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***ELECTIVE (PERFORMANCE MANAGEMENT):***

*Elective examinations are 4 hours in length but are designed so there is minimal time constraint. The Elective examinations are made up of a mix of objective-format questions and cases. The split and length may vary somewhat across the Electives to adapt to learning outcomes required.*

*Elective examinations use larger and more complex cases than those used for Core 1 and Core 2, requiring a minimum of 60 and a maximum of 120 minutes to complete. The assessment of professional skill continues in a multi-competency environment, building on prior learnings, however, greater than 50% of assessment opportunities will relate to the Elective area being examined.*

*Elective cases require candidates to simulate the “roles” they will play in real life, and therefore access is provided to the reference tools they would use, where practical to do so.*

**Granger Automotives**

**Suggested time: 90 minutes (represents the time judged necessary to complete the simulation)**

Harry Granger has operated an automotive dealership for the past 20 years. The dealership has three departments: new car sales, used car sales, and a service department. Customers appreciate the excellent service at Granger Automotives and often return for their next car purchase. Most customers also bring their cars to the service department for regular maintenance and repairs (the service department is operating at capacity all year). The used car sales department obtains most of its inventory from trade-ins when return customers purchase a new car.

Harry expects to retire soon, so he has been doing some planning to allow the dealership to continue once he relinquishes day-to-day management. He wants to ensure its future success for two reasons: he is counting on it as a source of income in retirement and he wants to maintain its excellent reputation, given that the business will continue in his name.

In planning for retirement, Harry has recently appointed his most trusted employees as managers of each of the three departments. To ensure the new managers have incentive to run their departments effectively, Harry has proposed that a large portion of their compensation be based on their division’s gross margin. It is February 2022, you, CPA, have reviewed a typical transaction (Appendix I) to determine what policies need to be in place to set up the new compensation system. Harry remarked on the transaction, “I don’t understand why these problems arose. There were no problems when I oversaw all three departments. I thought Nancy made a good decision regarding the sale of the new car and accepting the trade-in. Now I’m rethinking this new incentive structure.

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“I need your advice. First of all, what is the overall profit for the dealership for the transaction described? The used car sold for \$8,500 and the new car was purchased from the supplier for \$19,550. Next, what is the profit for each of the divisions on this transaction? I thought the transaction would have been profitable for all three. You can ignore any commissions for this example.

“Before I make a final decision on an incentive scheme, I would like your recommendations on an appropriate transfer price policy for used cars from the new car division and for service charged on used cars we take as trade-ins. Then I would like your comments on my proposed incentive scheme. I have obviously overlooked some problems with it that I would like you to explain to me. Please give me any recommended changes to the incentive scheme so that I can retire knowing my managers are motivated to base decisions on what is best for Granger Automotives.

“I’ve always focused on new car sales and thought of the service department as a necessary service to offer, knowing it would generate only a small profit. Maybe I’m wrong? Aside from inventory and the building, the equipment and tools in the service department are our biggest assets, and I always hoped that the small profit would cover their cost and upkeep.

“I don’t understand Frank’s comment about charging full price to fix trade-ins. Here is our latest income statement (Appendix II). It looks like new cars makes the most profit which is why I’ve always focused on new cars but maybe I’m misreading the financials? Please tell me which division I should be focused on based not only on the financials but other factors you think are important. On that point, I’m sure some of those important factors should influence performance measures, so please give me some other metrics I should consider to measure my managers.

“Based on everything you report and recommend to me, please include operational actions that we need to implement to ensure that Granger Automotives will continue to be successful once I cease managing the day-to-day operations.”

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**APPENDIX I**  
**EXAMPLE OF A TYPICAL TRANSACTION**

Nancy Newsome, manager of new car sales, provided you with information related to a recent sale. The customer had purchased a new car with a list price of \$23,000. The customer paid \$15,500 in cash and provided a trade-in car that Nancy valued at \$7,500. Without the trade, Nancy would expect to sell the new car for around \$21,720, in line with typical margins for the dealership. The trade-in car needed repairs that cost \$800 for the parts and labour.

Oliver Olam, manager of used car sales, did not agree with the price given for the trade-in. He indicated that he would have offered \$5,500 for the trade-in, which he considered the value of the car (\$6,300) less the cost of repairs (\$800). He obtained the value of the trade-in from an industry listing of car values based on make, model, year, and mileage.

Frank Fixit, manager of the service department, got involved in the discussion when he realized that Oliver expected him to repair the car at cost. Frank commented that with the new compensation scheme, he should be charging the same markup for internal work as he would charge to external customers. He estimated the price for the repairs on the trade-in car to be \$1,080. Frank indicated that customers frequently have to wait for an appointment because the service department is so busy. Oliver said it was ridiculous for the dealership to be making profits on internal work. In his opinion, it is the responsibility of the service department to ensure all cars are ready for sale.

Frank went on to comment that the service department realized the highest gross profit of all divisions and that he should be able to make the same profit on all work done. Otherwise, he was not maximizing the profits of the dealership and was perhaps hurting Harry in the process.

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## APPENDIX II

*Granger Automotives  
Income Statement  
For the year ended December 31, 2021*

New car sales		\$7,634,961	
Cost of new car sales*	\$6,871,465		
Commission on new car sales	152,699	7,024,164	
		<u>610,797</u>	
Allowance on trade-ins		190,874	
Gross profit on new car sales			<u>\$419,923</u>
Used car sales		3,435,733	
Cost of used car sales*	\$2,920,373		
Commission on used car sales	103,072	3,023,445	
		<u>412,288</u>	
Allowance on trade-ins		68,715	
Gross profit on used car sales			<u>\$343,573</u>
Service sales to customers		1,145,244	
Cost of work* (customer repairs and maintenance for external work)		848,329	
Cost of work* (for internal jobs)		<u>274,859</u>	
Gross profit on service work			<u>\$ 22,056</u>
Dealership gross profit			785,552
General and administrative expenses			<u>306,365</u>
Profit before taxes			<u>\$479,187</u>

\*Includes direct costs incurred within the departments, but does not include dealership overhead costs.

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