

## Global Ltd.

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Global Limited is a small company which supplies quality inspectors to the pipeline industry. The company's clients include some of the major plcs in the UK, such as the major petroleum and gas companies. The inspectors are required by these companies to provide an independent certification that the steel used in the construction of the pipes, which channel the gas and oil, meets the required standard. Additionally, inspectors are required to provide an independent certification that the joinings (known as 'welds') made when laying the pipelines are also made in accordance with industry standards. The pipelines are either laid under the ground or on the sea bed. Some inspectors are therefore required to work in rolling mills, inspecting the quality of steel and the production of the pipes, whilst others are required to work on installation sites, checking the welds. These locations can be anywhere in the world.

The company is owned and managed by Alex and over the past few years the turnover has grown to £2.5 million. The company is financed solely by a bank overdraft. Alex operates out of offices within a prestigious Georgian property development in a northern town, on the basis of a sub-let from the company which rents the entire building. Since the operations of the company take place on clients' own sites, the building houses only the head office staff.

The head office staff consists of Alex, Tony the Operations Manager, Helen and Mary who work in the general office, and Tracy who acts as secretary and receptionist. Inspectors are recruited in response to clients' requirements and there are currently 50 inspectors working on various sites, although this number can fluctuate substantially depending on the contracts in operation. In order to operate this recruiting system, the company holds on file the CVs of inspectors with relevant skills and qualifications as a source of reference, and contacts (usually by telephone) inspectors with appropriate skills and qualifications to match clients' requirements, to ascertain if they are available for work.

Some of the inspectors are highly qualified and can command high salaries as well as being selective about the work they take on. Additionally, since many of the clients' site are overseas, and sometimes offshore, salaries and subsistence allowances are generally high. Sites on the UK mainland are generally widely spread and in out-of-the-way places, and so transport is needed for the inspectors (who may have to visit more than one site as part of a particular contract). The company therefore hires cars through a firm situated near to the head office for most inspectors working in the UK. Additionally, Tony is also supplied with a hire car. Sometimes the charges for car hire can be reclaimed from the client, but this depends on the terms of the contract.

The company requires little capital investment in fixed assets. However, it does supply specialist equipment to the inspectors for use on site. The cost varies between £200 and £1000 per item and often the company hires this in, rather than purchasing it.

The recently issued financial results have been rather disappointing for Alex (the company only just broke even), even though the turnover had been increased considerably. In addition to this, Alex is finding that the company is regularly short of cash and creditors are continually telephoning to find out when they are likely to be paid. One source of this cashflow problem over the past few years has been Alex's own spending habits - he has made some significant personal drawings from the organisation to fund his high standard of lifestyle. Marketing expenditure on client entertainment is also a significant cost and cash outflow source, although this type of marketing activity is standard for the industry.

Alex has recently approached the bank manager and asked for an increase in the overdraft facility in order to ease the situation. While the bank has agreed (subject to the provision of extra security for their support), it has insisted that Alex supplies them with regular information about the performance of the company. Alex has little experience of the accounting side of the business, since his background is

more on the operational side, and he has realised that he needs someone with the relevant expertise to provide such information. Consequently, he has just recruited a management accountant.

In the past, the administration/accounting staff have been left to get on with things as best they could and no one in particular has been in charge of this part of the business. Alex tends to 'have a go' when he is in the office but a lot of his time is spent out on site checking on the operations or visiting clients in search of more business. As a result of this situation, systems for 'doing things' emerge rather than being planned and many of the jobs are duplicated or overlooked. Helen is a very efficient bookkeeper and does various other tasks which she feels need doing. Tracy is a very efficient secretary and maintains an orderly CV system. However, Mary is rather inefficient and ineffectual, even though she herself has rather a high opinion of her abilities. She tends to be rather bossy, has taken it upon herself to manage the office and is very protective of what she considers to be her responsibilities. She is particularly disdainful of Alex's managerial abilities and is often rude to him in front of other office staff. She is also resentful of the new accountant who has just arrived and the working environment in the office, on the whole, is not pleasant.

Over the past year Tony, the operations manager, has been absent 'sick' more than he has attended work. A major problem at the outset of a new contract is that of recruiting inspectors with the necessary qualifications and capabilities. Not unnaturally, this seems to have become more problematic as the organisation has grown its business. In the absence of the operations manager, most of this task of recruitment falls to Alex.

The inspectors send in time-sheets each week from their various locations, stating the number of days or hours worked on each contract. These time-sheets are counter-signed on site by a representative of the client and this acts as the basis for invoicing work to the client and payment of salary to the inspector.

Sales invoicing tends to be a somewhat ad hoc process. Mary sometimes prepares invoices and passes them to Tracy for typing. On other occasions Alex and Tony have a go. Salaries to the inspectors are paid monthly, but subsistence allowances and site expenses are paid weekly.

The company works for a number of well established clients and when decisions are made regarding how much to charge them for the services of the inspectors, Alex tends to give quotations 'off the top of his head', or bases them on what he has charged in the past. Alex often fails to pass on this sort of information to the office staff. Some inspectors and some customers clearly create profits but, equally clearly, some do not.

To date, the inspectors who have been recruited have proven to be highly capable and self motivated people who, once allocated to a project, more or less look after their 'own' contracts and clients. They do, however, press Alex for improved conditions of employment - particularly higher salaries and subsistence allowances. Alex often accedes to these demands in order to get a good job done and to keep the contract moving to the satisfaction of the customer. However, in the absence of appropriate management information systems, Alex is never sure about the effect that acceding to these demands has on the profitability of the contracts.

The company has just been given the opportunity to bid for a contract to supply a large number of inspectors to a new client over a two year period. Alex is keen to attract this order but, as usual, a number of competitors will be bidding for it.

Alex anticipates that this new contract could be worth in the region of £2 million over the two year period, which means that, if he can secure it, added to the work already obtained, the company should achieve a turnover of £2.7 million for the coming year. The first six months of the contract, however, requires 10 inspectors to work in the rolling mills in Japan. This would entail Alex finding ten inspectors willing to go out there at very short notice and prepared to remain for the six month period.

Japan's cost of living is very high and this will mean that the company will have to very quickly make available a great deal of cash in order to provide subsistence allowances on a weekly basis to the inspectors in Japan. The terms of the contract are monthly invoicing with payment one month later. Additionally, it is difficult to recruit inspectors to work in Japan because of the language barrier. Alex anticipates that to compensate for this, he will have to make the deal very attractive to them.

The new accountant is anxious that Alex does not make a bid for this contract based on his usual 'off the top of his head' approach and has become involved in the process of putting the bid together. She has perused the specification of the contract and Appendix 1 provides an extract for the first phase to take place in Japan. In conjunction with Alex, she has gathered some information relevant to the contract which is illustrated in Appendix 2.

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## **APPENDIX 1**

### **Extracts from the contract specification for the first six months**

#### **Rolling Mill - Japan - April to September**

##### **Services required:**

- 1 highly qualified inspector to act as supervisor on site
- 9 suitably qualified inspector

Each inspector and supervisor will be expected to work 25 days each month

##### **Additional Chargeable items:**

- Subsistence allowance for each inspector and supervisor for every day of each month whilst in Japan
- A charge for equipment provided by the bidding company
- One return air journey for each of the 10 inspectors (cost + 10% to be included in invoice for work completed in April)
- Travel costs to and from the rolling mill each working day

##### **Invoicing and payment terms:**

- All chargeable items should be invoiced at the end of each month. The invoices must clearly itemise the various chargeable costs
  - Payment will be made at the end of the following month
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## **APPENDIX 2**

### **Forecast costs for the Japanese phase of the contract**

##### **Inspectors:**

Rate per Inspector	£100 per day worked
Supervisor	£220 per day worked
Subsistence allowance	£80 per day for each inspector/supervisor
Daily travel in Japan	£3 per day worked for each inspector/supervisor
Return airfare	£1050 per person

##### **Additional Costs:**

Equipment costing £3000 would be purchased by Global especially for the contract and a hire charge of £400 per month would be invoiced to the client.

##### **Forecast Revenues**

Rates to be charged to Client:

Supervisor	£300 per day worked
Inspector	£180 per inspector per day worked
Subsistence allowance	£80 for each inspector/supervisor per day
Equipment hire	£400 per month
Travel expenses	£3 per inspector/supervisor per day worked

### **Additional information**

1. The inspectors would be employed by Global Limited and would receive their salary on the last day of each month. The supervisor would work on a sub-contract basis for Global. He would invoice Global at the end of each month and receive payment at the end of the following month.
2. The flights would have to be booked and paid for in March.
3. The equipment would be acquired in March on one month's credit.
4. It is company policy to depreciate equipment on a straight line basis over 3 years. The equipment does not usually have any scrap value at the end of three years.
5. Global will set up a bank account in Japan and will advance one month's subsistence allowances to this account on the first day of each month. The supervisor, who will control this account, will then issue subsistence allowances weekly in advance to the inspectors and himself. These transactions will be subject to exchange rate fluctuations, the subsistence allowance being converted to Yen before being transferred from the UK.

### **Question 1**

- a) In the role of Global's new management accountant, prepare a forecast cash budget for the Japanese phase of the contract, commencing with the month prior to the start of the contract and continuing to the end of the first six months of the contract, clearly identifying the month by month impact on cashflow. You should assume that no cash is available at the start.
- b) Write a short memo to Alex which refers to the statement you have produced in (a) above and which:
  - i. comments on the potential impact of the first phase of the contract on Global's cash-flow situation;
  - ii. makes recommendations which might help to address the issues you raise.

### **Question 2**

Alex is sceptical of the information which the management accountant has gathered **for Appendix Two**. He has asked her for further explanation on:

- a) the sources of her information and how certain she is of its accuracy;
- b) why she feels that she needs to produce a cashflow projection before the bid has even been made;
- c) what she means by her statement that 'in order to monitor and control the financial performance of this contract (if we get it) we have to produce budgets'.

In the role of Management Accountant for Global Limited, write a memo to Alex which responds to each of these issues.

### Question 3

As the newly appointed Management Accountant at Global Limited, propose and justify changes which you would wish to introduce, commenting on the acceptability of these changes and the likelihood that they will be implemented successfully. These changes should include, amongst other areas, reference to organisational structure, information requirements, methods and techniques of accounting and control.

### Question 4

As the new Management Accountant at Global Limited, you are concerned by the lack of profitability. You are keen to bring certain issues relating to this problem to the attention of Alex and as part of this process you decide to:

- a) calculate the potential gross profit of the Japanese phase of the contract for which the company is bidding, based on the information you have collected in **Appendices one and two**.
- b) write a report to Alex which comments on your findings in (a) above and which makes recommendations regarding other aspects of the organisation which might lead to greater profitability for the company.