STRATEGIC BUSINESS MANAGEMENT **July-August 2024**

Time allowed- 3:30 hours
Total marks- 100

[N.B. - The figures in the margin indicate full marks. Questions must be answered in English. Examiner will take account of the quality of language and of the manner in which the answers are presented. Different parts, if any, of the same question must be answered in one place in order of sequence.]

Marks

1. The Global Recycling Standard (GRS) is an international, voluntary standard that sets out requirements for the certification of recycled content in products. Developed by Textile Exchange, a global non-profit organization focused on sustainability in the textile and apparel industry, the GRS aims to promote the wide use of recycled materials and encourage transparency and integrity in recycling and supply chains. Also, the Recycled Claim Standard (RCS), developed by Textile Exchange, provides a clear framework for verifying the recycled content of textiles and apparel products globally. They establish certain criteria for assessing the recycled content of products and verify compliance through regular audits and inspections. These certifications provide assurance to consumers and businesses along with investors that products claiming to contain recycled fibres meet certain environmental and social standards.

Regulations concerning recycled fibres vary across different regions and industries worldwide, but they generally focus on ensuring the quality, safety, and environmental sustainability of products made from recycled materials. These standards often specify criteria for the percentage of recycled content, the types of materials that can be recycled, and the processes used to collect and process recycled fibres.

These regulatory frameworks and responsible bodies work together to establish guidelines, conduct audits, and provide certification to ensure that products claiming to contain recycled fibres meet established standards for sustainability and quality. Compliance with these regulations and certifications helps businesses demonstrate their commitment to environmental stewardship and meet the growing demand for eco-friendly products.

For instance, in the United States, the Environmental Protection Agency (EPA) and the Federal Trade Commission (FTC) may regulate certain aspects of recycled fibre usage and labelling. In the European Union, again the European Commission sets regulations regarding the use of recycled materials in products, and they will enforce it and ensure before buying any product from exporters globally in upcoming years. Overall, these regulations and responsible bodies aim to promote the use of recycled fibres as a sustainable alternative to virgin materials, while also ensuring transparency and credibility in the marketplace.

The GRS and the RCS set the criteria for the third-party certification of recycled materials and chain of custody. The GRS includes a higher (50%) minimum recycled content percentage and additional social and environmental requirements related to processing and chemical use.

The RCS and GRS have three main objectives:

1. Align definitions of “recycled” across different applications.
2. Verify recycled content in products.
3. Give brands and consumers a means to make informed buying decisions.

The GRS has additional aims:

4. Reduce the harmful impact of production on people and the environment.
5. Provide assurance that products are processed in a more climate-friendly way.
6. Encourage higher proportions of recycled content in products.

Recycled Limited, a subsidiary of global textile giant, started its commercial operations in Bangladesh in January 2020, emphasizing the upcoming need for recycled fibre products globally.

The principal activity is to carry out the business of collecting, processing, recycling, selling of all types of recycled artificial, synthetic, natural cotton raw materials and any other type of fibrous material wastes. At present, the Company has three major product lines. Geographically, 85% sales are made in Bangladesh (as deemed export against of foreign currencies) and the remaining 15% is made to foreign countries.

The Company is facing recurring net loss and does not have formalised internal controls as it is still relatively new. Management is trying to create a standard internal control policy and culture throughout the entity. Also, the company is facing tax rate dilemma where they are paying regular rate of corporate income tax (30%) despite being a deemed exporter (though deemed exporters pay a reduced tax rate) as current tax legislation does not specifically address suppliers of recycled materials to exporters.

Management is actively engaging with regulatory authorities to resolve this.

As material recycling technology is still evolving and industry awareness is developing, costs remain high and domestic demand is still low. Finished goods inventory is building up. The company has a clear vision to become industry leader by 2030 and banking on upcoming regulation preventing EU and US buyers not buying products made from virgin fabrics. In the meantime, the company's parent issues support letter pledging to continue financial and non-financial support to the company for the foreseeable future.

Below are some financial highlights of the Company: (all amounts are in BDT million)

Particulars	**Year 1**	**Year 2**	**Year 3**
Tax on gross receipt (Minimum tax on gross receipts)	19,600	20,500	27,000
Withholding tax (Suffered at source)	32,500	41,000	39,000
Regular tax (Based on calculated taxable income, @30% tax rate)	12,000	15,000	21,000
Tax base of PPE (@30% tax rate)	10,500	11,000	9,000
Accounting base of PPE	7,000	9,000	6,500

Requirements:

a) Briefly describe prospects and challenges faced by the recycling industry in Bangladesh. 4

b) What are initiatives the government may take to boost the recycling industry? 4

c) What are the main essences of IFRS Sustainability standards 1 and 2? 3

d) Comment on the implications of deferred tax in the above scenario as per IAS 12? 4

2. a) Energy Ltd, an energy company, offers a diverse range of products including Solar Panels, Wind Turbines, Natural Gas Generators and Hydroelectric Power Systems. The Company is performing well in many matrices compared to competitors in recent years. Recently the company's Board initiated a strategic review including discussion of the competitors' action and market trends etc. As part of this process, the company's management team seeks to analyse the current performance of these products and determine their strategic positions in the market. Below is the summary of recent growth and market share:

Product	**Growth (%)**	**Market Share**
Solar Panels	10	20%
Natural Gas Generators	15	30%
Wind Turbines	20	35%
Hydroelectric Power Systems	5	10%

Also, several years ago the company bought a substantial plot of land in the northern area of Uttara, Dhaka where it now operates a parts service and repair workshop. Recently, the Government of Bangladesh has issued a notice declaring its intention to acquire this land for a public infrastructure project such as roads, utilities, or public facilities that are deemed essential for the community and city development. The acquisition is conducted under relevant provisions of the Land Acquisition Act, which empowers the government to compulsorily acquire land for public purposes upon payment of considerable compensation to landowners.

The Company had engaged in discussions with the relevant government authorities to understand the scope of the project, timelines, and potential compensation, considering perceived market value, development potential and investment made by the company to date. After various discussions, both parties have in principle agreed on a significant compensation amount.

Requirements:

i) Analyse the product portfolio of the Energy Ltd as per BCG matrix and draft some suggestions for strategic decisions. 5

ii) Comment and analyse the above land acquisition proposition considering PESTEL framework. 5

b) ORGANIC Group competes in the natural and organic food industry where its main focus is to differentiate itself from competitors in ways that create value for which target customers are willing to pay. By developing and using capabilities and competencies to produce and distribute unique types of natural and organic foods, ORGANIC differentiates itself from competitors. The company's strategy attempts to utilize the advantage of a newly evolving preference for food that is healthier and, in some cases, more responsive to environmental challenges among some consumers.

The founding CEO of ORGANIC set the mission to facilitate people look for a transformation in the choice of healthier food and lifestyle. From the beginning of its journey, the company achieve growth by acquiring a series of small and start-up organic and natural food production firms ranging from vegetables growers to producers of teas and juices. The firm's successful acquisition strategy has focused on buying brands started by someone else and then figuring out how to grow them from there. Successful acquisitions have made it the largest supplier of organic foods in the country, and a globally renowned brand for organic food lovers. The company supplies its products through existing groceries. As the demand for organic food has been growing globally, this company could maintain positive growth rate of earnings and sales revenue although most of its competitors faced a stagnation in sales growth. Besides, stock prices of ORGANIC have also climbed.

To deal with the slump in revenue and earnings, large branded firm companies are implementing different strategies. As such some competitors acquired related companies to enter into pet-food segment and diversify earnings. On the other hand, some companies attempted to remove artificial ingredients such as colors, fructose syrup, saturated fats and dyes from candy, chocolate and snacks. However, these changes do not allow firms to overcome the problem of rapidly changing consumer preferences toward organic and natural foods.

Other known brand grocery stores in the industry like Fresh, Farmers, Greens are also seeking to enter the natural or organic segment. Given its commitment to using the cost leadership strategy, Green's decision to introduce low-priced organic foods is not surprising. Green is joining with independent producer in the natural food segment to procure about 100 organic products into its store and the new items will be priced 25 percent lower than competing national organic brands. Competition from a firm with success using the cost leadership strategy (such as Green) will challenge ORGANIC to emphasize the value of differentiated products to customers wanting to purchase natural or organic food.

Besides, the restaurants also present a growing trend toward organic foods. More and more restaurants are committed to deliver customers with foods with local and sustainably produced organic products and using meats from naturally raised animals instead of cattle raised in factory farm. However, ORGANIC faced unimpressive sales growth in recent years that prompted its desire to sell organic meat unit and focus on other existing business areas.

Requirements:

i) Referring to above case, provide some examples of the competitive dimensions on which ORGANIC focuses while implementing its competitive strategy. On what environmental trends did ORGANIC base its business-level strategy? What environmental trends could have a negative effect on this firm's strategy in the future? Why? 6

ii) What are the most serious competitive challenges you anticipate ORGANIC will face over the next ten years? In your view, how should the firm respond to these challenges? 4

3. a) Assume that Rainbow company hired you as an analyst. For the following five factors, determine if the given change or level of that factor would lead you to believe that managers at Rainbow are more or less likely to engage in earnings manipulation:

i) Days Sales in Receivable Index increases 1

ii) Gross Margin Index decreases below 1 1

iii) Asset Quality Index increases 1

iv) Depreciation Index decreases to below 1 1

v) Leverage Index increases 1

b) Height Construction Company expects that it will receive a large order from a European country. If Height Construction Company gets the order, it will receive about 3 million euros. However, the company pays all of its expenses are in dollars. Therefore, Height Construction Company would like to hedge this position. Height Construction Company has contacted a commercial bank, with brokerage subsidiaries that can help it hedge with foreign exchange derivatives.

i) How could Height Construction Company use currency futures to hedge its position? 1

ii) What is the risk of hedging with currency futures? 1

iii) How could Height Construction Company use currency options to hedge its position? 1

iv) Explain the advantage and disadvantage to Height Construction Company of using currency options instead of currency futures. 2

4. a) In macroeconomics, crawling peg is an exchange rate regime that allows currency depreciation or appreciation to occur gradually. It is usually seen as a part of a fixed exchange rate regime. The system is a method to fully use the key attributes of the fixed exchange regimes, as well as the flexibility of the floating exchange rate regime. The system is shaped to peg at a certain exchange rate value, but at the same time is designed to "glide" to respond to external market uncertainties.

Recently, Bangladesh Bank has rolled out a plan to introduce an interim crawling peg system for the Taka to regulate abrupt fluctuations against various major currencies, paving the way towards a fully flexible regime in the foreseeable future. The system will be tethered to a carefully chosen basket of currencies within a defined band corridor, BB said in a monetary policy statement. Expert says that this would be a relatively transparent mechanism and much more aligned with the market conditions prevalent in the country. It would establish transparency and bring stability in the foreign exchange market.

A prominent banker said, "we need to wait for details of construct of the benchmark or reference rate. However, it is clear that the intention is to move to a market-based rate over time and this is a step in the right direction." Since this framework would be implemented by BB itself, it can create a legally binding obligation for compliance on the commercial banks.

Requirements:

i) Describe the benefits of and challenges in implanting the crawling peg model in Bangladesh economy. 5

ii) As a CFO of a company, describe the implications of the crawling peg system in terms of financial management and financial reporting. 5

b) Star Ltd is a reputed multinational company and has been maintaining a funded gratuity scheme for its employees. The investment manager of Star Gratuity Fund is concerned that prices of share of its portfolio will fall over the coming months and wishes to hedge against this using June stock index options. The fund's portfolio comprises investments, which have a value of BDT 4,000,000 on 1 January 2024.

On 1 January, the following options are available for the hedging:

Index Option (*4,000) BDT 10 per full index point

	3800		**3900**		**4000**		**4100**		**4200**	
	Call	**Put**	**Call**	**Put**	**Call**	**Put**	**Call**	**Put**	**Call**	**Put**
Jan	110	40	120	45	70	75	55	95	40	110
Feb	225	50	140	65	90	85	80	125	80	140
Mar	200	70	160	85	110	115	120	155	110	150

*Underlying index value.

Requirement:

Calculate the net value if the portfolio value falls to BDT 3,800,000, and the index drops to 3,800 on 30 January 2024. 5

c) A Bangladeshi company owes a Qatari creditor QAR 13,600,000 in three months' time. The spot exchange rate is QAR/Tk 32.5509 – 32.5548. The company can borrow in Taka for three months at 2.15% per quarter and can deposit QAR for three months at 2.5% per quarter.

Requirement:

Define derivative products. What is the cost in Taka with a money market hedge and what effective forward rate would this represent? 5

5. a) Several years ago, Confidence plc, a listed company, suffered a large fall in annual profits. A new Chief Executive Officer (CEO) was appointed. He was very successful in restoring the profits of the company and gained a reputation as a top-class businessman.

The chairman of the company retired recently, and the CEO was invited to become the new chairman whilst retaining his position as CEO, in contravention of „best practice‟ in corporate governance. The company explained its non-compliance to investors by stating that there was no individual better qualified for the role of company chairman, and that despite its best efforts the nominations committee had not yet identified a suitable successor as CEO.

As company secretary of Confidence plc, you are aware that several major shareholders are angry about this arrangement and expect it to be temporary so that the best standards of corporate governance are maintained. They have written a joint letter of protest to the board of directors.

Requirements:

i) Explain briefly why it is best corporate governance practice that the roles of CEO and chairman should not be held by the same individual. 2

ii) Discuss briefly the measures that the shareholders might take if their demands for the separation of the roles of CEO and chairman are not satisfied. 3

b) An entity sometimes displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency simply by translating all amounts at end-of-period exchange rates. This is sometimes called a convenience translation. A result of making a convenience translation is that the resulting financial information does not comply with all IFRS, particularly IAS 21: The effects of Changes in Foreign Exchange Rates.

Requirement:

Explain the disclosure requirements when convenience translation is used to display financial information. 3

c) Asma Ltd has two receivables that it has factored to a factoring agency, the NRB Bank, in return for immediate cash proceeds of less than the face value of the invoices for the year ended 31 December 2023. Both receivables are due from long standing customers who are expected to pay in full and on time. In addition, Asma Ltd has agreed to a three-month credit period with both customers.

The first receivable is for BDT 400,000, and in return for assigning the receivable, Ajara Ltd has just received from the factor BDT 360,000. Under the terms of the factoring arrangement, this is the only money that Asma Ltd will receive regardless of when or even if the customer settles the debt; that is, the factoring arrangement is said to be "without recourse."

The second receivable is for BDT 200,000, and in return for assigning the receivable, Asma Ltd has just received BDT 140,000. Under the terms of this factoring arrangement, if the customer settles the account on time, then a further BDT 10,000 will be paid by the factoring agency, the NRB Bank to Asma Ltd, but if the customer does not settle the account in accordance with the agreed terms, then the receivable will be reassigned back to Asma Ltd who will then be obliged to refund to the factor the original BDT 140,000 plus a further BDT 20,000. This factoring arrangement is said to be “with recourse”.

Requirement:

Advise the directors of Asma Ltd on the proper accounting treatment of the monies received under the terms of the two factoring arrangements in the financial statements for the year ended 31 December 2023 in accordance with IFRS 9: Financial Instrument. 7

d) Company X, a payroll processing company, enters a contract with Customer Z, a medium-sized business, to manage its payroll processing for a period of ten years. The contract involves comprehensive payroll services, including payroll calculation, tax filing, and employee benefit administration. As part of obtaining the contract, X incurred initial set-up costs amounting to BDT 5,000,000 which is expected to be recoverable. These set-up activities primarily involve system configuration, software customization, and staff training to ensure seamless payroll processing for Customer Z. Based on historical experience and customer analysis of the industry, X expects that the contract will be renewed for an additional five years, making a total of 15 years.

Company X’s CFO is not certain regarding the recognition of cost incurred for the set up and has reached out to you for advice on the accounting treatment of the costs.

Requirement:

Based on the above scenario, advise on corporate reporting requirement in accordance with the IFRS 15: *Revenue from Contracts with customers.* 5

6. a) You are an audit manager of Enam & Partners and have been assigned to the audit of Jessore Plant Company Ltd (Jessore Plant), which has been an audit client for 6 years and specializes in manufacturing fertilizers in Bangladesh.

The company was introduced to the firm by Mr. Latif 6 years ago when he was a Commissioner at the NBR. Mr. Latif is not a member of the Institute of Chartered Accountants, Bangladesh. However, since his retirement from NBR, last year, he joined the firm as a tax partner to provide tax consultancy services. He has good relations with the client as his daughter is married to the son of the CEO for Jessore Plant.

Mr. Ahmed who has been the audit engagement partner for Jessore Plant for the past 6 years and has recently been rotated off the audit engagement. The current audit partner, Mr. Islam, has suggested that in order to maintain a close relationship with Jessore Plant, Mr. Latif should undertake the role of an engagement quality reviewer this year. In addition, Jericho Plant has requested that Mr. Ahmed assist them by attending their audit committee meetings, as a non-executive director has recently left the company.

Jessore Plant has also asked Mr. Latif and the other partners at Enam & Partners to help them in recruiting a new non-executive director.

Fees paid by Jessore Plant forms 35% of the firm's total fee income (both audit and non-audit fees) and the partners have anticipated that the fees for this year would be greater than last year. Since joining as a tax partner, Mr. Latif has been aggressive in generating revenue for the tax department and does not keep records of his work. He argues that the most important issue is for the firm to generate revenue which he does. Some of the clients have complained about the cash collected by Mr. Latif as part of his consultancy services.

The audit manager for Jessore Plant last year has just announced that he is leaving Enam & Partners to join Jessore Plant as the financial controller.

Requirements:
Using the information above:
i) Evaluate FOUR (4) ethical threats which may affect the independence of Enam & Partners 4
ii) For each threat, advise on how it might be mitigated to an acceptable level. 4

b) Aman & Associates, a reputable auditing firm, was approached by Kumudini Ltd to conduct an annual financial audit for the fiscal year ending December 31, 2023.

Below is the audit engagement letter.
Re: Engagement Letter for the Audit of Financial Statements of Kumudini Ltd

We are pleased to confirm the terms of our engagement for the audit of your financial statements for the year ended December 31, 2023. This letter will serve as our agreement with Kumudini Ltd and outlines the scope of our services, responsibilities, and fee structure. Please review this letter carefully and let us know if you have any questions or concerns.

i) **Audit Period:** The audit will cover the financial statements of Kumudini Ltd for the fiscal year beginning January 1, 2023, and ending on March 31, 2023.

ii) **Audit Fees:** Our fee structure will be based on a fixed fee of BDT 10,00,000 for the audit, payable in two instalments. The first instalment of BDT 500,000 will be due at the commencement of the audit, and the remaining BDT 500,000 will be due upon completion of the audit.

iii) **Timeline for Reporting:** We will deliver the audit report and financial statements to you within two months after the conclusion of our fieldwork.

iv) **Conflicts of Interest:** We do not anticipate any conflicts of interest that may affect our independence or objectivity during the audit. If any conflicts arise, we will address them promptly.

v) **Audit Scope:** We will perform audit procedures in accordance with Generally Accepted Auditing Standards (GAAS) to obtain reasonable assurance about whether the financial statements are free from material misstatement. Specific audit procedures will be determined during the audit process.

vi) **Contingency Plan:** We do not have a contingency plan in place for unexpected disruptions or events that may affect the audit process.

Please acknowledge your agreement to the terms outlined in this letter by signing and returning a copy to us at your earliest convenience. If you have any questions or require clarification on any aspect of this engagement, do not hesitate to contact us.
We look forward to working with you and providing high-quality audit services to Kumudini Ltd. Thank you for entrusting us with this important engagement.

Requirement:
In accordance with ISA 210: Agreeing the terms of audit engagements, discuss FIVE (5) issues with the engagement letter. 7

---The End---