

Professional Level – Essentials Module

# Governance, Risk and Ethics

September/December 2017 – Sample Questions



**Time allowed:** 3 hours 15 minutes

This question paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

**Do NOT open this question paper until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

# Paper 1

Think Ahead

**ACCA**

The Association of  
Chartered Certified  
Accountants

## Section A – This ONE question is compulsory and must be attempted

- 1 The National Football Association (NFA) is the governing body of the game of football in the country of Geeland and is tasked with administering the rules of the game. The NFA is not a listed company and so is not subject to listing rules. However, as the regulator of the game, the NFA is expected to adopt governance arrangements which are in line with best practice for listed companies. Football is the most popular sporting activity in the country of Geeland and all the national league football matches are televised. The right to televise games is also sold to other countries meaning that Geeland football games are seen by many people who enjoy the game around the world, giving the NFA a very high public profile.

The NFA is also responsible for all regulatory aspects of the game of football and one of its core aims is 'to govern the game effectively and maintain integrity'. The role of the football referee is critical in achieving this aim and being a referee is considered to be a key role by the NFA, as well as being important to the continued popularity of the game of football. A football referee is the person responsible for enforcing the laws of the game during each football match and is the final authority of all decisions on the football pitch, giving the referee a significant amount of discretion as to the interpretation of the laws of the game. The amount of authority and responsibility they have is equivalent to that of senior managers in a listed company. For this reason the referee role within the NFA is full time and prestigious.

The main board at the NFA delegates responsibility for referees to a referee sub committee whose brief is to emulate the role and responsibility of board committees in a listed company. This means the committee is expected to follow best practice governance guidelines relating to the responsibility of the nomination, remuneration and audit committees in governance and apply the guidelines to the recruitment, remuneration and control of football referees and refereeing.

Referees are supported by two assistant referees who are empowered to advise the referee in certain situations such as the ball going out of the field of play. However, the assistant referees' decisions are not binding and the referee has authority to overrule his assistants. This is one of the reasons why refereeing decisions are sometimes controversial.

Referees have autonomy in their choice of assistants for each game. The NFA believes that working with officials you are familiar with stimulates a better team spirit and the confidence to make the correct decisions and not to let your colleagues down. This should motivate the officials towards better performance during the game. The names of the officials for each match are normally released 28 days before any match takes place and this information is readily available to external parties.

The referee sub committee applies very general guidelines on what is required of a referee, believing that if you have a passion for the game you can become a referee. Referee appointments are often via word-of-mouth recommendations and are influenced by social connections and personal influence rather than meeting objective selection criteria. After an initial induction training course, which is delivered at local level and is not regulated by the NFA, there is no formal on-going training programme. Any changes to the laws or regulations of the game are distributed from the NFA to the local level of the football association whose responsibility it is to make sure individual referees are aware of the updates.

Although the NFA sees the role of a referee as prestigious, this is not reflected in their current pay structure. The reward package of a referee is substantially lower than equivalent senior management in listed companies. Many of the referees have expressed their resentment on the disparities to the NFA, but this has never been addressed. Referees are facing the lowest level of year on year pay increases in Geeland at just 0.1%. Equivalent positions in listed companies, and footballers playing in the national league in Geeland, are expected to receive on average a 15% increase year on year. Referees are paid around one-tenth of the average wage of the footballers playing in the national league. Despite the apparent disparity in earnings, many of the referees live in very expensive houses and live lavish lifestyles, well beyond their apparent means.

The NFA has faced a number of criticisms in the press in recent months. One criticism refers to the corruption of football referees. The referees have been accused of match fixing. Match fixing generally refers to influencing the final result of the game. One form of match fixing is where the referee favours one side throughout the match in exchange for a fee so that the outcome of the game is effectively agreed before the match starts. The referee can influence the outcome by adding on more extra time than justified, awarding penalties unfairly or disallowing legitimate goals. The referee has complete autonomy over the game which means that any decision made during the game is not questioned and the referee's decision is final. National league football clubs cannot appeal against any decision made by the referee.

The media has also criticised the lack of use of readily available technology within the sport of football in Geeland. Technology used in many other sports is increasing rapidly but the sport of football has been slow to incorporate the use of technology. The technology could be used to enable the referee to make the correct decisions. The NFA believes

there is no value in technology and suggests that it will reduce the viewing experience for spectators who, it believes, are more concerned about respecting the game's traditions. A goal decision system is used in other parts of the world to rule on whether the ball has crossed the line when a goal is awarded. This supports better decision making, but this is not currently used in Geeland.

The media highlighted the NFA's failure to govern the game effectively and its inability to maintain integrity in its operations, which the NFA promotes as core values. In an effort to address the criticisms, the NFA has recently appointed a football regulation and administration director. The administration director will oversee areas of discipline and governance within the NFA, and the game of football, which includes responsibility for football match refereeing. The media believes that as a governing body the NFA is weak and has organisational shortcomings which are leading to control failures and that the NFA is tolerant of breaches in governance and turns a blind eye to corrupt practices. This is contributing to the poor performance of referees and their inability to make the correct decisions.

The new football regulation and administration director went on television to explain that in his new role he would be drawing on his previous experience of board positions of listed companies. This will influence his approach to governance and ethics at the NFA. He said that there appears to be a culture of carelessness at the NFA and that parts of the organisation are too autonomous, without any effective internal or external oversight. He supports the NFA's view that the role of a referee should be considered as responsible as senior managers of a listed company, due to the great responsibility they bear. He recognised the failings of the referee sub committee and is concerned that it is composed of ex-footballers with little prior management experience. He stated that the NFA could learn from the governance required of listed companies. He believes that more rules related to conduct on and off the field will be needed and that his priority is to review the governance, ethics and internal controls within the NFA and the role of the referee sub committee in overseeing the changes.

**Required:**

- (a) Explain the important role which board committees have in governance and critically assess the governance arrangements of the referee sub committee in recruiting, remunerating and controlling referees. (10 marks)**
- (b) Discuss the conditions which currently exist at the NFA which make the referees and their officials vulnerable to corruption. (8 marks)**
- (c) Describe the general purposes of an internal control system and recommend control measures which could be implemented to ensure the overall control environment and the refereeing of football matches at the NFA is improved. (12 marks)**
- (d) Prepare briefing notes for the newly appointed football regulation and administration director in readiness for the next board meeting. The notes should:**
  - (i) Explain the importance of independence in refereeing decisions to football supporters. (4 marks)**
  - (ii) Assess the damaging effect any suspicion of bribery and corruption of match officials can have on the NFA and the wider reputation of the game of football. (6 marks)**
  - (iii) Discuss the benefits and contents of a professional code of ethics which could be used by referees at the NFA. (6 marks)**

Professional marks will be awarded in part (d) for clarity, persuasiveness, tone and flow of the briefing notes. (4 marks)

**(50 marks)**

## Section B – TWO questions ONLY to be attempted

- 2 TR Co is a well-established public limited company listed on the national stock exchange of a western European country. It is currently undergoing its statutory annual audit from the reputable firm of accountants Shaw & Bennett LLP, who have been its auditors and business advisors for more than 10 years. Over this period the managing partner of Shaw & Bennett has become a very good friend of the chief executive officer (CEO) of TR Co, and their families regularly holiday together.

The chairman of TR Co is expecting the audit to be signed off, but the audit partner managing the audit has suspicions around the adequacy of a series of provisions and whether contingent liabilities noted in the accounts would not more accurately be accounted for as provisions. She also disagrees with the capitalisation of research expenditure and other intangible assets on the statement of financial position, rather than treating them as expenses in the statement of profit or loss. She has questioned the financial controller, who is a professionally qualified accountant, about these matters but is getting minimal cooperation from him. It appears that the chief financial officer (CFO) has pressurised the financial controller to apply these accounting policies, as he has himself been pressurised by the CEO to ensure that profits over the next two years are presented favourably towards the time which the CEO's share options can be exercised.

The audit partner herself is being pressurised by the managing partner of Shaw & Bennett to sign off the accounts as a 'true and fair view' and not to challenge the accounting policies of the company, as the renewal of the audit contract with TR Co is imminent.

### Required:

- (a) Describe the primary roles of a chief executive officer (CEO), and criticise the actions of the TR Co CEO described in the scenario, recommending more appropriate behaviour. (7 marks)
- (b) Explain the threats to independence to the Shaw & Bennett audit team, the financial controller and the CFO of TR Co which arise from this situation. (6 marks)
- (c) Recommend suitable safeguards at TR and Shaw & Bennett to prevent such conflicts as identified in the scenario, and to address the threats to independence identified. (12 marks)

**(25 marks)**

- 3** Skydda is a global pharmaceutical company listed on a major stock exchange. It is currently undertaking a major project to develop a new medical drug to cure influenza. If it is successful, this research could result in the company's most profitable product ever and strengthen its already dominant market position. Skydda has gained an excellent track record for developing medical solutions by employing the best research scientists in the field and constantly investing in cutting edge technology. It has a large modern research facility, where it encourages all its staff to suggest ideas which could be taken forward through the development process.

Although large amounts of cash are required to operate the research facility, the high levels of returns from commercial successes delivered by the company has meant that it has never had a problem raising finance from either equity or debt sources. The company's level of financial gearing is high relative to other companies in the industry, but since it is a cash generative business it can easily service its debt.

The board historically has had a good long-term relationship with the majority of the investors, particularly the institutional shareholders, because Skydda continues to deliver high returns on capital employed and excellent earnings per share. The company has established an extensive and very effective range of internal controls covering all primary business areas including:

- (i) Marketing. Regular examinations of the pharmaceutical market are undertaken to identify propositions which could result in potentially lucrative commercial products. Suitable propositions are then submitted to a board level steering committee who assign a team who evaluate their feasibility and make appropriate recommendations.
- (ii) Research. Prior to the commencement of any new research, a detailed and fully costed project proposal must be submitted to the steering committee for approval. Only then, are the required resources assigned to the research project and permission granted to proceed.
- (iii) Financial management. Annual capital budgets are agreed by the board at the start of every financial year. These budgets are absolute limits and cannot be exceeded without the expressed permission of the board.
- (iv) Internal control reports. All research projects are required to produce and submit regular reports detailing progress achieved and expenditure incurred against budget.

The board regularly provides voluntary reports on its internal controls to shareholders, which further inspires confidence in the company and provides reasonable assurances on the safeguarding of their investments.

**Required:**

- (a) Evaluate the main elements or components of the internal control system at Skydda using a suitable framework, including an assessment of the importance to Skydda of each element or component.** (12 marks)
- (b) Explain the need to report on internal controls to the shareholders of Skydda, and describe the main content of an effective report on internal control for Skydda.** (8 marks)
- (c) Explain the need for adequate information flows to management for the purposes of managing internal controls at Skydda.** (5 marks)

**(25 marks)**

4 Livermouth, a large and fast growing city in Deeland, is desperately in need of additional supplies of clean water to meet the increasing demand from its growing population. So, following extensive investigation by the Livermouth Water Authority (LWA), a suitable location near to the village of Housewater, a site less than 20 kilometres from the city, with a substantial underground reserve of natural water, has been identified. This land is owned by Roger Capstone, a prominent local businessman with powerful connections and influence over some of the key ministers in the national government. He has been effectively lobbying government to ensure that the construction of the necessary water pipe channels from his land to the city of Livermouth will not happen, even though it would have a minimal adverse effect on the local natural environment and people; furthermore it would create more jobs in this economically challenged region.

An alternative proposal from the LWA is to build a huge dam at the bottom of the Coombe Valley, which is in the neighbouring administrative region of Lambria about 60 kilometres from Livermouth. The effect would be to create a large reservoir from which water could be diverted to Livermouth. The cost of this proposal is five times greater than the original Housewater option, and would also lead to hundreds of people being relocated to a town to the east of the new dam construction due to their homes being submerged. In addition, the dam project would include major tunnel building and blasting to channel the water from the newly created reservoir to the city of Livermouth. This would be through a series of mountains and valleys, many of which lie in an area of outstanding natural beauty and contain many species of protected animals and birds. The Deeland government has stipulated that the total cost of the Coombe Valley project is to be recovered through a special water services tax on Livermouth's householders and the population of Lambria, which already has access to more water than it requires. By contrast the Housewater solution would not require extra taxes to be paid; on a positive note, the Coombe Valley project will create many more construction jobs than the Housewater option would require and is located in the relatively much poorer region of Lambria.

When the national government of Deeland finally decided on the costlier Coombe Valley proposal, there were large demonstrations in Lambria. The demonstrators comprised many disparate groups objecting to the forced relocation of the population, damage to the natural environment and more generally about the additional costs to taxpayers of this much more expensive and disruptive project.

**Required:**

- (a) **Explain the importance of the 3Es (value for money) criteria in the evaluation of a public sector investment proposal and use these criteria to evaluate the water diversion project proposals for Housewater and the Coombe Valley, Lambria.** (8 marks)
- (b) **Using Tucker's 5-question model, evaluate the moral case for or against obtaining the water from the Coombe Valley in Lambria, rather than from Housewater.** (10 marks)
- (c) **Discuss the contestable nature of public sector policy in Deeland, and how supplying drinking water to Livermouth should be decided.** (7 marks)

**(25 marks)**

**End of Question Paper**