

# Acca paper p1 governance, risk and ethics june 2011 assignment

[Art & Culture](#)



ACCA Paper P1 Governance, Risk and Ethics June 2011 Final Assessment ???

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All rights reserved. No part of this examination may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system, without prior permission from Kaplan Publishing. 2 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS ANSWER 1 Key answer tips (a) (b) This requirement has two parts, to discuss both the responsibilities for an employee and as accountant.

The definition of 'reputation risk' used to this answer, was taken from the examiners definition used in the 2007 pilot paper. When asked to Evaluate remember to discuss both the positives and negatives. This requirement

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asked you to describe 'sound' this should indicate the three features of a sound system of internal control described in the Turnbull guidance. It is important for this requirement that you ensure your tone and language is appropriate for a Chairman to use in speaking to the shareholders of M & A Consulting.

Ethical responsibilities of a professional accountant A professional accountant has two 'directions' of responsibility: one to his or her employer and another to the highest standards of professionalism. Responsibilities to employer An accountant's responsibilities to his or her employer extend to acting with diligence, probity and with the highest standards of care in all situations. In addition, however, an employer might reasonably expect the accountant to observe employee confidentiality as far as possible.

In most situations, this will extend to absolute discretion of all sensitive matters both during and after the period of employment. This point is likely to be particularly relevant in the government / public sector work that M & A Consulting undertakes, since any information could have a political impact and would certainly be of interest to the media. The responsibilities also include the expectation that the accountant will act in shareholders' interests as far as possible and that he or she will show loyalty within the bounds of legal and ethical good practice.

There would be an expectation that an employee would not make public failings of internal controls of a company, since this may lead to loss of future business. Responsibilities as a professional In addition to an accountant's responsibilities to his or her employer, there is a further set of

expectations arising from his or her membership of the accounting profession. At times these responsibilities may conflict with those as an employee, as may be seen in the situation that Marjorie Basil faced at M & A Consulting.

In the first instance, professional accountants are expected to observe the letter and spirit of the law in detail and of professional ethical codes where applicable (depending on country of residence, qualifying body, etc. ). (c) (d) (a) KAPLAN PUBLISHING 3 ACCA P1 : GOVERNANCE, RISK AND ETHICS In any professional or ethical situation where codes do not clearly apply, a professional accountant should apply ' principles-based' ethical standards (such as integrity and probity) such that they would be happy to account for their behaviour if so required.

Finally, and in common with members of other professions, accountants are required to act in the public interest that may, in extremis, involve reporting an errant employer to the relevant authorities. This may be the situation that Marjorie Basil finds herself in at M & A Consulting. It would clearly be unacceptable to be involved in any form of deceit and it would be her duty, as an accountant, to help to correct such malpractice if at all possible. b) Reputation risk Defining reputation risk Reputation risk is one of the categories of risk identified by the ACCA and by Turnbull. A number of events in various parts of the world have highlighted the importance of this risk. Reputation risk concerns any kind of deterioration in the way in which the organisation is perceived, usually, but not exclusively, from the point of view

of external stakeholders. Tutorial note Learn this definition of ' Reputation risk' could be useful for the exam.

The cause of such deterioration may be due to irregular behaviour, compliance failure or similar, but in any event, the effect is an aspect of corporate behaviour below that expected by one or more stakeholder. When the ' disappointed' stakeholder has contractual power over the organisation, the cost of the reputation risk may be material. Tutorial note When asked to ' Evaluate' think positive and negative Adverse effects on M & A Consulting

There are several potential adverse effects of reputation risk on an affected organisation, such as M & A Consulting: ??? When more than one stakeholder group has reason to question the otherwise good reputation of an organisation, the effect can be a downward spiral leading to a general lack of confidence in the business. This may impact the ability of M & A consulting to win future contracts involving highly sensitive data. ??? 4 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS ??? It is likely to affect the Group's interactions with resource providers and hence this may affect procurement of supplies or the ability to obtain other inputs such as (in extremis) real estate, stock or intellectual capital.

Existing employees may be demotivated due to the ' bad press' that the organisation is receiving and hence may look elsewhere for employment. Recruitment of new staff may be similarly inhibited. Investor confidence is important in public companies where any reputation risk is likely to be reflected in market value. The potential for any additional enforcement costs

(claims, penalties or damages awards) being imposed will form a further risk to the market value of M & A Consulting.

Auditors, representing the interests of shareholders, would have reason to exercise increased scrutiny if, say, there are problems with issues of trust in a company. ??? ??? ??? Positive effects on M & A Consulting Although this incident is likely to damage the reputation of M & A Consulting with regards to information security there are at least two positive effects that the business may feel: ??? The publicity received in the press will ensure that the name of the business is known to potential customers.

On this basis it may be able to gain publicity for future positive announcements, such as that explained in the next point. M & A Consulting can use this as an opportunity to implement and publicise new information security procedures, and potentially turn this incident around to be perceived as a reformed business, working with 'best practice' ideas and latest technology. ??? (c) M & A Consulting and a 'sound' system of internal control Tutorial note You could also of used the COS framework to answer this requirement.

Features of sound control systems The Turnbull code employs the term 'sound' to indicate that it is insufficient to simply 'have' an internal control system. They can be effective and serve the aim of corporate governance or they can be ineffective and fail to support them. In order to reinforce 'soundness' or effectiveness, systems need to possess a number of features. The Turnbull guidance described three features of a 'sound' internal control

system. (1) The principles of internal control should be embedded within the organisation's structures, procedures and culture.

Internal control should not be seen as a stand-alone set of activities and by embedding it into the fabric of the organisation's infrastructure, awareness of internal control issues becomes everybody's business and this contributes to effectiveness. Internal control systems should be capable of responding quickly to evolving risks to the business arising from factors within the company and to changes in the business environment. Any change in the risk profile or environment of the (2) KAPLAN PUBLISHING 5 ACCA P1 : GOVERNANCE, RISK AND ETHICS rganisation will necessitate a change in the system and a failure or slowness to respond may increase the vulnerability to internal or external trauma. (3) Sound internal control systems include procedures for reporting immediately to appropriate levels of management any significant control failings or weaknesses that are identified, together with details of corrective action being undertaken. Information flows to relevant levels of management capable and empowered to act on the information are essential in internal control systems.

Any failure, frustration, distortion or obfuscation of information flows can compromise the system. For this reason, formal and relatively rigorous information channels are often instituted in organisations seeking to maximise the effectiveness of their internal control systems. Shortcomings at M & A Consulting The case highlights a number of ways in which the internal control at M & A Consulting fell short of that expected of a 'sound' internal

control system. First, and most importantly, the case suggests that the culture of M & A Consulting did not support good internal control.

The relaxed response from the COO to the concerns raised by the internal auditor (referring to use of common sense) suggests that formal controls are not viewed as critical to this business. While having systems in place to support sound internal control, it is also important to have a culture that also places a high priority on it. Second, there is evidence of that the control systems have not been updated to reflect the changing nature of the business and technology.

Recent growth in the government sector work will have led to increased exposure to highly sensitive data. This increase in risk should have been met with a stricter control regime. In addition changes in technology, particular the increased prevalence of memory sticks and portable media devices, necessitates a thorough review of all controls. All laptops will have USB ports via which data can be transferred using the latest devices. It is critical for an effective control system that controls respond quickly as risks evolve in the business environment.

This is particularly essential where it concerns data and technology. Finally, there is evidence of a lack of reporting procedures at M & A Consulting. The concerns of the internal auditor were not acted upon, nor appear to have been taken seriously. The internal auditor appeared to have no other route through which to raise such concerns. (d) Chairman's speech at AGM Tutorial note In this answer pay particular attention to the tone of the language and



the additional paragraphs that help set the scene such as ‘thank you for coming’ etc.

Thank you for coming to the annual general meeting of M & A Consulting. It is a pleasure to see you all here today, and I will be glad to answer any additional questions that you may have following the events of the last few weeks at the end of the meeting today. 6 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS I would now like to take this opportunity to respond to a specific concern that has been raised regarding the independence of a member of the remuneration committee, and a director’s remuneration package.

I will outline the roles of a remuneration committee, explain how the existing cross directorship may undermine these roles and provide details of actions that the board will be taking. (i) Cross directorships Before we look into the specific issues regarding the remuneration committee I think it would be helpful to clarify what is meant by the term ‘cross directorship’. This term is used to explain a potential relationship between the executive directors of two companies.

It occurs when an executive director of one company operates as a non-executive in another company, and there is an identical reciprocal arrangement. Hence the directors are non-executives in each other’s companies. This being the case, both directors are in a position to influence the others’ executive rewards assuming they are both serving members of the remuneration committee (as is common for all non-executive directors).

It is not the case that both men would necessarily use their position to gain

undue influence and reward but rather that there is a clear perception that this may be the case. ii) Remunerations committees Remunerations committees comprise an important part of the standard board committee structure of good corporate governance, which we at M & A Consulting, strive to follow at all times. There are thought to be four major roles of a remuneration committee which I will now outline. Firstly, the committee is charged with determining remunerations policy on behalf of the board and the shareholders. In this regard, they are acting on behalf of yourselves as the shareholders, but for the benefit of both shareholders and the other members of the board.

Policies will typically concern the pay scales applied to directors' packages, the proportions and terms of different types of reward within the overall package and the periods in which performance related elements become payable. Secondly the committee ensures that each director is fairly but responsibly rewarded for their individual contribution in terms of levels of pay and the components of each director's package. It is likely that discussions of this type will take place for each individual director and will take into account issues including market conditions, retention needs, long-term strategy and market rates for a given job.

Thirdly, the remunerations committee reports back you as the shareholders on the outcomes of their decisions, usually in the corporate governance section of the annual report (to which I refer you page X of the draft report circulated at the start of today's meeting). This report, which is auditor reviewed, contains a breakdown of each director's remuneration and a

commentary on policies applied to executive and non-executive remuneration. KAPLAN PUBLISHING 7 ACCA P1 : GOVERNANCE, RISK AND ETHICS

Finally, where it is appropriate and required by statute or voluntary code, the committee is required to be seen to be compliant with relevant laws or codes of best practice. In the case of M & A Consulting this will mean that the remunerations committee is made up of non-executive members of the board and will meet at regular intervals (quarterly in the case of our business). Cross directorships I have been specifically asked to respond in reference to a cross directorship that exists between Thomas Mint, our sales director, and Jack Grass, a nonexecutive director and head of the remunerations committee.

It is believed that this cross directorship may undermine the independence of the remunerations committee. In providing a duty of loyalty to shareholders it is essential that directors do not put themselves in a position where that duty may be called into question. Cross directorships undermine the independence of remunerations committees in that a director deciding the salary of a colleague who, in turn, may play a part in deciding his or her own salary, is a clear conflict of interests.

In practice, such arrangements also involve some element of crossshareholdings which further compromises the independence of the directors involved. Neither director involved in the arrangement is impartial and so a temptation would exist to act in a manner other than for the benefit of the shareholders of the company on whose remunerations committee they

sit. It is for this reason the cross directorships and cross shareholding arrangements are explicitly forbidden by many corporate governance codes of best practice.

I would like to stress that I am not stating that the remuneration of our Sales Director has been set inappropriately, but the perception that this may have occurred can be damaging. (iii) Governance actions that will be implemented In order to ensure that you, as shareholders and investors in this company can have absolute faith in the running of the management of the business by the directors I am proposing that the following actions are taken to rectify this situation.

Firstly, having established that a cross directorship exists between Thomas Mint and Jack Grass and that it has not been previously been disclosed, the board, excluding Mr Mint and Mr Grass, will seek reasons why this is the case and rectify the situation by asking both directors to resign their non executive positions. As an extension to this action the board will consider the possibility of asking Mr Mint to resign from the board in his executive capacity since his integrity has been called into question with the non-disclosure.

This consideration will take place at the next board meeting scheduled for next Tuesday. Secondly, and going forward, all shareholders of M & A Consulting will receive clear communication of the commitments of all directors, both executive and non-executive, in any other companies. This will take place via the annual disclosure of directors interests. This leaves yourselves in a position to assess the extent to which you believe that an

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individual's integrity might be compromised. 8 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS

If shareholders are concerned about the integrity of any specific individual, and hence that of the remunerations committee (or any other board committee), then action can be taken. The director in question will be given the choice of either cessation of his or her external commitments or resignation from the board. In extreme circumstances it can be said that both men in this situation are operating outside of the law in this instance. It will be difficult to prove but there may be a legal case for prosecuting the directors for not demonstrating a duty of loyalty to shareholders or skill and care in their professional dealings.

This proposal will also be considered by the board at the next meeting. I would like to reassure you of our continuing commitment to corporate governance best practice, and obviously, adherence to all listing regulations of the stock exchange of this country. We have taken the concerns regarding independence very seriously, propose to take all action necessary to ensure that you can have faith that all directors act within their duty of loyalty to shareholders. Thank you for your time today, and for listening to this response. KAPLAN PUBLISHING 9 ACCA P1 : GOVERNANCE, RISK AND ETHICS

Marking scheme a) 1 mark for each point made as to the responsibilities to employer 1 mark for each point made as to the responsibilities as a professional 1 mark for each point on application to M & A Consulting

Maximum (b) 1 mark for each point on definition of 'reputation risk' 1 mark for each point of explanation of the adverse effects on M & A Consulting 1

mark for each point of explanation of the positive effects on M & A

Consulting Maximum (c) Up to 2 marks in a description of each feature of a 'sound' control system: - embedded - responds to changing risks -

procedures for reporting 1 mark for each point made, or example given from

scenario, in explaining shortcomings at M & A Consulting Maximum (d) (i) 1

mark for each point demonstrating an understanding of cross directorships

Up to 2 marks for each point made on roles of remuneration committees Up

to 2 marks for each point on undermining the roles 1 mark for each

governance action Professional marks available for: ??? structure of speech

(introduction and concluding sentences) ??? written in style of speech that

could be read out ??? covers required areas, and without including irrelevant

information ??? logical flow of points and linkages between sections

Maximum Total Marks Up to 3 Up to 3 Up to 3 ?????????????? 8 ?????????????? Up

to 3 Up to 5 Up to 2 ?????????????? 8 ?????????????? 6 Up to 6 ??????????????

10 ?????????????? 2 8 6 4 (ii) 4 ?????????????? 24 ?????????????? 50 ??????????????

10 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS ANSWER 2

Key answer tips (a) (b) Carrolls' model of Corporate Social Responsibility is an important model for your exam, make sure you learn both the model and how to apply it Ensure you can comment on the difference between

Kohlberg's model ??? which includes ethical behaviour and AAA and tuckers models which are ethical decision making ??? But not necessarily action This

is a just in case requirement really ??? We have not had Transaction cost theory examined and it is specifically mentioned in the syllabus Corporate

social responsibility (CSR) positioning Archie Carroll defines Corporate Social Responsibility through a four tier model of organisational responses to social

or ethical issues. He suggests companies can only be truly considered as socially responsible if they respond to the demands of all four levels.

The levels are: Economic This is the foundation of the model or the foundation of a company's response suggesting it needs to act in shareholders' best interests by providing a return on the investment made. This is a very limited view of responsibility. Legal The company must operate within the legal framework set within its given markets. This is obviously not what has happened in this case. Ethical In line with the underpinning concepts of good governance this relates to the need to act responsibly, even-handed, with integrity and probity and to be fully accountable for one's actions. Philanthropic At the highest level the company or individual should make decisions for which there is simply no return. These decisions are charitable in nature and should not be carried out through motives of self-interest. Application (c) (a)

Tutorial note Make sure you learn the model itself, but also think how does this apply?. KAPLAN PUBLISHING 11 ACCA P1 : GOVERNANCE, RISK AND ETHICS The supermarket has failed to deliver at any of these levels. It is not in shareholders' best interests to attract so much negative publicity although the company does say that its actions sought to screen shareholders from any costs relating to their relationships with farmers. This may actually be true and the point could be extended to state that the shareholders may also be customers of the company and so would be paying the higher prices to pay themselves with dividends, although the circular nature of this argument probably only serves to confuse.

The company clearly fails to remain within the legal framework of its home country. Given that this is the case it seems very difficult to argue that they are operating to a higher ethical level by breaking the rules of the lower level, as Mr Lee seems to imply. The company seems to believe that the local community should finance its own community projects yet use the company to decide and take credit for these. This seems very difficult to accept. Apart from failing at all four levels there is an interesting addition to the discussion when the farmers and government are taken into account. The supermarket states that it is willing to break the law in order to operate at a higher ethical or even philanthropic level.

It does not adhere to competition law because it has so much sympathy with the plight of the farmers. This seem difficult to understand since the supermarket sets the price it is willing to pay for the farmers' products and so is essentially responsible for their plight in the first place. Further, although it is willing to break the law to help the farmers it cannot go so far as to reduce shareholder returns in order to support them. The position regarding customers seems to suggest that the company is in part replacing government as a tax collector and wealth distributor through its local community roles. Overall, Mr Lee must rethink his position since it makes little sense. b) Ethical decision making There are four stages to Kohlberg's model of ethical decision making: Tutorial note Kohlberg's ethical behaviour model has not yet been examined Recognise the moral issue This stage involves consideration of the moral sensitivity of the situation in question, recognising the moral dilemma or being aware to the morality of issues raised in business affairs. Food Store should know that price fixing is



inexcusable and would not be acceptable in a free market economy where prices are assumed to be set by market actions. Hence any attempt to excuse the matter by citing higher ethical standards is likely to be met with derision and scorn.

Moral judgement Mr Lee can make a moral judgement on the behaviour of Food Store and hence decide if this behaviour is acceptable or not. 12

KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS The moral motivation can therefore be established. If this is to be operating in the shareholders' best interests then the widest view of their interests must be evaluated, including the impact of association with a company that purposefully lies about its own moral motivation. Moral intent Following sensitivity and the decision regarding judgement the company needs to take a position regarding what it is going to do. This is termed its moral intent. In this case the advice given by Mr Lee to the company might be to quietly admit its mistake and make charitable gestures in recompense.

Moral behaviour This final step is critical since without action the entire process seems pointless. Behaviour must be in line with the decision and motivation and acted out sensitively so that it is most effective. Hence the intent decided upon above needs to be turned into action. Consistency in approach shows and develops moral character, and if exacted from the highest levels of the company, demonstrates leadership and a spine of ethical excellence drilling through organisational layers. To date in the case of Food Store, as explained in Mr Lee's statement, the opposite is true, the

company seems morally moribund. (c) Transaction cost theory Tutorial note  
Transaction cost theory, again has not yet been examined!

Transaction cost theory is a framework used to evaluate the nature of agency costs or the agency relationship between directors and owners. In this scenario the transaction being described would be the price fixing operations between the companies. Any transaction that occurs frequently, has levels of risk associated with it and is complex or unique in nature should be carefully monitored and controlled. In this scenario the relationship between suppliers and the company and the critical process of price setting are key areas where senior management simply must be involved. These criteria could be associated with the concept of critical success factors and the importance of senior management involvement in these areas.

The problems associated with transactions are bounded rationality and opportunism. The former relates to the clouding of a decision due to the existence of limited information regarding the nature of the decision. In this scenario it could relate to the limited understanding of the senior managers regarding the likely outcome of price fixing operations (unlikely) or more likely the bounded rationality of the board if they did not know what was going on as Mr Lee states. Opportunism is essential in successful business or transaction dealings. It is problematic when it relates to personal benefit from a decision as opposed to corporate benefit. KAPLAN PUBLISHING 13  
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In this scenario the company itself acts opportunistically in the hope that it will not be caught price fixing. If the board is unaware of the problem then it

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still should have seen the potential for opportunistic behaviour by those below board level and so should have put in place measures to combat this. Agency theory describes the relationship between the owners of the company and the directors. The relationship only exists at this level. It is therefore ultimately the board's responsibility to ensure the owners assets are safe or that they are aware and take responsibility for all of the actions of their employees. They cannot expect the rewards of office without accepting the attached obligations. Marking scheme a) 1 mark for each point in explanation of the four variables: - economic - legal - ethical - philanthropic 1 mark for each relevant point in application to the scenario Maximum (b) 1 mark for each point in identification of a stage of Kohlberg's model - Recognise moral issue - Moral judgement - Moral intent - Moral behaviour (only these points earn marks) 1 mark for each point of application Maximum (c) 1-2 marks for each relevant point made, including - ? mark for mentioning terms ' bounded rationality' and ' opportunism - further ? mark for explaining these terms Maximum Total Marks 4 Up to 6 ?????????????? 10 ?????????????? 4 Up to 4 ?????????????? 8 ?????????????? 7 ?????????????? 7 ?????????????? 25 ?????????????? 14 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS ANSWER 3

Key answer tips (a) There are a number of risks that could have been identified from the scenario. The model answer only contains a selection. The marking scheme will reflect this open ended requirement by awarded one mark per valid point Strategies to manage risk = TARA Assessment of each risk should include reference to the Probability of consequence and potential impact, often referred to as the ' Risk map' Identification of risks <https://assignbuster.com/acca-paper-p1-governance-risk-and-ethics-june-2011-assignment/>

Risk can be defined as the possibility that events or results will turn out differently from that which is expected. There are a number of risks facing Hansen – SIX key risks are outlined below. ??? The unexplained fall in gross profit in some stores may be indicative of fraud or other accounting irregularities.

Low gross profit in itself may be caused by incorrect stock values or loss of sale income. Incorrect stock levels in turn may be caused by incorrect inventory counting or actual stealing of inventory by employees. Similarly, loss of sales income could result from accounting errors or employees fraudulently removing cash from the business rather than recording it as a sale. ??? Transferring data to head office at the end of each day may be inadequate for backup purposes. There is a risk that failure of computer systems during the day will result in loss of that day's transaction data. Although inventory information is collected using the system, re-ordering of inventory takes a significant amount of time.

Transferring data to head office for central purchasing may lead to some discounts on purchase, but the average 12-14 days before inventory is received at the store could result in the company running out of inventory (i.e. stockouts). The possibility of sunlight making some of Hansen's products potentially dangerous may give rise to loss of sales, inventory recall and may even expose Hansen to legal action in the form of compensation for damages. The company is dependent on one market sector and vulnerable to competition in that sector. If the current trend for healthy outdoor activities declines, Hansen will suffer since most of its business is

concentrated in this one sector. The most important social change is probably a change in fashion. Hansen has not changed its product designs for several years indicating some lack of investment in this area.

Given that fashions tend to change frequently, Hansen may experience falling sales as customers seek new designs for their outdoor clothing. (b) (c)

(a) ??? ??? ??? ??? KAPLAN PUBLISHING 15 ACCA P1 : GOVERNANCE, RISK AND ETHICS (b) Risk management strategies Tutorial note This should be an easy four book work marks. Make sure you link Risk strategies with the TARA framework There are four strategies for managing risk and these can be undertaken in sequence. In the first instance, the organisation should ask whether the risk, once recognised, can be transferred or avoided.

Transference means passing the risk on to another party which, in practice means an insurer or a business partner in another part of the supply chain (such as a supplier or a customer).

Avoidance means asking whether or not the organisation needs to engage in the activity or area in which the risk is incurred. In some cases it may be possible to restructure a process, or pull out of a market, and hence avoid a particular risk completely. If it is decided that the risk cannot be transferred nor avoided, it might be asked whether or not something can be done to reduce or mitigate the risk. This might mean, for example, reducing the expected return in order to diversify the risk or reengineer a process to bring about the reduction. Finally, an organisation might accept or retain the risk, believing there to be no other feasible option.

Such retention should be accepted when the risk characteristics are clearly known (the possible hazard, the probability of the risk materialising and the return expected as a consequence of bearing the risk). (c) Risk analysis and strategies Tutorial note It helps here if you have planned your answer, and have realised when doing part a) you will need to refer back to the risks you have identified and assess them with a greater level of depth. Also the requirement asks you to recommend a strategy, so again careful planning would ensure a student thought carefully about how to best approach this 15 marks By identifying and profiling the effect (impact or consequences) of a risk and the likelihood (probability) of occurrence Hansen can assess the risk and its significance to the business.

This process, often referred to as risk mapping, will enable a decision to be made as to the appropriate strategy for a given risk. ??? Accounting/cash irregularities The potential impact on Hansen is loss of income either from inventory not being available for sale or cash not being recorded. The overall total amount is unlikely to be significant as employees would be concerned about being caught stealing. 16 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS However, the probability of occurrence is quite high for a business with cash and stock accessible to employees. The risk can be reduced by introducing additional controls including the necessity of producing a receipt for each sale and the reconciliation of cash received to the till roll by the shop manager.

Loss of inventory may be identified by more frequent checks in the stores or closed-circuit television. ??? Systems backup The potential impact on Hansen

is relatively minor, details at one shop's sales could be lost for part of one day. However, the cash from sales would still be available, limiting the actual loss. The probability of this occurring would depend entirely on the robustness of the organisation's computer systems. If they are up to date and appropriately maintained and protected, this will have a low likelihood. To reduce this risk additional procedures could be implemented to back up transactions as they occur, using online links to head office.

The relative cost of providing these links compared to the likelihood of error occurring will help Hansen decide whether to implement this solution. ???

Delays in inventory ordering following head office collation The potential impact on Hansen is immediate loss of sales, as customers cannot purchase the garments that they require. In the longer term, if running out of inventory becomes more frequent, customers may not visit the store because they believe inventory will not be available. They may choose to take their business to a competing store, or to purchase on line. The probability of the loss of custom is quite high since customers will have a number of alternative methods of purchasing the items they require, and often require the goods straight away. The risk can be avoided completely by letting the stores order goods directly from the manufacturer using an extension of the current electronic point of sale system. Costs incurred will relate to the provision of Internet access to the shops and possible increase in cost of goods supplied. However, this may be acceptable compared to overall loss of reputation. ??? Products releasing toxic chemicals The impact on Hansen is the possibility of having to reimburse customers and the loss of income from the product until the problems are resolved. The probability of

this occurring is hard to gauge until further investigations have been undertaken into this claim. There is a more significant impact if a claim for damages is made against Hansen as a result of these chemicals.

The probability of a successful claim being made would be low since it is unlikely that chemicals released from an item of clothing could seriously harm an individual. The risk can be reduced by Hansen taking the claim seriously and investigating its validity, rather than ignoring it. For the future, guarantees should be obtained from suppliers to confirm that products are safe and insurance taken out against possible claims from customers for damage or distress, thereby transferring the risk to the insurer. KAPLAN PUBLISHING 17 ACCA P1 : GOVERNANCE, RISK AND ETHICS ??? Market sector  
The potential impact on Hansen largely depends on its ability to provide an appropriate selection of clothes. It is unlikely that demand for its products will fall to zero, so some sales will be expected.

However, an increase in competition, or decline in business in that economic sector, may result in falling demand, and without some diversification, this will automatically affect the overall sales of Hansen. The likelihood of this occurring can be better assessed by reviewing consumer spending patterns. Current trends indicate that the ' healthy living' sector will continue to be strong, but the introduction of competition into this sector is harder to predict. To a large extent Hansen will have to accept the risk of a decline in the popularity of the sector as a whole since there is little that the business can do to influence overall consumer spending patterns and tastes. However,



Hansen can minimise the impact of competition in the clothing market by diversifying into other areas.

Given that the company sells outdoor clothes, then commencing sales of other outdoor goods such as footwear and camping equipment may be one way of diversifying risk. ??? Fashion leading to a reduction in demand Given that Hansen appears not to have updated its ranges for a number of years the likelihood that it will lose business due to being 'out of date' is quite high. The impact on the business could be significant if competitors are keeping their products more in fashion, though it might be offset by the fact that the outdoor clothing ranges are rarely expected to be at the height of fashion. Ultimately the risk of loss of demand and business to competitors may undermine Hansen's ability to continue in business.

This risk can be reduced by having a broad strategy to maintain and develop the brand of Hansen. The board must therefore allocate appropriate investment funds (R) to updating the products and introduce new products to maintain the company's image. Tutorial note The strategies for the individual risks identified in the case are not the only appropriate responses and other strategies are equally valid providing they are supported with adequate explanation 18 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS Marking scheme (a) 1 mark for each risk identified and explained (1/2 mark only for bullet points) Maximum (b) 1 mark for each strategy identified and explained (? ark just for identification of each strategy) – Transfer – Avoid – Reduce – Accept (Note: no marks for other, or more general, strategies) Maximum (c) For each risk: – 1 mark for assessment of impact (with reasons)

- 1 mark for assessment of likelihood (with reasons) - 1 mark for strategy recommendation (with explanation) (must state one of the TARA strategies with explanation) up to maximum 3 marks for each risk Maximum Total Marks 6 ?????????????? 6 ?????????????? 4 ?????????????? 4 ??????????????

15 ?????????????? 15 ?????????????? 25 ?????????????? KAPLAN PUBLISHING 19

ACCA P1 : GOVERNANCE, RISK AND ETHICS ANSWER 4 Key answer tips (a)

(b) This is a straightforward requirement, expecting the candidate to display a good knowledge of the Corporate Governance arrangements in the UK and US Both parts here (i) and (ii) are regular requirements within the P1 paper.

Ensure you are fully aware of the areas of debate Main requirements of an effective code of corporate governance (a) Tutorial note For this requirement a brief introduction detailing the UK corporate Governance Code and Sarbanes-Oxley in the USA. , will enable the marker to be aware of your knowledge and that you have actually read the scenario In recent years there have been many developments around the world that have resulted in improved corporate governance in companies. Examples of the approaches are the UK corporate Governance code in the UK applicable to all UK-listed companies, and the Sarbanes-Oxley Act in the USA applicable to US-listed companies.

These codes have different specific rules but similar themes and requirements. The following cover some of the main requirements of an effective code of corporate governance. Directors An effective code must consider the responsibilities of directors, as directors are in a position to influence the actions of companies and potential conduct themselves in ways

that would not be in the best interests of the stakeholders of the company. Specific issues addressed for directors would include: ??? Composition of the board: There should be a significant number of independent non-executive directors on the board with the responsibility to scrutinise and advise on the actions of executive directors.

Remuneration of board members: There should be procedures in place to ensure that the remuneration of board members is not excessive and has a genuine performance-based element to it. Service contracts: Directors' service contracts should be of a length such that it is not financially damaging to the business to dismiss directors. A suggested length is no longer than one year. Ability to seek independent advice: Directors should have the right to seek independent advice if they feel it necessary, at the expense of the company. Biographical details: Shareholders should be given biographical details of proposed directors so that they can make an assessment of the suitability of directors. ??? ??? ??? ??? 20 KAPLAN

#### PUBLISHING FINAL ASSESSMENT ANSWERS

Communication with investors An effective code of governance should ensure that companies communicate regularly and effectively with investors, whether they are institutional investors or private investors. Specific proposals include: ??? A requirement for companies to communicate with institutional investors on certain key strategic decisions, and formally ensure that the opinions of major investors are taken into account. Ensuring that the annual general meeting is used properly as a medium to communicate with all investors, both major and minor. This means that the AGM should perhaps

include assessment of the business and future aims, as well as the legal requirements such as appointment of directors and auditors. ???

Audit Audit requirements could be looked at from both the internal and external audit perspectives. The internal audit function is a key part of the monitoring activities of the business whereas external audit provides an assurance to investors on the financial statements. To make both functions effective, procedures may include: ??? A requirement for companies to maintain an effective audit committee which is given the responsibility of liaising with external auditors and taking recommendations from internal audit. The audit committee should be effective and have clearly defined composition, responsibilities and actions. Procedures could be put in place to restrict the non-audit work that can be performed by the external auditor.

This should hopefully enhance the independence of the external auditor and increase the credibility of the audit opinion. ??? Internal controls A key part of good governance is the need to have an effective internal control system. Internal controls should prevent or detect errors in the financial statements but also help to reduce operational risks. Specific corporate governance requirements may include: ??? A requirement for directors to assess and report on the effectiveness of their internal control systems every year. The requirement to assess and report would force companies to consider what internal practices they have and whether those practices reduce risks to an acceptably low level.

External auditors could be required to attest to the assessment provided by management. To do this, the external auditor would need to consider what

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controls should be in place and also consider whether the directors have an attitude that supports strong controls. ??? Tutorial note The model answer has lots of detail within it. A good student answer would cover the main points KAPLAN PUBLISHING 21 ACCA P1 : GOVERNANCE, RISK AND ETHICS (b) (i) Voluntary or legislative code Tutorial note Rule versus principle is a common exam requirement. A well prepared student should ensure the following points are known and clearly understood There are different views over how corporate governance systems should be established and operated.

In the UK, for example, corporate governance codes have been developed by a number of non-governmental committees and have then been built into stock exchange listing requirements, whereas in the US a legislative approach has been adopted. Both of these approaches do have an element of compulsion for listed companies, however the UK code is easier to avoid (and therefore more voluntary) and does not contain the burdens of personal responsibility that the US system has. Both voluntary and legislative systems have benefits and drawbacks however: ??? A voluntary system has the benefit that it will often arise from the consensual agreement of many different groups and as such be widely accepted. This means that the systems are more likely to be applied by all businesses.

In a legislative system, there may be a feeling that companies are being forced into the code and therefore view them as an unnecessary administrative requirement. Companies outside the scope of the legislation are unlikely to comply. A further benefit of a voluntary system is that it can

be quicker to introduce and change. If there are weaknesses in a voluntary system they can be addressed, whereas weaknesses in a legislative system require statute for changes. Voluntary systems also give benefits in corporate governance if there is a belief that corporate governance should be a set of moral and ethical principles to which companies adhere. A legislative system by its nature is more likely to be viewed as a set of prescriptive rules that have to be complied with.

A legislative system has benefits however, in that it is compulsory for those companies governed by the legislation and therefore it should be more consistently applied. Legislation can also build-in clear and firm penalties on both a company and personal level for non-compliance. A voluntary system will rarely have the enforceable authority of the legislative approach. By having legislation there is also an implicit indication of the seriousness of the issue. Arguably, the US required legislation for corporate governance, for instance, because the loss in confidence in corporate reporting was much greater there than in the UK. ??? ??? ??? ??? 22 KAPLAN PUBLISHING FINAL ASSESSMENT ANSWERS ii) Application of codes of governance The discussions above have looked at whether corporate governance codes should be voluntary or statutory, but consideration should be given also to whom to apply the codes to. Most governance codes are only mandatory for listed companies, but their benefits could also be benefits to unlisted businesses. There are perhaps drawbacks and other considerations in applying strict governance codes to unlisted companies: ??? Unlisted companies do not have anywhere near the same public interest issues as do

listed companies, and therefore it could be argued that the benefits of applying the codes are much reduced.

Many small companies could even justify that the costs of implementing strict codes would outweigh the benefits they obtained. In addition, a limit would need to be set on the unlisted companies to whom they should apply. There is obviously a very different need in a very small owner-managed business than in a listed business, and therefore the same prescriptive code could not apply to both. Including unlisted companies gives a big problem in setting the scope for the requirements, or alternatively requires different codes to be set for different businesses leading to criticisms of inconsistency and manipulation of the divisions between different business types. ??? ???

In conclusion, both voluntary and legislative systems can work, but it would be difficult to apply a strict code outside the listed sector due to practical problems of costs and benefits, and scope of the codes. Marking scheme (a) 1 mark per point in introduction to answer For each heading – 1 – 2 marks per specific point – max 4 per heading / section Maximum (b) 1 ??? 2 marks per relevant point (i) benefits of voluntary code benefits of legislative code (ii) application to unlisted companies Maximum Total Marks 2 Up to

15 ?????????????? 13 ?????????????? Up to 5 Up to 5 Up to 5 ??????????????

12 ?????????????? 25 ?????????????? KAPLAN PUBLISHING 23 ACCA P1 :

GOVERNANCE, RISK AND ETHICS 24 KAPLAN PUBLISHING