

General Comments

Overall, performance was poorer than expected. Well-prepared candidates, however, were capable of obtaining very clear passes. 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.

There were fewer clear passes than expected in this paper.

Generally one of the main problems was a failure to relate the answers to the situation portrayed in the question. Candidates who did this achieved high marks. When information is given in the scenario, candidates are expected to use it to illustrate the main issues in their answer.

Using the reading time wisely can be of huge benefit. Candidates should always plan their answers and ensure they read the questions carefully before starting the paper. Candidates who answer the specific question asked will achieve high marks. Candidates waste valuable time if they fail to be specific in their answer, as only the points which answer the question will gain marks.

There was evidence of time pressure in a number of scripts. This can be avoided by use of an answer plan and by using the reading time to plan answers.

At the strategic level, candidates are expected to use knowledge gained at the managerial level to inform their answers. It would have been useful had candidates used the knowledge gained in P5 integrated management, in particular, when answering Q1. This is one of many examples of where prior knowledge of previous subjects is expected.

There was no question noticeably avoided by candidates.

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 and so there is no advantage to be gained from over-developing the answer to one question at the expense of another that may appear more difficult.

SECTION A – 50 MARKS
ANSWER THIS QUESTION

Question 1

- (a) Discuss the extent to which **each** of the following characteristics of NOP creates potential risks for the company's shareholders:

- (i) Branding and marketing strategy;
- (ii) Design and procurement strategy;
- (iii) Remuneration of senior management and executive directors;
- (iv) Corporate Treasury function;
- (v) Social and environmental policies.

(30 marks)

- (b) Prepare a report to be presented at the board meeting that:

- Explains why the principle of risk ownership at board of director level is a vital form of control, especially in extremely large companies such as NOP;
- Discusses the relative merits of the Finance Director's and the Marketing Director's proposals. (Your discussion should be from a risk management perspective, and should therefore focus on the risks created by the share price fall and the impact of each proposal on the group's overall risk profile.)

(5 marks)

(15 marks)

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

Rationale

Question One is a case study of a UK based global clothing retailer which is dual listed in both London and New York. The question expects candidates to apply the theoretical principles of good risk management to a specific scenario and thus tests higher level learning skills.

The first part of the question requires evaluation of the risks created for shareholders across a broad range of business areas, from branding through to social and environmental policy. The second part relates to the need for director involvement in risk management via ownership of specific risks and the evaluation, from a risk management perspective, of two alternative strategies to encourage a share price recovery.

The question is focused on the risk and internal control section of the syllabus. Part (a) addresses the syllabus area B (i) *Define and identify risks facing an organisation*, whilst part (b) of the question covers syllabus sections B(iv) *Evaluate risk management strategies* and B (vii) *Discuss the principles of good corporate governance for listed companies, particularly as regards the need for internal controls*.

Suggested Approach

(a) This question asked candidates to comment on potential risks for the company's shareholders. A lot of information was included in the scenario about specific areas to think about. The use of categories to structure an answer helps to avoid the risk of repetition and hence wasted time. Business knowledge gained from reading the financial press would have been useful when answering this question. Comments on areas outside the categories specifically asked for in the question were not rewarded.

(b) In the first part of the question the route to marks was to note the significant key term of 'risk ownership'. Many candidates did not mention this in their answer at all. The question was specific and general answers about the control environment were not a requirement of the question. This approach would not gain many marks. Answers needed to be very specific about risk ownership.

As with the first part of the question, this second part focuses on a specific issue, namely the effect of the Finance Director's and the Marketing Director's proposals on the risks created by the share price fall and the impact on the group's overall risk. Generic answers covering a whole range of risks which are unrelated to the proposals gain no additional marks and answers which did not discuss the share price fall would not be complete.

Marking Guide

Marks

Part (a)	
Branding and marketing	9
Design and procurement	6
Remuneration	6
Corporate treasury	6
Social and environmental	4
Total Part (a)	30 max
Part (b)	
Risk ownership	5 max
Relative merits of finance director's proposal	9 max
Relative merits of marketing director's proposal	6 max
Conclusion	2 max
Total Part (b)	20 max

Total for Question 1

50

Examiner's Comments

This question was very badly answered by both home and overseas candidates. Candidates showed a very poor level of appreciation of the risks involved in the scenario. Much of the knowledge required to answer this question could have been gained by reading the business news over the last year. Large multinational companies have faced problems with branding and procurement and many have received poor publicity over environmental issues and child labour.

It would have been helpful for candidates to think about difficulties faced by consumers in the clothing industry to answer the branding and marketing and design parts of the question. Very few candidates mentioned the issues of sizing or culture, which were easy points to make. Even thinking from a practical view of the issues of ensuring comparable quality across a world-wide market would have been very useful when answering the question.

The level of general business knowledge demonstrated by candidates was very disappointing. Marks were low compared to usual for question one. This meant that candidates had to achieve good marks in the other two questions to pass.

Common Errors

Part (a) was done badly by many candidates. The sections on branding and marketing strategy and design and procurement were very poor. Few candidates managed to address these risks in any depth. General business knowledge demonstrated was poor and knowledge of business news was also poor. There have been numerous accounts in the press on the problems of Marks and Spencer, which could have been used to inform candidates' answers. Candidates did not use knowledge gained in the managerial level P5 Integrated Management, which would have improved their answers.

Social and environmental strategy was a little better with candidates showing some appreciation of the problems; again reading the business press would have really helped candidates. Many large well known companies have had widely publicised difficulties over child labour and poor working conditions in the last few years.

Part (b) was also poor as many candidates failed to answer the first part on risk ownership at all and then failed to discuss the effects of the proposals on the share price fall. The question specifically asked candidates to comment on the effect on the share price fall and it was surprising how many candidates failed to mention this in their answer.

SECTION B – 50 MARKS
ANSWER TWO QUESTIONS ONLY

Question 2

- (a) It has now been forecast that the Euro is likely to strengthen against sterling by 5% in each of the next four years.

Calculate and briefly comment upon the revised Expected Net Present Value if the product is launched in France.

(5 marks)

- (b) Identify the different risks associated with each launch option and discuss how these may be managed by the company.

(8 marks)

- (c)
(i) Briefly discuss the potential benefits and hazards of interest rate swaps as a tool for managing interest rate risk.

(6 marks)

- (ii) Show the transactions involved, the bank charges and the interest terms payable if X and HTM agree to the swap.

(6 marks)

(Total for requirement (c) = 12 marks)

(Total for Question Two = 25 marks)

Rationale

Question Two tests candidates' understanding of discounted cash flow analysis in an international context, where exchange rate movements may impact upon the NPV. The first part of the question requires calculation of a revised expected NPV if the company opts to change the country in which it launches a new product. The second part of the question broadens the requirement to test knowledge of the wider risk implications of strategies which are domestically versus internationally focused. In other words, candidates are expected to recognise that risk cannot be defined in purely monetary terms, and company planning must also take into account the risks arising from levels of market concentration, lack of local knowledge etc. The final part of the question requires candidates to discuss the specific benefits and hazards of interest rate swaps as a tool for managing interest rate risk and to then to undertake and interest rate swap calculation.

The syllabus area covered by the question is that relating to the management of financial risk. The calculation element in the first part of the question covers syllabus area D (i) *Identify and evaluate financial risks facing an organisation*. The requirement to discuss how the risks might change and how these should be managed i.e. the second part of the question, covers syllabus areas D (ii) and D (iii) *Identify and evaluate appropriate methods for managing financial risks*, and *Evaluate the effects of alternative methods of risk management and make recommendations accordingly*.

Suggested Approach

Part (a) The first task is to calculate the effect on the exchange rate of the Euro strengthening against sterling over the next four years then to calculate the Expected Net present Value. This should be straightforward. A brief comment on the result is also required.

Part (b) There are a number of risks associated with each option such as the risk that the expected cash flows may not be achieved or that the exchange rate may not be as expected for the next four years. There are also difficulties in starting a new business in a foreign country, the culture is different and the product may not be received as well as expected. A brief comment on how these risks could be managed is also required, market research for example.

It would be helpful to break the risks down into sections such as exchange rate risk , business risk , political risk etc and to use the same headings when considering ways of managing the risk.

Part (c)(i) This is a very straightforward question, which could be answered from a textbook. A sentence on each hazard and each benefit is all that is required.

Part (c)(ii) This question just required a straightforward interest rate swap calculation. The question suggested that both companies would like a fixed rate loan. This is not possible, as there would be no advantage to one of the companies in this. This means that in order for a swap to be carried out one of the companies has to accept a floating rate loan. There is a comparative advantage to both companies and so the swap is possible.

Marking Guide

Marks

Part (a)	
NPV and cash flow	3
Commentary	3
Total Part (a)	5 max
Part (b)	
Types of risk	6 max
Limitations of NPV methodology	4 max
Total Part (b)	8 max
Part (c)(i)	
Advantages of interest rate swaps	5
Disadvantages of interest rate swaps	3
Total Part (c)(i)	6 max
Part (c)(ii)	
Calculations	6 max
Total for Question 2	25

Examiner's Comments

Many candidates did very well in this question.

Most candidates who selected this question demonstrated a good knowledge of interest rate swaps, which was heartening.

The few candidates who demonstrated that there would be no advantage to the companies in carrying out a fixed to fixed rate swap and did not go on to suggest one should accept a floating rate were not penalised, and were given reasonable marks. Most candidates however calculated the fixed/ flexible rate swap extremely well and achieved high marks for this question.

Common Errors

Part (a) The calculations in this part of the question were carried out very well. The most common error was where candidates got weakening and strengthening confused. Some calculated this the wrong way and showed the forecast as if the Euro was weakening against sterling rather than strengthening. Many candidates did not then go on to comment on the results and did not get as many marks as they could have for part (a).

Part (b) was done reasonably well in parts, however, very few candidates noted the problems of launching a product in a new market in a different country but covered other aspects of the question well.

Part (c) This question was answered well by many candidates.

Many candidates did not calculate the bank charges. This was a very easy mark and was missed by over 50% of candidates.

The interest rate swap was done well. Many candidates noted that a fixed to fixed interest rate swap was not possible as there was no advantage to both companies in doing so. These candidates were all given reasonable marks. The candidates who carried out the calculations for a fixed to floating rate swap usually did so correctly. There was a huge improvement in candidates' knowledge in this diet compared to that shown on a similar question, which appeared in a previous diet.

Question 3

- (a) Discuss the purposes and value of an internal control system for Accounts Payable to a company like VWS.
(10 marks)
- (b) Identify the information systems controls that should be in place for Accounts Payable in a company like VWS.
(10 marks)
- (c) Explain the risk of fraud in a computerised Accounts Payable system for a company like VWS and how that risk can be mitigated.
(5 marks)

(Total for Question Three = 25 marks)

Rationale

Question Three focuses on internal controls in a fairly traditional Accounts Payable function. The brief scenario is largely about the flow of inventory from purchasing and receipt to payment in a manufacturing/distribution company with multiple branches. The first part of the question relates to the purposes and value of internal controls for accounts payable generally, with an emphasis on authorising and paying suppliers. The second part relates to specific IS controls for accounts payable (personnel, access, processing, network, business continuity, etc.) and the third part to the risk of fraud and controls to mitigate fraud. The syllabus areas covered are B (iii) *Discuss the purposes and importance of internal control and risk management*; B (v) *Evaluate the essential features of internal control systems for identifying, assessing and managing risks*; and E (iv) *Evaluate and recommend improvements to the controls of information systems*.

Suggested Approach

Part (a) The route to success in this part is to think of the purposes and value of internal control systems and then to relate these specifically to accounts payable. Marks are available for generic purposes but to gain the highest marks, candidates must discuss specific controls which relate to the question scenario. Listing all the purposes and value of internal control systems in general will not gain more marks.

Part (b) As in Part (a) the question is looking for controls that are specific to accounts payable. General controls will gain a few marks but candidates must be specific and answer the question to achieve a high mark.

Part (c) As in the 2 previous parts the answers must be specific to accounts payable.

Marking Guide

Marks

Part (a)	
Importance of internal controls – general	6
Importance of internal controls – accounts payable	4
Total Part (a)	10

Part (b)	
Controls – general	6
Controls – accounts payable	4
Total Part (b)	10
Part (c)	
Relating risk of fraud to accounts payable	5
Total for Question 3	25
Examiner's Comments	
<p>Parts (a) and (b) were poorly done by many candidates. However Part (c) was done extremely well.</p> <p>Candidates failed to address the problem in relation to accounts payable, which was what the question asked.</p> <p>There were several marks available for general controls but to gain high marks candidates had to relate their answer to accounts payable.</p> <p><i>Common Errors</i></p> <p>In Parts (a) and (b) candidates showed a disappointing knowledge of accounts payable systems. Marks were allocated for general IT and accounting controls, but several were for points specific to accounts payable.</p> <p>The answers were very vague and lacked depth.</p> <p>Candidates just tended to write everything they knew about general controls, this did not gain high marks.</p> <p>Part (c) was done very well.</p>	

Question 4

- (a) Identify the major types of risk facing EWC that arise from its style of management. Give reasons to support your answer.

(10 marks)

- (b) Explain the significance of the control environment in EWC.

(5 marks)

- (c) From the perspective of a newly appointed non-executive director, evaluate the financial, non-financial quantitative, and qualitative controls in EWC in the context of EWC's goals and the risks facing EWC.

(10 marks)

(Total for Question Four = 25 marks)

Rationale

Question Four concerns a telecommunications company with a rather unhealthy approach to budget targets, cost reduction, minimal policies and overlooking unscrupulous practices in the relentless pursuit of sales growth. The question asks candidates to identify the major reputational, business/operational and financial reporting risks flowing from this approach to business, the significance of the control environment, and from the perspective of a newly appointed director, an evaluation of the company's controls given the risks it faces. Importantly, this last part of the question expects candidates to address financial, other quantitative and qualitative controls. The syllabus areas covered are A (ii) evaluate the control of activities; B (i) *identifying risks*; and B (v) *Evaluate the essential features of internal control systems identifying, assessing and managing risks*.

Suggested Approach

Part (a) It is helpful to have a structure in mind when answering these type of questions. An answer plan is the first step in achieving a good structured answer, which will achieve high marks.

The route to success with this part of the question is to carefully think about the main risks facing EWC. These are reputation risk, business/operational risk and financial reporting risk. Remember that the question asks for risks that arise from EWC's style of management.

Marks are available for all of these categories of risk. Generic answers, which give a list of all possible risks to any business, would not achieve high marks. The next step is to give good reasons why EWC's style of management gives rise to those particular risks.

Part (b) The significance of the control environment in EWC is huge. There are many poor working practices evident from the scenario which has an effect on the control environment. A good answer would demonstrate how the lack of good systems and the poor management style have led to a poor control environment. It is this poor control environment which increases many of the risks in Part (a).

Part (c) This is a straightforward question which should be laid out well. A short paragraph evaluating each type of control in relation to the goals and risks facing EWC is all that is required. Identifying the controls is not sufficient.

Marking Guide	Marks
Part (a)	
Identify major risks:	
• Reputational	3
• Business	3
• Reporting	3
General comment on risks	1
Part (b)	
Significance of control environment	
• Culture and values	2
• Context for internal control procedures	2
• Relate to EWC culture (singleminded pursuit of growth and profit)	1
Part (c)	
Evaluation of controls	
• financial	2
• non-financial quantitative	2
• qualitative	2
Relate controls to EWC goals and risks	2
Address role of NED in monitoring	2
Total for Question 4	25
Examiner's Comments	
Candidates' performance in this question was generally reasonable.	
Most candidates did very well in Part (a) and managed to identify most of the risks facing EWC. Answers to parts (b) and (c) were poorer.	
Part (b) was very disappointing as the level of knowledge that was demonstrated about the control environment was very poor.	
Part (c) asked candidates to evaluate the financial, non-financial quantitative and qualitative controls in EWC. Many candidates attempted to identify the controls but that was all. Some attempt at evaluation was required to get a high mark.	
<i>Common errors</i>	
Part (a) was done well by most candidates.	
Many candidates failed to mention the problems created by having unscrupulous working practices in Part (b). This was important and it was disappointing to note that candidates did not make the link between the control environment and poor working practices. It was also surprising how many candidates still have trouble understanding what the control environment is.	
Part (c) was done well by some candidates although candidates failed to evaluate controls in all three areas in any depth. They also failed to identify any qualitative controls. Many candidates simply wrote "balanced scorecard", which did not achieve any marks. Some discussion was required. This has been asked in several previous diets and it is disappointing to note that candidates still do badly in this type of question. Merely identifying the controls was not enough to get a high mark.	

Question 5

“Effective internal control, internal audit, audit committee and corporate governance are all inter-related”.

Discuss this statement with reference to:

- (a) How internal audit should contribute to the effectiveness of internal control;

(7 marks)

- (b) How an audit committee should contribute to the effectiveness of internal audit;

(9 marks)

- (c) The role of an audit committee in promoting good corporate governance.

(9 marks)

(Total for Question Five = 25 marks)

Rationale

Question Five is an essay-style question not based on a scenario. However, it requires candidates to identify the inter-relationships between internal audit and internal control, the audit committee and internal audit, and the audit committee and corporate governance. In answering this question, it is not sufficient for candidates to merely repeat what they know about each, but to identify the contribution of each to the other. The syllabus areas covered are B (vii) *Discuss the principles of good corporate governance for listed companies, particularly as regards the need for internal controls*; C (ii) *Evaluate the process of internal audit*; C (v) *improving control*; and C (vi) *Discuss the principles of good corporate governance for listed companies, for conducting reviews of internal controls and reporting on compliance*.

Suggested Approach

The question is very specific.

For Part (a) the answer to this question should make a very clear link between internal audit and the effectiveness of internal control.

The route to success in this question is to think of the role of internal audit and then to only discuss the parts of it that relate to the effectiveness of internal control. Answers, which just discussed the role of internal audit in general terms, will not achieve a high mark.

For Part (b) the answer should make a clear link between the audit committee and its contribution to the effectiveness of internal control. Generic answers on the role of the audit committee will not be rewarded. For parts b and c candidates should think of the role of the audit committee and then think which parts of its role promote effective internal control and good corporate governance. There is some overlap in (b) and (c) but candidates should not just write everything they know about the audit committee in both parts.

Part (c) asks for the role of the audit committee in promoting good corporate governance.

As in Parts (a) and (b) generic answers will not gain a high mark. The question is quite specific and answers should also be specific.

Marking Guide	Marks
Part (a)	
IA contribution to internal control effectiveness:	
Risk based internal auditing	2
Managers' responsibility for adequacy of controls and possible conflict of interest	2
Risk Management (RM) informs priorities for IA plan	2
RM itself is audited	2
Total Part (a)	7 max
Part (b)	
Audit committee (AC) contribution to internal audit (IA) effectiveness:	
Function of IA (independent and objective assurance)	2
IA Charter, Head of IA, resources	2
IA plan based on risk assessments, approved by AC as addressing main risks	2
AC ensures recommendations implemented	2
AC monitors and reviews IA effectiveness	2
Total Part (b)	9 max
Part (c)	
Audit committee contribution to corporate governance:	
Define corporate governance	1
Define audit committee	1
Roles of audit committee especially in relation to risk management & internal controls	2
Reliance on external audit	2
Benefits: reduced risk, improved performance, access to capital markets, stakeholder confidence, transparency and accountability etc.	3
Total Part (c)	9 max
Total for Question 5	25
Examiner's Comments	
<p>This question was done poorly by many candidates. Many candidates just listed the roles of the audit committee and made no attempt to link them to corporate governance or the effectiveness of internal audit.</p> <p><i>Common Errors</i></p> <p>Part (a) was done reasonably well by many candidates which was heartening.</p> <p>Answers to part (b) and (c) were disappointing. Many candidates failed to answer what was asked in the question. Many candidates wrote everything they could think about on the roles of the audit committee in both parts of the question. This approach did not get high marks. The links to internal audit and corporate governance were the crux of the question and if the links were not made low marks were awarded.</p> <p>It is vital that candidates read the question carefully and tailor their answers to the specific requirements of the question.</p> <p>Make good use of the reading time and structure the answer well. Candidates will find an answer plan is very helpful.</p>	