The Institute of
Chartered Accountants
of Pakistan

Multi Subject Assessment Stage

6 June 2023
4 hours and 15 minutes – 100 marks

Management Professional Competence

CRN: | | | | | | |

Name: ______________________________

INSTRUCTIONS

Please carefully read the following instructions:

1. You are required to access your Examination Questions by using your Student ID and Password as mentioned on your Admit Card.
2. The overall duration of the exam is 4 hours and 15 minutes, which includes the reading time and an extra 30 minutes of time that has been allocated due to the introduction of computer-based examinations, for the June 2023 examinations only.
3. All questions are compulsory.
4. Questions can be attempted in any sequence.
5. There is no specific time allocated for individual questions.
6. An auto-save function runs every minute, ensuring that your answers are saved automatically when you navigate between questions or click on the > **(NEXT)** or < **(BACK)** symbols.
7. Each question provides an answer area with a Rich Text Format (RTF) editor for writing your answers. Additionally, below the RTF editor, a spreadsheet is provided to facilitate examinees in doing rough calculations or other workings. **However, please note that any work performed in the spreadsheet will not be considered for marking. To ensure your work is considered, you must copy and paste it from the spreadsheet to the RTF editor.**
8. Work done in the spreadsheet of one question can also be copied into the RTF editor of the same or another question.
9. You may use Microsoft Office applications such as MS Word or MS Excel for rough working. However, please remember that any work performed in these applications cannot be copied into the examination software, and vice versa. Furthermore, any such work cannot be uploaded with your exam for marking.
10. You may use pen and paper for rough work, but please note that pen and paper work should only be done on the last two pages of the question paper that are specifically allocated for this purpose. Remember that any rough work done on these pages cannot be uploaded with your exam for marking.
11. In accordance with the open book policy of this paper, you are allowed to have a maximum of **FIVE** original books duly bound. Please ensure that the books or notes you bring are permissible under the open book policy. Keeping a book or notes that are not permissible will be considered a violation of the use of unfair means policy.
12. An external calculator can be used, provided it is included in the list of permissible calculators issued by ICAP.
13. During the exam, access to any website other than Assessment Master is strictly prohibited. Engaging in such activities will be considered a violation of the use of unfair means policy, leading to disciplinary action.

QUESTION 1

Today is 3 March 20X6.

Multan Communications Ltd (MCL) is listed on the Pakistan Stock Exchange and provides both inbound and outbound call centre services to a range of clients globally. By revenue, 40% of sales have been to Europe, 50% to the USA and the remainder to various countries throughout Asia. All the call centres are located in and around Multan in the Punjab region, with new call centres recently opened in Bahawalpur, Khanewal and Muzaffargarh. MCL historically leases call centre space, but owns the technology used in the centres to facilitate calling.

Outbound calling services may include, for example: telephone advertising campaigns, gathering customer feedback, and product recalls. Inbound calling services may include, for example: providing after sales service contacts for the client's customers, or pre-sales product enquiries. MCL utilises state-of-the-art systems to navigate its call operatives through lists of questions. The questions adapt according to earlier answers to provide more relevant interactions with callers. The call centres also follow up calls using various means of communication – including email and social media messaging services – should follow-up be required. All calls use VoIP (Voice over Internet Protocol) to manage call costs. The business is, therefore, heavily reliant on the availability and consistency of the internet. That said, outages have been incredibly rare for the business, with reliable fibre broadband being common in the region.

The state-of the-art operational systems also gather significant amounts of data to support extensive and detailed reporting to clients. The CRS (Client Reporting System) produces tailored reports for clients, and is capable of profiling callers, not only by their call responses but by linking those responses to other data sources found on client systems and social media platforms amongst others. This helps clients with their decision-making and targeted marketing campaigns. MCL has been approached by one of its existing major clients, who has offered to purchase this information not just from its own campaigns but also from the campaigns of others in its industry, to help its product planning and approach to marketing.

MCL's financial performance has been improving in recent years (see Appendix 1), but foreign exchange gains have contributed significantly to this, leading to large executive and staff bonuses being paid. Clients are invoiced in their domestic currency, but all costs are denominated in Pakistan Rupees. Due to the COVID-19 pandemic, call volumes have increased significantly as many face-to-face interactions have been transferred to telephone (see Appendix 2 for more details). The call centre industry has attracted new entrants with increased competitive pressure as a result. MCL has relatively low staff turnover compared to industry averages, which has contributed to its success as call satisfaction ratings are relatively high. Inflation is high at 25% per annum in 20X5, reflecting a post pandemic 'bounce' and global energy prices.

The finance function has within it a separate treasury function that is currently treated as a profit centre. The treasury function charges other group functions for its services and is incentivised financially (via a generous bonus scheme) to make a profit. Treasury function staff have earned significant bonuses in recent times. The treasury function is responsible for interest rate and foreign exchange risk management, liquidity management, and long-term capital structure.

MCL's internal audit function reports to the head of finance, Ghayas Malik. The head of internal audit recently raised a concern with the level of risk that the treasury function potentially exposes the wider group to. The ensuing discussion is noted in Appendix 3.

MCL is also planning to devise its tax strategy in the context of recent acquisition as explained in Appendix 4.

Requirements

(a) Evaluate the performance of MCL for the year ended 31 December 20X5. **(14 marks)**

(b) Assess whether treating the treasury function as a profit centre is optimal for MCL. **(08 marks)**

(c) Evaluate how the information gathered through operations could be used to create or increase competitive advantage for MCL. **(08 marks)**

(d) Assess whether selling call data is ethical, and discuss possible consequences of selling the call data. **(05 marks)**

(e) Identify the risks associated with the current reporting structure for internal audit, and recommend (with justification) suitable changes. **(05 marks)**

(f) Discuss tax strategies which MCL may consider and advise which strategy MCL should follow. **(10 marks)**

Total: 50 marks

APPENDIX 1 – MANAGEMENT ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 20X5

	Note	31 December 20X5	31 December 20X4
		------- Rs. in million -------	
Revenue	1, 2	35,817	24,544
Call centre staff costs		(14,372)	(10,145)
Site rental		(9,581)	(7,222)
Other (including power, telecommunications cost)		(4,792)	(2,923)
Gross profit		**7,072**	**4,254**
Depreciation		(1,201)	(1,102)
Sales and marketing		(150)	(120)
Head office costs		(1,825)	(1,204)
Other		(772)	(435)
Profit before interest and tax		**3,124**	**1,393**
Interest		(685)	(685)
Profit before tax		**2,439**	**708**
Taxation @ 33%	3	(805)	(234)
Profit after tax		**1,634**	**474**

Note 1: % revenue

	20X5	20X4
Inbound	45%	35%
Outbound	55%	65%
	100%	100%

Note 2: Average exchange rates (Pakistan Rupees per $ or €)

	20X5	20X4
US $	Rs. 231.1	Rs. 202.1
Euro	Rs. 235.2	Rs. 199.8

Note 3: 29% corporate tax plus 4% super tax

APPENDIX 2 – OPERATIONAL PERFORMANCE DATA FOR THE YEARS ENDED 31 DECEMBER 20X5 AND 20X4

	31 December 20X5	**31 December 20X4**
Number of calls (millions)	1433.2	1360.2
Caller satisfaction rating*		
MCL	3.9	3.9
Industry average	3.1	3.3
Staff turnover		
MCL	15%	12%
Industry average	35%	45%
Number of call centres	12	9
Number of call centre staff	14,625	12,500

Rating scale
Scale is 0–5 with 0 = very poor, 5 = excellent

APPENDIX 3 – MINUTES OF MEETING BETWEEN THE HEAD OF INTERNAL AUDIT AND THE HEAD OF FINANCE

Monthly internal audit meeting

Present:
- Head of Finance – Ghayas Malik (GM)
- Head of Internal Audit – Talib Khan (TK)

22 January 20X6

Meeting minutes extract

The internal audit report for December 20X5 was discussed, and all recommendations adopted with the exception of reviewing the treasury function in detail, including its status as a profit centre. GM noted the amount of profit that had been generated by the treasury function, and hailed its performance as a huge success. GM added "that's why I authorised you to do it when you were the financial controller Talib, and what a great decision it has turned out to be! In these turbulent times, the profits generated by treasury have saved our skins with the investors!"

APPENDIX 4 – DETAILS OF RECENT ACQUISITION

FILE NOTE

Prepared by: Ghayas Malik, Head of Finance
Subject: Note forward for tax planning
Date: 10 January 20X6

MCL is currently paying 29% corporate tax rate and 4% super tax. MCL has been paying taxes for many years under Normal Tax Regime.

On 1 January 20X5, MCL acquired 100% shares of Sahiwal Limited (SL), a company engaged in the same business as MCL. SL's financial year end is also 31 December. SL had brought forward assessed tax losses on the date of acquisition. Additionally, SL also incurred tax losses during the financial year 20X5.

The above will need reflecting in tax calculations going forward.

QUESTION 2

Today is 14 February 2023. Sagala Leather Ltd (SLL) is based in Sialkot, Punjab. It takes raw hides from a range of suppliers nationally – mainly cowhides but others are processed as well. SLL then produces leather from the raw hides through to the dressed, coloured leather ready to be used by others in the production of clothing and accessories, including shoes, handbags and belts. This is a long process that involves bating (softening), tanning (to prevent the leather decomposing), dyeing, dressing (stretching and buffing the leather) and finishing (e.g. adding a grain to the surface).

SLL has a good reputation in Pakistan for the reliable production of high-quality leather. SLL has historically sold business-to-business to a small number of large customers in Pakistan who then export around the world. Last year, SLL surprisingly lost one of these large customers that represented 20% of SLL's annual turnover to a competitive overseas bidder from China. This served to demonstrate how exposed SLL is to their current customer base. This loss of a regular customer lead to dividends needing to be halted for the year, and the owners (the Javed family) have asked the board to reconsider the downstream supply chain strategy as a result.

The chief executive officer, Moazzam Hassan, has proposed shortening the supply chain downstream and selling direct to the overseas clothing and accessory manufacturers that SLL's current customers sell to. He argues this will diversify the base to a larger number of smaller customers, as well as diversifying operations internationally, reducing reliance on the Pakistan economy.

The marketing director, Rehan Ahmed, objects strongly to this suggestion: "We have nurtured relationships with our current customers over decades. Trying to bypass them is an abuse of their trust, and we can expect to lose every last one of them when they find out! Our reputation will be ruined!" Nevertheless, Rehan has conducted some preliminary research into the proposition at Moazzam's request (see Appendices 1 and 2). In addition, Rehan has prepared an outline of SLL's current marketing strategy to help the board consider how marketing will need to adapt should the suggestion be accepted (Appendix 3).

In addition, the operations director is concerned that a wider variety of customers will want a wider variety of products, and the current operation may struggle to deliver this. The finance director is, however, a little more supportive of the suggestion, but points out that the suggestion will expose SLL to foreign exchange risk (transaction, translation and economic in nature) that they have not been exposed to before, and says he will seek advice as to the best way to manage this risk.

Requirements

(a) Evaluate the suitability, acceptability and feasibility of the option to sell directly to overseas customers, and recommend whether or not this option should be adopted. **(12 marks)**

(b) Recommend a suitable foreign exchange hedging strategy should SLL decide to sell directly to overseas customers. **(07 marks)**

(c) Assess how the current marketing mix will need to change if SLL decides to sell direct to overseas customers. **(06 marks)**

Total: 25 marks

APPENDIX 1 – PRICE COMPARISONS – CURRENT CUSTOMER BASE COMPARED TO DIRECT SALES

Memorandum

From: Rehan Ahmed
To: Moazzam Hassan
Subject: Downstream price comparisons

Dear Moazzam,

As requested, I have conducted some preliminary research comparing price per 'side' of bovine leather for our current customers, compared to prices we could charge the next stage down the supply chain. It is worth noting that the 'next stage' prices are the result of internet-based research and may not be the final price we achieve. As discussed, our brand is not well known outside Pakistan.

Per 'side' of leather	Price after average discount to current customers	*Downstream price
	---------------- Rupees ----------------	
Grade 1 grained	9,500	16,300
Grade 1 ungrained	6,000	11,000
Grade 2 ungrained	3,800	6,800
Grade 3 ungrained	2,375	4,100

Internet prices found in Europe and the USA, converted at the spot rate prevailing at the time of research.

I hope you find this useful. Any questions, please don't hesitate to ask.

Regards,

Rehan

APPENDIX 2 – MARKET RESEARCH – POTENTIAL GLOBAL CUSTOMER BASE BY LOCATION AND VALUE

Briefing note

Global leather market value and forecast:

Prepared by Maira Aslam, marketing assistant, 22 January 2023.

Revenue share by market in 2022:

Europe	35%
North America	30%
Asia Pacific	22%
Latin America	9%
Middle East and Africa	4%

Global market by product in 2022:

Handbags	12%
Small leather goods/accessories	5%
Apparel	20%
Footwear	48%
Home décor and furnishing	7%
Pet accessories	1%
Automotive	7%

Global revenues in 2022 were US$ 387 billion, with a forecast compound annual growth rate of 6.5% for the coming decade. There was a reduction in demand during the COVID-19 pandemic but this is forecast to be temporary.

APPENDIX 3 – EMAIL FROM THE MARKETING DIRECTOR EXPLAINING THE CURRENT MARKETING STRATEGY

To: The Board, SLL
From: Rehan Ahmed
Subject: Current marketing plan
Date: 2 February 2023

Dear Fellow Board Members,

In order to consider how our marketing approach would need to change should we target downstream customers, I thought it would be useful to outline our current approach as a starting point for discussion at the next board meeting. I welcome your thoughts and questions in the meantime.

Product
Broad range of finishes and leathers, generally of higher quality, specified by the customer. We currently have a small number of large, established customers whose needs are generally well known and predictable.

Price
We price competitively to reflect volume and loyalty to our customers. The quality of leather is high so we accept low % margins on the basis that high volumes will, give us the profits we need. We have typically five-year contracts in place that fix price for that period.

Promotion
We do no 'above the line' advertising. In fact, we do very little advertising of any sort. The majority of our customer base were introduced to us by the Javed family. We have picked up one or two through word of mouth.

Place
We transport in bulk throughout Pakistan to our customers who then distribute overseas. We have no retail operations, and no retail website. We deal with customers face-to-face and email them bespoke price lists. When they place orders via email or phone, we deliver direct to their warehouses.

If you have any questions, then please ask.

Best wishes,

Rehan

QUESTION 3

Duki Fossil Fuels (DFF) is a medium-sized listed business in the Balochistan Province. It has for many years focused on coal mining. Although DFF prides itself on its good safety record, mining is inherently dangerous and there are occasional accidents and miners with health-related issues as a result of their work. DFF is a large local employer – the local community is heavily reliant on DFF for work.

A traditional hazard in coal mining is the presence of methane, a flammable gas. It is released as coal is disturbed and, in its raw form (known as 'coal mine methane' or CMM), it is of variable quality and concentration. Mines traditionally ventilate to release the gas so mining can continue safely. However, methane gas is particularly bad for the environment as a greenhouse gas (having 21 times the effect of carbon dioxide), plus it is also saleable if it can be processed to make it sufficiently pure. DFF have developed and patent-protected an innovative method for capturing the gas from ventilation ducts, and processing it efficiently for bottling sale.

The technology is unique, and was expensive to develop. The board of DFF set up a separate division – the 'Methane Extraction Division' – to develop the technology, and this division is now responsible for commercialising it. Although the new technology has proven its value in a laboratory environment, clear estimates of yields and running costs in the real world are not yet available.

DFF is keen to exploit this technology beyond its own business and is, therefore, looking to divest itself of the Methane Extraction Division. Some information has been gathered by Mazaar Talpur – the head of finance – to produce a valuation of the division (see Appendix 1).

Two potential methods of divestment are being considered: a demerger and a management buy-out. Both were discussed at a recent board meeting (see Appendix 2).

Requirements

(a) Evaluate the issues in valuing the Methane Extraction Division, and recommend an indicative valuation based on the information available. State and explain any assumptions you feel are required. **(13 marks)**

(b) Compare the two proposed methods for disposing of the Methane Extraction Division and recommend which should be adopted. **(08 marks)**

(c) Explain the key corporate social responsibility issues facing DFF, and recommend how they should be addressed. **(04 marks)**

Total: 25 marks

APPENDIX 1 – INFORMATION RELATING TO THE METHANE EXTRACTION DIVISION

Divisional Statement of Financial Position: Methane Extraction Division as at 31 December 20X4

	Rs. in million
Non-current tangible assets	4,012
Intangibles – product development at cost	4,832
Net current assets	127
Intercompany loan	(6,835)
Accumulated losses	(2,136)
	Nil

Divisional Statement of Profit or Loss

	Rs. in million (Dr)/Cr
Depreciation: Non-current tangible assets	(401)
Amortisation: Intangible assets	0
Other operating expenses	(535)
Loss before interest	**(936)**
Interest on intercompany loan	(332)
Loss for the year	**(1,268)**

The intercompany loan would need to be repaid in full if the ownership of the division changes.

Subject to field testing, the following is currently anticipated:

- First year sales potential – assuming the technology is licenced to manufacturers: PKR 5,000 million, growing at 20% per year thereafter
- First year costs – following from the anticipated sales = PKR 4,000 million, growing at 15% per year thereafter

The price to earnings ratio of a 'similar' business is 48 times.

The equity beta to use for valuing this division: 2.1

The current risk-free rate of return is 5%.

The market rate of return is 14.5238%.

APPENDIX 2 – EXTRACT OF BOARD MINUTES DISCUSSING A MANAGEMENT BUY-OUT COMPARED TO A DEMERGER FOR DISPOSING OF THE METHANE EXTRACTION DIVISION

Duki Fossil Fuels: Board meeting 5 January 20X5

Present:
- Chief Executive Officer – Kambar Umrani (KU)
- Chairman – Basharat Jalal (BJ)
- Head of Operations – Murad Mailk (MM)
- Head of Finance – Mazaar Talpur (MT)

Apologies: Bilal Ghaffari (human resources), Eshin Jatoi (IT), Rahson Damanis (marketing and sales)

Minutes:

Agenda item: Divestment of Methane Extraction Division
MM reported that research and development was more or less complete, with field trials due to begin soon. All being well, the division should be ready for sale in a month or two.

MT reported he is working on a potential valuation and will report back to the board as soon as possible.

The board discussion turned to the method of divestment where a demerger and management buy-out were discussed as follows.

Demerger
The division could be moved into a separate legal entity that would either be floated on the stock exchange or sold privately, perhaps to a private equity group who may have expressed an interest.

Management buy out
MM reported that the divisional management team have worked tirelessly to develop the methane extraction technology, and preliminary discussions indicate they would be keen to acquire the division from DFF. The management team would, however, need to obtain finance as their personal financial resources are limited. MT suggested that DFF could potentially lend the team the money to acquire the business with a loan repayable in, for example, 10 years' time.

MM added that the team were essentially all research engineers, with the exception of a financial controller and newly appointed marketing manager. KU asked for an action point to be recorded for Bilal Ghaffari (absent) to conduct an HR audit of the division to consider the ability of the management team to manage a stand-alone business.

There being no further business, the meeting closed at 4.30 pm.

(THE END)