

ICMAP Pathway exam

Wednesday 15 June 2022

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.

Paper 1PE

ACCA

Think Ahead

The Association of
Chartered Certified
Accountants

1 **Company background**

Valmine was originally established in 1950 as a government-owned company to mine the natural iron ore resources in the country of Vetland.

Valmine is responsible for the extraction of the iron ore from rock through its operating mines, and then converting the raw iron ore into iron ore pellets. The finished iron ore pellets are then sold to steel-making companies throughout the world. The pellets produced by Valmine are ultimately used in the construction of buildings, bridges, cars, planes, bicycles, household appliances and many other products.

To realise cash from its original investment, the Vetland government arranged for Valmine to become a listed company on the Vetland Stock Exchange in 2018, with the government retaining a 51% share. The remaining shares in Valmine Plc are now primarily owned by institutional investors in Vetland, with a small percentage owned by Valmine's employees.

Valmine currently has 10 mines and four pellet-making plants operating across Vetland and is now one of the world's largest producers of iron ore pellets. In 2021 Valmine produced 350 million tonnes of iron ore.

Valmine has not yet explored the possibility of mining in other countries. It has an exclusive licence from the Vetland government to mine iron ore in Vetland.

Purpose and values

The stated purpose for Valmine is "we view mining as essential to the development of the world and we will do this by taking care of society and the environment". Its key values are to:

- Act with integrity;
- Act responsibly to generate results; and
- Respect the planet and our communities.

Valmine plans to produce its first integrated report for 2022 and will present this to its stakeholder forum in January 2023. Valmine's board has outlined a number of sections it would like to include in this report (Exhibit 1).

Global demand for steel

There has been strong global demand for iron ore pellets over the past few years in the steel industry. A significant proportion of this demand has come from Ceeland, a country which has experienced a rapid rise in industrialisation and is now the world's largest steel manufacturer. 40% of Valmine's iron ore pellet production in 2021 was exported to Ceeland.

The steel industry is currently looking to reduce its carbon emissions by moving to fewer polluting methods of steelmaking, such as hydrogen-based production. This will require a shift towards using only a higher quality of iron ore, such as that mined in Vetland.

The 2021 price of iron ore has reached an all-time high at \$230 per tonne, and although most mining companies have large, fixed costs, the average variable cost of extracting and producing the iron ore pellets is \$50 per tonne. This has meant that mining companies like Valmine are currently able to generate significant profits.

Valmine shipping

Traditionally Valmine has exported its iron ore pellets overseas using a fleet of ships. The current fleet of ships are now approaching the end of their expected lifespan of 12 years and require significant, ongoing maintenance and repair work. This work is undertaken in Altura, a major international port in Vetland, where Valmine Shipping (a division of Valmine Plc), rent space for its ships and operational facilities for its staff.

Valmine has experienced several events in the last two years, where shipping accidents were narrowly avoided, but one month ago there was an accident involving one of Valmine's ships, where one hundred containers carrying a total of 3,000 tonnes of iron ore pellets for a major customer in Ceeland were lost at sea. On investigation there appear to have been multiple reasons for the accident, including bad weather conditions, too many containers on board, tight deadlines for departure and insufficient rest time for crew between sailings.

Future plans

Until 2021, Valmine's Chief Executive had always been appointed by the Vetland government, but during 2021 Valmine recruited its first chief executive officer (CEO) from outside the company, Manuel Sanchez, an experienced director who has previously worked in several other listed companies in Vetland.

Manuel has identified two strategic issues facing Valmine:

Issue 1: Valmine's ability to meet increasing demand

Manuel believes that Valmine needs to identify further locations where iron ore deposits exist, to build more mines and pellet-making plants. The technical staff at Valmine have undertaken exploratory research across Vetland and found seven further potential mining locations, which would also require investment in two further pellet-making plants. The staff have estimated that the combination of the new and existing mines in Vetland could provide sufficient production quantities to meet demand for the next 45 years.

This level of expansion will require investment, and the Vetland government is reluctant to provide any further financial support now that Valmine is a listed company. Before Manuel investigates potential financing options from other shareholders and lenders, he has called for a review of all non-core activities (i.e., activities not linked directly to mining or pellet production) to identify possible savings which could help to fund the development of future mines and pellet-making plants. Manuel has a track record in successfully implementing organisational efficiency and cost savings in his previous roles and is eager to demonstrate his value and impact to Valmine's shareholders.

Manuel has identified Valmine Shipping as an area for potential savings. He believes that an outsourcing agreement with a global shipping company, who could take responsibility for all of Valmine's sea transport needs, could provide significant future savings to Valmine.

There are currently ten ships in Valmine's fleet, all designed to carry shipping containers. Five of the ships have been in operation for 11 years and five for 9 years.

If an outsourcing agreement is established Valmine will need to dispose of their entire fleet of ships, and therefore Manuel would like to understand the potential fair value for the fleet to help support a more detailed proposal.

Issue 2: Diversification away from iron ore

Although the price of iron ore is currently high, Manuel recognises that the market can be volatile, and would like to reduce the sensitivity of the Valmine share price to this market.

Manuel has identified the increasing electrification of the car industry as a potential future market for Valmine. Vetland is a country with large amounts of natural resources and Manuel believes that Valmine could mine for other natural resources, most notably cobalt which is used in the production of lithium-ion batteries. Manuel is a friend of the Chief Executive at Tilson Plc, a large producer of electric cars, and they have recently discussed how a collaboration between Valmine and Tilson could be mutually beneficial.

The proposed collaboration would involve Tilson and Valmine providing equal funding to cover the costs of Valmine researching and exploring for cobalt in Vetland. Once suitable locations for mining are found and licences are approved by the Vetland government, Valmine would export the cobalt to Tilson's preferred suppliers, who would produce the batteries for Tilson. Valmine would operate the new mines with no direct involvement or ongoing financial support from Tilson. In return, Tilson would obtain a five-year contract from Valmine which would guarantee minimum export volumes and a fixed price to Tilson's chosen suppliers. Valmine would only be able to sell to other customers once the volumes required by the Tilson contract had been satisfied.

At a recent meeting with the Chair of the Valmine board Manuel briefly discussed the two strategic issues as part of his CEO business update. The Chair requested that Manuel prepare a report to the board covering the two issues in more detail, in preparation for their next meeting.

You are Valmine's head of finance and you have been asked to provide advice to Manuel on Valmine's integrated report and the two strategic issues he has identified. To assist you, Manuel has provided further information in the following exhibit:

Exhibit 1: Proposed content for the 2022 integrated report for Valmine.

Required:

- (a) Prepare a briefing note for Manuel that analyses the proposed content for Valmine’s first integrated report (Exhibit 1) and comments on its suitability in accordance with the International <IR> framework.**

(10 marks)

Professional skills marks are available for demonstrating *analysis* skills in comparing the proposed content of Valmine’s draft integrated report with the International <IR> framework.

(3 marks)

- (b) Prepare a report for Manuel to:**

- (i) Evaluate the proposal to outsource the transport of Valmine’s exports to a global shipping company and provide an overall opinion on whether this arrangement would be beneficial for Valmine.**

(12 marks)

Professional skills marks are available for demonstrating *evaluation* skills in appraising the benefits and problems of the proposal for Valmine.

(3 marks)

- (ii) Discuss factors for Valmine to consider before entering into a collaboration agreement with Tilson to directly supply cobalt for use in the production of electric cars. Provide a brief conclusion to your discussion.**

(10 marks)

Professional skills marks are available for demonstrating *commercial acumen* skills in identifying and understanding suitable factors to consider for Valmine before entering a collaboration agreement with Tilson.

(2 marks)

- (c) If the board agree to the outsourcing proposal Valmine will need to dispose of its fleet of ships.**

Prepare an email to Manuel that briefly explains the concept of “fair value” and considers on what basis a fair value could be applied to the Valmine fleet of ships.

(8 marks)

Professional skills marks are available for demonstrating *communication* skills in clearly explaining fair value and how it may be applied to the Valmine fleet of ships.

(2 marks)

(50 marks)

Exhibit 1: Proposed content for the 2022 integrated report at Valmine

The following sections have been identified as the proposed content for the first integrated report for Valmine.

Section 1

The Valmine purpose, values, behaviours and strategy.

Section 2

Summary financial results for 2022 including, revenue, margins, EBITDA and assets.

Section 3

Business model covering the various Valmine functions, i.e. research, exploration, mining, production, distribution

Section 4

Governance, to include information on the board of directors, the committee structure, the remuneration policy, risk management and culture.

Section 5

Environmental matters concerning activities at Valmine, including mines, dams, biodiversity, eco-efficiency, climate change and renewable energy.

Section 6

Social matters including its employees, health & safety, the involvement with local communities and the Valmine charitable foundation.

2 Company background

Bam-Khan (BK) is a clothing company that was started by its founder, Jane Khan, in 2010. After finishing university, Jane travelled around the world, and whilst travelling discovered that bamboo plant could be used as a fabric to make clothes. On her return she decided to set up a sustainable clothing business BK, and her first creation was a range of T-shirts made from bamboo fabric. Since then, she has extended the product range to include a complete range of fitness clothing made purely from bamboo fabric.

BK sells its products entirely online and sources all its raw materials from three suppliers in Eastville, a country whose climate is suitable for growing bamboo. All clothing production takes place in two further supplier factories in Southdown, a country in the same geographic region as BK's home country of Northport. All five suppliers have been with BK since it started and BK demands that all suppliers provide a clean, safe working environment and treat their employees fairly in terms of both pay and working hours.

BK's total revenue for 2021 was \$24.2m, with pre-tax profit of 17%. However, the revenue and pre-tax net profit have dropped by 10% and 2% since 2020 and Jane feels that this, in part, is due to her being less involved in the business due to her other external commitments. In response, six months ago Jane appointed a new managing director (MD), Andrew Cox, to develop and grow the business with Jane remaining with BK as an executive chair.

As part of the recruitment process for the new MD position, Jane proposed a bonus scheme for the current year based on targets for improving BK's revenue and net profit. If the targets are achieved Andrew could achieve a bonus equivalent to 50% of his base salary.

The journey from plant to clothing

Bamboo is a plant that can be naturally grown, without the use of chemicals, in forests located in countries with warm climates. It grows quickly and can produce yields up to 10 times higher than cotton, a more traditional plant used for clothing. The bamboo is harvested and transported to factories where it is converted into pulp. The pulp is then turned into a bamboo fibre. This process is carried out by BK's fibre suppliers in Eastville.

This fibre is then sent to BK's manufacturers in Southdown, where it is processed into fabric and used to create clothing based on the designs provided by BK.

The bamboo harvest normally takes place twice per year – in February and August – with clothing orders then shipped to BK in May and November. BK provides designs and forecast demand figures every six months when it places its supplier orders with no changes permitted after orders have been placed. For example:

	Summer season	Winter season
BK provides designs and demand figures to suppliers	December	June
Harvest of Bamboo	February	August
Bamboo converted to pulp and then to bamboo fibre	March	September
Clothing manufacturers convert fibre into finished clothing	April	October
Finished products delivered to BK	May	November

BK's mission and 2025 environmental goals

BK's mission statement is "to be a financially viable and environmentally sustainable business that offers an excellent product and service".

BK promotes itself as an ethical and sustainable business, not just using bamboo as its main fabric, but also throughout everything it does as a business. To support this position BK has achieved significant progress towards its four environmental goals for the next 3 years.

- Carbon – BK is committed to net zero carbon by 2025;
- Waste – BK is committed to zero waste to landfill by 2025;
- Pollution – BK is committed to zero pollution from its factory production by 2025;
- Plastic – BK is committed to removing all plastic from its packaging by 2025.

Jane ensures that the mission and goals for BK are regularly included in her company update sessions with employees. These briefings also provide Jane with an opportunity to introduce the mission and goals to BK's new employees, where she is keen to check their understanding and receive any feedback.

Supplier communication

Traditionally senior managers from BK have visited Eastville and Southdown on a regular basis to meet with their suppliers. These visits have always been valuable to BK and the suppliers. The main purpose of the visits was to discuss plans, including product volumes and garment designs, and to then place orders. In addition, the visits enabled Jane to build a good relationship with suppliers and to update the suppliers on BK's future strategy. Outside of these visits all orders, contracts, and queries are dealt with through emails exchanged between Jane and the suppliers.

When Andrew joined BK, Jane passed over responsibility for managing BK's suppliers, which included the supplier visits and all on-going communication. However, in practice, the suppliers have continued to email Jane and she has continued to respond, often without informing Andrew.

To support BK's environmental goals, Jane believes that the physical visits should now stop and would like to investigate how a cloud-based procurement system could be introduced to allow BK and its suppliers to trade more efficiently and be more environmentally friendly.

Kingdom Clothing

BK have received an increased number of customer complaints in the last 12 months. The complaints are about the quality of BK's clothing. BK's customer satisfaction score has dropped from 95% to 82% and customers have been sharing their negative experience on social media, which has led to an estimated 5% decline in sales.

Jane has spoken with all BK's suppliers on this issue, who have assured her that both the raw materials from Eastville and the finished clothing from Southdown continue to be at the same quality levels as previously supplied.

In response, BK decided to appoint an additional supplier for a summer clothing range that it has designed for 2022, for BK to compare the quality of different clothing products across its supply chain. Andrew Cox had recommended Kingdom Clothing (KC) as an alternative clothing supplier when he joined BK as he had dealt with them before. Andrew visited the KC factory in Southdown and approved KC as a clothing supplier. A contract has been agreed between BK and KC for the summer clothing range and an additional clothing range later in the year – this additional clothing range would usually have been supplied by one of BK's existing suppliers.

The first batch of products produced by KC have recently been received and inspected by BK's warehouse team and are now available for sale on the BK website.

One of BK's existing suppliers, Southdown Clothing Company (SCC), has sent an email to Jane expressing concern at BK's decision to place an order with KC and has made certain allegations about the materials used by KC and its production process (Exhibit 1).

You are a qualified accountant and have recently joined BK as its financial controller from a rival clothing retailer. You report to Jane, and she has invited you to a meeting to discuss your initial impressions and observations about working at BK and to seek your advice on several strategic issues.

Required:

- (a) In preparation for your meeting Jane has asked for your view on the company's mission and goals.

Prepare a briefing note to Jane that critically assesses the BK mission statement and the environmental goals and recommend FIVE performance measures that you believe could be used to track whether BK is succeeding in achieving its mission.

(12 marks)

Professional skills marks are available for demonstrating *scepticism* in challenging the BK mission statement and environmental goals.

(3 marks)

- (b) **Prepare a report for Jane that demonstrates how the use of a cloud-based procurement system will benefit BK and allow its suppliers to trade more efficiently and support its environmental goals.**

(10 marks)

Professional skills marks are available for demonstrating *commercial acumen* skills in identifying how the use of cloud-based technology will be beneficial for BK and its suppliers.

(2 marks)

- (c) Jane has asked for your advice on two issues. Firstly, she has forwarded you the email that she has received from SCC and asked for your advice on this matter. Secondly, Jane is unsure whether she has used the most appropriate criteria for the MD's current bonus scheme, and would therefore like your opinion, given your previous retail experience.

Provide a confidential briefing paper to Jane that:

- (i) **Evaluates the implications for BK of the issues raised in the email (Exhibit 1) from the owner of SCC. Recommend actions that Jane should consider as a result of your evaluation.**

(10 marks)

Professional skills marks are available for demonstrating *evaluation* skills in assessing the implications for BK of the allegations made in the email from SCC.

(3 marks)

- (ii) Assesses why the current MD bonus scheme is not appropriate and proposes alternative criteria that would be more suitable for BK**
(8 marks)

Professional skills marks are available for demonstrating *analysis* skills in assessing why the current MD bonus scheme is appropriate for BK
(2 marks)

(50 marks)

Exhibit 1: Email from Southdown Clothing Company to Bam-Khan

Email – Confidential

To: Jane Khan, Bam-Khan

From: Southdown Clothing Company (SCC)

Subject: BK's decision to appoint Kingdom Clothing

Date: XXX

Hi Jane,

I hope you are well.

It has come to my attention that Bam-Khan has recently appointed Kingdom Clothing (KC) as a supplier. There is a relatively small community of clothing manufacturers in Southdown and therefore the informal network that exists between us always ensures that news of any new contracts is shared.

As you know SCC has been supplying BK for 12 years and I feel that we have developed an excellent working relationship over these years, built on trust and a similar work ethos.

We know that BK is a fair organisation and likes to do business in a way that can satisfy key stakeholders, including shareholders, employees, customers and, from our perspective, suppliers. We also know that you care for the environment, which is why we are so grateful to work for you and use materials that are more sustainable and processes that try to limit environmental damage.

However, given this background to how you operate, your decision to appoint KC is worrying. KC operates a factory environment that is both unclean and dangerous, with equipment and machines that are old and in need of repair or replacement.

The conditions for staff are appalling, with limited health and safety measures in place, and long working hours for many of its machinists. Pay is low, even by the standards often seen in Southdown.

Although you will obviously be supplying the raw material fibre to KC, as you do with your other supplying factories in Southdown, the accessory materials (i.e. buttons, zips etc) required to produce your clothes will be of an inferior quality at KC, given their desire to always cut costs wherever possible.

KC has been forced to terminate contracts in the past due to quality issues, deadlines being missed and a general lack of communication with its customers. I am therefore surprised to see that KC has passed the supplier selection process that I would expect BK to perform.

Given our long and successful trading relationship I wanted to email you personally. We would obviously like to continue working with BK and are proud of our working relationship and track record, but I am concerned that the appointment of KC demonstrates a change in strategy for BK, and therefore would politely request a response from you.

Regards

Owner
Southdown Clothing Company