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ACCA – Paper P1
Governance, Risk and Ethics
June 2015
Final Assessment

Instructions

- Please complete your personal details above.
- All scripts should ideally be submitted to your Kaplan centre for marking via email to help speed up the marking process.
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Marking Report

Notice to Markers

1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

• Time management	• Handwriting	• Presentation and layout	• Use of English
• Points clearly and concisely made	• Relevance of answers to question	• Coverage and depth of answer	• Accuracy of calculations
• Calculations cross-referenced to workings	• All parts of the requirement attempted	• Length of answers equates to marks available	• Read the question carefully

2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

ACCA FINAL ASSESSMENT

Governance, Risk and Ethics

June 2015

Paper P1

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:
Section A – This question is compulsory and MUST be attempted
Section B – TWO questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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SECTION A

This ONE question is compulsory and MUST be attempted

1 The Baltic Pipe company is a European-Russian joint venture to plan, construct and operate two 1,200 km pipelines carrying gas from Russia to Europe under the Baltic Sea. The company was established in late 2006 when the project was initiated.

Baltic Pipe has four major shareholders: the largest Russian gas supplier, Gazco, holds a 51 per cent stake, while the remainder is split between three major European energy companies (who are all household names operating in the power generation and retail supply businesses). The pipeline project has substantial national and governmental support and has Ten-E classification (given to trans-European network energy projects), meaning that it is a priority for European Union (EU) energy security.

Europe needs energy, and it is estimated that by 2025 the EU's annual import needs will have increased by about 200 billion cubic metres because of the decline in gas production within Europe and the ongoing increase in demand for energy. The pipelines that Baltic Pipe will operate can supply Europe with about a quarter of this energy requirement. The demand for gas as the most environmentally friendly fossil fuel is expected to continue, which makes the project commercially secure.

The chief finance officer (CFO), Melanie Zubrowski, has been, and will continue to be, engaged in many activities to raise the necessary finance to fund construction of the pipeline. The project is expected to cost in the region of €8bn of which the shareholders will provide 30 per cent. The remainder will be debt financed.

The work to build the pipelines is expected to be contracted out to a number of major construction companies who will have to work closely together to coordinate activities. This approach has been taken by the board to ensure that the project is not overly reliant on a single company. Once the pipeline is in place there will be operatives at either end, in Russia and in the European country where it will terminate. The operational work, including manning the pumping stations at either end of the pipelines and associated support activities, is expected to create in the region of 200 jobs in each location.

Once the pipelines are up and running the income stream will come from selling transport capacity to Russian gas suppliers. Within two years of establishment the company secured a contract for 22 years promising a safe, steady income stream. The technical life of the pipes is 50 years, so renewal of this contract would be expected in 22 years' time.

The company operates with a two-tier board structure, with the supervisory board consisting of several senior business representatives, high-ranking government officials and ex-politicians. Amongst these are the chief executives of the major shareholders and the former chancellor of a European country.

From its inception Baltic Pipe has encountered opposition from political and environmental campaigners. There have been recent disruptions experienced by Russian gas suppliers, in particular Gazco, supplying through former Soviet Bloc countries which have led to questions as to whether this pipeline is a wise move.

The chief executive believes that this concern is mitigated by having Gazco as the majority shareholder. This business owns a quarter of the world's gas resources and gets relatively little of its money from its domestic market. Furthermore, it represents a significant part (eight per cent) of Russia's gross domestic product (GDP), so there is a political and commercial need for the company, and country, to continue exporting gas.

Baltic Pipe does not believe that the pipeline will have any major impact on the environment. Disturbances associated with the construction phase are expected to be minimal and temporary. During the operational phase, the impact of the pipeline will actually be positive, as gas emits 50 per cent less carbon dioxide than coal and oil, and hence the use of gas as an energy source by Europe will benefit the global environment.

The chairman of Baltic Pipe, Pierre Coran, believes that it is important for the company to be transparent because the pipeline passes through the jurisdictions of five countries, with a possible impact on four others. He, along with the chief executive, Sanjit Khor, have spoken to many interest groups to aid this policy of openness. He accepts that some campaign groups have legitimate concerns, and is seeking to provide information, including financial data, to put these concerns into perspective. The company has spent more than €100m on gathering technical and ecological data, on seabed topography and fish stocks for example, to be published to the media.

In conjunction with the release of this research, Sanjit Khor and Pierre Coran have decided that Baltic Pipe will announce plans to analyse and quantify its environmental footprint (completion expected end of 2009), and introduce a programme of environmental audit of the pipelines once in operation.

Required:

(a) **Evaluate the argument for Baltic Pipe operating with a two-tier board structure. Your answer should include a balanced discussion of such a board structure, and a convincing case for the Baltic Pipe board remaining a two-tier structure. (10 marks)**

(b) **Identify SIX stakeholders of Baltic Pipe and, utilising the Mendelow framework, assess their influence over the organisation's strategy and actions. (15 marks)**

(c) **Draft a press statement for the media accompanying the release of the ecological data, covering the following points:**

- **(i)** **A definition of the term 'environmental footprint', discussed in the context of Baltic Pipe. (6 marks)**
- **(ii)** **An explanation of an environmental audit and how one would be carried out at Baltic Pipe in future years once the pipelines are established. (6 marks)**
- **(iii)** **Professional marks for structure, style, content and logical flow of this statement. (4 marks)**

(d) **Discuss the reasons why management need to balance risk and return, with reference to the case where applicable, and explain the term 'risk appetite'.**
(9 marks)

(Total: 50 marks)

SECTION B

TWO questions ONLY to be attempted

2 WC Engineering is a large manufacturer of diesel and gas engines. WC Engineering has recently experienced a period of rapid growth in its product range, and as a result the company has taken on many more activities and expanded its workforce by 20%.

In recent months it has come to light that there have been problems with internal control systems in two main aspects of the operations. Firstly, poor quality components are being accepted into stores. When these are deployed onto the shop floor they cause delays, rework and minor stoppages. Complaints have been made by operatives about these components but no improvement has yet been seen. Additionally the training of new operatives appears unsatisfactory, with workers joining the production line without full knowledge of the product and hence mistakes are arising.

Last week an event occurred which resulted in a stoppage of the entire Delta engine production line, rectification of 30 engine heads and quarantining (awaiting full quality inspection) of a further 1,000 heads. A new operative had been put to work on the final assembly station for the Delta engine head, and he had incorrectly assembled the heads for 6 hours before this was picked up by a colleague. There was no real-time quality control in place on his work, which had led to this continuing for most of the operative's shift. The production director, Jon Benedict, angrily described the stoppage as 'entirely avoidable' and the finance director, Katie Walker, said that the stoppage had been very costly.

Upon questioning about this event the shift team leader made the following points:

'I've raised the issue of poor training with my manager 3 times in the last month – we need to give the operatives an opportunity to work alongside an experienced person for a week before allowing them to work on their own on the line. My manager wasn't interested in my suggestions, informing me that we had to keep the production lines running at all costs – we're too busy to allow for any more non-productive hours. I've seen a culture of 'sloppy training' develop at WC Engineering over the last few months, and it is making all our jobs more difficult.'

This incident has prompted the board to conduct a full review of its internal control systems, and to set up an internal control and audit function. The proposal is to appoint an internal auditor at mid-management level and also to establish a board level internal audit committee made up mainly of non-executive directors. The board has sought your advice as a senior accountant in the company.

Required:

(a) Critically evaluate the internal control systems at WC Engineering highlighting how they differ from a 'sound' system of internal control, such as that set out in the Turnbull guidance, for example. (10 marks)

(b) Explain, with reference to the case, the factors that are typically considered when deciding to establish internal audit in an organisation. (10 marks)

(c) Define 'objectivity' and describe how an internal auditor's professional objectivity may be protected. (5 marks)

(Total: 25 marks)

3 ABC is a relatively small manufacturing company listed on a European stock exchange. James Toon, the CEO, is in buoyant mood following a meeting with the company's CFO. He has been told that interim profits are likely to exceed expectations and that subsequently he could confidently expect share price to rise considerably once the figures are released into the market next month.

This is good news since Mr Toon has been concerned about the company's future given the increasing pressure placed on exports due to local competition in overseas markets. During the meeting he reminded the CFO of the need for continued vigilance in relation to cost control in order to sustain profits. The CFO pointed out that the weight of governance regulation placed on companies such as ABC did not help their position. In particular, he felt that placing the same constraints on a small listed company as larger concerns in their home market and the fact that overseas competitors had to operate under much less regulated regimes damaged the organisation's ability to compete.

Mr Toon agrees, and is adamant that the company will not employ board committees as identified by the principles-based governance code through which ABC has gained listing. He feels that this is an unnecessary overhead and will not cede to the 'unacceptable demand'. He is however concerned as to the possible consequence of this action should he choose not to comply.

Mr Toon is the majority shareholder in the company and, following the news relayed to him at the meeting, has contacted his wealthy friend, Joe Ng, asking him to purchase a large block of ABC shares. The two men hope to sell the shares following the interim announcement and split the profits between them. During their discussion, Mr Toon stated that he would rather not purchase the shares himself since such an action 'might look bad' if minority investors were to discover what he had done.

Required:

(a) **Discuss the scope of governance regulation affecting the board at ABC and consider the extent to which governance regulation can have a negative impact on companies such as ABC.** **(15 marks)**

(b) **Discuss the likely regulatory reaction to Mr Toon's decision not to employ committee structures in board operations.** **(5 marks)**

(c) **Discuss possible outcomes to the agreement made between Mr Finn and Joe Ng.** **(5 marks)**

(Total: 25 marks)

4 Hansen Outdoors Ltd sells a wide range of outdoor clothing apparel such as coats, anoraks, waterproof trousers and related outdoor clothing from its 112 stores located in a country in Europe. The company has been profitable however there are signs that gross margin in some stores has declined recently for no, as yet identified, reason.

Each store uses the latest electronic point of sale technology to maintain control of its stock and provides the facility for customers to use electronic means of payment such as credit and debit cards. However, about 45% of all transactions are still made by cash. Details of sales made and inventory below re-order levels are transferred to head office on a daily basis where management information reports are also prepared.

Stock is ordered centrally from Hansen's Head Office, details of requirements being obtained from the daily management information provided by each store. Orders are sent to Hansen's suppliers in the post, inventory arriving at each store approximately 12–14 days after the re-order level is reached.

Recent media reports have highlighted that one of the components used to waterproof garments releases toxic chemicals after prolonged exposure to sunlight. The media have published what it called a 'risk assessment' for the components used. It said it had calculated the probabilities (P) and impacts (I) of potential risks.

Risk of major threat to human health: P = 10%, I = 20

Risk of toxins creating environmental damage: P = 20%, I = 50

Impacts were on an arbitrary scale of 1–100 where 100 was defined by the media as 'Huge impact causing death and environmental catastrophe '.

The board of Hansen are investigating the claim, but are currently treating it with scepticism. The product range involved (Red brand) has generally sold well, although there has been little innovation in terms of developing the garment design in the last few years.

Required:

(a) Identify SIX risks facing the Hansen company. (6 marks)

(b) Describe FOUR strategies that Hansen could use to manage risk. (4 marks)

(c) Acting as a consultant to the board, assess each risk identified in (a) and recommend an appropriate strategy for each risk. (15 marks)

(Total: 25 marks)