AUDIT AND ASSURANCE
Suggested Answers
March-April 2021

1. (a) As several staffs of the firm including the members of my team has joined accounts and finance teal of SAL, it is highly likely that auditor independence has impaired. As the former audit staffs and team members are familiar with our audit procedures, they might try to hide material misstatements to save the company. Moreover, even if audit team finds material misstatements, they may remain silent on the identified misstatement in order to save employment of the firm alumnus. Engagement partner should review whether the audit engagement of Salman Apparels Limited should be continued. If auditor independence is impaired, your firm might choose to resign from the engagement or rotate the engagement to other engagement partners. Engagement partner should also consider whether there is adequate human resource to pull off the engagement.

(b) My firm has been providing accounting and financial statement preparation services to Carnival Limited which is now been acquired by Rejoice Limited which an audit client of my firm. Because of the acquisition, Rejoice will now prepare consolidated financial statements incorporating Carnival financial statements. If my firm audit the Rejoice consolidated financial statements, it would be treated as auditing own work as material portion of the financial statements has been prepared by our firm. In this case it would not be ethical to audit the consolidated financial statements of Rejoice Limited. For current year My firm may audit the standalone financial statements of Rejoice Limited as it would not incorporate any financial information of Carnival Limited. In subsequent year, my firm must forgo either Carnival's financial statement preparation service or auditing Rejoice financial statements. Firm should identify the profitable engagement and forgo other one. In addition, firm must consider issues that might lead to threat to auditor's independence and ethics.

(c) We are auditing group reporting package and statutory financial statements. We have identified some material misstatements which management is refusing to correct in the group reporting package. These adjustments will be corrected in the statutory financial statements. Management has requested us to issue unmodified opinion in both cases.
We must not deviate our audit procedures because of the management request. As the misstatement would be corrected in the statutory financial statements, assuming all other areas are presented fairly, an unmodified opinion on statutory financial statements would be issued. However, in case of group reporting package, it contains misstatements. Now we must consider whether these misstatements are exceeds materiality level provided in the audit instruction shared by the group auditor. If these misstatements exceed group materiality level, an modified opinion will be issued. An unmodified opinion will be issued only in case misstatements are either below group materiality or been corrected.

(d) Sharing client confidential information over social media falls under professional misconduct. Kamal must review the photos taken in the client premises and before sharing he must make sure that no client information is visible in the photos.
As client confidential information was visible in Facebook, it might be possible that some information was leaked out before it was taken down. Kamal should inform he matter to his seniors or managers or engagement partner. Furthermore, firm should notify the client about potential data leak. Kamal should also resign from the engagement team as client might not feel comfortable to share further confidential data.

(e) ***Purpose of DVS:***
Primary objective of DVS is to authenticate the originality of the audit reports and audited financial statements. There are significant anomalies between number of audit report issued by the auditors and the number of audit report regulators receives. This constitutes submission of Fake audit reports by various companies. In order to eradicate the Fake audit reports, DVS has been introduced.
Use of DVC:
Once the financial statement is ready for auditors' sign off, engagement partner will provide necessary information in the DVS from his account and generate a DVC. This DVC will be mentioned after the auditors' signature in audit report and the financial statements.
Benefit to the audit profession:
At present approximately 26,000 companies submit original audit report whereas nearly 125,000 audit reports are being submitted to the regulators. This huge gap is considered as fake report and because of DVS and DVC, it is expected that number of fake audit reports will be eliminated. As a result, demand for original audit report will raise significantly. As a result, number of practicing members as well as practicing firm is likely to increase. Furthermore, audit fees will likely to increase which will lead to increase in audit quality. In addition, as the fake reports will be eliminated quality of reporting will significantly increase tax

revenue to the government. It will be expected that DVS system will benefit not only the audit profession but also entire economy.

2. (a) From the descriptions given in the question it is evident that Shimanto Jute Industries Ltd. (SJIL)
- has not established standard internal control system and
- It has no formal accounting and bookkeeping function established in the company
- It does not maintain various essential registers like production ledger, sales ledger, raw jute purchase & consumption, salary & wages, consumables stores and electricity & power
- and information about installed capacity

As a result,
- It cannot provide proper balance of opening and closing stock of raw jute
- It cannot provide raw material consumptions, WIP and finished goods
- Cost of raw materials, Cost of production not accounted for properly
- Fixed assets are not properly accounted for which made depreciation accounting unreliable.
- Proper record of Export not maintained and subsidy received from government by virtue of export are not accounted for properly.

Observations by ADD review authority
Previous auditor failed to present any acceptable financial statements. When the so called FSs was presented for ADD exemption the following observations were declared by review authority:

i. The quantitative records related to opening stock, closing stock and consumption of raw jute were not provided and could not be verified. The depreciation shown only 1.15%, financial and other expenses claimed in the audited accounts for POI is very low as compared to other companies in Bangladesh.

ii. The impact of cash subsidy granted by GoB in respect of export sales was neither considered in cost nor the same was added to the sales realization to work out the dumping margin

iii. As per audited accounts, the other income includes shopping mall sales, agricultural income and miscellaneous income. Agriculture expenses as claimed by the company has not been considered in COP and therefore, the income is also not considered.

As per above observations cost of production could not be verified/authenticated by the ADD review authority, therefore, ADD exemption application of SJIL was turned down.

Guaranty of successful ADD exemption at sunset review:
Our firm should not go for such arrangements where it has to give guaranty that the set of financial statements and other financial & nonfinancial information prepared by us will come out successful ADD exemption at sunset review.

Conditional Fee Arrangement
The MD of SJIL offered our firm to pay a fixed amount and 0.25% of the estimated exempted ADD. Such fee arrangement in which the amount of the fee is dependent on the attainment of a specific result for the client is called contingent fee. Whether or not accepting such fees constitutes an act discreditable depends, in part, on what services the audit firm is performing for the client and how the result is determined. It might create threats to compliance with the fundamental principles, particularly a self-interest threat to compliance with the principle of objectivity and independence.

However, following factors to be evaluated to assess the level of threats and determine fees:
- The nature of the engagement.
- The range of possible fee amounts.
- The basis for determining the fee.
- Disclosure to intended users of the work performed by the professional accountant and the basis of remuneration.
- Quality control policies and procedures.
- Whether an independent third party is to review the outcome or result of the transaction.
- Whether the level of the fee is set by an independent third party such as a regulatory body.

The professional accountant or firm may take following actions to safeguard against threats such a self-interest threat:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the work performed by the professional accountant.
- Obtaining an advance written agreement with the client on the basis of remuneration.

(b) **Threats to objectivity**

Threats to objectivity might include the following:

The self-interest threat: A threat to the auditor's objectivity stemming from a financial or other self-interest conflict. This could arise, for example, from a direct or indirect interest in a client or from a fear of losing a client.

The self-review threat: The apparent difficulty of maintaining objectivity and conducting what is effectively a self-review, if any product or judgement of a previous audit assignment or a non-audit assignment needs to be challenged or re-evaluated in reaching audit conclusions.

The advocacy threat: There is an apparent threat to the auditor's objectivity, if he becomes an advocate for (or against) his client's position in any adversarial proceedings or situations. Whenever the auditor takes a strongly proactive stance on the client's behalf, this may appear to be incompatible with the special objectivity that audit requires. (And see paragraphs 4.67 *et seq.* (below).)

The familiarity or trust threat: A threat that the auditor may become over-influenced by the personality and qualities of the directors and management, and consequently too sympathetic to their interest. Alternatively, the auditor may become too trusting of management representations so as to be inadequately rigorous in his testing of them – because he knows the client too well or the issue too well or for some similar reason.

The intimidation threat: The possibility that the auditor may become intimidated by threat, by dominating personality, or by other pressures, actual or feared, by a director or manager of the client or by some other party.

Each of the above threats may arise either in relation to the auditor's own person or in relation to a connected person such as a member of his family or a partner or a person who is close to him for some other reason, such as past or present association or obligation or indebtedness.

The safeguards which are available to offset the threats

- Auditors should always consider the use of safeguards and procedures which may negate or reduce threats. Professional code of ethics where appropriate imposes specific prohibitions where the threat to the auditor's objectivity is so significant.

- Chartered accountant's firm should be the first place to develop countervailing activities to provide safeguards to its professionals. Engagement partners should have sufficient regard to encourage practitioners towards objectivity and to effective use of safeguards.

- Chartered accountants are taught to behave with integrity in all their professional and business relationships and to strive for objectivity in all professional and business judgements. Objectivity and independence should not be jeopardies by a CA for short term benefit or gain.

- The quality assurance committee of ICAB also plays a significant role in safeguarding threats to auditors' objectivity by visiting firms to examine compliance with audit regulations. FRC is also a very big institute that help firms mitigating threats.

Steps taken by firms to ensure that threats to objectivity are recognized, documented and mitigated

- Arrangements to ensure that staff are adequately trained and empowered to communicate any issue of objectivity that concerns them to a separate principal.
- The involvement of an additional principal to carry out a concurrent review of audit files and opinion.
- Rotation of engagement partners and staff.
- The evaluation of a potential client when a firm is approached to act, to assess such facts as the integrity of the client's management, company profile, accountancy competence, etc.
- Formal consideration and review of the continuance of all engagements before the firm's name is

allowed to go forward for reappointment as auditor.

An overall control environment, starting with a professional approach towards matters of quality and ethics, and taking in staff training, development and performance appraisal, and the assurance provided by a regularly monitored and evidenced control system.

3. (a) *Risks of Material misstatements due to fraud:*

- **Sales representatives are allowed to reduce price without permission**
  FTL's sales representatives are allowed to negotiate with customer and allowed to reduce prices. They don't have to take permission to reduce the price. As a result, sales representatives might report lower sales revenue but charging full to the customers. Sales representative might take the difference as personal benefit.

- **Lack of segregation of duties in accounts department**
  As company revenue is decreasing, company reduced the number of employees to control the cost. But as a result, there is only two employees in accounts department who are charged with maintaining cash and preparing financial statements. Because of this lack of segregation and lack of reviewer, there are possibilities that employee will collude together in fraud and misstate the financial statements.

- **Sales representatives collect payments on cash.**
  FTL's sales representatives collect cash from the customers and deposits to the accounts department. It might be possible that sales representatives might collect the cash and report the management that the receivables have become uncollectable.

(b) *Significant risks of Material misstatements other than fraud:*

- **Unavailability of Galileo GDS**
  FTL's business operation is significantly dependent of Galileo GDS. FTL pays fees in order to obtain access to the GDS. However, in case GDS become unavailable due to system maintenance or technical issues, FTL will not be able to serve its customers leading to significant financial loss. Furthermore, as FTL is losing business, it might fall short on money to pay the fees. Thus, access to GDS will become unavailable and FTL might face going concern threat.

- **Decline is sales commission due to increased trend of self-ticketing**
  FTL is being challenged by online self-ticketing system. Because of widespread availability of internet and accessibility of plastic money, customers are now self-purchasing air and hotel tickets online. These led to decline in commission income. This trend is expected to grow causing FTL to lose its income in future even more. It might lead to threat to company's going concern.

- **Hack of customer data and potential financial lass due to customer lawsuits**
  FTL new server held confidential customer and financial data which has been hacked. This might lead to loss of financial assets and customer litigation. Customers might feel that their confidential data has been breached and sue FTL for compensation. Under the current financial situation, it might lead to company's going concern threat. Furthermore, FTL might not charge adequate provision or disclose contingencies due to these lawsuits.

- **Incorrect recognition of website cost**
  Company has made a significant investment to develop the company but charged as expenses in the statement of financial performance. These website costs are generally charged as expenses but due to nature of revenue generating purpose and directly linked with revenue generation, these website cost might be eligible for recognition of intangible assets under IAS 34. If the website cost can be recognized as intangible assets, FTL will experience significant reduction in losses.

- **First time adoption of IFRS 16**
  FTL has adopted IFRS 16 for the first time. As a result, it is possible the FTL has recognized the ROU assets and liabilities incorrectly. Furthermore, FTL might incorrectly assess whether the leases fall under scope of IFRS 16. As a result, financial statements might be misstated.

(c) *Audit strategy*

From the risk assessment it appears that FTL has significant going concern threat and misstatement in the financial statements. Therefore, it would be appropriate not to follow control reliance strategy. Rather substantive procedures should be followed to address the identified risks.

Audit Procedures to address identified risks:

- **Sales representatives are allowed to reduce price without permission**
  - Perform analysis on standard price and actual price charged for each sales representative.
  - Obtain explanation for frequently provided discounts.
  - Obtain sales invoice and copy of money receipts issued to customers.

- **Lack of segregation of duties in accounts department**
  - Obtain understanding on process for cash receipts and financial statement close process.
  - Identify the controls available in the process
  - Perform walkthroughs on process for cash receipts and financial statement close process.
  - Perform test on controls addressing the significant risk.
  - Performing substantive procedures on cash receipts.

- **Sales representatives collect payments on cash.**
  - Obtain sales invoice and copy of money receipts issued to customers.
  - Match invoice with cash receipt documents.
  - Check the cash receipt date and date of deposits in accounts department.
- **Unavailability of Galileo GDS**
  - Check the agreement with Galileo GDS to understand the arrangement.
  - Confirm the fees has been paid to GDS to continue of access.
  - Identify the next payment date and confirm FTL has sufficient fund to pay the fees.

- **Decline is sales commission due to increased trend of self-ticketing**
  - Perform analysis on sales commission and check correlation with tend of self-ticketing service.
  - Inquire management about their plan to increase the sales commission.

- **Hack of customer data and potential financial lass due to customer lawsuits**
  - Inquire management about hacking, data leak and potential lawsuits.
  - Inquire management regarding how the plan to address the situation.
  - Confirm whether management has calculated potential financial impact.
  - Confirm how adequate provision has been kept in the financial statements or disclosed in the notes to the financial statements as contingent liabilities.
  - Discuss with lawyer about management assessment of lawsuits and potential financial impact.

- **Incorrect recognition of website cost**
  - Check the website development cost and segregate the amounts that could be recognize as intangible assets.
  - Check the requirement of IAS 34 and confirm whether those costs can be recognized as intangible assets.

- **First time adoption of IFRS 16**
  - Obtain list of leases and check whether these fall under scope of IFRS 16.
  - Obtain and check management calculation of ROU Assets and Liabilities.
  - Check explanation/ supporting for determining Lease term and incremental borrowing rate.
  - Check the amortization of ROU assets and charge of interest on outstanding lease liabilities.
  - Check the payment of lease liabilities.

(d) Evidences to be collected
  - Analysis on standard price and actual price charged for each sales representative.
  - Sales invoice and copy of money receipts issued to customers.
  - Documentation of walkthrough done on cash receipts & financial statement close process.
  - Documents related to test on controls addressing the significant risk.
  - Work papers and supporting obtained from substantive procedures on cash receipts.
  - Agreement with Galileo GDS.
  - Documents related to GDS fees payment

- ➢ Analysis on sales commission and correlation with tend of self-ticketing service.
- ➢ Documentation of inquiries made to management.
- ➢ Calculation made by management on potential financial impact due to data leak.
- ➢ Confirmation from lawyer about potential financial impact.
- ➢ Documents related to website development cost.
- ➢ List of leases that fall under scope of IFRS 16.
- ➢ Management calculation of ROU Assets and Liabilities.
- ➢ Supporting for determining Lease term and incremental borrowing rate.
- ➢ Calculation of amortization of ROU assets and charge of interest on lease liabilities.
- ➢ Payment of lease liabilities.

(e) Control to address risk of material misstatements:

- ➢ Sales discount should be pre-approved.
- ➢ Introduce more monitoring in accounts and finance department by segregating duties.
- ➢ Collect customer receipts over banking channels.
- ➢ Accounts department should be pre-informed before customer collection and printed receipt should be given to the customers.
- ➢ Before posting, invoice and cash receipt should be matched.
- ➢ Regular monitoring about payment date of Galileo GDS fees.
- ➢ Regularly search for opportunities to be get benefit from self-ticketing system.
- ➢ Introduce IT general controls and IT application controls for IT security threat.
- ➢ Limit access to confidential information.
- ➢ Regular monitories unrecorded liabilities, adequacy of provision and identifying contingencies.
- ➢ Regular review of the financial statements.
- ➢ Regular review of requirements and compliance with financial reporting standards.
- ➢ New leases should be reviewed to whether falls within lease accounting scope.
- ➢ Payments are checked against invoices or agreements.

4. (a) **Risks associated with IT System used in Sunshine Limited**

- **Books of accounts are maintained in spreadsheets**
  Sunshine maintains books of accounts in spreadsheets. Because of this there is no control mechanism for review. Therefore, it is not possible to identify if anyone make any error or tries to commit fraud. This could lead to significant misstatements in the financial statements.

- **Remote access of confidential data**
  Employees of sunshine are allowed to take their laptops home from where they can work remotely on cloud server. As these is no under control, anyone else can hack the laptop and get access to classified information related to sunshine.

- **Employees use personal email ID**
  Employees of Sunshine Limited uses their personal email for office business. As a result, these emails are not monitored and could lead to breach of confidential data. Furthermore, emails can be hacked and could lead to financial and reputational loss.

- **Use of pirated software**
  Sunshine used unlicensed software and downloaded off the internet. As a result, there is risk that these could contain trojans and virus that could affect the functionality of the computer, lead to data breach and financial loss. Furthermore, these viruses and trojans could held confidential data for Ransome.

- **Users can install software without administrative password**
  Laptops that sunshine employees use doesn't have any administrative password protection. Therefore, employee can download any software they want and install. As a result, employees might install malicious software which could lead to data security.

(b) **Risk of material misstatements other than due to IT Risks:**

- **Risk of improper revenue recognition as goods receipt & sale are done simultaneously.**
  Sunshine business model involves delivering purchased goods directly to distributor's warehouse. This could lead to cut-off issues at the year end. Goods delivered to Distributor might not be recognized as sales. Furthermore, as goods are directly taken to distributors warehouse, Sunshine might not record the

purchase and hence might not recognize the related sales as well.

- **Potential misstatements due to lack of segregation of duties in Sales department.**
  Sales department is solely responsible for import of goods, setting price and negotiating with the distributors. As there is lack of segregation of duties, it might be possible for employees of sales department to get involved in the fraudulent activities. Sales department might overstate the price and report lower revenue than what collected from the distributors.

- **IT manager may involve in fraudulent activities as he works independently.**
  IT manager works independently and responsible for purchase and disposal of IT assets. As a result, it is possible that he might overstate the purchase price or dispose assets which could be still usable. In addition, as the as IT manager holds significant control over companies financial and other data, it might be possible that IT manager might be involved in leaking confidential data.

- **Online banking facility is single headedly operated by head of Accounting & Finance department.**
  Head of Accounting and finance department operates sunshine's online banking facilities. As there is no control mechanism, it might be possible for head of department to make fraudulent fund transfer. In addition, without proper review, it might be possible that funds are transferred to wrong employee or vendors.

(c) **<u>Audit procedures to be performed:</u>**

<u>To address IT Risks:</u>

- Inquire IT manager regarding company policy regarding IT securities.
- Inquire IT manager regarding how company detect and prevent threats of IT security.
- Check whether the laptops have antivirus and firewalls enabled.
- Check access control of could server.
- Check for approval process of transactions posted in books of accounts recorded in Spreadsheets.
- Perform test of controls around IT system.
- Check for disaster recovery system.

<u>To address Risks other than IT:</u>

- Review purchase process and sales recognition process.
- Perform walkthrough test on purchase and sales process.
- Review import process, price setting process and negation process with distributors.
- Review IT manager reporting responsibilities.
- Obtain change and approval logs and check for anomalies.
- Check payment process over online banking facilities.
- Obtain payment lists and cross check with payments from bank statements.

(d) **<u>Suggested IT General Control</u>**

- Introduce access control for laptops and introduce administrative password.
- Limit unauthorized installation of software.
- Introduce IT Security policy.
- Introduce data backup and disaster recovery system.
- Employees should be required to use organization's email.
- Review for suspicious receiver and sender.
- Use of encryption software for data transfer.

<u>Suggested IT Application control</u>

- Use of firewall system and use of licensed software.
- Use of accounting software for bookkeeping.
- Use of private server.
- Keeping logs of unauthorized access.
- Keeping logs of system change.

5. (a) **<u>Basswood Limited (BWL):</u>**

Analysis:

BWL is operating at quarter of its production capacity as its product has lost demand over plastic and plywood furniture. It is experiencing negative gross profit but has small positive bottom line due to non-operating income. This means BWL is not incurring any profit from operating. Most of the income is arising from interest income and dividend income. This indicates that company is holding liquid cash but is not able to invest it to earn operating profit. All these indicate that company has a going concern threat. It is possible that in future shareholder will decide to cease the operation and distribute the liquid assets as dividend before winding up the company.

Explanation to team members:

As the company has going concern threat, we need to incorporate this risk in our audit strategy. We need to perform specific procures to the assess company's going concern status. If the company is not a going concern, it should prepare its financial assets in liquidation basis. All non-current assets will be revalued to its net realizable value and presented as current assets in accordance with applicable reporting framework. This will affect out substantive procedures for all line items in the statements of financial position.

Audit procedures to be performed:

- Obtain management assessment of BWL's going concern.
- Confirm whether management assessment is correct.
- Inquire management about their plan about business operation.
- Obtain BWLs business planning for next five years.
- Confirm whether adequate disclosures have been made in the financial statements.
- If the BWL is not going concern, confirm that assets are revalued at realizable value.
- If BWL is not going concern, confirm that financial statements are prepared under liquidation basis.

<u>Hackberry Limited (HBL):</u>

Analysis:

BHL made an error in prior year in recognition of asset. As a result, Asset and liability has been overstated by BDT 400,000. This also lead overcharge of depreciation. This year HBL has made an adjustment by adjusting assets and liabilities. As this is error made in prior period, it needs to be corrected retrospectively. My team's suggestion to adjust retrospectively is correct.

Explanation to team members:

I would explain to my team members that Management's claim on current year adjustment is not valid. We need to explain the requirement to the management that prior year errors need to be adjusted retrospectively. If prior year adjustment is done, overstatement of depreciation will automatically be corrected. If management doesn't agree, it would become a reportable item as it is material. Furthermore, HBL has practice of recognizing assets at budgeted amount instead of actual cost. It could cause to overstatement of other assets and liabilities as well. We should check whether there are any unnecessary liabilities in the financial statements that needs to be reversed.

Audit procedures to be performed:

- Explain to management about procedures for prior period adjustments and suggest adjustment entries.
- Check for liabilities what are outstanding for long period without proper explanation.
- Obtain understanding about the asset addition procedures and perform walkthrough.
- Identify controls over asset recognition.
- Confirm that asset is recognized at cost instead of budgeted amount.

<u>Redbud Limited (RBL):</u>

Analysis:

Management representation letter is required to be signed by the management. All corrected and uncorrected misstatements are need to be included in the management representations to confirm management awareness about those misstatements. From the scenario, it appears that Finance manager doesn't want board of directors or Those who are charged with governance to know.

Explanation to team members:

As the finance manager doesn't want board of directors of directors to know about the corrected and uncorrected misstatements, it raises doubt regarding management intention and requires revisiting fraud risk assessment. We should try to understand underlying reason and purpose of the finance manager. We may need to perform additional procedures for this new concern.

Audit procedures to be performed:

- Explain to finance manager regarding purpose of sharing corrected and uncorrected misstatements in the management representation letter.

- Analyse the nature of misstatements and revisit fraud risk assessment.
- If finance manager doesn't want to share to management for signing, consider its implication in audit report.

<u>Hawthorn Limited (HTL):</u>

Analysis:

Management has informed my team that ongoing litigation doesn't have financial impact as the verdict is expected to be favourable for HTL. However, the lawyer's confirmation mention that verdict is still uncertain. This shows that management assessment of outcome of the litigation is incorrect. Management needs to revisit their judgement and consider potential impact in the financial statements.

Explanation to team members:

As we have received lawyer's confirmation which shows difference in management expectation about litigation outcome. We much communicate with management and try to understand the reason for the difference. Explain to management that due to the difference in the expectation, management should consider its financial impact.

Audit procedures to be performed:

- Review lawyers' confirmation and consider whether a provision is required in the financial statements.
- If a provision is required, suggest and adjustment entry.
- If provision is not required, consider where the information need to be disclosed as contingent liability.

(b) <u>BWL:</u>

As the company is not going concern, management should disclose the fact in the notes to the financial statements. If management believe the entity is a going concern, it should disclose who it plans to improve its financial condition.

<u>HBL:</u>

In order to correct the prior period material misstatements, management need to make retrospective restatements. Management should explain in the notes to the financial statements regarding reason for this restatement.

<u>RBL:</u>

In matters of signing of management representation letter, there is no disclosure is required in the notes to the financial statements.

<u>HTL:</u>

HTL management should disclose the fact that a litigation is ongoing and explain the uncertainty of the outcome. If management believe outcome is uncertain, it should disclose a contingent liability in the notes to the financial statements in relation to the litigation.

(c) <u>BWL:</u>

If BWL management couldn't provide financial forecast, it should consider BWL as not a going concern. In that case they should disclose the fact in the notes. If disclosure is given, unmodified opinion will be issued after including a para explaining 'material uncertainty over going concern' and referring to the disclosure note. If disclosure is not made, adverse opinion will be issued.

<u>HBL:</u>

If management make retrospective adjustment of the material error, an unmodified opinion will be issued. However, if management plans to continue adjustments in current year, a modified opinion will be issued.

<u>RBL:</u>

If management doesn't sign the management representation letter, issue a disclaimer opinion. If representation letter is signed by management, unmodified opinion will be issued.

<u>HTL:</u>

If management provide disclosure for contingent liability or provide for penalty, an unmodified opinion will be issued. Otherwise a qualified opinion will be issued.

---The End---

Financial Accounting and Reporting
Suggested Answers
March-April 2021

1 (a) "To maintain consistency, the presentation and classification of items in the financial statements should stay the same from one period to the next. There are two exceptions to this:

(i) Where there is a significant change in the nature and operation or a review of the financial statements presentation which indicates a more appropriate presentation. (This change is only allowed if the resulting information is a more faithful representation and more relevant than the previous presentation. If two presentations are equally appropriate, then the current presentation must be retained.)

(ii) Where a change in presentation is required by an IFRS

When a change of presentation and classification is made, figures for the previous period must be restated on the new basis, unless this is impracticable (i.e., not possible 'after making every reasonable efforts'). "

(b) "IAS 1 ends by listing some specific disclosures which will always be required if they are not shown elsewhere in the financial statements.

(i) The domicile and legal form of the entity, its country of incorporation and the address of the registered office (or, if different, principal place of business);

(ii) A description of the nature of the entity's operation and it's pribcipal activities;

(iii) The name of the parent entity and the ultimate parent entity of the group. "

(c) A discontinued operation is a component of an entity that has either already been disposed of or is classified as held for sale that represents a separate major line of business or geographical area of business operations (or is part of a coordinated plan to dispose of such). It also applies to a subsidiary that is acquired specifically with a view to resale.

A component of an entity has operations and cash flows that are clearly distinguished for reporting purposes from those of the rest of an entity. It would normally be a cash generating unit (or a group of cash generating units) or a subsidiary.

This information is important to users of financial statements when they are forming an assessment of the likely future performance of an entity. For example, if a group made a large profit from one of its subsidiaries that it has recently sold (or will soon sell), this will have a material effect on any forecast of the group's future profit. This is because the profits from the subsidiary disposed of will no longer contribute to future group profit (though the re-investment of any sale proceeds from the disposal could). Also, the converse would be true where the disposal or closure of a loss-making subsidiary could improve future profitability.

2

Taka	Net Income for 2019		Retained Earnings 31/12/20	
Item	Understated	Overstated	Understated	Overstated
1	14,100	-	-	-
2	3,500	-	2,500	-
3	-	22,000	-	11,000
4	28,000	-	28,000	-
5	-	24,000	-	12,000
6	18,200	-	-	-

Although explanations were not required in answering the question, they are included below for your interest.

Explanations:

(a) The net income would be understated in 2019 because interest income is understated. The net income would be overstated in 2020 because interest income is overstated. The errors, however, would counter-balance (wash) so that the statement of financial position (Retained Earnings) would be correct at the end of 2020.

(b) The depreciation expense in 2019 should be Tk 500 for this machine. Since the machine was bought on July 1, 2014 only one half of a year's depreciation should be taken in 2019 (Tk 4,000/4X1/2=Tk 500). The company expensed TK 4,000 instead of Tk 500 so net income is understated by Tk 3,500 in 2020. An additional Tk 1,000 of depreciation expense should have been taken in 2020. At the end of 2020, retained earnings would be understated by Tk 2,500 (Tk 3,500-Tk 1,000).

(c) IFRS requires that all research costs should be expensed when incurred. Net income in 2019 is overstated TK 22,000 (Tk 33,000 research costs capitalized less Tk 11,000 amortized). By the end of 2020, only Tk 11,000 of the research costs would remain as an asset. Therefore, retained earnings would be overstated by Tk 11,000 (Tk 33,000 research costs- Tk 22,000 amortized).

(d) The Security deposit should be a long-term asset, called refundable deposits. The Tk 8,000 of the last month's rent is also an asset, called prepaid rent. The net income of 2019 is understated by Tk 28,000 (TK 20,000 + Tk 8,000) because these amounts were expensed. Retained earnings will continue to be understated by Tk 28,000 until the last year of the lease. The security deposit will then be refunded, and the last month's rent should be expensed.

(e) Tk 12,000 or one third of Tk 36,000 should be reported as income each year. In 2019 Tk36,000 was reported as income when only Tk 12,000 should have been reported. Because Tk 24,000 too much was reported, the net income of 2019 is overstated. At the end of 2020, Tk 24,000 should been reported as income, so retained earnings is still overstated by Tk 12,000 (Tk 36,000 – Tk 24,000).

(f) The ending inventory would be understated since the merchandise was omitted. Because ending inventory and net income have a direct relationship, net income in 2019 would be understated. The ending inventory of 2019 becomes the beginning inventory of 2020. If beginning inventory of 2020 is understated, then net income of 2020 is overstated (inverse relationship). The omission in inventory over the two-year period will counterbalance, and retained earnings at the end of 2020 will be correct.

3 (a)

Worksheet to Compute Deferred Tas Asset and Liability for Desh Company — Taka

	2015	2016	2017	2018	2019	2020	2021 Deductible	2021 Taxable	2022 and thereafter Deductible	2022 and thereafter Taxable
Pretax accounting (loss)						8,000				
Less Nontaxable income						(2,000)				
Temporary diffference:										
Warranty costs						(10,000)	40,000			
Royalty income						30,000	40,000			
Prepaid expenses						8,000		25,000		
Depreciation						(5,000)				9,000
Net taxable income before carryback and carryforward	2,000	17,000	(78,000)	24,000	9,000	29,000				
Total temporary differences							80,000	25,000	-	9,000
Net operating loss carryback and carryforwards	(2,000)	(17,000)	78,000	24,000	9,000	(26,000)				
Total future taxable and deductible amounts						3,000	80,000	25,000	-	9,000
Marginal tax rate						34%	34%	34%	40%	40%
Taxes currently payable						1,020			-	
Gross deferred tax asset at December 31, 20X0							27,200		-	
Gross deferred tax liability at December 31, 20X0								8,500		3,600

The income tax expense for the period can be computed as:

Income taxes payable	1,020
Less: Decrease in deferred tax liability	(3,880)
Add: Decrease in deferred tax assets	2,040
Add:Increase in valuaiton allowances	2,720
Income tax expense	1,900

The current portion of income tax expenses is Tk 1,020 and the deferred portion is Tk 880.

(b)

Valuation Allowance worksheet

Assumptions: Expect Taxable income of Tk 20,000 in 2021 and Zero in 2022 and thereafter

		2021		2022 and thereafter
Gross deductible temporary difference		80,000		-
Less:				
Gross taxable temporary difference	25,000		9,000	
Estimated taxable income before temporary differences	20,000	45,000	-	9,000
Excess deductible (taxable)		35,000		9,000
Carryforward of future deductible amounts to offset future taxable amounts		(9,000)		
Carryback of future deductible amounts to offset 2020 taxable income		(3,000)		
Excess deductible amounts not expected to be realized		23,000		
Marginal tax rate		34%		
Valuation Allowance		7,820		

Adjustments and Balance Sheet Classification- Debit(Credit)

Debit (Credit)	Gross amount	Current	Non Current
Deferred tax asset, December 31, 2020	27,200	27,200	
Deferred tax asset, January 1, 2020	29,240		
Adjustment (included in income tax expense)	(2,040)		
Valuation allowance, December 31 2020	(7,820)	(7,820)	
Valuation allowance, January 1 2020	(5,100)		
Adjustment (included in income tax expense)	(2,720)		
Net deferred tax asset after valuation allowance		19,380	
Deferred tax liability, December 31, 2020	(12,100)	(8,500)	(3,600)
Deferred tax liability, January 1, 2020	(15,980)		
Adjustment (included in income tax expense)	3,880		
Net deferred tax asset (liablity) reported on balance sheet		10,880	(3,600)

Journal entry:

Deferred tax liability	3,880		
Income tax expense	1,900		
Income taxes payable		1,020	
Deferred tax asset		2.040	
Valuation allowance			2,720

4 (a)

Hamid Ltd
Statement of profit or loss and other comprehensive income
for the year ended 31 December 2020

Particulars	Taka
Revenue (3,500,000 – 1,000)	3,499,000
Cost of sales (Note 1)	(2,809,800)
Gross profit	689,200
Operating expense	(10,000)
Bad debt (10,000 – 1,000)	(9,000)
Loss on scrapped office furniture (32,000 – 28,500)	(3,500)
Depreciation on new furniture	(11,175)
Amortization of patent	(750)
Impairment of patent	(250)
Operating profit	654,525
Finance cost: preference dividend	(4,800)
Profit before tax	649,725
Provision for income tax	(250,000)
Net profit for the year	399,725

Note 1:

Particulars	Taka	Taka
Raw materials and consumables	1,570,000	
Less: raw materials used for office furniture and capitalized	(54,000)	
Material used for production of goods		1,516,000
Salaries and wages	1,250,500	
Less: Employees' time used for office furniture and capitalized	(20,500)	
Salaries and wages used for production of goods		1,230,000
Work in progress inventories at 1 January 2020		45,600
Work in progress inventories at 31 December 2020		(50,200)
Depreciation:		
Building Tk [(5,000,000 – 4,000,000) x 4%]	40,000	
Plant Tk [(520,000 – 375,000) x 20%]	29,000	69,000
Finished goods inventories at 1 January 2020		13,400
Finished goods inventories at 31 December 2020 Tk [15,000-1,000]		(14,000)
		2,809,800

(b)

Hamid Ltd
Statement of financial position at 31 December 2020

Particulars	Note	Taka
Assets		
Non-current assets		
Property, plant and equipment	2	5,139,325
Intangible assets Tk [15,000-750-250]		14,000
		5,153,325
Current assets		
Inventories Tk.[50,200+(15,000-1000)]		64,200
Account and other receivables Tk [37,500-10,000]		27,500
Cash and cash equivalents		263,500
		355,200
Total assets		5,508,525
Equity and liabilities		
Capital and reserves		
Ordinary share capital Tk [500,000+(50,000/5x10)]		600,000
Share premium account Tk [200,000-100,000]		100,000
Revaluation reserve Tk [5,000,000-(3,600,000-		2,040,000

640,000)]

Retained earnings Tk [1,968,600+399,725]	2,368,325
	5,108,325
Non-current liabilities	
4% redeemable preference share	120,000
Current liabilities	
Preference share dividend payable Tk [120,000x4%]	4,800
Income tax payable	25,400
Dividends payable	250,000
	280,200
Total equity and liabilities	5,508,525

Note 2: Property, plant and equipment (PPE)

Particulars	Land & Building (Tk)	Plant & Machinery (Tk)	Furniture (Tk)	Total (Tk)
Cost:				
Opening balance	3,600,000	520,000	32,000	4,152,000
Addition during the year	-	-	74,500	74,500
Revaluation reserve	1,400,000	-	(32,000)	1,368,000
Closing balance	5,000,000	520,000	74,500	5,594,500
Accumulated depreciation:				
Opening balance	640,000	375,000	28,500	1,043,500
Revaluation/adjustment	(640,000)	-	(28,500)	(668,500)
Depreciation for the year	40,000	29,000	11,175	80,175
Closing balance	40,000	404,000	11,175	455,175
Net book value/Carrying amount	4,960,000	116,000	63,325	5,139,325

Note 3: The dividend on ordinary share capital does not meet the criteria of a present obligation. No provision should be recognized at 31 December 2020. Such dividends are disclosed in the notes to the financial statements in accordance with BAS 1.

5 a)

	Warranty provision (Tk.'000)	Compensation claim (Tk.'000)	Provision for closure of division (Tk.'000)	Total (Tk. '000)
At 1 January 2020	1,000	-	-	1,000
Utilized in the year	(600)	-	-	(600)
Profit or loss charge (balance figure)	400	9,500	16,000	25,900
At 31 December 2020 (Note 1 & 2)	800	9,500	16,000	26,300

The warranty provision is in respect of warranties provided to customers. The provision is based on the level of past claims.

The compensation claim provision is in respect of a claim made by a customer for damages as a result of a faulty computer supplied by the company. It represents the present value of the amount at which the company's legal advisers believe the claim is likely to be settled.

On 15 December 2020, Cosmo Ltd announced that it would be closing its loss making space technology division. Details of the closure have been fully communicated to those affected. The cost of the closure, which began on 4 January 2021, is estimated at Tk. 16 million and completion is expected by 30 June 2021.

b)

A counter-claim in respect of the compensation claim provided for above has been made against the supplier of parts for the affected computer. Lawyers have advised that this claim is likely to succeed and should amount to around 40% of the total damages (Tk. 3.8 million).

Working notes:

		Tk.
(1)	Provision for closure of division	
	Employee redundancy costs	12,000
	Lease termination costs	4,000
		16,000

(2) Warranty provision
Tk. 8 million x 10% = Tk. 800,000

6. a)

Home Ltd
Consolidated Statement of Financial Position
As at 31 March 2020

Particulars	**Note**	**Tk '000**	**Tk '000**
Assets			
Non-current assets			
Property, plant and equipment Tk [12,600+15,900+1,600]	7	30,100	
Intangibles	3	4,270	
Investment in Associates	8	6,600	
			40,970
Current assets			
Inventories Tk [7,800+4,930-150]	6	12,580	
Trade receivables Tk [6,550+4,650]		11,200	
Cash and cash equivalents Tk [3,450+150]		3,600	
			27,380
Total assets			68,350
Equity and liabilities			
Capital and reserves			
Ordinary share capital			12,000
Retained earnings	5		10,865
Attributable to the equity holders of Home Ltd			22,865
Minority interest	4		5,835
Equity			28,700
Non-current liabilities			
7% secured bank debts Tk [25,500+1,500]			27,000
Current liabilities			
Trade payables Tk [5,110+5,150]		10,260	
Taxation Tk [1,250+580]		1,830	
Provisions		200	
Dividends payable Tk [300+200-140]		360	
			12,650
Total equity and liabilities			68,350

b)
Group profit on disposal of shares in School Ltd:

Particulars	**Tk '000**	**Tk '000**
Sales proceeds		3,500
Less: Share of net assets disposed of at date of disposal		
Net assets at 31 March 2020	18,200	
Fair value adjustment [2,000x8/10]	1,600	
Add back dividend	200	
Less: Profit for 6 months [3,000x6/12]	(1,500)	
	18,500	

	x 10%	(1,850)
		1,650
Less: Carrying amount of goodwill on disposal relating to Shares disposed (note 3)		(610)
		1,040

Notes:

1. Group structure

Particulars	Tk '000	Tk '000	%
School Ltd (initial)	8,000	10,000	80%
School Ltd (after disposal of shares)	7,000	10,000	70%
Airlines Ltd	1,500	5,000	30%

2. Net assets

Particulars	Note	Statement of financial position Date Tk '000	Tk '000	Acquisition Tk '000	Post-acquisition Tk '000
School Ltd					
Share capital			10,000	10,000	-
Retained earnings					
Per question		8,200			
Provision for unrealized profit	6	(150)			
Depreciation adjustment	7	(400)			
			7,650	5,000	2,650
Fair value adjustments					
PPE	7		2,000	2,000	
Contingent liability			(200)	(200)	-
			19,450	16,800	2,650
Airlines Ltd					
Shared capital			5,000	5,000	-
Retained earnings			9,000	7,000	2,000
			14,000	12,000	2,000

3. Goodwill – School Ltd

Particulars	Tk '000
Cost of original investment [8,000xTk 2.50]	20,000
Less: Share of fair value of net assets acquired [16,800x80%]	(13,440)
	6,560
Impairment to March 2019	(1,680)
Balance at disposal	4,880
Less: Disposed of (1/8)	(610)
Balance c/f	4,270

4. Minority interest – School Ltd

Particulars	Note	Tk '000
Share of net assets [19,450x30%]	2	5,835

5. Retained earnings

Particulars	Tk '000
Home Ltd	9,740
Add: Dividend not recorded [70%x200]	140
	9,880
School Ltd [70%x2,650]	1,855
Airlines Ltd [30%x2000]	600
Less: Goodwill impairment to date on shares retained [1,680x7/8]	(1,470)

10,865

6. Provision for unrealized profit

Particulars	%	Tk '000
Sales proceeds	110	1,650
Cost	100	(1,500)
Gross profit	10	150

7. Fair value adjustments – PPE

Particulars	Tk '000
Additional depreciation for revalued amount is for two years.	
Accumulated depreciation [2/10x2,000]	400
Net adjustment to PPE	1,600

8. Investment in associates

Particulars	Note	Tk '000
Cost		6,000
Share of post-acquisition change in net assets [30%x2,000]	2	600
		6,600

---The End---

BUSINESS STRATEGY
Suggested Answers
March-April 2021

1. (a) **BCG matrix**
To the Board of Directors
Report on portfolio study

BCG classifies the product into four categories.
Stars:
Stars are products with a high share of a high growing market. In the short term, these require capital expenditure in excess of the cash they generate in order to maintain their market position, but promise high return in the future.
Their market share is big enough to exploit opportunities but high growth rate will attract new comers
Cash must be reinvested heavily to hold their existing position and build upon it
Overall moderate cash flow
Cash cow
In due course, stars will become cash cows, with a high share of a low growth market. Cash cows need very little capital expenditure and generate high level of cash income.
Cash cows generate a high cash returns, which can be used to finance the stars.
- Low growth so high market share is unlikely to be attacked by new firms wishing to enter the market.
- Therefore little investment required to defend position but large enough market share to exploit available opportunities.
- Large positive cash flow.

- **Question marks (or problem children)**

Question marks are products in a high-growth market, but where they have a low market share. Do the products justify considerable capital expenditure in the hope of increasing their market share, or should they be allowed to die quietly as they are squeezed out of the expanding market by rival products? Because considerable expenditure would be needed to turn a question mark into a star by building up market share, question marks will usually be poor cash generators and show a negative cash flow.
- Attractive markets but insufficient market share to exploit them.
- Choice between getting out or getting big .
- If deciding to stay in the market, must invest heavily to gain market share.
- Large negative cash flow

- **Dog products**

Dogs are products with a low share of a low growth market . They may be ex-cash cows that have now fallen on hard times of question marks that never succeeded in gaining critical mass in a market. Dogs should be allowed to die, or should be killed off. Although they will show only a modest net cash out flow, or even a modest net cash inflow , they are 'cash traps' which tie up resources such as stocks and productive capacity and provide a poor return on investment, and not enough to achieve the organization's target rate of return.
- Unattractive markets without the market share to really benefit from what could be achieved if bigger.
- The best strategy may be to exit the market ('divest').
- Modest cash flow.

Although the best strategy is often to exit the market, this is not the case for all dogs . They can be valid part of a product portfolio, for example to complete a range, or to fill a niche market.
There are also **infants** (ie products in an early stage of development), **war horses** (ie products that have been cash cows in the past, and are still making good sales and earning good profits even now) and even cash dogs, which are dogs still generating cash, and dodos, which have low shares of low growth markets and which are losing cash.

(b) Portfolio analysis of SFV

I have analysed the product portfolio of the firm using the BCG matrix. The matrix is designed to consider the products of the firm from two prospective – how fast the market for such a product is growing, and what share of the market the firm currently enjoys in the case of a consumer based industry such as SFV the product offered in the market.

The logic behind the use of the matrix is that to be successful it is necessary to have a significant market share. It is at that point that economies of scale become achievable and brand strength will become established. However, since all products have limited life span a firm must also have newer products to take over as the products decline.

Question marks

These are products for which the market is growing but where the share of the firm is still limited. Although they have the potential to become profitable, services in this category are usually expensive to offer as the firm is not yet operating at full efficiency and share will need defending against other players.

Two of the product offered should fall into this category: Chashi and chopstics both are newly offered products and SFV do not yet have significant share. However, whilst the former sounds very likely to become a star in near future, the latter is very much an unknown and it may never get fully off the ground.

Stars

Products in this category are already doing well. Successful market share has been achieved and the long term future of the product seems likely. However, the market is still growing and the risk of losing share to other entrants before achieving long term success still exists.

Radhuni products would be considered stars. In both areas SFV have recently won a number of cexport orders which will improve their share of the overall market. However, the markets are still growing fast, offering real potential only if they can hold their share against their competitors.

Cash cows

Cash cow products are the real money earner. Marker share is established and a slow down in the growth of the market should prevent many new players entering. It is the funds from these products that support the investment in the newer product areas.

SFV's Ruchi product is a cash cow. It is well established and profitable. Chopsticks is probably also a cash cow. Modest increases in revenues are not unusual in slow growth markets. However, if the income from Ruchi has been following a downward trend then a new approach will be needed to share being eroded.

Dogs:

Dog products are those with a low share of market with little growth potential. They may be previously successful products that are coming towards the end of the life cycle, or question marks that never did achieve share. They make little or no contribution to profits.

Chashi brand is clearly a dog product. The market for Chashi is in declines as the smaller firms come within the market. As liability fears continue to abound in the industry it is seen as higher risk

Conclusion:

SFV has on the face of it a balanced portfolio. It has services in all the key areas. However, closer examination suggests a less optimistic picture..

It is the income from the cash cow products that supports the new investment. It is not clear from the information provided what proportion of the firm's turn over their cash cows make up. However, Chashi is only earning limited profits which puts the pressure on the other products to earn enough to fund the business.

The star products Radhuni and Ruchi will make them money in time. However, spending on staff and training is probably matching any increase in revenue from them at the moment. .Dog products are often a drain on a firm's resources. Whilst the firm may well cease offering aggressive sales planning, if they continue to offer better services, these may end up being provided at an effective loss.

SFV will need to make some difficult decisions if they are not to run out of the funds they need to support their current product portfolio.

(c) Short comings of BCG Matrix.

i. Portfolio models are simple, they do not reflect the uncertainties of decision making
ii. BCG analysis in particular, does not really takes risk into account.

iii. They ignore opportunities for creative segmentation or identifying new riches.
iv. They assume a market is given rather than something that can be created and nurtured. After all, industries may be unattractive because needs have not been analysis sufficiently.
v. They rely on identifiable products rather than services, or more nebulous relationships.
vi. They ignore the profit generating capability of business relationships.
vii. Creating a corporation with the financial characteristics of a well-balanced portfolio does not increase the share price. This is because investors can diversify risk in how they construct their own portfolio.
viii. Recycling cash flows from cash cows to question marks ignores the alternative of paying out dividend and letting shareholders decide where to invest the money.
ix. Creation of portfolios may cause may cause the business to move beyond its core competences and so lead to diminishing returns on investment through time.

2. (a) The origin of Islamic banking can be traced back to the practice of muradaba by the prophet Muhammad (SM) himself. Islamic banking operates on principles adhering to the Quranic norms forbidding usury and transaction, including granting of loans or credits for interest. It is assumed that under the system of Islamic banking, the industrial and commercial risk is shared more equitably between the entrepreneur and the capital owner and the return on investment are shared among the investors on the basis of their proportionate capital.

Bangladesh is the third Muslim majority country. A significant portion of the population wants to follow Islamic sharia based economy where there would be interest free economy. Bangladesh government signed a charter of Islamic Development Bank in 1974 and committed to recognize its economic and financial system as per Islamic Shariah. As a consequence, the first interest free shariah based Bangladesh Islamic Bank was established in Bangladesh in 1983. Since then six full-fledged Islami banks in the private sector, 10 conventional banks with Islamic services, and a number of conventional banks with Islamic banking windows have been established.

Broadly speaking, compliance with sharia means that:

1. any profits derived from these funding arrangements must be derived from commercial risk-taking and trading only;
2. all forms of conventional interest income is prohibited; and the assets that are subject to the funding arrangement must, themselves, be permissible (halal).

Islamic banking in Bangladesh is becoming popular for the following reasons:

i. Bangladesh is a muslim majority country. A study shows that 28% of the population is reluctant to invest in interest bearing investments
ii. Interest (riba) is strictly forbidden is Islamic Shahria. So, there is awareness among the religious muslims not to involve any transaction where interest involved
iii. For the last few years Islamic Development bank financing the developing Muslim country following the Islamic shariah and inducing muslim majority countries to follow non-interest bearing invtment.
iv. After formation of Islami bank Bangladesh Ltd. in 1984 a revolution has been created in the banking sector. It became the most preferred bank to the Muslim Community.
v. Government also patronized the islami banks to grow. It has formed Central Shariah Board to recommend on the different investment schemes as to the acceptability as per Quranic principles.
vi. Now most of the commercial banks has started Islami shaiah based banking unit to collect customers who avoid interest.

(b) Sukuk are financial products whose terms and structures comply with Shariah, with the intention of creating returns similar to those of conventional fixed-income instruments like bonds. Unlike a conventional bond (secured or unsecured), which represents the debt obligation of the issuer, a Sukuk technically represents an interest in an underlying funding arrangement structured according to sharia, entitling the holder to a proportionate share of the returns generated by such arrangement and, at a defined future date, the return of the capital.

Although a common starting point for explaining Sukuk is to use bonds as a comparison point, it is important to understand that there is certain fundamental differences.. Sukuk adhere to an Islamic view of finance avoiding Riba (generating money from money that is interest or usury, bonds are securities that are very Riba due to the fact that they have a fixed interest.

There are five important differences between Sukuk and traditional interest bearing bonds:

i. Sukuk indicates ownership of the assets. Bonds indicate a debt obligation.
ii. The assets that back Sukuk are compliant with Shariah. Asset backing bonds may include products or services that that are against Islam.
iii. Sukuk is priced according to the value of the assets backing them. Bond price is based on credit rating.
iv. Sukuk can increase in, which the assets increase in values. Profit from bonds correspond to fixed interest, making them Riba.
v. When you sell Sukuk, you are selling ownership in the asset backing them. The sale of bond is sale of debt.

Although some may argue that the difference between Sukuk and bonds are merely technicalities, but the differences matter to Muslims.
Advantages of Sukuk
For a corporate or a sovereign, some key advantages of tapping the sukuk market include:

- There is a potential marketing benefit for issuers active in Islamic markets, should they be seeking investments in those markets.
- The investor base represented by Islamic compliant investors is still largely untapped and there has traditionally been significant unmet demand for products such as sukuk.
- There is potential for crossover into other niche financial markets, such as the broader ethical investment market, that may provide a reputational benefit.
- The main advantages of Sukuk over traditional bonds is that their value increases in relation to the asset the SUKUK certificates. It the assets raises in value, then the value of the ownership of the assets backed by Sukuk increases

Initially Sukuk developed exclusively in jurisdictions with majority Muslim populations, the global market for Sukuk has seen considerable development over the past 10 years, with a number of high-profile corporate issuances and a number of sovereigns tapping the market.
Generally known by their Arabic name, Sukuk, and often incorrectly referred to as 'Islamic bonds', sharia-compliant, fixed-income capital markets instruments have steadily increased their share of global markets over the past decade. The overall risk profile and economic return for the investor is akin to a conventional bond where the bondholder is a debtor of the issuer. The issuance of Sukuk bonds can create opportunities for investors from Malaysia and Dubai to look into Bangladesh as another potential investment destination. Experts stressed on the role of Sukuk as a game-changer in project financing in Bangladesh. A Sukuk is an Islamic financial certificate, similar to a treasury bond, which complies with Shariah laws.
The Sukuk industry remains one of the main components of the Islamic finance system. Now, mega projects are developing in Bangladesh. There is a need for more investment. The demand for this investment can be met through Sukuk bonds.
Long-term finance for the development of the private sector is necessary. Bangladesh is mostly dependent on commercial banks for any financing but banks are not supposed to provide funds for the long term.There are many opportunities to launch Sukuk Bonds in Bangladesh. It is possible to get good returns from this bond. The first Sukuk in the country was issued by the Bangladesh Bank on December 28 last year for financing safe water supply projects across the nation.
The government had collected Tk 8,000 crore for the projects through an auction in last December. Investors submitted bids worth Tk 15,153 crore during the auction. So there is huge demand for the Sukuk bonds
As Islami banks in Bangladesh is looking investment in shariah based bond like Sukuk, Government may issue sukuk bond to raise money for investment in the mega infrastructure projects.

(c) For sustainable economic growth Bangladesh needs huge investments. Few features are now visible in Bangladesh economy:
Bangladesh is going to become a middle income country with in short time. That may reduce foreign donations and loans.
There is huge idle money collected from the depositors but could not invest as many of the investment not follow Islamic principle. So there is huge unutilized fund remaining with the different islami banks in Bangladesh. They are looking for shahriah based investment.
Development in Bangladesh is tremendous and Government need huge investment for the mega projects.

The Sukuk industry remains one of the main components of the Islamic finance system.Now, mega projects are developing in Bangladesh. There is a need for more investment. The demand for this investment can be met through Sukuk bonds.
Long-term finance for the development of the private sector is necessary. We are mostly dependent on commercial banks for any financing but banks are not supposed to provide funds for the long term.
There are many opportunities to launch Sukuk Bonds in Bangladesh. It is possible to get good returns from this bond. The first Sukuk in the country was issued by the Bangladesh Bank on December 28 last year for financing safe water supply projects across the nation. Good is also planning more Sukuk to finance infratrusure projects.
This may be mentioned that most of the commercial banks are practicing islamic banking system as there are demands from about 29% of the population of the country. Though the Islami banks has huge surplus capital but there is no scope for investment following the Islamic principle.. The Sukuk bond issued by the government shall be purchased by the Islami Banks and government can raise fund to finance the big infrastructure projects. This will help the nation for sustainable economic growth.

3. To: Board of directors
From: BTC Consultants
Date:
Subject: Evaluation of potential investments
This report evaluates four options available to management and sets out reasons for recommendations being made.

1. **Selection Sequence – Impact on Acquisition of undervalued companies (PQR, RST, XYZ) applying both NPV and profitability index methods, as well as considering the risk profile & the balance capital available.**

The project evaluation summary is depicted below.

Company	NPV (Tk million)	Profitability index (PI)	PI 9NPV/Outlay)
PQR	(318)	0.77	-23%
RST	160	1.13	13%
XYZ	161	1.13	13%

Refer annexure 01 for workings.
As reflected above, acquiring PQR would have a negative impact on cash flows, based on both NPV as well as profitability index methods. However, both RST and XYZ report positive NPVs. Therefore, further evaluation of these two options may be made, to pick the best option.
RST and XYZ give similar results using NPV and profitability index methods. Hence other qualitative factors should be considered, to decide between RST and XYZ.
XYZ receives its cash flows at the end of the project, and has a larger terminal value than RST, with a differential of Rs. 122 million (present value). It therefore appears that the rate of payback is faster in RST, which appears to be a lower risk, when compared with the timing of cash flows from XYZ. Therefore, RST stands out among the rest and qualifies for selection. However, given that partial acquisition is not possible, neither RST nor XYZ can be acquired.
This investment decision would leave Tk. 310 million (TK. 1,500 million – Tk 1,190 million) available for reducing debt or for other investment options.

2. **Discussion on whether the investment should be made in undervalued companies, Stock market or Money market,**

The reason for disposal of its foreign subsidiary by BCC, was to shift long-term investment into more profitable and diversified market segments, particularly consumer products, towards maximizing shareholder value and diversifying risk.
The Money market, which encompasses short-term, high quality debt securities issued by the government and corporates, does not seem to be a suitable option, as it focuses on short-term returns.

Maturities can range from overnight to up to a year. The Money market creates liquidity for borrowers to fund their short-term cash flow needs.

Hence an investment of TK. 1.5 billion in common Money market instruments would include treasury bills (T-bills), certificate of deposit (CDs), commercial paper, and banker's acceptances.

Rates of return from such Money Market instruments however, stay low, when compared with that of equity market investments or of one's own business investments.

Average Money market returns remained between 8.7% – 9.5% at the end of the period under review (TB as the base).

The Stock market on the other hand, could be an investment method, targeting longer-term returns, and the market indices could be used as a Dash Board to figure out an average rate of return.

Average returns for the last year have been calculated in the table below using DSE and S&P as indicators.

	DSE	S&P
Beginning	6164	3492
Movement	448	380
Return	7%	11%

This shows that Stock market returns have remained even lower than the money market returns under review.

An alternative way to maximize shareholder value would be to look for a venture capital arrangement, where the company can invest in a start-up with high growth potential, towards making larger profits in the long run. As venture capital investments span unrelated businesses in various industries, the objective of diversification too is achieved.

Given the circumstances, the largest possible return that can be achieved from available options, would appear to be from investing in one of the companies - RST or XYZ.

Summary

Segment	**Average return**
RST/XYZ	**13%**
Money market	9.1% (8.7% ∞ 9.5%)
Stock market	9% (7% ∞ 11%)

The criteria for selecting any one option would therefore be dependent on whether the company can make sufficient payout to investors. Both Money market and Stock market returns do not exceed the WACC of BCC company and would therefore not enable a dividend payout to its stakeholders.

Additionally, Money market and Stock market investments can easily be made by the shareholders themselves, instead of their investing in BCC to achieve this end. Hence maximizing Shareholder Value is of greater importance.

The BCC company should therefore look to achieving 'higher than WACC' returns from avenues other than investing in the Money market or Stock market.

3. **Looking for debt capital or extra capital in accepting both RST and XYZ from a financial management perspective**

The current capital structure does not seem to be highly geared unless the fund providers already raised their concerns in raising further funds as debt.

However, raising of funds as capital or debt, for the proposed acquisitions, amounting to Tk. 920 million, may be acceptable, if the WACC of the company remained below the expected returns from the projects/investments, i.e., showing positive net present values after factoring for increased gearing.

Additional funds needed: TK. 920 million (1,190+1,230 -1,500).

Note: WACC is supposed to come down as the company adds more and more debt to the capital structure unless the company is very highly geared.

Therefore, raising additional capital or debt, to finance both projects RST & XYZ, may be acceptable, from a financial management perspective, given their healthy positive net present values, as reported.

4. **The chairman's attempt to repay debts.**

The chairman's attempt to repay debt at the cost of proceeding with the new project, would bring down company's value in many ways. Given below are three ways.

- It will create an upward pressure on WACC with reduced debt in capital structure; hence future cash flows will be discounted at a greater WACC, in valuations of BCC.
- As the proposed investment would have brought down aggregated beta factor for BCC, through diversification, if the chairman opts to utilize cash for debt settlement instead, the beta factor reduction would not be possible, and as a result, cost of equity in BCC, would be greater.
- There would be a negative impact from the diluted tax shield benefit.

Annexure 01

Risk free rate =	11%+ 10.5% +9.5% = 10.33%	
	Based on the CAPM model:	Approximately
PQR	10.33% + 1.4(3)= 14.50%	15%
RST	10.33% + 1(3) = 13.33%	13%
XYZ	10.33% + 0.8(3)= 12.73%	13%

Profitability Index

PQR				
Year	Cash flows (Tk. Million)	DF 15%	PV	NPV
0	-1360	1	-1360	
1	-20	0.870	-17	
2	150	0.756	113	
3	220	0.658	145	
4	1400	0.572	801	-318

RST				
Year	Cash flows (Tk. Million)	DF 13%	PV	NPV
0	-1190	1	-1190	
1	410	0.885	363	
2	330	0.783	258	
3	255	0.693	177	
4	900	0.613	552	160

RST				
Year	Cash flows (Tk. Million)	DF 13%	PV	NPV
0	-1230	1	-1230	
1	90	0.885	80	
2	300	0.783	235	
3	580	0.693	402	
4	1100	0.613	674	161

4. (a) According to the given scenario, the hotel is at maturity stage. It can be further proved by the following features given in the scenario.

- Lakeside Hotel experienced a rapid growth in the past years in terms of number of guests and profits. Further the hotel has faced a slowdown in the growth rate.
- Market share and profits have also faced a declining trend. However, the hotel is still generating positive cash flows.

Therefore, it was noted that the hotel has passed its growth stage and now arrived at the maturity stage.

(b) As the hotel is in the service business, the extended marketing mix (7Ps) will be applied. Therefore, the service marketing mix relevant to Lakeside Hotel is given below.

- **Product**

Product consists of luxury rooms and suites, and other facilities such as a swimming pool, gymnasium which are available to all resident guests and a business center, spa, and an ayurvedic center which are available on payment. Therefore, all the service components and brands of each service can be included into the "Product" of the given scenario.

Price

All the listed prices of each service and payment terms and conditions can be included in the price element of the marketing mix. Therefore, prices of rooms and suits, discounts rates and payment methods and conditions belong to the price element.

- **Place**

Location of the hotel is included in the place element of the marketing mix. The Place is a very important element in the marketing mix for a hotel to attract customers. The location of the hotel is the place where services are provided and received by the customers.

- **Promotion**

The Promotion element consists of all the promotional efforts of the Riverside Hotel. Therefore advertising, sales promotions, public relations, personal selling, direct marketing etc. adopted by Riverside Hotel includes to the promotional element, e.g., seasonal discounts.

- **People**

All the human elements involved in providing services include the people element of the marketing mix. The services provided by the waiters in the restaurant of the hotel, management, room service staff, staff in the reception to welcome the guests to the hotel are a few examples of the people element. They can create a pleasant environment to customers, and it has a direct impact on customer satisfaction of the services provided by the hotel.

- **Processes**

Process is the steps to be followed by guests for getting the service of Lakeside Hotel. For E.g.: The hotel must ensure that customers make reservations for rooms and food before they arrive at the hotel.

- **Physical evidence**

All the physical aspects that may have an impact on the quality of services provided by Lakeside Hotel will consist of physical evidence. The architectural design of the Lakeside hotel, staff uniforms, colours used by the hotel, decorations, website design, are a few examples for physical evidence of the hotel. It can provide very powerful images to attract customers to the hotel.

(c) **Product**

The hotel management should consider some modifications to the product element with the following improvements for the purpose of increasing sales.

- Luxury rooms and suites need to have more space and facilities given to it and the suites should have more space than the luxury rooms.
- The beds must be larger and more comfortable.
- Provide more facilities for guests- for example suites could be given free access to the spa and the ayurvedic center, while luxury rooms could have free access to one of them.
- A more private dining area for guests of luxury rooms and suites.

Price

The Lakeside Hotel management can make the following modifications to the price element for improving the performance of the hotel.

- Revise the room rates for the suites based on the number of guests.
- Offer special discounts for seasons and types of guests.
- Arrange facilities to make payments by different channels etc.
- Offer special packages for special groups such as families and staff of different companies.

Place

The Lakeside Hotel management can make the following modifications to the place element for improving the performance of the hotel.

- Ensure the environment is clean and there are no disturbances to the customers.
- Take action to develop the surrounding road system for improving the convenience of customers to access the hotel premises.

Promotions

The Lakeside Hotel management can make the following modifications to the promotion element for improving the performance of the hotel.

- Design new advertising campaigns
- Carry out sales promotions by offering special rates offering special discounts for frequent occupiers of luxury rooms or suites based on a loyalty program.
- A direct marketing campaign using social media and web base promotions etc.
- Designing new PR programs to enhance the credibility of the hotel People The hotel management can take the following action to improve performance through people.
- Allocate staff to handle the needs of guests in luxury rooms and suites. Special training might be needed on how to interact with guests.
- Motivating hotel staff by deploying an attractive rewards scheme.

People

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- Motivating hotel staff by deploying an attractive rewards scheme

Process

The hotel management can take the following action to improve processes which leads to higher customer satisfaction and to improve the results of the hotel.

- A faster check in and check out process for the luxury rooms and suites.
- Introduce an easy-to-use online booking system etc. Physical evidence

The hotel management can take the following action to improve the "physical" evidence element.

- An enhanced ambience for the luxury rooms and suites. Each suite could be decorated on a unique theme (jasmine suite and lotus suite and so forth).
- Refurbishment/construction to make the location more natural and relaxed.

(d) Customer Relationship Management (CRM)is the establishment, development, maintenance, and optimization of long-term, mutually valuable, relationships between consumers and organizations. Many companies provide customized services by using CRM based computer software and customer databases.

Therefore, the Lakeside hotel can obtain certain benefits by having a good customer relationship strategy. The benefits to the hotel are given below:

- Hotel management can ensure that customers have a memorable experience and thus also generate positive word of mouth and revisits.
- Help to boost the reputation of the hotel and further boost revenue and occupancy based on positive word of mouth recommendations.
- Good CRM will also ensure that the hotel will obtain feedback from customers and the hotel should act on specially the negative comments. This will help to improve the operations of the hotel.
- Ability to identify customers who have come many times to the hotel. This will also enable to implement loyalty cards, and promotions for customers who are in this category. Further their choices/preferences could be noted and adhered to and the check in for such customers could be handled faster.
- Further good CRM could ensure that the hotel collects data on all customers. This will give a rich pool of data such as demographics, preferences of the customers which will aid in decision making.
- For example, if a lot of visitors were observed to prefer peace and quiet and closeness to nature, the hotel could now act to further ensure that it happens. Further this pool of data will also give insights on consumer behavior, what are the consumers' wants and how they decide their requirements. Example whether the consumer is price sensitive or not.

5. (a) Merits of industrial relocation:

Moving your business is never a decision to be taken lightly. Long distance moves can be costly, disrupt your business operations, and impact your ability to expand. So, why the entrepreneurs choose to relocate their industries? A change in location also lead to an opportunity that doesn't currently exist for the business. The potential revenue growth outweighs the nominal cost of hiring long distance movers and the risk of uprooting the operation. Coming to this conclusion takes careful consideration and usually the following merits can be achieved::

i. Better pool of employees in the new location
ii. Incentives that can be achieved in new location

iii. Remove problems in the present location
iv. Lower cost of doing business
v. Better quality of life for the employees
vi. Possibility to upgrade technologies

Business are well positioned to benefit from a relocation because they already know the shortcomings that are stifling growth. .By looking outside of the immediate area business owners improve their chances of finding the location that's best suited for the company's needs and will support revenue generation. However, this requires that company clearly define what a new location must offer. If you take your time to fully assess all viable options and research all of the factors above the risk of a relocation is usually lower than the rewards.

(b) Industrial relocation is often a necessary though complicated undertaking. Several factors are involved which must be carried out successfully in order to achieve a smooth and fully functioning industrial relocation Whether relocation entire .facilities or just moving single units of machinery, both objectives require meticulous planning and precise management in order to stay within budget and on schedule. It is also crucial to maintain a safe and regulated working environment at all steps of the process. Protocol to follow include equipment and electrical test certification, method statement, risk assessment, individual training records and lifting guidelines. All of these elements are fundamental to industrial relocations projects and cannot be completed effectively without the knowledge and expertise of relocation services.

Unsuccessful, incomplete, late or incorrect relocation can cause huge disruption and potentially disastrious problems in terms of slow productivity and financial losses for industrial facilities. Safety regulations alone warrants extremely meticulous care and a high level of detail orientation if hazardous situations are to be avoided. No matter what the project, large or small, consulting the best industrial relocation service is absolutely crucial.

Industries commonly cite five reasons for changing its locations. These are labour and work forces issues, the desire to reach new markets, need to upgrade facilities or equipment, the desire to lower cost or increase cash flow, and considerations about the quality of life. For different business and different times, certain concerns are more important than others. But just about all moves can be attributed to some combination of these issues.

Columbia Garments should decide for locate their factories/industry due to the following considerations:

i. A dedicated industrial zone for garments industries. Industries of Comulbia group is now located in Gazipur and Saver. This area is highly populated and labour problem is a common phenomena.
ii. All utility services are not available in the present location. Electricity supply is very unreliable. In the special zone there will be no such problem
iii. Transportation of raw material and finished goods comes trhough the Chittagong port, which is far away from the factory. It takes long time to carry raw materials. This will help them to resolve the problems.
iv. Shipment of finished products is also hazardous They are to maintain a separate office in Chattogram to handle shipment. Relocation will help them to resolve shipment and reduce transportation cost.
v. Building a new deep sea port near the project will save time and hazards.
vi. Resolve labour problem: Now as the factories are in private areas labours try to create problems which will not be possible in the specialized protected zones.
vii. New area will offer different tax benefit and incentives
viii. Create a better pool of employees in the new location.
ix. Offer better quality of life and environment
x. Lower overall cost of doing business

(c) Change management:

Industrial relocation is always affect employees and they always try to resist the relocation. Company management need to make a long term strategy for relocation. They should implement it phase – wise. To motivate the employees the following steps to be taken;

i. Employees of the Chattogram area should be moved frist
ii. Employees should be given recreational opportunity, education facility for children, health care facilities,,

iii. Employees to be given a better quality of life;
iv. Special salary and increment to be given to the employees who opt for new locations;
v. Provide good working environment for the employees

(d) Role of government
Management of land: government should allocate proper quantity of land for the industry
Provide infrastructure facilities: Provide gas, uninterrupted power supply, road transportation, sanitation facilities, and others benefits.
Tax benefits: government should consider tax benefit for initial few years for the relocated industries
Duty free provisions: Government should allow the industries to import raw materials without duty and taxes.
Reduce rental: Initially the rental charge may be reduced
Support services: Provide all support services in one stop mode.
Labour accommodation: Government should build residential area surrounding the Economic Zone for the employees and work force.

6. **Ethical implications**

Are all the facts and/or information available?
They study is only 30% complete, so the possibility that in the end the situation may be better than it appears currently should be considered. It is also sensible to double check that correct information gathering procedures are being implemented in the study, and that the preliminary conclusion has been soundly arrived at.

Is there any legal issue?
There is likely to be considerable Bangladesh and international legislation governing the pharmaceuticals industry and the safety of drugs and medicines. This may dictate the responsibilities of Suez's directors in relation to transparency and communication of any possible safety issues and the timing of any announcements.

Do any other codes or professional principles apply?
The pharmaceutical industry will almost certainly have its own code of conduct and guidelines to ensure members behave in an ethical and professional manner. As a highly successful player, Suez is likely to have a high profile in the industry and will be expected to set high standards of responsible behavior. Most drugs on the market carry warnings of possible side-effects. A key issue here is the timing of any announcement and the point at which the legislation and/or any professional code of conduct specifies that an announcement and warning of possible side-effects is necessary.

Which stakeholder does the decision/action impact?
Pharmaceutical companies are commercial organisations and it is reasonable to assume Suez's long term objectives is to maximise shareholder wealth. If the board announces the research findings and they subsequently prove to be unfounded, then Suez's share price and shareholders are likely to have suffered unnecessarily. Also, sufferers of the chronic illness who stop taking the drug immediately may have a lower quality of life as a result. However, were the board not to announce preliminary findings and the tests went on to be conclusive, patients taking the drug may experience adverse side-effects in the meantime.

The issue here involves balancing the interests of the shareholders with Suez's wider corporate responsibility to its other stakeholders and society.

What are the implications in terms of transparency, effect and fairness?

Transparency – would Suez mind if it subsequently came to light that the company was unaware of the potential safely issues but has chosen not to disclose their concerns until the results were conclusive?

The issue here would be whether a reasonable person would have expected disclosure of the results. Suez may have grounds for believing that the initial results will not prove representative, given that the study is only 30% complete. If however, it is likely that the final results will confirm the initial findings then Suez would probably not want to the fact that it was aware of the problem earlier but took no action ever to come to light.

Effect – whom does the decision affect/hurt?
The possible side-effects may affect a significant number of people if the new over-the-counter remedy is widely used. Any side-effects would also have financial consequences for Suez in terms of compensation payments and legal costs, as well as reputational consequences – lost customer and possible withdrawal of license to produce the drug.

Fairness – would the decision be considered fair by those affected?
This partly depends on whether any action taken by the board is seen as justifiable business decision, which might take into account cost/benefit analysis, risk assessment and normal practice within the industry.

Stakeholder conflict
Stakeholders are groups of people who are interested in what Suez does. In the case of Suez's approach to the safety of its products this would include internal stakeholders, connected stakeholders and external stakeholders.

Here the issue highlights the potential conflict within and between various stakeholder groups.

Shareholders want profitability so some may prefer Suez to limit the damage and keep the information confidential until it is forced by legislation and/or regulation to announce it. Users of the drug and regulatory bodies may value safety more highly however and prefer to in possession of the relevant information in order to make an informed choice.

Conclusion
Which stakeholders' interests determine Suez's action will depend to an extent of their relative power. Clearly, Suez's primary focus is to maximise shareholder wealth. However, the users of the drugs are very important to success and may choose to stop buying the product or look to other companies if they think their safety is being compromised. Also, shareholders may acknowledge that going beyond the basic requirements and demonstrating a responsibility to wider society will Suez's reputation and ensure government and public support, giving it a competitive advantage and higher profits in the long run.

legal needs of other shareholders and treating them with equity and fairness. Whether or not equity and fairness is viewed as a set of objectives or conditions is not particularly important in practice, provided it is acknowledged.

It should be noted that increasing dividends each year is not necessarily the same as profit maximisation. Dividends are, of course, paid from distributable profits and profit maximisation will lead to shareholder wealth maximisation. If, as the FD's comments suggest dividends need to increase every year this will not necessarily lead to profit maximisation as large investment projects, for example, may mean a reduction in dividends in the short term in exchange for even higher dividends in the future.

The question then turns to whether 'maximisation of shareholder wealth' is something that can actually be achieved, and if so, how? Some writers would say that 'satisficing' (i.e. paying a **minimum required rate of return**) is the closest that can be achieved, with surpluses generated by the company being the subject of bargaining between stakeholders..

A range of performance objectives

The other directors propose a range of 'objectives' which are probably best described as targets, designed to help achieve the main objective of shareholder wealth creation. Thus a target return on investment is a way of trying to increase shareholder wealth. In setting these financial targets, however, it is vital to recognise the relationship between risk and return and to put boundaries on risks taken in pursuit of the targets.

The problem with financial targets is that they depend on non-financial actions, such as increases in sales or productivity. Hence non-financial performance improvement measures are vital as a component of the set of targets the company should seek.

Strategic plan

This leads to the most important criticism of all. The company appears to have **no strategic plan**, but appears to working on the basis that its **current success** will continue unchanged. In particular it is likely to be outflanked by some of its competitors that have relocated production facilities to low cost countries.

Conclusions

The company's main objective should be to **pay shareholders a minimum rate of return** consistent with the **risk** they are prepared to accept. The company should investigate attitudes to risk among its main shareholders.

The main objective should be presented in conjunction with statements that the company will **fulfil its legal obligations** and will **treat other stakeholders with equity and fairness**.

The main objective should then be accompanied by a set of **financial and non-financial targets**, based on the **strategic plan.**

(b) Financing or refinancing strategies

The treasury department should develop a **financing strategy** based on its ongoing business and investment plans, and the cash requirements forecasts that come out of these plans. The financing strategy should consider:

(i) **Debt or equity**

Treasury should **evaluate the project plans** in conjunction with the **gearing ratio** and decide whether it is **worthwhile taking out more debt or redeeming it with surplus cash** instead of paying dividends. Some investments will provide **good security** for borrowing and may allow gearing to be increased without taking undue financial risk. Other investments are **less certain** in the development stage and

FINANCIAL MANAGEMENT
March-April-2021
Suggested Answers

1. (a) Corporate objectives for Best Water

Best Water has two main objectives at present:
- To treat all stakeholders with even-handedness
- To increase dividends each year

(i) **Even-handedness**

Stakeholders

There will always be a number of **stakeholder groups** interested in a company's operations, including shareholders, loan creditors, directors and managers, other employees, customers, suppliers, government (including tax authorities), and the communities in which the company is based.

Shareholders

The primary stakeholders are the **shareholders,** who are the owners of the company. They appoint **directors as agents** to run the company on their behalf. In a private company like Best Water, the directors will almost invariably also be shareholders. Thus private sector companies **must** have a primary objective that is related to the needs of shareholders.

Stakeholders with legal rights

Some of the stakeholder groups (e.g. loan creditors and the national and local tax authorities) have **clear legal rights** to payments by the company, and the concept of 'even-handedness' will not really apply. For the most part these are stakeholders whose sole need is for the law to be satisfied, that is they expect to be paid on time, and any negotiations start from this premise.

Other stakeholders

For the other stakeholders, the concept of even handedness is a good general approach to adopt. Even those who assert that a company's **sole objective** should be to benefit shareholders will agree that this is best done by considering the needs of other stakeholder groups. For example:

(1) **Customers** should **not be cheated** on the quality of goods (or they will buy elsewhere).
(2) **Suppliers** should **not be made to wait unduly** for payment (or they will increase their prices).
(3) **Directors and key managers** should be given **fair rewards** for their successes (or they will lose motivation, divert benefits to themselves or leave the company); however they should not be allowed to take the same rewards if they are unsuccessful.
(4) **Other employees** should **not only be paid fair market rates** but also encouraged to participate in company plans.
(5) **The local community** should **not be subjected** to **unnecessary noise or pollution**, and can provide powerful good publicity for the company.

(ii) **Increasing dividends each year**

Although it correctly focuses on shareholders, the objective of increasing dividends each year is unsatisfactory as a primary objective for Best Water. This is because the pattern of dividends may need to be **varied** to take advantage of **investment opportunities.** In some years it may be wise to restrict dividends in order to reinvest in the company for growth.

Finance Director's statement

The FD stated that 'As a company our main financial objective should be to increase dividends each year'. As stated above, the **primary objective** of a **private sector company** must be to **benefit its owners**, taking into consideration the fact that this cannot be properly done without also satisfying the are **better financed with equity**. The directors may also wish to consider **ownership** implications, the tax shield effects of debt, and the **interest commitment** made if debt is taken out.

(ii) **Short- and long-term debt**

It is best to obtain a **satisfactory mix** of short- and long-term debt, in order to manage financing risk at the minimum interest cost. In general **long-term debt** will be **more secure** but **more expensive** because the lender does not have the option to withdraw it so soon. The policy should consider **financing assets out of funds** from the **same type of duration**. For example non-current assets and the permanent part of working capital can be financed from equity and longer-term loans, whereas fluctuating working capital should be financed from overdraft or other short-term funds.

(iii) **Fixed or floating rate loans**

Interest on fixed rate debt is **easier to forecast** but **may be more expensive** in the long run than floating rate debt. The fact that interest rates are predicted to fall is an indicator that floating rate debt may be beneficial at the moment but interest rate risk must be acknowledged. There may be **cash flow problems** in the event of rising interest rates.

(iv) **Foreign currency loans**

A foreign currency loan should probably only be considered as a **hedge against income received** in that currency. For example a euro loan can be **matched** against **expected euro receipts**. Foreign currency loans should not be taken out simply because the interest rate appears cheap, because unhedged exchange rate movements can cause significant losses.

Financing and overall strategy

Financing strategies will be reflected in the company's overall strategic plan. In general the aim should be to **trade off** the **cost and risks** of finance. The decisions taken on financing will be reflected in some of the target figures accompanying the corporate objectives – for example gearing, cost of capital and duration of finance.

2. (a) Determinant factors of dividend decision:

Factors a company is likely to consider in determining its dividend policy may include the following:

Dividend signaling
The dividend itself is taken as an important indicator by many investors of company health, and cutting the dividend from its previous fairly constant level may convince the investors of problems in the company. If enough shareholders decide to sell their holding the share price will drop.

Liquidity
Companies that are experiencing cash flow difficulties may decide to retain earnings rather that pay dividends. This should improve cash flow.

Growth opportunities
Maintaining financial flexibility to enable investment in opportunities. If there are viable projects which need funding then management can cut dividend for funding the investment through retained earnings as it is far cheaper than any other source of equity finance.

Taxation Regime
The tax regime that exists may influence dividend policy insofar as it may/may not be advantageous not to distribute dividends in lieu of capital gains. The different tax positions of investors will mean that some prefer dividend income, while some prefer an increase in share prices.

Gearing
Retaining earnings may enable a company to avoid raising debt financial and increasing financial gearing related risks.

Control
Companies may decide to retain profits rather than risk the dilution of control by issuing additional equity shares.

Future fund raising
If the firm is about to embark upon a major expansion programme, it is likely to need external equity in the near future. It could therefore be unwise to cut dividends too sharply, as this could undermine shareholder confidence in the new management and make later issues of new equity difficult.

(b) (i) **D/P and P/E ratio**

	Z Ltd.					ST Ltd.				
Year	**EPS**	**DPS**	**Price**	**Dividend payout ratio (DPS/EPS)**	**P/E (Price / EPS)**	**EPS**	**DPS**	**Price**	**Dividend payout ratio (DPS/EPS)**	**P/E (EPS / Price)**
1	9.30	2.00	82.50	21.51%	8.87	9.50	1.90	70.00	20%	7.37
2	7.40	2.00	67.50	27.03%	9.12	7.00	1.40	45.00	20%	6.43
3	10.50	2.00	90.00	19.05%	8.57	10.50	2.10	57.50	20%	5.48
4	12.75	2.25	110.00	17.65%	8.63	12.25	2.45	100.00	20%	8.16
5	20.00	2.50	167.50	12.50%	8.38	20.25	4.05	167.50	20%	8.27
6	16.00	2.50	170.00	15.63%	10.63	17.00	3.40	160.00	20%	9.41
7	19.00	2.50	182.50	13.16%	9.61	20.00	4.00	160.00	20%	8.00
(ii)	**Average D/P ratio and P/E ratio**									
Total	94.95	15.75	870.00			96.50	19.30	760.00		
Average				**16.59%**	**9.16**				**20.00%**	**7.88**

iii) <u>**Reason for lower share price of company Y**</u>

Z Ltd. is following a stable dividend policy whereas ST Ltd. is following a stable dividend payout ratio. In the latter case, sporadic dividend payment occurs (because dividend amount is highly dependent on earnings) which make the investors uncertain about its returns they expect from the company. As a result, the share price will be depressed.

It is probably for the reason that Z Ltd's average price per share exhibited a constant increase compared to ST Ltd.. ST Ltd. is advised to follow a stable dividend policy.

3. (a) The cost of capital, r, can be found by rearranging the terms in the dividend growth model,

Po = D1 / (r – g) so:
r = (D1/po) +g = (1.2/24) +0.12 = 0.05 + 0.1 = 0.15 = 17% = the cost of capital

Granting rights to use patent

NPV = PV of Benefits – PV of costs

PV of **benefits** = BDT 20m x PVIFA (12yrs, 17%) + PVIF (2yrs, 17%) {CF / (r – g)}
= BDT 20m x 4.9884 + 0.7305 {BDT 50m / (0.17 – 0.075) }
= BDT 99.768 m + 0.7305 X 526.3158
= BDT 99.768 m + BDT 384.4737

= BDT 484.2417 m

PV of Costs = BDT 60 m + [PVIF (2yrs, 17%) x {BDT 50 m x PVIFA (20yrs, 17%}]
= BDT 60 m + [0.7305 x {BDT 50 m x 5.6278}]
= BDT 60m + (0.7305 x 281.39)
= BDT 60 m + BDT 205.5554= **BDT 265.5554 m**
Thus **NPV** = BDT 484.2417 – BDT 265.5554 = BDT 218.6883

Thus as NPV of 1st investment proposal > 0 using the NPV decision criteria alone the firm should undertake the project. However as the two investment proposals are mutually exclusive therefore we must look at Investment B and see which has the highest NPV.

Setting up a new plant

Year	Cash Flows (m)	17% factor	PV	20% Factor	PV
1	-175	1	-175	1	-175
1-20	25	5.6278	140.695	4.8696	121.74
20	2,000	0.04328	86.56	0.0261	52.2
NPV			**52.255**		**-1.06**

IRR = 17% + 52.255 / (52.255 - -1.06) x (0.2 – 0.17)
IRR = 17% + 52.255 / (53.315) x (0.03)
IRR = 17% + 0.9801 x 0.03
IRR = 17% + 0.0294
IRR = 19.94%

At 17%, the NPV of 2nd Investment is also >0. Using the NPV decision criteria alone the firm should undertake the Second Investment.
However even though the IRR for 2nd Investment at 19.94% is bigger than the discount rate in 1st Investment, the NPV of 1st Investment is greater than the NPV of 2nd Investment proposal.

Hence as 1st Investment and 2nd investment is mutually exclusive, 1st Investment proposal should be chosen over 2nd investment.

(b) NPV is considered the academically preferred investment appraisal method.

- The NPV method works out the present values of all cash inflows & outflows of an investment at a target rate of return, & calculates out a net total.
- Projects with a positive NPV are deemed acceptable or viable. Projects that exhibit a negative NPV are considered to be unacceptable or not viable.

Strengths:
- The NPV takes into account the time value of money
- It is expressed in today"s money terms
- It uses cash flow rather than accounting profits over the entire life of the project.
- It is the academically preferred method.

Weaknesses:
- It is not easily understood as pay-back or ARR
- The discount factor that is appropriate can be a complex decision.

IRR
Strengths:

- It considers both the magnitude and the timing of the project's cash flows over the entire life of the project.
- IRR is measured as a percentage, which is easy to understand.

Weaknesses:

- It ignores the relative size or scale of investments.
- More than one IRR may result if the cash flows from projects are not conventional".
- IRR should not be used to assess mutually exclusive projects.
- When projects are mutually exclusive, the NPV is a better criterion for making investment decisions.
- IRR assumes cash flows related to a project can be re-invested elsewhere at the IRR.

NPV is superior to IRR because:

- Mutually exclusive projects can lead to total vs. average returns problem.
- If projects are mot independent it can lead to capital constrained problem, (soft or hard rationing).
- Multiple rates of return problem.
- Tem structure; (IRR assumes or does not change).

(c) By its nature the future is uncertain. Hence planners must accept that financial plans for the future will rarely be completely accurate. Where forecasts are dependent on economic events, changes in the market or changes in an industry for example they will be very difficult to make. Financial forecasts should be based on realistic assumption. This will allow the forecasts to be compared to actual and expected performance. Companies should make contingency plans, for what they will do if the most likely predicted events fail to occur. They can also use risk management techniques such as hedging procedures could be put in place to protect against adverse movements in interest rates or foreign exchange rates for example.

While planners should accept uncertainty they should also try to consider the costs of forecasts being erroneous. Methods of assessing uncertainty are:

- Sensitivity analysis / "what if "questions.
- Best case / worse Case and most likely scenarios forecasts
- Probability distribution of possible outcomes
- Simulation models
- Statistical models

Sensitivity analysis;

Forecaster can try to cost erroneous forecast by carrying out **sensitivity analysis**. By asking "what id" questions and finding out the effects of changes in the underlying assumptions of the forecast. e.g. what would be the effect of every one percent increase/decrease in the predicted in flation, sales, wages, interest rates etc. What would be the cost of every delay of one week / month? This approach can be used in conjunction with the probability distributions methods outlined below.

Best case / worse Case and most likely scenarios forecasts

This is a very common approach in uncertain situations. It involves asking "what is the best case, (optimise), scenario?" "What is the worst case, (pessimistic). Scenario?" "What is the most likely scenario?" Forecasts can be prepared for each of these outcomes. This approach is also often used in conjunction with probability distributions methods outlined below.

Prepare a probability distribution of possible outcomes

A probability distribution can be prepared either in conjunction with the best case/worse case scenario or as an alternative to it. A probability distribution can be forecast either for the possible range of different outcomes or for any key variable in the business plan. The effects of changes in unknowns such as sales, materials, wages and other costs, Interest rates, foreign exchange rates, and so on can be prepared. Form these probability distributions, forecasts can be made of the expected value of or alternatively the probability distribution of sales, profits or cash flow for example.

Simulation models

Simulation model are put together by assigning a range of random numbers to each possible value for each of the uncertain variables. These random numbers should exactly match their respective probabilities. This can be achieved for example by working upwards cumulatively from the lowest value to the highest value and assigning numbers that will match up to its probability groupings.

Statistical models

Statistical model can be used to predict likely outcomes given interdependent variables. Multi-variate models are becoming more common as computing power becomes cheaper and knowledge of their use becomes more widespread. With all these techniques there is a danger that while acknowledging risk and uncertainty they appear to be able to "control it" or at least "control for it". This can give a false sense of security can be almost as dangerous as not acknowledging uncertainty in financial forecasts in the first place.

4. (a) In order to evaluate the effects of the acquisition on Walton's beta, we can do the analysis in two parts. First, we examine the effects of the merger on the business risk of the combined firm, by estimating the unlevered betas of the two companies and calculating the combined firm's unlevered beta:

Walton's unlevered beta = 1.15/(1+0.64*(3,186/31,100)) = 1.08
Capital Hill's unlevered beta =0.95/(1+0.64*(615/18,500)) = 0.93

The unlevered beta for the combined firm can be calculated as the weighted average of the two unlevered betas, with the weights based on the market values of the two firms.
Market value of Walton = 31,100 + 3,186 = TK 34,286
Market value of Capital Hill = 18,500 + 615 = 19, 115
Unlevered beta for combined firm = 1.08 (34,286/53,401) + 0.93 (19,115/53,401) = 1.026

Effects of the financing of the merger on the betas by calculating the debt/equity ratio for the combined firm after the acquisition, assuming that Tk 10Bn is borrowed to finance the acquisition:
Debt = Capital Hill old debt + Walton's old debt + New debt
= TK 615 + TK 3,186 + Tk 10,000 = Tk 13,801mn.
Equity = Walton's old equity + New equity used for acquisition
= TK 31,100 + Tk 8,500 = Tk 39,600mn

Where, New equity = Total cost of acquisition – new debt issued
= Tk 18,500 – Tk 10,000 = Tk 8,500mn

The debt/equity ratio can then be computed as follows:
D/E Ratio = 13,801/39,600 = 34.82%
The debt/equity ratio, in conjunction with the new unlevered beta for the combined firm, yields a new beta of:
New beta = 1.026 (1+0.64(0.3482)) = 1.25

(b) The exporter pays the premium immediately, that is a sum of 0.025XTk 500,000 X86 = Tk 1,075,000. Now there can be three different possibilities that can occur:
(i) The rate becomes Tk 85/$ means US$ depreciated. In this situation, the exporter will sell the dollar, exercise the option at Tk86 per dollar and net receipts would be
= Tk 86xtk 500,000 – (86x0.025x500,000)
= 43,000,000 – 1,075,000= Tk 41,925,000
If we had not covered with option, the net loss he has to incur Tk 42,500,000 but would not be certain about actual amount to be received.

(ii) If the dollar rate becomes Tk 86.50. This means dollar appreciates. He sells his dollar directly in the market at the rate of Tk 86.50 and the net amount to be received

= Tk 86.50 x Tk 500,000 – 86 x 0.025 x 500,000

= Tk 43,250,000 – Tk 1,075,000

= Tk 42,175,000

If he had not covered, he would have got,

Tl 86.50 x Tk 500,000 = Tk 43,250,000

(iii) Dollar rate on settlement become equals to strike price. Net amount received by the exporter = Tk (86x 500,000- 86x0.025x500,000)

= Tk (86-86x0.025)x500,000 = Tk 41,925,000

5. Impact of the new project and related finance.

	Tk Mn	
Current ex-dividend of shares = 5mn X Tk 5		25
NPV of the project		0.5
Increase in equity capital		0.5
Ex-div value of shares afterwards	26mn	

Alternative working:

Exisiting dividend = Tk 0.5X5m = TK 2.5mn

Increase dividend = Tk 0.1mn

P = D1/Ke = (TK 2.5m + TK 0.1m)/0.1 = Tk 26m

This will be the ex-dividend value of the equity irrespective of how the money is raised. The cum-div value will obviously be affected if some of the dividend is retained, but the wealth of the shareholders will not be

(a) Retained earnings

Tk mn		Ex-div value	+ Dividend	= Cum Div value
Before		25	2.5	27.5
Capital: using dividend		0.5	-0.5	
Project outlay:	(0.50)			
PV (inflow)	1			
NPV Project		0.5		
		26m +	2m	=28m,

So, increase in shareholder wealth is TK 0.5m being NPV of project.

(b) Rights issue

Tk mn		Ex-div value	+ Dividend	= Cum Div value
Before		25	2.5	27.5
Capital:		0.5		
Project outlay:	(0.50)			
PV (inflow)	1.0			
NPV Project		0.5		
		26m +	2.5	28.5

Increase in shareholder wealth is : Increase in value of equity Tk 1mn less cost of new shares Tk (0.5m) = Tk0.5mn

In conclusion, the change in shareholders' wealth is the same, irrespective of how the new capital is injected.

(c) New share issue

While the wealth of the shareholders in total is unaffected by the source of the new equity, the way that wealth is divided between the shareholders is influenced by the price chosen. The company therefore needs to consider carefully the asking price per share.

If these new shareholders are allowed to enter the company too cheaply, the increased number of shares will detract from the wealth of existing shareholders; if priced too highly they will refuse to subscribe.

If all of the gain is to go to the existing shareholders, the ex-div value of their 5m shares must be Tk 25.5m after accepting the project i.e. TK 5.10 each. If the company wants to set a price of Tk 5.10, they will need to issue Tk 500,000 /Tk 5.10 = 98,039 new shares.

Taking into account the NPV of the subsequent project, the value of the shares would change as follows:

	Shares	Price Tk	Value of shares Tk
Amount issued	98,039	5.1	500,000
Currently in existence	5,000,000	5.0	25,000,000
			25,500,000
NPV of project			500,000
	5,098,039	5.1	26,000,000

The combined value of the shares would be Tk 26mn. This would be shared over the 5,098,039 shares to give a share price of Tk 5.10

				Gain
Amount issued	98,039	5.1	500,000	nil
Currently in existence	5,000,000	5.1	25,500,000	500,000
				500,000

Once all shares have moved to the equilibrium price of Tk 5.10, it can be seen that all of the gain has in fact gone to the existing shareholders.

If the company set an issue price of only Tk 5, the number of shares issued would have to rise i.e. 100,000 new shares issued. Taking into account the NPV, the value of the shares is again Tk 26m, but this time with a share price of Tk 5.098 (Tk 26m/5.1m shares).

	Shares	Price Tk	Value of shares Tk
Amount issued	100,000	5	500,000
Currently in existence	5,000,000	5	25,000,000
			25,500,000
NPV of project			500,000
	5,100,000	5.098	26,000,000

Once all of the shares have moved to an equilibrium price of Tk 5.098, the gain of Tk 500,000 due to the NPV is shared between existing and new shareholders.

				Gain
Amount issued	100,000	5.098	509,800	9,804
Currently in existence	5,000,000	5.098	25,490,000	490,196
				500,000
				0

In conclusion, the share price set for a new issue determines how the wealth is shared, but not the amount of the wealth, which is unaffected.

Summary of overall position:

	Retained earnings		Right issue		New share issue (assuming price of Tk 5.10)	
	Tk mn	Tk mn	Tk mn	Tk mn	Tk mn	Tk mn
Original value of equity cum-div 5mxTk 5.5		27.5		27.5		27.5
Ex-div value of original equity with scheme and project	26.0		26.0		25.5	
Proposed dividend	2.0		2.5		2.5	
Cum-div value	28.0		28.5		28.0	
Less investment to buy rights	-		(0.5)		-	
		28.0		28.0		28.0
Net gain to exisitng		**0.5**		**0.5**		**0.5**

From the above, it is concluded that strict application of the dividend valuation approach indicates that the source of equity finance is irrelevant. This is because whichever way the finance is provided, equity shareholders require a return of 10%pa.

Note that in all cases the increase in total shareholder wealth equals the NPV of the project.

6. (a) The forward contract: The forward rates are calculated by deducting the premium from the spot rate:

Spot rates	**BDT/USD**
	85
Forward premium	0.1114
Forward rates BDT/USD	85.1114

The payment will cost $1,500,000 X 85.1114= **BDT 127,667,083**

Currency futures:

Since we need to buy $, we will SELL currency futures contracts (i.e Selling BDT on the futures exchange).

The number of contracts to sell: ($1,500,000 X BDT 85.30)/ BDT 10,000,000 = 12.80 contracts.

Rounding the number of contracts to 13.

On 31 July the futures will be closed out and bought at BDT 85.28. This will result in a profit of (BDT 85.30 – BDT 85.28) X (10,000,000 X 13) = BDT 2,600,000.

Net payment ($ 1,500,000 X BDT 85.28) – BDT 2,600,000 = **BDT 125,320,000**

Over the counter call option:

Option premium = ($1,500,000) x BDT 0.35 = BDT 525,000

The total cost with interest = BDT 525,000 x (1 + 0.06 x 4/12) = BDT 535,500.

The spot price on 31 July is BDT 85.30 per USD. So Sadik would exercise its option.

The cost of the payment would be USD 1,500,000 X BDT 85.15) + BDT 535.500 = **BDT 128,260,500**

(b) The forward contract and futures contracts both lock Sadik into an exchange rate and do not allow for upside potential.

Forwards:

- Tailored specifically for Sadik
- However there is no secondary market

Currency futures:

- Not tailored so one has to round the number of contracts
- Requires a margin to be deposited at the exchange
- Need for liquidity if margin calls are made
- However there is a secondary market

OTC currency options:

- The options are expensive
- There is no secondary market
- However the options allow Sadik to exploit upside potential and protect downside risk

---The End---

CORPORATE LAWS & PRACTICES

Suggested Answers

March April 2021

1 (a). **Answer:**

i) As per section 392kha of the Companies Act 1994, only a natural person can form an OPC

ii) As per section 392ga of the Companies Act 1994, following are provisions regarding paid-up capital and turnover for incorporation as OPC;
- Paid-up share capital has to be minimum Tk. 50 lacs but not exceeding 10 crores
- Prior year's annual turnover should be minimum 2 crores but not exceeding 100 crores

iii) As per section 392ga of the Companies Act 1994, an OPC will have only one shareholder director. However, for managing the OPC, Manager, Secretary and other employees can be appointed

iv) As per section 392ja of the Companies Act 1994, shares of OPC can be transferred to only a natural person following the provisions of law

v) As per section 392cha of the Companies Act 1994, an OPC can have at least one board of director's meeting in a calendar year

1 (b) The basic principle of modern company law is that in the administration of the company's affairs, majority rules prevail. Company is run primarily by the directors who are appointed and removed by the shareholders of the company. The directors are accountable to the shareholders and are controlled by them. So the acts of the directors are also approved by the majority shareholders in the Annual General Meeting (AGM) where the minority shareholders have no control. This principle is known as "Majority Rules". So, in case of any mismanagement causing loss to the company, it is only the company who can seek remedy. Individual shareholder or the minority shareholders have no right to prevent it. The proper authority is the company and the company only. This principle was first established in a case "Foss VS Harbottle"-1843.

1 (c) **Answer:**

Regulation 51 of Schedule I of the Companies Act 1994 specifies that all business shall be called special business that is transacted in an Extra Ordinary General Meeting (EGM), however following businesses cannot be called as special business:

i) Declaring of dividend

ii) Consideration of the accounts, balance-sheets and the ordinary report of the directors and auditors

iii) Election of directors and other officers in place of those retiring by rotation

iv) Appointing auditors and fixing their remuneration

From the above, it is clear that (i) Appointment and fixation of the remuneration of M/S AQM as the auditor and (ii) Declaration of dividend cannot be treated as special business and therefore should not to be part of the EGM

Further, in relation to the special businesses to conduct, not specifying the nature of meeting as Extraordinary General Meeting and lack of clarity on the intention of the resolution to be passed as to whether 'ordinary' or 'extraordinary' or 'special' may make this meeting invalid

Also, all the business whether ordinary or special businesses incorporated in the notice lacked material facts/details, which may enable the members to understand the meaning and implication of items of business to be transacted and to take decision thereon.

Moreover, considering the different natures of businesses i.e. ordinary and special cannot be passed in the same meeting.

The notice is, therefore, not a valid notice as per the Companies Act 1994.

1 (d) **Answer:**

As per Regulation 52 of Schedule I of the Companies Act 1994, unless the articles of the company provide for otherwise, the quorum for the meeting of a Public Limited Company shall be 5 members personally present. In this regard, regulation 53 of the same law stipulates that if within half an hour from the time appointed for the meeting a quorum is not present, the meeting shall stand adjourned to be the same day in the next week at the same time and place. If at the adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting, the members present shall be a quorum.

In this particular case based on the information available, we can see following facts:

(1) Mr. Anand, Mr. Khan and Mr. Rahman will be counted as three members.
(2) If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum. Hence, Mr. [illegible] will be counted as one member for the purpose of quorum
(3) Mr. Chowdhury representing XYZ LMN Ltd. failed to reach in the meeting within half an hour from the time appointed for meeting, hence he should not be counted for the purpose of quorum.

Based on the above facts, we can see on the meeting date only four members present in person, which is not sufficient to form a quorum if it was a meeting scheduled without any adjournment. However, if it was an adjourned meeting, the four members present will form quorum as explained above.

2 (a) **Answer:**

An issuer company shall conduct its general meeting (AGM or EGM) using Hybrid System in combination of physical presence of shareholders at the venue of general meeting and presence or connection of shareholders by using digital platform or online platform ensuring, among others, the following voting manner and other rights of the shareholders as well as limitations and compliances of other regulatory framework:

1) An issuer company using Hybrid System for conducting its general meeting (AGM or EGM) shall notify its shareholders the address of the meeting venue and web-link for joining the meeting or e-voting through online platform or system or digital platform, with intimation to the Commission and the stock exchange(s).

2) An issuer company shall have a facility to exercise the shareholder's (holders of paper shares or dematerialized shares) voting rights on the resolution proposed to be considered at the general meeting ensuring voting system through physical or paper ballot at the venue of general meeting or through electronic ballot or any e-voting system using online platform or system or digital platform.

3) The voting system shall have pre-registration facility for attendance of shareholders, casting vote and also have log register.

4) For the purpose of attending the general meeting and casting of vote on behalf of the entitled shareholders either by physical or paper ballot or electronic ballot or e-voting system at the venue of general meeting or using online platform or system or digital platform, an issuer company shall send proxy form in hard/ paper or soft or online system to the shareholders mentioning that each shareholder or his proxy has right to vote either for or against each of the agenda or resolution.

5) The facility for on-line (real time) or e-voting and physical voting shall be agenda-wise voting option either for or against each of the resolution:

Provided that on-line (real time) or e-voting option shall be opened at least 24 (twenty-four) hours but not exceeding 72 (seventy-two) hours prior to start of general meeting and shall remain open up to the closure of general meeting.

6) An issuer company shall provide one-way live or live streaming or webcast of the proceedings of its general meeting.

2 (b) (i) As per BSEC directives no. BSEC/CMRRCD/2021-386/03 dated: 14 January 2021, paragraph (3)

(a) the company shall within 10 (ten) days of declaration of cash dividend by the board of directors, an amount equivalent to declared cash dividend payable for the concerned year shall be kept in a separate bank account dedicated for this purpose.

(b) The company shall pay off cash dividend directly to the bank account of the entitled shareholders as available BO account maintained with the Depository Participant (DP) or the bank account as provided by the shareholders, through BEFTN. (Bangladesh Electronic Fund Transfer Network). Provided that the issuer may pay off such cash dividend through bank transfer or any other electronic payment system as recognized by the Bangladesh Bank, if not possible to pay off through BEFTN.

(c) In case of non availability of bank account information or not possible to transfer through BEFTN or any other electronic form, the issuer shall issue dividend warrant and shall send it through post to the shareholder.

(d) The issuer shall pay off cash dividend to non-resident sponsor, director, shareholder or foreign portfolio investors through the security custodian in compliance with rules or regulations in this regard.

(e) The company immediately after disbursement of cash dividend and issuance of certificate of tax deduction at source if applicable, shall intimate to the shareholder through SMS or email as provided in the BO account or as provided by the shareholder.

(f) The company shall maintain detailed information on unclaimed or unpaid dividend and shall disclose the summary in the annual report and shall also report in the statement of financial position (quarterly / annually) as separate line item 'Unclaimed Dividend Account'. The company shall also publish the year wise summary of unclaimed or unpaid dividend in the website. Unclaimed or unpaid dividend shall be transferred to a separate bank account within 1 year from the date of declaration or approval or record as the case may be.

2 (b) (ii) As per BSEC notification no. SEC/CMRRCD/2009-193/163/Admin/57 dated: 13 November 2014, the Annual General Meeting (AGM) of a listed company shall be held within the city, town or locality in which the registered office of the company is situated. However the Commission may, in special circumstances, upon application of the company, permit for holding of such AGM at any other place

3 (a) **Answer:**

To qualify as a Public Interest Entity (PIE) under Financial Reporting Act 2015 the criteria of 'Yearly revenue', 'Total asset value' and Total liabilities excluding shareholders equity' are described below:

a) Criteria of Yearly revenue' for PIE is Tk. 5 crores based on prior year's yearly revenue

b) Criteria of 'Total asset value' for PIE is Tk. 3 crores

c) Criteria of Total liabilities excluding shareholders equity for PIE is Tk. 1 crore

3 (b) **Answer:**

Comments based on the provision of Bangladesh Labour Rules 2015:

As per Rule 263 of the Bangladesh Labour Rules 2015, any member leaving the company is eligible for getting both employer's and own contribution, if he/she completes two years from the date joining. Here date of confirmation will not be counted.

- Hence, in case of Mr. X he will be entitled to get both employer's and own contribution of Tk. 60,000 as he has completed 2 years 3 months from the date of joining.
- However, in case of Mr. Y, since he has not completed two years of employment from the date of joining, Mr. Y will be entitled to get only his own contribution of Tk. 10,000 and the rest Tk. 10,000 will be forfeited

Comments based on the provision of Financial Reporting Act 2015:

- As per notification issued by Financial Reporting Authority (FRA) dated 7th July 2020, it will intervene on the allocation of Forfeiture Account to the existing members.
- Hence, we will discuss about the amount to forfeited on account of company's contribution for Mr. Y i.e., Tk. 10,000
- Based on the above-mentioned circular, FRA has clarified that no amount lying under forfeiture account should be allocated to the existing members, hence the Trust cannot take any such resolution
- FRA further instructed, any such amount lying under forfeiture account should be returned to the PIE (in this case Welfare Ltd), which the PIE should show as other income in its financial statement.

4 (a) **Answer:**

(i) Both CRR, ADR/IDR increases or decreases the capacity to provide loans and advances of the commercial banks in the context of liquidity. CRR directs the banks to block certain amount of money with Bangladesh Bank. So higher CRR is higher blockage and lower CRR is lower blockage of cash with Bangladesh bank. On the other hand, ADR for conventional Banks or IDR for Shariah based banks directs the banks to when to stop loans/investment. Because banks are not allowed to allow loans/invest all of its deposits. Higher ADR/IDR allows the banks to increase loans/investments. So, decease and increase of ADR/IDR shall allow the commercials banks to implement the government incentive packages to fight the CORONAVIRUS PANDEMIC.

(ii) According to MPD circular no: 3 dated April 09, 2020, all scheduled commercial banks including Shariah based banks operating in Bangladesh are required to maintain CRR @ 4.0% on Bi-weekly average of Total Time & Demand Liability and 3% on daily average w.e.f 15th April 2020.

(iii) According to DOS Circular No: 02 April 12, 2020, ADR has increased from 85% to 87% on the other hand IDR has increased from 90% to 92%.

4 (b) **Answer:**

Considering the financial capabilities of the scheduled banks and in the interest of the investors return, Central Bank through DOS Circular No. 01 dated 7th February 2021 issued following instruction for declaration of dividend by scheduled banks for the year ended on 31 December 2020:

A: (1): The scheduled bank, who are able to keep a capital reserve at a minimum 15% or more including 2.5% capital conservation buffer against the risk-based assets for maintaining provision reserve and meeting other expenditures without taking any deferral benefits in the calendar year or before shall be allowed to declare a maximum at 30% dividend including a cash dividend of 15% subject to their financial ability.

A: (2): The scheduled bank, who are able to keep a capital reserve at a minimum 13.5% to 15% or more including 2.5% capital conservation buffer against the risk-based assets for maintaining provision reserve and meeting other expenditures without taking any deferral benefits in the calendar year or before shall be allowed to declare a maximum at 25% dividend including a cash dividend of 12.5% subject to their financial ability.

A: (3): The scheduled bank, who are able to keep a capital reserve at a minimum 11.875% or more including capital conservation buffer against the risk-based assets for maintaining provision reserve and meeting other expenditures without taking any deferral benefits in the calendar year or before shall be allowed to declare a maximum at 15% dividend including a cash dividend of 7.5% subject to their financial ability.

B: (1): The scheduled banks, who are able to maintain a capital at a minimum 12.5% or more including the capital conservation buffer against the risk-based assets for maintaining provision reserve and meeting other expenditures without taking any deferral benefits in the calendar year or before shall be subject to approval of Central Bank allowed to declare a maximum at 12% dividend including a cash dividend of 6%.

B: (2): The scheduled banks, who are able to maintain a capital at a minimum 11.875% to 12.5% or more including the capital conservation buffer against the risk-based assets for maintaining provision reserve and meeting other expenditures without taking any deferral benefits in the calendar year or before shall be subject to approval of Central Bank allowed to declare a maximum at 10% dividend including a cash dividend of 5%.

B: (3): The scheduled banks, who are able to maintain a capital at a minimum 10.625% to 11.875% or more including the capital conservation buffer against the risk-based assets for maintaining provision reserve and meeting other expenditures without taking any deferral benefits in the calendar year or before shall be subject to approval of Central Bank allowed to declare a maximum at 5% stock dividend

5 **Answer:**

According to section 17 of Financial Institutions Act 1993 there is some restriction on the possession of immovable property. No financial institution may acquire or possess immovable properties exceeding in value 25 per cent of its paid-up capital and reserves. In this case we find that the equity of the company (paid up capital and reserve) is Taka BDT 1000 million and maximum limit for purchasing of immovable properties is BDT 250 million. Here, the Company has some movable properties of which value is BDT 200 million and hence can acquire immovable properties of which maximum value is BDT 50 million. So, the purchase deal is henceforth cancelled.

It is mentioned here that nothing contained in this section shall be applicable in the case of immovable property required for the granting of facilities to employees of the financial institution and in the case of property acquired in the interest of realizing unrealized credits granted by it.

6 (a) **Answer:**

Surrender value under life insurance policy is the amount the policyholder will get from the life insurance company if he decides to exit the policy before maturity

6 (b) **Answer:**

Group Insurance Premium matter:

Comparative position:

Particulars	Company A (Rate/000) Tk.	Company B (Rate/000) Tk.
Gross premium	8.00	7.00
Retention (A: 30%; B: 30%)	2.40	2.10
Net premium after retention	5.60	4.90
Profit bonus after retention (A: 75%; B: 60%)	4.20	2.94
Effective premium rate	3.80 (8-4.20)	4.06 (8-2.94)

Based on the above calculation, it is clear that ABC Ltd should go for company A, as effective premium cost is lower Tk. 3.80/000 compared to Tk. 4.06/000 calculated for company B.

7 **Answer:**

My observations are as follows based on the provisions of Bangladesh Labour Act 2006 and relevant Rules thereon:

Page Book-265, (5.2)

1) As per section 102 of the Bangladesh 108 Labour Act, total working hours including overtime for an adult worker in a week should not exceed 60 hours (except lunch time), which should compute as 48 hours normal working hours and 12 hours overtime. It also says, on an average per week such working hours should not exceed 56 hours in a week. in a year.
2) Based on the above, all three employees' working hours in the first week of April'21 exceeds the legitimate norm, which will be seen as a violation of the law
3) The overtime calculations are incorrect, which is also a violation of the laws
4) As per Rule 102 of the Bangladesh Labour Rules 2015, the overtime should be calculated in the following manner:

    Monthly basic wages including dearness allowances ÷ 208 x overtime hours x2

    Hence the revised overtime calculation should be as follows:

Worker	Total wages (Tk.)	Overtime hour	Hourly rate (Monthly gross/208) (Tk.)	Overtime to be paid *double the rate* (Tk.)
X	4,160	16	20	640
Y	5,200	20	25	1,000
Z	6,240	13	30	780
Total				2,420

TAX PLANNING & COMPLIANCE
Suggested Answers
March-April 2021

1. (a) As per section 18 (2) of the ITO, 1984, any income accruing or arising, whether directly or indirectly, through or from, inter alia, any property, asset, right or other source of income, including intangible property, in Bangladesh; or the transfer of any assets situated in Bangladesh. According to the explanation provided for the purpose of subsection (2) of section 18 of the ITO, 1984, the shares of any company which is a resident in Bangladesh shall be deemed to be property in Bangladesh. Accordingly, capital gain arising from transfer of shares held by a resident of Singapore in N Ltd. to a resident of the USA shall be deemed to accrue or arise in Bangladesh.

As per section 56 (1) of the ITO, 1984, subject to the provisions of sub-section (2), the specified person or any other person responsible for making payment to a non-resident of any amount which constitutes the income of such non-resident chargeable to tax under the said Ordinance shall, unless such person is himself liable to pay tax thereon as agent, at the time of making such payment, deduct tax on the amount so payable at the rate, specified therein. According to the table presented under section 56 (1) of the ITO, 1984, rate of deduction of tax at source from capital gain is 15%. Provided that when any capital gain arises from the transfer of any share of a company, the person or the authority, as the case may be, responsible for effecting the transfer of shares shall not give any effect in respect of such transfer if tax on such capital gain has not been paid.

Section 56 (2) of the ITO, 1984, provides that where, in respect of any payment under this section, NBR, on an application made in this behalf, is satisfied that due to tax treaty or any other reason the non-resident is not be liable to pay any tax in Bangladesh, or is liable to pay tax at a reduced rate in Bangladesh, NBR may issue a certificate within 30 days from the date of receipt of such application accompanied by all the documents as required by NBR to the effect that the payment referred to in section 56 (1) shall be made without any deduction or, in applicable cases, with a deduction at the reduced rate as mentioned in the certificate.

Under section 56 (1) of the ITO, 1984, tax is deductible at source from payment made to a non-resident. It is implied that payment is to be made from Bangladesh. In the case under discussion, consideration for transfer of shares in a Bangladeshi company from a non-resident to another non-resident will be paid outside Bangladesh. Hence, there is a bit haziness in the provision of section 56 (1) of the ITO, 1984, for observance of the proviso thereof and the provisions of section 18 of the ITO, 1984.

From the above-stated provisions of tax laws, it emerges that capital gain arising from transfer of shares in a Bangladeshi company from a non-resident to another non-resident shall be deemed to accrue or arise in Bangladesh. The person or the authority, as the case may be, responsible for effecting the transfer of shares shall not give any effect in respect of such transfer if tax on such capital gain has not been paid. The Board of Directors approves transfer and transmission of shares as a usual business transacted at their meeting. Registrar of RJSC also plays a vital role in verification of signature of the transferor in share transfer instrument. Despite it has not been specified who/which person or authority will be responsible for effecting transfer of shares, it is understood from the aforesaid discussion that Board of Directors of the company will be primarily responsible for ensuring payment of capital gain tax on transfer of shares before approving such transfer. Furthermore, RJSC has an implied responsibility for checking whether capital gain tax has been paid or not while verifying signature of the transferor in the share transfer instrument.

(b) i) Paying 50% salary in cash to the employees and showing the same as business expenses is not tax-deductible expense as per section 30 of the ITO 1984 and is an act of Tax Evasion. This is ethically incorrect, as it construes evading tax liability by dishonest means like conscious violation of laws/rules.

ii) Designing salary structure to reduce excess perquisite tax and ultimately to reduce the tax burden for the company by Y Ltd is an act of Tax Planning. There is no ethical issue on such Tax planning as it was carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing the tax liability for the company.

iii) Investment in tax saver savings certificate by Z is allowed as deduction u/s 44(2)(b) of the ITO

1984 and is an act of Tax Planning. There is no ethical issue on such Tax planning as it was carried out within the framework of law to reduce the tax burden of Z.

iv) Planning of ABC Ltd. to setup a new factory under Bangladesh Economic Zone Authority (BEZA) to get tax incentives as announced by BEZA is an act of tax planning. There is no ethical issue on such Tax planning as it has been carried out within the framework of law as announced by BEZA for availing the tax incentives.

v) Obtaining information by DEA Ltd. regarding filing of return by employees for submission of return u/s 108A of the ITO 1984 is an act of Tax Management. There is no ethical issue on such Tax Management as it was carried out to comply with the law only.

2. i) Considering overall circumstances including take-home salary per month, Mr. Bawani may consider joining the new company. However, Mr. Bawani should go for option 2 offer in the new company. The details of the computations are given below:

Amount in Tk.

Requrement (i):		Offer from new company	
Total effective salary & benefits per month	**Existing**	**Option-1**	**Option-2**
Basic Salary	336,000	365,000	365,000
House Rent Allowances (HRA)/Benefit	120,000	120,000	120,000
Conveyance: Car Allowances/Benefit	50,000	50,000	50,000
Gross Salary	**506,000**	**535,000**	**535,000**
PF contribution by employer	33,600	36,500	36,500
Gratuity benefit	28,000	60,833	60,833
Incentive bonus	101,200	107,000	107,000
Total salary & benefits	668,800	739,333	739,333
Less:			
Benefit will not be available due to company policy			
PF contribution by employer	-	-	-
Gratuity benefit	-	(60,833)	(60,833)
Total Effective salary & benefits	668,800	678,500	678,500

Amount in Tk.

Requrement (ii):			
Total taxable income (annual)			
Basic Salary	4,032,000	4,380,000	4,380,000
House Rent Allowances (HRA)/Benefit (exempt Tk. 300,00/annum)	1,140,000	1,140,000	1,095,000
Conveyance: Car Allowances/Benefit (exempt Tk. 300,00/annum)	570,000	570,000	219,000
PF contribution by employer	403,200	438,000	438,000
Incentive bonus	1,214,400	1,284,000	1,284,000
Total taxable income (annual)	7,359,600	7,812,000	7,416,000
Total taxable income (monthly)	613,300	651,000	618,000

Amount in Tk.

Requrement (iii):			
Monthly takehome Salary			
Total Effective salary & benefits	668,800	678,500	678,500
PF (Own and company)	(67,200)	(73,000)	(73,000)
Withholding tax	(120,909)	(129,392)	(121,967)
Monthly Take-home Salary	480,691	476,108	483,533

Tax computation:

Taxable income (Existing)	7,359,600		
	Actual income	Rate	Tax (Tk.)
	300,000	0%	-
	100,000	5%	5,000
	300,000	10%	30,000
	400,000	15%	60,000
	500,000	20%	100,000
	5,759,600	25%	1,439,900
Gross tax	7,359,600		1,634,900
Investment tax credit - [10% on (25% of taxable income)]			183,990
Net tax per year			1,450,910
Net tax per month			**120,909**

Taxable income (Option-1)	7,812,000		
	Actual income	Rate	Tax (Tk.)
	300,000	0%	-
	100,000	5%	5,000
	300,000	10%	30,000
	400,000	15%	60,000
	500,000	20%	100,000
	6,212,000	25%	1,553,000
Gross tax	7,812,000		1,748,000
Investment tax credit - [10% on (25% of taxable income)]			195,300
Net tax per year			1,552,700
Net tax per month			**129,392**

Taxable income (Option-2)	7,416,000		
	Actual income	Rate	Tax (Tk.)
	300,000	0%	-
	100,000	5%	5,000
	300,000	10%	30,000
	400,000	15%	60,000
	500,000	20%	100,000
	5,816,000	25%	1,454,000
Gross tax	7,416,000		1,649,000
Investment tax credit - [10% on (25% of taxable income)]			185,400
Net tax per year			1,463,600
Net tax per month			**121,967**

3. **Resuming submission of pending returns:**

Mr. Karim is a non-resident in Bangladesh and has no fixed base in Bangladesh. As per section 75(2), submission of income tax return is not mandatory for a non-resident individual having no fixed base in Bangladesh. Hence, he does not need to submit the income tax return in Bangladesh.

Taking loan from company:

Under section 2(26)(e) of the ITO, 1984, if any shareholder takes loan from his company or any payment is made by the company on behalf of or for the benefit of him and such company possesses accumulated profit, such amount of loan will be treated as dividend in the hand of shareholder. Hence, Tk. 80,000/= will be treated as income of Mr. Karim.

Payment of Engineering Fee:

Any payment to any non-resident will fall under the ambit of deduction of tax at source under section 56 of the ITO, 1984. Hence, payment under the head Engineering Fee will attract 20% TDS rate as per

Sl No. 4 of the table of section 56. As per section 56 (2) of the ITO, 1984, where, in respect of any payment under this section, the Board, on an application made in this behalf, is satisfied that due to tax treaty or any other reason the non-resident is not be liable to pay any tax in Bangladesh, or is liable to pay tax at a reduced rate in Bangladesh, NBR may issue a certificate within 30 days from the date of receipt of such application accompanied by all the documents as required by NBR to the effect that the payment referred to in sub-section (1) shall be made without any deduction or, in applicable cases, with a deduction at the reduced rate as mentioned in the certificate. However, the German's company is not required to submit any income tax return as it has no permanent establishment in Bangladesh.

Payment to Law Firm:

Any payment to any non-resident will fall under the ambit of deduction of tax at source under section 56 of the ITO, 1984. Hence, payment under the head Professional Services will attract 20% TDS rate as per Sl No. 3 of the table of section 56. The Australian Firm will get Tk. 4,00,000/= from Bangladesh. As per section 56 (2) of the ITO, 1984, where, in respect of any payment under this section, the Board, on an application made in this behalf, is satisfied that due to tax treaty or any other reason the non-resident is not be liable to pay any tax in Bangladesh, or is liable to pay tax at a reduced rate in Bangladesh, NBR may issue a certificate within 30 days from the date of receipt of such application accompanied by all the documents as required by NBR to the effect that the payment referred to in sub-section (1) shall be made without any deduction or, in applicable cases, with a deduction at the reduced rate as mentioned in the certificate. But the Australian Firm won't need to submit any income tax return as it has no permanent establishment in Bangladesh.

4.

Sonali Ltd

Computation of Total Income and Tax Payable

Assessment year 2022-2022 (income year ended 30 June 2021)

	Note	Taka in crore
A. Income from Business or Profession:		
Profit before tax as per statement of profit and loss and comprehensive income		456.00
Less: Accounting gain on sale of fixed assets for separate consideration	1	2.00
		454.00
Add: Revenue gain on sale of fixed assets	1	1.50
		455.50
Add: Inadmissible expenses as per provision of law:		
Accounting depreciation and impairment loss for separate consideration		59.90
Gratuity provision (funded)		6.00
Interest charged on foreign loan	5	5.00
		70.90
		526.40
Less: Admissible expenses as per provision of law:		
Fiscal depreciation	2	70.00
Gratuity amout paid to the fund		5.00
Admissible interst on foreign loan	5	4.06
Total Income from Business or Profession		79.06
		447.34

Allocation of business income between manufacturing unit (other than section 82C) trading unit (section 82C) and Export unit on the basis on gross profit ratio:

Unit	Ratio	Amount
Manufacturing (other than section 82C and Export)	**66.00%**	**295.24**
Trading (section 82C)	**22.00%**	**98.41**
Export	**12.00%**	**53.68**
Total Business income		**447.34**

	Note	Taka in crore
B. Capital gains:		
From sale of fixed asset	1	1.00
C. Income from Other Sources:		
Inadmissible expenses u/s 30B of the ITO 1984	4	43.52
Total Income (A+B+C) [Requirement (i)		491.86

Tax Liability/Payable

Business income from manufacturing undertaking (other than section 82C):			
Tax payable @25% on Tk.	295.24		73.81
Income from Trading unit (u/s 82C):			
Taxpayable @25% on Tk.	98.41	24.60	
Analysis of minimum tax under section 82C:			
Tax payable on regular business income (@25% on Trading profit)		24.60	
Tax deduction under section 53 considered as minimum tax		30.00	
(Actual tax payable, the higher one)			30.00
Income from Export Unit:			
Tax payable @25% on Tk.	53.68	13.42	
Less: Exemption of income under para 28 of Part A of 6th Schedule		6.71	6.71
Capital gains:			
Taxpayable @15% on Tk.	1.00		0.15
Income from Other Sources:			
Taxpayable @ 25% on Tk.	43.52		10.88
Total Tax Payable [Requirement (ii)			121.55

		As per book	As per Tax
Note:1	Gain on sale of asset		
	Cost of acquisition	2.00	2.00
	Sale value	3.00	3.00
	Written down value	1.00	0.50
	Total gain	2.00	2.50
	Split:		
	Capital gain (sale vaule exceeding cost of acquisition)		1.00
	Balance: Revenue gain		1.50
	Total gain	2.00	2.50
Note:2	Depreciation allowances as per Book		
	Total depreciation charged including fixed asset sold		60.00
	Less: Depreciation of fixed asset sold during the year		(0.10)
	Toatal Depreciation allowances as per Tax law		59.90
Note:3	Royalty disallowances as per section 30h of the ITO 1984		
	Royalty amount claimed in the financial statement		75.00
	Admissible Royalty (8% of disclosed profit Tk. 456 crore)		36.48
	Inadmissible amount		38.52
Note:4	Income to be considered from other sources u/s 30B of ITO 1984		
	Inadmissible excess perquisite u/s 30e		5.00
	Inadmissible Royalty expenses u/s 30h (Note:3)		38.52
			43.52
Note:5	Iadmissible interest on Foreign loan		
	Foreign loan amount (back calculation)		125.00
	Interest charges @ 4%		5.00
	Admissible Libor +2.5% i.e. (0.75+2.5)%		4.06

5. **Financing Options available for expansion of Zian Ltd.**

Particulars	Amount in Tk.		
	Option-1	Option-2	Option-3
Share Capital	7,500,000	10,000,000	25,000,000
12% Debentures	6,000,000	10,000,000	-
Bank Loan @ 9%	11,500,000	5,000,000	-
Total Capital	25,000,000	25,000,000	25,000,000
PBIT (Expected Rate of Return @ 35% of total Capital)	6,250,000	6,250,000	6,250,000
Less: Interest on debenture @12%	(720,000)	(1,200,000)	-
Less: Interest on bank loan @ 9%	(1,035,000)	(450,000)	-
Profit Before Tax (PBT)	4,495,000	4,600,000	6,250,000
Tax @ 25% on PBT	1,123,750	1,150,000	1,562,500
Net Profit After Tax	3,371,250	3,450,000	4,687,500
Rate of Return in % (Net profit / Share Capital)	45%	35%	19%

From the above, it appears that Option-1 the maximum rate of return (45%) on share capital. Hence, Zian Ltd. should go for Option-1.

6. (a) Here, since the foreign company, Construction Ltd., holds more than 25% shares (i.e. 30%) in ASRM Ltd., both be deemed to be associated enterprises within the meaning of section 107A(2) of the ITO 1984

As ASRM Ltd. supplies similar product to an unrelated entity, Build Ltd. Singapore, the transactions between ASRM Ltd. and Build Ltd. can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between ASRM Ltd. and Construction Ltd.

Thus, Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with Construction Ltd. are on FOB basis, whereas transactions with Build Ltd are on CIF basis. This difference needs to be adjusted before comparing the prices.

Particulars	Amount in USD
Price per ton of iron rods to Build Ltd.	850
Less: Cost of insurance and freight per ton	150
Adjusted price per ton	700

Since, the adjusted price for Build Ltd, Singapore is greater than the price fixed for Construction Ltd., the arm's length price (ALP) should be USD 700 per ton.

(b) The CFO
MNC Ltd.
....
Dhaka, Bangladesh

.......November 2020

Dear Sir

Report on the query based on Transfer Pricing Provisions

Please refer to the subject mentioned above and your request for providing professional opinion(s) on the various issue(s) raised therein. As requested, we are providing below our report based on the review of the relevant provisions of laws:

(i) **Brief discussion on relevant TP regulations:**

Provisions relating to TP as mentioned in Chapter XIA, Section 107A to 107J of the ITO, 1984, is applicable from income year 2014. The provisions relating to TP has been summarized below:

TP refers to the pricing of international transactions between two associated enterprises. Due to the special relationship between related parties, the transfer price may be different than the price that would have been agreed between unrelated parties. A price between unrelated parties is known as the "arm's length" price. The provisions of TP are applicable only if:

- There are two or more enterprises
- The enterprises are Associated enterprises
- The enterprises enter into a international transaction

Method of TP: There are five method for TP:

- comparable uncontrolled price method;
- resale price method;
- cost plus method;
- profit split method;
- transactional net margin method;

A statement of international transactions is required to be submitted under section 107EE. The DCT may require a report singed by a Chartered Accountant or Cost and Management Accountants. There are also penal provisions for non-compliance regarding TP provisions.

(ii) **Elaborating TP aspects on the above issues with tax impact:**

MNC Ltd., the Turkey-Bangladesh joint venture and ZIAN Inc., a Turkey based company are deemed to be associated enterprises as per section 107A(2) as ZIAN Inc. holds shares carrying not less than 25% of the voting power of ABC Ltd.

As per section 107A(5), the transactions entered into between these two companies for sale of product, lending or guarantee and provisions of services are included within the meaning of international transactions. Accordingly, provisions of transfer pricing would be attracted and the income arising from such international transactions have to be computed having regard to arm's length price. In this case from the information given, the arm's length price has to be determined taking the uncontrolled price method to be the most appropriate method.

Amount by which total income of MNC Ltd. is enhanced on account of adjustment in the value of international transactions:		**Taka '000**
a)	Difference in price of TV @ $ 50 each for 100,000 pieces sold to ZIAN Inc. ($ 50 X 100,000 X 85)	425,000
b)	Difference for excess payment of guarantee fee to ZIAN Inc. for loan borrowed from foreign lender ($ 2000 X 85)	170
c)	Difference for excess payment for services to ZIAN Inc. ($ 15,000 X 85) = 1,275,000 – 1,000,000	275
d)	Difference for excess payment for services to ZIAN Inc. ($ 5,500 - $ 4,500) X 85 = 1000X 85	85
e)	Machine procurement in four installments: data is not available for comparison.	-
f)	Bad debt written off: it will be admissible expenditures only when proper supporting is presented, such as, supporting related legal action taken for recovery, board resolution, etc. No impact under TP regulations.	-
	Total	425,530

The above amount will be added back to the taxable income under section 107C(5) of the ITO, 1984.

(iii) **Suggestion on minimizing tax exposure:**

Depends on examinee's opinion and suggestion may vary from person to person.

Should you have any query in this regard, feel free to contact us.

Yours faithfully,

....

Transfer Pricing Department
ABC & Co.
Chartered Accountants

7. (a) VAT Act 2012 imposes VAT on "economic activity". The VAT Act 2012 defines economic activity as any activity carried on regularly or continuously for making supply of any goods, services or immovable property. The definition of economic activity also includes:

   1) any business, profession, vocation, means of earning livelihood, manufacturing or undertaking of any kind;
   2) supply of any goods, services or properties made under any lease, license or similar arrangement
   3) one-off initiative in the nature of a commercial activity or enterprise

However, any service rendered by an employee to his employer or any service rendered by any director of a company in general or any recreational pursuit or hobby performed on a non-commercial basis or any activity carried on by the Government without any commercial motive are excluded from the definition of economic activities.

As explained in the definition, the services provided by the employees to its employers are not economic activities, hence there should not be any VAT applicable for such services of the employees. Since I'm aggrieved, I will initiate following steps as per section 121 of the VAT and SD Act 2012:

1) I will file an appeal to the Commissioner (Appeal) since the order has been passed by someone below the rank of a commissioner
2) The appeal has to be filed within 90 days of the issuance of such order, which can be extendable to another 60 days subject to there is a valid reason and the commissioner (appeal) is convinced on the valid reason
3) Along with the appeal 20% of the disputed amount has to be deposited

In case the order was passed by the commissioner, following the procedures laid down in section 122 of the VAT and SD Act 2012, I would have taken following steps:

1) File the appeal to the Appellate Tribunal instead of Commissioner (Appeal) since the order has been passed by commissioner
2) In this case also the appeal has to be filed within 90 days of the issuance of such order
3) Along with the appeal 20% of the disputed amount has to be deposited

(b) i) According to section 138 of the VAT & SD Act, 2012, notwithstanding the provisions contained in section 33, VAT imposed on a taxable supply shall be payable on the day of commencement of the VAT & SD Act, 2012, if-

- a supply has been or is made after the day of commencement; and
- a tax invoice for a supply was issued or the value of the supply was paid, or both the actions were completed before the day of commencement

Provided that no VAT shall be payable if such person had paid VAT on the supply under the VAT Act, 1991, and the said VAT was shown in a return submitted to the Commissioner under the VAT Act, 1991.

In this respect, provisions of SRO No. 149-Aain/2020/110-Mushak dated 11 June 2020 should also be considered. According to the said SRO, where contract was made before the VAT & SD Act, 2012, entered into effect but value has not yet been paid, provisions applicable at the time of payment shall be applied to such supply.

General Order No. 03/Mushak/2019 dated 13 June 2019, further provides that where any of the events, namely supply, issuance of invoice and payment of price, occurs on or after 01.07.2019, provisions of the VAT & SD Act, 2012, and the VAT & SD Rules, 2016 and other provisions relating to VDS, including issuance of VDS certificate, made under thereunder shall be complied with.

In light of the above, VAT shall be deducted at source applying the current rate.

ii) As per section 139, the VAT & SD Act, 2012, where a contract is concluded after the introduction of the VAT & SD Act, 2012, and the contract does not include a provision relating to VAT and SD-

- such contract price shall be deemed to include VAT and SD (if any) payable on the supply; and
- the supplier under the contract shall be required to pay VAT and SD (if any) imposed on supplies made under the contract, whether or not the supplier include those taxes in the price for such supplies under such contract.

Based on the above, VAT shall be borne and paid by the supplier.

8. Adore Ltd.

Coputation of net VAT payable for the month of March 2021

Particulars	Base Value Amount (Tk.)	VAT Amount (Tk.)
SUPPLY - OUTPUT TAX:		
For supply of goods at standard rate	5,000,000	750,000
For supply of goods at "0" rate	345,000	-
For supply of service at standard rate	260,870	39,130
Import of service (Royalty)- output VAT (Note-1)		180,000
Total Output Tax (A)		969,130
SUPPLY - INPPUT TAX		
Standard Rated Goods (import)	2,000,000	300,000
Standard Rated Goods (local) - (Note-2)	1,000,000	150,000
Input tax credit on import of service (Royalty)-(Note-1)		180,000
Transport service 80% rebateable	100,000	8,000
Total Input Tax (B)		638,000
INCREASING ADJUSTMENTS (VAT)		
VAT deducted against suppliers payment		46,000
Total Increasing Adjustment (C)		46,000
DECREASING ADJUSTMENTS (VAT)		
VAT deducted by service recipient		25,000
Deposit against VAT deducted at source		30,000
Credit note issued against market return	200,000	30,000
Advance tax (VAT) paid at port point		76,800
Total Decreasing Adjustment (D)		161,800
NET VAT PAYABLE		
Net payable from the above (A+C-B-D)		215,330
Less: Deposit on Import of Service under Royalty) - (Note-1)		180,000
Net VAT paybel for the month of March 2021		35,330

Note-1: Under reverse chanrge mechanisim, for import of service both output VAT and Input VAT entry has to be recorded u/s 46(1)(kha) of the VAT and SD Act 2012

Note-2: Input tax credit is not depended on when it was paid.

9. I would recommend Zen Ltd should consider import in bulk and repack the same at its own factory, as it will result in higher profitability compared to import in finished form.

The details calculation in support of my recommendation are given below:

Particulars	For Bulk import/Kg		Imported Finished goods/kg	
	Rates	Amount in Tk.	Rates	Amount in Tk.
Selling price inclusive of VAT		16,000.00		16,000.00
VAT	15%	2,086.96	5%	761.90
Selling price without VAT		13,913.04		15,238.10
Supp. Duty @ production satge	5%	662.53	0%	-
Selling price without VAT & Supp. Duty		13,250.52		15,238.10
Product cost per unit (Note-1)		11,476.00		13,823.60
Profit per kg		1,774.52		1,414.50

Note-1: Computation of per kg cost under both the options

Component	For Bulk import		For Finished good import	
	Rates	Amount in Tk.	Rates	Amount in Tk.
C&F Value per kg (to be paid to bank)		7,000.00		7,500.00
Minimum assessable value per kg		N/A		8,000.00
Assessable value in Tk		**8,000.00**		**8,000.00**
Customs duty (For Bulk FTA benefit under SAFTA)	5%	400.00	25%	2,000.00
Regulatory duty	3%	240.00	3%	240.00
Supplementary duty	0%	-	10%	1,024.00
Value Added Tax	15%	1,296.00	15%	1,689.60
Advance Income Tax	5%	400.00	5%	400.00
Advance Tax (VAT)	4%	432.00	5%	563.20
Total duities and taxes in Tk		**2,768.00**		**5,916.80**
Total Assessable values + duities and taxes in Tk		**9,768.00**		**13,416.80**
Less: Recoverable amount				
Value Added Tax		1,296.00		-
Advance Income Tax		400.00		400.00
Advance Tax (VAT)		432.00		563.20
Total recoverable amount on import		2,128.00		963.20
C&F Value per kg (to be paid to bank)		7,000.00		7,500.00
Total duties and taxes less recoverable amount		640.00		4,953.60
Additional cost:				
Conversion cost without VAT		2,600.00		-
Marketing and media expenses inclusive of VAT		1,150.00		1,150.00
Less: Recoverable amount		(150.00)		-
Transport cost (including 10% VAT)		220.00		220.00
Recoverable VAT (80%)		16.00		-
Total cost per kg		11,476.00		13,823.60