

General Comments

Overall, performance was in line with expectations. Well prepared candidates were capable of obtaining very clear passes. Weaker candidates tended to avoid the requirements of the question, either through a failure to grasp what was required or as an attempt to obtain marks for repetition of memorised facts and information.

Generally one of the main problems was a failure to relate the answers to the situation portrayed in the question. Good marks were achieved by candidates who did this.

There was a tendency for the choice in the optional section to be biased towards discursive rather than numerical questions. While candidates should always select the questions with which they feel most comfortable, those preparing for future diets should take care to ensure that they are capable of performing all the calculations which may be required in the syllabus.

Note that the attached marking scheme often makes more marks available than indicated on the question paper. This reflects the fact that questions at this level can often be approached in more than one way and that there is no single “perfect” answer. In applying this marking scheme, marks are always restricted to the total offered by the question and so there is no advantage to be gained from over-developing the answer to one question at the expense of another that may appear more difficult.

SECTION A – 50 MARKS
ANSWER THIS QUESTION

Question 1

- (a) Identify and evaluate the existing controls within VCF (including those applied by Viktor).

(20 marks)

- (b) Write a report to the Board of VCF recommending improvements to the company's corporate governance, risk management strategy, and internal controls.

Note: You should use examples from the case to illustrate your answer.

(20 marks)

- (c) Identify the exchange risks faced by VCF and recommend the methods that could be used to manage those risks.

(10 marks)

(Total for Question One = 50 marks)

Rationale

Question One is designed to test the candidate's ability to identify and evaluate a range of internal controls, including those that are financial and non-financial, qualitative as well as quantitative. The question further tests the candidate's ability to recommend improvements to corporate governance, risk management strategy and internal controls. This requires the candidate to apply knowledge of best practice in these areas to the facts of the case. The syllabus topics being tested are widespread, covering A (i), (iii) & (iv), B (iv), (v) and (vii), C (v) and (vi), D (i), (ii) and (vi). The question meets the learning outcomes by providing a case study of a small multinational distribution organisation that is controlled by a dominant individual. Candidates are expected to apply their understanding of management control, risk and internal controls to this case.

Suggested Approach

- a) This question is about identifying the controls that are described in the scenario. This includes non-financial and qualitative controls, not just financial controls. The question asks candidates to identify and evaluate. Most marks are given for evaluation, for example the strengths and weaknesses of the main controls. It is not necessary to discuss risks in detail here, although a brief mention of the major risks may help candidates in their evaluation, i.e. do the controls actually address the key risks or not. In answering the question, candidates need to recognise the social controls exercised by Viktor. Answers need to be specific, i.e. clearly related to the case, not general.
- b) This question requires candidates to give equal emphasis to each of corporate governance (especially the role and function of the Board); risk management strategy; and internal controls. A good report is likely to utilise the evaluation in the answer to part (a) but needs to make specific recommendations for improvement. It is insufficient to identify weaknesses in existing governance, risk management strategy and internal controls. Recommendations need to be specific, e.g. 'establish a risk register and assess risks by considering their likelihood and impact', rather than general such as 'improve risk management procedures'. Although marks are not allocated for a report format, a report format will help candidates focus on the important aspects of the case in making specific recommendations to the Board.
- c) Although using a general classification structure such as transaction, translation and economic risk may be helpful, candidates are expected to identify the particular exchange risks faced by VCF and recommend methods for managing those particular risks.

For each of parts (a), (b) and (c), candidates are required to apply their knowledge to the facts of the case, and it is insufficient to merely repeat either facts from the case or material from the study packs.

Marking Guide

	Marks
(a) Identify AND evaluate existing controls	20
(b) Recommendations (up to 8 marks for each of corporate governance, risk management strategy and internal controls)	20
(c) Identify AND recommendations (up to 4 marks for each risk)	10

Examiner's Comments

This question was reasonably well done.

The best scripts synthesised corporate governance frameworks with the specifics of the question whereas weaker answers listed these points without connecting them to the scenario.

A failure to evaluate the controls in part (a) led to poorer marks than expected for this section.

The candidates were expected to discuss the specific controls and problems in the scenario not any others.

Candidates who only discussed hedging instruments in part (c) did not achieve high marks.

Common Errors

Part (a) Most candidates identified existing controls but then failed to evaluate them. Good marks could only be achieved by in depth evaluation of the existing controls. The controls also had to be related to the case.

Part (b) This part was generally well done. Detailed recommendations were required for each area highlighted in the question and most candidates achieved this. Many candidates in discussing risk management merely re-iterated the text book "PEST" acronym without relating it to the question.

Part (c) This part was slightly poorer with many candidates only discussing various hedging instruments; this approach did not achieve high marks. Some candidates failed to discuss the problems identified in the scenario and discussed translation risk in great detail even although it did not affect VCF greatly.

SECTION B – 50 MARKS
ANSWER TWO QUESTIONS ONLY

Question 2

- (a) Explain the role of internal audit in internal control and risk management. (5 marks)
- (b) Analyse the potential risks faced by SPQ that have been exposed by the review of IT security and recommend controls that should be implemented to reduce them. (8 marks)
- (c) Discuss the issues that need to be considered when planning an audit of activities and systems such as the one undertaken at SPQ. (5 marks)
- (d) Explain the ethical principles you should apply as the Head of Internal Audit for SPQ when reporting the results of this internal review and how any ethical conflicts should be resolved. (7 marks)
- (Total for Question Two = 25 marks)*

Rationale

Question Two is designed to test the candidate's ability to explain the role of internal audit and to analyse and discuss the risks exposed by the internal audit of security in a newly implemented computer system. The question further tests the candidate's ability to apply CIMA's ethical guidelines to the case. The syllabus topics being tested are mainly B (i) and (iii), C (ii), (iv) & (vii), E (iv) & (v). The question meets the learning outcomes by providing a scenario in which the Head of Internal Audit has to address the risks of an inadequately designed IT system in which there are ethical issues surrounding how these risks and weaknesses are reported. Candidates are expected to apply their understanding of risks, internal control, internal audit and ethics to the scenario.

Suggested Approach

- a) Candidates need to explain the role of internal audit in relation to internal control and risk management. It is insufficient to merely describe each of these, but to demonstrate an understanding of how internal audit is used in each of the internal control and risk management processes. This question can be answered in general terms, without regard to the scenario in the case.
- b) The question requires candidates to interpret the risks faced by SPQ in the scenario. Candidates are expected to recognise the three categories of possible risk emerging from the review described in the scenario: failures in the systems development process; network failures resulting in possible hacking; and fraud, whether by employees or customers. Candidates should then analyse (i.e. examine in detail) each of these categories of risk.
- c) Candidates need to demonstrate an understanding of audit planning generally, although the scenario may be helpful in illustrating the importance of audit planning.
- d) The question requires candidates to demonstrate an understanding of the principles found in CIMA's Ethical Guidelines, and then to apply those principles to the facts of the case.

Marking Guide	Marks
(a) Role of internal audit	5
(b) Up to 4 marks for analysis of each of the three major areas of risk (systems development, network/operations, & fraud)	8
(c) Discussion of issues in planning an audit	5
(d) Explanation of ethical principles AND application to case	7

Examiner's Comments
<p>This was one of the most popular of the optional questions and was well done by a substantial number of the candidates.</p> <p>The main problem encountered was where candidates failed to apply their knowledge to the case. General essays on ethics got poor marks. Good answers specifically discussed the problems in the scenario.</p> <p><i>Common Errors</i></p> <p>Part (a) Some candidates merely described internal control and risk management and failed to explain the role of internal audit in each.</p> <p>Part (b) This part of the question was generally well done.</p> <p>Part (c) This part of the question was well done by most candidates although few attempted to apply audit planning to the case. Most candidates simply replicated text book answers.</p> <p>Part (d) This part was poorly done by a number of candidates. Many had very short bullet point answers and made no attempt to apply the ethical principles to the case.</p>

Question 3

- (a) Identify the additional risks that the doctors' practice may expect to face as a consequence of the introduction of the new facility, and explain how a model such as CIMA's risk management cycle might be used to understand and control such risks. (12 marks)
- (b) Explain the meaning of the term "risk appetite" and discuss who should take responsibility for defining that appetite in the context of the scenario outlined above. (5 marks)
- (c) Critically discuss the role of systems based internal auditing in relation to the assessment of risk management procedures in any organisation. (8 marks)

(Total for Question Three = 25 marks)

Rationale

Question Three is designed to test the candidate's ability to identify risks within a particular context, explain possible tools for their control, and discuss the appropriateness of systems based internal audits for monitoring risk controls. The syllabus topics being tested are mainly B (Risk and Internal Control) and C (ii) and (iv) on internal audit. The learning outcomes are achieved by the creation of a mini scenario of a doctors' practice that is expanding into a new area of work that carries different risks. Candidates are thus required to apply their knowledge of risk identification, risk management and internal audit to a specific case.

Suggested Approach

- a) The key requirement here is to *apply* core knowledge, and this requires both some reflective thought and a recognition that common sense will help in drafting an answer. One way of approaching this would be to list the various categories of risks that you know from reading textbooks and then think about which specific categories might be affected by the introduction of day surgery facilities. The problem with this method is that you can get caught up in the limitations of the categories that you have learned. An alternative approach, which is the one used in the suggested solution, would be to simply identify all the factors you can think of that would change and potentially create new risks as a result of the new facility. Discussion of the CIMA risk management cycle, or an equivalent model should be used to explain how risk management involves the use of a control loop, which ensures the continual review of new risks and the effectiveness with which they are managed. It is important to ensure that you apply the description/explanation to the scenario in the question – a theoretically based application will lead to reduced marks.
- b) The requirement here is very clearly specified, and the definition does not have to be regurgitated word for word from a study text. Understanding the syllabus will mean that you can create your own definition. Responsibility for defining risk appetite ALWAYS rests with the senior management in an organisation e.g. Board of Directors, and so in this case it lies with the practice partners.
- c) This is not an answer that you can waffle your way through – you either know about systems based auditing or you don't, although a bit of common sense should give you some hint of what it is about. You should explain the systems that are used in risk management and clearly specify how they might be audited. The explanation will highlight the different roles played by risk managers and internal audit in the control of risk.

Marking Guide	Marks
(a) Additional Risks identified	6
Explanation of risk management cycle and its application to the scenario	6
(b) Explanation and discussion of the term risk appetite	5
(c) Explanation of systems based audit	3
Critical discussion in relation to risk management	5

Examiner's Comments
<p>This was by far the least popular of the optional questions and was not particularly well done. It was surprising how very few candidates mentioned the CIMA risk management cycle or appeared to know what it was. Many candidates failed to appreciate that the medium sized doctors' practice only did minor surgery not general surgery, which led to some unrealistic answers.</p> <p>Part (c) caused candidates huge problems and very few had acceptable answers.</p> <p><i>Common Errors</i></p> <p>Part (a) Candidates did not read the question closely and some gave answers which were unrealistic. Lack of knowledge of the CIMA risk management cycle was a problem. Or knowledge of any other credible risk management model.</p> <p>Part (b) This question was well done.</p> <p>Part (c) This part was very poorly answered. Very poor level of knowledge on systems based auditing or any other alternative approaches. Very vague answers by the majority of candidates who did this question.</p>

Question 4

- (a) Discuss the factors that should be taken into account by the Treasurer of LXN when deciding whether to raise fixed rate or floating rate debt for the expansion project and whether to hedge the resulting interest rate exposure.

(10 marks)

(b)

- (i) Briefly discuss the advantages and disadvantages of interest rate swaps as a tool for managing interest rate risk.

(5 marks)

- (ii) Draw a diagram to illustrate how the transactions between LXN and MGV and the two lenders will operate if the swap is agreed.

(4 marks)

- (iii) Calculate the interest rate terms payable by LXN. Evaluate the potential annual saving resulting from borrowing at a fixed rate and engaging in an interest rate swap, as against a straightforward floating rate loan.

(6 marks)

(Total for Question Four = 25 marks)

Rationale

Question Four tests a candidate's understanding of the tools that may be used to manage interest rate risk. Within the context of a scenario that contains information on a company's existing capital structure, the first part of the question requires discussion of the relative merits of using fixed or variable rate borrowing to fund an expansion project. The syllabus topic being tested is D (i) (Management of Financial Risk). The second part of the question, which also carried more marks, tests understanding of the use of swaps to manage interest rate risk. The syllabus topics being tested are D (ii) and (iii). The separate elements of the sub-question on interest rate swaps test both theoretical and application skills, including computation.

Suggested Approach

- a) As with Question Three, the correct approach is to apply your knowledge to the specific context and avoid answering the question from a purely textbook perspective. List the issues that matter in comparing fixed versus floating rate debt, and deciding whether or not to hedge – relative cost; risk; scale of the borrowing; interest rate forecasts etc and then discuss these in the specific context given in the question. Don't forget there are two elements to the question.
- b) The mark split between the different parts of (b) is small and so be careful about allocation of time. In particular do not spend too long on drawing the diagram for part (ii) as it carries the least marks. In (i) remember to identify disadvantages as well as advantages of swaps. In (iii) the quickest way of computing the saving is to firstly work out the new interest rate, and then simply multiply the sum borrowed by the incremental saving of 0.1%.

Marking Guide	Marks
(a) Two marks for each factor identified AND discussed.	10
(b) Advantages and disadvantages	5
Diagram	4
Net interest rates payable	4
Resulting saving	2

Examiner's Comments

This question was the second least popular. Some excellent answers to this question and some dreadful ones. It was disappointing to note a lack of understanding of interest rate swaps. Some very poor attempts at calculations. There are very few numerical topics in the syllabus but it is important that candidates are prepared for these. Had this been a compulsory question the results would have been very variable.

Common errors

Part (a) Most candidates could identify factors which might influence the treasurer's decision but did not discuss them in any detail. Higher marks could have been achieved with more focussed discussion.

Part (b) Presentation of the diagram was generally poor.
Many candidates could not perform the calculations required. There were some very poor attempts.

Question 5

- (a) Identify the key reasons for the emergence of corporate governance regulations around the world.
(5 marks)
- (b) Explain the core principles that underpin corporate governance regulations.
(10 marks)
- (c) Discuss the role and responsibilities of audit committees as laid down in the Combined Code.
(10 marks)

(Total for Question Five = 25 marks)

Rationale

Question Five is a straightforward test of knowledge of corporate governance regulations and falls into syllabus section B (vii) on risk and internal control. Parts (a) and (b) of the question are phrased in a generic style that tests overall understanding of the reasons for the development of governance regulations and requires discussion of their link to risk management. Part (c) requires more detailed understanding of the UK regulations as laid down in the Combined Code with specific reference to the role of the audit committee.

Suggested Approach

- a) Do not get bogged down in discussing the question from the angle of one specific geographical location – the question takes a global perspective and so should your answer. The reasons behind tighter regulations lie in poor transparency and a need to renew shareholder confidence via greater accountability.
- b) The core principles can be divided into various categories that can be used as a framework for your answer – there are the role and appointment of directors, and their remuneration arrangements; accountability and audit and relations with shareholders.
- c) Role and responsibilities are separate components in this question and both must be addressed in order to gain maximum marks. Your answer should make specific reference to the requirement for an audit committee under the Combined code, and detail its separate responsibilities in respect of both internal control and the external auditors.

Marking Guide

	Marks
(a) Reasons for emergence of regulations	5
(b) Core principles – identification AND explanation in each case	10
(c) Roles and responsibilities of the audit committee as per the Combined code – marks for each point identified and discussed	10

Examiner's Comments

This question was generally very well done. There were some excellent answers. Most candidates did very well particularly in part (c).

Common Errors

Part (a) Some candidates only mentioned recent corporate scandals and did not get high marks as a wider answer was expected. Some discussion of other factors was required.