

Examiner's report

P1 Governance, Risk & Ethics

June 2014



General Comments

The June 2014 P1 paper, as in previous diets, was based on a compulsory multi-part question for 50 marks in section A, followed by a choice of two from three 25 mark questions in section B. I am pleased to report that many people passed the exam with some achieving excellent marks, and as usual, I congratulate all successful candidates and their tutors for all the hard work and commitment they put into the teaching and learning.

The paper itself was similar in tone and feel to previous P1 diets and there should not have been anything too surprising or difficult for well-prepared candidates to cope with. In section B of the paper, most candidates chose to do question 2, which was done better overall than questions 3 and 4.

Specific Comments

Question One

As in many previous P1 diets, the case scenario in question 1 was based on a real-life case that happened to a major international company some years ago. The company in question suffered a lot of reputational damage but continued with its practice of supplying formula baby products to developing country mothers. The questions in this compulsory question explored some of the issues that were caused by the decision to continue marketing formula baby foods when others had withdrawn from the market.

As in all previous P1 questions, a thorough analysis of the case scenario was essential to achieve a good level of performance. In requirement (a), for example, it was not enough to be able to define the three terms (transparency, judgement and reputation). The requirement was clearly to assess the Xaxa board's performance against each one. Many candidates seemed to default to assuming that the board's performance against each one was negative, but a careful analysis of the case showed that the company had been relatively transparent about its actions and had been transparent to its shareholders. This, again, underlines the importance of a thorough analysis of the case.

Part (b) was answered poorly by many candidates. The first task was essentially knowledge based and so should have been done well by well-prepared candidates. Most candidates should have been able to explain the purposes of a corporate code of ethics and many did this well. But it was surprising that many answers did not attract these relatively straightforward marks. The second task was poorly done overall. Candidates were asked to examine how the adoption of such a code might make Xaxa reconsider its marketing of baby foods, and this was done well by only a minority of candidates. Some weaker answers attempted to answer this requirement using the Tucker or AAA framework. It was difficult to see what lay behind such attempts but in each such case, they were not well-rewarded.

There were two tasks in part (c), both carrying equal marks. Part (c)(i) was essentially a knowledge based question for 5 marks and asked about the reasons for shareholder intervention in the governance of a company. Most candidates were able to gain some marks here but I was disappointed that we were unable to give higher marks for this in many cases. A well-prepared candidate who had worked through the study manual and the past papers should have been able to gain full marks for this part. Part (c)(ii) was more ambitious and required a careful analysis of the case to discuss the reasons why the Oublie Group (a group of influential shareholders) might intervene in the management at Xaxa Company. The case was carefully written to include several reasons why such intervention might be considered necessary. To do this task well required that candidates not only knew what the preconditions for shareholder intervention were (i.e. part (a)), but also that they had studied the case to select the reasons from the behaviour of Xaxa Company. This was less well done than part (c)(i).

As in previous P1 papers, part (d) contained the requirement to complete the answer in a certain way to gain some or all of the four professional marks. In this case, answers had to be prepared as notes from the consulting company for the Xaxa board. This means that they had to be written in a way that was easily understandable for the purposes of briefing, and also clear in that the board sought help on the subject of risk auditing. Quite a lot of candidates made no effort to answer the requirements in a suitable manner at all, whilst others, perhaps unexpectedly, set out their answer as a letter or similar.

There were two requirements in part (d). The first (part (d)(i)) asked candidates to discuss the stages in a risk audit. This was essentially a knowledge based requirement but it also asked that the discussion take place 'in the context of Xaxa'. This means that to achieve the highest marks, it was necessary not only to know the main stages in risk audit but also to analyse the case to place these stages in the context of the case. A common error was to list the main stages in a risk audit as a bullet list without any 'context of the case' and these answers did not attract high marks.

Part (d)(ii) asked candidates to distinguish between internal and external risk audit, and this was done well by many candidates. The second task was to discuss the advantages for Xaxa of an external risk audit. The second task was less well done, with answers often taking a general approach rather than locating the discussion in the context of Xaxa.

Question Two

The case in question 2 described the situation of Bob Wong who had inherited some money that he wanted to invest for his retirement. He did not know much about investment so he read about it on websites and gained some information that was helpful. The three requirements all concerned things that Bob, as a small investor, might need to know about, or things he might find helpful in his investment decisions.

Part (a) contained three tasks. The first two were to explain risk appetite and risk awareness, and these were done well on the whole and there were excellent answers from some candidates. The third requirement was to discuss how Bob's risk appetite might affect his investment decisions. Basic answers to this third task tended to point back to the definition of risk appetite and base the answer on that which was not well rewarded.

Part (b) was also often done very well. Again, it contained three tasks. The first two were to explain business risk and financial risk. Many candidates did this by including some examples of these two risks, which was a good approach. The third task was to discuss why risks might vary by sector. This was less well done, with some answers resembling, and using the same examples, from the technical article on the ACCA website rather than answering the question directly. Again, though, there were some very good answers to this question.

Part (c) was worth nine marks and was the least well done of the three requirements in question 2. Again containing three tasks, most candidates were able to distinguish between mandatory and voluntary disclosures. The best answers also included examples of each type, to demonstrate understanding. The third task was to assess the usefulness of corporate governance disclosure to Bob in selecting his investments. Although a similar requirement has been on previous P1 papers, this still seemed to confuse some candidates. Corporate governance disclosure includes those things required under listing rules, or which describe the company's approach to corporate governance challenges, and so includes, remuneration information, strategy disclosure, risk reporting, directors' information and similar.

Question Three

The case in this question was about Hum and Hoo, an audit practice in Deetown. As with many small audit firms, Hum and Hoo have sought to increase incomes by offering non-audit services. As other audit firms have found, the delivery of non-audit services can sometimes introduce ethical threats.



Part (a) asked about these ethical threats and the importance of ethical safeguards to address those threats. A common error when explaining ethical threat was to list each of the main five threats and explain each one. Given that there were a total of eight marks for this requirement and there were three tasks in the requirement, it should have been clear to those that had studied the marking schemes of past papers that a long a detailed explanation was not necessary for a third of the requirement. The second task was to explain ethical safeguards. Both if these two explanations were done well by many candidates.

The third task in part (a) was more difficult for some candidates. The task was to discuss the benefits of ethical safeguards for Hum and Hoo, so it was necessary to analyse the case to understand the particular situation that Hum and Hoo were in. Some candidates gave only a sketchy attempt at this, which was disappointing.

Part (b) was about environmental audit. The requirement contained two tasks: firstly to explain environmental audit and second to show how environmental reporting might enable companies to demonstrate their environmental sustainability. The second task was a more ambitious one, and some candidates did less well on that than on the first task (which was to explain environmental audit). It is important to understand that one of the key purposes of environmental reporting is to convey the company's sustainability to interested stakeholders and there are several ways in which environmental reporting can be used to achieve this.

Part (c) was less well done than the first two requirements in question 3. Most candidates could explain 'public interest' but far fewer were able to explain why a company's audit committee is a suitable body to advise on non-audit service purchase from Hum and Hoo. To answer this task required a knowledge of the role of an audit committee in a listed company and particularly its role in ensuring the independence of external auditors.

Question Four

The case in question 4 was about Mahmood, and employee of Tzo Company. He noticed that some of the meat being processed was not up to the usual standard of quality and, after getting what he considered to be an inadequate response from his boss, he considered whistleblowing to the local press, but this might have implications for his and colleagues' jobs at Tzo Company. In this regard, he faced an ethical dilemma and this framed the requirements.

Part (a) asked how Mahmood might act if he was acting with Kohlberg's conventional and post-conventional assumptions. Most candidates that attempted this were able to explain these two terms, but fewer were able to link the two motivations to behaviours that Mahmood might adopt. The central point here was that if Mahmood was conventional in his morality, he would see the moral position as being to comply with his orders as an employee and he would certainly therefore not inform the press. But if he were post-conventional, he might see a higher or universal good in not deceiving the public, in which case he might go to the newspaper. Post-conventional behaviour normally incurs a high personal cost for the person adopting that behaviour and in this case, the high cost would be borne by Mahmood himself and his colleagues, all of whom might lose their jobs.

Part (b) was not done well overall. The requirement was to construct a case for Mahmood to take the matter of the use of the inferior meat to the newspaper. This involved carefully considering the ethical issues that the use of the meat raised but some candidates used the Tucker or the AAA framework to attempt to make sense of it. Such attempts were not well-rewarded because they failed to construct the case as the requirement asked for. Both Tucker and the AAA framework are ethical decision-making tools and so were not suitable for this task. To 'construct' is a level three verb in terms of intellectual outcome and is one that P1 candidates should prepare for. Practicing these requirements from past papers is, of course, an excellent way of preparing for requirements such as this one.

The final requirement, part (c), was based on the notion of externally reporting on internal controls. The point here is that a reporting requirement, especially if underpinned by statute, can affect and drive internal behaviour. When a company has to externally report on internal controls, it is necessary to convey the robustness of internal



controls to shareholders and to include compliance reports as a part of that reporting. The inclusion of inferior meat in Tzo's products is in part because of weak internal controls and so the need to convey their robustness to shareholders would help to prevent such failures. This requirement was not done well by many candidates. Some seemed to think it was about Sarbanes-Oxley and some answered by listing the benefits or characteristics of internal controls, both of which were incorrect approaches.