



The Institute of
Chartered Accountants
of Nigeria (ICAN)

SKILLS LEVEL EXAMINATION

2019

Mock Exam

(3 hours)

Corporate Strategic Management and Ethics

1. This paper consists of **SEVEN** written test questions of which you must answer **FIVE** questions in total.
 - Section A (40 marks) consists of **one compulsory** question
 - Section B (60 marks) consists of five 20-mark questions.
You must **answer three questions only**.
2. Ensure your candidate details are on the front of your answer booklet.
3. Answer each question in black ballpoint pen only.
4. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
5. The examiner will take account of the way in which answers are presented.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

DO NOT OPEN THE QUESTION PAPER UNTIL INSTRUCTED

Enter your candidate number in this box

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Section A: 40 marks (compulsory)

Question 1

Introduction

Network Solutions (NS) is a privately owned high technology company established in 2002 by computer engineer, Kevin Testa. It is situated in the country of Redland, a prosperous developed nation with a stable well established political system. Successive governments in Redland have promoted technology by providing grants and tax incentives. Tax credits are also provided to offset company investment in research and development. The government, like many governments worldwide, have invested heavily in a national telecommunications infrastructure. However, in 20X4 the country suffered an economic downturn that led many companies to postpone technological investment.

By 20X4 NS employed 75 full-time employees in a new, purpose-built factory and office unit. These employees were a mixture of technically qualified engineers, working in research and development (R&D), factory staff manufacturing and assembling products and a small sales and service support team.

Product areas

In 20X4, NS had three distinct product/service areas – data communication components, network management systems and, finally, technical support.

NS sells data communication components to original equipment manufacturers (OEMs), who use these components in their hardware. Both the OEMs and their customers are predominantly large international companies. NS has established a good reputation for the quality and performance of its components, which are competitively priced. However, NS has less than 1% of the domestic marketplace and faces competition from over twenty significant suppliers, most of who also compete internationally. Furthermore, one of the company's OEM customers accounts for 40% of its sales in this area.

The international market for data communication components had increased from ₦3.3 trillion in 20W1 to ₦8.1 trillion in 20X4. Forecasts for 20X5 and beyond predict growth from increased sales to currently installed networks rather than from the installation of new networks.

The maturity of the technology means that product lifecycles are becoming shorter. Success comes from producing high volumes of reliable components at relatively low prices. NS produces components in a relatively prosperous country where there is significant legislation defining maximum work hours and minimum wage rates. All new components have to be approved by an appropriate government approval body in each country that NS supplies. This approval process is both costly and time consuming.

The second product area is network management systems. NS originally supplied fault detection systems to a small number of large end-users such as banks, public utility providers and global manufacturers. NS recognised the unique requirements of each customer and so it customised its product to meet specific needs and requirements. They pioneered a modular design which allowed customers to adapt standard system modules to fit their exact networking requirements. The success of their product led to it being awarded a prestigious government technology award for "technological innovation in data communications". This further enhanced the company's reputation and enabled it to become a successful niche player in a relatively low volume market with gross margins in excess of 40%. They only have

two or three competitors in this specialist market. Unlike component manufacture, there is no requirement to seek government approval for new network products.

Finally, the complexity of NS products means that technical support is a third key business area. It has an excellent reputation for this support. However, it is increasingly difficult and costly to maintain the required level of support because the company does not have a geographically distributed network of support engineers. All technical support is provided from its headquarters. This contrasts with the national and international support services of their large competitors.

Current issues

NS currently manufacture 40% of the components used in its products. The rest of the components, including semiconductors and microprocessors, are bought in from a few selected global suppliers. Serious production problems have resulted from periodic component shortages, creating significant delays in manufacturing, assembly and customer deliveries.

NS is still a relatively immature organisation. There are small functional departments for sales and marketing, technical research and development, manufacturing and procurement. Kevin still personally undertakes all staff recruitment and staff development. He is finding the recruitment of high calibre staff a problem, with NS' small size and geographical location making it difficult to attract the key personnel necessary for future growth.

Required

- (a) Evaluate the macro-environment of NS using a PESTEL analysis. **(14 marks)**
- (b) Analyse the competitive environment that NS is competing in. **(14 marks)**
- (c) Gray, Owen and Adams (1996) provided a framework for classifying different groups of people and their views of the relationship between business organisations and society. They identified seven different positions that might be taken on the responsibility of companies towards society and the environment.

Explain briefly the nature of these seven different positions, and suggest how the analysis of Gray, Owen and Adams can contribute to an understanding of business ethics.

(12 marks)

(Total: 40 marks)

Section B: 40 marks – answer three out of five questions

Question 2

Feathers Theatre is located in a large commuter town 30 miles from Lagos. David Manning has recently been appointed as the new chief executive with a brief to improve attendances, which have fallen to their lowest level ever in recent years, with some shows only one-third full. He has put together a plan that will hopefully improve the current situation.

It is apparent that the differences in opinions held by the theatre stakeholders – e.g. actors, the local council and the theatre volunteers who help out with the running – will present problems to management and in particular to David Manning. He will have to initiate change within the theatre if the required solutions are to be introduced. This will be neither welcome nor easy to implement.

Required

- (a) Examine why the different parties might resist the introduction of new objectives and new operations. **(10 marks)**
- (b) David Manning will need to provide leadership if he is to be successful in introducing change. Discuss the key attributes he will need if he is to be a successful change agent. **(10 marks)**
- (Total: 20 marks)**

Question 3

- (a) Bobby Smythe has just been elected to the board of directors of Trans Gadgets, a large manufacturing company, as an independent non-executive director. It is his first appointment as a non-executive director, and he is not yet familiar with his role and responsibilities.

At the next board meeting, an item on the agenda is a review of risk management within the company. The board are required by the country's code of corporate governance to review each year the adequacy of the system of risk management.

Bobby Smythe is preparing a list of questions to ask at the board meeting on this topic. He wants to obtain satisfactory answers to his questions before he will be prepared to agree that the risk management system is adequate.

Required

Prepare a list of at least six questions that Bobby Smythe should ask, to help him assess the adequacy of the company's risk management system.

(9 marks)

- (b) The finance director of Basket Company is preparing a proposal to put to the board of directors. He believes that the company is much too cautious in its policy of giving credit to customers. At the moment all customers are given 30 days' credit.

He believes that by increasing its exposure to credit risk, and increasing credit terms to 60 days, the company will achieve an increase in annual sales of up to 20%. He also thinks that some improvements in debt collection procedures will reduce the level of bad debts, although some bad debts cannot be avoided. He thinks that the value of sales where there is a default will fall each year from 2% of sales to 1.8% of sales.

He believes that in order to increase annual sales and profits, the company should be willing to increase its risk appetite, and accept the risk of higher bad debts.

Required

Using this example of managing credit risk, explain and illustrate the meaning of:

- exposure to risk
- risk of losses
- residual risk
- risk appetite.

(11 marks)
(Total: 20 marks)

Question 4

In a recent case, it emerged that Les Lund, a sales director at LMN Co, had been awarded a substantial over-inflation annual basic pay award with no apparent link to performance. When a major institutional shareholder, Groover Investments, looked into the issue, it emerged that Mr Lund had a cross directorship with Joe Ng, an executive director of DEF Co. Mr Ng was a non-executive director of LMN and chairman of its remunerations committee. Groover Investments argued at the annual general meeting that there was “a problem with the independence” of Mr Ng and further, that Mr Lund’s remuneration package as a sales director was considered to be poorly aligned to Groover’s interests because it was too much weighted by basic pay and contained inadequate levels of incentive.

Groover Investments proposed that the composition of Mr Lund’s remuneration package be reconsidered by the remunerations committee and that Mr Ng should not be present during the discussion. Another of the larger institutional shareholders, Hannover House, objected to this, proposing instead that Mr Ng and Mr Lund both resign from their respective non-executive directorships as there was “clear evidence of malpractice”. Groover considered this too radical a step, as Mr Ng’s input was, in its opinion, valuable on LMN’s board.

Required:

- (a) In many countries, companies have a unitary board structure. In some countries, large companies have a two-tier board structure.
Explain the advantages and disadvantages of a unitary board structure, compared with a two-tier board structure, for large stock market companies. **(6 marks)**
- (b) Groover Investments believed Mr Lund’s remunerations package to be ‘poorly aligned’ to its interests. With reference to the different components of a director’s remunerations package, explain how Mr Lund’s remuneration might be more aligned to shareholders’ interests at LMN Co. **(8 marks)**
- (c) Evaluate the proposal from Hannover House that both Mr Ng and Mr Lund be required to resign from their respective non-executive positions. **(6 marks)**
(Total: 20 marks)

Question 5

As part of a review of its internal control systems, the board of GG co, a large textiles company, has sought your advice as a senior accountant in the company.

GG's stated objective has always been to adopt the highest standards of internal control because it believes that by doing so it will not only provide shareholders with confidence in its governance but also enhance its overall reputation with all stakeholders. In recent years, however, GG's reputation for internal control has been damaged somewhat by a qualified audit statement last year (over issues of compliance with financial standards) and an unfortunate internal incident the year prior to that. This incident concerned an employee, Miss Jenkins, expressing concern about the compliance of one of the company's products with an international standard on fire safety. She raised the issue with her immediate manager, but he said, according to Miss Jenkins, that it wasn't his job to report her concerns to senior management. When she failed to obtain a response herself from senior management, she decided to report the lack of compliance to the press.

This significantly embarrassed the company and led to a substantial deterioration in GG's reputation. The specifics of the above case concerned a fabric produced by GG Co, which, in order to comply with an international fire safety standard, was required to resist fire for ten minutes when in contact with a direct flame. According to Miss Jenkins, who was a member of the quality control staff, GG was allowing material rated at only five minutes fire resistance to be sold labelled as ten minute rated. In her statement to the press, Miss Jenkins said that there was a culture of carelessness in GG and that this was only one example of the way the company approached issues such as international fire safety standards.

Required:

- (a) Describe how the internal control systems at GG Co differ from a 'sound' system of internal control, such as that set out in the Nigerian Corporate Governance Code, for example. **(5 marks)**
 - (b) Define 'reputation risk' and evaluate the potential effects of GG's poor reputation on its financial situation. **(5 marks)**
 - (c) What is the main difference between a rules-based and a principles-based code of professional ethics for accountants? **(5 marks)**
 - (d) Explain, with reference to GG as appropriate, the ethical responsibilities of a professional accountant both as an employee and as a professional. **(5 marks)**
- (Total: 20 marks)**

Question 6

At a recent conference on corporate social responsibility, one speaker (Professor Li) argued that professional codes of ethics for accountants were not as useful as some have claimed because:

“They assume professional accountants to be rules-driven, when in fact most professionals are more driven by principles that guide and underpin all aspects of professional behaviour, including professional ethics.”

When quizzed from the audience about his views on the usefulness of professional codes of ethics, Professor Li suggested that the costs of writing, implementing, disseminating and monitoring ethical codes outweighed their usefulness. He said that as long as professional accountants personally observe the highest values of probity and integrity then there is no need for detailed codes of ethics.

Required

- (a) Explain and contrast a deontological with a consequentialist based approach to business ethics. **(5 marks)**

 - (b) With reference to Professor Li’s comments, explain what is meant by ‘integrity’ and assess its importance as an underlying principle in corporate governance. **(5 marks)**

 - (c) Critically evaluate Professor Li’s views on codes of professional ethics. Use examples of ethical codes, where appropriate, to illustrate your answer. **(10 marks)**
- (Total: 20 marks)**

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