

Examiner's report

P1 Governance, Risk & Ethics

December 2012



General Comments

The overall performance in December 2012 was similar to previous diets. There were some excellent scripts and many candidates had obviously worked hard and prepared thoroughly for the exam. As usual, I extend my congratulations to all successful candidates and their tutors. The remarks I make in this report are intended to help less successful and future candidates and I hope they are useful in that regard.

As in the past, the structure of the P1 paper comprised one compulsory question in section A and a choice of two from three in section B. Question 1 was worth 50 marks overall and each section B question was worth 25 marks.

Before I go on to discuss the individual questions in detail, I am able to give a general overview of the questions that were done well and not so well in general. The parts of questions done well by many candidates were 1(a), 1(c), 2(a), 2(b), 3(a), 3(b) and 4(a). The parts that were often done poorly were 1(b), both parts of 1(d) and also 4(b). I will discuss the reasons for the weaker performance in the question reports below.

Specific Comments

Question One

The case in section A (question 1) was about a company called P&J that made a product (X32) that was discovered to be toxic and hazardous to health. With so much investment in the X32 supply chain, P&J had to face several strategic problems, not least of which was a likely long-term liability from litigation claims from employees and others that had been exposed to X32. The requirements examined a range of issues concerned with P&J and its difficult situation.

Part (a) asked about P&J's social footprint. Most candidates were able to define what it means (the first requirement) and the question then asked for four particular social implications of Professor Kroll's findings. The case described these and this showed the importance of carefully studying the case to gather this information. The emphasis here was on exploring how people and communities can be affected by business issues. In the case of X32, these issues concerned health, employment and the loss of company value.

Part (b) asked about the diversification of risk. Overall, this requirement was done poorly. A minority was able to describe well what the term means. The requirement was to explain why diversification of its risks would be very difficult for P&J. Again, it was necessary to study the case in some detail to answer this well as all the reasons for the difficulties were there. Weaker answers attempted to fit the TARA framework into the answer although this was an inappropriate and incorrect approach.

Part (c) was about the unethical and unprofessional behaviour of Hannah Yin, who was a qualified accountant and therefore subject to the fundamental principles of professionalism contained in the IFAC code of ethics. The case contained evidence that her behaviour breached three specific fundamental principles (integrity, objectivity and professional behaviour). Weak answers listed all of the IFAC principles with some attempting to show either their importance (which was not required) or to show how Hannah had somehow breached all of them. In understanding ethical behaviour for professionals, it is important to be able to criticise poor ethical behaviour and this was the main purpose of this question.



I was disappointed that neither requirement in part (d) was done well by many candidates. The first part of (d) (i) was to distinguish between strategic and operational risk and this was done quite well by many candidates. It was the second requirement in (d) (i) that was done less well: to show how the findings in the Kroll report are a strategic risk to P&J. This involved being able to apply the idea of strategic risk and to analyse the case to show why these risks are strategic (as opposed to operational). This second requirement was less well done. It is important, then, not only to know what terms like 'strategic risk' mean, but also to be able to apply them in the context of information from a case study.

I was surprised that part (d) (ii) was not so well done because five of the nine marks available were effectively testing theoretical knowledge (the board's responsibilities for internal control). A thorough and systematic revision schedule should have provided candidates with a full knowledge of the board's responsibilities in respect of internal controls and the COSO guidelines were a helpful framework around which to base a good answer.

The second task in (d) (ii) was to criticise Mr Ho's decision to choose Plan B. This was poorly done overall even although there were clear criticisms to be made of Plan B (in the case) from an ethical perspective: Plan B knowingly overlooked the health needs of some employees and acted based on how visible the changes would be, thereby ignoring the need to upgrade the facilities in the developing countries.

The four professional marks were awarded for writing the answer in the form of an article in a magazine called *Investors in Companies*. There were some excellent attempts from some candidates whilst others seem to have made no attempt at all to frame their answers according to this requirement. As in previous reports, I would remind candidates, that making an attempt to gain the professional marks is very worthwhile and in some cases, can be the difference between a pass and a fail.

Question Two

The case in question 2 was about corporate governance in the country of Oland. All of the themes raised in the requirements had been on previous P1 papers (some on more than one) and so well-prepared candidates who had worked through the past papers would have seen similar requirements before.

Part (a) appeared to be straightforward at first glance but the emphasis here was on how sound corporate governance can make it more difficult for companies to fail. This, after all, is one of the most important purposes of corporate governance (protecting the value of shareholders' investment) and so the emphasis here was on showing how the measures in sound corporate governance make a company more robust and more able to cope with threats to its ongoing existence.

Weaker answers listed the key underpinning concepts from study guide section A1d). It wasn't clear how this approach was attempting to answer the requirement about making it more difficult for companies to fail and so these answers were not well-rewarded. Good answers reflected upon the essential features of good governance and then, importantly, considered how each of these made a company more robust and less likely to get into financial difficulty.

Part (b) was quite well done overall. The distinction between rules and principles-based approaches to corporate governance was well understood by most candidates but the second task was less well done by some. In the case, Martin Mung had insisted that 'comply or explain' was ineffective, thereby arguing for a more rules-based approach in Oland. The task was to argue against his position, thereby arguing in favour of 'comply or explain'. Some tagged this onto their discussion of the principles-based approach whilst others added it as a separate



section after distinguishing between the two. Either was acceptable as long as the appropriate content was included in the answer.

Part (c) began by asking for an explanation of 'accountability', which most candidates could do successfully. The tasks asking about how shorter re-election periods and the provision of biographical detail might result in greater accountability were less well done by candidates. It was important to understand the link between accountability as a concept and the mechanisms of calling to account (such as those described in the case). Again, the ability to apply a piece of knowledge (knowing what accountability means) to a case was key to gaining good marks.

Question Three

The case in question 3 was about Yaya Company and a number of failures of internal control, mainly centred around the quality control laboratory. Part (a), on the typical reasons why internal control systems might be ineffective, was done quite well overall, partly because it was mainly bookwork. On a P1 paper containing so much need to analyse the case and engage with higher level cognitive verbs, it is very important that bookwork marks are obtained where available. This underlines the importance of revising the main 'lists', themes and concepts in the study guide and in study texts.

Part (b) was a typical P1 question and one that has been asked, in various forms, several times before. The task was to look carefully at the case and explain (not just list) the internal control deficiencies that led to the problems at Yaya. Well-prepared candidates were able to gain good marks on this requirement with the best approach being to carefully pick out the IC failures, one at a time, with a separate paragraph dedicated to each.

Part (c) was done less well. Weaker answers used a mnemonic to list the qualities of useful information (typically the 'ACCURATE' mnemonic) but the question specifically asked how they would be of benefit to Mr Janoon. Those that just listed the general qualities did not score highly as they failed to engage with the value to Mr Janoon. A second task was to recommend specific measures that would improve information flow from the QC lab to the case. Many answers given were general or vague whereas a good answer considered the specific information needs of Mr Janoon and was framed in that way

Question Four

This was a 'stakeholder' question in which a disputed route for a new railway set the scene. Both routes (A and B) had their pros and cons and eventually, Route A was chosen which would protect Mr Krul's farm but destroy the feeding ground for the colony of endangered birds.

The Tucker 'five question' framework for assessing the decision to choose Route A (part A) was done well for the most part but some candidates merely listed the five questions with little attempt to engage with the case. The point here was that whilst the decision to choose Route A was profitable and legal, there were questions over its fairness, its rightness and its sustainability. The better answers were able to engage with these issues and show that the selection of Route A was not without its complexities.

Part (b) was done poorly overall. A similar version of this question was on a previous paper so it was disappointing to see that many candidates performed poorly. A common, and incorrect, response was to frame the answer around the Mendelow matrix. Perhaps the word 'stakeholder' in the question triggered an assumption that the answer must involve the Mendelow matrix – but this was not so, except to highlight that some stakeholders are more influential than others. The question specifically asked about the importance of recognising all of the stakeholders in a decision and therefore concerned stakeholders as sources of risk, disruption, conflict



and reputation loss. A careful reading of the wording of the question was necessary to get the actual meaning of what was required.

Finally, part (c) asked about stakeholder 'claims' and then asked candidates to critically assess the claims of the three main stakeholders discussed in the case. I wrote a technical article about this in early 2008 and it was pleasing to see that most could explain the notion of a 'claim'. The second task, to critically assess the three claims was done less well, with weaker answers just repeating information from the case about each one.