

[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 ripple effect of the 2020 COVID 19 had begun to hurt the Taka 1200 crore A J Paper Ltd like all other business houses in Bangladesh. A J Paper also finding the going tough. The general trend of soaring prices and contraction in demand had started affecting the sale of AJ Paper products also. Its customers were focusing on correcting their inventory positions (using existing stocks materials to keep production line and marketing activities rolling). Consequently, they were not buying much from AJ. Even the investors did not like what they saw – AJ Papers stock fell from Taka 57 on 1 January 2019 to Taka 14 on April 2020. The company is in the midst of economic crisis. Mr. Ahmed Kabir, Managing Director of the Company realized that some strong measures must be taken to extricate the Company from its present crisis. To this end, Mr. Kabir had several brainstorming sessions with the top management team and finally identified the focus areas: Managing working capital flows, cutting costs, and paying attention to employees' productivity.

Moving away from the traditional approach one usually follows during the necessity periods, Mr. Kabir instead of shutting down the Company's plants and cutting production, decided to continue to operate the Company's two plants at Chittagong and Khulna at 100% capacity. To match sales with production, he planned to reach out to newer customer by widening Company' distribution network. He identified packaging boards to be marketed in the rural areas where meltdown was lower effect. As the market conditions are still difficult, company also decided to cut the prices by 2 to 3 per cent. Along with the price cut, its marketing thrust in the rural areas ensured that sales are not impacted much. Net sales remain flat throughout 2019-20, though the profitability of the company suffered because of the lower margins it received from the rural thirst.

For raising capital, the company did not approach banks and investors, rather it intensifies its efforts to recover its receivables from its clients. The efforts resultant in fast recovery of crores Taka. Disputed debts were also settled expeditiously to raise more cash.

To cut costs further, company took steps to improve productivity and reduce its wages bill. Inefficient employees were asked to leave. No new appointments were made unless they are critically important. In addition, employees received lower increments for 2019-20, even Mr. Kabir did not take any increment.

When the global shutdown sent the international price of the pulp the main raw material for the paper industry, crashing from Tk 76,500 per ton in Jan 2019 to Tk 36,500 in December 2019, the company bought enough pulp to last for 9 months as against the policy of buying in the normal course pulp for 2-3 months. According to Mr. Kabir, this decision also resulted in a huge saving.

Mr. Kabir and his senior management team also re-evaluated the organization structure to improve efficiency in the organization.

When all the above strategic decisions had been successfully implemented Mr. Kabir knew that the worst of the company was over. This was also reflected in the gradual in the quarterly profits of the company. Mr. Kabir however, sounded very modest about his stewardship of the company while appreciating his senior management team for the great job done to ride out the slowdown.

Requirements:

- a) Explain with reasoning the corporate strategy A J Paper Ltd., had adopted for its survival. 4
- b) What functional strategies were undertaken by the company to overcome its crisis? 4
- c) State the basic responsibilities of a strategic leader in a business house. Explain whether or not Mr. Kabir provided strategic leadership to the company. 4
- d) What lessons are learnt from the experience of A J Paper to ride out the economic slowdown? 3

2. a) Prepare a checklist for Enterprise Risk Management protocols. 3
- b) You are Chief Financial Officer (CFO) of Surma Bank Limited (Surma), a state owned commercial bank with over 1,000 branches in all important business locations in Bangladesh. The bank has number of branches and outlets in the UK and USA as well. Surma needs to make periodical settlements between local and foreign operators. Net receipts or payments are made in US Dollar.

In a recent meeting of Board Risk Management Committee of the bank, it was resolved to assess foreign exchange exposure risk of the bank with a view to formulate policies to reduce risks. The Chief Executive Officer (CEO) of the bank has asked you to prepare a report on this for discussions in the next management committee of the bank to finalise a memo to be placed to the Board Risk Management Committee of the bank.

Requirement:

Prepare a report for the management committee of the bank explaining main types of foreign exchange risk exposure that are likely to affect Surma Bank Limited and advise on policies the bank could consider reducing exposure of these risks. 5

- c) Appollo PLC is a UK company involved in import and export trade with the USA. The Following transactions are due within next six months. Transactions are in the currency specified.

Purchase of components, cash payments due in three months:	GBP 116,000
Sale of finished goods, cash receipt due in three months:	USD 197,000
Purchase of finished goods for resale, cash payment due in six months:	USD 447,000
Sale of finished goods, cash receipt due in six months:	USD 154,000

Exchange rates (London Market)

	USD/GBP
Spot	1.7106 – 1.7140
Three months forward	0.82 – 0.77 cents premium
Six months forward	1.39 – 1.34 cents premium

Interest rates:

Three months or six months	Borrowing	Lending
GBP (Pound Sterling)	12.50%	9.50%
US Dollar	9.00%	6.00%

Foreign currency option prices (New York market)
Prices are cents per GBP, contract size GBP 12,500

Exercise price (USD)	Calls			Puts		
	March	June	September	March	June	September
1.60	-	15.20	-	-	-	2.75
1.70	5.65	7.75	-	-	3.45	6.40
1.80	1.70	3.60	7.90	-	9.32	15.35

Assume that it is now December with three months to the expiry of March contracts and that the option price is not payable until the end of the option period, or when the option is exercised.

Requirements:

- i) Calculate the net GBP receipts and payments that Appollo Limited might expect for both three and six month transactions if the company hedges foreign exchange risk on:
- The forward foreign exchange market 3
 - The money market 3
- ii) If the actual spot rate in six months' time turned out to be exactly the present six-month forward rate, calculate whether Appollo Limited would have done better to have hedged through foreign currency options rather than the forward market or the money market. 8

3. a) If the benefits of globalization concern the expansion of operations across international borders, why then is it necessary to consider a strong home base? 3
- b) Under what conditions are the four strategic approaches for global level business most appropriate? 4
- c) How can downsizing be used to sustain competitive advantage? 3
- d) AB Ltd. has two manufacturing divisions, A and B, operating as profit centers. A has a production capacity of 3500 units of product A per month, but presently, it produces 2000 units for a special customer S, @ a selling price of Taka 400 per unit (which will not accept partial supply) and 1000 units for B. S has an agreement with AB that A shall not supply to the external market at any price lower than that to S, or it can supply to the market at any price after discontinuing supplies to S. Division B does some further work on A, incurs a variable processing cost of Taka 220 per unit to produce its product B. The monthly fixed costs of Division A is Taka 2,00,000. The monthly fixed costs of B is Taka 1,50,000. Division A's raw material cost is Taka 150 per unit and its variable manufacturing costs are Taka 100 per unit. Variable selling overhead of Taka 50 per unit of A and Taka 70 per unit of B are incurred for sales other than transfers. A had been selling to the outside market at a price of Taka 460 per unit. Due to competition, it has to reduce its price to Taka 380 per unit on the entire supplies if it has to sell any quantity above 2000 units. At Taka 380/unit, its entire output can be sold. B has an outside market price of Taka 800 per unit and can sell up to 2500 units. If A does not supply to B, a close substitute is available in the market for purchase by B at Taka 380, on which some additional work costing Taka 40 per unit has to be done to make it comparable to A. Assume that B will accept partial supply from A and that both divisions have complete autonomy in deciding their strategy and they have the knowledge of costs/revenues/supply conditions in each other's divisions.

Requirements:

Using figures relevant for the following questions and calculations for the monthly period:

- i) Find out the optimal strategy for A - how much to produce each month, how much to supply to external market and how much to supply to B and at what minimum cost to maximize its Divisional profits. 4
 - ii) What would be the range of transfer price per unit and the quantity that Manager of A will try to successfully negotiate with the Manager of B? 2
 - iii) What would be the range of transfer price that the Manager of B would consider negotiating with A? 2
 - iv) As the top management person, what would you quote as the appropriate transfer price to be fair to A and B in their performance evaluation? 3
4. Three years ago, Safwan Ltd suffered a recession along with other firms in the industry. As a result of the poor economic condition, the firm reduced administrative staff by 30%. Top management issued a policy stating that they were trying to create an atmosphere that stimulated creative thinking and some risk taking. This staff reduction eliminated three layers of management leaving division managers responsible for implementing corporate strategic goals. Decisions regarding capital outlays, personnel, product mix and promotion, which formerly were jointly decided by division managers and top management, are now under the authority of division managers. Along with this change, which leaves division managers responsible for the success or failure of their operations, the company instituted a bonus based on these three items for each division manager:
 - i) Division net income
 - ii) Return on investment for each division
 - iii) Achievement of budgeted profit

Safwan Ltd uses a fixed or static budgeting system assembled during the prior year; for the budget to be printed and distributed, it is prepared five months before the operating year begins. Because there are now few top managers and their time is valuable, the budget for each division is not changed after its preparation. As a result of the recent financial downturn, division managers are encouraged to think optimistically when submitting raw financial data for the budget which is translated into the final budget by top management. Rather than express future division performance in realistic terms, many division managers overstate revenues or understate expenses in the hope that conditions will improve. In fact, word has leaked out that the division managers who failed to follow this optimistic approach

were called into corporate offices to explain why they thought conditions would be so unfavorable for their divisions.

Evaluation is made quarterly for each division for all revenue and expense items used to arrive at divisional net income. Since the budget is not adjusted for competitors' actions or the state of the economy, division managers who failed to live within their budgets received unfavorable performance evaluations. Several division managers have been heard to remark that there is no way to win with this system because they are criticized for presenting realistic data, but if they fail to meet the optimistic budgets, they receive no bonuses.

Requirements:

- a) Describe the expected behavior of division managers as a result of the present system of performance evaluation regarding:
 - i) Operating expenses 2
 - ii) Product mix 2
 - iii) Capital outlays 2
 - b) Evaluate whether these behavioral patterns are normal for division managers under the current evaluation system. Why or why not? 2
 - c) Discuss some disastrous long-term effects resulting from performance evaluation plans such as that used by Safwan Ltd. 4
 - d) Outline five features of an evaluation system that would overcome some of the problems inherent in the present system used by Safwan Ltd. 4
5. Shabib & Company is an assurance firm with a diverse range of audit clients. One client, Sarwar Ltd is listed on the stock exchange. You are the engagement partner on the audit; you have been engagement partner for four years and have an experienced team of eight staff to carry out the audit. The most junior member of the audit team, Kalam, has recently disclosed that he has taken out a personal pension plan that invests in many of the major listed companies in your jurisdiction, including Sarwar Ltd.

The audit is made slightly more complicated because Shabib & Company rent out office space from Sarwar Ltd. The total rental cost of that space is about 10% of the total income from Sarwar Ltd. Office space is also made available to other companies including Walker Ltd that, another of your audit clients. You are aware from the audit of Walker Ltd that the company is close to receivership and that the rent arrears is unlikely to be paid by Walker to Sarwar Ltd.

In an interesting development at the client, the Finance Director resigned just prior to the audit commencing and the Board asked Shabib & Company for assistance in preparing the financial statements. Draft accounts were available, although the final statutory accounts had not been produced.

As part of your review of the draft accounts you notice that the revenue recognition policy includes an estimate of future revenues from the sale of deferred assets. One of the activities of Sarwar Ltd is the purchase of oil on the futures market for delivery and resale between 6 and 12 months into the future. As the price of oil rises, the increase has been taken to the statement of comprehensive income. When queried, the directors of Sarwar Ltd state that while the accounting policy is new for the company, it is comparable with other firms in the industry, and they are adamant that no amendment will be necessary to the financial statements. They are certain that other assurance firms will accept the policy if asked.

Requirement:

- Discuss the ethical and professional issues involved with the planning of the audit of Sarwar Ltd. 12

6. RR International manufactures two types of computer chips, RAM and ROM. Both chips are sold in a local market and an overseas market. The following is the latest quarterly income statement:

	Amount in Tk		
	Local	Overseas	Total
Sales	150,000	200,000	350,000
Cost of goods sold	50,000	165,000	215,000
Gross Margin	100,000	35,000	135,000
Marketing expenses	20,000	15,000	35,000
Administrative expenses	10,000	10,000	20,000
Total expenses	30,000	25,000	55,000
Operating income	70,000	10,000	80,000

The management is very concerned with its overseas market because of the low return on sales. Many computer chip manufacturers are retreating from their overseas markets and the demand for computer chips does not seem like it will increase in the near future. Thus, management desires a final analysis of its overseas market so it can decide whether to leave this market. The cost structure is as follows for the individual products:

	RAM	ROM
Sales	Tk 200,000	Tk 150,000
Variable production cost as a percentage of its sales	24%	28%
Variable marketing expense as a percentage of its sales	4%	8%
Sales by markets:		
Local	Tk 100,000	Tk 50,000
Overseas	Tk 100,000	Tk 100,000

All fixed production expenses and all administrative expenses are indirect to the two products and the two markets and are fixed for the period. The remaining marketing expenses are fixed for the period and traceable to the markets. RR's management bases fixed expenses on a prorated yearly amount.

Requirements:

- Prepare the quarterly income statement showing contribution margin and segment margin by markets. 4
- Assume RR International decides to abandon its overseas market under the assumption there are no alternative use for their capacity. Prepare the new income statement based on the preceding information. Should RR International keep the overseas market? 4
- Prepare the quarterly income statement showing contribution margin by products. 4
- Assume that RR International can begin producing a new version of the ROM chip next year. Then, the company will no longer produce the current ROM chip. However, to manufacture the new version, RR International needs to buy a new machine that costs Tk 200,000, has TK 0 salvage value and has a useful life of 10 years. RR uses straight-line depreciation. Besides, the purchase of the new machine, RR will not incur any additional cost if the new ROM is produced. What must be the minimum contribution margin per quarter for the new product to make the changeover financially feasible? 2

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