

General Comments

Overall, performance was comparable to previous diets. Well prepared candidates were capable of obtaining very clear passes, it was pleasing to see some candidates achieve exceptionally good marks. Weaker candidates tended to avoid the requirements of the question, either through a failure to grasp what was required or as an attempt to obtain marks for repetition of memorised facts and information.

Generally one of the main problems was a failure to relate the answers to the situation portrayed in the question. Good marks were achieved by candidates who did this.

Question 3 was noticeably avoided by candidates. Candidates should always select the questions with which they feel most comfortable, however those preparing for future diets should take care to ensure that they are capable of answering questions on all areas of the syllabus.

The same is true of Question 5, many candidates made very poor attempts at the calculations. It is important to cover the whole syllabus when revising.

Note that the attached marking scheme often makes more marks available than indicated on the question paper. This reflects the fact that questions at this level can often be approached in more than one way and that there is no single “perfect” answer. In applying this marking scheme, marks are always restricted to the total offered by the question or sub-question and so there is no advantage to be gained from over-developing the answer to one question/sub-question at the expense of another that may appear more difficult.

SECTION A – 50 MARKS
ANSWER THIS QUESTION

Question 1

- (a) State the recommended components of any organisation's risk management strategy and evaluate ACB's approach to risk management in terms of those components.
(12 marks)
- (b) Identify the major categories of risk facing ACB and evaluate the controls adopted by ACB in relation to each category.
(28 marks)
- (c) Risk treatment (or risk response) is an important component of risk management strategy. Explain what is meant by risk treatment and its benefits to a Board of Directors.
(10 marks)

(Total for Question One = 50 marks)
(Total for Section A = 50 marks)

Rationale

This case study brings together many aspects of the Risk and Control syllabus. Focused on risk management, the setting is an aircraft assembly operation that relies extensively on information technology, is heavily reliant on its supply chain management, has foreign exchange exposure and uses lean accounting techniques. The case is designed to test the candidate's ability to apply learning from across different syllabus areas.

The main syllabus areas covered are A (ii) *Evaluate the control of activities and resources within the organisation*; B (i) *Define and identify risks facing an organisation*; B (iv) *Evaluate risk management strategies*; D (i) *Identify and evaluate financial risks facing an organisation*; and E (iii) *Evaluate benefits and risks in the structuring and organisation of the IS/ IT function and its integration with the rest of the business*.

Suggested Approach

Requirement (a) requires candidates to state the components of a risk management strategy and apply those elements against the scenario to evaluate the company's approach. As a minimum, candidates should recognise risk appetite, risk assessment, treatment, responsibility and reporting/monitoring processes as they have been applied by the company.

Requirement (b) requires candidates to identify the main categories of risk facing the company and evaluate the company's controls in relation to those risks. As well as the conventional cost control, economic and exchange rate risks, candidates should identify the less obvious reputation, IT and supply chain risks faced by the company. The question also requires candidates to evaluate the controls used in the company in terms of whether they effectively treat risks.

Requirement (c) requires candidates to demonstrate their understanding of how an organisation's risk appetite influences its assessment of likelihood and consequences of risks and the cost/benefit of different risk treatments including avoidance, reduction, sharing and acceptance of risk. Candidates also have to identify the benefits of risk treatment to Boards, in terms of assessing how well they have met their governance responsibilities for risk management.

Marking Guide	Marks
1 (a) Components of risk management strategy	5
Evaluate company's approach	7
1 (b) Identify major categories of risk	14
Evaluate controls in relation to risk	14
1 (c) Explain risk treatment	5
Benefits of risk treatment	5
Examiner's Comments	
<p>Part (a) This part of the question was poorly answered by some candidates. Many candidates missed out the review and monitoring stages and only discussed identification and assessment.</p>	
<p>Part (b) This part of the question was done well by most candidates, there was a tendency to write about every risk possible and not have a well structured answer. Candidates who related their answer closely to the scenario achieved high marks.</p>	
<p>Part (c) This part was well done by the majority of candidates. However more detail was required in many answers.</p>	
<i>Common Errors</i>	
<p>Part (a) was poorly answered in some cases as the later stages of risk management were largely ignored.</p>	
<p>There was a tendency in part (b) to ignore the scenario. Answers should always relate to the scenario wherever possible. Many candidates wasted time by discussing risks which were not apparent from the scenario. Generally many candidates achieved very high marks in this section of question 1.</p>	
<p>In part (c) more detail would have improved the answers. In some cases a bullet point list of risk treatments was given with very little elaboration. This approach got very few marks.</p>	

SECTION B – 50 MARKS
ANSWER TWO QUESTIONS ONLY

Question 2

- (a) Explain why the review and audit of control systems is important for the Governing Body of a school such as PKG.

(5 marks)

- (b) Evaluate the effectiveness of the Governing Body's control over PKG High School and recommend ways in which it might be improved.

(20 marks)

(Total for Question Two = 25 marks)

Rationale

Question Two largely concerns the review and audit of control systems. It uses the setting of a government-funded school to test candidate understanding of how a governing body can evaluate the effectiveness of controls. The question also tests an understanding of the role of different types of audit. The syllabus areas covered are C *The review and audit of control systems*, in particular C (v) *Recommend action to improve the efficiency, effectiveness and control of activities*, and C (ii) *Evaluate the process of internal audit*.

Suggested Approach

Requirement (a) expects candidates to explain the importance of the review and audit of controls. This requires a risk-based approach that identifies the major risks and then applies controls to mitigate those risks. Importantly, the risks and controls should not be limited to financial ones but should include operational risks.

Requirement (b) asks candidates to evaluate the effectiveness of the governing body in terms of the controls over the school's operations and to recommend improvements to those controls. Again, this should not be limited to financial issues. Candidates should consider a broad range of controls including strategic planning; the adequacy of annual reports; financial reporting; expenditure approval; staff recruitment; and other personnel controls

Marking Guide

Marks

2 (a) Importance of review and audit of controls	5
2 (b) Effectiveness of control – evaluation of existing controls	10
Recommendations for control improvements	10

Examiner's Comments

This was the most popular of the optional questions and was also the most poorly answered question.

Candidates did not seem able to relate corporate governance to the scenario.

Common Errors

Part (a) This question was done poorly as candidates tended to write about corporate governance in limited companies rather than relating it to the scenario.

Part (b) was also poor as the candidates did not pick up the main points in the scenario. The control exerted by the headmaster was a major issue as was the lack of frequency of information. Many candidates did not discuss these issues in any detail.

Question 3

- (a) A company has a pension fund deficit equal to ten per cent of its market capitalisation. Explain and discuss the nature of the risks posed to **both** the company and its current employees by the existence of such a substantial pension fund deficit.

(10 marks)

(b)

- (i) Discuss the proposal to request the actuaries to use out-of-date tables.

(8 marks)

- (ii) Identify the internal and external financial reporting controls that could be used to prevent the manipulation of the liability valuation in the manner suggested by the Head of Financial Reporting.

(7 marks)

(Total for Question Three = 25 marks)

Rationale

Question Three tests a candidate's understanding of the potential risks arising from a company's provision of pension benefits for its employees. Under IAS 19, a company's balance sheet must record the present value of the future benefits payable, net of the value of the pension fund assets. As a result, any deficit on the fund is made transparent, but may consequently affect the company's cash flows, financial position and share price. The issue of the ethics of trying to manage the deficit downwards is also addressed in this question. The syllabus topics being tested are B(i) *Define and identify risks facing an organisation*; C (vii) - *Discuss the importance of exercising ethical principles in conducting and reporting on internal reviews* and A(i) *evaluate and recommend appropriate control systems for the management of organisations*.

Suggested Approach

The question is divided into three sections, all of which carry similar marks and so in attempting this question good time management is essential to ensure all parts are answered.

Part (a) requires explanation and discussion of the risks facing both a company and its employees when there is a high pension fund deficit on the balance sheet. From the company perspective, this requires consideration of the risks to current and future operating capacity, access to finance and shareholder value. From the perspective of the pension fund member, the main risks to be considered are in terms of both current and future income, but also morale and career opportunities with the existing employer.

Both elements within part (b) address an ethical issue associated with the reporting of a pension fund deficit which makes it essential to refer to a basic principle of financial reporting, namely the concept of true and fair. Reference, but not detailed knowledge of, the CIMA ethical guidelines is important here. In suggesting the controls that may be helpful in preventing manipulation of the liability valuation maximum marks required reference to BOTH internal and external controls.

Marking Guide	Marks
3 (a) Risks to the Company	5
3 (a) Risks to employees	5
3(b) (i) Unethical and in conflict with accounting principles	6
Reference to professional ethical guidelines	2
3(b) (ii) Internal controls	4
External controls	3
	25

Examiner's Comments
This was the least popular of the optional questions. Where candidates chose this question it was very well answered.
<i>Common Errors</i>
All parts of this question were answered well by the majority of candidates.

Question 4
<p>(a) Recommend three ways of improving your company's internal control systems to ensure better management of risks throughout the product life cycle.</p> <p style="text-align: right;"><i>(10 marks)</i></p> <p>(b) Prepare a memo for your Head of Division recommending which product your company should support. You should clearly explain and justify your recommendations in the context of risk management.</p> <p style="text-align: right;"><i>(15 marks)</i></p> <p style="text-align: right;"><i>(Total for Question Four = 25 marks)</i></p>
Rationale
<p>Question Four provides the scenario of a need to choose between investment in two alternative new products, which are perceived as carrying different levels of risk. The question tests ability to interpret cash flow and NPV information and use risk management principles to reach a decision on the best option. Identification of suitable controls to effectively manage product development risks also forms part of the question. The syllabus topics being tested in the first part of the question are A(iii), A (iv) and B (v), <i>"Recommend ways in which the problems associated with control systems can be avoided or solved"</i>; <i>"Evaluate the appropriateness of an organisation's management accounting control systems and make recommendations for improvements"</i> and <i>"Evaluate the essential features of internal control systems for identifying, assessing and managing risks."</i> Part (b) tests syllabus section D (iii) <i>Evaluate the effects of alternative methods of risk management and make recommendations accordingly.</i></p>

Suggested Approach

This question builds directly upon knowledge gained in Paper 2 but creates new investment risks by its incorporation of an international scenario.

Part (a) should be approached by starting with a definition of the product life cycle because this provided the framework for the control system. The scenario tests ability to apply general principles of control to a specific situation and so mimics the sort of problems that may be faced in the workplace. In answering the question therefore, it is vital to not reproduce a rote list of typical controls, but to use the information in the question to illustrate your argument on the need for improvement.

Part (b), although it asks for a recommendation on which product to support, does not require lots of numerical work. Instead, the emphasis in answering the question should be on interpretation. Using the correct memo format will also gain a mark. Most importantly, the criteria for the choice of product is based on relative risks and NOT financial returns.

Marking Guide

Marks

4(a) Definition of product life cycle	1
Each suggested control 1-3 marks depending upon level of comment	9
4(b) Memo format	1
Risk impact of factors influencing the choice	10
Case for use of risk adjusted rates to drive strategies	3
Recommendation	<u>1</u>
	25

Examiner's Comments

Reasonable marks were achieved for this question.

It was heartening to see that most candidates had well structured answers.

Common errors

Part (a) was answered poorly with candidates failing to relate their answers to the product life cycle. Candidates should always relate their answers to the scenario.

Part (b) was answered well.

Question 5

Produce a response to the CEO.

Note: Your response should include a brief explanation of theories and appropriate calculations to support your discussion. Five marks will be allocated for **explanation** of appropriate theories. The balance of twenty marks is for **application** of those theories and relevant calculations.

(Total for Question Five = 25 marks)

Rationale

Question Five requires understanding of exchange rate theory and an ability to apply that theory to calculate forward exchange rates. The question does not require detailed numerical calculations but is instead focused on underlying understanding of the principles that underpin exchange rate determination. The syllabus topics being tested are D(iv) *Calculate the impact of differential inflation rates on forecast exchange rates*; D (v) *Explain exchange rate theory* and D (vi) *Recommend currency risk management strategies*.

Suggested Approach

This question tested understanding of basic principles of foreign exchange risk management using a combination of both narrative and computational arguments. The format of the question meant that the best approach was to begin with an explanation of the underlying theories of exchange rates determination and relative inflation rates. Following on from this, it was easiest to deal with each point of the memo in turn, in order to ensure that all issues had been covered. Using the memo format gained a mark.

Marking Guide

	Marks
PPP theory	3
Interest rate theory	3
	Max 5 for theory
Relevant calculations of forward and cross rates	8
Relevant commentary	10
Memo format	1
	25

Examiner's Comments

This question was straightforward and yet was badly answered. Memo formats were excellent. Candidates had difficulty with the fairly standard calculations. Candidates should ensure they cover all areas of the syllabus when revising.

Common Errors

The calculations were poorly done, this is an area where many candidates would benefit from revision. Candidates used the wrong exchange rate and failed to calculate the 3 month forward rate correctly. These calculations are quite straightforward so it was disappointing to see such poor attempts. The written explanations, in many cases, were also poor.