return of kits under the recall achieving level 1 with ease. Some of these failed to identify the applicable aspects of IAS37 or were unable to justify the accounting rules adequately, thus grading through the level 2 attainment. On the whole however, while most candidates provided reasonable coverage for the recall aspect, extremely few actually covered the potential compensation or litigation costs which might be possible or the likelihood of these being upheld in any legal proceedings, so there were a minority of candidates who achieved a level 3 response.

The second task requested candidates to consider the likely impact this recall would have on Prybloxx's WACC.

Answers here were rather weak on the whole. Many candidates were confused regarding whether an increase in WACC was financially favourable or unfavourable for the firm. Many identified that the expectations of the stock market and the effect on share price would be more likely to influence WACC than the relatively small amounts of cash required to carry out the reimbursement program. Level 3 responses considered the efficiency of the market and the speed and efficiency with which Prybloxx dealt with the situation as being the crucial factors affecting WACC in the short to medium term.

The final task in this section asked candidates to evaluate concerns some Board members may have about quality failures within Prybloxx. There was some potential evidence of time management issues here as many candidates provided few details on this part. Although often brief, most candidates identified that this was an external failure, that the quality issue had reached the customer and therefore had some reputational impact. Better candidates went on to explain how difficult it would be to predict a product failure two years after production and that wider research should be done as to possible failures on products using similar chemicals in their production.

Section 2

Following extended discussion at Board level it has been decided to form a project team to implement the product recall.

The first task asked candidates to advise the board on factors needing to be considered to ensure the project team has suitable terms of reference.

While many candidates gave considerable discussion on the nature of teams, leadership, cross departmental composition and the methodology of project management in itself, many did not discuss the influence of the board in its success. Higher scoring candidates observed the need for clear objectives with defined milestone completion to understand rate of progress against those objectives. Level 3 answers combined Board clarity with success measures and a forward look to lessons learned.

The second task here asked for recommendations, with reasons, as to four performance measures to monitor the progress of the project team.

This, on the whole, was very well answered. The vast majority of candidates were able to make good recommendations as to the measures to define, percentage of units traced or recalled, costs per unit, overall cost of project, customer feedback, social media posts. Good level 2 and level 3 responses.

Reasons given were also good although not quite so thorough as in the measures themselves. Often somewhat generic but most attaining a good level 2 response. Higher scoring candidates were able to differentiate business benefits derived from carrying out successful completion of the project.

Section 3

A new process is being defined and developed to produce bricks of any colour, allowing matching and small run production.

Part one asks candidates to identify the challenges associated with determining the NPV of the project. On the whole this was not well answered with most of the discussion being around the NPV without much regard to its make-up, expected cash flows, cash flow timing and so on. However, many candidates identified some of the difficulties in determining the differences in future cash flows derived from this new process.

Part two asks candidates to identify operating risks associated with the commercial exploitation of the new process.

This on the whole was very well answered with candidates appreciating the relative higher costs associated with short run setup and consequent pull through on pricing relative to standard bulk production. Higher scoring candidates recognised the difficulties with

inventory identification and storage of potentially thousands of new stock items and were able to provide good reasoning behind the potential risk areas.

The final part of the question related to the treatment of the costs described in the report in Prybloxx's financial statements.

This on the whole was very well answered including the allocation of the costs. A few candidates failed to define the accounting rules that needed to be followed within IAS38, but differentiation between capital and expense was mostly correct.

Section 4

Prybloxx decide instead to acquire a foreign subsidiary for the production of new colour products. Plazchrom will operate as a profit centre and candidates are firstly asked to identify the problems associated with determining an appropriate transfer price for colour matched bricks and to include the impact of transfer prices on Prybloxx profits. This task was generally done well. There was good generic coverage of the various problems associated with price determination between two profit centres. Better candidates achieved level 2 where approaches were defined with dispute resolution and dysfunctional behaviour tendencies identified. Level 3 responses took this to a good level, identifying overall impact to the various parties as related to the components of the group in the specific application to the scenario in a specialist market.

The second task asked for recommendations as to the approach to be taken with the Eastovian Tax Authorities to reassure them that transfer pricing is not being used to manipulate tax liabilities. This part was often done well, particularly in describing the approach to the negotiation process itself in seeking mutual benefit and understanding so level 1 was almost universally attained. However, there was a tendency to over-emphasise that because the firm had provided employment and have a good attitude towards social responsibility, these in turn give the firm leverage over the amount of tax it was willing to pay. Many candidates missed the obvious advantage in calculating and comparing the relative tax burdens in each of the countries and chose instead to take an open book approach to demonstrate cost plus recognition for profit and tax. Level 3 attainment was less common with most candidates failing to engage in deep ongoing communications with the tax authorities in order to maintain a good efficient process both now and in future.

Variant 6

Section 1

Section 1 provided an extract from a Board meeting discussing concerns about Prybloxx's growth being restricted by production capacity. As a result, four potential acquisition targets had been identified. Each of the targets was smaller than Prybloxx but well established and a desirable brand in the market for construction bricks. The Board agreed that they should investigate acquiring these companies as 100% subsidiaries.

The first task sought to advise the Board with reasons whether the proposed acquisition of these companies was compatible with Prybloxx's existing business model.

A level 3 response would demonstrate a good range of aspects from the business model in the pre-seen and provide a full discussion of the compatibility of acquiring the subsidiaries to the aspects identified. These candidates would also provide a full discussion of the reasons why they matched. A level 3 candidate was able to produce a balanced discussion that didn't just state that every aspect matched but could also provide some challenges to indicate that they may not all match. A level 1 answer would either just copy out the aspects of the business model from the pre-seen without discussing them in terms of acquiring the subsidiaries or they only focused on one aspect so the answers were very narrow.

The second task asked candidates to advise the Board of the factors that would have to be considered in determining the goodwill on the acquisition of the four subsidiaries. This section was often badly answered due to weak knowledge of goodwill or answers that were just generic with no reference to the scenario and had limited explanation.

A level 3 response would discuss the requirements of IFRS 3 to the scenario with some justification provided. The answers were well structured starting with a definition of the goodwill calculation and then applying the scenario to each part. This would include discussing the fair value of the net assets in terms of the difficulty in assessing brand names acquired or PPE and noting that, as they would acquire 100% of the subsidiaries, there would be no NCI which made the answers relevant to the situation in the scenario. A level 1 answer usually provided a brief outline of goodwill with a statement stating it was the difference between the consideration and the net assets which showed limited technical knowledge and no link to the scenario.

The third task asked candidates to advise the Board on the implications of the goodwill on acquisition for the interpretation of the Group's consolidated financial statements. This section was also not answered well due to weak knowledge of goodwill and too many answers being limited to just stating that goodwill would be included as an intangible asset. Most candidates did not discuss the implications of the goodwill on the financial ratios. A level 3 candidate was expected to be able to evaluate the impact of the goodwill on acquisition of key ratios with justification. In addition, many of these candidates also included the impact of any initial impairment on the key ratios providing very comprehensive answers. A level 1 candidate demonstrated a weak knowledge of goodwill and could

provide only a reference to the goodwill on acquisition being an intangible asset, usually no impact on ratios was discussed resulting in very limited answers.

Section 2

Section 2 contained an article about Hobrix, one of the companies that Prybloxx was considering acquiring, and noted that the CEO of Prybloxx had met with the founders of Hobrix who indicated that they would exchange 100% of Hobrix's shares for shares in Prybloxx.

The first task asked candidates to identify the challenges associated with determining the present value of the cash flows arising from an investment in Hobrix and to recommend how those challenges might be overcome.

A level 3 response would provide a full discussion of the challenges associated with determining the present value of the cash flows with good justification and offer sensible suggestions for addressing the challenges with good explanation. The level 3 candidates were able to discuss the challenges in determining the present value of the cash flows both in general terms i.e. considering the difficulty of estimating cash flows into the future as well as using the article in the scenario to describe the challenges with cash flows arising from the new venture into licensed character kits. The level 1 candidates found it very difficult to discuss any challenges in determining the present value of the cash flows. Unfortunately, many candidates decided to discuss the problems of using NPV to appraise the investment in Hobrix and expanded the answer to generally discuss project appraisal techniques of NPV, payback, IRR and ARR.

The second task asked candidates to advise the Board on the approach that should be taken to negotiate the exchange of Prybloxx's shares for 100% of Hobrix.

This question was usually well answered as candidates followed the structure of the stages of a negotiation (preparation, opening, bargaining and closure) and then discussed what Prybloxx should consider at each stage. The main weakness with answers was that the answers did not consider Hobrix's needs enough other than to suggest that the founders would seek a higher number of Prybloxx's shares in exchange.

A level 3 response offered a full discussion of both Prybloxx's and Hobrix's needs in reaching an agreement. These answers were good with each stage of the negotiation process considered in detail. A level 1 response usually did not refer to Hobrix's needs and had an incomplete discussion of the negotiation process by just stating some of the stages and with too little detail.

Section 3

Candidates were informed that an agreement to purchase Hobrix had been reached. An attachment was provided which detailed manufacturing arrangements following the Hobrix acquisition.

The first task asked candidates to identify the key risks and uncertainties that could impact on the operational compatibility of Hobrix and Prybloxx and recommend how they could be managed.

Most candidates did very well at this part of the exam paper. They successfully utilised the attachment to extract potential risks and uncertainties and generally sought to recommend how each of the identified risks and uncertainties could be managed. A level 3 candidate was expected to provide a full discussion of risks and recommend responses. A level 1 candidate knew what was required but could not identify enough risks or provide enough of a detailed discussion explaining the risks and responses.

The second task asked candidates to recommend the composition of the project implementation team.

There was some good knowledge shown here with many candidates discussing in good detail the need for project sponsors, project manager and other members of the team by department including ensuring there was a mix of Hobrix and Prybloxx staff.

A level 3 answer looked for sensible suggestions for team membership with good justification, whereas a level 1 answer usually just provided a list of the team roles with no detail explaining why they were needed or what the role would involve. Some of the less strong candidates could only mention the project manager so their answers were very limited.

The third task asked candidates to evaluate the possibility that establishing the Hobrix factory as a responsibility centre could lead to dysfunctional behaviour and to recommend with reasons the type of responsibility centre that should be used in order to discourage dysfunctional behaviour. Most candidates could list the types of responsibility centres, but many did not describe how each of the responsibility centres might lead to dysfunctional behaviour.

A level 3 answer would have included a good discussion of the risks of dysfunctional behaviour for each type of responsibility centre and make a sensible recommendation with good support. A level 1 answer provided a brief or no definition of dysfunctional behaviour and couldn't support a recommendation for a responsibility centre.

Section 4

Candidates were told that some of the Board members had asked for explanations on some matters arising from the expansion through acquisition. In particular, that greater use should be made of Activity-Based Management (ABM) and cost transformation methodology.

The first task asked candidates to evaluate the potential benefits of introducing ABM and cost transformation techniques across the Prybloxx Group. Candidates were comfortable to discuss activity based costing as part of ABM and showed good knowledge in how this would bring benefits to Prybloxx. As a result, reasonable marks were obtained.

A level 3 candidate was expected to be able to discuss the benefits of both ABM and cost transformation techniques with good justification. This was generally achieved for ABM but candidates showed a lack of knowledge for cost transformation techniques. Higher scoring candidates also made good use of the scenario as they appreciated that knowledge of costs/cost savings could now be shared between Prybloxx and Hobrix for best practice rather than just producing a textbook answer describing ABM. A level 1 response provided little more than a brief description of ABM and there was usually no mention of cost transformation techniques.

The second task asked candidates to evaluate the problems associated with conducting an impairment review on the goodwill arising on the acquisition of Hobrix and recommend a response to those challenges.

As with task 1, candidates' knowledge of goodwill and impairment was very weak resulting in poor answers to this task. The majority of answers were lacking in detail with many only managing to give a brief definition of goodwill copied from task 1 and to state that it could be either impaired or amortised. A level 3 answer would offer a full explanation of the challenges associated with conducting an impairment review and offer a full range of responses with justification. There were some good answers where candidates would discuss the difficulties in obtaining market values or, realising that the acquisition of Hobrix had only taken place the month before, that there hadn't been a long enough timeframe to assess any impairment and also suggesting responses for each of the challenges identified. A level 1 answer usually only provided a brief definition of goodwill and didn't provide explanations or suitable responses to the challenges of conducting an impairment review.



Management/Gateway Level Case Study November 2020–February 2021
Marking Guidance
Variant 1

About this marking scheme

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General marking guidance is given below, markers are subject to extensive training and standardisation activities and ongoing monitoring to ensure that judgements are being made correctly and consistently.

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- An answer which does not address the requirements of the task must be awarded no marks.



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How to use this levels-based marking scheme

1. Read the candidate's response in full

2. Select the level

- For each trait in the marking scheme, read each level descriptor and select one, using a best-fit approach.
- The response does not need to meet all of the criteria of the level descriptor – it should be placed at the level when it meets more of the criteria of this level than the criteria of the other levels.
- If the work fits more than one level, judge which one provides the best match.
- If the work is on the borderline between two levels, then it should be placed either at the top of the lower band or the bottom of the higher band, depending on where it fits best.

3. Select a mark within the level

- Once you have selected the level, you will need to choose the mark to apply.
- A small range of marks may be given at each level. You will need to use your professional judgement to decide which mark to allocate.
- If the answer is of high quality and convincingly meets the requirements of the level, then you should award the highest mark available. If not, then you should award a lower mark within the range available, making a judgement on the overall quality of the answer in relation to the level descriptor.

Summary of the core activities tested within each sub-task

Sub-task	Core Activity		Sub-task weighting (% section time)
Section 1			
(a)	A	Evaluate opportunities to add value	60%
(b)	C	Manage performance and costs to aid value creation	40%
Section 2			
(a)	E	Manage internal and external stakeholders	60%
(b)	C	Manage performance and costs to aid value creation	40%
Section 3			
(a)	E	Manage internal and external stakeholders	33%
(b)	D	Measure performance	34%
(c)	A	Evaluate opportunities to add value	33%
Section 4			
(a)	B	Implement senior management decisions	60%
(b)	D	Measure performance	40%

SECTION 1			
Task (a) Firstly, evaluate the impact that the new product range will have on Prybloxx's business model.			
Trait			
Disruptive	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines business model	1-2
	Level 2	Offers good argument for or against product causing a significant change	3-5
	Level 3	Offers full argument for or against product causing a significant change with good justification	6-7
Consistency	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies factors for evaluation in business model	1-2
	Level 2	Offers logical evaluation of consistency with business model	3-5
	Level 3	Offers full and logical evaluation of consistency with business model	6-8
Task (b) Secondly, explain the issues we need to consider when determining the cost of each My Prybloxx Kit.			
Trait			
Cost recovery	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need to recover costs	1
	Level 2	Discusses factors that will ensure cost recovery	2-3
	Level 3	Offers good discussion of factors that will ensure cost recovery	4-5
Customer demand	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need to avoid mispricing added value items	1
	Level 2	Discusses factors relating to customer demand	2-3
	Level 3	Offers good suggestions for managing customer demand	4-5

SECTION 2			
Task (a) Please answer Yudi's question, stating the assumptions that you need to make.			
Trait			
Subsidiary	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies reporting issues for subsidiary	1-2
	Level 2	Relates reporting issues for subsidiary to decision between going concern and start-up	3-5
	Level 3	Offers full discussion of reporting issues for subsidiary arising from decision between going concern and start-up	6-7
Group	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies reporting issues for group	1-2
	Level 2	Relates reporting issues for group to decision between going concern and start-up	3-5
	Level 3	Offers full discussion of reporting issues for group arising from decision between going concern and start-up	6-8
Task (b) Please recommend , giving reasons, the type of responsibility centre you think would be most appropriate for monitoring the financial performance of the Fulfilment Centre when it is operational.			
Trait			
Factors	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies factors to be considered	1
	Level 2	Offers some factors to be considered in this case	2-3
	Level 3	Offers full discussion of factors to be considered in this case	4-5
Recommendation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some justification for recommendation	1
	Level 2	Offers good justification for recommendation	2-3
	Level 3	Offers full justification for recommendation	4-5
SECTION 3			

Task (a) Firstly, **evaluate** the possibility that transferring parts from the Production Department to My Prybloxx at marginal cost would prevent suboptimal behaviour.

Trait			
Transfer pricing	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies transfer pricing issues	1-2
	Level 2	Identifies transfer pricing issues, with good discussion of dysfunctional behaviour	3-5
	Level 3	Identifies transfer pricing issues, with full discussion of dysfunctional behaviour	6-8

Task (b) Secondly, **explain** how the choice of retail pricing strategy will affect the key accounting ratios based on the Prybloxx Group's consolidated financial statements.

Trait			
Accounting ratios	Level	Descriptor	Accounting ratios
		No rewardable material	0
	Level 1	Identifies key ratios that will be affected	1 - 3
	Level 2	Identifies key ratios and explains direction of change	4 - 6
	Level 3	Identifies key ratios and explains direction of change and impact on interpretation	7 – 9



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Task (c) Thirdly, **recommend** a retail pricing strategy for My Prybloxx, with a justification that takes account of the nature of the product. Remember that the My Prybloxx software will restrict the selection of parts to generic items, including “added value” parts such as motors and lights.

Trait			
Pricing	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes pricing strategies	1-2
	Level 2	Relates pricing issues to scenario	3-5
	Level 3	Relates pricing issues to scenario with full justification for recommendation	6-8

SECTION 4

Task (a) Firstly, **discuss** the problems that will arise if the directors do not reach agreement on the management of this project and recommend, with reasons, the director whose manager should be the designated project leader.

Trait			
Lack of agreement	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need for coordination	1-2
	Level 2	Discusses problems arising from lack of coordination	3-5
	Level 3	Offers full discussion of problems arising from lack of coordination	6-7
Project lead	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Gives some justification for recommendation	1-2
	Level 2	Offers good justification for recommendation	3-5
	Level 3	Offers full justification for recommendation	6-8

Task (b) Secondly, **identify** the key operational risks that could arise after the launch and recommend the manner in which the project team should manage them during the implementation.

Trait			
Identify risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines operational risk	1
	Level 2	Identifies some operational risks	2-3
	Level 3	Identifies good range of key operational risks	4-5
Address risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some response to risks	1
	Level 2	Offers good response to risks	2-3
	Level 3	Offers full and logical response to risks	4-5



Management/Gateway Level Case Study November 2020–February 2021
Marking Guidance
Variant 2

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Sub-task	Core Activity		Sub-task weighting (% section time)
Section 1			
(a)	A	Evaluate opportunities to add value	60%
(b)	D	Measure performance	40%
Section 2			
(a)	C	Manage performance and costs to aid value creation	60%
(b)	E	Manage internal and external stakeholders	40%
Section 3			
(a)	B	Manage internal and external stakeholders	40%
(b)	E	Measure performance	60%
Section 4			
(a)	A	Evaluate opportunities to add value	33%
(b)	B	Manage internal and external stakeholders	33%
(c)	D	Measure performance	34%

SECTION 1			
Task (a) Firstly, identify and evaluate the challenges associated with predicting costs and revenues for this new range			
Trait			
Costs	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some discussion of challenges relating to predicting costs	1-2
	Level 2	Offers good discussion of challenges relating to predicting costs	3-5
	Level 3	Offers full discussion of challenges relating to predicting costs	6-8
Revenues	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some discussion of challenges relating to predicting revenues	1-2
	Level 2	Offers good discussion of challenges relating to predicting revenues	3-5
	Level 3	Offers full discussion of challenges relating to predicting revenues	6-7
Task (b) Secondly, evaluate the usefulness of Ckonstro's segmental report as a basis for addressing those challenges.			
Trait			
Ranges	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes rules relating to analysis	1
	Level 2	Describes usefulness of reported breakdown of figures	2-3
	Level 3	Evaluates usefulness of reported breakdown of figures	4-5
Profits	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies problems associated with determining segmental profits	1
	Level 2	Discusses problems associated with determining segmental profits	2-3
	Level 3	Evaluates problems associated with determining segmental profits, including predictive value	4-5

SECTION 2			
Task (a) Recommend , with reasons, the ways in which we might improve the design team's engagement with the development of this range of products.			
Trait			
Recommendation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines engagement	1-2
	Level 2	Offers some relevant suggestions	3-5
	Level 3	Offers good range of suggestions	6-8
Justification	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need for engagement	1-2
	Level 2	Offers good justification for suggestions	3-5
	Level 3	Offers full justification for suggestions	6-7
Task (b) Identify the challenges associated with setting a suitable transfer price for the time spent by Production Department staff assisting the Design Department and recommend, with reasons, how those challenges might be overcome.			
Trait			
Challenges	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies transfer pricing approaches	1
	Level 2	Discusses transfer pricing in context of scenario	2-3
	Level 3	Provides good discussion of dysfunctional behaviour arising from transfer pricing	4-5
Responses	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some justification for recommendation	1
	Level 2	Offers good justification for recommendation	2-3
	Level 3	Offers full justification for recommendation	4-5

SECTION 3

Task (a) Firstly, please **identify** and **evaluate** the factors associated with debt and equity that are relevant to Prybloxx's decision concerning the financing of the new moulds and moulding equipment and the inventory. Your evaluation should take Prybloxx's current financial position into account.

Trait			
Debt	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Outlines characteristics of debt	1
	Level 2	Discusses characteristics of debt in relation to scenario	2-3
	Level 3	Offers full discussion of characteristics of debt in relation to scenario	4-5
Equity	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Outlines characteristics of equity	1
	Level 2	Discusses characteristics of equity in relation to scenario	2-3
	Level 3	Offers full discussion of characteristics of equity in relation to scenario	4-5

Task (b) Secondly, **identify** the impact that the new range will have on our integrated reporting capitals: Financial, Manufactured, Intellectual, Human, Social and Relationship, and Natural.

Trait			
Financials & manufactured	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines capitals	1
	Level 2	Identifies impact	2-3
	Level 3	Discusses impact	4
Intellectual & human	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines capitals	1-2
	Level 2	Identifies impact	3-4
	Level 3	Discusses impact	5-6
	Level	Descriptor	Marks



Social & natural		No rewardable material	0
	Level 1	Defines capitals	1
	Level 2	Identifies impact	2-3
	Level 3	Discusses impact	4-5

SECTION 4

Task (a) Firstly, our Board has still not made a final decision on whether to emphasise consumers, colleges or corporate customers in developing the Prybloxx Gear range. I need you to **explain** how that decision will affect the management of the project to design and launch of the range.

Trait			
Project management	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need for coordination	1-2
	Level 2	Discusses problems arising from lack of coordination	3-5
	Level 3	Offers full discussion of problems arising from lack of coordination	6-8

Task (b) Secondly, **recommend**, with reasons, the approach that we should take to setting recommended retail prices for Prybloxx Gear.

Trait			
Pricing	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describe pricing strategies	1-2
	Level 2	Offer sensible recommendation with some justification	3-5
	Level 3	Offer sensible recommendation with good justification	6-8

Task (c) Thirdly, **identify** the key product and product reputation risks associated with developing this range, justifying your selection.

Trait			
Business risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Define business risks	1-3
	Level 2	Offer a discussion of the business risks arising in the scenario.	4-6
	Level 3	Offer a full discussion of the business risks arising in the scenario, with good justification of selection.	7-9

Management/Gateway Level Case Study November 2020–February 2021
Marking Guidance
Variant 3

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How to use this levels-based marking scheme

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2. Select the level

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3. Select a mark within the level

- Once you have selected the level, you will need to choose the mark to apply.
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Summary of the core activities tested within each sub-task

Sub-task	Core Activity		Sub-task weighting (% section time)
Section 1			
(a)	A	Evaluate opportunities to add value	60%
(b)	E	Manage internal and external stakeholders	40%
Section 2			
(a)	E	Manage internal and external stakeholders	50%
(b)	D	Measure performance	50%
Section 3			
(a)	C	Manage performance and costs to aid value creation	60%
(b)	A	Evaluate opportunities to add value	40%
Section 4			
(a)	B	Manage internal and external stakeholders	60%
(b)	D	Measure performance	40%

SECTION 1			
Task (a) Firstly, discuss the suggestion that adding Toyz's electronic components will be consistent with Prybloxx's business model.			
Trait			
Describing model	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies business model	1-2
	Level 2	Offers some discussion of relevance of proposal to business model	3-4
	Level 3	Offers good discussion of relevance of proposal to business model	5-6
Consistency	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies factors for evaluation of proposal in relation to business model	1-3
	Level 2	Offers logical evaluation of consistency with business model	4-6
	Level 3	Offers full and logical evaluation of consistency with business model	7-9
Task (b) Secondly, identify and evaluate the significance of the challenges associated with negotiating the potential acquisition of Toyz with the company's present owners.			
Trait			
Identification	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers basic description of issues, including win-win	1
	Level 2	Identifies challenges relating to negotiation	2-3
	Level 3	Identifies challenges relating to negotiation with good justification	4-5
Evaluation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some explanation of significance of identified challenges	1
	Level 2	Discusses significance of identified challenges	2-3
	Level 3	Discusses significance of identified challenges with good justification	4-5

SECTION 2

Task (a) Explain the problems associated with determining the value of Toyz's property, patents and trademarks and inventory for the purpose of valuing goodwill on the acquisition.

Trait			
Property	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies fair value as an issue for property	1
	Level 2	Discusses problems associated with determining fair value of property	2-3
	Level 3	Discusses problems associated with determining fair value of property, offering justification	4
Patents	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies fair value as an issue for patents and trademarks	1
	Level 2	Discusses problems associated with determining fair value of patents and trademarks	2-3
	Level 3	Discusses problems associated with determining fair value of patents and trademarks, offering justification	4-5
Inventory	Level	Descriptor	Marks
		No rewardable material	0
		Identifies fair value as an issue for inventory	1
		Discusses problems associated with determining fair value of inventory	2-3
		Discusses problems associated with determining fair value of inventory, offering justification	4

Task (b) Identify the problems associated with applying *IAS 38 Intangible Assets* to Toyz's post-acquisition expenditure on the adaptation of its electronics to make them compatible with Prybloxx's bricks and recommend appropriate responses to those problems.

Trait			
Problems	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need to predict outcome	1-2
	Level 2	Relates prediction of outcome to <i>IAS38</i>	3-4
	Level 3	Relates prediction of outcome to <i>IAS38</i> with good discussion	5-6
Responses	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers basic response	1-2
	Level 2	Offers reasonable response	3-4
	Level 3	Recommends good response	5-6

SECTION 3			
Task (a) Firstly, evaluate the potential usefulness of target costing in developing these new products.			
Trait			
Application	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes application of target costing to scenario	1-2
	Level 2	Relates pricing issues to scenario	3-5
	Level 3	Relates pricing issues to scenario with full justification for recommendation	6-8
Usefulness	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes potential usefulness of application	1-2
	Level 2	Discusses potential usefulness of application	3-5
	Level 3	Discusses potential usefulness of application with good justification	6-7
Task (b) Secondly, discuss the problems that we will face in choosing a pricing approach to setting a recommended retail price for these electronically enhanced sets and kits and recommend, with reasons, the approach that we should adopt.			
Trait			
Issues	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes pricing approaches	1
	Level 2	Discusses implications of pricing decision in relation to scenario	2-3
	Level 3	Discusses implications of pricing decision in relation to scenario, with justification	4-5
Recommendation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies pricing strategy that is consistent with issues	1
	Level 2	Recommends pricing strategy, with reasons	2-3
	Level 3	Recommends pricing strategy, with good justification	4-5

SECTION 4

Task (a) Firstly, **discuss** the challenges of evaluating the respective product reputation and operating risks associated with choosing between the two launch approaches described above. Recommend, with justification, responses to those challenges.

Trait			
Risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies risks	1-2
	Level 2	Identifies challenges associated with evaluating risks	3-5
	Level 3	Identifies challenges associated with evaluating risks and offers good justification	6-8
Responses to risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some response to challenges	1-2
	Level 2	Offers good response to challenges	3-5
	Level 3	Offers good response to challenges with good justification	6-7

Task (b) Secondly, **explain** the implications for Prybloxx of the possibility that the remote-control feature could become “disruptive technology”.

Trait			
Disruptive technology	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines disruptive technology	1-3
	Level 2	Discusses classification of product and its relevance	4-7
	Level 3	Evaluates classification of product and its relevance	8-10

Management/Gateway Level Case Study November 2020–February 2021
Marking Guidance
Variant 4

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Summary of the core activities tested within each sub-task

Sub-task	Core Activity		Sub-task weighting (% section time)
Section 1			
(a)	A	Evaluate opportunities to add value	50%
(b)	C	Manage performance and costs to aid value creation	50%
Section 2			
(a)	C	Manage performance and costs to aid value creation	50%
(b)	E	Manage internal and external stakeholders	50%
Section 3			
(a)	D	Measure performance	34%
(b)	A	Evaluate opportunities to add value	33%
(c)	B	Implement senior management decisions	33%
Section 4			
(a)	B	Implement senior management decisions	34%
(b)	D	Measure performance	33%
(c)	E	Manage internal and external stakeholders	33%

SECTION 1			
Task (a) Firstly, discuss the implications of the report's findings for Prybloxx's business model.			
Trait			
Defining/creating	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies link to defining/creating value	1-2
	Level 2	Discusses link to defining/creating value	3-4
	Level 3	Offers full discussion of link to defining/creating value	5-6
Delivering /capturing	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies link to delivering/capturing value	1-2
	Level 2	Discusses link to delivering/capturing value	3-5
	Level 3	Offers full discussion of link to delivering/capturing value	6-7
Task (b) Secondly, evaluate Mary's suggestion that the report findings indicate that the senior management team should pay closer attention to Prybloxx's value chain.			
Trait			
Arguments for	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies arguments for regular discussions	1-2
	Level 2	Discusses arguments for regular discussions	3-4
	Level 3	Discusses arguments for regular discussions with good justification	5-6
Arguments against	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies arguments against regular discussions	1-2
	Level 2	Discusses arguments against regular discussions	3-4
	Level 3	Discusses arguments against regular discussions with good justification	5-6

SECTION 2			
Task (a) Firstly, recommend with reasons whether the new Account Management Department should be established as a cost centre, a revenue centre or a profit centre.			
Trait			
Issues	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need to decide on responsibility centre	1-2
	Level 2	Discusses issues arising from scenario	3-4
	Level 3	Offers full discussion of issues arising from scenario	5-6
Recommendation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines type of responsibility centre	1-2
	Level 2	Recommends type of responsibility centre with some justification	3-5
	Level 3	Recommends type of responsibility centre with good justification	6-7
Task (b) Secondly, recommend the approach that the new department should take to negotiating with Vretail to improve the visibility of Prybloxx's products when customers search for generic items such as "building bricks" or "construction toys".			
Trait			
Prybloxx interests	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies Prybloxx interests	1-2
	Level 2	Describes Prybloxx interests	3-4
	Level 3	Discusses Prybloxx interests	5-6
Retailer interests	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Refers to win-win	1-2
	Level 2	Describes retailer interests	3-4
	Level 3	Discusses retailer interests	5-6

SECTION 3			
Task (a) Firstly, advise the Board, stating reasons, on the correct recognition of the revenues and profits from the contract with Vretail.			
Trait			
Revenue recognition	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies accounting issues	1-3
	Level 2	Discusses application of <i>IFRS 15</i>	4-6
	Level 3	Discusses application of <i>IFRS 15</i> with good explanation	7-9
Task (b) Secondly, explain how the contract with Vretail will affect Prybloxx's weighted average cost of capital (WACC) at the date of announcement and throughout the contract's duration.			
Trait			
WACC	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines WACC	1-2
	Level 2	Discusses impact on WACC	3-5
	Level 3	Discusses impact on WACC with good justification	6-8
Task (c) Thirdly, this contract will require Prybloxx to invest V\$250 million in inventory. Recommend , with reasons, how that investment should be funded.			
Trait			
Funding inventory	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies issues	1-2
	Level 2	Discusses debt v equity in context	3-5
	Level 3	Recommends debt or equity with good justification	6-8

SECTION 4

Task (a) Firstly, **evaluate** the argument that Prybloxx's Board was reckless in signing the contract with Kidmation, given the terms referred to by Indra Nooyi.

Trait			
Decision	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies issues	1-3
	Level 2	Offers sensible recommendation with some justification	4-6
	Level 3	Offers sensible recommendation with good justification	7-9

Task (b) Secondly, **discuss** the operating risks for Prybloxx of disappointing Vretail by permitting the contract to lapse.

Trait			
Business risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies business risks	1-2
	Level 2	Discusses business risks	3-5
	Level 3	Evaluates business risks with good justification	6-8

Task (c) Thirdly, **recommend** an approach that could be taken to resolve the conflict between Kidmation and Vretail with regard to their different wishes for the style of Newton Sound kits.

Trait			
Conflict resolution	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need for conflict resolution	1-2
	Level 2	Offers sensible suggestion with some support	3-5
	Level 3	Recommends suitable response with good justification	6-8

Management/Gateway Level Case Study November 2020–February 2021
Marking Guidance
Variant 5

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Sub-task	Core Activity		Sub-task weighting (% section time)
Section 1			
(a)	A	Evaluate opportunities to add value	33%
(b)	D	Measure performance	33%
(c)	C	Manage performance and costs to aid value creation	34%
Section 2			
(a)	B	Implement senior management decisions	50%
(b)	C	Manage performance and costs to aid value creation	50%
Section 3			
(a)	A	Evaluate opportunities to add value	34%
(b)	B	Implement senior management decisions	33%
(c)	D	Managing Performance	33%
Section 4			
(a)	A	Evaluate opportunities to add value	60%
(b)	E	Manage Internal and external stakeholders	40%

SECTION 1			
Task (a) Firstly, advise the Board, stating your assumptions, on whether we should make provisions in our financial statements in respect of the hazards associated with splinters from bricks and in respect of the cost of reimbursing customers.			
Trait			
Provision	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines provision	1-2
	Level 2	Discusses application of <i>IAS 37</i>	3-5
	Level 3	Recommends response based on <i>IAS 37</i> and with good justification	6-8
Task (b) Secondly, advise the Board on the likely impact that this recall will have on Prybloxx's weighted average cost of capital (WACC).			
Trait			
WACC	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines WACC	1-2
	Level 2	Discusses impact on WACC	3-5
	Level 3	Discusses impact on WACC with good justification	6-8
Task (c) Thirdly, evaluate the concern expressed by some Board members that the manufacture and subsequent recall of the purple bricks is evidence of quality failures within Prybloxx.			
	Level	Descriptor	Marks
Quality failure		No rewardable material	0
	Level 1	Discusses quality failure	1-3
	Level 2	Offers some discussion of quality failure issues in respect of the scenario	4-6
	Level 3	Evaluates quality failure issues in respect of the scenario, with good justification	7-9

SECTION 2			
Task (a) Firstly, advise the Board on the factors that need to be considered to ensure that the project team has suitable terms of reference.			
Trait			
Board factors	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need for Board to be clear	1
	Level 2	Discusses need for clarity by Board	2-3
	Level 3	Evaluates need for clarity by Board, with good justification	4-5
Other factors	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need for Team to understand remit	1-2
	Level 2	Discusses need for clarity in remit	3-5
	Level 3	Evaluates need for clarity in remit, with good justification	6-8
Task (b) Secondly, recommend , with reasons, four performance measures that could be used to monitor the progress of the project team.			
Trait			
Recommendation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies some potential measures	1-2
	Level 2	Offers a range of sensible measures	3-4
	Level 3	Offers a full range of sensible measures	5-6
Reasons	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines dysfunctional behaviour	1-2
	Level 2	Offers justification for measures	3-4
	Level 3	Offers full justification for measures	5-6

SECTION 3			
Task (a) Firstly, identify the challenges associated with determining the net present value of the project.			
Trait			
NPV	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies challenges	1-3
	Level 2	Discusses challenges and offers solution	4-6
	Level 3	Discusses challenges in detail and offers good solutions	7-9
Task (b) Secondly, identify the main operating risks associated with the commercial exploitation of this process.			
Trait			
Risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes some risks	1-2
	Level 2	Offers range of risks	3-5
	Level 3	Offers full range of risks with justification	6-8
Task (c) Thirdly, how the costs described in the report will be accounted for in Prybloxx's financial statements.			
Trait			
Reporting	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need to decide on capitalisation	1-2
	Level 2	Identifies relevant accounting standards and discusses application	3-5
	Level 3	Recommends suitable accounting treatment, with justification from standards	6-8

SECTION 4

Task (a) Firstly, **identify** the problems associated with determining an appropriate transfer price for the supply of colour-matched bricks from the Production Department to Prybloxx Short Run and ensure that you include the impacts of transfer prices on the profits of Prybloxx Short Run and of the Prybloxx Group.

Trait			
Problems	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes problems with pricing	1-2
	Level 2	Recommends strategy, with some support	3-5
	Level 3	Recommends strategy with good support	6-8
Impacts	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes impacts	1-2
	Level 2	Discusses impacts, with some discussion	3-5
	Level 3	Evaluates impacts, with good discussion	6-8

Task (b) Secondly, **recommend** the approach that Prybloxx should take in negotiating with the Eastovian Tax Authorities in order to reassure them that we are not using transfer pricing to manipulate the tax that we must pay in their country.

Trait			
Negotiation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes win-win	1-3
	Level 2	Identifies respective interests of parties	4-6
	Level 3	Recommends sustainable solution to conflict, with reasons	7-9

Management/Gateway Level Case Study November 2020–February 2021
Marking Guidance
Variant 6

About this marking scheme

This marking scheme has been prepared for the CIMA 2019 professional qualification Management/Gateway Case Study [November 2020–February 2021].

The indicative answers will show the expected or most orthodox approach; however, the nature of the case study examination tasks means that a range of responses will be valid. The descriptors within this level-based marking scheme are holistic and can accommodate a range of acceptable responses.

General marking guidance is given below, markers are subject to extensive training and standardisation activities and ongoing monitoring to ensure that judgements are being made correctly and consistently.

Care must be taken not to make too many assumptions about future marking schemes on the basis of this document. While the guiding principles remain constant, details may change depending on the content of a particular case study examination form.

General marking guidance

- Marking schemes should be applied positively, with candidates rewarded for what they have demonstrated and not penalised for omissions.
- All marks on the scheme are designed to be awarded and full marks should be awarded when all level descriptor criteria are met.
- The marking scheme and indicative answers are provided as a guide to markers. They are not intended to be exhaustive and other valid approaches must be rewarded. Equally, students do not have to make all of the points mentioned in the indicative answers to receive the highest level of the marking scheme.
- An answer which does not address the requirements of the task must be awarded no marks.



- Markers should mark according to the marking scheme and not their perception of where the passing standard may lie.

Where markers are in doubt as to the application of the marking scheme to a particular candidate script, they must contact their lead marker.

How to use this levels-based marking scheme

1. Read the candidate's response in full

2. Select the level

- For each trait in the marking scheme, read each level descriptor and select one, using a best-fit approach.
- The response does not need to meet all of the criteria of the level descriptor – it should be placed at the level when it meets more of the criteria of this level than the criteria of the other levels.
- If the work fits more than one level, judge which one provides the best match.
- If the work is on the borderline between two levels, then it should be placed either at the top of the lower band or the bottom of the higher band, depending on where it fits best.

3. Select a mark within the level

- Once you have selected the level, you will need to choose the mark to apply.
- A small range of marks may be given at each level. You will need to use your professional judgement to decide which mark to allocate.
- If the answer is of high quality and convincingly meets the requirements of the level, then you should award the highest mark available. If not, then you should award a lower mark within the range available, making a judgement on the overall quality of the answer in relation to the level descriptor.

Summary of the core activities tested within each sub-task

Sub-task	Core Activity		Sub-task weighting (% section time)
Section 1			
(a)	A	Evaluate opportunities to add value.	40%
(b)	E	Manage internal and external stakeholders.	30%
(c)	D	Measure performance.	30%
Section 2			
(a)	A	Evaluate opportunities to add value.	50%
(b)	E	Manage internal and external stakeholders.	50%
Section 3			
(a)	B	Implement senior management decisions.	30%
(b)	B	Implement senior management decisions	30%
(c)	C	Evaluate opportunities to add value	40%
Section 4			
(a)	C	Evaluate opportunities to add value	50%
(b)	D	Measure performance.	50%

SECTION 1			
Task (a) Firstly, advise the Board, stating reasons, whether the proposed acquisition of these companies is compatible with Prybloxx's existing business model.			
Trait			
Compatibility	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies business model	1
	Level 2	Discusses compatibility with business model	2-3
	Level 3	Offers a full discussion of compatibility with business model	4-5
Reasons	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Makes limited reference to reasons	1
	Level 2	Discusses reasons	2-3
	Level 3	Offers a full discussion of reasons	4-5
Task (b) Secondly, advise the Board of the factors that would have to be considered in determining the goodwill on the acquisition on the four subsidiaries.			
Trait			
Goodwill	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Refers to fair value	1-2
	Level 2	Applies requirements of IFRS 3 to scenario	3-5
	Level 3	Applies requirements of IFRS 3 to scenario and offers justification	6-8
Task (c) Thirdly, advise the Board on the implications of the goodwill on acquisition for the interpretation of the Prybloxx Group's consolidated financial statements.			
Trait			
Interpretation	Level	Descriptor	Marks
Interpretation		No rewardable material	0
	Level 1	Describes goodwill	1-2

	Level 2	Discusses impact on key ratios	3-5
	Level 3	Evaluates impact on key ratios with justification	6-7

SECTION 2

Task (a) Firstly, **identify** the challenges associated with determining the present value of the cash flows arising from an investment in Hobrix and recommend how those challenges might be overcome.

Trait			
Challenges	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes need to understand cash flow and rate of return	1-2
	Level 2	Discusses challenges associated with determining NPV	3-5
	Level 3	Offers full discussion of challenges associated with determining NPV, with good justification	6-7
Response	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some suggestions for addressing challenges	1-2
	Level 2	Offers sensible suggestions for addressing challenges	3-4
	Level 3	Offers sensible suggestions for addressing challenges with good explanation	5-6

Task (b) Secondly, **advise** the Board on the approach that should be taken to negotiating the exchange of Prybloxx's shares for 100% of Hobrix.

Trait			
Prybloxx	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies need to minimise payment	1-2
	Level 2	Offers some discussion of Prybloxx's needs in reaching a sustainable agreement	3-4
	Level 3	Offers full discussion of Prybloxx's needs in reaching a sustainable agreement	5-6



Hobrix	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes win-win	1-2
	Level 2	Offers some discussion of Hobrix's needs in reaching a sustainable agreement	3-4
	Level 3	Offers full discussion of Hobrix's needs in reaching a sustainable agreement	5-6

SECTION 3			
Task (a) Firstly, identify the key risks and uncertainties that could impact on the operational compatibility of Hobrix and Prybloxx, and recommend how they could be managed.			
Trait			
Risks	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes risks	1-2
	Level 2	Discusses risks with some recommended responses	3-5
	Level 3	Full discussion of risks and recommended responses	6-8
Task (b) Secondly, recommend the composition of the project implementation team for putting Gunther Krebs' arrangements into effect.			
Trait			
Project team	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Identifies issues	1-2
	Level 2	Offers sensible suggestions for team membership	3-5
	Level 3	Offers sensible suggestions for team membership with good justification	6-7
Task (c) Thirdly, evaluate the possibility that establishing the Hobrix factory as a responsibility centre could lead to dysfunctional behaviour and recommend, stating reasons, the type of responsibility centre that should be used in order to discourage dysfunctional behaviour.			
Trait			
Dysfunctional	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines dysfunctional behaviour	1
	Level 2	Relates risks of dysfunctional behaviour to type of responsibility centre	2-3
	Level 3	Offers good discussion of risks of dysfunctional behaviour and type of responsibility centre	4-5
Recommendation	Level	Descriptor	Marks
		No rewardable material	0



	Level 1	Offers a suggestion with little support	1
	Level 2	Makes a sensible recommendation with some support	2-3
	Level 3	Makes a sensible recommendation with good support	4-5

SECTION 4			
Task (a) Firstly, evaluate the potential benefits of introducing ABM and cost transformation techniques across the Prybloxx Group.			
Trait			
Implementation	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Describes ABM and cost transformation	1-2
	Level 2	Discusses implementation challenges	3-4
	Level 3	Discusses implementation challenges with good justification	5-6
Responses	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some response to challenges	1-2
	Level 2	Offers good suggestions for responses	3-4
	Level 3	Offers full range of responses with justification	5-6
Task (b) Secondly, evaluate the problems associated with conducting an impairment review on the goodwill arising on the acquisition of Hobrix and recommend a response to those challenges.			
Trait			
Review	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Defines impairment	1-2
	Level 2	Explains challenges associated with conducting review	3-5
	Level 3	Offers full explanation of challenges associated with conducting review	6-7
Recommend	Level	Descriptor	Marks
		No rewardable material	0
	Level 1	Offers some response to challenges	1-2
	Level 2	Offers good suggestions for responses	3-4
	Level 3	Offers full range of responses with justification	5-6