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

Instructions

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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

September and December 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 answered

1 Airport Services is a large quoted company. It owns three of the major airports in its home country, including Heathtown which is a large airport serving the capital city.

Heathtown is one of Europe's main airports. It attracts passengers who wish to travel to or from the capital city for business or leisure purposes, as well as passengers from intercontinental flights who wish to transfer to short flights to other destinations in Europe. The airport is becoming increasingly congested because the airport's two runways are operating at close to full capacity. Airport Services has applied for permission to build a third runway that would increase the number of flights that it could handle.

Gaining planning permission for the new runway has been a major activity for Airport Services. The government demanded very detailed plans before granting initial permission to proceed with the project. Airport Services had to spend €50m on feasibility studies, architects' plans and on marketing the proposal just to get to the stage of obtaining permission to proceed. The airline operators which use Heathtown have made major commitments to expand their services in order to utilise the potential new capacity.

The proposed construction of this third runway has upset a number of local environmental campaigners. Their concerns are twofold. Firstly, they fear that the new runway will lead to a massive increase in air travel, and hence should be stopped on the grounds of damage to the global environment. Secondly, and of more direct importance to the campaigners, they fear that it will have a major impact on the local area with increased noise pollution, traffic congestion and a drop in value of local properties. Airport Services board members carried out numerous local community consultations in the process of gaining planning permission for the new runway, and they addressed many of the campaigners' concerns. Their proposal is that the new runway will have separate road access for commercial vehicles, which, it is argued, will take the pressure off the existing airport access road network. The runway will be situated such that the approach flight path will pass over an area of woodland, hence avoiding residential districts.

Despite all their efforts it is still thought that the environmental campaigners may lobby the government to reconsider its decision on planning permission. Furthermore, the major airline operators feel that environmental concerns will encourage passengers to use alternative forms of transport such as high-speed rail links for journeys within Europe, which will take business away from the short flights that they provide.

Last week the environmental campaigners took dramatic action by buying a small area of the land that Airport Services will have to purchase in order to build the runway. The runway plan faces a further problem in that the global economy has gone into recession which has reduced the demand for business and leisure travel. Airport Services' economists have forecast a recovery over the next few years. It will take at least five years to build the runway.

The chairman of Airport Services, Mike Ingram, met with the chief executive (CEO), Anjad Shah, and asked why the company had not planned ahead in order to deal with risks such as the difficulty of obtaining the land and the unexpected decline in the demand for air travel. Mr Shah responded that it would have been very expensive for Airport Services to have purchased the land before obtaining permission to build the runway, and that the company would have had no use for that land if the government had refused permission for the runway. He believes that the environmental campaigners can be pacified once they fully understand the minimal noise and traffic impact that this project will have on the local community. They should then be willing to release their land.

Anjad Shah does not believe that there will be significant, long-term decline in demand for air travel. He believes economic downturns happen from time to time and are generally short-lived. The runway is a project that should be viewed as an investment in the company's future for the next fifty years and demand for air travel is likely to remain robust over most of that longer-term period.

Mr Ingram has decided to call an immediate meeting of the non-executive directors. After the non-executive directors have been briefed, there will be a meeting of the full board to prepare a statement for release to the media to reassure them of Airport Services' focus on environmental issues, and its proposed introduction of environmental audit and accounting programmes. It is hoped that these programmes, in addition to a commitment to publish data on the business' environmental footprint, will lead to the campaigners agreeing to sell the land and allowing the runway to go ahead without further delay.

Required:

(a) Explain the concept of Corporate Social Responsibility (CSR) (5 marks)

(b) Distinguish between the normative and instrumental views of organisational behaviour towards stakeholders, and analyse the motivation of the board of Airport Services using this theory. (7 marks)

(c) Compare and contrast the responsibilities of Airport Services' executive directors and non-executive directors for the management of the risks associated with this project. (10 marks)

(d) (i) Define the terms 'generic risk and 'specific risk' giving examples from the situation of Airport Services. (4 marks)

(ii) "For any business, managing specific risk should always take priority over the management of generic risks". Critically evaluate this statement with reference to the scenario where appropriate. (6 marks)

(e) Draft the press statement to be released to the media by Airport Services' board, covering the following points:

(i) An explanation of an environmental audit and discussion of how this could ease stakeholders' concerns. (5 marks)

(ii) A description of the benefits that the introduction of environmental accounting could bring to Airport Services. (4 marks)

(iii) A definition of the term 'environmental footprint', illustrated with reference to the situation of Airport Services. (5 marks)

Professional marks for structure, style, content and logical flow of this statement. (4 marks)

(Total: 50 marks)

SECTION B

TWO questions ONLY to be answered

2 Sharpe Clothing (SC) is a European listed company selling a wide range of affordable clothing lines. It has a number of stores across the country and imports its clothing lines from producers in developing countries.

Recently, a national television documentary has revealed that SC's producers use child labour in the production of the clothing lines. This has led to widespread condemnation from the public. The documentary went on to reveal that whole communities have sprung up around the factory sites, and that these communities are wholly dependent on SC for their income and livelihood.

The board of SC met to discuss the problem and concluded that while it is not illegal, based on the laws of the countries in questions, to employ child labour, it is inappropriate to continue with the practice from an ethical viewpoint. There were opposing viewpoints at the meeting from the Sales Director and Production Director.

The Sales Director felt that SC should immediately remove itself from the situation by ceasing to use developing countries to manufacture the clothing lines of the business, as sales would undoubtedly suffer from the negative public reaction.

The Production Director argued that the practice of SC employing people in developing countries was something that could be supported. In continuing to import from these countries the company provided much needed income for families in very deprived areas, and that removing this source of income would mean that SC would do more harm than good.

In addition, he also argued that moving production to a developed country would greatly increase production costs which could not be passed onto the customer, and hence would result in a reduction in margins. The Production Director argued that, if the board was willing to accept such a fall in profit, the company could become an example to others by remaining in the developing country and investing money in education and reasonable pay structures.

Required:

(a) Assess the Production Director's view that using child labour is morally justifiable using both the absolutist (dogmatic) and relativist (pragmatic) ethical perspectives.
(8 marks)

(b) Using the American Accounting Association (AAA) model, analyse this situation and evaluate the alternative actions that SC could take. (12 marks)

(c) With reference to the work of Gray, Owens & Adams, discuss where the differing views of the Sales Director and Production Director would place the company's position on social responsibility. (5 marks)

(Total: 25 marks)

3 Euro Bank, a major banking group has become embroiled in two rows over executive pay.

Firstly, details have emerged of an incentive scheme just introduced under which the bank is proposing to pay executives a cash bonus worth as much as three-and-a-half times basic salary, dependent upon the performance of the bank's share price relative to other bank stocks listed on the same exchange.

The scheme was approved by Caroline Lee, the present remuneration committee chairman, who is also the group's executive chairman. Major institutional shareholders feel the proposed scheme is "excessive and contrary to the policy we have adopted when voting our shares". No other bank in this country operates such a large cash bonus scheme at present.

The announcement of this scheme comes shortly after Euro Bank's remuneration committee was called to account to explain the significant pension settlement that had been reached with the former Chief Executive, Glyn Fredson, prior to his departure from the bank on the grounds of mismanagement of the business. The terms of this settlement were agreed upon by the committee just the day before Mr Fredson was requested to resign from office.

Rumours are circulating in the banking industry that Euro Bank may be subject to a take-over bid by the French owned National Bank of Paris (NBP). NBP is a listed company with many major corporate shareholders who are represented on the supervisory board of directors of the bank.

Required:

(a) **Criticise the performance of the remuneration committee of Euro Bank with regards to accepted corporate governance principles. (8 marks)**

(b) **Explain the role of stock exchanges in corporate governance. (4 marks)**

(c) **(i)** **Describe the main differences between the unitary board structure of Euro Bank and the two-tier (dual) board structure of National Bank of Paris (NBP). (5 marks)**

(ii) **Construct the argument in favour of the two-tier (dual) board structure of NBP, making specific reference as to how this structure would assist in preventing the issues that have been seen recently in Euro Bank. (8 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 have 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 skepticism. 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)