ICMAP Pathway exam

Thursday 15 December 2022

Paper IPE

Time allowed

4 hours including reading, planning and reflective time.

This question paper is an integrated case study with two questions containing a total of 100 marks and ALL questions must be completed.

All questions contain professional skills marks which are included in the marks shown.

Do NOT open this question paper until instructed by the supervisor.

You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

ACCA Think Ahead

The Association of Chartered Certified Accountants

1 Company background

Sinton Bank (SB) was founded in 2013 in Denland, as the country's first digital bank. A digital bank is one where customers can only access the bank's products and services over the internet allowing customers access to manage their money 24 hours a day and 365 days per year.

SB was regarded as a "challenger" bank (a small bank set up with the intention to compete for business with larger, more established banks) to Denland's "legacy" banks (banks that deliver their products and services using a network of physical branches). The legacy banks found it difficult to change due to the cost and disruption of updating their processes and systems. SB therefore challenged these traditional banking norms by offering customers a new, easier, and more efficient way of banking.

SB currently provide both personal and business banking services and are part of the growing "fintech" sector in Denland, which includes financial technology firms, like SB, that use technology to support and enable banking and financial services.

SB was founded by Andy Jackson and Stewart Roper, experienced bankers who were disillusioned with the slow pace of change they experienced whilst working in Denland's legacy banks and believed that technology could provide a more efficient and sustainable banking business model for the future. Their guiding vision was to "change how people accessed and managed their money". Although the founders had both worked for many years in Londeen, Denland's capital city and major financial centre, they decided to establish SB's head office in the north of Denland, where they were both born and raised.

Andy is SB's Chief Executive Officer (CEO) and Stewart is the Chief Technology Officer (CTO). They are supported by five other board directors who each have responsibility for one the following functions: finance, marketing, human resource, banking operations (BO), and technology operations (TO). Andy directly oversees all functions except TO, which Stewart oversees, as this is the largest department within SB with 60% of all SB employees.

Culture at SB

SB is based in a small town called Durpeth and operates from a modern, glass-fronted building on the banks of a river. It occupies the most prestigious office location in Durpeth which is a matter of pride for Andy, as he was born in the town. Given its location in the centre of town, parking is not available for staff, but Andy and Stewart have their own designated parking spaces at the front of the building.

Staff in most SB departments wear formal business wear (i.e. suits) except for the TO team who are very informal and commonly wear jeans and SB branded polo shirts.

When SB was created, the founders wished to create a similar work ethic to what they had themselves experienced in Londeen, where employees were encouraged to show commitment to SB by working long hours, which includes evenings and weekends, and to also relax and socialise with other staff at the end of the working day. The founders believe that this way of working creates a great team environment.

An example social activity is the “weekender” event at 16.00 every Friday, where drinks and snacks are provided for staff to informally meet and chat with their colleagues for the last hour of the working week. Andy often persuades several members of staff to continue into the evening, where they will finish up in one of Andy’s favourite bars in Durpeth, with Andy often recounting the “good old days” in Londeen.

The TO team is responsible for the development and maintenance of the SB technology platform and most employees in the TO team are male. The BO team are responsible for ensuring that the bank has appropriate products available for customers and most employees in the BO team are female. The TO team are led by Simon Williams, who joined SB as one of its first developers. He not only believes that the best developers are male, but also that technology is the key differentiator for SB, and therefore he and his team are more important than other departments and should be rewarded with higher levels of remuneration.

This often leads to disagreement and tension between the TO and BO teams. The TO team are often critical and dismissive of the BO team and are unwilling to involve BO team members in their technology development plans. Although Stewart observes the tension between the two teams, he agrees with Simon Williams that the TO team are more important and generally does not intervene. Over the past year Stewart has started to consider his future retirement plans, which has led to him becoming less engaged in the management of the business and thereby allowing Simon to exert more influence on the TO team.

Although SB has grown to now employ 356 staff, the founders have always resisted the implementation of a formal management system, as they feel that such a system can create unnecessary bureaucracy within the business. They do, however, recognise that they cannot personally manage the current number of staff, so have appointed several of their longest-serving developers as managers to oversee the TO staff.

However, these developers were given limited training for their roles and therefore lack the skills required to carry out such a role. Many of them are not confident, or even interested, in managing others and most prefer to continue with their development work rather than supporting staff. The founder's offered significant salary and bonus incentives to encourage the developers to take on these roles.

Several of the staff within the TO team have recently made complaints to human resources (HR) regarding the absence of any personal objectives and development opportunities. Although Jenny Scott, the HR director, has attempted to address this issue with Stewart, he continues to ignore her emails.

SB has increasing difficulty in recruiting and retaining its staff and, on average, 35% of new joiners leave within their first year with SB, and this figure is nearer 50% for female members of staff. Andy and Stewart have stated that there have always been gender diversity issues across the financial services and technology industries and therefore believes that these issues are not unique to SB.

Television documentary

Recently SB has been approached by a television (TV) production company requesting permission to film a documentary at SB. The production company are producing a series on how the banking sector is changing and wanted to compare what life is like for staff working for a legacy bank in Denland compared to one of the challenger banks. The TV company would like to film at the SB head office for one month.

Andy thinks that this would be a great opportunity for a new audience to become aware of SB and believes that "all publicity is good publicity" which should result in new customers. Stewart, however, is more cautious as it has come to his attention that several current and former SB employees have created an online chat group, where they have shared stories about what it is like working at SB. Although posts are anonymous, most are not complementary about the working practices and culture at SB.

At a recent SB board meeting where the documentary proposal and the online chat group were discussed, it was agreed that SB should first ask an external consultant to provide a report giving an independent perspective on the current culture at SB. This should then help inform the board's decision on whether to proceed or not with the TV documentary.

Skills shortage in the north

An increasing issue for SB has been the ability to recruit younger members of staff to work for SB in the north of Denland. The south of Denland, and particularly Londeen, is considered more attractive for banking and technology careers, given the greater number of employers and opportunities.

It is anticipated that staff numbers may increase beyond 500, based on SB's short-term growth plans for new customer acquisition in Denland and SB's planned entry into neighbouring countries. Therefore, it is important that SB makes plans on how its future staffing requirements may be met. The founders have asked Jenny Scott for her view, and Jenny has suggested that SB could consider the introduction of a graduate development programme. The founders, however, would like to consider how they can not only attract external recruits but also create opportunities for existing SB staff to move into management roles, and Andy is aware that talent management programs are being implemented by several other challenger banks operating in Denland.

SB shareholdings and proposed listing plans

To raise the initial start-up funds for SB, Andy and Stewart attracted two investors, who remain key shareholders. Its largest shareholder is an overseas bank, TDG Bank (TDG), who was keen to invest in a new fintech bank, to help TDG understand how technology could impact the sector and to inform its own future strategy in its home country. TDG has a representative non-executive director (NED) position on the SB board.

The second key shareholder is Higham Investment Fund (HIF), a venture capital fund specialising in fintech, which has traditionally invested in similar start-up organisations usually for a period of 3-5 years. HIF has retained its investment in SB for longer than usual as it anticipated significant future growth and profits but has acted in a more passive role than TDG given its larger portfolio of investments. Recently, however, Andy is aware that an analyst at HIF has produced a report recommending that HIF should consider a sale of its investment in SB during 2023 due to predicted future trends for the sector.

Currently TDG owns 35% and HIF owns 15% of SB's shares, with Andy and Stewart each owning 20% and the remaining 10% owned equally by SB's five functional board directors.

SB was loss-making for its first four years but has made incremental profits since 2017 and 2023 is forecast to be its most profitable year. Andy wants to grow the bank further but believes that SB will require additional capital to make this happen, which the current shareholders are unwilling to provide. Andy has been encouraged recently by two other challenger banks whose value has increased significantly following recent funding rounds.

Andy thinks that the time is now right for SB to become a listed company in Denland, and would like to proceed with an initial public offering (IPO) during

2024, which would require all existing shareholders to agree to sell up to 50% of their shareholding in SB. Andy is mindful that a decision to proceed with an IPO will therefore need shareholder support and would like to understand how each of the shareholders may view a proposed IPO, to help him clarify whether they will support or object his proposal.

Golf sponsorship opportunity

SB has recently been approached by one of its employees to see if SB would be willing to support their son as he embarks on a career as a professional golfer. Stewart has provided Andy with the background to this request in exhibit 1.

External advice

You are an external consultant and qualified accountant hired by Andy to provide advice on several issues and opportunities facing SB. In addition, Andy has not had time to respond to Stewart's recent email so has also asked for your guidance, as an accountant, on the proposed sponsorship opportunity.

Exhibit 1: Email regarding a potential sponsorship opportunity for SB

Exhibit 1: Email regarding a potential sponsorship opportunity for SB

EMAIL

To: Andy Jackson
From: Stewart Roper
Subject: Sponsorship opportunity
Date: XXX

Hi Andy,

I have recently been approached by Dave Robins, one of our most experienced developers in the TO team, as his 18-year-old son, Max, is a promising golfer and has recently qualified to play on the Denland professional golf tour. Dave has asked whether SB would be willing to provide Max with financial support to help him become established on the tour.

Max is now ranked number one in Denland for his age and to compete on the tour he will need to incur significant costs, including travel and hotel accommodation, equipment, competition fees and payments for caddies. Dave has suggested that in return for any financial support provided by SB, Max would use the SB logo and branding on all his equipment and clothing, commit to entering a minimum number of tournaments and be active across all SB's social media channels.

As you know I am a big fan of golf and therefore I would certainly be happy to support Max through a two-year sponsorship agreement. I have drafted some ideas below on how such an arrangement could work.

- An initial payment of $10,000 paid to Max at the start of the agreement.
- An annual retainer payment of $25,000 paid to Max at the end of each year of the agreement.
- A requirement for Max to enter and compete in a minimum of 20 tournaments each year.
- If Max finished in the top 10 at any tournament, then he would receive a bonus from SB, equivalent to 10% of the prize money won at the tournament.

I have not discussed this any further with Dave, as I wanted to first discuss it with you, and I know that you may have some queries on how this sponsorship arrangement could be reflected in SB's accounts.

Any further questions please give me a call.

Regards
Stewart

Required:

(a) Prepare a report for the board of directors that:

(i) Analyses the culture at SB;

(8 marks)

(ii) Assesses the potential consequences for SB if this culture is accurately portrayed in the proposed TV documentary and recommends whether SB should proceed with the documentary,

(4 marks)

Professional skills marks are available for demonstrating *analysis* skills when reflecting on SB's culture.

(3 marks)

(b) Prepare a briefing note for Andy that outlines the components of a talent management programme and discusses how it may help SB resolve its potential future skills shortage.

(10 marks)

Professional skills marks are available for demonstrating *commercial acumen* skills in identifying how talent management could help resolve the skills shortage at SB.

(2 marks)

(c) Prepare an email to Andy that evaluates whether each of the following shareholders would be supportive of the proposed IPO in 2024.

(i) TDG Bank (TDG)
(ii) Higham Investment Fund (HIF)
(iii) Stewart Roper (CTO)
(iv) The five functional board directors

(12 marks)

Professional skills marks are available for demonstrating *evaluation* skills in investigating whether each shareholder would be supportive of the IPO.

(3 marks)

(d) Andy has forwarded you the email from Stewart (exhibit 1). Prepare a briefing note to Andy that discusses how the amounts paid as part of the proposed sponsorship agreement should be reflected in the financial statements of SB.

(6 marks)

Professional skills marks are available for demonstrating *communication* skills in providing clear guidance on how payments should be reflected in the financial statements.

(2 marks)

(50 marks)

2 Company background

During his time working at his fathers' furniture retail shop, Amir Patel identified two major problems with the traditional sofa market (a sofa is a cushioned item of furniture for seating multiple people and is also referred to as a settee or couch): firstly, that sofas were mostly made-to-order, which meant that delivery times to customers were often two to three months, and secondly, that it was often difficult to deliver fully assembled sofas into the homes of customers. Amir felt that the solution was a "sofa in a box", where a sofa could be designed and manufactured in a standard way, delivered using standard packaging, and then easily self-assembled by the customer at home.

Over a nine-month period in 2017, Amir worked with a furniture technician to design, test and produce the first "sofa in a box". His company, Patel Furniture Company (PFC), was created in 2018 to manufacture and market the sofa within PFC's home country of Sharpton. PFC was successful in securing a patent for the innovative design used in the production of its sofas.

Amir's father provided the initial capital for PFC in return for a 50% share of the business but is not involved in the running of the business. The remaining 50% of PFC is owned by Amir.

PFC's only current product – the "sofa in a box" – sells for $1,500 and can be ordered in a range of colours. The sofa is available for next day delivery and can be assembled (and de-assembled) in five minutes by manually connecting the 10 sofa components with no additional tools required. The box that contains the sofa has dimensions that can easily be transported through the doorways of most properties. All PFC's sofas have a six-month warranty period, where damaged sofas may be repaired or replaced.

PFC designs, manufactures, and stocks sofa products in its facility in Sharpton and has achieved significant growth in their first four years of operating and is expected to achieve a turnover of $40 million in 2022. PFC also has no debt and has achieved good profits for the previous two years. PFC has a small team of furniture designers, whose objective is to develop and expand the PFC range of furniture items, using the same key design principles used in the "sofa in a box". The team has developed a new "bed in a box" and manufacture of this product is due to start in 2023.

Distribution channels and marketing

Amir decided that selling through shops was not appropriate for PFC, and therefore targeted sales online through the PFC website. Sales are supported by a social media presence, with communication particularly aimed at young couples and families, who may have both budget and space constraints when buying home furniture. PFC also targeted the increasing trend in Sharpton for people, both young and old, to choose city centre living, where there has been a significant increase in the construction of new apartment buildings.

During the first 9 months of 2022 PFC has trialled a new sales channel - a pop-up shop - which is a temporary retail space opened for a short period of time, often a couple of days, and normally aligned with some form of temporary event. PFC identified potential locations for its pop-up shops at music and lifestyle festivals in rural locations and at themed events and shows in urban locations. Each pop-up shop includes a display of PFC's sofa in all colours, an area that presents how the sofa is delivered and boxed in its 10 component parts, and periodic demonstrations of how to easily assemble the sofa in no more than five minutes.

Customers have been able to purchase sofas at each pop-up shop, and sales made at pop-up shops have been increasing during 2022. However, Amir feels that the major benefit and value of hosting the pop-up shops has been the opportunity for potential customers to hear about PFC and to see and touch its sofas and understand how they are delivered and assembled. He believes that many customers may be purchasing through the PFC website after they have visited the pop-up shops. This, however, is difficult to prove, so to gather evidence on the interest generated in the pop-up-shops, Amir has asked the marketing team to provide data on the social media activity in relation to the pop-up-shops (exhibit 1).

Overseas expansion

Given PFC's rapid growth to date in Sharpton, Amir would like to expand the business further, and he has a long-term vision that PFC can become the largest producer of self-assembled furniture in the world.

As part of this vision, he would like to expand PFC's market coverage into other countries and has identified Sharpton's larger neighbouring country of Durton as the initial target, due to its similar economy and population profile. Amir believes that a joint venture (JV) arrangement would be most suitable to allow PFC to enter the country with a partner, and the intention would then be to buy out the partner in three years' time. He has held initial discussions on a JV structure with a company called X-Furniture (XF), where each company would own 50% of the new JV company. Under the proposed terms PFC would be responsible for the design of the products for the Durton market, with XF responsible for the manufacture, marketing, and distribution of products to the residential market within Durton.

XF is a large business producing modern, contemporary furniture for offices and other commercial clients. This is a highly competitive market within the Durton furniture sector, where margins remain very small. The shareholders of

XF see the current business as mature and do not forecast any future growth. Following recent cash flow issues at XF the shareholders are concerned about the survival of the business and they view the possible JV with PFC as an opportunity to generate additional cashflow which may support the continued operation of XF's core business in Durton.

Before he proceeds further, Amir would like to understand more about the possible problems PFC may encounter in managing the performance of the proposed JV company.

Quality costs

Amir is determined that PFC continues to offer quality products, especially with the plan to produce additional products for the PFC range. He would like to ensure that PFC is continuing to invest in the processes required to maintain what he perceives to be its high levels of product quality. He has recently read a report that companies in Sharpton operating at the highest level of quality will often spend between 10% and 15% of their annual revenue on improving quality processes, often referred to as the Cost of Quality (CoQ).

The finance team has provided a breakdown of the 2022 production and cost data (exhibit 2).

Amir would like to determine, using the data provided, how much PFC is currently spending on its CoQ. He recognises that this may be an approximation, but this should be sufficient to provide a good comparison with best practice in Sharpton.

2022 financial results

PFC achieved good levels of profits in 2020 and 2021 and Amir would like PFC to demonstrate a further increase for 2022, as he sees this as a motivational indicator for both himself and PFC's employees. He is concerned that this may not be possible, as PFC will incur additional expenditure, on both resources and infrastructure during 2022 in preparation for its new product launch of the "bed in a box" in 2023. Amir has therefore proposed some changes to how PFC accounts for its non-current assets, which may have a positive impact on 2022 performance.

He would like to extend the useful lives of all PFC's specialist production equipment from five years to eight years, and to also adjust the residual values on the equipment to be 30% of the original value rather than 10% as currently applied.

His justification is that most of the equipment was originally purchased in 2018, and PFC does not expect to replace this equipment next year as planned, meaning the assets will continue to be used in the production of PFC’s sofas. Given the extended life of the equipment, he also believes that the usefulness, and therefore, value of the equipment is still relatively strong, which supports the change in residual value.

Before Amir discusses this with PFC’s finance team, he would value an external perspective on his proposal.

Advice and guidance on PFC’s business matters
On a recent visit to see his father, Amir briefly spoke about some of the issues that PFC is currently facing. His father recommended that Amir meet with a business consultant that he himself had previously used with his own furniture business.

You are the business consultant. You have recently met with Amir, where he discussed with you the various issues facing PFC and has asked for your advice on these. He has asked you to present a report for him, which he will review before making any further decisions about the future of PFC.

Exhibit 1: Social media posts and followers in relation to PFC’s pop-up shops
Exhibit 2: Quality costs - production and cost data

Exhibit 1: Social media posts and followers in relation to PFC's pop-up shops

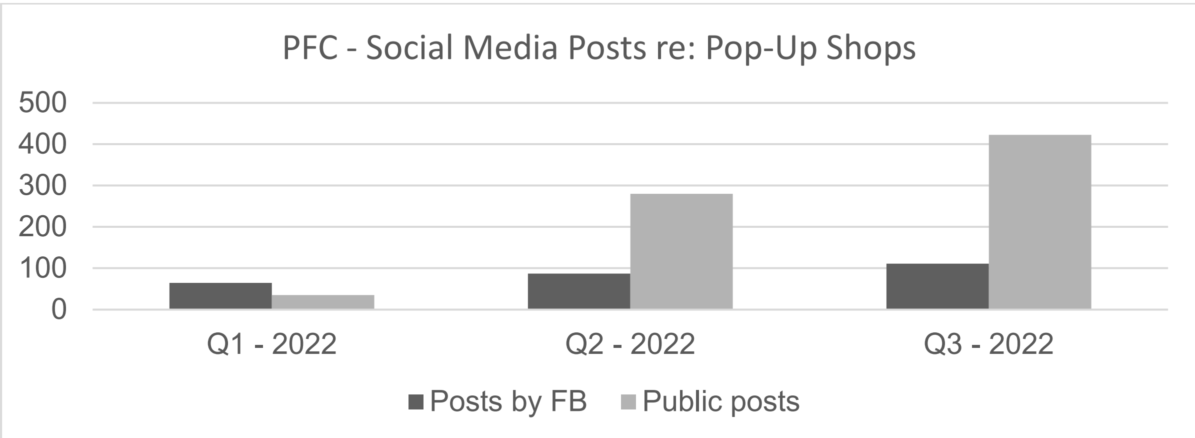
The marketing team have produced the following visualisations of the social media activity in relation to the operation of PFC's pop-up shops during 2022. The key data is explained here:

- Posts by PFC – this includes any posts across PFC's social media channels that made specific reference to one of the pop-up shops. Posts may have been made before, during or following the pop-up-shop at a particular event.

- Public posts – this includes any posts across PFC's social media channels that made specific reference to one of PFC's pop-up-shops and posted by a member of the public. The posts may include posts by existing or new customers of PFC.

- New followers – this includes the number of new people subscribing to follow PFC using one or more of our social media channels. Data from the last two quarters of 2021 has been provided for comparison.

The lines in the visualisations show trends in the quarterly data.



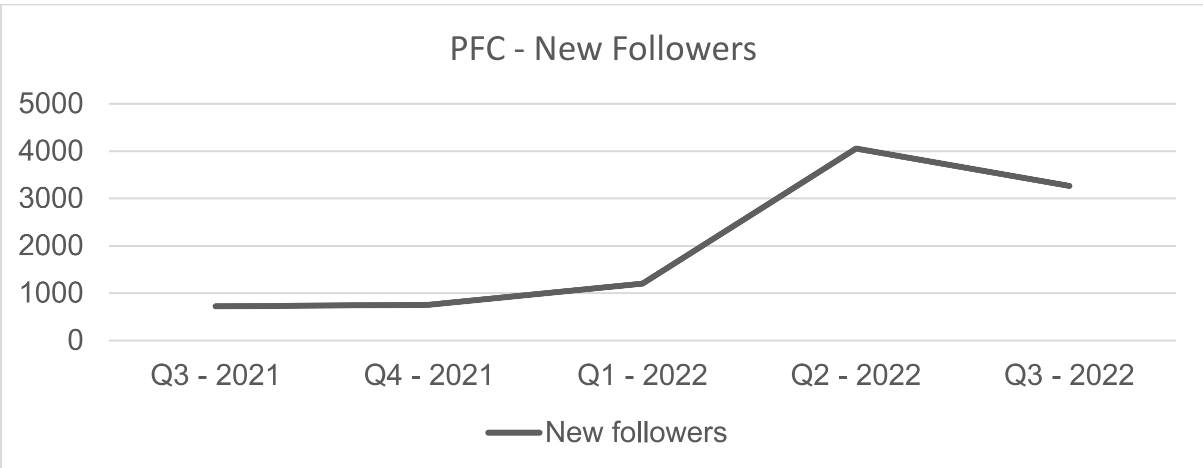


Exhibit 2: Quality costs - production and cost data

The following information relates to trading for twelve-month period up to and including November 2022.

Production data

Number of sofas manufactured and sold	26,523
Number of sofas needing rework before sale	531
Number of sofas repaired under warranty	1,268
Number of sofas replaced under warranty	218
Hours spent on the design of the sofa (design)	7,700
Hours spent on the design of the manufacturing process (process)	4,620
Number of inspection hours during manufacturing	5,305

Cost data

	$
Design cost per hour	65
Process cost per hour	50
Inspection cost per hour	35
Average rework cost (before sale) per sofa	96
Average warranty repair cost per sofa	375
Warranty replacement cost per sofa	1,000
Customer support cost for each sofa repaired/replaced under warranty	100
Transportation cost for each sofa repaired/replaced under warranty	150
Total staff training costs on the importance of quality	62,500

Required:

Prepare a report for Amir that covers the following:

(a) Using exhibit 1, analyse and interpret the social media data that has been presented in relation to PFC's pop-up shops, identifying any additional information that may be useful.

(12 marks)

Professional skills marks are available for demonstrating *analysis* skills in interpreting the social media data visualisations.

(3 marks)

(b) Assess the possible problems that PFC may encounter in managing the performance of the joint venture proposed with XF.

(8 marks)

Professional skills marks are available for demonstrating *commercial acumen* in identifying problems for PFC in managing performance in a joint venture with XF.

(2 marks)

(c) Using exhibit 2

(i) Calculate the following quality costs:

- **Prevention costs**
- **Appraisal costs**
- **Internal failure costs**
- **External failure costs**

(8 marks)

(ii) Compare PFC's total cost of quality (CoQ) to best practice companies in Sharpton, advising Amir on areas that PFC could improve.

(4 marks)

Professional skills marks are available for demonstrating *communication* skills in presenting the quality cost calculations and advice to Amir in a clear and logical format.

(3 marks)

(d) Assess the accounting and ethical issues which arise from Amir's proposal to adjust how non-current assets are reported in 2022. Provide Amir with a clear recommendation.

(8 marks)

Professional skills marks are available for demonstrating *scepticism* skills in discussing relevant accounting or ethical issues in relation to Amir's proposal.

(2 marks)

(50 marks)