



CIMA EXAM PRACTICE KIT

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CIMA

MEMBER

Paper P10
**Test of
Professional Competence
in Management Accounting**

Relevant for **May & November 2005** examinations



Geoff Little

CIMA Exam Practice Kit

Test of Professional Competence in Management Accounting

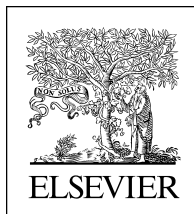
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Test of Professional Competence in Management Accounting

Geoff Little



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Foreword

How to use this book

The TOPCIMA examination is quite unique in the current CIMA syllabus.

In the real world there are no formal forms of study that can teach professional people to analyse and solve practical problems. CIMA's Paper 10 prepares you for the vital role of acting as an advisor to management who have to make complex decision that have an impact on business survival. Case studies simulate real-world problems and test your higher skills.

This book gives you a **SIX STAGE METHODOLOGY** that you need in order to confidently analyse any case study and obtain a pass.

Chapter 1 tells you about the examination and how it is assessed.

Chapter 2 describes the **PROCESS OF ANALYSIS** that you must carry out in order to digest the case material.

Chapter 3 contains two short cases with answers provided. They test business awareness.

Chapters 4–7 contain the analyses of past cases set by CIMA between November 2001 and May 2005.

Six simple Stages will give you the confidence that you need.

Stage 1 – The Appendices contain the relevant pre-seen material. If you are attempting Chapter 4 you must refer to FLCS November 2001 which is in Appendix 1.

Stage 2 – Read and make a summary of the pre-seen using the chapter paragraphs as a guide (180 minutes minimum).

Stage 3 – Refer to the unseen and summarise it; compare your summary with the relevant part of the chapter (45 minutes).

Stage 4 – Read the question requirement and compare it to your notes that you made when doing Stage 2 and Stage 3 (45 minutes).

Stage 5 – Attempt an answer in 2,500 words (180 minutes).

Stage 6 – Review your answer with the Case Writer's Answers at the end of the book (Appendix 1 contains the answer to FLCS November 2001). **DO NOT NEGLECT TO USE THE RELEVANT ASSESSMENT MATRIX AND MARK YOUR ANSWER CAREFULLY.** Repeat this exercise using other chapters.

The TOPCIMA Examination

1

1.1 Introduction

The TOPCIMA examination is the final hurdle to be overcome in proceeding to qualification for membership of CIMA. The examination can only be attempted after you have passed all three of the final level papers, or if you have passed the three final papers from the old syllabus.

The aim of the examination is to test you in your ability to apply your skills and demonstrate that you are an effective communicator in written form.

World-class professional bodies like CIMA aim to test “higher skills”.

The business environment is complex, fast moving and inherently risky. The senior management of large organisations are often called upon to make complex decisions which cannot be solved by the exercise of logical thought alone. Writers, such as Herbert Simon, identify that business decisions at a high level are solved by a special form of decision-making that relies upon the use of skill, intuition and experience. These decision-making skills are acquired by exposure to various real-world situations which are set out in the form of a case study.

The CIMA member is expected to have a broad knowledge of the world of business and he/she is expected to help management to solve unstructured problems which are a part of running a business in the real world. In short, TOPCIMA aims to develop and test the skills associated with management consultants and other top level people who earn their living through the provision of professional advice.

Please note that as from September 2005 there are two sittings of TOPCIMA each Spring and Autumn (four sittings in all). Students can attempt TOPCIMA in March or May. If they are unsuccessful they can resit the examination the following September or November.

1.2 Is there a syllabus?

The strategic level of the new syllabus consists of three core subjects:

- Paper 3 Risk and control strategy
- Paper 6 Business strategy
- Paper 9 Financial strategy.

You can expect elements from all three papers to appear in Paper 10. CIMA also assumes that your previous studies in areas such as management and financial reporting are not forgotten. Therefore you should expect to demonstrate a wide area of business awareness when you tackle Paper 10.

1.3 The case study – “pre-seen”

The case study is presented in two parts. The pre-seen appears around 8 weeks before the examination and sets out the scenario for the examination. It consists of some 18 pages. The data is a mixture of textual and numerical information and this will be supported by various exhibits. These can take the form of press reports, e-mails, memoranda or letters. There will also be some numerical data which are essential for any decision-making process. Financial data will be set out in IFRS format.

1.4 The “unseen” material

On the examination day, you will be presented with the original pre-seen with around 5–10 pages of additional data. This additional data is the unseen part of the case study. The unseen part tells you what the examiners want. The presumption is that you, the examination candidate, are retained as a management consultant by the senior management of a company and your task is to advise the management on some form of strategic decision.

1.5 The case study – “pre-seen” has two possible unseens

You should note that the pre-seen material will actually serve **two** examination sittings.

The pre-seen produced for the March examination will also be used by students sitting in May. The pre-seen issued to students sitting in September will also be used by students sitting in November.

Students sitting the examination in March or September will produce their scripts using Personal Computers (PCs). Textual data will be done using Microsoft Word. The computational elements will be done using Microsoft Excel. Students sitting the examination in May or November will produce their scripts by conventional handwritten methods. The method of examination can be illustrated using the table below which illustrates the scheme for September 2005.

The pre-seen dealt with a construction company called “Domusco”. The same pre-seen was used by students sitting in September and November. However, the unseen material was different for each sitting.

Examination sitting	Method of completion	Pre-seen	Unseen
September 2005	Computer-based	Domusco	different
November 2005	Handwritten	Domusco	different

1.6 History of the examination

The case study approach originated under the old syllabus first examined in 2001. The style of examination has not changed significantly with the new syllabus introduced in 2005. In order to illustrate how the examiner's mind has worked, a brief history of the examination is set out below.

Examination sitting	Case study	Task
May 2001	Proton Quest – a biotechnology company	Disposal of non-core subsidiary to provide funds for continuation
November 2001	IRS – a company engaged in refrigeration	Evaluation of an expansion proposal over three years
May 2002	Constro – a company diversifying from construction to mobile phones	Evaluation of perusals to diversify
November 2002	Global supermarkets	Evaluating suitable acquisition to support a strategy of expansion
May 2003	Sparkle – a chain of health clubs	Rationalisation of a chain of clubs in a competitive niche market
November 2003	Homejay – a diversified retailer	Rationalisation of a retailer by disposing of non-core activities
May 2004	OFood4U – a small organic food provider and expansionist plans	Recommendation of viable financial strategies
November 2004	Mayah Hospital – unusual case dealing with a public sector agency providing health care	Recommendations on financial management in a public sector environment
May 2005 New syllabus	Two companies in the recycling of waste are evaluated by a major player	Acquisition of a significant company to safeguard supplies of recycled material

1.7 Assessment matrix

The assessment process for your script is laid down in the form of a matrix, which illustrates how marks are awarded.

The mark allocation for each criterion will vary from one sitting to the next.

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A concise view of typical mark allocation is set out below.

Criterion	Mark %	Explanation
Technical	10	This would involve a display of knowledge from the papers studied to date. Strategic frameworks from Paper 6 would include use of the BCG matrix, the SWOT analysis and the models devised by Porter, Ansoff and other writers on strategy. Financial and numerical analyses can be demonstrated by techniques involving DCF and ratio analysis from Paper 9.
Applications	10	Marks will be awarded for choosing and using the right technique for right situation. For example, the techniques for valuing a quoted company may not be relevant to the valuation of an unquoted company.
Diversity	10	Marks are awarded here for use of business knowledge and business awareness generally.
Focus	10	This tests the candidate's ability to select appropriate data and to discard irrelevant matters from relevant matters.
Prioritisation	10	This is a key feature of success at this type of examination and the need to identify the critical issues to achieve success in a business venture. You must state which issues are critical and why they are important to the scenario. For example, in the IRS case (November 2001) many candidates ignored the risks of a rapidly increasing bank overdraft in a relatively small business run by a risk-taking autocrat.
Judgement	10	CIMA are asking students to apply their skill and judgement in evaluating courses of action. This is the essence of the skills required of a strategic manager.
Integration	10	Integration implies the ability to choose the essential elements from the case study and use them to provide an effective business solution. A management consultant's report should cover all the essential issues but should not be overly technical in some areas and sketchy in others. Beware of the temptation to stress the areas where you are strong while skimming over areas where you are weak. A frequent criticism of the examiner has been the reluctance of some candidates to perform any calculations at all.
Logic	20	This criterion carries the largest mark weighting of 20 percent. This is an indication of the importance of a well-structured report format with all issues and recommendations identified in order of importance. Recommendations are required for all issues and must be clearly prioritised.
Ethics	10	This is a new assessment criterion and reflects the importance of ethical conduct. The issue of ethics runs through several papers. Paper 3 contains a significant element on corporate governance which was an issue in the May 2005 sitting of Paper 10.
Total Marks	100	

You should note that the examiners attach great importance to issues such as ethics and corporate governance and you can expect ethical issues to be part of future examinations.

The examiner also attaches great importance to knowledge and application of well-known strategic frameworks that are used by strategic planners today. The May 2005 examination required students to apply and explain the Boston Consulting Group (BCG) matrix when evaluating the company called “Shard”. This company had a variety of products at various stages of development. A good student would have gained useful marks by identifying those products which were mature and those which were of future strategic significance.

Future sittings may well require a knowledge of Porter’s frameworks for analysing issues relating to competitive advantage, as well as those of Ansoff *et al.* You must demonstrate that you have not forgotten what you learned at Paper 6.

Finally, management accountants are expected to be numerate as well as literate. Strategic decisions are justified by financial evaluations. Do not neglect the toolbox of techniques from Paper 9. In particular, you must be comfortable with the various business valuation models (see May 2005), the various discounted cash flow techniques, the CAPM and the techniques for analysing financial statements.

1.8 Useful background knowledge

The examiner recommends that students improve their confidence by the use of real-world examples. This can extend their levels of business awareness and improve the quality of their answers. Useful research can be obtained using the Internet in the following ways:

1. *Interim Accounts of listed companies.* These are useful sources of knowledge and interim accounts are usefully concise. Students researching property and construction companies for the Domusco scenario would have found useful data from the interim statements of Costain PLC and Bovis Homes PLC.
2. *Trade associations.* These also provide useful background information.
3. *Newspaper extracts.* *The Financial Times* and the *Business* section of a quality newspaper are essential reading.

It is recommended that the student consult the published CIMA guides S11 and S12 as well as the post-exam guidance on the www.cimaglobal.com website.

I am a Management Consultant and I Solve Other People's Problems

2

2.1 Consultants are very useful to top management

You need to develop an attitude that will enable you to role-play the case study scenario. Try and imagine that you are a management consultant (indeed the scenario may ask you to assume that you are one) and you have considerable problem-solving experience.

Many significant business decisions have been taken after reports were commissioned from influential management consultancies. The UK government employed McKinsey and Co. to study the feasibility of separating the Postal service from the Telephone service. Both of these activities were run by the Post Office Corporation which was a public sector body. The result of the study led to the privatisation of the telephone service and allied technologies into what is now called British Telecom PLC.

Management consultants are not cheap so why use them? **Management use consultants because they provide an objective sounding board for the long-term plans of top management.**

2.2 Essential methodology (1) find out about the business

Any consultant or problem solver has to know and understand how the "client" functions on a day-to-day business. This involves a through process of familiarisation with the business model. Consultants undertake a review of the business and create a business profile. A business profile enables the consultant to familiarise himself with the issues listed below.

- *The trade carried on.* Every business has unique features which have evolved over time. You will find clues to the trade carried on in the unseen. In IRS (November 2001), the company had developed refrigeration control systems which were sold to

major supermarket chains. This required the candidate to try and understand how the business model functioned.

In OFoodU, the business was small and family dominated. Organic food remains a niche market supplying consumers who are well to do.

- *The markets.* Apply your marketing knowledge from earlier studies. A business cannot function without customers. Knowledge of frameworks such as the 4 Ps in the marketing mix is fundamental to understanding the case material. The competitive nature of the business environment can make or break an organisation.
- *The products.* What does the business produce? In Constro, the business was diversifying into mobile phones. This product is heavily influenced by legal, technological and social issues. The Nokia mobile sacrificed customer appeal by failing to capitalise on the new “clam-shell type” handsets which are perceived as a fashion norm by some consumers.
- *The competitors.* Use the framework that you studied at earlier levels. Porter’s five force model is a shrewdly observed analysis of competitive forces. The need to achieve competitive advantage is the driving force behind the business plans of major organisations. The credit card business is a good example of how organisations use various ploys to tempt customers to “sign up” for their product.
- *The management and the organisation structure.* Organisations depend on people, and the strengths and weaknesses of the management are a critical part of business success. British Airways dispensed with the services of one CEO because he had lost track of the need to focus on the high profit-earning sectors of business.

Hewlett Packard recently dispensed with the service of a high-profile CEO because she had lost track of the essential aim in business which is to satisfy the investors’ needs.

2.3 Essential methodology (2) The business risk model

With the introduction of Paper 3, students can expect to be aware of the nature and impact of business risks in a particular scenario. Business risks constrain the operations of any organisation large or small. Risk management is now assumed to be an essential part of good corporate governance. There are various tools and frameworks that facilitate risk analysis.

PESTLE – This is a useful framework because it provides six generic types of risk.

Political or operational issues – This refers to the way in which the business carries on its day-to-day operations. Any organisation is at risk from process failure. (For example, a strike by Royal Mail could paralyse many organisations.)

Economic – This refers to ability of the business to survive in the business jungle or to generate wealth for shareholders.

Social – This refers to the attitudes of customers which may be shaped by changes in the fabric of society. (For example the growth in wireless communications is not just for business use. The mobile phone is perceived as an essential fashion accessory.)

Technological – This refers to the way in which technological change can affect business prospects. (The development of handheld computers created a new product group for Hewlett Packard at the expense of Potter Scientific Instruments who developed the Psion.)

Legal – Laws and regulations constrain business activities. The employment of casual labour is regulated by minimum wage rates and by stringent record keeping.

Environmental – There is growing awareness for responsible policies in the handling of hazardous substances or in sustaining natural resources.

Note the importance of the degree of **integration** between various types of risk. It is now socially desirable to recycle as well as be environmentally responsible. Legality of employment practice is also driven by social and operational needs.

2.4 Essential methodology (3) SWOT analysis

The SWOT analysis is a technique with considerable appeal because it focuses on both internal and external risks in an economical way. It is a summary of the issues that are derived from a technique covered in Paper 6 – the position audit.

Think of the Ms model

- Manpower
- Machines
- Money
- Management
- Management information
- Mechanics of doing business
- Mission and objectives

Summarise what you have done by a **SWOT** analysis. The Strengths and Weaknesses are generally concerned with internal issues, and the Opportunities and Threats are concerned with external issues.

Some students use the “cruciform” type of summary; use whatever is convenient to you. Strengths and weaknesses are concerned with internal issues and opportunities and threats are concerned with external issues. For virtually all cases to date, a SWOT analysis has been part of the facilitator’s/case study writer’s answer.

A typical SWOT analysis for a manufacturing company in the UK could look like this.

Strengths

Strong brand name generates customer loyalty.
Loyal management ensures stability of the organisation.
Longevity of existence indicates survival skills.
Good trading record encourages investors.
Good products indicate competitive edge.

Opportunities

Outsourcing manufacturing overseas will reduce costs of supply and improve margins.
Withdraw obsolete products and improve sales mix.
Develop new markets and create opportunities for cash generation.
Re-engineer products and reduce costs.

Weaknesses

Unreliable IT systems.
Aggressive style of management.
Unreliable management information systems.
Liquidity problems.
Mature markets.
High costs of manufacture.
Quality failures.

Threats

Competition from other key players will constrain growth.
Attitude of loan creditors may change if the company is a bad credit risk.
Technology change can damage product reputation.

2.5 Essential methodology (4) Identifying the corporate mission and corporate objectives

Case study writers are never obvious. You are often required to work out what drives the business forward. Many companies do not formally articulate their corporate vision or mission statement. Remember that a mission statement is a very broad statement of aims often presented in an eye-catching memorable form. The often quoted example is “definitely positively overnight” which neatly sums up the work ethic of Federal Express. The corporate objectives of the organisation may sometimes be difficult to discern. For example, in IRS the CEO was driven by a need to expand and innovate but this aim was not shared by his closest subordinates. They wanted a secure and comfortable lifestyle and were inherently risk averse. Conflicts like this occur in the real world and are often difficult to resolve. Remember what you were taught in Business Strategy. Corporate objectives must be SMART.

- Specific
- Measurable
- Attainable
- Relevant with a
- Time frame for achievement

The formulation of strategy can be expressed in a number of different ways. A simple model that would be useful for Paper 10 uses the following three-stage approach.

Stage 1	Stage 2	Stage 3
Where we are now Typically this can be represented by a SWOT analysis	Where we want to be Corporate goals or objectives	Going to get there Analysis of PESTLE factors and developing action plans to achieve the objectives identified in stage 2

2.6 Essential methodology (5) Analyse the financial data

If financial or numerical data is provided in the unseen IT HAS BEEN PROVIDED FOR A PURPOSE SO ANALYSE IT.

The techniques of using accounting ratios have been studied in Paper 9 as well as Paper 3. If you attempted subjects under the old syllabus you would have been used to the techniques. Beware of using the data in a formulaic fashion. There are a number of assumptions that underlie the use of accounting ratios but they may not always apply to a particular case because every business has its own particular model.

For example, the received wisdom of ratio analysis is that a negative current ratio is a sign of weakness. This does not apply to retailers like the supermarket giants where a negative current ratio is a sign of good working capital management. The trade creditors are being used as a zero cost source of finance.

BE PREPARED TO BE CHALLENGED BY AN INNOVATIVE CASE WRITER.

Do not forget the obvious. If financial statements are provided, calculate some useful ratios and compactors.

Ratios	Comparators
Gross profit: sales	Sales growth per annum
EBIT: sales	EBIT growth per annum
Interest cover	Interest costs: total costs
EPS (essential for quoted companies)	Fixed costs as a percent of Sales
Current ratio	Fixed costs change year by year
Quick asset ratio	Any other useful indicators that you can think of should be used to help understanding
Debtor days	
Stock turnover	
ROCE (if you must!)	
Debt/equity	

The whole point of calculating ratios is to draw some useful inferences from the exercise. So write down your thoughts as it is a way of retaining knowledge.

Do remember that the examiners will expect you to use your initiative in selecting the most appropriate technique.

Typical tools are:

- Calculate WACC (May 2001)
- NPV/IRR (May 2001)
- Dividend growth models
- Cash flows arising in perpetuity (May 2001)
- Currency parity models
- Techniques to manage forex risk
- Techniques to value unquoted companies

Always look at the company's cash flow. Cash enables the company to survive and achieve its goals.

2.7 Essential methodology (6) Good communication

2.7.1 Style and use of English

The examiners do **not** penalise students for lapses of grammar or spelling errors. This would obviously be unfair as the CIMA examinations are held worldwide. However, what they expect to see is a good standard of communication. By this they mean reports or answers structured in a logical fashion and with clear evidence that you have prioritised the issues posed by the case. In terms of style it is better to be safe rather than sorry and the following tips are suggested to you:

- Avoid slang or colloquial English.
- Keep sentences short.
- Always refer to case characters **by name**. For example, "John Parker stated that . . ." is better than "He stated that . . .".
- If you must use abbreviations stick to well-known ones. For example, ROCE stands for Return On Capital Employed but examiners get irritated by obscure acronyms. If you must abbreviate explain the abbreviation first.

- Keep your sentences short and simple.
- Avoid jokes or humorous comments; they annoy markers who are known to be without a sense of humour.
- Remember that calculations are done for a purpose. Tell the examiner **why** you have done them and **what** they are supposed to prove.
- If you use bullet points as illustrated above, make sure that each bullet is a complete sentence (even if it is a short one).

2.7.2 Report writing

You can expect the examiners to test your professional skills by asking you to write a report. Structure is all-important. Typical features of a report are

Terms of reference which explain to the reader what you were asked to do.

- A “current position” section which deals with the present state of the business.
- An examination of some key issue(s) that must be analysed. (This may take up the main body of the report.)
- Conclusions and recommendations.
- Appendices (these are reserved for any complex data such as calculations or tabulations).
- Ensure that the report has a **front sheet** and an **index** to help the reader to navigate around the report.

Test of Business Awareness

3

3.1 Examiner's expectations

At the strategic level you will be expected to know how the business world functions and understand the inter-relationship between various types of risk. If you are new to the case study approach you will find the case study in this chapter a useful preparation for the larger scale studies that are examined in Paper 10.

This is a small case study and should be solved in 45 minutes.

This case is adapted from an earlier CIMA question.

3.2 Welwyn Garden City Manufacturing Engineers Ltd

You have been recruited to fill the position of financial controller with this company.

The company was incorporated in 1959 in order to take over a business carried on by Maurice and Peter Bodger. Initially, the company was very successful and developed a unique welding process which they patented in 1965. The company owned a freehold site, which occupied 20,000 square feet of factory space on the industrial estate.

In 1989 the company had net assets of £10 m. There were no borrowings as the management team prided themselves on being "cash-rich" and particularly that they survived the disaster of Black Monday when the UK was racked by storms and the interest rates soared to dizzy heights.

The Bodger brothers retired in 1994 and sold their shares to a consortium of senior managers. The business was valued at £6 m. The managers commissioned a due diligence exercise from PDQ the international accountants who also advised on the valuation.

The managers financed the buy-out by introducing £1 m of their own money and by obtaining a loan facility of £5 m from Venture CAP plc. The loan is secured by means of a fixed charge on the land and buildings and by a floating charge on all the other

assets. Venture CAP plc insisted that a senior member of their corporate finance team be appointed as a non-executive director. This person is called Melinda Barr who has a legal background but is “good with numbers”. There is an overdraft facility of £2 m provided by Gloyds Bank plc which is the provider of day-to-day banking facilities. Both Gloyds and Venture CAP are subsidiaries of Gloyds Holdings plc.

One of the conditions of the loan is the provision of monthly management accounts with a rolling cash flow forecast for the next twelve months. There is a reliable accounting system supported by a system of budgeting. Monthly and year-to-date comparisons are provided to the Board by the 15th of the month following the control period.

The products are sold in the UK and abroad. The export is achieved via distributors, as the company has no overseas branches or subsidiaries. Sales are financed by 90-day drafts – the goods are not released until the consignee signs a banker’s acceptance.

Sales in the UK are to a variety of specialist businesses – many are quoted companies with a good reputation for financial strength. They are often slow to pay. Delays are blamed on technical issues that arise after delivery of the goods.

You are aware that the shareholders are under some financial pressure. Before you accepted the post you obtained a search of the company’s file from Dun and Bradstreet. They gave the company a high risk rating. The search results are summarised below.

	2005	2004
Sales	£20 m	£24 m
Contribution/sales	45%	63%
PBIT	£890,000	£2,350,000
Interest charges	£656,000	£378,000
Long-term borrowings	£2.2	£3.2 m
Quick asset ratio	0.8	1.2
Current ratio	1.4	2.2
Stocks in days sales	248	91
Debtors in days sales	98	56
Staff numbers	180	140

The organisation chart is shown below. Assume that you are the CIMA member.

