

Examiner's report

P1 Governance, Risk and Ethics

September 2016

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black square.

General Comments

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

P1 questions are based on case scenarios and those candidates who studied the information in the case and applied it suitably in their answer were well rewarded. There is a temptation for candidates to use bookwork type answers and reproduce remembered notes and candidates taking this approach are unlikely to be well rewarded. There is sometimes a temptation to spend more time answering the questions and requirements that candidates are happier with but most candidates need to answer all of the questions on the paper to receive a passing mark so good time budgeting is important.

Question One

The subject of the case scenario in Q1 was bribery and corruption. The corruption was proliferate in the country and within the listed company that were at the centre of the case scenario. Although a listed company there were a number of governance principles that were not being adopted examples being the roles of chairman and chief executive being held by one person who received a substantial fixed salary, the remuneration report was inaccurate because of the bribes being received by the chairman/chief executive. There was no scrutiny of the chairman/chief executive allowing unacceptable behaviour and ethical failures to take place. The company operates in the oil and gas industry and because of a number of recent high profile incidents relating to poor environmental performance companies are potentially going to be asked to produce high quality environmental reports each year.

Part (a) was worth eight marks and required the candidate to explain why splitting the roles of the chairman and chief executive and appointing an effective non-executive chairman would be beneficial to the shareholders of the company in the case scenario. There was no currently no scrutiny and supply contracts were not controlled allowing corruption to take place. The result of this "tone at the top" meant the shareholders were receiving poor value for money from the current leadership.

Many candidates failed to recognise that the requirement was to look at the benefits to the company in the case scenario and produced a bookwork answer on the benefits of a split role and the appointment of an effective non-executive chairman making no reference to the case throughout their answer and failed to obtain the marks available.

Part (b) (i) was worth eight marks and contained two tasks. The first task required candidates to discuss the importance of completeness in a remuneration report. Most candidates recognised that the report provides shareholders with information on how much the executive directors are paid and how their remuneration is configured. Most candidates recognised transparency and being given the whole picture is important to enable the shareholders of the company in the case scenario to decide whether they are getting good value from the executives. Many candidates obtained good marks on this part of the question.

The second task required candidates to explain how the inaccuracy of information on remuneration of executive directors creates a potential agency problem. Many candidates produced a bookwork answer explaining the agency problem and failed to explain how inaccurate information is a breach of trust and a serious agency failure which might lead to more monitoring and increased agency costs. Candidates who just explained the agency problem failed to obtain the marks available.

Part (b) (ii) was worth six marks and required the candidate to explain why most shareholders would support a link between rewards and performance. Many candidates recognised that this motivates the directors and encourages them to think about creating shareholder value and were well rewarded on this part of the question.

Part (c) was worth 8 marks and required the candidate to explain the importance of effective internal controls and internal audit in underpinning the proposed compulsory environmental reporting requirement. Candidates were required to explain how this would lead to assurance on the collection of the relevant metrics and the need for accuracy in measurement to enable progress year on year to be measured. The users of the information would be assured of reliable and accurate information. Many candidates failed to explain how internal controls and audit underpinned the report itself and produced answers that focused on the environmental footprint and supporting reputation. Weak answers produced a general explanation of the role of internal controls and internal audit. Candidates who answered in context and focused on the report itself were well rewarded.

Part (d) contained two requirements and was to be written in the form of an article for publication. The four professional marks were awarded for flow, persuasiveness, tone and format of the answer. The professional marks should be straightforward marks for a well prepared candidate who has rehearsed the different communication types that can be examined in P1. Evidence on this paper is that many candidates are not clear how a media article should be structured. Candidates would be well advised to remind themselves of the communication types and the correct ways of structuring each requirement type.

Part (d) (i) was worth eight marks and required the candidate to explain the meaning of corruption and discuss the barriers to improving the corrupt practices in the country and within the company in the case scenario. It was necessary to carefully study the case to draw out the evidence of the barriers and many candidates managed to do this and were well rewarded.

Part (d) (ii) was worth eight marks and required the candidate to propose measures to defeat the corruption identified in d (i). Candidates appeared to find d (ii) more difficult and many candidates did not attempt this part of the question. Those candidates who gave sensible suggestions for defeating corruption were well rewarded.

Question Two

The case scenario was based on a bank and its manipulation of the London interbank offer rate (LIBOR) an internationally recognised benchmark interest rate which is published every day. The difficult economic conditions which the bank had endured in recent years meant that the board was under immense pressure to deliver and maintain improved profitability. As a consequence a number of directors including the chief executive officer chose to turn a blind eye to the manipulation of LIBOR because the manipulation allowed for higher levels of shareholder returns

and all of the executive directors earned substantial bonuses because of the bank's inflated profit. The audit committee had also failed to task the bank's internal auditors to investigate the effectiveness of its LIBOR internal control system and the internal audit had not alerted the committee to the clear procedural and compliance failures.

Part (a) was worth eight marks and required the candidate to evaluate the importance of internal control compliance to the shareholders of the bank in the case scenario. Many candidates failed to acknowledge the word compliance or shareholders and produced bookwork answers about the importance of internal controls with no reference to compliance or shareholders and did not gain as many marks. Candidates who considered the consequences for the shareholders of the failure to follow internal banking procedures and external laws and regulations were well rewarded.

Part (b) was worth 12 marks and contained three tasks. The first task required the candidate to discuss the importance of an effective audit committee in internal control compliance. Many candidates again failed to acknowledge the word compliance and produced a bookwork answer on the audit committee role in internal control and did not gain as many marks. Candidates who discussed the role in relation to reviewing compliance with laws and regulations and important internal controls were well rewarded. The second task required the candidate to criticise the performance of the audit committee at the bank in the case scenario. Candidates who answered in context and used the case evidence to criticise the performance were well rewarded. The third task was to criticise the performance of internal audit at the bank in the case scenario. Candidates who answered in context and used the case evidence to criticise the performance were well rewarded. The performance on parts (a) and (b) of this question highlights the need for candidates to read question requirements carefully to ensure they are very specifically answering the question asked. Part (c) was worth five marks and required the candidate to recommend effective internal controls which could have helped to avoid the LIBOR scandal at the bank in the case scenario. Those candidates who gave sensible suggestions for effective controls were well rewarded.

Question Three

The case scenario was based on a company who had developed an ambitious plan to help the company emerge from the difficulties it had experienced in recent years. The plan was to diversify the core business model from a traditional retail model to one which included a significant element of e-commerce. The development of the technological infrastructure was delivered on time and within budget but the supporting logistical infrastructure proved to be wholly inadequate. A promotional campaign to coincide with the launch of the new online sales channel appears to have been successful and many orders were placed with payment being taken when the order was placed. Many of the orders were not fulfilled because the goods to be supplied were not available in the warehouse. The board did not have a separate risk committee and had not assigned internal audit to appraise the risks involved in the new venture. The company had collapsed and the shareholders had lost most of their investment.

Part (a) was worth 9 marks and contained two tasks. The first task required the candidate to explain the fiduciary duty of the board of the company in the case scenario. Many candidates recognised the duty of care and trust and to act in the best interest of the company and were well rewarded. The second task required the candidate to discuss how the board's failure to fully consider risk had resulted in a fiduciary failure to the shareholders. Candidates needed to recognise that the directors had been responsible for committing significant resources to a venture which had not been fully or effectively risk assessed and that this could be viewed as carelessness

on the part of the board. The lack of sound judgement when devising and implementing the strategic plan and the consequential financial losses would be a breach of fiduciary duty. Candidates who produced answers that evidenced the breach were well rewarded.

Part (b) was worth eight marks and required the candidate to assess the importance of risk awareness for the new venture and within the assessment make reference to the dynamic nature of risk in the retail sector. Some candidates produced generic answers on the importance of risk awareness and the dynamic nature of risk with no reference to the case scenario and failed to gain the marks available. Some candidates produced a list of the risks the venture had faced and failed to address risk awareness and failed to gain the marks available.

Candidates needed to carefully study the case scenario and recognise the lack of communication between colleagues in the various departments. Consequently the risks were not identified and as a result the controls were not in place. Awareness would have allowed for pre-emptive action to be taken to ensure supply was apply toample to meet demand. Good candidates recognised that in the retail sector customers' tastes can change regularly and this combined with the internally generated factors of the rapid introduction of the new venture required regular risk assessments to detect any sudden or significant changes. Candidates who produced answers incorporating these points were well rewarded.

Part (c) was worth 8 marks and required the candidate to explain how risk auditing could have helped to avoid the corporate failure of the company in the case scenario. Candidates who worked through the stages in a risk audit and evidenced how the stage would have helped to avoid the failure were well rewarded. It was important to recognise that the audit would have created the awareness that had been lacking throughout the company. Audit would have assessed the likelihood and impact ensuring that the venture was fully assessed before going ahead in order to prevent the failure. Audit gives a fresh pair of eyes that may have picked up omissions not identified by management.

Question Four

The case scenario was based on a qualified accountant acting as the finance director of a listed international construction company. The accountant was jailed for insider trading and the case scenario explained that the insider trading had taken place when a government contract was awarded to the construction company in the case scenario. Once the deal had been finalised and announced the share price soared. The accountant had used a false name to avoid being detected and had bought the shares in small batches regularly during the three-month period before the lucrative deal was finalised. The government contract awarded was for the building of new social houses and so after the incident the construction company issued a statement that an independent investigation into the company's financial conduct surrounding the insider trading incident had confirmed that the internal controls were sufficiently robust and that there were no wider governance concerns.

Part (a) was worth eight marks and contained three tasks. The first task required the candidate to describe insider trading. Many candidates produced good answers and gained good marks. The second task required the candidate to describe how insider trading compromised directors' corporate responsibilities. Many candidates recognised that this was a breach of fiduciary duty and produced good answers gaining good marks. The third task was to explain how the accountants' behaviour could have undermined the general confidence in the stock market. Many candidates

struggled with this task and failed to recognise that if insider trading is viewed as systemic the loss of confidence among shareholders may result in them withdrawing their investments.

Part (b) was worth 10 marks and required the candidate to discuss how the accountants' behaviour was a clear breach of the IESBA [IFAC] code of ethics which as a professional accountant he should have strictly followed. This required an understanding of the principles which underpin professionals and then drawing out the necessary evidence in the case to support each principle breached. Many candidates failed to find the evidence from the case and consequently failed to gain the marks available. These candidates might have benefited from highlighting the evidence when reading through the case to ensure maximum marks for this part of the question.

Part (c) was worth 7 marks and contained two tasks. The second task being answered better than the first by many candidates. The first task required the candidate to explain how the construction company has a corporate social responsibility to act in the public interest because of the publicly funded building contract they had been awarded. Candidates needed to recognise the contract is publicly funded and therefore society as a whole has a stake in the building contract and therefore needs so the public money needs to be protected. The construction company needs to demonstrate they have used the public money for the purposes intended. The second task required the candidate to evaluate how the construction company would demonstrate good value for money. Candidates discussing and applying economy, efficiency, effectiveness or other sensible suggestions were well rewarded on the second task.ft.