

A Module

Diploma in Financial Management

PROJECT DA2, INCORPORATING SUBJECT AREAS

- INTERPRETATION OF FINANCIAL STATEMENTS
- PERFORMANCE MANAGEMENT

All questions are compulsory and **MUST** be answered

The project **MUST** be written in English.

The maximum word count (including appendices and tables but excluding table of contents, references and bibliography) is 5,000.

The project **MUST** be **TYPED** in black ink, one-sided, double-spaced, using a minimum 12-point font size and a 1-inch margin at each side. **HANDWRITTEN SUBMISSIONS WILL NOT BE ACCEPTED.** The project must be submitted by post, electronic submissions are not acceptable.

The project should be submitted on A4 paper with your student number, project name, date and page number at the top of each page.

A project submission form **MUST** be completed for each project submitted and attached to the front of the project.

The Association of Chartered Certified Accountants



Section 1 – incorporating subject areas – Interpretation of Financial Statements and Performance Management.

1 Background

You are employed as a loans officer in a financial institution. One of the cases you are dealing with is Exfood, a UK based limited liability company. The company provides outsourced catering services to a range of customer groupings in the UK, Europe and North America.

Exfood has grown steadily and is now seeking to undertake a major expansion, and your organisation has been approached with a view to providing finance.

At the request of your departmental manager, you are required to assess the performance of Exfood and consider its expansion plans. You have obtained the summarised financial information in appendix 1 for this purpose.

You have also obtained the extracts from the financial statements of Compass plc which are in appendix 2.

You have chosen Compass because this is a key company in the industry, and you believe this will provide a useful benchmark against which to assess both the past performance and future plans of Exfood.

The management team of Exfood have stated that their objectives for the expansion are to achieve profitable growth, combined with a positive cash flow, thereby increasing shareholder value.

They believe that these objectives will be achieved by identifying key growth markets as well as gaining customers in existing markets, through offering unrivalled customer service and value for money.

Although the company completed an acquisition in the last month of the 2006 financial year, the management team do not envisage further acquisitions forming part of the growth strategy. They have given two reasons for this view. The first is that they believe that significant opportunities for organic growth exist and that these can be exploited by constantly improving the service to customers. As growth is achieved, the company will be better placed to improve profit margins due to economies of scale, and improved supply chain management.

The second reason is that they are concerned that the requirement under IFRS for an annual impairment review of purchased goodwill may lead to increased volatility in earnings.

Required:

Prepare a report to the Lending Committee of your institution, which:

- (a) Identifies five ratios or other measures, derived from the financial statements, which would be of most significance for your institution in assessing the performance of Exfood, and explains why these are significant for your assessment.** (11 marks)

- (b) Assesses the performance of Exfood, using relevant ratios and other measures, including those you have identified in (a).**

This assessment is to be carried out using Compass plc as a benchmark, in the context of the information referred to in the reports of the Chairman, Chief Executive and Financial Director of Compass plc with regard to the business environment and market conditions, and should also suggest possible reasons for any differences in the performance of the two companies. (26 marks)

- (c) Assesses the view of the directors that the need to carry out an annual impairment review of purchased goodwill may lead to increased volatility in earnings, by:**

- (i) explaining how purchased goodwill arises;**
(ii) explaining the nature of impairment; and
(iii) explaining why earnings may be more volatile. (13 marks)

(50 marks)

2 Background

Your lending manager has indicated that if a decision is taken to advance funds to Exfood, it is likely that your institution will take a close interest in the ongoing performance of the company. This will mean that internally generated management information will be made available to your institution. He has also questioned the validity of using Compass as a benchmark for the assessment carried out in question 1.

You have been asked to consider these points and make a presentation to the Lending Committee.

Required:

Prepare a presentation* to the Lending Committee, which:

- (a) **Evaluates the suitability of Compass plc as a benchmark for the performance of Exfood.** (11 marks)
- (b) **Identifies and explains the measures of shareholder value which may be used by Exfood, and recommends a specific measure for use by the company.** (11 marks)
- (c) **Discusses how improved supply chain management may assist Exfood to achieve the stated objectives.** (9 marks)
- (d) **Identifies and, in the context of the company's stated objectives, justifies critical success factors (CSFs) which could be used to manage performance.** (13 marks)
- (e) **Provides specific measures for the CSFs you have identified in (d).** (6 marks)

(50 marks)

*Your presentation should include suitable visual aids and a text of the speech you would make when delivering the presentation.

(100 marks)

Summarised financial information for Exfood Ltd

	2006 \$000	2005 \$000
Summary Income Statement		
Revenue	248,180	180,560
Cost of Sales	216,840	157,420
Gross Profit	31,340	23,140
Expenses	27,000	19,500
Operating profit	4,340	3,640
Other income	80	80
Profit before interest	4,420	3,720
Interest paid	240	180
Profit before tax	4,180	3,540
Tax	1,180	1,140
Profit for year	3,000	2,400
Dividends paid	1,400	640
Retained Profit	1,600	1,760
Summary Balance Sheet		
<u>Fixed Assets</u>		
Tangible non-current assets	5,800	3,960
Intangible non-current assets	860	-
	6,660	3,960
<u>Current Assets</u>		
Inventories	3,420	1,380
Trade receivables	29,200	22,520
Bank	11,640	4,120
Prepayments	6,100	5,520
	50,360	33,540
<u>Current Liabilities</u>		
Trade payables	28,680	19,400
HP and other loans	2,860	1,860
Tax	1,500	1,280
Accruals	14,360	7,780
	47,400	30,320
<u>Non-current liabilities</u>		
HP and other loans	1,700	860
Total net assets	7,920	6,320
<u>Equity</u>		
Share capital	1,460	1,460
Share premium	220	220
Retained profit	6,240	4,640
	7,920	6,320

End of Project