

Examiner's report

P1 Governance, Risk & Ethics

June 2013



General Comments

June 2013 was another successful diet for many thousands of P1 candidates all over the world. As always, I extend my warm congratulations to all successful candidates and their tutors. I hope the remarks I make in this report will be helpful for tutors and also to ACCA students preparing to sit P1 in a future diet. Please study these comments carefully as they explain where many candidates went wrong or underachieved on each question.

The June 2013 paper was similar to previous papers in terms of its 'feel'. The structure was also unchanged, containing as it did a compulsory 50 mark question (in section A) and a choice of two from three 25 mark questions (in section B). In each case, requirements followed on from a case scenario, and it was necessary to have studied each scenario before meaningfully engaging with the requirements.

A general comment I have with regard to this paper is that weaker candidates used 'trigger' words in the question requirements to sometimes produce 'lists' of content rather than actually answering the question set. This was a general problem among the weaker scripts and I will return to this as I discuss each question below. This paper contained relatively few 'bookwork' marks and mainly required detailed application of material from the case scenarios, so candidates that saw a key phrase and reproduced remembered notes in the hope of attracting marks were often not well rewarded. As in all exams, it is important to answer the question set, not the one you wish you had been set.

Specific Comments

Question One

The scenario in section A was about a report produced by a major accounting firm on a rare material (TY13) that was essential for use in some modern electronic products. As with many previous cases, this scenario was based on a real-life situation.

As in the past, the requirements for question one covered several areas of the study guide and, as mentioned above, most required answers related to details in the case in order to attract the highest marks.

Parts (a), (b) and (c) were worth ten marks each. Part (a) asked about related and correlated risk, with the particular example of the correlation between legal risk and reputation risk given the situation in the case. Many candidates were able to explain the two terms although some candidates confused positive and negative correlation of risks in their explanations. The better answers were able to see and explore the reputational difficulties of legal cases especially if details of Hoppo's own behaviour was made public in a legal case.

Part (b) was about environmental reporting. The wording of the requirement showed that it is important to determine how many tasks there are in the requirement. The first was to describe the purpose and contents of an environmental report, and the second was to discuss the advantages of an environmental report for the company and its shareholders. The best answers divided up these two tasks and approached them separately. Candidates who had read the technical article on this would have been better prepared for this requirement than others.

There were some very good answers to the first part (on purpose and content) but the highest marks were awarded for those also able to meaningfully approach the second part, on the advantages to Hoppo and its shareholders. This involved examining the specific environmental challenges faced by Hoppo and then showing how producing an environmental report could help with these. General answers on the generic advantages of environmental reporting were less well-rewarded.

Part (c) was about internal controls and, again, the requirement contained two tasks. The first task was to explain how internal controls can be strategic in nature. In order to answer this well, it was necessary to know



what 'strategic' meant and this is usually contrasted with the operational. Each level has its own objectives, activities, timescales and areas of responsibility. In addition though, risks can also be strategic or operational in nature, and the internal controls at the two levels are also different. Many candidates had a good idea about this and were able to gain at least one of the two marks available, with many achieving both marks.

The more ambitious task in part (c) was to 'explain, using detailed examples from the case, why developing sound internal controls over the supply and processing of TY13 would be important if Hoppo opted to build its own factory in Yuland'. This obviously necessitated a detailed analysis of the case in order to gather the reasons why such internal controls would be necessary. The case mentioned a number of features about TY13 that meant that sound controls would be necessary were Hoppo to process it in its Yuland factory. These included its high cost, its toxicity, the general supply problems and the variable quality of the raw material. All of these would be essential in any processing facility. It is clear from this example that it would not be possible to gain marks in this task without a detailed examination of the case.

The professional marks in part (d) were for presenting the answers in the form of a press release. As with previous exams, there was a full range of attempts with varying degrees of success in framing the answers in the requested manner. Many made a good attempt, gaining three or four of the professional marks, whilst others made no obvious attempt at all. It was frustrating to see some candidates setting out their answer as a memo or a letter when this was clearly not what was being asked in the requirement. It was also important to present the answer as a press release and not just as an exam answer. In a press release, for example, it would be unusual to see terms like deontological or consequentialist in part (d)(ii). The model answers present the contents of these two positions but do not use the actual terms except as a commentary.

The content of the press release was intended to address concerns over the request for a bribe by the mayor of Ootown. For six marks in part (d)(i), candidates were required to define and explain integrity and transparency in the context of the case. The marking scheme allowed three marks for each but answering it 'in the context of case', i.e. relating to Hoppo's situation, was important to get full marks. A common approach was to define the two terms (essentially bookwork) but then fail to adequately develop the connection to the case. It was disappointing to see this because it didn't take very much extra analysis to attract the extra 'case related' or applied marks.

There was a wide range of answers to part (d)(ii). The requirement examined the content on bribery in the P1 study guide and asked candidates to construct the argument against paying the bribe to the mayor of Ootown. The requirement asked that this argument should include both business and ethical perspectives against paying the bribe. For ten marks, candidates should have been alerted to the need for a fairly detailed consideration of these issues. A typical poor answer briefly discussed the essential features of both deontological and consequentialist ethical approaches, but did not then adequately relate these to the case. This requirement was done poorly on average. Perhaps the verb 'construct' was difficult for some candidates but in addition, the business case for not paying the bribe was often poorly developed.

Question Two

The themes examined in question 2 were the importance of internal audit, audit committees, the internal audit function and the role of internal audit in providing assurance in the integrity of financial reporting. Overall, it was disappointing to sometimes see candidates resorting to memorised 'lists' rather than answering the questions set.

In part (a), for example, the question was not asking about the importance of internal audit *per se*, but rather to consider the importance of internal audit in responding to regulation in highly regulated industries (such as water in the case). This task required candidates to consider the roles of internal audit in a specific industry situation. Higher scores were awarded to those able to do this more successfully and this, again, underlines the importance of answering the question actually set rather than the one that candidates wish had been set.



There were two requirements in 2(b) with both carrying equal marks (6 marks each). The first was to criticise the audit committee's performance in the case. This involved knowledge of best practice so as to assess how the audit committee has failed against that, and also, of course, a thorough reading of the case. Again, the question was not asking about the roles of an audit committee, and weaker answers wrote in general terms rather than analysing the content of the case.

The second task was to explain one particular aspect of an audit committee's work with regard to its oversight of the internal audit function. There is a difference between an audit committee and the internal audit function: the committee is a board level committee and the internal audit function is a department in an organisation responsible for monitoring compliance and other important internal audit outcomes. In many organisations, the internal audit function reports its findings to the audit committee and the question was asking why this arrangement is chosen in most cases. This means, 'why is the audit committee a suitable body to perform this function?'. Weaker answers, perhaps on seeing the words, 'internal audit function' produced a list of the purposes or functions of internal audit from COSO or similar. This was not the correct approach, and better answers considered the relationship in terms of internal audit helping to achieve the strategic aims of the company, remaining independent of those being audited, operating with the necessary board-level authority and meeting the compliance needs of the company as determined by the non-executive directors on the audit committee.

Part (c) was on the use of internal controls in assuring the integrity of financial reporting. It was disappointing to see this being poorly answered by many candidates, especially when the subject matter of the requirement was so important in corporate governance. It was a lack of confidence in financial reporting that led to the rise of corporate governance regulation in many countries of the world. It was the restatement of the financial reports of Enron in 2001/2 that was the first signal that its corporate governance systems were ineffective, and so the assumption that financial statements are true and fair is a very important assumption for investors to make. Strong internal controls are necessary to underpin this integrity of reporting. The most common answer to this was a brief discussion of the general importance of internal controls and this was clearly not what the question was asking.

Question Three

The case in question 3 was about a reduction in bank lending in Dubland, with one bank in particular, BigBank, being the subject of discussion. The requirements were about risk assessment, fiduciary duties and financial risk.

Part (a) began by asking candidates to explain the meaning of 'risk assessment'. This was a relatively straightforward requirement for many (with regard to the impacts and probability of identified risks). Weaker answers discussed the whole risk auditing process: identification, assessment, management, reporting, but this was not necessary. The question was only about risk assessment.

The second task in part (a) was to examine the case and to use that analysis to explain why risk assessment need to be 'continuous and ongoing'. Weaker answers forgot to attempt this task at all after discussing risk assessment but better answers showed how frequent and unpredictable environmental changes create changes to an organisation's risk profile.

Part (b) touched on the stakeholder/shareholder debate and asked candidates to critically evaluate a remark made by Mr Ng in the case. His remark that his 'only duty' was to the shareholders, was a 'pristine capitalist' type remark and the critical evaluation involved a consideration of both sides of the argument. Candidates who were able to see what this question was asking (the stakeholder/shareholder debate) often achieved good marks but weaker answers attempted to define 'fiduciary duty' but offered little discussion beyond that.

Part (c) was about embedding financial risks in large organisations using BigBank as an example. The requirement contained two tasks: to explain financial risk and then to discuss how financial risks can be embedded in BigBank. Weaker answers made an attempt to explain financial risk but then failed to develop the

second task on embedding risk. Stronger answers were able to place the idea of embedding risk into the context of the case and with regard to BigBank's situation in particular.

Question Four

This question was about Boom Co and the deliberations of its remuneration committee in meeting to agree the rewards of its executive directors. In the committee's discussions, its chairman, Sarah Umm, read out the relevant part of the corporate governance code on the subject (this was drawn from a real code of corporate governance). The requirements were on the purposes of corporate governance codes, how reward packages can be balanced to achieve a particular outcome (in this case, to incentivise medium to long-term growth) and finally on the roles of non-executive directors.

Many candidates performed poorly on parts (a) and (c) and in most cases, this was due to a failure to develop answers to the second task in each requirement. The first task in part (a) asked for an explanation of a code of corporate governance and whilst most candidates were able to offer a fair answer to this, a minority seemed to be confused over the word 'code', and instead offered a definition of corporate governance itself. The second task in part (a) was about the general purposes of a CG code for listed companies such as Boom Co and I was surprised that many answers failed to address this very well, especially as it was substantially bookwork and could have been answered by a well-prepared candidate.

A frustration with part (b) was candidates, seeing the term 'components of a reward package', automatically reproduced the list of such components (basic pay, performance bonuses, etc.). This was not what the question was asking for. The requirement specifically asked about incentivising medium to long term growth whilst retaining the existing board in place. So candidates needed to think about how these components could be blended and offered to achieve these outcomes. There were no marks for a list of the components of a reward package on its own.

Part (c) contained two tasks. The first was a relatively straightforward task about the general roles of non-executive directors. Most candidates were able to make a reasonable attempt at this (strategy, scrutiny, people, risk) and were able to attract four of the ten marks available. The second task was poorly done overall, requiring candidates to discuss a specific restriction on the rewards of non-executives. The importance on a non-executive's independence and his or ability to provide scrutiny on behalf of the shareholders is the key to understanding this. Some otherwise weak answers were able to discuss non-executive independence and were of course rewarded for that.