

THE INSTITUTE OF CHARTERED ACCOUNTANTS, GHANA
NOVEMBER 2015 PROFESSIONAL EXAMINATIONS
CORPORATE STRATEGY, ETHICS AND GOVERNANCE
EXAMINERS GENERAL COMMENTS

GENERAL PERFORMANCE

Candidates' performance was generally abysmal and quite disappointing (below average) considering the nature of the questions administered. The poor performance may be attributed to two reasons. Firstly, candidates could be described as ill-prepared towards the examination and lacked in-depth understanding of the subject area. There was a general shallowness exhibited by candidates throughout all centres. Secondly, candidates seem to lack enough information regarding the nature of the examination. Candidates may have expected to meet scenario-based questions throughout as was administered in the immediate past sitting but were met with a call and response demand type of questions that required less of analytical thinking and more of ability to memorize and recall. Quite frankly, the nature of examination influenced, to a large extent, the approach candidates resorted to in their preparation towards the examination. Generally, high performers were concentrated within Accra and Cape Coast centres while low performers were outside these centres.

STANDARD OF THE PAPER

The standard of the paper was good. It compares favourably with those of May, 2015 except that the length of the essay questions was shorter than that of previous sitting. Candidates were required to attempt question one and any other three questions. There were no ambiguities, typing or other errors in the paper. The marks allocation was fair and marks were allocated to each sub-question. All the questions were within the scope of the syllabus.

STRENGTHS OF CANDIDATES

The main strength was that almost all the candidates attempted the required number of questions. Strengths in the performance of candidates mostly centered on question six, which required candidates to outline qualities (personal and professional) expected of an accountant and explain

five principles of corporate governance. These questions reflected the ethics and governance aspects of the syllabus. Most candidates who attempted the question, however, did well with the governance question. Almost all candidates who attempted it approached it from the OECD principles of corporate governance even though what was expected was for them to explain the general principles underlying corporate governance. Apparently, candidates approach to the question could have been influenced by the preamble to the question. Overall, candidates demonstrated an understanding of the general themes enshrined in the OECD principles of corporate governance.

WEAKNESSES DEMONSTRATED BY CANDIDATES

Candidates demonstrated weak performance for the compulsory scenario-based question. This aspect of the exam required analytical and problem-solving skills from candidates in bringing to bear their understanding of strategic concepts in business problems. Candidates generally demonstrated weak analytical skills and shallow application of the strategic concepts. Overall, candidates demonstrated weak performance in all questions attempted. Most candidates found it difficult to express themselves in their attempt to explain concepts.

THE INSTITUTE OF CHARTERED ACCOUNTANTS
NOVEMBER 2015 PROFESSIONAL EXAMINATIONS QUESTIONS
CORPORATE STRATEGY, ETHICS & GOVERNANCE (2.6)

QUESTION ONE

CASE STUDY: GRACE TELECOM LIMITED

Introduction

Grace Telecom Ltd. is a well-established company which is providing telecommunications services both nationally and internationally. Its business has been concerned with telephone calls, the provision of telephone lines and equipment, and private telecommunication networks. Grace Telecom Ltd. has supplemented these services recently by offering mobile phone, which is an expanding market worldwide

The company maintains a diverse customer base, including residential users, multi-national companies, government agencies and public sector organisations. The company handles approximately 100,000 million calls each working day, and employs nearly 140 personnel.

Strategic development

The Chairman of Grace Telecom Ltd stated within its latest Annual Report that there were three main areas in which the company aimed to develop in order to remain a world leader in the telecommunications market. He believes that the three main growth areas reflect the evolving nature of the telecommunications market and will provide the scope for development.

The areas in which development is planned are:

- expansion of the telecommunications business in the national and overseas markets, both by the company acting on its own and through partnership arrangements with other suppliers
- diversification into television and multi-media services, providing the hardware to permit telephone shopping from home and broadcasting services
- extension of the joint ventures and strategic alliances which have already been established with companies in West Africa.

The Chairman explained that the company is intent on becoming a world leader in communications. This will be achieved through maintaining its focus on long-term development by improving its services to customers, developing high quality up-to-date products and being innovative, flexible and market-driven. His aim is to deliver a world-class service at competitive cost.

Financial information

The following comparative statistics show extracts from the company's financial performance in its national telecommunications market over the last two years:

	Last year	Previous year
	GHS'000	GHS'000
Revenue/Turnover	16,613	15,977
Profit before interest and tax	3,323	2,876
Capital employed	22,150	21,300

The company estimates its cost of capital to be approximately 18%.

The Chairman expressed satisfaction with the increase in turnover and stated that cost efficiencies were now being generated following the completion of a staff reduction programme. This would

assist the company in achieving a target return on capital employed (ROCE) of 20% in this market over the next three years.

Business opportunities

The Chief Executive of Grace Telecom Ltd. has stated that the major opportunities for the company lie in the following areas:

- encouraging greater use of the telephone
- provision of advanced services, and research and development into new technology, including the internet and systems integration
- the increasing freedom from government control of worldwide telecommunication services.

An extensive television and poster advertising campaign has been used by the company. This was in order to penetrate further the residential market segment by encouraging greater use of the telephone with various charging incentives being offered to residential customers.

To further the objective of increasing long-term shareholder value, the company is actively considering an investment of GHS200 million in each of the next three years in new technology and quality improvements in its national market. Because of its specialist technical nature, the investment is not expected to have any residual value at the end of the three-year period.

Following the investment, the directors of Grace Telecom Ltd. believe that its rate of profit before interest and tax to turnover in its national telecommunications market will remain constant. This rate will be at the same level as last year for each of the three years of the investment.

Markets and competition

The company is currently experiencing an erosion of its market share and faces increasingly strong competition in the mobile phone market. While Grace Telecom Ltd. is the leader in its national market, with an 85% share of the telecommunications business, it has experienced a reduced demand for the supply of residential lines in the last five years as competition has increased.

The market for the supply of equipment in the national telecommunications market is perceived to be static. The investment of GHS200 million in each of the next three years is estimated to increase Grace Telecom Ltd.'s share of this market to a level of 95%. The full improvement of 10% is expected to be received by Grace Telecom Ltd. next year, and its market share will then remain at this level for the full three-year period. It is anticipated that unless further investment is made after the three-year period, Grace Telecom Ltd.'s market share will revert to its current level as a consequence of the expected competitive response.

Industry regulation

The government has established an industry regulatory organisation to promote competition and deter anti-competitive behaviour.

As a result of the activities of the regulator and aggressive pricing strategies, it is anticipated that charges to customers will remain constant for the full three-year period of the new investment.

All cash flows can be assumed to occur at the end of the year to which they relate. The cash flows and discount rate are in real terms.

Future outlook

The business still remains under family control, but the board is considering an expansion programme for which and that the family would need to raise GH¢200 million in equity or debt finance. One of the possible risks of expansion lies in the fact that the market for fixed telephone

lines is falling. New income is being generated by expanding the product range to include mobile money transfer. The key to profit growth for Grace Telecom is the ability to generate sales growth, but the company recognizes that it faces stiff competition from large telecom companies in respect of the prices charged.

In planning its future, Grace Telecom is advised to look carefully at a number of external factors which may affect the business including government economic policy. In recent months the following information has been published in respect of key economic data.

- i) Bank base rate has been reduced from 22% to 20%, and the forecast is for a further 0.5% reduction within six months.
- ii) The annual rate of inflation is now 12%, down from 14% in the previous quarter, and 16% 12 months ago. No further falls in the rate are expected over the medium term.
- iii) Personal and corporate tax rates are expected to remain unchanged for at least twelve months.

Required:

- a) Explain the nature of the political, economic, social, and technological forces which will influence Grace Telecom Ltd. in developing its business and increasing its market share. **[8marks]**
- b) Apply Ansoff's Product/Market Growth matrix to assess the extent of the potential market development opportunities available to Grace Telecom Ltd. **[12marks]**
- c) Explain the relevance of each of the items of economic data listed in the case to Grace Telecom Ltd. **[6marks]**

d) Explain whether Grace Telecom should continue with its expansion plans. Clearly justify your argument for or against the expansion. **[10marks]**

e) Outline **FOUR (4)** methods whereby Grace Telecom Ltd can obtain quotation for its share on the Ghana Stock Exchange. **[4marks]**

(Total: 40 marks)

QUESTION TWO

a) Managers have a duty to aim for profit. At the same time, modern ethical standards impose a duty to guard, preserve and enhance the value of an enterprise for the good of all touched by it, including the general public.

Explain **FOUR (4)** ethical problems managers face in dealing with stakeholders.

[10marks]

b) Business activities, in general, were formerly regarded as problem for the environmental movement, but the two are now increasingly complementary. There has been an increase in the use of green approach to market products.

Explain in **FOUR (4)** ways how physical environmental conditions are important for strategic planning.

[10marks]

(Total: 20 marks)

QUESTION THREE

- a) The role of Audit Committee in corporate governance cannot be overemphasized.
- i) What should be the composition of an Audit Committee? **[4marks]**
 - ii) Explain **FOUR (4)** functions of an Audit Committee. **[6marks]**
- b) Corporate governance is now a very popular and important area in strategic management. However, corporate governance is poor in a number organisation. Explain **FIVE(5)** symptoms of poor corporate governance **[10marks]**
- (Total: 20 marks)**

QUESTION FOUR

- a) A mission statement describes an organization's basic purpose and what it is trying to achieve. It can play an important role in the strategic planning process. There is no standardized format for mission statements. However, there are common elements included in most mission statements. Outline any **FIVE (5)** of these elements. **[5marks]**
- b) Strategy evaluation is as important as strategy formulation. One of the tools used in resource audit as part of strategy evaluation and control is the Ms Model. Identify and explain any **FIVE (5)** elements in the Ms Model. **[5marks]**

- c) Reporting on corporate governance is one way of ensuring transparency. Based on recent corporate governance concerns, explain **FIVE (5)** issues that are contained in corporate governance reports.

[10marks]

(Total: 20 marks)

QUESTION FIVE

- a) Strategic management is a cross-functional activity. The production function for example, has relationship with other functions of a company. Explain how the production function can be integrated with other functions in company.

[4marks]

- b) Explain the **FOUR (4)** different orientations organisations have towards customers.

[8marks]

- c) What is meant by sustainability? Using relevant examples, explain the concept of the triple bottom line.

[8marks]

(Total: 20 marks)

QUESTION SIX

- a) The personal qualities as well as the professional qualities of an accountant can influence his/her role in the strategic management process. Outline three personal qualities and two professional qualities expected of an accountant.

[5marks]

- b) Ghana has adopted the principles published by the organization for Economic Co-operation and Development (OECD) which deal mainly with performance problems that result from the separation of ownership and management of a company. Explain **FIVE (5)** principles of corporate governance. **[15marks]**

(Total: 20 marks)

SUGGESTED SOLUTIONS

QUESTION ONE

a)

- **Political factors**

Grace Telecom Ltd. currently dominates its national telecommunications market with an 85% shares of the market. The company will be under political pressure from the national government to reduce its dominance by opening up the national telecom market to competition and reducing prices for telecom products charged to consumers.

The government has appointed an industry regulator to be directly involved in the control of the telecom industry and no doubt Grace Telecom Ltd will be under close scrutiny. Political forces will be a major factor affecting the operations and plan of Grace Telecom Ltd.

Also a very important consideration is the political conditions comprising of the stability and the policies of the government of the day in the international markets where Grace Telecom Ltd has operations.

- **Economic factors**

There are three main economic elements that Grace Telecom Ltd. needs to consider. These are;

- ***Shareholder wealth*** – Grace Telecom Ltd.’s shareholders are a major stakeholder group who will have economic objectives of profit maximization and rising share value. This is crucial especially as the company plans of obtaining public funds from the stock exchange.

- ***The contribution of the telecommunications industry to the national economy*** – The telecommunications industry plays a major role in contributing towards economic growth and prosperity. Grace Telecom Ltd. has a responsibility to develop new technology and to provide a reliable, value for money service to its users.

- ***The economies of foreign countries*** – the economic conditions in each foreign country that Grace Telecom Ltd. operates in should be considered e.g. foreign currency exchange rates and national economic boom and slump cycles.

- **National Economic Indicators**- Considering the propose investment in technology for Grace Telecom Ltd. and considering the favorable national economic indicators within the external environment, the company can capitalize on the reducing interest rate to acquire cheaper debt capital towards its anticipated expansion programmes. The operational expansion could be supported by increasing demand within the economy due to falling inflation- however, this would largely depend on the elasticity of the products and services supplied Grace Telecom.

- **Social factors**

Telecommunication products are social products used by people for many reasons. The company should ensure that it understands the social needs of its customers and provide a reliable service. The company should also portray itself as socially responsible company with a set of social objectives and keep close contact with consumers e.g. by producing a range of services for elderly citizens who are more dependent on telephones for obtaining help when needed. Another dimension of the social environment, which includes the culture of the different markets where Grace Telecom operates, is issues of branding. Grace Telecom could pursue a strategy of inculcating the values and culture each of their local markets into their products and services

- **Technical factors**

The telecommunications industry is a high-tech industry that is currently very dynamic. Grace Telecom Ltd. is the market leader in the industry and must be innovative to maintain its competitive advantage. The company must invest in research and development to ensure it has a constant supply of new products in the years ahead to replace those going into the decline stage of their product life cycle. Grace Telecom may also have to think of integrating after sales support services as a core activity in its value chain for very technical products especially as they are contemplating on investing in high technology.

(2 marks each)

[8marks]

b) By relating products to markets, Ansoff identified four main strategies for achieving long-term growth.

1. **Market penetration strategies** – Grace Telecom Ltd. currently has 85% of its national market. There is little scope for obtaining any growth by increasing its market share. Most households and businesses will have a conventional telephone line so some of the company's products will be at the maturity stage of their life cycle offering little prospect of growth. Some market growth might be achieved by getting existing customers to use the telephone more. A market penetration strategy only offers limited growth prospects.

2. **Product development strategy** – This strategy involves introducing new products into existing markets. Grace Telecom Ltd. has already achieved a good track record for new product development and with continued investment in research and development should maintain its momentum. There is a lot of market opportunity in the industry for this strategy e.g. further development in mobile phone and internet technology.

3. **Market development strategy** – Grace Telecom Ltd. has pursued a successful strategy of expanding into foreign markets with existing products. It currently has operations in North America, Europe, India and the Far East. In Grace Telecom Ltd.'s latest annual report, the Chairman refers to developing countries such as those in Africa where the company currently has operations.
4. **Diversification strategy** – This involves introducing new products to new markets and is a high-risk strategy. Grace Telecom Ltd. is a large profitable company with a prospector (innovative) culture. The company should evaluate carefully the risk of any diversification strategy and if opportunities exist they should be considered e.g. digital television technology.

The company should pursue all four strategies with the main emphasis on product development and market development, as these exploit the company's main strengths of expertise in research and development, and growth in foreign markets.

(3 marks each)

[12marks]

Note: Some students may draw the Ansoff's Matrix. If this is correctly done without any subsequent explanation and relating it to the case, half of the total mark may be awarded (i.e. 1.5 each)

c)

i) **Reduction in bank base rate**

1) **Change in costs of borrowing**

This may occur directly through the change in the cost of borrowing and therefore the cost of capital. A fall in interest rates will make borrowing cheaper, and therefore reduce the cost of raising the finance for the proposed expansion. This is likely to apply to any means of financing the company, since corporate borrowing

rates are generally set at a certain premium above base rate. If Grace Telecom Ltd. applies DCF techniques in evaluating the expansion, the reduction in the cost of capital will lead to an increase in the level of the NPV for the proposals.

2) **Level of demand**

Level of demand within the economy could be indirectly affected through the effect of interest rates. Keynesian theory contends that a fall in the level of interest rates will increase the demand for money, and hence the overall level of demand within the economy. Monetarists, on the other hand, believe that the level of consumer demand is unaffected by changes in interest rates. Grace Telecom Ltd is trading in low value basic products for which the level of demand is relatively inelastic. Even if a fall in interest rates affects overall demand in the way that Keynesians predict, this is unlikely to have any significant effect on the level of demand for Grace Telecom Ltd.'s products.

3) **Economic confidence**

The reduction in the interest rate will increase general economic confidence and encourage expansion. Again though it is likely that the level of confidence will not have much impact on the type of product the company is dealing in.

4) **Summary**

To summarize, the reduction in the bank's base rate is likely to reduce the cost of the expansion plans, but will probably have little effect on the level of sales.

(2 marks)

ii) **Effect of present and forecast rates of inflation**

1) **Interest rates**

Interest rates are unlikely to rise if inflation remains so low

2) **Costs of purchases**

The cost of the products that Grace Telecom purchase should remain stable. Wage rates may be less affect, there may be pressures other than inflation rates that cause wage increases.

3) **Price increases**

In conditions of low inflation, it is hard to make any price increase without losing business. Grace Telecom, as already noted is offering low value products and services and thus are unlikely to increase prices up to a certain extent, thereby reducing its ability to compete favourably based on price.

Low inflation is therefore likely to present more of a threat than an opportunity to Grace Publishing

(2 marks)

iii) **Effects of stable tax rates**

1) **Consumer demand**

Changes in personal tax rates can affect consumer demand, but as was discussed above, demand for Grace Telecom products and services are inelastic, and therefore the stability or otherwise of tax rates is unlikely to have much effect on sales.

2) **Tax relief**

When planning the expansion, it is easier to plan with confidence since the levels for tax relief available to both the company and individual equity investors are known.

Stable personal and corporate tax rates will therefore help in developing the expansion plans.

[2 marks]

d) **Arguments in favour of expansion**

i) **Need to increase sales**

Due to the low level of gross margins, Grace Telecom Ltd needs to increase the level of sales in order to trade profitably. In view of the low level of recent sales growth, in spite of the addition of new products, it seems that the only way to increase sales significantly is by the opening of new outlets.

ii) **Bulk order discounts**

Expansion of the business will increase the level of purchase and could lead to an improvement in the level of buying power with suppliers, and the ability to take advantage of bulk order discounts. This would in turn have a positive impact on gross margins and profitability.

iii) **Wider geographical spread**

A wider geographical spread will make the business less vulnerable to local events, such as an increase in the level of unemployment or the opening of a new superstore.

iv) Economic of scale

Expansion could lead to some economies of scale, for instance in the wider deployment of regional management.

Arguments against expansion

i) Nature of products

Expansion will not change the fundamental weakness of the business, which is that most of the business is in low value products with strong price competition. There is limited potential to grow, and other factors, the greater convenience of being able to buy practically all products required at a single large store, are working against the business.

ii) Risk of political pressure

Grace Telecom Ltd. risk coming under greater political pressure if it tries to expand further to obtain large share of the marker (already 85% is very significant and could lead to monopolistic behaviours by the company). Such political pressures could lead to greater political regulation and costs that may hinder the operations of the company.

iii) Competitive pressures

Strong price competition due to low inflation and the position of the supermarket sector is likely to continue for the foreseeable future.

Conclusion

In conclusion, Grace Telecom Ltd should think very carefully before committing to the expansion, since this is unlikely to do much to increase margins and profitability. The company could perhaps consider an alternative strategy of selling different higher added value products, and changing the whole style of the operation. For example, it could consider expanding into areas which present greater opportunities for competing based on cost/price.

[10marks]

- e) The Ghana Stock Exchange Listing requirements provide for six major ways by which a listed company can obtain quotation for its shares as follows:
- i. An **offer for sale**, which is an offer to the public by an issuing house or broker of securities already in issue or for which they have agreed to subscribe.
 - ii. An **Offer for Subscription**
 - iii. A **Right issue**, which is an issue of shares at a special price by a company to its existing shareholders in proportion to their holding of old shares.
 - iv. A **Bonus/Capitalization issue**, which is an issue of additional shares to shareholders instead of paying dividend, in proportion to shares already held.
 - v. A **placing**, which is the term used to describe the sale of or obtaining subscription for securities privately by an issuing house or broker through the market and to or by their own clients.

- vi. An **introduction**, which describes an application where no marketing arrangements are required because the securities to be listed are already of such an amount and so widely held that their adequate marketability when listed can be assumed.

[4marks]

EXAMINER'S COMMENT

CASE STUDY

This was a compulsory question. Some of the issues tested included environmental factors which affected businesses, Ansoff's Product/Growth Matrix and decision on expansion.

The (b) sub question was also poorly answered. Many candidates confused the Ansoff's Matrix with other frameworks such as the BCG Matrix *et al.* Those who could properly identify it had difficulty explaining it and relating it to the scenario. Others also failed to explain all the four strategies and concentrated on only the market development strategy.

Such candidates, presumably, confused themselves with the phrase 'potential market development opportunities' in the question. Candidates were expected to first of all identify each of the elements/strategies in the matrix, explain them and suggest ways the company (Grace Telecom Ltd.) could pursue such strategies.

Sub-question (c) was almost a repeat of the economic element of the macro-environmental factor asked in sub-question (a). Candidates were expected to zero-in on each of the economic elements given in the scenario and discuss how they could affect the operations of Grace Telecom Ltd. – i.e. what kinds of opportunities they presented or threats they posed to the company.

In sub-question (d), candidates were expected to make a case for and against in terms of Grace Telecom Ltd's plans to expand and then to draw valid conclusions based on the arguments so advanced. Majority of candidates only dwelt on one side of the argument. Additionally, candidates arguments advanced were not based on sound analysis. This particular question exposed the weakness of candidates so far as analytical thinking and problem-solving was concerned. It is imperative to state that candidates must always approach questions of such nature by discussing pros and cons and drawing appropriate conclusions. Candidates must also not lose sight of possible quantitative and qualitative analysis to earn high quality marks.

Sub-question (e) required candidates to draw on their knowledge from other disciplines (e.g. company law and finance) to be able to earn the full marks. Unfortunately, candidates disappointed once again. This question revealed candidates shallowness in approaching corporate strategy as well as non-appreciation of the multi-disciplinary nature of the paper. Candidates are advised to be open-minded and bring to bear their knowledge from other subject areas in business. .

QUESTION TWO

- a) In the area of products and production, managers have responsibility to ensure that the public (consumers) and their own employees are protected from danger. Attempts to increase profitability by cutting costs may lead to dangerous working conditions or to inadequate safety standards in products. In the United States, product liability litigation is so common that this legal treat may be a more effective deterrent than general ethical standards.

Another ethical problem concerns payment by companies to government officials who have power to help or hinder the payers' operations. Some of the issues which exist in this area are:

- i. **Extortion.** Foreign officials have been known to threaten companies with the complete closure of their local operations unless suitable payments are made.
- ii. **Bribery.** This refers to payments for services to which a company is not legally entitled. There are some fine distinctions to be drawn; for example, some managers regard political contributions as bribery.

- iii. **Grease money.** Multinational companies are sometimes unable to obtain services to which they are legally entitled because of deliberate stalling by local officials. Cash payments to the right people may then be enough to oil the machinery of bureaucracy.
- iv. **Gifts.** In some cultures (such as Japan) gifts are regarded as an essential part of civilized negotiation, even in circumstances where to Western eyes they might appear ethically dubious. Managers operating in such a culture may feel at liberty to adopt the local customs.
- v. **Discrimination** against an employee or any group of employees based on gender, religion, beliefs, etc.
- vi. **Environmental pollution and degradation**
- vii. Failure to provide the right working environment and conditions of service for employees (e.g. unfair labour practices on the part of management-which can result in legal actions and avoidable cost for the company).

[10 marks]

b) Physical environmental conditions are important for strategic planning.

- i. **Resource inputs.** Managing physical resources successfully (e.g. oil companies, mining companies) is a good source of profits.
- ii. **Logistics.** The physical environment presents logistical problems or opportunities to organisations. Proximity to road and rail links can be a reason for sitting a warehouse in a particular area.

- iii. **Government.** The physical environment is under the control of other organisations.
 - 1. Local authority town planning departments can influence where a building and necessary infrastructure can be sited.
 - 2. Governments can set regulation about some of the organization's environmental interactions.

- iv. **Disasters.** In some countries, the physical environment can pose a major 'threat' to organisations.

[10marks]

EXAMINER'S COMMENT

The First part of this question tested the candidates on four ethical problems managers face in dealing with stakeholders The Second part was on how physical environmental conditions are important for strategic planning.

The question was attempted by a good number of candidates and the performance was generally not good.

QUESTION THREE

a) i) The composition of the Audit Committee

- 1) The audit committee should comprise at least three directors, the majority of whom should be non-executive.
- 2) The membership of the audit committees should ideally comprise directors with adequate knowledge of finance, accounts and the basic element of the laws under which the corporate body operates or is subject to.
- 3) The chairman of the committee should be a non-executive director.
- 4) The managing director/chief executive officer , the finance director, the head of internal audit and a representative of the external auditors should ordinarily be invited to attend meetings

(4 marks)

ii) Functions of the Audit Committee

The primary functions of the audit committee will be to:

- 1) Recommend the appointment of the external auditors of the corporate body;
- 2) Liaise with the external auditors for the purposes of maintaining and ensuring audit quality, effectiveness, risk assessment, interaction with internal auditors and dealing with situations governing the resignation of the external auditors and dealing with situations governing the resignation of the external auditors;

- 3) Review with the auditors their report on the financial statements of the corporate body;
- 4) Review the adequacy of systems and internal controls and of the degree of compliance with material policies, laws and the code of ethics and business practices of the corporate body;
- 5) Provide a direct channel of communication between the board and the external and internal auditors of the corporate body, accountants and compliance officers (if any) of the corporate body;
- 6) To report to the board on all issues of significant extraordinary financial transactions;
- 7) To assist the board in developing policies that would enhance the controls and operating systems of the corporate body.

(6 marks)

b) Five symptoms of corporate governance

1. Domination by a single individual

A feature of many corporate governance scandals has been boards dominated by a single senior executive with other board members merely act as a rubber stamp. Sometimes the single individual may bypass the board to action his own interests. This can result in management and directors awarding themselves remuneration and company perks that do not align with company performance or shareholder interests. This is an inherent problem in agency theory.

Even if an organisation is not dominated by a single individual, there may be other weaknesses. The organization may be run by a small group centered round the Chief Executive and Chief Financial Officer and appointments may be made by personal recommendation rather than a formal, objective process.

2. Lack of involvement of board

Boards that meet irregularly or fail to consider systematically the organization's activities and risks are clearly weak. Sometimes the failure to carry out proper oversight is due to lack of information being provided.

3. Lack of adequate control function

Another potential weakness is a lack of adequate technical knowledge in key roles, for example in the audit committee or in senior compliance positions. A rapid turnover of staff involved in accounting or control may suggest inadequate resources, and will make control more difficult because of lack of continuity.

4. Lack of supervision

Employees who are not properly supervised can create large losses for the organization through their own incompetence, negligence or fraudulent activity. The behaviour of Nick Leeson, the employee who caused the collapses of Barings bank was not challenged because he appeared to be successful, whereas he was using unauthorized accounts to cover up his large trading losses. Leeson was able to do this because he was in charge of dealing and settlement, a systems weakness of lack of segregation of key roles that featured in other financial frauds.

5. Lack of independent scrutiny

External auditors may not carry out the necessary questioning of senior management because of fears of losing the audit, and internal audit do not ask awkward questions because the Chief Financial Officer determines their employment prospects. Often corporate collapses are followed by criticisms of external auditors, such as the Barlow Clowes affair were poorly planned and focused audit work failed to identify illegal use of client monies.

6. Lack of contact with shareholders

Often, board members grow up with the company and lose touch with the interests and views of shareholders. One possible symptom of this is the payment of remuneration packages that do not appear to be warranted by results.

7. Emphasis on short-term profitability

Emphasis on success or getting results can lead to the concealment of problems or errors, or manipulation of accounts to achieve desired results.

8. Misleading accounts and information

Misleading figures are often symptomatic of other problems (or are designed to conceal other problems) but clearly poor quality accounting information is a major problem if markets are trying to make a fair assessment of the company's value. Giving out misleading information was a major issue in the Enron scandal as discussed previously.

(Any 5 @ 2 marks)

(10 marks)

EXAMINER'S COMMENT

This question was in two parts. Part (a) of this question examined candidates about the composition of an Audit Committee and explain four functions of an Audit Committee. In part (b), the candidates were required to explain five symptoms of poor corporate governance.

The performance was not good considering the fact that the content is also covered in the Auditing paper. The candidates had problem explaining the composition of an Audit Committee.

QUESTION FOUR

a) Common elements in mission statements

- 1) Stating the purpose of the organization
- 2) Stating the business areas in which the organization intends to operate
- 3) Providing a general statement of the organization's culture
- 4) Acting as a guide to develop the direction of the entity's strategy and its goals/objectives
- 5) *Customers*. Who are the enterprise's customers?
- 6) *Products or services*. What are the firm's major products or services?
- 7) *Markets*. Where does the firm compete?
- 8) *Technology*. What is the firm's basic technology?
- 9) *Concern for survival, growth, and profitability*. What is the firm's commitment towards economic objectives?
- 10) *Philosophy*. What are the basic beliefs, values, aspirations, and philosophical aspirations of the firm?
- 11) *Self-concept*. What are the firm's major strengths and competitive advantages?
- 12) *Concern for public image*. What is the firm's public image?
- 13) *Concern for employees*. What is the firm's attitude toward employees?

(Any 5 @ 1 mark)

(5 marks)

Note: Any student who approaches this question from the Ashridge College model perspective should earn the full mark. Find below

- 1) **Purpose:** Why does the company exist? Who does it exist for?
- 2) **Values:** are the beliefs and moral principles that underlie the organisation's culture.
- 3) **Strategy:** provides the commercial logic for the company (the nature of the organisations business), and so addresses the following questions. 'What's our business? Or, what should it be?' What are our elements of sustainable competitive advantage?
- 4) **Policies and standards of behavior:** provides guidance on how the organistaion's business should be conducted.

b) **Elements in the Ms Model**

Resource audits identify human, financial and material resources and how they are deployed. A resource audit is a review of all aspects of the resources the organisation uses.

The Ms Model categories the factors as follows:

Resource	Example
Machinery	Age. Condition. Utilization rate. Value. Replacement cost.
Make-up	Culture and structure. Patents. Goodwill. Brands
Management	Size. Skills. Loyalty. Career progression. Structure.
Management information	Ability to generate and disseminate ideas. Innovation. Information systems.

Markets	Products and customers. Specialized or general, national, international.
Materials	Source. Suppliers and partnering. Waste. New materials. Cost. Availability. Future provision.
Men and women	Number. Skills. Efficiency. Industrial relations. Adaptability. Innovatory capacity. Wage costs. Labour turnover.
Methods	How are activities carried out? Outsourcing, quality.
Money	Credit and turnover periods. Cash surpluses/deficits. Short-term and long-term finance. Gearing levels. Debts.

(Any 5 @ 1 mark)

(5 marks)

c) Issues contained in corporate governance reports.

All corporate governance reports (included Ghana's Code of Best Practices in Corporate Governance) state that board directors should explain their responsibility for preparing accounts. They should report that the business is a going concern, with supporting assumptions and qualifications as necessary.

In addition, further statements required include:

1. **Information about the board of directors:** the composition of the board in the year, the role and effectiveness of the board, information about the independence of the non-executives, frequency of, and attendance at, board meetings, how the board's performance has been evaluated. For example, the South African King Report suggests a charter of responsibilities should be disclosed.
2. Brief report on the remuneration, audit and nomination committees covering terms of reference, composition and frequency of meetings.
3. Information about relations with auditors, including reasons for change and steps taken to ensure auditor objectivity and independence when non-audit services have been provided (Ghana's code requires that audit and non-audit fees are disclosed).
4. A statement that the directors have reviewed the effectiveness of internal controls, including risk management. Also sufficient disclosures should be given for shareholders to understand the main features of the risk management and internal control processes. Board should also give details of, or at least confirm, any action taken to remedy significant failings or weaknesses. (This is required by Ghana's Code).
5. A statement on relations and dialogue with shareholders.
6. A statement that the company is a going concern. (This is required by Ghana's Code).
7. Sustainability reporting, defined by the King Report as including the nature and extent of social, transformation, ethical, safety, health and environmental management policies and practices.

8. A business review
9. A statement detailing the compliance by the organisation with corporate governance, legal and statutory requirements. (This is required by Ghana's Code)
10. Ghana's Code of Best Practices in Corporate Governance also requires the following disclosure:

The board should also ensure that information is disclosed on the following matters in the annual report insofar as they are relevant to the period under review –

- (a) All management fees paid by the corporate body with details of the names of the parties and their relationship to the corporate body;
- (b) The identities and percentage holdings of substantial shareholders;
- (c) significant cross shareholding relationships;
- (d) Related party transactions;
- (e) Details of incentive schemes, such as stock option scheme;
- (f) The fees paid to the auditors of the corporate body for audit and non-audit related work; and
- (g) Any other material issues concerning employees and other stakeholders such as creditors and suppliers.

EXAMINER'S COMMENT

This question was in three parts. Part (a) of this question required candidates to outline any five elements in mission statements. In part (b), the candidates were required to explain any five elements in the Ms Model used in resource audit as part of strategy evaluation and control. The final part (c) required the candidates to explain five issues that are contained in corporate governance reports.

A good number of the candidates attempted this question and the performance was generally good.

QUESTION FIVE

a) Production function integration with other functions

Longer term decisions, particularly relating to design and the innovation of improved products, cannot be taken by the production department alone; its activities must be integrated with other functions in the firm.

- Product design is co-ordinated with R&D. Production should advise R&D as to the consequences of particular designs for the manufacturing process.
- Job design will involve consultation with human resources specialists.
- The quantities needed to be produced will be notified by the sales department.
- The human resources department will be involved in managing the work force.

- The finance department might indicate the resources available for new equipment.

(4 marks)

b) Four different orientations organisations have towards customers

Orientation	Description
Production orientation	Customers will buy whatever we produce – our job is to make as many as we can. (Demand exceeds available supply.)
Product orientation, a variant of production orientation	Add more features to the product – demand will pick up. Such firms do not research what customers actually want.
Sales orientation	Customer are naturally sales resistant so the product must be sold actively and aggressively and customers must be persuaded to buy them.
Marketing orientation	The key task of the organization is to determine the needs, wants and values of a target market and to adapt the organisation to delivering the desired satisfactions more effectively and efficiently than its competitors.
Societal orientation	This holds that a company should make marketing decisions by considering consumers’ wants, company’s requirements,

and society's long-term interest. An organisation's task is to determine the needs, wants and interest of a target market and to deliver the desired satisfactions more effectively and efficiently than competitors in the way that preserves or enhances the society's well-being.

Relationship orientation This is a facet of customer relationship management which focuses on customer loyalty and long term customer engagement rather than shorter-term goals like customer acquisition and individual sales. The goal here is to create strong, even emotional, customer connections to a brand that can lead to ongoing business, free word-of-mouth promotion and information from customers that can generate leads.

2 marks each

(8 marks)

c) Definition of sustainability and Concept of the triple bottom line

Sustainability involves developing strategies so that the company only uses resources at a rate that allows them to be replenished such that the needs of the current generation can be met without compromising the needs of future generations. At the same time, emissions of waste are confined to levels that do not exceed the capacity of the environment to absorb them.

The triple bottom line (TBL) is sometimes summarized as People, Planet, and Profit. It consists of:

- **Social justice:** fair and beneficial business practices towards labour and the community and the region in which a corporate conducts its business. A TBL company conceives a reciprocal social structure in which the wellbeing of corporate, labour and other stakeholder interests are interdependent.
- **Environmental quality:** a TBL company endeavours to benefit the natural order as much as possible, or at the least do no harm and curtail environmental impact. In this way, the company tries to reduce its ecological footprint by, among other things, carefully managing its consumption of energy and non-renewable resources, and by reducing manufacturing waste, as well as rendering waste less toxic before disposing of it in a safe and legal manner.
- **Economic prosperity:** the economic benefit enjoyed by the host society. It is the lasting economic impact the organisation has on its economic environment. Importantly, however, this is not as narrow as the internal profit made by a company or organisation.

(8 marks)

EXAMINER'S COMMENT

The first part of this question examined candidates on how the production function can be integrated with other functions in a company. The second part asked candidates to explain four different orientations organizations have towards customers. The third part was on the meaning of sustainability and the concept of the triple bottom line.

The candidates did well in the first part of the question but most of them performed poorly in the part (b) and (c) of the question. The key points that they missed included:

b)

Orientation	Description
Production orientation	Customers will buy whatever we produce – our job is to make as many as we can. (Demand exceeds available supply.)
Production orientation, a variant of production orientation	Add more features to the product – demand will pick up. Such firms do not research what customers actually want.
Sale orientation	Customer are naturally sales resistant so the product must be sold actively and aggressively and customers must be persuaded to buy them.
Marketing orientation	The key task of the organization is to determine the needs, wants and values of a target market and to adapt the organization to delivering the desired satisfactions more effectively and efficiently than its competitors.

c)

Sustainability involves developing strategies so that the company only uses resources at a rate that allows them to be replenished such that the needs of the current generation can be met without compromising the needs of future generations. At the same time, emissions of waste are confined to levels that do not exceed the capacity of the environment to absorb them.

The triple bottom line (TBL) is sometimes summarized as People, Planet, and Profit. It consist of:

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- **Economic prosperity:** the economic benefit enjoyed by the host society. It is the lasting economic impact the organization has on its economic environment. Importantly, however, this is not as narrow as the internal profit made by a company or organization.

QUESTION SIX

- a) Three personal qualities and Two professional qualities

Personal quality	Detail
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Reliability	When taking on work, you must ensure that it gets done and meets professional standards.
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Responsibility	In the workplace you should take ownership of your work
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Timeliness	Clients and work colleagues rely on you to be on time and produce work within a specified time frame.
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Courtesy	You should conduct yourself with courtesy and consideration towards clients and colleagues.
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Independence	You must be able to complete your work without bias or prejudice and you must also be seen to be independent.
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Skepticism	You should question information given to you so that you can form your own opinion regarding its quality and reliability.
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Professional quality**Detail**

Accountability

You should recognize that you are accountable for your own judgements and decisions.

Social responsibility

Accountants have a public duty as well as a duty to their employer or client. Audit work, accountancy work and investment decisions may all affect the public in some way.

(5 marks)

b) Five principles of corporate governance

Most corporate governance codes are based on a set of principles founded upon ideas of what corporate governance is meant to achieve. This is based on a number of reports.

- 1) To ensure adherence to and satisfaction of the strategic objectives of the organisation, thus aiding effective management.
- 2) To minimize risk, especially financial, legal and reputational risks, by ensuring appropriate systems of financial control are in place, systems for monitoring risk, financial control and compliance with the law.

- 3) To promote integrity, that is straightforward dealing and completeness.
- 4) To fulfill responsibilities to all stakeholders and to minimize potential conflicts of interest between the owners, managers and wider stakeholder community.
- 5) To establish clear accountability at senior levels within an organisation. However, one danger may be that boards become too closely involved with day-to-day issues and do not delegate responsibility to management.
- 6) To maintain the independence of those who scrutinize the behaviour of the organisation and its senior executive managers. Independence is particularly important for non-executive directors, and internal and external auditors.
- 7) To provide accurate and timely reporting of trustworthy/independent financial and operational data to both the management and owners/members of the organisation to give them a true and balanced picture of what is happening in the organisation.
- 8) To encourage more proactive involvement of owners/members in the effective management of the organization through recognizing their responsibilities of oversight and input to decision making processes via voting or other mechanisms.

Note: Some students may approach this question from the perspective of the OECD principles of corporate governance as follows:

- 1) **The right to shareholders:** Shareholders should have the right to participate and vote in general meetings of the company, elect and remove members of the board and obtain relevant and material information on a timely basis. Capital markets for corporate control should function in an efficient and timely manner.

- 2) **The equitable treatment of shareholders:** All shareholders of the same class of shares should be treated equally, including minority shareholders and overseas shareholders. Impediments to cross-border shareholding should be eliminated.
- 3) **The role of stakeholders:** Rights of stakeholders should be protected. All stakeholders should have access to relevant information on a regular and timely basis. Performance-enhancing mechanisms for employee participation should be permitted to develop. Stakeholders, including employees, should be able to freely communicate their concerns about illegal or unethical relationships to the board.
- 4) **Disclosure and transparency:** Timely and accurate disclosure must be made of all material matters regarding the company, including the financial situation, foreseeable risk factors, issues regarding employees and other stakeholders and governance structure and policies. The company approach to disclosure should promote the provision of analysis or advice that is relevant to decisions by investors.
- 5) **The responsibilities of the board:** The board is responsible for the strategic guidance of the company and for the effective monitoring of management. Board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interest of the company and its shareholders. They should treat all shareholders fairly. The board should be able to exercise independent judgement; this includes assigning independent non-executive directors to appropriate tasks.

(Any 5 points for 3 marks each)

(15 marks)

EXAMINER'S COMMENT

The first part of this question asked candidates to outline three personal qualities and two professional qualities expected of an accountant. The second part examined the principles of corporate governance.

The performance in the first part of the question was poor. Some of the candidates the missed include:

a. Three personal qualities and two professional qualities:

Personal quality	Detail
Reliability	When taking on work, you must ensure that it gets done and meets professional standards.
Responsibility	In the workplace you should take ownership of your work
Timeliness	Clients and work colleagues rely on you to be on time and produce work within a specified time frame.
Courtesy	You should conduct yourself with courtesy and consideration towards clients and colleagues.
Professional quality	Detail
Independence	You must be able to complete your work without bias or prejudice and you must also be seen to be independent.
Scepticism	You should question information given to you so that you can form your own opinion regarding its quality and reliability.
Accountability	You should recognize that you are accountable for your own judgements and decisions.
Social responsibility	Accountants have a public duty as well as a duty to their employer or client. Audit work, accountancy work and investment decisions may all affect the public in some way.