



## Strategic level case study

### *Wodd*

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Mock exam 6

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### Strategic Level Case Study Exam

This examination is structured as follows.

Section number	Number of tasks	Time for section (minutes)
1	1	60
2	1	60
3	1	60

The time available for each section is for reading, writing and planning your answer(s).

## Section 01

You have received the following email from Marcus Svenson early in the morning.

From: Marcus Svenson, Finance Director  
To: Senior Finance Manager  
Subject: Unrealised gain on biological assets

Hi,

I received the below attached email from Ibrahim Bengassa the Forestry Director (Reference material 1). I am disturbed about many of my colleges on their lack of interest and knowledge on the accounting concepts and the implications of accounting on our share price.

I want a good report that I can convey a firm message to the board of directors regarding a recent issue related to the recognition of the unrealized gain on biological assets. I am specifically not interested in accounting rules since as you know you need not need specific accounting knowledge to ascertain whether a particular disclosure is misleading.

I have attached an extract from the notes to the Financial Statements (Reference material 2) as an ease for your understanding of the detailed accounting concepts behind the recognition of gains and losses of the biological assets followed by our company.

What I want you to include in your report are:

- Should we make a public announcement of this information on the downgrading of the unrealized gain on biological assets? I want you to comment on the ethical issues that you feel are relevant.
- What are the implications on our share price from the announcement? I want your analysis of the factors that will indicate how our share price will change upon the announcement.

I will be awaiting your reply within one hour.

Thanks,

Marcus

## **Reference Material 1**

From: Ibrahim Bengassa, Forestry Director  
To: Senior Finance Manager  
Subject: Downgrading the gain on Eucalyptus trees

Hi Marcus,

I have reviewed and come to conclusion on the matter related to the unrealised gain on biological assets. I am sorry to mention that we have to lower the unrealised gain on biological assets of M\$ 1,108 million which we have recorded in our latest financial statements for the year ended 30 September 2015.

In the last financial statements the majority of the 'Eucalyptus' trees we own were classified as 'Merchantable timber' from their earlier classification of 'Pre-merchantable timber' since they surpassed 15 years of age.

However recently our independent valuers were arguing that given the soil conditions and the weather conditions where the trees were grown, an additional two years were needed for the Eucalyptus trees to be fully merchantable, which in other words to be harvested for selling.

Therefore as you know since the value of the trees categorised under the 'Pre-merchantable timber' class is lower than that of the 'Merchantable timber', the gain on biological assets will be reduced.

On a positive note the benefit is that the financial statements for the year ended 30 September 2015 have already been published and filled in the Marland Stock Exchange as well. My understanding is that there is no need to withdraw them and also since it is almost two weeks now after publishing, and we can carry on without much noise and present updated financial statements on the next quarterly financial statements release.

I am hopeful that the prices of timber would pick up in the coming months and this will improve our gains on biological assets and minimise the reduction caused by this issue.

Regards,

Ibrahim.

## **Reference Material 2**

### **Extracts from the Notes to the Financial Statements**

**For the year ended 30 September 2015**

#### ***SIGNIFICANT ACCOUNTING POLICIES***

##### **5.0 Standing Forests/Plantations**

Standing forests or plantations are recognised as biological assets when the company controls the asset as a result of past events, it is probable that future economic benefits will flow to the company and the fair value or cost of the asset can be measured reliably. Standing forests are measured on initial recognition and at each reporting date at fair value less cost to sell.

Fair value less cost to sell is determined by independent professional valuers on a six monthly basis. Gains or losses arising from changes in the fair value of or from disposal of standing forests are recognised in the Statement of Comprehensive Income.

Agricultural produce harvested from standing forests are classified as harvested timber. Standing forests can be divided in two classifications:

##### ***5.1 Pre-merchantable timber***

Agricultural produce that has not matured to an age and class to be sold as harvested product is classified within this asset class. Pre-merchantable timber is carried at fair value less cost to sell. Once the pre-merchantable trees mature they are transferred to merchantable timber at fair value less cost to sell at the time of transfer.

##### ***5.2 Merchantable timber***

Standing forests are classified as merchantable timber when they mature to an age that the trees can be traded actively in the markets. This asset class does not include harvested trees. The age at which trees are transferred into this class can differ by type of tree. Currently the majority of trees owned by the company are transferred at the age of 15 years. Merchantable timber is carried at fair value less cost to sell.

The valuations of merchantable timber is generally much higher than the pre-merchantable timber.

## Section 02

Further on in the day you receive a phone call from Marcus.

Hi,

Good afternoon!

As you know since our revenue for the latest financial statements have reduced compared to the prior year, and thus our board is actively considering possibilities for improving revenue and to generate a steady revenue growth over the long term. Moving in to the paper production business, which even though is outside our long-term strategy was a potential solution considered by the board in the last week's meeting.

Attached herewith is a profile of a potential paper production plant for acquisition (Paper Craft Ltd) which I received from Peter Sorchi today. Last week Peter and his team have visited the paper production plant and have initiated discussions (Refer Attachment 1).

I need your help with two matters.

- Firstly please identify the key strategic impacts on Wodd, both positive and negative that could arise from this acquisition and evaluate each of them.
- Several arguments that were raised against the acquisition by the Non-executive chairman, Dr Anton Carlov was that the paper manufacturing industry is one of the least sustainable sectors where there was a huge usage of water and emission of greenhouse gases and this will harm the sustainable image of Wodd. I want an explanation on what sustainability really means for our business and how the sustainability of Wodd will be affected by this acquisition.

The final decision on this acquisition will be with the board of directors. However I am more concerned on financing this acquisition since you know financing is a core responsibility for us as finance professionals working in Wodd.

I want you further to identify and discuss the types of potential long-term finance available for Wodd to fund the acquisition of the paper production plant.

I will be waiting for your reply in an hour.

Thanks again!

## **Attachment 1**

### **Profile of Initial discussion with Paper Craft Ltd**

- Name of entity: Paper Craft Ltd
- Type of entity: Limited liability (Private)
- Established: 1910
- Owner: Morris Family
- History: The Morris Family has been in the production of paper for almost a century. Presently the founder's grandson, Martin Morris is the managing director of Paper Craft Ltd.
- Location: North of Marland.
- Issues & Concerns: Several of the machinery used are aged and needs urgent replacement and some machinery needs repairs. The initial audit discovered that the usage of water of the plant is above average industry norms as well as the green house has emissions were at a higher level.
- Opportunities: Land available within the premises for future expansion. The plant is located close to several major forests of Wodd. Highly skilled and long experienced staff available for many of whom are from the nearby towns. Experienced management and supervisors available.



### Section 03

In the evening you receive another call from Marcus.

“Hi,

Thank you for your ideas on the questions related to the acquisition of the paper production plant. It seems that the board might go ahead with the acquisition of Paper Craft Ltd and I have some additional tasks needed by you.

The board is concerned that there will be a major resistance to change for this acquisition which can significantly affect the success and profitability. Many of the workers in the plant have been working for some time in Paper craft and are from the surrounding towns and they might pose a threat to the acquisition both before and after.

I need you to draft a report on the following matters:

Firstly I need to think about the change management issues related to Paper Craft’s managers and supervisors. The management team at Paper Craft is experienced and skilled as well as they have a good relationship with the workers, for which I see as key benefits to drive post acquisition performance. Therefore proper management of change in relation to the managers and supervisors is vital to gain benefits from the acquisition.

Secondly, I need your thoughts on how to motivate and drive performance of the management team at Paper Craft. The management team would play a vital role in the success of Paper Craft and we need to make them achieve their maximum potential.

Paper Craft sells its products to companies located in several countries and it also sets the sales prices in the customer’s home currency to make the products more marketable. This strategy was questioned by our Chairman due to the inherent currency/foreign exchange risks. Therefore finally I want you to comment on why the management of currency risk is critical and what methods are available for managing the currency risks.

I will be awaiting your response within one hour. Thank again”.