ACCA INTERIM ASSESSMENT

Governance, Risk and Ethics

December 2011

Paper P1

Time allowed:

Reading and planning: **15 minutes**

Writing: **3 hours**

ALL QUESTIONS ARE COMPULSORY.

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

QUESTION 1

Quasi is an unlisted company operating in a country where there is a principles-based code of corporate governance. Listed companies should follow the code, or explain why not in their annual report, while other companies can follow the code if they choose to do so. Many of Quasi's shareholders are members of the same family and an application for listing has not been one of their aims.

However, Quasi is larger than many listed companies and the board is attempting to follow patterns of good corporate governance. The board consists of six executive and six non-executive directors (NEDs), with the roles of CEO and chairman being carried out by two different people. NEDs are appointed for a maximum of six years. There are audit, nominations and remuneration committees which all comprise wholly of non-executive directors. A senior independent director has been appointed (SID) who maintains close contact with the chairman to obtain a better understanding of the business. A recent innovation has been a weekly squash match to improve their business relationship. Control systems are implemented by department heads as required.

The nominations committee produces job descriptions for each director and provides suggestions for new directors as existing directors leave Quasi, and not before. However, one NED believes that this is inadequate and has had lengthy, and at times argumentative, discussions with two of the executive directors on this point. The issue has yet to be resolved.

All directors are required to hold shares in Quasi, although the timing for share sales and purchases is limited to a few months in the year and board approval is needed for large purchase. The CEO is also directly responsible for the implementation of board policy at an operational level, with performance appraisal being linked partly to this area.

Remuneration of the executive directors is a mixture of basic salary, annual bonus and performance related pay (PRP) along with regular [pension contributions and a company car. Basic salary continues to be determined by reference to the average salaries paid in Quasi's country of operation. The bonus payments are linked partly to guaranteed elements, taking into account the risky nature of Quasi's business and the amount of net profit made. The performance element of remuneration is linked to change in Quasi's share price; the total amount of PRP consists of 25% of remuneration to again recognise the risky nature of Quasi's business. Directors are also provided with share options, normally exercisable after five years.

There has been some controversy over recent pay rises awarded to the directors, with some managers protesting that these were unreasonably high. The remuneration committee has been asked to provide further information to the board on this matter in preparation for a meeting with senior and middle management.

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Required:

(a) **Critically evaluate Quasi's board and committees, recommending any changes you consider appropriate to meet generally accepted standards of good corporate governance.** **(14 marks)**

(b) **Discuss how the Chief Executive Officer (CEO) and the non-executive directors (NEDs) of Quasi should be appraised, explaining any limitations relevant to the Quasi.** **(8 marks)**

(c) **Describe the role of NEDs. Explain how NEDs can enhance the standing of board sub-committees.** **(12 marks)**

(d) **Prepare a briefing paper, from the remuneration committee to the board of directors of Quasi, in preparation for the management meeting providing a description of how the components of executive directors' remuneration should be determined, and a discussion as to whether this has been correctly carried out in Quasi.**

Note: Four professional marks are available within the marks allocated to requirement (d) for the structure, content, style and logical flow of the briefing paper. **(16 marks)**

(Total: 50 marks)

SECTION B

BOTH questions to be attempted

QUESTION 2

Eddis manufacturers motor vehicles in a number of different countries. Forecast demand for motor vehicles for the next five years is for a fall for three years followed by a strong increase. The directors of Eddis are considering closure of one branch of the company which is located in a relatively poor region, mainly to save costs in the short term, although it may re-open the branch in three years. However, adverse publicity regarding this move and comments from some NEDs that Eddis may not be acting ethically has made the board re-consider the closure option.

Required:

(a) Define corporate social responsibility (CSR) and assess the benefits of voluntary disclosure of CSR information to a company. (10 marks)

(b) Describe Carroll's four-part model of CSR, and using this as a framework to your answer, advise the board of Eddis on closure of the branch. (15 marks)

(Total: 25 marks)

QUESTION 3

CityWide provides banking and investment services to the general public and other companies in its country. The company was formed a few years ago when a society which focused on providing finance to assist members of the general public to purchase houses (a 'building society') changed to become a listed company.

The majority of shareholders of CityWide are members of the general public who borrowed money from CityWide when it was a building society and were allocated shares when CityWide obtained a listing because of their borrowing from CityWide; there are only a few institutional investors. The members' register shows 20% of the company's shares are owned by 5 institutional investors with the remainder owned by about 2,000,000 members of the public.

There are no trade unions and employees of CityWide are general satisfied with working conditions, though they were disappointed by a recent decision to transfer the call centre to a low wage economy for cost cutting purposes.

CityWide attempts to attract customers for its banking services using publicity about its good customer service and ethical investment policy. This policy has been largely successful though the standard of service is perceived to have fallen following the call centre move.

Required:

(a) Explain the terms 'agency theory' and 'stakeholder theory' and describe the link between the two theories. (10 marks)

(b) Describe Mendelow's stakeholder mapping matrix, and use this model to discuss the actions that CityWide should take in respect to its stakeholders. (15 marks)

(Total: 25 marks)

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