

Examiner's report

P1 Governance, Risk & Ethics

December 2014



General Comments

The rubric for the December 2014 P1 diet was the same as previous diets: a compulsory 50 marks question 1 (in section A) and a choice of two from three 25 mark questions in section B.

As usual, there were some excellent papers and the overall performance was comparable to previous diets. As usual, the P1 examination team congratulates successful candidates and their tutors.

The professional marks in question 1(d) were in the form of a press statement. This has appeared before in a P1 exam and so well-prepared candidates who had studied previous model answers on the ACCA website would have been aware of how to set out this answer. It was disappointing, then, to see many candidates set out the answer as a letter or a memo. I often emphasise this in examiner's reports but these should be fairly straightforward marks that many candidates fail to achieve.

A second problem for some candidates was to fail to locate their answers in the context of the case scenario as asked for by the question. If a question requires the answer to be set out in the context of the case, then to achieve high marks for that requirement the answer must be set out and framed in accordance with the case. In question 1(d)(ii), for example, weaker answers simply defined the terms accountability, fiduciary duty and pristine capitalist without attempting to base the answer upon the case.

Question One

The case scenario for the compulsory question 1 was about a company (Cheapkit) who sourced its inputs from Cornflower, a producer based in a developing country. In order to control its costs, Cornflower was corrupt in some of its dealings, and this contributed to the building weaknesses that eventually led to the building collapsing, killing many people. This is similar to a real life case that took place a few years ago. The requirements explored a range of issues around these events.

Part (a) asked candidates to discuss the stakeholder claims of Cornflower's employees and customers and how these might be in conflict. The customers include Cheapkit and they rely on very low unit prices from Cornflower in order to be competitive in their own strategies. The case suggests that the need to remain competitive was a factor in Cornflower entering into corrupt practices to keep unit prices low, and these badly affected the health and safety of its employees. The point being explored in the question was that companies have to decide which stakeholders to privilege over others, and in many cases, claims are in conflict meaning that one must be chosen over others. Weaker answers defined stakeholder claim and considered the respective claims of the two stakeholders, but then failed to consider the conflict between the two. Answers that discussed Mendelow and/or the types of stakeholder (active/passive, primary/secondary, etc.) missed the point and were not well-rewarded.

Part (b) contained two tasks. The first was to explain corruption. This was done well by most candidates. The second task was to discuss how corruption at Cornflower contributed to the collapse of the building. This involved carefully studying the case and drawing out the corrupt practices that made the collapse of the building more likely. Cornflower's owners, the Fusilli brothers, were corrupt in several ways in establishing the new Cornflower building and its fitting out, most of which made it less safe and more likely to fail. This was not difficult for those candidates who took the time to study the case and discuss the various contributory factors. Of course this requirement showed the importance of complying with building regulations and other building requirements in order to ensure the health and safety of employees and the dangers of corrupt practices.

Part (c) asked about three risks that Cheapkit faced. Candidates were required to explain the three risks (exchange rate risk, supply risk and international political risk). In addition, however, candidates were required to explain how each of the three risks might be of importance to Cheapkit's shareholders. A common answer was to explain the three risks and then to offer only a weak explanation of their relevance to shareholders but it should be remembered that the shareholders collectively own the value of a company and so any threat to company



value is a threat to the value of a shareholder's investment. According to agency assumptions, a company has no money of its own: all of the value of a company belongs to the shareholders.

Part (d) contained three parts and the requirements asked that the answer be presented as a press statement. As mentioned in the introductory remarks, this was done with varying degrees of success. It has been stressed before in previous examiner's reports that these marks can often make the difference between a pass and a fail, and so it is baffling why so few seem to take this seriously. The default, in many cases, was to (incorrectly) set the answer out as a memo:

From: board of Cheapkit
To: magazine.
Subject: press statement

I would encourage tutors to work through these issues with candidates, as these four marks can often be very helpful in accumulating marks on the exam.

In terms of content, 1(d)(i) asked candidates to explain Cheapkit's role as a corporate citizen. This has been examined before on a previous P1 paper and the key was to explain citizenship in terms of the company's rights and responsibilities. Weaker answers described Cheapkit's CSR or ethical postures, which, whilst relevant to a degree, missed the main point of the answer.

Part (d)(ii) asked candidates to explain 'accountability' and 'fiduciary duties' and then, importantly, to relate these concepts to Cheapkit if were to adopt a pristine capitalist perspective. The task here was not to define 'pristine capitalist' but to use this perspective to show how its view of accountability and fiduciary duty would be viewed. Weaker answers defined the three terms and moved on but there were some excellent answers that correctly interpreted accountability and fiduciary duty in terms of a pristine capitalist understanding.

Part (d)(iii) asked candidates to discuss integrated reporting. There was a recent technical article on integrated reporting and it has been on the P1 study guide for some time. It was disappointing to see that many candidates had little idea of this initiative with some, seeing the word 'stakeholders' in the question, assuming it to perhaps be a Mendelow question or similar. Integrated reporting is an international initiative supported by many of the world's most important organisations, including ACCA, seeking to increase the materiality and usefulness of business reporting. It does that in part by specifying the content of business reporting and strongly encouraging reporters to consider the materiality and usefulness of what they report. The six capitals are a part of this, intended to convey to investors and others, the net change from year to year in the quality and stock of those six capitals. This part of question (d) was worth 8 marks and this shows the importance of studying all the study guide including any new additions, included to keep the P1 study guide relevant and up-to-date.

Question Two

The case scenario in question 2 was about a public school and the requirements focused on public sector governance issues. The scenario concerned a school having to submit a performance report to the local government authority but one member of the board of governors, Sally Murol, suggested submitting a partial report to prevent the feared closure of the school. There were also issues with the effectiveness of the head teacher, Mr Besse.

Part (a) should have been straightforward for any candidates familiar with the characteristics of a public sector organisation. To answer this well, candidates needed to study the case to pick out the characteristics which identified Chambon school as a public sector organisation. Poorer answers listed the points as bullets but the verb at the beginning of the question was 'explain'. This meant that to gain high marks, each relevant point had to be explained and not just stated.

In part (b), it was evident that had the governors followed Sally Muroi's suggestion about submitting a partial report, the governors would have failed in its duty of transparency. In fact it would have submitted what is essentially a fraudulent report. In public sector organisations, governors are put in place to deal with integrity and transparency with the funders of the work (in this case the local government authority) and to facilitate the effective running of the organisation. There were two requirements in this part. The first was to explain the roles of a board of governors, which should not have been difficult for well-prepared candidates. The second requirement was to discuss the importance of transparency for the governors in its relations with the local government authority. This second requirement was less well answered, although it was relatively straightforward to candidates who had studied the importance of transparency in agency relationships.

Part (c) concerned the possible replacement of the head teacher at Chambon school. The case highlighted several problems with Mr Besse and the requirement was to discuss the potential advantages of replacing him. The case contained several issues that were relevant to the discussion, and many candidates failed to adequately study the case and therefore missed some factors relevant to the discussion.

Question Three

The case in question 3 was about New Ideas Company (NIC), a university 'spin-off' company arising from an important discovery at the university. The case described the situation of Dr Ranjana Foo, an excellent scientist but with clear limitations as a business leader. Part (a) asked about Ranjana Foo's suitability to be the chief executive of NIC. In order to achieve a high mark on this part, candidates needed to know about the roles and personal qualities necessary to be an effective CEO, and also to study the case to gather the information on her suitability for the role. The case made clear on several occasions that she did not have the necessary qualities to lead the company, whilst nevertheless being a very good scientist. Less-prepared candidates listed the roles of a CEO as a bullet list and this approach did not attract high marks. This type of question demonstrates the importance of sound knowledge of the study guide, and also the necessity of studying the case. It was not possible to achieve a high mark in this part without studying the case in detail.

Part (b) was about non-executive directors (NEDs). For a small and risky company such as NIC, the role of NEDs could be decisive in its success or failure. Some candidates, perhaps on seeing the words, "non-executive directors" framed their answer in terms of the four general roles of NEDs (strategy, scrutiny, risk, people) but this was not what the question was asking. There were two tasks in this requirement. The first was to explain the benefits to NIC of suitable NEDs and the second was to discuss the difficulties, given the information in the case, that NIC might have in making NED appointments. In each task, it was necessary to situate the answer in the specific context of NIC. General lists of the advantages of NEDs were not what was required. Likewise, the second task required candidates to consider the issues that NIC might encounter – again, a general response was not a well-rewarded answer. The case contained information about NIC's location, its risk problems, etc. that would make it difficult to appoint suitable NEDs.

Part (c) was about a potential conflict of interest that one proposed NED might encounter. This requirement, worth 6 marks, was less well done than the first two requirements in question 3. Most candidates were able to explain 'conflict of interest' to some extent but many were less confident on the second task which was to discuss the specific conflict of interest that Dr Idris is likely to encounter. Again, a short time studying the case would have enabled candidates to gather the information from the case necessary to answer this task. It shouldn't be difficult to discuss a conflict of interest when one of the directors also owns a large shareholding in a potential supplier to NIC, but many were seemingly unable to spot this.

Question Four

The case in question 4 was about Loho Company which had recently undergone some internal changes and restructuring. These changes meant that its situation had become more complicated, thereby changing its need for internal controls. The scenario describes a number of risk changes and also a situation in which the finance director (Sonja Tan) has explained the limitations of some internal controls.

Part (a) should have been straightforward for candidates who were aware of the criteria for changed internal controls in an organisation. The case was seeded with a number of these changes that meant it would be favourable for Loho Company to review its internal audit needs. Given the changes (increased risks, more employees, more decentralised, etc.) there was clearly a case for strengthening the internal audit function in Loho. The task was to construct the case which means to argue in favour of it based on evidence from the case. Weaker answers listed the criteria for strengthened IA but failed to fully analyse the case from evidence. The task was not to argue for internal audit but to do so in the context of Loho Company and this was missed by some candidates. This should act a reminder to study the case for evidence if this is what the requirement is asking candidates to do.

Part (b) referred back to the case and a point made by Sonja Tan, the finance director. Whilst she believed that Loho needed tighter internal controls, she also emphasised that internal controls could only provide 'reasonable assurance' and each had inherent limitations that can affect their effectiveness. For 9 marks, this requirement asked candidates to explain why this is the case and to discuss why controls being 'very expensive' is no guarantee of effectiveness. So the requirement contained two tasks.

Candidates receiving the most marks were able to link their answer into the case. There are a number of reasons why internal controls can never be fully effective and this was book work to a certain extent with those able to link it back to the case of Loho receiving the most marks. The second task, to discuss why expense is no guarantee to effectiveness, was more difficult for many candidates as it required considering the specification of the control. An internal control has to be specified correctly for the thing it is controlling. It can be over-specified, which means the organisation receives poor value for money for the control, or underspecified, meaning that the control is not sufficiently effective. So the first task was done better than the second in some cases.

The final part of question 4 was about continuing professional development (CPD). Most professionals, including accountants, have a CPD requirement built into their continuing registration with their professional body and so it was surprising that some candidates made only a weak attempt on this question (although many produced excellent answers). CPD is an essential part of continuing professional competence and important in any professional career.