The Institute of Chartered Accountants of Pakistan

Multi Subject Assessment Stage

8 June 2021
3 hours and 45 minutes – 100 marks

Management Professional Competence

CRN:

Name: ______________________________

INSTRUCTIONS

Read the instructions carefully:

1. Answer all **THREE** questions.

2. Write your Name and CRN on the front page of the **MAIN ANSWER SCRIPT** and CRN on the front page of the **SUPPLEMENTARY SCRIPT.** Do not write your Name, CRN or any other identification mark on any other portion of the main or supplementary answer script.

3. Answer to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your main and supplementary answer scripts.

4. Answer in **black** pen only.

5. You are allowed to write notes/comments on the question paper. However, you must write your CRN and name on the question paper at the space provided above before starting to write any notes/comments.

6. The questions in this paper have been prepared on the assumption that examinees do not have a detailed knowledge of the types of organisations to which they relate. No additional mark will be given to examinees displaying such knowledge.

7. Only **FIVE** original books duly bound are allowed.

QUESTION 1

RhanaPharm Ltd (RhanaPharm) is a pharmaceutical company based in Lahore. The mission of the company is as follows:

> We exist to provide essential medicines in Pakistan at affordable prices to all, while providing a good return on investment to our shareholders.

The board has developed the following corporate objectives to support this mission:

- To develop and grow a diverse portfolio of products
- To continuously achieve efficiency in production

The company was founded in 1993 by Mustafa Sharif, a qualified pharmacist. It expanded quickly and, in 2010, obtained listing on the Pakistan Stock Exchange (PSX). Mustafa is now the CEO of the company. The Sharif family still own 51% of the shares in the company.

The company manufactures and markets generic drugs and drugs under license at two factories in Pakistan and sells them to hospitals, doctors' surgeries and pharmaceutical retailers. Some research and development costs are also incurred in developing generic drugs and obtaining approval from the Drug Regulatory Authority of Pakistan. These costs are capitalised and amortised over the expected useful life of the products, which is usually between 5 to 15 years.

At the start of the year 2020, the company recruited a new Finance Director, Shahid Nawab. Shahid had previously worked as a manager for a large international accounting firm. He believes that the performance management and measurement systems at RhanaPharm need improvement. He has already prepared a draft balanced scorecard. He also suggests that the existing remuneration scheme for executive directors and structure of the board need to be improved.

Your employer, Blue Horseshoe consulting, has been engaged by the directors of RhanaPharm to review the suggestions made by Shahid, and propose any changes to these.

Shahid has provided you with a file containing following Appendices:

Appendix 1: Management accounts of RhanaPharm

Appendix 2: Key performance indicators of AsilPharma, a pharmaceutical company based in Dubai

Appendix 3: Proposed balanced scorecard for RhanaPharm prepared by Shahid

Appendix 4: Details of the current board structure

Appendix 5: Existing remuneration scheme for executive directors

Requirements

(a) Evaluate the financial and non-financial performance of RhanaPharm based on the information provided in Appendices 1 and 2. **(16 marks)**

(b) Evaluate the proposed balanced scorecard prepared by Shahid. **(08 marks)**

(c) Assess the effectiveness of the current board structure at RhanaPharm and explain its possible impact on the performance of the company. **(10 marks)**

(d) Evaluate the current remuneration scheme for executive directors. **(06 marks)**

(e) The board of directors are considering acquiring 50% to 60% shareholdings in HPL, a company engaged in discovery, development and commercialisation of prescription medicines. Mustafa has been proactively advocating the acquisition, as he believes that this acquisition is in line with the company's mission, and the existing and future losses of HPL would also be available to be set off against the income of RhanaPharm.

Prepare a briefing paper for the board of directors of RhanaPharm outlining the tax implications of acquiring HPL. **(10 marks)**

Total: 50 marks

APPENDIX 1 – MANAGEMENT ACCOUNTS OF RHANAPHARM

Statement of profit or loss for the year ended 31 March

	2021	2020
	------- Rs. in '000 -------	
Revenue	178,712	175,207
Cost of sales	(86,643)	(85,478)
Gross profit	92,069	89,729
Selling, general and admin expenses	(37,373)	(37,200)
Operating profit	54,696	52,529
Interest expense	(4,800)	(4,800)
Profit before tax	49,896	47,729
Tax	(14,470)	(13,841)
Profit after tax	35,426	33,888
Gross profit margin	51.52%	51.21%
Operating profit margin	30.61%	29.98%

Statement of financial position as at 31 March

	2021	2020
	------- Rs. in '000 -------	
Non-current assets		
Intangible assets	45,623	43,388
Property, plant and equipment	75,240	74,762
	120,863	118,150
Current assets		
Inventories	21,661	14,246
Trade and other receivables	29,785	29,201
Cash and cash equivalents	10,156	2,345
	61,602	45,792
Total assets	182,465	163,942
Equity		
Share capital (shares of Rs. 1,000 each)	100,000	100,000
Retained profits	18,763	1,050
	118,763	101,050
Long-term bank loan	40,000	40,000
Current liabilities		
Trade payables	9,232	9,051
Tax payable	14,470	13,841
	23,702	22,892
Total equity and liabilities	182,465	163,942
Total dividends **(Rs. '000)**	17,713	16,944
Dividend per share **(Rs.)**	177.13	169.44
Share price **(Rs.)**	4,723	4,548
ROCE	34.5	37.2

Non-financial performance indicators

Number of new products launched in most recent year	2
Employee engagement	50%*

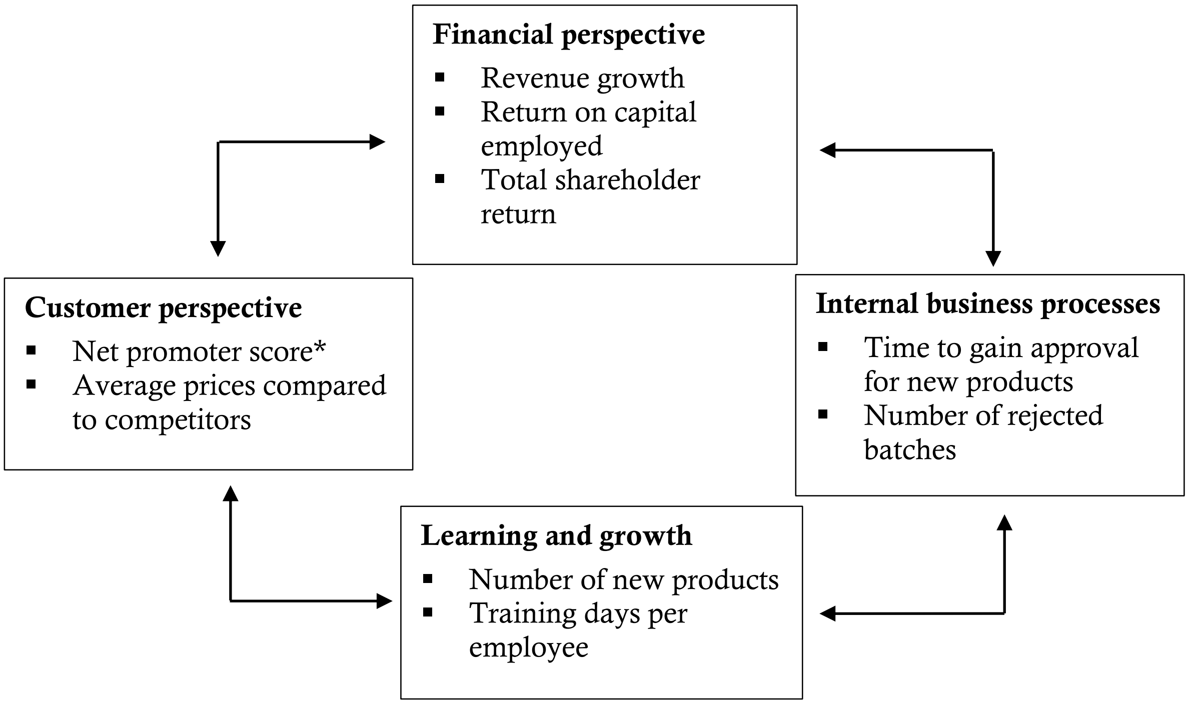
*Employee engagement is the percentage of employees that feel valued and supported by the company, according to an employee survey carried out by an independent company.

APPENDIX 2 – KEY PERFORMANCE INDICATORS OF ASILPHARMA

AsilPharma is a pharmaceutical company based in Dubai. The company is a similar size to RhanaPharm and has a similar business model.

Growth in revenue vs previous year	6%
ROCE	17.3%
Gross profit margin	45%
Operating profit margin	19%
Gearing (debt ÷ equity plus debt)	13%
Total shareholder return for most recent financial year	5%
Number of new products launched in most recent year	10
Employee engagement	65%

APPENDIX 3 – PROPOSED BALANCED SCORECARD FOR RHANAPHARM



*Net promoter score is the score given on a scale of 1 to 10 to the question "would you recommend RhanaPharm to other buyers of pharmaceuticals?" Customers would be surveyed twice per year.

APPENDIX 4 – DETAILS OF CURRENT BOARD STRUCTURE

The following is taken from the annual report of RhanaPharm.

Director	Career at RhanaPharm
Mustafa Sharif (Age: 62 years) **Chief Executive Officer**	Mustafa founded RhanaPharm in 1993. He became CEO when the company listed on PSX in 2010. Mustafa holds a doctorate in pharmacy from the University of Karachi.
Shahid Nawab (Age: 32 years) **Finance Director**	Shahid joined RhanaPharm in 2020 after working for 11 years for an international accounting practice in Karachi. Shahid is a member of the Institute of Chartered Accountants of Pakistan.
Asif Awais (Age: 60 years) **Production Director**	Asif has been working for RhanaPharm since 1994. He joined the company as a research scientist. He was appointed head of production in the year 2001 and became production director in 2004. Asif holds a BSc degree in pharmacy.
Dr Abdul Khan (Age: 58 years) **Independent Director** **Chairman**	Dr Khan joined the board of RhanaPharm as chairman in 2013. He has enjoyed a successful career working and teaching at the Jack Beecham School of Pharmacy in Lahore.
Famida Sharif (Age: 60 years) **Non-executive Director**	Famida, wife of Mustafa, joined the board as a non-executive director in 2010 at the time of the company's listing. She had previously worked for RhanaPharm on a part-time basis as office manager.
Muhammad Mujahid (Age: 59 years) **Independent Director**	Muhammad joined the board in 2015. Prior to joining the board of RhanaPharm, he was the head of research for one of RhanaPharm's competitors. He now runs his own consulting firm.
Dr Ali Tariq (Age: 65 years) **Independent Director**	Dr Tariq joined the board in 2018. He has had a distinguished career as an orthopaedic surgeon, and still works as a consultant for several hospitals.
Dr Yasmin Tokhi (Age: 55 years) **Independent Director**	Dr Tokhi joined the board of directors in 2010 at the time of the company's listing. She had a distinguished career in the pharmaceutical industry including five years working in a senior position for the Drug Regulatory Authority of Pakistan.
Muhammad Suri (Age: 68 years) **Independent Director**	Muhammad joined the board in 2018. He worked for many years for a global investment banking firm. He retired from this in 2009 and is now an independent director of several listed companies in Pakistan.

APPENDIX 5 – EXISTING REMUNERATION SCHEME FOR EXECUTIVE DIRECTORS

Executive directors receive the following remuneration:

- A fixed salary element, which would be equivalent to 62.5% of the directors' total remuneration if maximum bonuses are achieved.

- A bonus as a percentage of the fixed salary element, which is awarded for the achievement of the following targets:

  – 10% if revenues grow by 2% or more compared with the previous years
  – 20% if return on capital employed is greater than 24%
  – 20% if operating profit margins are more than 30%
  – 10% if the gross profit margin is more than 50%

The bonuses paid for achieving a particular target are independent of the achievement of the other targets. For example, if return on capital employed is greater than 24%, the 20% bonus will be paid regardless of whether the other targets have been achieved.

QUESTION 2

Razasport is an international manufacturer and distributor of sports equipment since last 40 years. As market leader, Razasport is proud of its ability to innovate and incorporate the latest sports science into its products. Razasport currently owns a production facility in Lahore which also serves as a warehouse. The company also owns a fleet of vehicles used to perform local deliveries.

During the last year, the company has suffered from cancelled orders and falling sales as a result of the coronavirus pandemic. For the first time in its history, the owners and managers are concerned about the profitability of the business. Consequently, Farooq Ali, the Chief Financial Officer, is reviewing a range of different approaches to try and improve business performance.

Big Data and digital marketing
Farooq is aware of the benefits that using data can bring to an organisation. In response to declining sales, Farooq is considering to investigate how Razasport can better use the data they have by developing a digital marketing strategy. He has recently engaged the services of Gem Consulting to advise further on this which can be seen in Appendix 1.

Supply chain management
Until recently, 90% of Razasport's products were sold in either Pakistan or Iran and delivered using Razasport's own fleet or by using local couriers. In 2015, Razasport developed its e-commerce capability, with the majority of these sales being shipped to the United Kingdom. To avoid the current high shipping costs and long lead times, the Logistics Manager, Adnan Baig, is proposing a third-party logistics (3PL) strategy involving a purpose built e-commerce warehouse in Poland. Shipping and warehouse costs can be seen in Appendix 2. Razasport would co-share the warehouse with other businesses, making use of the specialist inventory management and logistics tracking technology supplied by the 3PL provider.

Factoring of trade receivables
Officially, payment terms are 30 days but due to its long-term relationships with many customers, Razasport does not enforce this. However, bad debts are minimal and Razasport has confidence that the majority of customers will eventually pay. Until now, Razasport has seen the delay in cash collection as a necessary cost of doing business and part of the customer service for which they are known. In order to improve the liquidity, Hamza Bukhari, Financial Controller has prepared a proposal to factor trade receivables which can be seen in Appendix 3.

Requirements

(a) Explain how the use of big data and a new digital marketing strategy could improve long-term financial performance for Razasport. **(08 marks)**

(b) Evaluate the proposed supply chain strategy and recommend whether Razasport should outsource its warehousing, in light of recent business performance. **(08 marks)**

(c) Advise Razasport on whether to proceed with the proposal to factor trade receivables, providing supporting calculations where appropriate. **(09 marks)**

Total: 25 marks

APPENDIX 1 – EMAIL FROM CONSULTANT ON DIGITAL MARKETING STRATEGY

To: Farooq Ali, Chief Financial Officer
From: Gem Consulting
Subject: Big Data and digital marketing
Date: 1 June 2021

Further to our discussions, please find enclosed a summary of the key findings from our review. The full report will be made available to you by the end of next week, per our initial discussions.

Big Data
A customer database is already in existence containing a wealth of untapped data, including: customer demographics, preferred sports, contact details and transaction history.

Digital Marketing

- Razasport is reliant on traditional marketing to promote its products, for example, billboards and sports magazine advertisements. Razasport also maintains a simple website.
- Industry average data suggests that the ROI of print marketing is approximately 5.5%. With current data, it is currently not possible to assess Razasport's marketing ROI.
- Approximately 63% of Razasport's sales in a year come from 20% of its customers.
- Approximately 76% of Razasport's sales in a year come from repeat customers who have made purchases in the last two years.

Recommendation
Gem recommends the introduction of a customer relationship management (CRM) system to extract the most value from the data currently available. Gem also recommends the use of digital marketing tools to significantly improve the ROI of marketing campaigns.

We would like to take this opportunity to thank you for using Gem Consulting and we look forward to working with you again in the future.

Regards,

Noor Abbas
Digital Marketing Consultant

APPENDIX 2 – SHIPPING AND WAREHOUSE COSTS

To: Farooq Ali, Chief Financial Officer
From: Adnan Baig, Logistics Manager
Subject: Shipping and warehouse costs
Date: 3 June 2021

Per your request, please find attached an extract of average parcel sizes and shipping costs from Lahore and Poland's warehouse to UK based customers.

Assumptions underlying the data are as follows:

- Parcels up to 29 kg in weight are always sent by air freight from Pakistan and this will also apply to shipments from Poland.
- Parcels of 30 kg or more are sent by sea freight from Pakistan. Similar sized parcels will be shipped using road transportation from Poland unless a customer is willing to pay extra for air freight.
- Customers can pay €0.8 per kg for faster delivery on large (30 kg+) orders.
- Lead times from Lahore to the Poland's warehouse (sea freight) are 19 days and the bulk shipping cost to replenish the Poland's warehouse is, on average, €2 per kg.
- One euro equals Rs. 200

Also please note the lease terms associated with the warehouse:

- The initial rental term is five years. Early termination requires four months' notice and an exit fee equivalent to six months' rental.
- An additional payment of €12,000 is payable annually in advance for e-commerce support. These fees are non-refundable.

Please do not hesitate to get in touch if you require further clarification.

Regards,

Adnan Baig

Attachment to letter received from Adnan Baig on 3 June 2021:

Courier shipping cost per kg to UK

	Poland	**Lahore**
up to 5 kg	€7	€21
6-29 kg	€3	€18
30-100 kg	€1	€12

Lead time to customer (days)

Air	1	6
Road	4	N/A
Sea	N/A	25

Average shipment weights	**% of shipments**	**Average net revenue per kg**
Small (10 kg)	48	€6
Regular (35 kg)	36	€12
Oversize (145 kg)	16	€14

APPENDIX 3 – PROPOSAL TO FACTOR TRADE RECEIVABLES

Proposal
Falling sales are currently putting profitability and liquidity under pressure. This proposal examines the use of debt factoring to improve liquidity and profitability.

Trade receivables
Razasport has traditionally maintained a high trade receivables balance. Although there is a 30-day credit policy, this has been overlooked for the vast majority of customers due to the longstanding relationships in place. Many customers tend not to pay for 90 days and Razasport finances trade receivables using the overdraft facility (interest rate of 12% p.a). There are very few bad debts to be written off.

Factoring
The factor will pay 70% of the trade receivables when a credit sale is made and the remaining 30% when the cash is received from the customer. This is estimated to be 45 days after the debt is factored.

The factor will charge interest at a rate of 10% per annum on cash advanced plus a fee of 2% of annual credit sales revenue. By reducing the administrative burden associated with managing the aged debtor list, it is estimated that we can rationalise the Trade Receivable department, reducing credit control costs by approximately Rs. 1.5 million each year if the factor is used.

Razasport currently has annual credit sales of Rs. 1.3 billion and trade receivables of Rs. 320.55 million which represents 90 days of sales (based on a 365-day year).

QUESTION 3

A2Z is a listed company providing data analytics and digital business solutions. The business is structured on divisional lines with one division specialising in data analytics whilst the other division focuses on digital business solutions such as artificial intelligence (AI). Clients are predominantly in the bricks and mortar retail sector and are located across Pakistan, India, Singapore and Australia.

Since its inception, A2Z has grown organically but the board is now looking to expand the business through acquisition. The Finance Director, Saeed Afridi, has identified Logical, a small, unquoted data analytics company specialising in online retail. The owner of Logical is planning his retirement and is therefore seeking an exit route within the next year. He has asked to meet with Saeed to discuss the valuation of Logical, with a view to selling the business to A2Z **(Appendix 2)**.

During the last year, the board have become increasingly concerned about the risks A2Z is exposed to as a result of its rapid expansion. As part of this risk focus, the board has engaged the services of a data security consultant after several high profile cyber-attacks on supermarkets in Pakistan. The consultant has identified that one of A2Z's clients has exposed A2Z to malware, which has potentially infected A2Z's data and processes **(Appendix 3)**.

A2Z has 50 million shares in issue, with a current share price of Rs. 37. A2Z had earnings of Rs. 66 million in 2020.

Requirements

(a) Identify and evaluate the key risks facing by A2Z. Recommend suitable mitigating strategies.

Note: Include an analysis of the data provided in Appendix 1 to identify risks and ignore cyber security risk. **(12 marks)**

(b) Estimate the value of the entire ordinary share capital of Logical for the purpose of A2Z making a bid. Explain any key concerns you have with your valuations. **(07 marks)**

(c) Explain the possible causes and consequences of cyber security incidents, such as the one highlighted by the data security consultant. Recommend actions that A2Z should take to prevent future cyber-attacks. **(06 marks)**

Total: 25 marks

APPENDIX 1 – COMPANY BACKGROUND

A2Z has been operating in the industry which is growing rapidly but having an intense competition. A2Z has always had a high turnover of client but with their reputation for client service, innovative technology and speed of response, they have always been able to win new client without any difficulty.

Data Analytics division
The Data Analytics division uses a cloud-based platform to capture, analyse and store high volumes of raw data, including publicly available data as well as data provided by clients. Client specific raw data remains the intellectual property of the client, but ownership of data becomes complex once it has been processed by A2Z, resulting in extensive legal issues when client change providers. All clients are invited to upload data from their own systems to A2Z's cloud. A2Z is then able to provide analysis to client, often within a few minutes of receiving their data.

Digital Solutions division
The Digital Solutions division specialises in providing retail clients with artificial intelligence (AI) solutions. This is a growth business and the speed of innovation is rapid, so much of the division's work involves research and development. The Digital Solutions division currently makes use of generic technologies, so any innovation is easily copied by competitors.

Divisional operating data – Years ending 31 December

	Data Analytics division		**Digital Solutions division**	
	2020	**2019**	**2020**	**2019**
Number of:				
New customers in year	26	21	12	8
Customers lost in year	17	14	15	4
Customers at 31 December	121	112	37	40
	--------------------- Rs. in million ---------------------			
Revenue	156	148	86	71
Operating profit	38	41	18	17
Total assets less current liabilities	220	220	148	144
Revenue from largest customer	95	82	26	26

Forecast growth rates	17%	-	36%	-

APPENDIX 2 – EXTRACTS FROM LOGICAL'S FINANCIAL STATEMENTS

Extract of statement of profit or loss for the year ended 31 December

	Notes	2020	2019
		--------- Rs. in '000 ---------	
Revenue	(i)	335,200	296,150
Cost of sales		(117,320)	(103,653)
Gross profit	(ii)	217,880	192,497
Operating costs	(iii)	(120,000)	(120,000)
Operating profit		97,880	72,497
Interest expense		(22,000)	(22,000)
Profit before tax		75,880	50,497
Tax		(22,005)	(14,644)
Profit for the year		53,875	35,853

Extract of statement of financial position as at 31 December

	2020	2019
	--------- Rs. in '000 ---------	
Total assets	150,197	142,460
Total liabilities	76,797	72,600

Notes:

(i) Revenue – growth of 14% is expected next year.

(ii) Gross profit margins will remain the same in 2021.

(iii) Operating costs include salaries. Logical has recently recruited three new IT administrators at a cost of Rs. 30,000 per month. Two employees started in January 2021 and one joined at the start of April 2021.

APPENDIX 3 – DATA SECURITY ISSUES

To: Board of directors **URGENT AND CONFIDENTIAL**
From: Sobia Shamin, InfoSec Data Security
Subject: Data Security issues
Date: 1 June 2021

Further to our review of A2Z's data security, testing has revealed a data breach in one of A2Z's clients, Bestbuy Supermarkets.

A2Z uses an in-house designed software application to identify breaches in the cloud-based storage. Our testing to date has revealed that the malware reached A2Z's systems via Bestbuy and remained undetected by the software for a period of six weeks, giving rise to potential infection of other clients' data and systems. InfoSec is currently undertaking further testing and scanning to establish the extent and severity of the attack. In the meantime, InfoSec requests authorisation to install our bespoke malware detection application 'Rapid Spy' to verify the integrity of all client data and to prevent similar breaches of A2Z's system.

With kind regards,

Sobia Shamin

(THE END)