The Institute of Chartered Accountants of Nigeria (ICAN)

FOUNDATION LEVEL EXAMINATION

2019

Mock Exam

(3 hours)

Business, Management and Finance

Answers

Section A: 20 marks

A1 **A**

Public sector organisations are government departments or organisations that are funded by the government. They are not-for-profit organisations that do not seek to make a profit.

A2 **B**

The scalar chain describes the number of different reporting levels through which communications and decisions are passed in an organisation. In a flat organisation, there are fewer reporting levels and the span of control may be wide which results in a lack of adequate supervision and control. Fewer reporting levels would reduce the opportunities for promotion.

A3 **B**

A4 **C**

Geographical immobility affects the supply of labour to a particular region or industry, not the total supply of labour to the economy as a whole.

A5 **A**

A company is likely to have a disciplinary code and grievance procedures but not as part of its code of ethics. A code of ethics does not go into detailed rules of conduct and behaviour.

A6 **C**

A7 **D**

8,100 / 0.09 = ₦90,000

A8 **D**

This function is more usually associated with management accounting.

A9 **C**

A10 **A**

A11 **B**

A fundamental ethical principle in accountancy is that an accountant should be objective, avoiding bias and undue influence. It seems that he has allowed his friendship with the production director to affect his forecasts of costs, and so he is in breach of the principle of objectivity.

A12 **B**

A13 **D**

A14 **B**

A15 **A**

A16 **C**

A17 **D**

A18 **B**

A19 **D**

A20 **D**

When there is economic stagnation, there is little or no economic growth, and with stagflation there is little or no economic growth and at the same time a high rate of inflation.

Section B: 80 marks

Question B1

(a) A charity is a non-government not-for-profit organisation, even when it receives most of its funding from the government.

A school is a public sector organisation when it is owned by the government. However, there are also private schools. Private schools in Nigeria might be established as business organisations, whose purpose is to make a profit. Alternatively they may be established as charities which are funded by school fees; in the latter sense they would be non-government not-for-profit organisations.

A state-owned electricity company is a public sector organisation. However, it might be required to operate at a profit, in which case it is also a business organisation.

(b) The six elements in the cultural web are:

(i) Routines and rituals. These are the established ways in which things get done.

(ii) Stories and myths. These are established tales about how the entity got to where it is today, that have become embedded in the way that individuals view the entity and what it should be doing.

(iii) Symbols. These are accepted signs that represent the character of the entity and what it represents.

(iv) Power structure. This refers to the sources of power within the entity. In many cases, power is in the hands of management, who control the resources of the entity. Sometimes, other individuals can wield power and influence, even when they are not in an official position.

(v) Organisation structure. Culture is affected by organisation structure. For example, large bureaucracies have a very different culture from small entrepreneurial businesses with a flexible organisation structure.

(vi) Control systems. Control systems, particularly systems of rewarding employees, help to establish a sense of what is important. Individuals will focus on what they regard as important.

(c) Achievement of the objective of maximisation of the value of a firm might be compromised by conflicts which may arise between the managers and the other stakeholders in an organisation. Such conflicts include:

(i) Managers might not work industriously to maximise shareholders' wealth if they feel that they will not have a fair share in the benefits of their labour.

(ii) There might be little incentive for managers to undertake significant creative activities, including looking for profitable new ventures or developing new technology.

(iii) Managers might be giving themselves high salaries and perks.

(iv) Managers might be providing themselves with larger empires, through merger and organic growth, thus increasing their opportunity for promotion and social status.

(v) Reducing risk through diversification which may not necessarily benefit shareholders, but may well improve the managers' security and status.

(vi) Managers might take a more short-term view of the firm's performance than the shareholders would wish.

(vii) Management acting on behalf of shareholders might also reduce the wealth and or increase the risk of creditors e.g. by selling off assets of the company.

Question B2

(a) **Computation of Net Present Value (NPV) of two mutually exclusive investment projects**

Year	Project 1 (₦) Cash Flows	Project 2 (₦) Cash Flows	Discount Factor @ 15%	Project 1 Present Value	Project 2 Present Value
0	(4,000,000)	(4,100,000)	1.000	(4,000,000)	(4,100,000)
1	2,450,000	2,225,000	0.869	2,129,050	1,933,525
2	2,600,000	2,950,000	0.756	1,965,600	2,230,200
N P V				94,650	63,725

Decision: The NPV of project 1 is ₦94,650 while that of project 2 is ₦63,725. Since the NPV of project 1 is greater than NPV of project 2, the management of Fresh Ltd is therefore advised to invest in project 1.

(b) Integrity means honesty. In business, it means 'straight dealing'. If you deal with a person of integrity, you know that he or she will tell you the truth and will not try to mislead you.

A person of integrity will behave in accordance with a set of ethical values, and so will always behave in an ethical way.

Integrity is important because it creates trust. Trust is an essential requirement for the creation and maintenance of constructive relationships.

It is important in corporate governance. Directors of companies should be individuals of integrity. If they are, the shareholders will believe what the directors tell them and will trust them to govern the company in the interests of the shareholders and not in the self-interest of the directors themselves.

Integrity is also important for professional accountants, and is one of the fundamental ethical values that accountants should demonstrate at all times. If accountants are able to show integrity, they will have the trust of their employer or clients and also the trust of the general public. (This is important, in view of the responsibility of accountants to consider the public interest.)

The behaviour of directors and professional accountants can be regulated to some extent, by rules and detailed codes of conduct. However, there are many situations that are not covered by rules or detailed codes. In these situations, directors or accountants with integrity can be trusted to 'do the right thing' and act in an ethical way.

(c) Belbin did not suggest that there is an ideal number of people to make an effective team, although if a group becomes too large it will lose the characteristics of a team (social interaction and teamwork). He suggested that in the most effective teams, the team members share a number of character types (he originally identified eight and then added a ninth, the specialist). One individual might possess several character types, so that a team of less than nine people can still be effective.

He argued that without some of the character types present within the team, the team would not perform as effectively as it might. For example, without a finisher/completer, some important details might be overlooked. Without a shaper, there might be inadequate progress with the team's work. Without the monitor-evaluator, the team might reach ill-judged decisions – and so on.

Question B3

(a) McGregor suggested that there were two management styles, Theory X and Theory Y. Theory X managers were authoritarian leaders, and McGregor suggested that these individuals focused on the requirements of the job and had little concern for the concerns of their subordinates. Theory Y managers are much more concerned about the needs of their employees, and seek to involve them in decision-making.

Blake and Mouton argued that managers need not be either job-focused or people-focused. They can show high or low concern for the needs of the job and high or low concern for people. For example, they can show:

- ❑ high concern for both the job and for people
- ❑ low concern for both the job and for people
- ❑ a high concern for the job and lower concern for people
- ❑ a high concern for people and a lower concern for the job.

In practice, many managers show a medium level of concern for both aspects.

(b) The main effect of increasing a group from an established team of three to a new size of nine is that the old team is effectively brought to an end and a new team is put in its place.

Since there is a new team with new team dynamics, it will have to go through the stages of formation and development identified by Tuckman – forming, norming and storming, before it can start performing. Since three of the new team members have been doing the work for some time, the team might succeed in getting through these stages fairly quickly – although much will depend on how the team members get on with each other.

The larger team might eventually become more effective than the previous team of three. This is because they are more likely as a group to share the 'essential' characteristics of team members for an effective team – as identified by Belbin. However, the nine team members need to adopt their appropriate roles, and this will only happen if the team comes together as a positively-minded group.

(c) The characteristics which are common in all grapevine networks are:

- official communication channels are weak or management deliberately withholds information.
- social and personal interaction of the employees exists.
- mostly oral communication.
- communication is very fast.
- mostly among workers, but it is also prevalent among managers.
- flows in all directions in the organization, spatially and hierarchically.
- people-oriented rather than work-oriented.

Question B4

(a) The public interest is the collective well-being of society or the community of people and institutions in which an individual lives and works.

Showing a concern for the public interest means recognizing responsibilities to the public. For a professional accountant, the public includes employers, clients, government, investors, employees, creditors, customers, the business and financial community and all people who rely on the objectivity and integrity of professional accountants to maintain the orderly functioning of business and commerce.

Professional accountants are required to show a concern for the public interest in the work that they do. They should put the public interest before their responsibilities to their employer or clients, for example when the employer or a client is acting illegally.

Accountants also have an obligation to the public in their everyday life, because they help to create public trust in business.

The public has a right to expect that:

- auditors will try to ensure the reliability of financial statements that are issued by companies
- financial managers will help to ensure the efficient and effective use of resources by the companies or other entities they work for
- tax experts will ensure a fair application of the tax rules
- accountants will give competent business advice to management.

(b) (i) These decisions will be taken by medical staff – the doctors.

(ii) Policy on hygiene standards should be set by head office, because common standards should be applied in all five hospitals. Responsibility for enforcing the standards should be delegated to hospital management.

(iii) Scheduling operations in the operating theatres should be the responsibility of the hospital management. However, in a centralised organisation, these decisions might be taken at head office.

(iv) Decisions about discharging patients should be taken by medical staff.

(v) The policy on visiting times for patients might be decided centrally by head office management. However, policy on visiting times might be delegated to hospital management, with each hospital allowed to decide its own visiting times.

(vi) Drugs should be prescribed by medical staff. However, head office might establish policies on drugs that should not be used in the hospitals – for example because they are too expensive.

(vii) Hiring employees might be the responsibility of head office (in a centralised management structure) or hospital management (in a decentralised structure).

(viii) Dealing with medical insurance companies about payments for patients is likely to be the responsibility of an accounts department at head office, because all five hospitals would otherwise have to deal separately with the same insurance companies.

Question B5

(a) **Capital markets**

Capital markets are financial markets for primary issues and secondary market trading in long-term investments: equities and bonds. The capital markets are both national ('domestic') and international.

Many countries have at least one stock market. Although some bonds might be traded on stock markets, the main purpose of stock markets is to trade in shares of companies.

There is a primary market and a secondary market for shares.

- The primary market is used by companies to sell shares to investors for the first time, for example by issuing new shares to raise cash. The primary capital markets are therefore a source of new long-term capital for companies, governments and other organisations.
- The secondary market is used by investors to sell shares that they own, or to buy shares that are already in issue.

A successful primary market relies on a large and liquid secondary market, because when investors buy shares in the primary market, they want to know that they can sell their investment at any time at a fair market price.

(b) **Stock markets**

A stock market is a marketplace for buying and selling shares in companies that apply to have their shares traded on the exchange and whose application is accepted. It acts as both a primary market and a secondary market for shares.

The **international stock markets** consist mainly of national stock exchanges that also trade shares of some foreign companies. However the New York Stock Exchange owns Euronext which in turn owns the national stock exchanges of France, Belgium and the Netherlands.

The main functions of a stock exchange are to:

- provide a system in which shares can be traded in a regulated manner
- enforce rules of business conduct on market participants, to ensure fair dealing
- ensure that there is an efficient system for providing new financial information about companies to investors in the market

- provide a system for recording information about the prices at which shares are bought and sold, and providing share price information to participants in the market.

(c) **Trade payables**

A company should try to negotiate more favourable credit terms from its suppliers in order to delay payment. This arrangement could be either temporary or permanent.

Trade credit from suppliers has no immediate cost, and is therefore an attractive method of short-term finance being similar to an interest-free loan.

However, a company should honour its credit arrangements and pay its supplier on time at the end of the agreed credit period. It is inappropriate for a company to increase the amount of its trade payables by taking excess credit and making payments late as consequences of such a strategy might result in:

- the reduction of further credit periods
- a refusal by the supplier to supply further goods
- an attempt by the unpaid supplier to have the company wound-up

(d) **Rights issue**

A rights issue is a large issue of new shares to raise cash, by a company whose shares are already traded on the stock market.

Company law about rights issues varies between countries. Typically, any company (public or private) wishing to issue new shares to obtain cash must issue them in the form of a rights issue, unless the shareholders agree in advance to waive their ‘rights’. Large new share issues by existing stock market companies will therefore always take the form of a rights issue.

A rights issue involves offering the new shares to existing shareholders in proportion to their existing shareholding. For example, if a company has 25 million shares in issue already, and now wants to issue 5 million new shares to raise cash, a rights issue would involve offering the existing shareholders one new share for every five shares that they currently hold (5 million: 25 million = a 1 for 5 rights issue).

Question B6

(a) Hersey and Blanchard argued that managers may be involved in directive activity (giving directions and instructions) and supportive activity (supporting subordinates and helping them through guidance, encouragement and suggestion). The four leadership styles they identified are based on differing degrees of supportive and directive activity of the manager.

Style	Directive activity	Supportive activity
Delegating style	Low	Low
Telling/directive style	High	Low
Selling style	High	High
Supportive/participative style	Low	High

(b) Hersey and Blanchard argued that managers should adapt their management style to the requirements of the situation, and vary the amount of their supportive activity and directive activity. For example, they suggested that the 'selling' style, where the manager gives a large amount of direction and support, is appropriate when the manager's employees have some competence in their work, but are:

- relatively inexperienced (therefore need direction) and
- lacking in confidence (therefore need support and praise from the leader to build their self-esteem).

(c) Fiedler argued that managers by nature are either authoritarian or democratic, and the most appropriate leadership style varies with the work situation. In this respect his views are similar to those of Hersey and Blanchard. However, unlike Hersey and Blanchard, Fiedler did not believe that individual managers could adapt their style to suit the needs of the work situation. Fiedler argued that managers with the appropriate style should be appointed according to the needs of the situation. For example, when a work situation calls for authoritarian leadership, an individual who is naturally authoritarian should be appointed: a democratic type of leader would be ineffective in the same situation.

(d) McClelland developed motivational needs theory. He argued that individuals have three needs that can be met by working: a need for achievement, a need for authority and power and a need for affiliation with other people. All individuals have these needs to a greater or lesser extent, but one of the three needs is likely to be dominant in his or her character.

The most successful individuals in work, and the individuals who make the best managers, tend to be individuals whose need for achievement ('n-ach people) is strongest.