
Answers

Section A

- 1 C
- 2 B
- 3 B
- 4 C
- 5 B
- 6 A
- 7 D
- 8 C
- 9 A
- 10 D
- 11 B
- 12 C
- 13 B
- 14 B
- 15 D
- 16 A
- 17 B
- 18 C
- 19 D
- 20 D

Section B

1 (a) There are many users of financial statements, including:

- Lenders
- Customers
- Suppliers
- Employees

The ASB's position is that while some users can obtain specialised information (for example, managers have access to detailed management information, which is tailored to their specific needs) the needs of a wide range of users will best be met by general purpose financial statements. Such reports are designed primarily to meet the needs of the investors (both present and future) in the company.

The respective needs of the users noted above may be summarised as follows:

Lenders will be primarily concerned with the ability of the company to meet the payments required by the loan agreement. In particular they will wish to ensure that interest will be paid on the due date and capital repayments will be paid when they fall due.

Customers wish to have a reasonable certainty that they can enjoy continuity of supply, and will therefore wish to assess the financial stability of the company. The interest in continuity will be increased if the customer has been provided with any form of warranty.

The prime concern of suppliers will be the ability of the company to pay for goods acquired on credit. To some extent suppliers will also wish to ensure that if the company is a major customer, there is a reasonable prospect of the company continuing to trade for the foreseeable future.

The stability of the company's financial position and its ability to offer reasonable rates of pay (and in the current economic climate, to meet pension obligations) will be the most pressing issue for employees.

These needs contrast with the needs of shareholders, which are essentially about ensuring that the directors have discharged their responsibility of stewardship, by achieving a return commensurate with the level of risk involved in the business.

Shareholders will therefore be concerned to assess the returns generated by the company in light of the overall investment. While the company may be producing returns which, for example, will satisfy lenders that the payments due under the loan agreement will continue to be made, shareholders will assess the returns generated by the company after payment of costs such as loan interest. Equally, while suppliers may be concerned with short term liquidity, shareholders will be more concerned with long term growth.

Mark allocation:

| | |
|------------------------------------------------------------------------------------------------|----------|
| $\frac{1}{2}$ mark for each user identified | 1 |
| 1 mark for each valid point to maximum of 2 for each user, to an overall maximum of | 3 |
| 1 mark for each comment contrasting user needs with the needs of shareholders, to a maximum of | 2 |
| | <hr/> |
| NB – The question only required two users to be identified | 6 |
| | <hr/> |

(b) Relevance refers to the ability of information to influence the decisions of the user. This means that the user should be able to use the information to predict what may happen in the future, and also to confirm any judgements which were made in the past. The relevance of information can be enhanced (or reduced) by the way it is presented. The requirement to report continuing and discontinued activities separately in the profit and loss account is an example of this. This form of presentation allows users to assess the underlying and continuing profitability of the company.

For example, employees will wish to assess the likelihood of continued employment by reference to the profit generated by continuing activities.

Reliability means that the user can have reasonable confidence that the information can be relied on. This is generally taken to mean that information is neutral, materially correct, complete and prudent.

The neutrality of financial information is enhanced by the requirement to meet the needs of a wide range of users, which means that it is not presented in a manner which seeks to influence the user in a particular way. Rather the user is left to apply his or her own judgement.

The notion of materiality is central to financial reporting. While one cannot expect financial statements to be absolutely correct, it is reasonable to expect that they are free from material error or omission. An item is considered material if its omission or misstatement could be reasonably expected to influence the decision of the users. It almost goes without saying that if financial information is incomplete, it is less than useful. However it must be remembered that 'completeness' must be judged in the context of materiality.

Prudence is often referred to as taking a pessimistic view. While few users would wish financial statements to include unjustifiably optimistic assumptions, prudence should only be exercised if there is an element of uncertainty with regard to a particular item. Reliability is an important issue for all users, but specific reference might be made to the needs of lenders, who will be concerned to ensure that the financial statements provide reliable information about the company's liabilities, in order to allow an assessment of the company's ability to service existing and proposed debt.

It is important that users are able to make comparisons of financial performance over time. As this will allow users to assess trends, it is relevant in all cases. Comparability is most often achieved by applying accounting policies consistently from one period to the next, and ensuring that any changes in accounting policies are disclosed, together with an evaluation of the effect of the change. This is of importance to lenders, particularly those who have provided long term funds to the company.

For information to be understandable, users must appreciate its significance. The extent to which information can be understood is affected by the manner in which it is presented. It is a basic tenet of financial reporting that users are assumed to have reasonable knowledge, and that they will take reasonable care in reviewing information. This is of significance to, for example, potential lenders who will be expected to carry out a reasonably thorough review of the company's position before committing any funds to the company.

Mark allocation:

| | |
|------------------------------------------------------------------------------------------------|-----------|
| 1 mark for each valid comment regarding the qualities of financial information to a maximum of | 10 |
| 1 mark for each comment about the needs of users to a maximum of | 4 |
| | <hr/> |
| | 14 |
| | <hr/> |
| | 20 |
| | <hr/> |

- 2 (a)** There are two types of research costs, pure research and applied research.

Pure research is expenditure which is theoretical or experimental, and does not have a commercial outcome, but is concerned with the advancement of knowledge. It is possible that the findings of such research could be developed into a commercial project in the future, but that is not the objective of the research.

Applied research, in contrast, seeks to build on the findings of pure research and has a specific objective. This objective may not be overtly commercial, but in many cases the expectation is that an applied research project will lead to commercial exploitation. Development expenditure uses existing knowledge with the express aim of achieving a commercial outcome. The outcome may be new or improved products or processes.

Mark allocation:

| | |
|---------------------------------------------|---|
| 1 mark for each valid point to a maximum of | 6 |
|---------------------------------------------|---|

- (b)** The accounting treatment is:

Both pure and applied research should be written off as incurred, and treated as an operating cost in the profit and loss account.

Development costs should normally be treated in the same manner as research costs. However, the relevant accounting standard (SSAP 13), does permit development costs to be capitalised and carried forward.

It is important to note that the standard does not *require* development costs to be capitalised, and therefore there is an element of choice.

In the event that the choice to capitalise costs is made, the accumulated expenditure should be amortised over the anticipated life of the product, not the sales.

Clearly, this approach defers charging expenditure against profit, and may be seen as not applying the principle of prudence. However, the accruals concept states that revenue and expenditure should be matched.

In order to provide a degree of constraint on accounting practices, the standard sets out specific criteria which must be met if expenditure is to be carried forward. These are:

- there must be a separately identifiable development project, with identifiable expenditure;
- the project must have been assessed to ensure that it will be technically feasible and will have a profitable outcome (i.e. it must be technically and commercially viable); and
- there must be sufficient resources to complete the project.

If expenditure is capitalised, an annual review must be carried out to ensure that the criteria for capitalisation continue to be met.

Mark allocation:

| | |
|---------------------------------------------|---|
| 1 mark for each valid point to a maximum of | 8 |
|---------------------------------------------|---|

- (c) Based on the above definitions and criteria, and taking into account the information available, the accounting treatment of the two projects should be:

Yerman project

This project seems to meet the definition of development expenditure and the criteria for deferment of the expenditure. It has separately identifiable expenditure, and the plans to establish a separate division indicate that it is both technically and commercially viable. As production is not due to start in the current (or indeed the following year), there will be no requirement for any amortisation. This means that an intangible asset of £2.45 million will be reported on the balance sheet.

It should be noted that it would also be acceptable to charge the expenditure of £2.45 million against profit as an operating expense. This is perfectly acceptable, and, it could be argued, is more prudent, as the project is still in its early stages, and the outcome is by no means assured.

If it is decided to capitalise the expenditure, a review will be required at the next balance sheet date to ensure that the criteria for capitalisation still apply. If not, the total expenditure to date must be written off.

Soawill project

This project seems to meet the definition of applied research, and as such should be charged to profit as an operating expense.

Therefore the profit and loss account will include a charge of £3.2 million.

Mark allocation:

| | |
|---------------------------------------------|-----------|
| 1 mark for each valid point to a maximum of | 6 |
| | <u>20</u> |

- 3 (a) Almon Ltd**
Cash Flow Statement for the year ended 31 May 2006

| | £ | | |
|-------------------------------------------|-----------------------|-------------|---|
| Net cash inflow from operating activities | 311,576 | (note 1) | 1 |
| Servicing of finance | (17,180) | (working 3) | 1 |
| Taxation | (40,350) | (working 4) | 1 |
| Capital expenditure | (182,000) | (working 5) | 1 |
| | <u>72,046</u> | | |
| Net Cash Flow before financing | 72,046 | | |
| Financing | 140,000 | (working 6) | 1 |
| | <u>212,046</u> | | |
| Increase in cash | <u><u>212,046</u></u> | | |

Note 1 Reconciliation of operating profit to net cash flow from operating activities

| | £ | | |
|-------------------------------------------|-----------------------|----------------|-----------|
| Operating profit | 203,720 | (working 1) | 2 |
| Depreciation | 127,480 | (per question) | 1 |
| Decrease in stocks | 17,728 | (working 2) | 2 |
| Increase in debtors | (45,690) | (working 2) | 2 |
| Increase in creditors | 8,338 | (working 2) | 2 |
| | <u>311,576</u> | | |
| Net cash inflow from operating activities | <u><u>311,576</u></u> | | <u>14</u> |

Working 1 Operating Profit

| | £ | | |
|------|--------------------------|---------|-------------|
| | Retained profit 2006 | 431,119 | |
| | Retained profit 2005 | 290,799 | |
| | <u>140,320</u> | | |
| thus | Retained profit for year | 140,320 | 1 |
| Add | Interest charge | 17,800 | (working 3) |
| | Taxation charge | 45,600 | (working 4) |
| | <u>203,720</u> | | <u>1</u> |
| | <u><u>203,720</u></u> | | |

Working 2

| | 2006 £ | 2005 £ | movemnet £ | |
|-----------|-----------|-----------|---------------|------------------|
| Stock | 162,832 | 180,560 | 17,728 | (dec. ∴ inflow) |
| Debtors | 241,580 | 195,890 | 45,690 | (inc. ∴ outflow) |
| Creditors | 136,907 | 128,569 | 8,338 | (inc. ∴ inflow) |

Working 3 Interest paid

| | £ |
|------------------------|-------------|
| Opening creditor | 6,800 |
| Profit and loss charge | 17,800 |
| | <hr/> |
| | 24,600 |
| Closing creditor | 7,420 |
| | <hr/> |
| = Amount paid | 17,180 |
| | <hr/> <hr/> |

Working 4 Taxation

| | £ |
|------------------------|-------------|
| Opening creditor | 23,400 |
| Profit and loss charge | 45,600 |
| | <hr/> |
| | 69,000 |
| Closing creditor | 28,650 |
| | <hr/> |
| = Amount paid | 40,350 |
| | <hr/> <hr/> |

Working 5 Capital expenditure

| | £ | |
|------------------------|-------------|-------------|
| NBV b/f | 1,486,200 | |
| Profit and loss charge | (127,480) | |
| | <hr/> | |
| | 1,358,720 | |
| NBV c/f | 1,540,720 | |
| | <hr/> | |
| = Amount paid | 182,000 | = Additions |
| | <hr/> <hr/> | |

Working 6

| | £ |
|------------------------------|-------------|
| Financing | |
| Increase in short term loans | 11,000 |
| Increase in long term loans | 129,000 |
| | <hr/> |
| | 140,000 |
| | <hr/> <hr/> |

(b) The most significant issues which are apparent from the cash flow statement are:

- The company has been successful in generating cash from its operating activities.
- There is evidence of continued investment in fixed assets, which should provide a basis for continued growth in the future.
- There is evidence of good financial management as much of the cash outflow for capital expenditure was raised by taking out a new loan.
- The company has remained profitable and has also reduced stock levels, which suggests good management of working capital.
- There has been an increase in the level of debtors, which may indicate problems in credit control.

Following from these observations, it would be appropriate to obtain more information on the following matters:

- Exactly what type of fixed assets were acquired, and how are these assets expected to contribute to future profitability and growth?
- Why was such a significant loan raised when the company was generating cash from its operating activities?
- What are the directors' plans for the future expansion, and how much funding will these plans require?
- What is the reason for the reduction in stock levels? Was this a result of a deliberate policy, or has the stock been artificially reduced for some reason?
- What is the company's policy on working capital management?
- Has there been any significant change in the working capital cycle?
- Over what period are the loans due to be repaid?
- How does the loan repayment term relate to the useful life of the fixed assets?

Mark allocation:

1 mark for each valid point, to a maximum of

6

Section C

| | | | | |
|--------------|--------------------------|--------------------------|----------------------------------|---|
| 4 (a) | Olympics Guide: | | | |
| | Contribution per guide | | $£5.00 - £1.75 = £3.25$ | 1 |
| | Total contribution: | | | |
| | 30,000 × £3.25 | | $£ 97,500 \times .25 = £ 24,375$ | 1 |
| | 50,000 × £3.25 | | $£162,500 \times .44 = £ 71,500$ | 1 |
| | 60,000 × £3.25 | | $£195,000 \times .31 = £ 60,450$ | 1 |
| | Expected contribution | | <u>£156,325</u> | 1 |
| | Less: Drawings/narrative | | <u>£ 14,600</u> | 1 |
| | | | <u>£141,725</u> | 1 |
| | General guide | | | |
| | Contribution = | 50,000 × (£4.00 – £1.75) | £112,500 | 1 |
| | Less: Drawings/narrative | | <u>£ 9,300</u> | 1 |
| | | | <u>£103,200</u> | 1 |

Based on the expected value criterion, the Olympics guide will be more profitable for the company. 1

11

NB The cost of commissioning the photographs is not included as this is a sunk cost.

(b) To Managing Director
From Production Director
Re Beijing City Guide
Date 5 June 2006

(i) In assessing the choice between an Olympics guide and a general guide for Beijing, the cost of the photography is not a relevant cost. As we have already commissioned the photographs, we are committed to the higher cost. This is what is often referred to as a 'sunk cost' as it cannot be recovered. The fact that the photography for the general guide would have been less than the cost for the Olympics guide would only have been relevant if we still had to commission the photographs. Therefore, my assessment does not include this cost.

The cost for the drawings and the narrative has to be included in the assessment of each choice as the amount we will incur will depend on which option we select.

This is an example of a discretionary cost.

It is also worth noting that as the decision to publish a guide has already been made, the print set up cost of both options is the same. Therefore this cost can be excluded from the assessment of which of the two guides to produce.

(ii) In this case, the use of the expected value criterion may be misleading. The approach calculates the weighted average of the results which would be expected if the project was undertaken many times. However, in this case, we can only make the choice once, and the return will depend on the actual sales volume. This means that if the sales volume is 30,000, the contribution will be £97,500. After the cost of drawings and narrative, this is reduced to £82,900, which is £20,300 less than the return from the general guide.

The expected value criterion is therefore a decision *support* technique, as opposed to a decision *making* technique. There is a 25% chance that our return will be reduced if we choose the Olympics guide. Of course, this means that there is a 75% chance that our return will be greater.

Ultimately, the decision will depend on our attitude to risk. If we are prepared to take 25% risk, in the hope of achieving a higher return, the Olympics guide is a better choice. However, if we wish to be more conservative, and have a greater degree of certainty with regard to our return, we should choose the general guide.

It is worth noting, however, that the downside risk is somewhat limited, as we have to choose between different returns. There does not appear to be any possibility that we will actually incur a loss, whatever decision we make.

| | | |
|---------------------------------------------------------------------------|-------------------------|-----------|
| Mark allocation: | | |
| For explanation of treatment of | Photography cost | 2 |
| | Drawings/narrative cost | 2 |
| For discussion of expected value, 1 mark per valid point, to a maximum of | | 5 |
| | | <u>9</u> |
| | | <u>20</u> |

5 (a) Production Budget

| Units | P1 | P2 | P3 | P4 | P5 | P6 | P7 | |
|---------------|------|------|------|------|------|------|-----|---|
| Sales Budget | 400 | 280 | 410 | 420 | 400 | 310 | 430 | |
| Opening Stock | (40) | (28) | (41) | (42) | (40) | (31) | | |
| Closing Stock | 28 | 41 | 42 | 40 | 31 | 43 | | |
| <i>Thus:</i> | | | | | | | | |
| Production | 388 | 293 | 411 | 418 | 391 | 322 | | 2 |

(b) Materials Usage

| | P1 | P2 | P3 | P4 | P5 | P6 | |
|--------------------|--------|-------|--------|--------|--------|-------|---|
| Production (units) | 388 | 293 | 411 | 418 | 391 | 322 | |
| Materials (kg) | 11,640 | 8,790 | 12,330 | 12,540 | 11,730 | 9,660 | 1 |

(c) Purchases

| | P1 | P2 | P3 | P4 | P5 | P6 | |
|----------------|---------|---------|---------|---------|---------|---------|---|
| Materials (kg) | 11,640 | 8,790 | 12,330 | 12,540 | 11,730 | 9,660 | |
| £ | 325,920 | 246,120 | 345,240 | 351,120 | 328,440 | 270,480 | 1 |

(d) Cash Budget £

| | P1 | P2 | P3 | P4 | P5 | P6 | |
|-----------------------|---------|---------|---------|---------|----------|----------|---|
| Inflow | | | | | | | |
| Debtors (W1) | 460,000 | 480,000 | 364,800 | 460,800 | 501,600 | 484,800 | 3 |
| Outflows: | | | | | | | |
| Suppliers | 293,510 | 325,920 | 246,120 | 345,240 | 351,120 | 328,440 | 1 |
| Wages (W2) | 47,136 | 47,136 | 51,552 | 52,896 | 47,712 | 52,704 | 2 |
| Employment costs (W2) | 4,714 | 4,714 | 5,155 | 5,290 | 4,771 | 5,270 | 1 |
| Other costs | 100,000 | 100,000 | 100,000 | 100,000 | 100,000 | 100,000 | 1 |
| Total outflow | 445,360 | 477,770 | 402,827 | 503,426 | 503,603 | 486,414 | |
| Net cash flow | 14,640 | 2,230 | -38,027 | -42,626 | -2,003 | -1,614 | 1 |
| Opening balance | -34,700 | -20,060 | -17,830 | -55,857 | -98,483 | -100,486 | 1 |
| Closing balance | -20,060 | -17,830 | -55,857 | -98,483 | -100,486 | -102,100 | 1 |

Comments:

Cash position deteriorates in almost every month.

Suggests an underlying problem

While cash position could be improved by:

Negotiating longer credit period from supplier

Encouraging all customers to pay within trading terms

Reducing stock of finished goods

These would not solve the underlying problem, which seems to be that the business is not viable.

Cost of product (before depreciation) exceeds selling price

Management needs to take more fundamental action. This would include:

Reduce material cost of product

Increase selling price.

Mark allocation:

Credit periods/reduce stock: 1 mark each

Not sufficient/underlying problem

Cost exceeds selling price

Before depreciation

Available

Maximum

| |
|-----------|
| 3 |
| 1 |
| 2 |
| 1 |
| <hr/> |
| 7 |
| <hr/> |
| 5 |
| <hr/> |
| 20 |
| <hr/> |

Working 1

| | | Debtors P1 | P2 | P3 | P4 | P5 | P6 |
|---------------|------|------------|--------------|--------------|--------------|--------------|--------------|
| Sales (units) | | 400 | 280 | 410 | 420 | 400 | 310 |
| Revenue | £000 | 480 | 336 | 492 | 504 | 480 | 372 |
| 1 mth 80% | £000 | 384 | 268·8 | 393·6 | 403·2 | 384 | 297·6 |
| 2 mth 20% | £000 | 96 | 67·2 | 98·4 | 100·8 | 96 | 74·4 |
| Received: | | | | | | | |
| 1 month | £000 | | 384·0 | 268·8 | 393·6 | 403·2 | 384·0 |
| 2 months | £000 | | | 96·0 | 67·2 | 98·4 | 100·8 |
| Op debtors | £000 | 460 | 96·0 | | | | |
| | | <u>460</u> | <u>480·0</u> | <u>364·8</u> | <u>460·8</u> | <u>501·6</u> | <u>484·8</u> |

Working 2

| | | Wages P1 | P2 | P3 | P4 | P5 | P6 |
|--------------------|---|---------------|---------------|---------------|---------------|---------------|---------------|
| Production (units) | | 388 | 293 | 411 | 418 | 391 | 322 |
| Normal capacity | | 380 | 285 | 380 | 380 | 380 | 285 |
| Overtime units | | 8 | 8 | 31 | 38 | 11 | 37 |
| Overtime Cost* £ | | 1,536 | 1,536 | 5,952 | 7,296 | 2,112 | 7,104 |
| Normal wages £ | | 45,600 | 45,600 | 45,600 | 45,600 | 45,600 | 45,600 |
| Total cost | £ | <u>47,136</u> | <u>47,136</u> | <u>51,552</u> | <u>52,896</u> | <u>47,712</u> | <u>52,704</u> |
| Employment costs | £ | 4,714 | 4,714 | 5,155 | 5,290 | 4,771 | 5,270 |

* In each week, the team can produce 95 units. The normal wages cost is £380 per week for each member of the team. Thus the wages cost is £120 per unit. The overtime premium is 60% increasing the cost to £192 per unit.

6 (a) Just in time (JIT) is often described as a management philosophy.

Whilst there are differences between just in time purchasing and just in time production, both are based on the same key elements. These are:

Continuous improvement

While it is probably true that the ultimate goal of perfect quality every time is not sustainable, the focus on continuous improvement is a key feature of just in time. By striving to match supply and demand, and always seeking a better way of carrying out processes, an organisation can get as close as possible to that ultimate objective.

Elimination of waste

Waste is defined as any activity which does not add value – as perceived by the customer. One key area which is identified as waste is items held in stock. The traditional view is that items in stock contribute to ensuring that customer demand can be met. The JIT view is that items in stock are tying up resources that could be put to better use, and are only held due to inefficiency.

Whole staff involvement

Based on the need for a product (or a service for that matter) to pass through various stages, every individual involved in the process is a potential guardian of the philosophy or has the potential to undermine it. For that reason all staff must be involved in the search for continuous improvement. It is also worth noting that 'all staff' means just that – not just production staff.

Pull system

In a JIT system, activity only takes place when there is evidence of demand. Such evidence is provided by a signal from the next stage of the process. This means that activity no longer takes place because it was planned, or the output of the previous stage of the process has 'pushed' the need for the activity. Rather, activity takes place as a result of a 'pull' from the next stage.

Just in time purchasing is when purchasing is planned and executed to ensure that materials are received when they are required. That is to say, receipt and usage coincide. Thus the objective is to eliminate stock of raw materials.

Just in time production is a 'pull' approach, as the need for production at each stage of the process is driven (or pulled) by the demand from the next stage of the production process. This means that stock of work in progress and finished goods is eliminated.

Mark allocation: 1 mark per valid point, to a maximum of

8

- (b) The culture of the company is likely to change in the following ways:

Customer focus

The focus of all the activities will be the customer. Production will take place in response to customer demand, and this will help to ensure that customer satisfaction takes precedence over all other objectives. It will also mean that it will be easier to respond to customer requests for minor changes without causing serious disruption to the production process.

Quality

The need to respond quickly to customer demand will mean that quality will become of critical importance. It will not be possible to respond to customer demand unless there is certainty that quality can be maintained and enhanced. The goal of continuous improvement must be accepted by all staff.

The approach to quality will become 'right first time' as opposed to 'right most of the time' which characterises the traditional approach.

Employee involvement

By asking employees to ensure that quality standards are met and improved, we will be asking them to expand the traditional boundaries of their role. This will mean that employee involvement in all aspects of performance will increase, as employees recognise that their contributions are valued.

Reduce in hierarchical authority

As employees become more involved, the traditional hierarchical lines of authority will become less important, and employees will begin to exercise greater autonomy.

Mark allocation:

For each aspect of culture identified, or valid comment regarding culture, 1 mark to a maximum of 6

- (c) While just in time brings numerous benefits, it is not without problems.

These can be summarised as:

Demand

For JIT to operate effectively, it must be possible to predict the level of demand and the pattern of demand. Any unforeseen increase in demand may lead to stock outs with a resulting fall in customer confidence. This will have a detrimental effect on future sales.

Disruption

As the JIT approach relies on predictability and certainty of delivery, any disruption in the supply chain, or fall in quality will lead to stock outs.

Relationships

A key element in the stability discussed above is good relationships with employees. As noted above, the introduction of JIT will lead to a change in culture within the company. It may be that employees are either unable or unwilling to accept this change.

Prices

The JIT approach leads to more regular deliveries of smaller quantities. As suppliers will normally attempt to minimise costs by encouraging larger orders, it is likely that a premium will be charged to handle small orders, and to guarantee delivery.

Possible solutions to these problems are:

Demand

It may be the case that demand is more predictable than might be currently accepted. Customers may welcome the opportunity to discuss the factors which drive demand, as this may enable them to improve their own stock management processes. A thorough investigation into the key factors which influence demand could be conducted to ascertain if it is possible to predict demand with a degree of certainty.

Disruption

In some instances, disruption in the supply chain arises due to a lack of communication. It may be possible to improve the flow in the supply chain by forming partnerships with suppliers. Such partnerships can provide benefits to both parties, as they encourage a longer term perspective.

Relationships

Like any other internal change, a shift to JIT must be carefully managed, and employees must be fully informed of the reasons for, and the benefits of, any change. This will be most effective if it is done in an atmosphere of openness and consultation. Many companies have had the experience of opening consultation with employees and finding that rather than resistance, they encounter enthusiasm, as employees are keen to be trusted and wish to become involved in positive and beneficial change.

Prices

As discussed above consultation with suppliers may highlight mutual benefits, and may result in lower (or indeed nil) price rises. If this is not the case, the associated costs and benefits should be considered to assess whether there will be a net benefit to the company.

Mark allocation:

For each problem identified, 1 mark to a maximum of

3

For each suggestion on how such problems may be overcome, 1 mark to a maximum of

3

20
