



ROLE SIMULATION EXAMINATION

ADVANCE INFORMATION

This material is issued prior to the examination session.

Candidates **must** bring this material with them
to the Exam.

No copies will be provided.

ADVANCE INFORMATION

This Advance Information is issued prior to the exam session to allow you to familiarise yourself with the information provided and to undertake any other appropriate research and analysis. The Advance Information is also published on the website: www.icaew.com/students.

You must bring this Advance Information with you to the exam, annotated if you wish, together with any other notes of your preparatory work. You must carry out sufficient and appropriate analysis work **of your own** in order to have a detailed understanding of the Advance Information. You should also undertake any additional research and analysis you feel necessary to enhance your awareness of the industry and market context and to enable you to clarify any technical terms or other issues of vocabulary. You will need to be able to refer back quickly to the Advance Information and your notes during the exam; you are therefore unlikely to benefit from taking large quantities of additional material with you into the exam.

The exam will contain questions with additional information which will complete the description of the Role Simulation scenario and state the Role Simulation requirements.

The exam is based on the 2021 Role Simulation Workbook and the 2022 Certificate Learning Materials.

Assessment of the Role Simulation exam

The marks in the Role Simulation exam are awarded for demonstration of competence in the knowledge, skills and behaviours set out in the Level 4 Accounting Technician assessment plan. The marks are allocated broadly as follows:

- Knowledge 30% - 40%
- Skills 30% - 40%
- Behaviours 30% - 40%

The knowledge, skills and behaviours will be assessed through a series of requirements in the Role Simulation exam. Marks available for each requirement will be shown next to each requirement.

Preparing your answers in the exam

You will need to refer to your copy of the Advance Information during the exam.

Answer all questions.

Respond directly to the exam question requirements. Do not include any content of a personal nature, such as your name.

Only your answer in the word processing area will be marked. You must copy over any data for marking from the spreadsheet area to the word processing area.

Mistral Train Operations Ltd

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This document reflects information available as at 17 January 2023.

Introduction: Mistral Train Operations Ltd

Mistral Train Operations Ltd (Mistral) is a company operating passenger train services in England.

Industry information

Background

Railways in England started in the early nineteenth century and quickly became an important means of transport, contributing to the social and economic development of the country.

Today, the passenger rail industry consists of many different companies competing and co-operating with each other, with extensive government regulation and direction. Both the industry and the relationships between different companies are complicated. The responses to the COVID-19 pandemic caused a significant decrease in rail travel and led to a restructuring of the industry. The situation is still evolving as the government moves towards a simpler and more effective system for managing and regulating passenger train travel.

Total annual revenue from passenger rail journeys is around £10 billion and there are possibilities for growth in the future. Travel by train is seen as more environmentally friendly than travel by car or plane, and recent investment in high-speed rail lines has facilitated international journeys by train.

England's railway infrastructure – stations, tracks, signalling equipment and electric power supply – is all owned and operated by Network Rail, a government-owned entity.

Most passenger rail services in England are operated within a system of contracts of different types that the government awards to train operating companies (TOCs). A national rail contract (NRC) is one type of contract introduced by the government. An NRC specifies the train services required for an individual route or area of the country and the price that passengers pay for tickets for travel. Competing TOCs bid to be awarded an NRC to operate the relevant train services. The NRC then forms an exclusive agreement for the successful bidder to operate the train services for a set period, usually between five and ten years. Many TOCs operate under well-known brand names such as Great Western Railway and London North Eastern Railway.

TOC revenue

The main source of revenue for TOCs is the money received from the government for the provision of train services, in line with the terms agreed in the NRCs. In addition, the government pays performance bonuses if the TOCs successfully meet targets in the NRCs related to performance indicators such as growth in passenger numbers, reliability and punctuality of services and passenger satisfaction.

TOCs sell tickets to passengers, either via retailers (eg Trainline) or directly, using ticket offices at stations and online sales channels. TOCs and retailers collect the money from passengers and pass it on to the government.

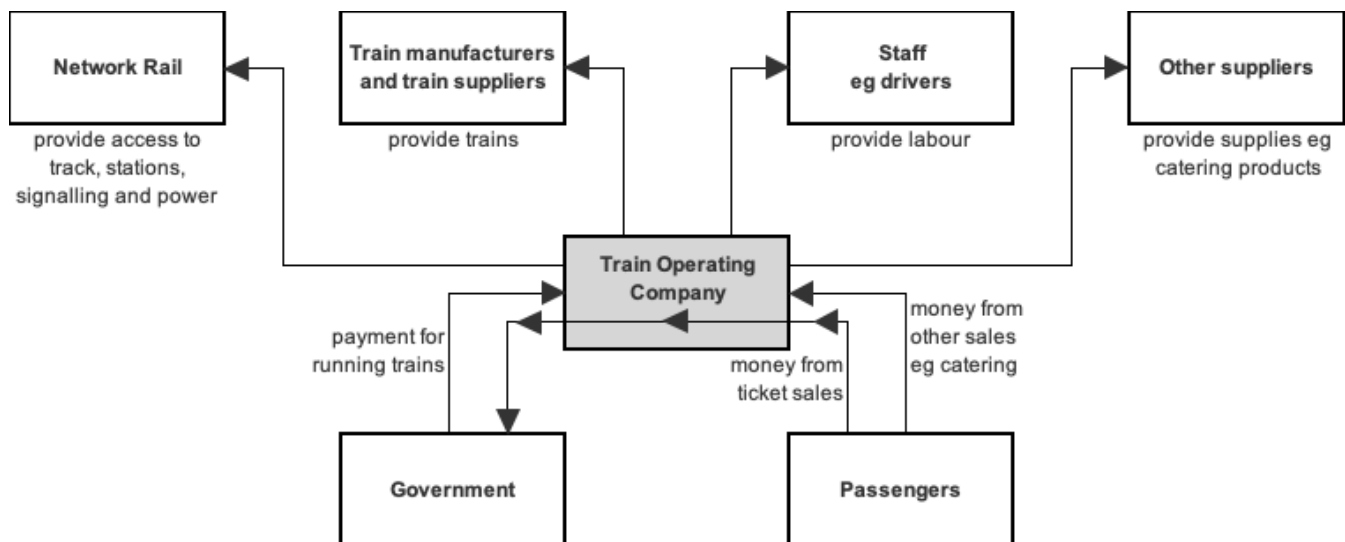
TOCs generate small amounts of ancillary revenue from additional activities such as on-board catering sales to passengers, and from organisations paying to display advertisements on trains. TOCs retain all this ancillary revenue rather than passing it to the government.

TOC costs

TOCs pay fees to Network Rail for using its infrastructure. Trains are owned by train manufacturers and then leased by TOCs, which make payments that reflect the type of train and the nature of the contract, for example whether it includes maintenance. TOCs employ their own on-board drivers, train managers and catering workers, plus other staff including general managers, administrators, cleaners and station workers.

Since TOCs do not retain any of the revenue from ticket sales, their profitability depends largely on achievement of performance bonuses and successful cost control.

The diagram below summarises the monetary flows between TOCs and suppliers, passengers and the government.



Company information

Introduction

Mistral is a TOC which is a wholly owned subsidiary of Valoro Group plc (Valoro), a large international passenger transport operator. Valoro has several subsidiaries and joint venture companies which operate bus, tram and train services in different countries.

Business activities

Mistral operates a network of passenger train services in the south of England under a single NRC which runs until 30 June 2027.

As with all NRCs, Mistral must operate services to a very tightly defined specification. The government makes a monthly payment to Mistral which includes a large, fixed element for the

services plus a variable element based on performance. Mistral can therefore increase its revenue by meeting or exceeding the performance targets in the NRC.

The performance targets cover several areas, including:

- reliability (the percentage of advertised train services that actually run);
- punctuality (the percentage of train services that arrive at their destination on time or within an acceptable margin of lateness);
- passenger capacity (based on the number of carriages in trains);
- passenger satisfaction as measured by regular independently conducted passenger surveys; and
- growth in passenger numbers.

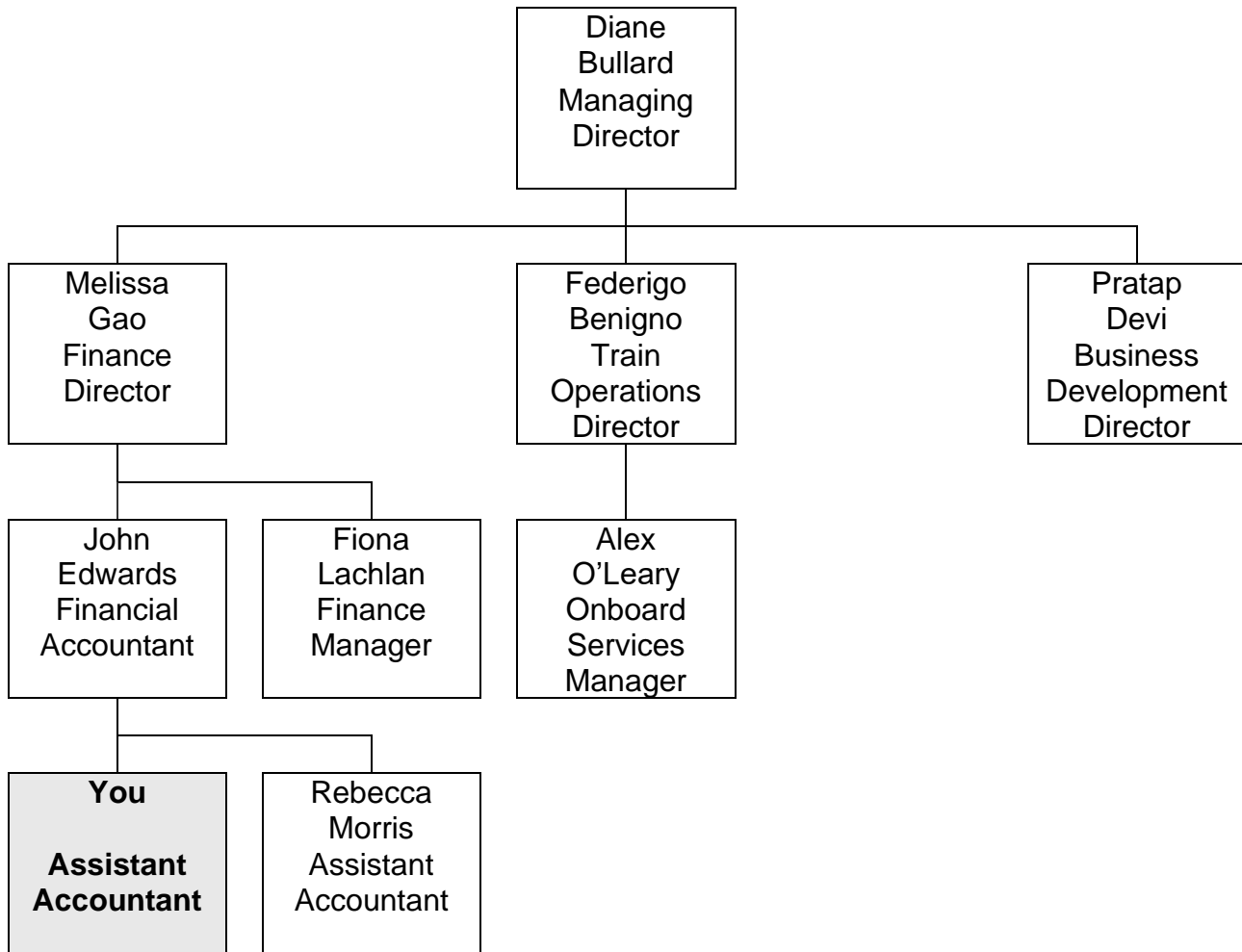
Around 2,000 people work for Mistral. The company owns office buildings in Hampshire, where many administrative staff are based, and owns or rents other buildings at four different locations on its network that are used to store and clean trains overnight (train depots). Employees who work on board trains, for example drivers and catering workers, are based at one of these train depots. Mistral also owns or rents several buildings in or near stations across its network. These buildings are used as staff rooms, catering hubs and storage facilities.

Mistral leases its trains from Onmotiv plc (Onmotiv), an established train manufacturer. Mistral uses only one basic type of train, although it can couple up to three trains together to increase the number of seats available on any given service. All trains are electric powered. Onmotiv carries out mechanical and electrical maintenance plus servicing of Mistral's trains.

Mistral offers catering services on many of its trains and because catering sales fall outside the NRC, Mistral can retain all the revenue. Passenger surveys indicate that the availability of catering attracts passengers to using train services and improves passenger satisfaction, so providing catering helps Mistral to achieve performance bonuses.

Mistral also has the potential to increase profit by successfully controlling costs. In recent months Mistral has changed staff rosters to make efficiency gains. It has also increased its use of technology in making ticket sales: selling tickets online via Mistral's website or its own app is significantly cheaper than operating ticket offices at stations or paying commission to retailers.

Extract from organisation chart



Key personnel

You are employed by Mistral as an assistant accountant. You have been working there for just over one year and you are training to be an ICAEW Chartered Accountant. You report to John Edwards, the financial accountant. John Edwards and Melissa Gao, the finance director, are ICAEW Chartered Accountants. Rebecca Morris started work as an assistant accountant for Mistral three months ago and is also training to be an ICAEW Chartered Accountant.

Financial performance

Mistral's financial performance has been stable. Its profit margins are generally low, in line with industry averages.

Mistral's operations were significantly affected by reduced travel during the COVID-19 pandemic, though the company did benefit from significant financial support given by the government to the railway industry. Passenger numbers across the rail network have increased steadily since the end of 2021 but are still significantly lower than in previous years.

See **Appendix A** for extracts from Mistral's financial statements for the year ended 31 January 2022 and **Appendix B** for extracts from the finance function handbook.

Internal control environment and audit

Melissa Gao is responsible for establishing and managing the internal control environment at Mistral.

See **Appendix C** for details of the internal control environment and audit.

Current issues

Legal claim

In July 2022, Mistral terminated, without notice, a contract it had with Cemec Ltd (Cemec) to rent a building as a storage facility since an alternative facility had become available at a much lower cost. Cemec made a claim against Mistral for breach of contract. Mistral's legal advisors estimate that there is a greater than 50% probability that Mistral will lose the claim and, in that case, the cost of settling the claim would be approximately £280,000. Accordingly, John Edwards made accounting entries to record a provision and an operating expense of £280,000.

Train depot refurbishment

Mistral is currently refurbishing and expanding one of its train depots. As part of this programme, Mistral intends to dispose of some equipment and invest in new equipment that will allow faster cleaning of trains.

Negotiations with staff

In April 2023, Mistral will begin annual wage negotiations with its drivers. Mistral's directors expect these negotiations to be difficult as the drivers want significant pay rises. Mistral finds it difficult to attract and retain qualified drivers; there is a nationwide shortage of qualified drivers and a long lead time for training new drivers.

Sustainability

Sustainability is an important issue in the passenger train services industry. Mistral's current NRC contains a clause which requires it to make an annual sustainability statement. See **Appendix D** for more information on sustainability. The directors are planning to run a marketing campaign based on the sustainability of travelling by train rather than by plane or car.

New opportunities

Catering

Mistral's directors have identified that catering on board trains could be improved and made more profitable. For example, some trains currently have only basic trolley services of drinks and cold snacks. These could benefit from a fuller catering service offering more substantial food and a greater variety of items. Pratap Devi, the business development director, and Alex O'Leary, the onboard services manager, are working on a six-month project – codenamed Project Ambrosia – to improve catering services. The first element of this initiative, starting in

January 2023, is the introduction of new high quality food items on key early morning trains. See **Appendix E** for more detailed information.

Technology

Diane Bullard, the managing director, is keen to investigate how greater use of technology could improve Mistral's efficiency and reduce costs. She believes that Mistral could make much more use of big data and that there are opportunities to use electronic data interchange (EDI) when dealing with, for example, catering suppliers.

Mistral does not know in advance how many passengers will travel on each train service since most tickets are flexible as to time of travel and there is no obligation on passengers to purchase a ticket in advance. Diane believes that Mistral could use big data to better forecast the likely numbers of passengers on different train services. Mistral could use this information to allocate trains more effectively so that capacity is appropriate for the expected number of passengers on each service. Mistral could then ensure there is an appropriate quantity of catering supplies on each train service so it can maximise catering sales and minimise wastage.

Project Golden Arrow

Most passenger train services in England are operated under contracts awarded by the government, for example the NRC awarded to Mistral. There are also a small number of open access services which are not covered by such contracts.

Open access services are train services that are operated independently by a TOC on a purely commercial basis, where the TOC believes there is an opportunity to meet unfulfilled demand for travel. The TOC must apply for approval from the government to operate open access services and must meet industry standards in a range of areas such as safety and passenger rights. When operating an open access service a TOC has the commercial freedom to set prices, timetables and standards of comfort on board. The TOC keeps all the revenue generated from ticket sales on open access services but receives no payment from the government.

Mistral's directors are considering the launch of a new open access service on a route that links two cities in southern England. For more information about Project Golden Arrow see **Appendix F**.

Appendix A – Mistral Train Operations Ltd financial statements for the year ended 31 January 2022 (extracts)

Statement of profit or loss for the year ended 31 January 2022

	£'000
Revenue	892,843
Operating expenses	(866,168)
Operating profit	26,675
Finance costs	(7,866)
Profit before tax	18,809
Income tax expense	(3,574)
Profit for the period	15,235

Statement of financial position at 31 January 2022

	£'000	£'000
ASSETS		
Non-current assets		
Intangible assets		2,625
Property, plant and equipment		150,852
		<u>153,477</u>
Current assets		
Inventories	463	
Trade and other receivables	54,968	
Cash and cash equivalents	84,026	
		<u>139,457</u>
Total assets		<u>292,934</u>
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)		1,000
Retained earnings		37,882
Total equity		<u>38,882</u>
Non-current liabilities		
Borrowings		132,328
Current liabilities		
Borrowings	8,334	
Trade and other payables	113,390	
		<u>121,724</u>
Total equity and liabilities		<u>292,934</u>

Statement of cash flows for the year ended 31 January 2022

	£'000	£'000
Cash flows from operating activities		
Profit before tax	18,809	
Finance costs	7,866	
Depreciation and amortisation	16,515	
Increase in inventories	(73)	
Decrease in trade and other receivables	4,919	
Decrease in trade and other payables	(7,706)	
Cash generated from operations	40,330	
Interest paid	(7,866)	
Income tax paid	(3,574)	
Net cash from operating activities		28,890
Cash flows from investing activities		
Purchase of property, plant and equipment	(600)	
Net cash used in investing activities		(600)
Cash flows from financing activities		
Decrease in borrowings	(8,211)	
Dividends paid	(8,471)	
Net cash used in financing activities		(16,682)
Net increase in cash and cash equivalents		11,608
Cash and cash equivalents at 1 February 2021		72,418
Cash and cash equivalents at 31 January 2022		84,026

Appendix B – Mistral finance function handbook (extracts)

Introduction

This handbook sets out basic information on operations of the finance function and on the relationship between Mistral and its parent company, Valoro Group plc (Valoro).

Financial statements and financial reporting standards

Mistral prepares financial statements in accordance with IFRS® Standards.

Assets, liabilities, expenses, income and equity items are recognised and measured in the financial statements in accordance with IFRS® Standards and the IASB's Conceptual Framework for Financial Reporting.

Key items in financial statements

Intangible assets mainly consist of software to manage ticket sales.

Property, plant and equipment consists of land, buildings, and equipment such as vans, office equipment and catering machinery. Property, plant and equipment does not include trains.

Amortisation of software and depreciation of property plant and equipment is in line with Valoro accounting policies.

Inventories consist of food and drink for sale to passengers on trains.

Trade and other receivables include:

- amounts owed to Mistral by third parties: the principal trade receivables are amounts due from the government under the NRC; and
- prepaid expenses.

Share capital: The entire share capital of Mistral is owned by Valoro.

Borrowings consist of loans from banks and other finance providers.

Trade and other payables include:

- amounts owed by Mistral to third parties, ie suppliers in respect of purchases and the government in respect of cash collected from ticket sales; and
- accrued expenses.

Tax management is the responsibility of Valoro's group finance department. Mistral makes a payment to Valoro in respect of Mistral's income tax due for a period so that there is no remaining tax liability in Mistral's financial statements at the reporting date.

Appendix C – Internal control environment and audit

Internal control environment

All staff receive training about the importance of internal controls, what those internal controls are, and how they work. Staff in the finance function receive additional training about internal controls and are assessed on that training. All managers are aware of their responsibilities in relation to establishing and respecting internal controls.

Valoro provides accounting and finance support to all its group companies, including sometimes supplying staff from the group finance department on a temporary or permanent basis. This helps to guarantee segregation of duties that would not otherwise be possible with the relatively small number of full-time staff employed in Mistral's finance function. Karolos Demetriou is an accounts payable manager in Valoro's group finance department. As part of his role, he works one day per week in Mistral's finance department.

Examples of internal controls

- Internal controls relating to purchases and payables:

Mistral buys from many different suppliers, including suppliers of office equipment and consumables, staff uniforms, IT and telephony services, cleaning products, and on-board catering products.

A goods received record is created for all deliveries. When invoices arrive, they are matched with purchase orders and goods received records, then entered into the payables ledger. A member of Mistral's finance function (not Karolos) produces a payment listing from the payables ledger each week. Karolos sets up payment by bank transfer for all payees on the payment listing. Payments are usually made four weeks after the invoice is received. All bank transfers are authorised by Karolos and by Fiona Lachlan, the finance manager.

Mistral's finance function staff carry out regular reconciliations of bank transfers to purchase ledger entries.

- Internal controls relating to payroll:

Mistral employs many staff in different roles. The company uses payroll software which produces weekly and monthly payrolls. A member of Mistral's HR function authorises each payroll by adding an electronic signature to the relevant payroll. A member of Mistral's finance function then prepares the journals to be posted to the nominal ledger and passes these with the payrolls to Karolos, who sets up payment by bank transfer.

Internal audit

Mistral's internal audit function is carried out by Valoro staff, who perform internal audit work in each of Valoro's group companies. The internal audit function's objective is to support managers in achieving corporate objectives and to monitor the effectiveness of the internal control environment. Alicja Zawisza is the internal audit manager for Valoro.

Alicja and Melissa Gao have agreed that, next month, internal auditors will conduct the following procedures:

- a review of purchases and payables procedures; and
- controls testing on purchases and payables.

External audit

Mistral's financial statements are audited by Smith and Henry LLP, which also performs the external audit of the consolidated financial statements of Valoro.

The external auditors will next visit Mistral in March 2023 to undertake the final audit of the financial statements for the year ended 31 January 2023.

It is a condition of Mistral's NRC that it prepares audited financial statements annually. Mistral must submit key figures from its audited financial statements, including revenue, operating profit and cash flows from operating activities, in a separate regulatory return to the government.

Appendix D – Sustainability

Annual sustainability statement

The NRC requires Mistral to make an annual return to the government containing a detailed sustainability statement, including:

- the company's approach to sustainability
- information on carbon emissions associated with the company's activities
- information about how the company's operations contribute to the government's commitment to the United Nations Sustainable Development Goals (UN SDG).

Mistral's directors have identified that the following goals from the UN SDG are the ones most relevant to its operations:

- Decent work and economic growth: promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.
- Industry, innovation and infrastructure: build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation.
- Responsible consumption and production: ensure sustainable consumption and production patterns.

Performance bonuses

Mistral's directors believe that in future NRCs the government is likely to offer performance bonuses for the achievement of targets related to sustainability. Mistral may benefit financially since all its trains are electric powered so its carbon emissions are lower than the average for TOCs, many of which still use trains powered by diesel engines.

Marketing campaign

Mistral is about to launch a marketing campaign based partly on the sustainability of travelling by train, rather than by plane or car. Mistral wants to increase passenger numbers to achieve its NRC performance target for growth in passenger numbers and receive the related bonus payment (see **Advance Information – Company Information**).

The marketing campaign will compare carbon emissions associated with different forms of transport. Mistral will use data supplied by Onmotiv for the type of train operated by Mistral, based on testing done in laboratory conditions. Pratap Devi intends to use this lab test data in comparison with real world data from selected cars and planes to illustrate the relatively low carbon emissions associated with travelling by train.

Federigo Benigno, the train operations director, has raised a concern that the lab tests are unrealistic, and that the data is not meaningful. Pratap has dismissed his concerns, arguing that a marketing campaign is designed to persuade, not inform, and that the overall story of trains having lower carbon emissions than other forms of transport is true.

Appendix E – Catering

Catering operations

Some of Mistral's trains offer onboard catering. Alex O'Leary and Federigo Benigno are responsible for deciding what catering provision to offer on each train. They use past data to estimate likely catering sales, which depend on the route the train is operating on, the time of day and the average number of passengers on board.

For the purposes of catering, Mistral's trains are divided into three categories:

- No catering
- Trolley service: One member of staff operates an on-board trolley serving hot and cold drinks and simple cold snacks such as biscuits and crisps.
- Café: Two or more members of staff operate an on-board café, located in one of the carriages. The on-board café menu includes an expanded range of hot and cold drinks and hot and cold food.

Mistral purchases all food and drink items from several different suppliers that deliver directly to Mistral's catering hubs located on or near stations. Mistral's staff collect the items from the catering hub and load them onto the trains.

Catering sales information

Catering sales are analysed every four weeks. Variance analysis is used to assess the performance of catering operations and inform future sales forecasts.

Alex knows that there is high variation in demand for food and drink items sold onboard trains. She would like to improve the quality and timeliness of information available about catering sales so that Mistral can:

- better respond to demand;
- reduce waste and stock outs; and
- increase sales volumes and profit.

Federigo knows that estimating the number of passengers on each train in advance is key to budgeting catering sales. He is investigating how better data on ticket sales can be obtained and whether electronic data interchange (EDI) and big data might help with this. He knows that some investment would be required in this area and is considering how to make the case for such investment to Diane Bullard.

Project Ambrosia – planned improvements to catering

Mistral has launched a plan – codenamed Project Ambrosia – to improve catering and increase the profits made from catering operations. The first stage of this plan is to improve the catering on key early morning trains to London.

Alex is confident that improving the quality and variety of food offered will increase revenue from catering operations and may also help to market Mistral's passenger train services as an alternative to car travel.

With effect from 30 January 2023, most weekday early morning trains to London will offer new premium hot drinks and new breakfast food items, produced using high quality ingredients. The new breakfast range will initially include three products:

- artisan bread rolls with air-dried ham and mature cheddar cheese (rolls);
- organic yoghurts with fruit puree and granola (granola pots); and
- organic fresh fruit salads, the contents of which will vary by season to maintain variety and allow Mistral to use good quality ingredients at reasonable prices (fruit salads)

Mistral will source all three products from an existing catering supplier – Epsilon Ltd – which already delivers food items daily to all of Mistral's catering hubs.

Budget for new products

Budgeted weekly sales quantities, sales prices and variable costs for the three new products are as follows:

Item	Rolls	Granola pots	Fruit salads
Budgeted sales volume (units per week)	4,800	2,400	2,000
Budgeted sales price per unit (£)	4.95	3.55	3.20
Budgeted variable cost per unit (£)	1.20	0.90	0.75

Alex intends to calculate sales volume variances and any sales price variances for each new product after the first four weeks of operations. She will then use this information to assess the market and amend forecast sales volumes and prices accordingly.

Appendix F – Project Golden Arrow

Mistral’s directors are considering the launch of a new open access train service on a route between two major cities. Pratap Devi has commissioned an initial market survey which indicates that there is significant unmet demand for travel on the route and he has convinced Diane Bullard that the new service could be profitable very quickly. However there is some uncertainty over the extent of future government regulation which may limit the profitability of open access services.

Operating open access services would give Mistral significantly more commercial freedom than it has on services specified in its NRC. Mistral would determine its own timetables (within the constraints of the infrastructure made available by Network Rail) and its own ticket prices. Mistral would receive no payments from the government but would retain all revenue from ticket sales for these services.

Initially, Mistral would operate four trains per day in each direction, using the same type of train that it currently uses.

Pratap has forecast total revenue in the first year of the service to be approximately £8 million, based on:

- an average ticket price of £17 per one way journey
- an average of 62% of seats occupied, in line with current operations

Pratap suggests that, as Mistral has commercial freedom to set ticket prices, it should consider strategies for maximising revenue by, for example, charging different prices in different market segments.

Government regulations require TOCs with NRCs to clearly identify costs and revenues associated with each service, separately from any other business activity. Mistral’s directors are considering whether to establish a separate company to operate Project Golden Arrow open access services. In this case they could either use an off-the-shelf company or ask Valoro’s legal function to form a new company. The new company would have approximately 20 employees.

Mistral’s directors will meet Valoro’s board of directors in March to make the business case for Project Golden Arrow. Valoro’s directors have asked for:

- an environmental analysis to better understand the market for open access train services and
- a detailed plan on how Mistral could structure and implement Project Golden Arrow and maximise profitability.