The Institute of
Chartered Accountants
of Pakistan

Multi Subject Assessment Stage

6 December 2022
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

Today is 1 March 20X6. Islamabad Couriers Limited (ICL) is a traditional family-owned courier business that arranges for the delivery of parcels and documents locally around Islamabad. It is also part of a national strategic alliance – 'Pakistan door-to-door' – for wider distribution needs, although the vast majority of ICL's business is local to Islamabad. Appendix 1 provides a research extract on the courier industry in the Islamabad city.

ICL offers a premium 'within an hour' service, as well as a 'same day' and 'two day' service. By volume, 50% of customers pay for the 'within an hour' service, with 40% opting for the 'same day' service.

ICL employs 15 people. This does not include the couriers who are hired on a job-by-job basis. Approximately 100 couriers are hired at any one time. They are self-employed and are paid a fixed fee for each delivery, provided they deliver within the specified time limits required by the tier of service the customer requires. Failure to deliver on time means the courier's fee is reduced by 75%. If late deliveries happen more than twice in a six month period, they are no longer provided work. There is no guaranteed minimum work provided to the couriers although many of them spend most of their time delivering for ICL. Work is allocated to couriers by monitoring their location and workload, and choosing couriers that are in the right place at the right time, with availability and the right kind of transport.

The couriers provide their own transport; many use bikes, others use petrol scooters, and a few use cars and vans for larger parcels.

The employment status of couriers as self-employed is controversial. Although it is beneficial for tax purposes for both ICL and the couriers, it affords little security to the couriers – they are not guaranteed any work, are not awarded pay when off sick, and receive no training or other benefits. This is increasingly becoming a public issue, with the media applying pressure (Appendix 3).

Recently, the company made two board level appointments from outside the family – Ranbir Malik (Marketing Director) and Yousuf Bhatti (Operations Director).

Yousuf is keen to update the image of the company and improve its corporate social responsibility credentials and is proposing that all but the largest deliveries should be made using ICL branded electric scooters. To facilitate this, ICL would buy the scooters, have ICL decals placed on them and hire them to the couriers. Couriers would have to use the ICL vehicles to obtain work. Details of the plan costs and its financing are provided in Appendix 4.

Ranbir is also concerned that the image of the company is a little old fashioned, and that customers are being lost to courier businesses that offer online booking and tracking services. Ranbir is working with the IT director to develop a smartphone app to make booking an ICL courier quick and easy, and to give real-time updates as to the package's location. In order to promote the adoption of the smartphone app, Ranbir wants to build an online brand that people can recognise and trust. Ranbir is aware that there are several options available to achieve this and raised the matter for further discussion with the board (Appendix 2).

Consideration will need to be given as to how to fund the expansion efforts. The family is not keen to invest significant additional sums at this time. In addition, existing variable rate debt is due for refinancing in the near future. The intention is to try and replace this with another five-year loan when the current one expires on 1 June 20X6. The finance director is increasingly concerned that interest rates look set to rise in the short to medium term, and is wondering about whether to hedge against rises when the loan is refinanced. Details of the current capital structure and financing needs are included in Appendix 4.

Requirements

(a) Evaluate the competitiveness of the courier industry in Islamabad using Porter's five forces. **(10 marks)**

(b) Recommend, with justification, whether debt or equity funding should be used to fund the expansion plans. **(08 marks)**

(c) Evaluate possible hedging strategies for the existing variable rate debt and recommend which should be adopted. **(08 marks)**

(d) Assess the options for developing an online brand and recommend which option ICL should pursue. **(08 marks)**

(e) Discuss the ethical issues surrounding the couriers' status as self-employed workers, including the forced hire of the new scooters, and recommend a course of action. **(06 marks)**

(f) Briefly discuss the tax implications on ICL's expansion plan (Appendix 4). Your discussion should also cover tax implications if ICL:

(i) Continues treating couriers as freelancers
(ii) Treats couriers as employees

Also, discuss the tax implications of ICL's decision of financing the expansion through equity or debt. **(10 marks)**

Total: 50 marks

APPENDIX 1 – RESEARCH EXTRACT: THE COURIER INDUSTRY IN ISLAMABAD

Islamabad: City and economy
Islamabad is home to approximately 4.1 million people and is a thriving and prosperous business hub. The city is well served with internal transport links. Intra-city travel is relatively easy apart from peak-time congestion. Many of the resident businesses are large and are keen to establish national or international exclusive arrangements with their suppliers to leverage their size.

Courier services
Couriers deliver documents and smaller parcels, usually offering a quick and efficient service for collection and delivery. Courier companies vary dramatically in size and geographical reach – from truly global operators to 'one city' businesses.

All that is needed to start a courier business is staff who are prepared to deliver, and a small amount of marketing. Many established businesses have a significant web presence.

The Islamabad courier market
The courier market in Islamabad is saturated. International businesses like DHL and Fedex have offices there, as well as many national businesses such as Leopards and M&P, let alone many locally based operators.

There are a small number of established online price comparison and review hubs that many customers use to procure their courier services, although repeat customers often stick with a trusted reliable service that they have used before.

There are also some national networks that small local courier businesses can belong to which also help to negotiate better rates. Pakistan Post offers a traditional postal service that typically delivers within Islamabad the following day. In recent times particularly, it is becoming increasingly popular to scan and email documents, and to have them signed digitally, which makes contracts legally binding. Some companies already offer the service of scanning post so it can be managed electronically.

APPENDIX 2 – EXTRACT FROM ICL BOARD MEETING MINUTES: DISCUSSION OF BRANDING OPTIONS

Islamabad Couriers Limited Board meeting
5 February 20X6
Present:
Ghulam Khan (GK) (CEO)
Saad Khan (SK) (IT)
Amir Khan (AK) (Finance)
Javeria Khan (JK) (Human Resources)
Yousuf Bhatti (YB) (Operations)
Ranbir Malik (RM) (Marketing)
Jasu Malik (Company Secretary)

…

Expansion
GK led a discussion on the expansion plans to include the use of electric scooters, and the use of a smartphone app for customer convenience and to increase loyalty. RM presented some analytics that showed that the ICL brand is almost non-existent online, especially when compared to better established international firms. The board agreed that investment in the online brand is also needed to ensure the success of the smartphone app.

JK expressed concern that the couriers would be forced to hire scooters at their own cost, especially given recent press coverage about the 'gig economy'. AK noted that the hire charge would not be designed to increase profits, simply to cover costs.

Branding options
RM made four suggestions for further discussion to build the ICL brand online.

Traditional brand: Promote the current brand online as it currently stands – same logo and advertising slogans.

Adapted traditional brand: Change the logo and slogans so they are still recognisable but revised with a modern font; insert the word 'online' in a swoosh underneath, and adapt slogans to include online references.

Co-branding: Work with an established online brand, such as one of the popular online procurement portals and co-brand with them.

Completely new brand: Develop a new logo and slogans, deliberately distanced from the existing brand.

AK suggested co-branding would be the least expensive option, but YB pointed out that the new partner would want something in return, which would likely cost money. GK asked RM to produce a board paper expanding on each of the options, and recommending which to take. RM agreed to prepare this in the near future and to circulate it to the board in advance of a future board meeting.

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There being no further business; the meeting closed at 16:00.

Jasu Malik
Company secretary

APPENDIX 3 – PRESS ARTICLE: FROM 'THE ISLAMABAD BUGLE' 1 FEBRUARY 20X6

I'm not "gig"gling now…

The freelancing dream. No boss, work when you like (as little or as much as you like) and maybe even lower the amount of tax you pay. Such are the attractions of being self-employed. The rise of technology platform hubs that link individual buyers with individual sellers (such as taxi drivers, delivery drivers and couriers) makes a self-employed workforce a more organised and overall viable proposition for businesses to adopt. The approach of using self-employed freelancers benefits businesses as well – they only pay for the services they use, they don't provide training, sick pay or other benefits. It's also less expensive and hence more profitable for them, and the workers have a more independent lifestyle. Pakistan revenues relating to the gig economy currently exceed $1 billion, and its growing fast.

So much for the sales pitch – what's the reality? Our research shows a reality closer to modern slavery, where the rates paid are competed down to an absolute pittance, leaving gig freelancers desperate to work long hours for very poor pay, no benefits and no financial security. Some are forced to be available 24/7, but aren't even guaranteed work. If they are unavailable when they're needed, they're taken off the list of suppliers permanently.

We spoke to Ghanim Ahmed, a courier in Islamabad. He owns his own bike and works for a well-known courier company. "I was so happy to start with – outdoors and exercising, working for myself. It was like living the dream, until I couldn't pay my bills. I couldn't pay my rent, so I asked for more work, which they gave me, but insisted on a lower rate 'in appreciation of the volume'. I was working all hours, and got so tired I hit the curb one day and fell off my bike. Luckily, I wasn't hurt too badly, but my bike was ruined and I needed four days off work to recover. That meant four days without pay, and I had to buy a new bike. My debt has been spiralling ever since. What started as a dream has turned into a nightmare. It feels like I'm on a treadmill and I can't get off."

As the gig economy continues to grow, hopefully regulations will adapt to protect individuals like Ghanim who are, in effect, little more than modern slaves.

In the meantime, when you next order a home delivery meal, think about tipping the delivery driver. They may have delivered your meal, but that doesn't mean they know where their own next meal is coming from.

APPENDIX 4 – BRIEFING MEMO: EXPANSION PLANS: COST AND FINANCING

To: The Board, ICL
From: Amir Khan
Date: 14 February 20X6
Subject: Expansion plans: cost and financing

Expansion investment:

Scooter investment: ICL currently uses around 100 couriers at any one time. We would need to buy 150 scooters (to allow for recharging times) at a cost of approximately Rs. 150,000 per scooter. We would need to spend Rs. 850,000 on a fast charging station, and approximately Rs. 15,000 per scooter on ICL decals. Maintenance and running costs would be covered by the rental charge to the couriers, as would a contribution to wear and tear.

App and website: Rs. 10 million investment is required to acquire hardware and develop the app, and for immediate online promotion of the brand. These costs could be capitalised and depreciated/amortised over the period of benefit.

Statement of financial position as at 31 December 20X5

	Note	Rs. in million
Non-current assets		10.5
Net current assets		14.4
		24.9
Share capital (Rs. 25 each)		1.0
Retained earnings	1	12.9
Loan	2	11.0
		24.9

Notes:
1. Profit after tax for the year ended 31 December 20X5 is Rs. 1 million.
2. The loan is repayable in full on 1 June 20X6. The rate attaching to the loan is KIBOR plus 6%. KIBOR currently stands at 9.75%. The loan contains a covenant to limit overall long-term borrowing to 75% of long term debt + equity by book values.

Industry comparatives:
Average P/E ratio: 20 times

Average gearing (long term debt/(long-term debt + equity)) = 65% using market values

QUESTION 2

Today is 20 February 20X5. Dandot Salt Limited (DSL) is a privately owned company that mines pink Himalayan rock salt in the Punjab region of Pakistan. It was founded approximately 100 years ago, and has a 500-year lease on the land it mines. Pink Himalayan rock salt is world renowned, not only for its superior flavour, but also potential health benefits. The pink colour is a result of the inclusion of several minerals that are good for health, and the sodium levels are lower than traditional table salt. This creates a stable, strong demand for the product. The company is relatively large, but is small compared to the largest supplier of Himalayan rock salt – the Khewra salt mine – the second largest salt mine in the world. DSL distinguishes itself as an 'unusual' brand for pink Himalayan rock salt, allowing it to command a premium price.

DSL is a large local employer in the village where it is based, and has been for several generations. As such, DSL contributes to the local community's needs, funds a school and contributes to local healthcare facilities. As a result, DSL has a good working relationship with its employees who are loyal to DSL.

The business has grown from an entrepreneurial structure. Pervaiz Chaudhary, an ambitious villager, started the business in the early 1900s, and was passionate about the product. Bookkeeping and administration were not his strong suits however, so he quickly learned to delegate to others more able in these areas in the community. Over time, the business developed into a functional structure (Appendix 2).

The board is ambitious like its founder, and keen to expand. It would like to seek a listing, and to expand operations to leverage its differentiated brand. The board has found a smaller, listed mining company − Nokundi Minerals Limited (NML) − that it is keen on acquiring by way of a reverse takeover. Initial talks with the management of NML have been positive – NML is keen to expand the rock salt side of its business, and DSL offer a way to achieve this. The intention is to arrange for NML to acquire the larger DSL company in a share-for-share exchange, such that the current DSL shareholders would end up being majority shareholders in NML. The company name could then be changed from NML to DSL, leaving DSL as a listed company without the traditional process needed for an IPO. Despite having lower sales than DSL, NML has a broader portfolio – it mines mainly copper and gold, as well as Himalayan rock salt.

Expansion via a share-for-share exchange will maintain cash reserves, although there is likely to be significant post acquisition integration expenses that must be paid for. The CEO of DSL, Kamran Chaudhary, is confident that this can be funded by reducing the dividend for the next couple of years (Appendix 3). The finance director, Salman Chaudhary, has started to plan for the terms of the share-for-share exchange in preparation for the next phase of internal discussions (Appendix 1).

Kamran is keen to plan for post-acquisition cultural and systems integration work in advance. He is aware that it will probably involve some of the loyal local managers relocating, at least temporarily, to work with NML on integration projects and is concerned about how best to manage this. Employees have always been sourced locally by DSL, and no one in the DSL business has any experience of arranging for relocations, or even how best to approach the topic with the staff concerned.

Requirements

(a) Recommend and justify the terms of a share-for-share exchange for DSL to acquire the share capital of NML. **(08 marks)**

(b) Evaluate the organisation structure of DSL in light of the acquisition and recommend suitable changes. **(05 marks)**

(c) Draft the outline contents of a suitable change programme for the rock salt business, justifying your suggestions in these circumstances. **(08 marks)**

(d) Evaluate the decision to finance the acquisition by withholding or reducing the dividends. **(04 marks)**

Total: 25 marks

APPENDIX 1 – CONFIDENTIAL MEMORANDUM: NOKUNDI MINERALS LIMITED ACQUISITION

To: The Board, DSL
From: Salman Chaudhary
Subject: NML terms
Date: 10 February 20X5

Dear fellow board members,

For discussion at the next board meeting and in relation to upcoming negotiations with NML concerning the terms of a share-for-share exchange, the below outlines the relative position of the two companies:

NML

20X4 Earnings	Rs. 24 million
Share capital	Rs. 6 million per the statement of financial position at 31-12-20X4, with a nominal value of Rs. 250 per share
NML P/E ratio	10 times

DSL

	31-12-20X4	31-12-20X3	31-12-20X2	31-12-20X1
Dividends paid (Rs. in million)	40	36.2	33.1	30.05

A suitable discount factor for DSL ordinary shares: Ke = 15%

Number of ordinary shares in issue: 158,000 shares

Synergies and integration costs
Synergies (net of integration and transaction costs) with a net present value of Rs. 80 million are estimated from the acquisition to be shared 50:50 with the current NML shareholders.

I will forward valuations in advance of the board meeting.

Best wishes,
Salman

APPENDIX 2 – DSL HUMAN RESOURCES DEPARTMENT REPORT EXTRACT: DSL STRUCTURE AND CULTURE

To: The Board, DSL
From: Jamil Chaudhary, Human Resources director
Subject: Structure and culture review – NML transaction
Date: 3 February 20X5

Introduction
This report seeks to summarise the current structure and culture of DSL in readiness for a business combination with Nokundi Minerals Ltd (NML) and, as such, will also consider these matters in relation to NML as far as we are able to at this stage.

DSL structure
DSL has a traditional functional structure including the following departments: operations, finance, human resources, information technology, and marketing and sales. Each department is led by an executive director that forms a part of the DSL board. There are no non-executive directors on the DSL board. All executives are members of the Chaudhary family and have obtained professional training and qualifications in their chosen area of expertise.

DSL culture
DSL has always been a local business for the local community. As such, it has very much a 'family' feel, an open communication style, and a consultative approach with the workforce. For 100 years now, generations have worked their entire lives for DSL, and DSL has always had a caring attitude towards its staff. Loyalty levels are very high. However, the organisation has been slow to update itself and remains entrenched in a 'that's the way it always been done' approach.

NML structure
NML has 3 divisions – Copper, Gold and Salt. Each division is led by an executive director who has considerable autonomy. All divisions have their own functions with the exceptions of finance and human resources which are shared service centres for the group. Formal service level agreements exist between the shared service centres and the divisions, and both shared service centres are led by executive directors. Half of the board is made up of non-executive directors. The company's ordinary shares are widely owned, and the directors are not significant shareholders. On average, an NML director has been in post for three years.

NML culture
My initial impressions of NML's culture is that it is modern and 'corporate'. It seems very focused on short-term profitability, and management consider that they should respect the privacy of their employees and not get involved with what they do outside of work. They provide generous benefits and training but, for professional training, they maintain a controversial 'clawback' clause allowing them to recover professional costs if staff leave within two years of qualification.

Conclusion
Significant differences are evident between the structures and cultures of the two companies. A full integration plan should be drafted before negotiations progress much further.

If you have any questions, please do not hesitate to contact me.

Regards,

Jamil Chaudhary
Director of Human Resources

APPENDIX 3 – BOARD REPORT EXTRACT: DSL DIVIDENDS

DSL Board meeting 6 February 20X5
Present:
Kamran Chaudhary (KC) (CEO)
Jamil Chaudhary (JC) (human resources)
Salman Chaudhary (SC) (finance)
Nadeem Chaudhary (NC) (operations)

Apologies:
Adeel Chaudhary (IT),
Sarah Chaudhary (marketing and sales)

Acquisition finance
SC raised the issue of paying the transaction and integration costs for the NML acquisition. Although the share-for-share exchange proposal preserve liquidity, SC expressed concern that there would still be some cash costs – approximately Rs. 42 million. DSL has no cash reserves and has always paid out most of its earnings as dividends. This is also the case for NML.

KC suggested a medium-term bank loan, but SC rejected this stating that the current gearing levels of the two companies were reasonably high, and was close to covenanted limits.

NC suggested withholding the dividends, or reducing them, for a year or two to finance these costs. SC said he was concerned that the end position for the NML transaction was for DSL to be a listed company, which meant external shareholders in the not too distant future – putting pressure on dividends being maintained. KC responded by saying that 'surely any new shareholders will appreciate that the retention of earnings will ultimately help create capital growth. I would assume withholding for this reason would be seen as good news by them rather than bad'.

SC agreed to explore all possible sources of finance and report back to the board in due course.

There being no further business, the meeting ended at 17:00.

QUESTION 3

GHF Farms Limited (GHF) grow, harvest and export tobacco for supply to major global businesses for use in the manufacture of cigarettes, cigars and pipe tobacco. They are based in the Charsadda district of Peshawar, and are majority owned by a well-respected Pashtun family − the Dawars − who hold aspirations to list the business on Pakistan Stock Exchange in the future. The Dawar family is from a farming background and provides accommodation for their workers. They contribute to their workers' general wellbeing, for example assisting with medical bills should assistance be required. They also contribute to the local community, and fund the provision of primary education for the local children.

The latest generation of the Dawar family have various legal and business qualifications, and now help to run the family business.

Performance has been suffering a little in recent years despite generally rising (if volatile) farm-gate prices and this is, in part, due to significant theft. It is normal to expect and accept a certain amount of theft, however the volume of thefts is rising significantly. Appendix 1 summarises recent financial performance. Appendix 2 is an extract from a 'business overview' document originally prepared in support of a bank-loan application.

The current CEO – Karim Dawar – is a qualified Chartered Accountant. He and the younger board members share an aspiration to get GHF listed. As such, Karim has encouraged the family to adopt corporate governance best practices. Half of the board is made up of independent non-executive directors, who form various board subcommittees – audit, nominations and remunerations committees.

The audit committee currently overseas risk management, as well as many other matters. They struggle to find the time to consider formal risk management in detail. Karim is concerned that this might be the underlying reason why theft is going unchecked, and is considering the formation of a separate risk committee to include executive directors.

An opportunity has arisen for a contract to supply product to a high-tech tobacco business that is developing products less harmful to human health (for example heating rather than burning tobacco, also known as 'baking'). However, the research and development involved is expensive, thus the price offered is only 50% of the usual price per tonne. They are looking for a strategic partner so would require 100% of the harvest to be supplied to them exclusively to protect the integrity of their supply chain. Much of its harvesting process would require automated picking and processing, meaning 70% of GHF's current pickers would be made redundant.

Requirements

(a) Evaluate the performance of GHF over the past two years and estimate the impact of accepting the new contract on the short-and long-term results of the business. **(12 marks)**

(b) Discuss the impact on GHF's corporate social responsibility programme of accepting the contract. **(09 marks)**

(c) Evaluate the decision to form a separate risk committee. **(04 marks)**

Total: 25 marks

APPENDIX 1 – MANAGEMENT ACCOUNTS

	Note	31-12-X8	31-12-X7
		------- Rs. in million -------	
Revenue	1	545.0	608.0
Cost of sales	2	(150.0)	(140.0)
Gross margin		**395.0**	**468.0**
Community projects		(45.0)	(40.0)
Worker accommodation	3	(5.5)	(5.5)
Administration		(25.0)	(25.0)
Sales and marketing		(4.5)	(4.0)
Distribution		(85.0)	(82.0)
Operating profit		**230.0**	**311.5**
Interest		(130.0)	(130.0)
Profit before tax		**100.0**	**181.5**
Tax at 21%		(21.0)	(38.1)
Profit after tax		**79.0**	**143.4**
Dividends		(100.0)	(100.0)

Note 1: Average farm-gate prices were Rs. 600,000 per tonne in 20X8 (20X7: Rs. 556,000)

Note 2: Includes the wages of 10 pickers at an average wage of Rs. 550,000 per year each. Other than workers' wages, all costs of sale are variable.

Note 3: Includes all costs associated with workers' accommodation for a total of 20 workers – including labourers and administration staff.

APPENDIX 2 – FINANCE DIRECTOR REPORT: BUSINESS OVERVIEW EXTRACT (SUPPORTING A BANK LOAN APPLICATION)

Product
The main product is dried tobacco leaves which is supplied to a small number of major international producers of traditional cigarettes, cigars and pipe tobacco. Annual yield is very dependent on weather conditions and the incidence of disease. Weather and disease levels were however consistent between the years 20X7 and 20X8. Despite health concerns connected with the use of tobacco, demand remains strong and is in fact growing in certain emerging economies.

GHF has a strong reputation for the high quality and consistency of its product, which is tested at the point of delivery by all major customers.

Harvesting methods
Harvest is a very traditional, labour intensive process. The company has not rushed to mechanise the process as it takes its responsibilities for the provision of local employment seriously.

Finance
The business is partly financed by a loan of Rs. 650 million at an interest rate of 20% per annum, due for repayment in 10 years' time on 31 December 20Y8. Dividends have been a steady Rs. 100 million for the last five years. This level suits the personal needs of the owners.

(THE END)