The Institute of
Chartered Accountants
of Pakistan

Multi Subject Assessment Stage

7 December 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

Uncle Azad is a partnership concern (the business) that owns three restaurants in Karachi. The business is 100% owned by the Chaudury family. Omar Chaudury is a qualified chef, who opened the first 'Uncle Azad' restaurant in 1987. It is located on Burns Road, Karachi, and serves traditional 'desi' food. The restaurant became popular very quickly among tourists and locals. Omar saved a large portion of the profits and opened a second restaurant five years later. A third restaurant was opened in the year 2000. All three restaurants are named 'Uncle Azad' and offer the same food and similar decor. Omar and his wife, Daulat, were the original partners, and also manage the Burns Road site. They have employed managers to run the two other restaurants.

The restaurants currently cater tourists and a loyal clientele who visit the restaurants regularly and have become friends with the managers. Most of the visitors attend the restaurants as a leisure activity although there are some business customers who come to the restaurants to entertain their clients. Omar has never thought too much about marketing. He places adverts for the restaurants in local newspapers and on some tourist brochures. While growth in revenue has not been spectacular over recent years, Omar is happy that he makes a good living doing something he enjoys.

Last year, Omar's daughter, Yasmin, joined the business as a third partner after graduating from university with a degree in Business Management. Yasmin has lots of new ideas for improving the business. Firstly, she believes that as the business has no formal mission or objectives, it lacks direction. She believes that the business needs to expand by opening more restaurants in other cities. She also thinks that the business needs to have a more formal marketing strategy to identify the target market segments and focus on satisfying these.

Yasmin has also suggested approaching a venture capital organisation to obtain finance to expand the business.

Revenues and, therefore, profits for the two most recent years were adversely affected by the coronavirus pandemic, due to lockdowns and restrictions on dining that were imposed by the government. The business started a takeaway service during the periods when the restaurants were forced to close due to lockdown. This takeaway service only offered a limited menu, but was popular with some of the regular customers.

Yasmin is interested in how the business has performed and the impact that the pandemic has had on it. She has suggested comparing the most recent financial year (ended 31 October 2021) with the last pre-covid year (the year ended 31 October 2019).

The summarised management accounts for the year ended 31 October 2021 are presented in **Appendix 1** along with comparative information for the year ended 31 October 2019, which was the last year before the pandemic. Some reviews of Uncle Azad in the Traveller's Choice website are presented in **Appendix 2**.

Omar and his wife own 75% of the shares in Uncle Azad, while Yasmin owns 25%. Inflation between 2019 and 2021 was around 20%. The Chaudury family do not take any salary from the business, but do take out share of profit. The business follows the policy of retaining profits of Rs. 1 million each year to meet future investment needs, and paying out any profits above this as share of profit.

Omar has just discovered that Asif Qazi, the manager of one of the restaurants, has been stealing money. Business policy is that any employee who is caught stealing will be dismissed immediately and reported to the police. This policy is well known by all restaurant employees. Omar knows that this should apply to Asif, but is worried about the impact it would have on Asif's family, especially his young children. He is thinking about giving him a warning instead. Yasmin is unaware of this theft. A transcript of Omar's conversation with Asif has been provided in **Appendix 3**.

Requirements

(a) Assess the financial and non-financial performance of Uncle Azad for the year ended 31 October 2021. **(13 marks)**

(b) Evaluate, from the perspective of key stakeholders, Yasmin's view that Uncle Azad needs to set an objective of growth in revenues and profits. **(04 marks)**

(c) (i) Discuss Yasmin's suggestion that the business needs to have a more focused approach to its marketing. **(06 marks)**

(ii) Suggest what dimensions should be used for segmenting the market for food and beverages, and recommend (with justification) the most appropriate segments for Uncle Azad to target. **(06 marks)**

(d) Evaluate Yasmin's proposal that Uncle Azad should apply for venture capital to expand. **(05 marks)**

(e) Advise Omar on what action should be taken, from an ethical perspective, in respect of the theft described in **Appendix 3**. **(06 marks)**

(f) Briefly discuss the tax implications for Uncle Azad and its members if it is decided to convert the AOP into a wholly owned company. **(10 marks)**

Total: 50 marks

APPENDIX 1 – FINANCIAL INFORMATION FOR THE YEARS ENDED 31 OCTOBER 2021 AND 31 OCTOBER 2019

	31 Oct 2021	31 Oct 2019
	------------ Rupees ------------	
Revenue – restaurants		
Food – eat in	7,649,762	12,749,604
Takeaway food	1,529,952	
Beverages	4,380,836	7,301,393
Total revenue	13,560,550	20,050,997
Cost of sales		
Food	(3,212,900)	(4,589,857)
Beverages	(832,359)	(1,314,251)
Gross profit	**9,515,291**	**14,146,889**
Managers' salary	(738,607)	(671,461)
Staff costs	(3,289,398)	(4,609,012)
Maintenance	(150,000)	(100,000)
Depreciation	(2,027,187)	(1,912,441)
Profit before tax	**3,310,099**	**6,853,975**
Tax	(959,929)	(1,987,653)
Profit after tax	**2,350,170**	**4,866,322**
Share of profit	(1,350,170)	(3,866,322)
Retained profits	**1,000,000**	**1,000,000**

APPENDIX 2 – REVIEWS FROM 'TRAVELLER'S CHOICE'

Traveller's Choice is an international website. People who register on the website can read reviews and leave their own reviews about hotels and restaurants around the world. A search on the site for 'Uncle Azad Karachi' comes up with the following:

Average rating: 3.5 out of 5 (91 reviews)

Sample of reviews:

(i) **A delightful experience (Laura from Manchester) 4 out of 5**
Fantastic. Had delicious genuine Pakistani food. My only problem was choosing what to have; they have such a large menu. Very friendly staff and great atmosphere. Loved the live music. It would be nice if there was more choice for vegans, as my friend did not have as many options. I will be back next time I visit Karachi.

(ii) **Good food but poor ambience (Arish from Dubai) 2 out of 5**
I was visiting a potential customer in Karachi and was told that this was a great restaurant. The food was good, but it was difficult to speak to my potential customer as the live music was too loud. The service was also a bit slow. It was not very smart, so did not give a good impression to my guest. We left after the food and had coffee in a very smart café down the road.

(iii) **Thanks for a wonderful birthday (Rhana from Karachi) 4 out of 5**
We took our children out to celebrate my 50th birthday. We had a lovely time; the food was fantastic and Mr Chaudury, the owner, came out to personally greet me. The music was lively so we all danced after our dinner. The prices were high, but worth it for a special occasion.

APPENDIX 3 – TRANSCRIPT OF A CONVERSATION WITH ASIF QAZI

Omar Chaudury (OC): Asif, I have to ask you something. Have you been stealing money from the restaurant?

Asif Qazi (AQ): Why do you say that, Sir?

OC: I have noticed that, for some time, the takings in this restaurant have been lower than expected. Daulat always reconciles the takings to the cash register reports and could find no discrepancies. We hired a forensic accountant who has been investigating. He has been sending customers here to pay in cash. We discovered afterwards that, sometimes, these bills had been 'voided' by yourself and, presumably, the cash taken. The accountant also spoke to some of the waiters; one of them told him that you often recycle bills. If one customer pays with cash, and does not take the bill, you often use the bill again for the next customer. Is this true?

AQ: Sir, I cannot deny this. I have not taken a great amount of cash but, as you know, it is my daughter's wedding next year and this will cost a lot of money.

OC: Asif, that puts me in a very difficult position. We have worked together for many years, and I thought we had become good friends. Now, I discover that you have been stealing from my business. I am sure you are aware that our business policy is to dismiss employees immediately who are caught stealing, and to report the matter to the police.

AQ: Please, I have a family to support. I have been really stupid, and I will repay all the money I have taken. Please don't dismiss me, and please do not prosecute me.

OC: I will need to give the matter some thought. I am suspending you until I have made a decision. You must not return to work until I have decided.

QUESTION 2

Today is **1 January 20X2**. Shikarpur Gas Supplies Ltd (SGS) is a listed company that supplies components and equipment to the gas extraction industry in the major natural gas field in Sui, Balochistan. The Sui field is state owned through Pakistan Petroleum Ltd and is entering its 'depletion phase' with reserves only expected to last another 20 years at current rates of extraction. SGS's main manufacturing facility is based in the city of Shikarpur in the Sindh province.

SGS's current organisation structure is functional in nature. The main functional departments include: Operations (both Manufacturing and Installation), Finance, Human Resources, Marketing & Sales, Product Design (including Research & Development) and Information Technology. Each department has board representation with one executive director. The board is further supplemented by the Chair, and five non-executive directors.

Over the years, SGS has invested a regular proportion of its retained profits in acquiring land. It has accumulated a significant land bank in a remote area outside the Sui field which, according to preliminary studies, may well contain substantial reserves of shale gas. Shale gas is natural gas that is trapped within shale rock formations. SGS is therefore planning to move into gas extraction organically and to scale back manufacturing as the Sui field winds down. The extraction process is likely to involve the use of hydraulic fracturing (or 'fracking'). Fracking is the process used to extract shale gas from shale rock, and involves drilling holes into the rock and pumping water and other fluids at high pressure through these holes to force the gas out. Fracking is a controversial process, as environmentalists and scientists claim it can pollute water supplies and cause serious tremors. SGS would ensure close monitoring for any unwelcome environmental side-effects of its fracking processes.

Various aspects of the change in strategic direction were discussed at a recent Board meeting:

- The Finance Director led a discussion on financing the expansion plans. Given SGS's current low level of gearing, he recommended a corporate bond issue through the Pakistan Stock Exchange. The bond issue would be an eight-year bond, issued at par and redeemed at a 10% discount. The Finance Director has prepared details of a similar bond issue in existence to be used as a benchmark for calculating the coupon rate required for the SGS's bond. Details are provided in **Appendix 1**.
- The Human Resources Director noted that the winding down of manufacturing activity in Shikarpur and the establishment of gas extraction operations on the land bank would present the company with unprecedented change management issues. He presented the Board with a paper outlining the scale of the task ahead (**Appendix 2**).
- The Marketing Director expressed fundamental concerns about the effect that the new business could have on the reputation of SGS.

Requirements

(a) Calculate the coupon rate required on the bond due to be issued to finance the new venture. **(05 marks)**

(b) Recommend, with justification, a new organisational structure to best accommodate the new business. **(06 marks)**

(c) Outline the main issues being faced by management and staff as a result of the proposed change. **(08 marks)**

(d) Explain the main Corporate Social Responsibility concerns associated with the proposed move into gas extraction, and recommend how these concerns should be addressed. **(06 marks)**

Total: 25 marks

APPENDIX 1 – KADANWARI HYDRAULIC EXTRACTION LTD - BRIEFING PAPER

To: **The Board, SGS Ltd**
From: Yousuf Bhati, Finance Director
Subject: SGS Bond issue
Date: 3 December 20X1

Comparable company:	**Kadanwari Hydraulic Extraction Ltd (KHE)**
KHE bond terms:	10 year bond issued two years ago, 8% coupon rate, redeemable at par i.e. Rs. 10,000 or convertible into 15 ordinary shares per bond
KHE current bond market price:	Rs. 9460, recently ex-interest
KHE current share price:	Rs. 325, anticipated growth rate approximately 10% CAGR
KHE Bond credit rating:	CCC
Proposed SGS terms:	Eight years, issued at par of Rs. 10,000, interest paid annually in arrears, redeemable at a 10% discount. Early indications imply a credit rating of BB+

The difference in credit rating implies a difference in required yield of 150 basis points.

Regards,

Y.B.

APPENDIX 2 – CHANGE MANAGEMENT CONSIDERATIONS FOR EXPANSION INTO EXTRACTION

To: **The Board, SGS Ltd**
From: Qadir Padishah, Human Resources Director
Subject: Human resources impact of SGS proposal to move into gas extraction
Date: 7 December 20X1

Operational impact
Manufacturing operations near Shikarpur will be reduced by around 50%. The current, highly-skilled workforce is approximately 200 individuals in size, all sourced locally and predominantly young to middle aged males from a variety of disciplines. SGS is by a long way the largest employer in the remote village our workers are sourced from. 60% of the workforce will no longer be required for manufacturing, with the other 40% needing to be retrained to operate in the downsized environment.

The new gas extraction site is to be located in the SGS land bank located in a remote area outside the Sui field. All employees will need to be relocated to the site given the lack of suitable skills in the local population. Approximately 100 workers will be required, some of whom may be sourced from the current Shikarpur manufacturing site, albeit significant retraining will be needed.

Organisational structure
The current business structure is unlikely to be appropriate post-expansion – some operational functions of the two businesses will be markedly different. Finance, Human Resources and IT needs, however, will not be so different between the two businesses.

Change management dimensions
To be considered in the change management programme:

Timescales: The Board have discussed commissioning the extraction site in early 20X5.

Management capability: The SGS manufacturing business has been essentially stable for many decades. As such, existing management have little experience in change management issues.

Workforce: preparedness, diversity and 'power-distance'. The workforce currently has a loyal, positive attitude, but significant change will be unfamiliar to them. SGS employees often consist of several generations from the same family. As all are sourced locally, socio-economic backgrounds tend to be similar, albeit there are different professional specialisms within the worker group. They are generally compliant and not heavily unionised.

Nature of the change: Workers are likely to be affected in one of three ways:

- Retraining to work at the new downsized manufacturing site
- Retraining and relocation to work at the gas extraction site
- Redundancy

Regards,

QP

QUESTION 3

Today is **1 February 20X2**. Karachi Auto Manufacturers (KAM) is owned by the Syed family and manufactures fuel injector units for motorcycles from its factory in the Korangi Industrial Area of Karachi. Over the years, it has organically increased its product range by buying-in other motorcycle parts from overseas and supplying them locally in addition to their own manufactured fuel injectors. This has been so successful that they now supply many auto manufacturers and assemblers throughout Pakistan.

The logistics associated with the distribution of parts to customers is managed by Malik Logistics Limited (MLL), a family-owned business that has grown through the strong personal and business relationship of its CEO – Fahad Malik – with the Syed family.

Demand for cars and motorcycles had been growing quickly until recent times, however the coronavirus pandemic has generally caused growth to halt and, indeed, decline. Legislation has historically provided tax incentives for auto manufacturers, but this legislation is due to expire shortly.

KAM is looking to use the current downturn as an opportunity to rethink the future strategy of the business. The Malik family are looking to retire and sell their logistics business, and KAM considers downstream vertical integration into auto part distribution/logistics as suitable to facilitate growth, and to offer a degree of diversification. In light of their strong past relationship with KAM, the Malik family have agreed to give KAM time to consider the potential acquisition in detail without seeking to sell to anyone else. The Finance Director of KAM, Danish Syed, has completed some initial research to facilitate a valuation (see **Appendix 1**).

As part of their planning, the Syed family need to decide how to raise the considerable funds needed to finance any such acquisition. One option would be to seek a listing on the Pakistan Stock Exchange. Danish is aware that the structure and operations of the Board currently suit the Syed family, but may not be considered suitable for a listed company. A copy of an email to the Syed family's investment bank from Danish outlines the current arrangements (**Appendix 2**).

The Rupee has depreciated against the US dollar and other currencies in recent times, yielding foreign exchange losses for the auto parts distribution business. As this business has grown, the losses have now become substantial. Danish feels it would be prudent to take steps to manage foreign exchange risk. He has produced a working paper to profile the sales and purchases of the auto parts business (**Appendix 3**).

Requirements

(a) Provide a range of values for the acquisition of the share capital of MLL and recommend (with justification) a bidding strategy. Provide supporting calculations. **(12 marks)**

(b) Discuss the real options that should be considered in relation to the acquisition, and their impact on the decision of whether or not to acquire MLL. **(04 marks)**

(c) Recommend changes that would need to be made to the corporate governance arrangements of KAM described in **Appendix 2** if the company were to consider seeking a listing on the Pakistan Stock Exchange. **(05 marks)**

(d) Recommend a hedging strategy for the transaction risk presented by KAM's overseas purchases. **(04 marks)**

Total: 25 marks

APPENDIX 1 – INITIAL RESEARCH ABOUT MALIK LOGISTICS LTD

Malik Logistics Ltd (MLL) is 100% owned by the Malik family. All active board members are shareholders while Fahad Malik, the CEO and Chair, owns 40% shareholdings.

An extract from the statement of financial position as at 31 December 20X1:

	Rs. in million
Non-current assets	350
Net current assets	75
	425
Ordinary share capital	100
Retained earnings	175
10% Long-term loan repayable on 31 Dec 20X9	150
	425

80% of the non-current assets are made up of vans, trucks and trawlers. Their market values are estimated to be 25% lower than their net book values. Warehouse space is leased.

The MLL brand is prominent on trucks, and is well regarded in the automotive industry and beyond. The current ROCE (based on operating profit) of MLL is 10%, compared to 5% on average in the industry.

The current cost of equity for MLL is estimated as 20%.

The rate of tax applicable on MLL is 29% and capital allowances can be ignored.

Depreciation equates to the cash spent on non-current assets each year.

Post-acquisition, earnings would be expected to grow at a rate of 17% for three years, then 14% per year indefinitely after that.

An equivalent listed distributor has a P/E ratio of 15 times earnings, although MLL's future growth potential is considered to be better than the listed company.

APPENDIX 2 – EMAIL TO KAM'S INVESTMENT BANK

To: U Mirza
From: Danish Syed, Karachi Auto Manufacturers
Subject: CONFIDENTIAL – Board structure
Date: 7 January 20X2

Hi Umar,

I hope you are well. Further to our discussions, I would appreciate your help in reviewing our corporate governance arrangements so I can better understand what is expected of the Board should we wish to seek a listing on the Pakistan Stock Exchange. I summarise here the current arrangements, and would appreciate a meeting with you in due course.

There are six Board members. Five of them are family members, with the sixth being an old friend of my father. He was brought in about seven years ago so we could benefit from his outside experience – before retiring, he worked for one of our main customers in Karachi. There are eight shareholders in total, all members of my family holding an equal share with the exception of my father who owns 40%. The five family members on the Board each have an executive role to play, and their basic salary reflects the amount of work required for each role. There is also an executive bonus scheme with each executive earning an equal share of a bonus pot. The pot is calculated based on profits compared to the prior year. We work as a team and we believe all team members should be incentivised to improve profits year on year.

The sixth Board member (the old family friend) is paid a moderate, fixed fee for his attendance at board meetings. Should we become listed, I would like to start granting share options to him also to incentivise his work.

My father (Fahad) is the Chair of the Board, and we all report to him in respect of all matters. He decides on Board remuneration and roles (although the latter have stayed the same as long as I can remember!) – after all he is the head of our family!

I am reluctant to change the way we operate – we rarely argue and I think we work well together as a team. However, I appreciate some small changes may be required should we become listed. I look forward to hearing from you in due course.

All the best to you and your family.

Regards,

Danish

APPENDIX 3 – WORKING PAPER: PROFILE OF SALES AND PURCHASES FOR THE PARTS BUSINESS

To: The Board, KAM
From: Danish Syed
Subject: Parts business foreign exchange profile
Date: 12 December 20X1

This paper seeks to profile the sales and purchases of the parts business, for the purpose of understanding the foreign exchange risk KAM is exposed to.

Sales
All sales are currently to auto manufactures and parts suppliers in Pakistan. We invoice in Rupees, so there is no transaction exposure relating to sales.

Purchases
Orders are placed by our customers which are passed back instantly to our overseas suppliers. Our purchases are in the region of Rs. 25 million per month. Underlying this region are regular purchases amounting to around Rs. 5 million per month. The remainder is highly dependent upon manufacturer activity levels.

The value of the Rupee has fallen consistently in recent times, exposing us to increased Rupee costs for these purchases as we settle them all in the suppliers' own currency. We have asked some of these suppliers to invoice us in Rupees, but they give us such low prices normally that their margins are already low. The Rupee prices they offered represented an unbearable increase in the current equivalent, due to KAM passing the foreign exchange risk completely onto them.

As this part of our business continues to flourish, I feel it is time to formally manage our foreign exchange exposure. I look forward to discussing this with the Board in the coming meeting.

Regards,

Danish

(THE END)