



# Examiner's report

## P1 Governance, Risk & Ethics

### December 2016

#### General Comments

The overall performance of candidates in this paper was generally good and it provided the opportunity for the well prepared candidate to score well.

#### General Comments

The examination consisted of the standard two sections. Section A contained one question for 50 marks and Section B contained three 25 mark questions, from which candidates had to answer two.

This is a Professional Level paper and as such candidates must be fully prepared, both in terms of technical knowledge and exam technique. Good exam technique is essential to this paper as it is in all others. As a starting point, the exam rubric of how many questions to answer in each section must be adhered to in order to maximise your chances of success. The exam is challenging enough to pass by attempting the correct amount of questions but becomes extremely difficult if only one question from Section B is attempted. There are very few candidates that will pass if insufficient questions have been answered. Similarly missing out sections of questions, which could add up to a significant number of marks, should also be avoided. Reasons why whole questions or parts of questions are not attempted are probably due to either lack of knowledge or poor time management or possibly both. Although tuition providers and candidates may attempt to predict which syllabus areas will feature in any particular session, it would be extremely hazardous for candidates to come into the exam hall with large syllabus gaps in their knowledge.

It was pleasing to see evidence of time planning on scripts, with many of the better candidates writing the time to start and stop for each question on their scripts. However there were many cases of poor time management displayed by the weaker candidates. This weakness can be corrected but does require practice. Candidates must use the permitted time wisely and use the mark allocation as a guide to how many points they need to make. Each question has a maximum number of marks and once this has been met then candidates cannot score any more regardless of how much they write. As a general rule at this level marks are often awarded for identification and then application. So for a 12 mark question if you can identify six relevant points from a case and then apply them (or state why these are relevant) to the case then you should move on. Do not try to find more and do not write reams about just one particular point. Once your time is up on any particular question part you also need to move on. As a general rule more marks will be scored by answering what you can from four questions than from answering at length only three questions.

Candidates are reminded of the exam resources available to students via the website which contain many technical articles, study support videos, syllabus updates and exam technique guidance which provide an invaluable sources of information. To illustrate this point the following technical articles were relevant to this particular paper; Corporate Governance – from the inside out, The Integrated Report Framework, Environmental Accounting and Reporting, COSO's Enterprise Risk Management framework, Internal audit, Independence as a concept in corporate governance and risk and environmental auditing. Future candidates are reminded to make full use of these resources as part of their overall learning strategy.

#### Question One

Question 1 was a typical P1 case consisting of a page and a half of information on a fictitious organisation. In this case the organisation was a listed company based in a country whose corporate governance regulations require such companies to adopt a particular board structure. Details were given as to the experience and qualifications of the directors as well as details of a world class research and development department within the company. A takeover offer was received for the company which valued it at twice its current market value and as such the Chairman, investment analysts and fund managers initially wanted to accept the offer. However

following discussions between the Chairman, the Financial Director and the Chief Executive it came to light that there were new products in R&D that once launched would increase the value of the company and as a result the offer should be rejected. Further information was then provided on the institutional investors (who predominantly owned the company), media comments on the corporate governance regulations within the country and the standard of corporate governance reporting of the company itself.

Part (a) for 12 marks required a critical evaluation of the particular board structure within the company. Generally this was not well answered as many candidates interpreted this to mean state the advantages and disadvantages of this particular board structure. Preparing a generic list of advantages and disadvantages with no reference to the case cannot score highly at this level. Candidates should consider carefully the verbs used in the requirements and construct their answer accordingly.

Part (b) required candidates to reflect on the level of communication within the company and suggest measures to mitigate the risk of communication failure for 6 marks. Generally this was well answered with many practical and logical solutions proposed. However, as one particular board structure was mandatory in this country, suggestions of a different structure scored no marks.

Part (c) was again generally well answered requiring a discussion on corporate governance and the particular agency problems the Chairman might face. Many candidates picked up the relevant information from the case and scored the majority of the 10 marks on offer.

Part (d) of the case study typically requires an answer in a particular format – whether this is a letter, email, press release, draft presentation etc. and four professional marks are available in total for flow, persuasiveness, tone and format. In this particular case, a letter from the Chairman to the shareholders to be included in the next annual report was required. Candidates should ensure that they understand the audience and write their response appropriately in order to maximise these professional marks. For further hints and tips on where more marks can be gained on this area please see

(d) (i) The first part of the letter for 10 marks required a discussion on the potential of corporate governance reporting to meet the information needs of the shareholders. In general this was not well answered. Some candidates included an explanation of whether the company should accept or reject the takeover offer which was not required and so scored no marks and wasted significant time. Other candidates wrote about corporate governance in general as opposed to corporate governance reporting and those that did write about corporate governance reporting were often too narrow in their answer. Candidates are reminded to plan their answers as two or three minutes spent planning could have avoided these common errors and enabled more marks to be gained

(d) (ii) The second part on institutional investors was by comparison well answered with many candidates scoring the majority of the 8 marks on offer.

### **Question Two**

This case concerned a fund manager working for an investment company looking after the portfolios of wealthy private clients. Following a period of success, where the fund manager received large bonuses and enjoyed a lavish lifestyle, he suffered a decline in fortune. Fearing losing his accustomed lifestyle and status within the investment company he resorted to drastic measures – initially investing in high risk securities, against client's instructions, until finally creating a fraudulent investment scheme. One client queried the volatility of returns and after an unconvincing explanation by the fund manager he referred the matter to a senior manager within the investment company.

Part (a) was worth 12 marks and required a discussion concerning internal controls (or lack thereof) evident in the case and a critique of the fund manager's behaviour. In general this was well answered with candidates highlighting the key objectives of internal controls and how they clearly were not working in this case. Many candidates scored highly also in the second part, drawing out elements of fiduciary and professional duty which the fund manager was in breach of.

Part (b) for 7 marks required an explanation of good quality information. Many candidates restricted the marks they could score by simply stating the characteristics of useful information with little or no reference to the case. If they had gone on to say why these characteristics would be useful in this particular scenario – as better candidates did – they could have scored more marks.

Part (c) for 6 marks required an explanation and application of ethical relativism. Unfortunately this was not well answered on the whole with many answers either mixing up various ethical theories or simply ignoring this part all together.

### **Question Three**

The case concerned a global oil company with onshore and offshore oil fields in four continents around the World. Following a major oil spillage from a competitor's oil rig off the African coast the case described how many international governments were imposing greater environmental regulations, in particular requiring companies to adopt a more interventionist approach. As a result the oil company in the case was setting aside a contingency fund to mitigate against the cost of any similar environmental disaster as well as undertaking a formal environmental risk assessment and the adoption of integrated reporting to demonstrate to shareholders that they were taking environmental issues seriously.

This question illustrates the importance of time budgeting as all three parts had very similar marks. The better candidates wrote similar amounts for all three parts whilst weaker candidates wrote at length for part (a) but just a short list by the time they got to part (c).

Part (a) required a description of environmental risk, an evaluation of the sources of environmental risk from the case and suggestions as to how the company could reduce their impact. There were 9 marks available for this and candidates generally scored very well on this part. If anything candidates wrote too much and as a result wasted time. The question required three things, a description, evaluation and suggestions all for 9 marks in total. Candidates who exhibited good time budgeting made two or three well-argued points for each and then moved on and these often scored a similar mark to those candidates who wrote pages on a description of environmental risk.

Part (b) asked for a description of a suitable framework to manage risk given the scenario. Better candidates brought out the key points of the COSO Enterprise Risk Management framework but the majority of candidates that attempted this used the TARA framework for risk assessment, considering likelihood and impact. As no definitive framework was required using TARA was acceptable but many lacked detail with very few examples linked to the case. There were 8 marks on offer for this part.

Part (c) required an understanding of integrated reporting in order to provide an explanation of how it could be useful to all interested parties of the oil company. It was disappointing that this was not better answered given the prominence of integrated reporting in the syllabus and in the wider business press. Some candidates clearly did not know and just guessed whilst some others listed the six capitals but did not relate them or provide

examples relevant to the case. Candidates can gain many more marks by ensuring there are no major syllabus gaps in their knowledge as well as always providing examples from the case to illustrate the statements made.

#### **Question Four**

The case was based on a recently qualified accountant landing his dream job at a football club that he had supported for many years. The accountant found discrepancies in the financial records which the FD summarily dismissed and brushed off, creating an ethical dilemma for the accountant. Should he investigate further and report his suspicions against the FD's wishes and risk losing his dream job and possible promotion or just keep quiet and do nothing? Although he suspected a criminal activity was taking place he did not investigate further or report to the organisation's compliance officer. Shortly before the external audit the football club was raided by the serious crime authority and now the accountant is worried that he will be implicated in a potential crime.

Part (a) was worth 10 marks and required candidates to display their knowledge and then application of the five fundamental ethical threats that could be identified in the case. Once again the verb in the requirement was 'evaluate' and as a consequence candidates who simply listed the fundamental threats with generic descriptions and nothing else failed to pick up as many marks as those that could give examples of each threat from the case and a description of the impact they had on the accountant.

Part (b) was also worth 10 marks and concerned threats to independence and safeguards that could have been in place to resolve the ethical dilemma before it became too late. Some candidates could not see the distinction between parts (a) and (b) and as a result repeated the same points and therefore did not score highly. Others however framed their answer in terms of the fundamental ethical principles and scored highly. This illustrates the need to plan your answers and think carefully about which two of the three optional questions to answer.

Part (c) required an explanation of the steps that the accountant could have taken to resolve the ethical dilemma and was for 5 marks. There were many generic answers stating either the American Accounting Association (AAA) model or Tucker's 5-question model which tended to be long-winded and unfortunately low-scoring as they did not answer the question set. The better answers presented a shorter more pragmatic series of steps that the accountant could have taken. If you were the accountant in this situation what would you do? Remember theoretical models are very useful as a means of generating ideas, but candidates should not always be looking for a model to use and apply for all questions in this exam – unless of course specifically asked for.