
Answers

1 (a) Seven-step (AAA) model

Step 1: What are the facts of the case?

The facts are that the Mary Jane, one of the company's ships, has sunk and that one contributory cause of the disaster was that the ship had not received the necessary modifications for operating in the rougher seas between Eastport and Northport. Had the recommended structural changes been made, the Mary Jane would not have sunk.

Step 2: What are the ethical issues in the case?

The ethical issues are whether to disclose the information publicly, thereby providing bereaved families with a better explanation of why their loved ones died (and potentially opening the company up to greater liability), or to conceal the information, thereby limiting the value of any punitive damages and protecting shareholder value, at least in the short term.

Step 3: What are the norms, principles and values relevant to the case?

The company is bound by the norms and expectations of its stock exchange and it has voluntarily claimed to have 'the highest standards of corporate ethics', particularly valuing its reputation for 'outstanding customer care'. This means that it owes an implicit and explicit duty of care to both its customers and its shareholders. As a company that seemingly values its reputation as a well-governed organisation, it is also bound by the underlying principles of corporate governance that include integrity, probity and transparency. Health and safety issues are also very important in all shipping operations and Sea Ships should ensure that all of its ferries are compliant with the highest health and safety standards.

Step 4: What are the alternative courses of action?

Alternative 1 is to disclose the information about the advice on structural work to the Mary Jane to the media, the government and the bereaved families. Alternative 2 is to seek to suppress the information within the company and hope that there is no leak.

Step 5: What course of action is most consistent with the norms, values and principles identified in step 3?

The information is material to a number of parties' better understanding of why the Mary Jane sank. The bereaved families, maritime accident investigators, the government, the ship's insurers and other shipping companies would all benefit from having the information. Disclosure would seem to be the most appropriate course of action notwithstanding the potentially unfortunate consequences for Sea Ships Company of this information leaking out. However, disclosure may result in greater penalties which will be harmful to shareholder value.

Step 6: What are the consequences of each possible course of action?

If the company makes the disclosure, there is a risk that the punitive damages (not yet agreed by the court) would be higher. The case says that 'the size of [the punitive damages] would ... reflect the scale of Sea Ships' negligence in contributing to the disaster'. A large enough fine would threaten future cash flows and hence future shareholder value. It would also threaten employees' jobs and the ability of the company to continue to provide the existing level of service to customers. Disclosure would potentially invalidate any insurance policy they had to deal with such a disaster, further harming shareholder value.

If the company were to suppress the information, then each person in possession of the knowledge would not only have to examine his or her own responsibilities in the matter but each would also have potentially damaging information if they were to leave Sea Ships or become disillusioned with it. The consultant who recommended the upgrade will also be a potentially major risk in the leaking of the information.

Step 7: What is the decision?

Alternative 1 is that the company should make a full and detailed disclosure, probably with an acceptance of full responsibility for the failure to make the necessary amendments to the ship. This would be a very costly choice but would be consistent with the company's claimed ethical values and also with the important core values of corporate governance (integrity, transparency, etc).

Alternative 2 is to suppress the information and take all necessary measures to ensure that it is not revealed. This would be a very risky option as the cost to the company and to the directors personally, if the information was ever to emerge, would be very serious. It would also be against the letter and spirit of the core values of corporate governance. It would be unlikely to protect shareholder value in the longer term, is the least ethical of the options and so should be avoided.

[Tutorial note: it is possible to argue for suppression of the report in the short term protection of shareholder value. Allow some marks for logic of reasoning process if coherently argued but alignment with the stated values of the company does not allow for suppression as a final decision.]

(b) Identify and analyse the internal control failures at Sea Ships Company and on the Mary Jane

The case describes internal control failures both on the Mary Jane herself and also at Sea Ships' head office.

The company *ignored important advice about necessary structural changes needed to the Mary Jane* to make her seaworthy for the Northport route. If there was an internal procedure for processing advice, presumably as a part of an economic evaluation of transferring the Mary Jane to the Northport route, then it was clearly ineffective. The document identified a major risk, but had been suppressed within the company and not brought to the attention of any party who could have authorised this to go ahead.

At head office, an *'oversight in the company's legal department'* resulted in the full value of the Mary Jane's liabilities not being insured. Presumably a human error, this created uninsured liabilities for Sea Ships after the Mary Jane sank. All

insurance policies should be reviewed annually and major changes in cover or changes of terms be recommended to the board so that issues like this do not arise. All insurance policies should be reviewed annually and major changes in cover or changes of terms be recommended to the board so that issues like this do not arise.

On the Mary Jane herself, lax internal controls produced four internal control problems. There should be a 'safety first' culture on board all ships in which safety considerations outweigh all commercial issues such as meeting schedules.

First, a system put in place to ensure that each department head signalled readiness for sea departure was abandoned. This is an example of a 'reporting by exception' system being wrongly assumed to be appropriate. Internal control reporting systems are there because they are important and the fact that they may be inconvenient should not be a reason for abandoning them.

Second, there was a 'mistake' in loading vehicles onto the car deck. A sound internal control system would have ensured that such a mistake could not have happened, possibly using physical 'fit' issues of loading ramps, appropriate signage, staff training, or similar mechanisms to ensure compliance. The result of the 'mistake' was that it created time pressure to leave the port and this contributed to the oversight of the rear doors not being secured and, possibly, the excess speed after leaving port.

The third internal control problem on the Mary Jane was the *confusion over responsibility for ensuring that the rear doors were closed* – a key safety procedure for any ferry. It is baffling that two people were, seemingly simultaneously, responsible for this and is a problem created by the poor design of internal reporting systems. According to the case, both had assumed that the other person was checking the doors.

The fourth problem was that the Mary Jane was *going too fast* and exceeding the maritime rules about speed in that section of sea. This created swell and caused turbulence at the back of the ship. This, in turn, caused water to enter the ship that wouldn't have been the case at lower speed. This was a failure to observe regulatory speed restrictions on the part of senior ship officers.

(c) Contribution that NEDs might make

The board of Sea Ships appears to be in need of help on a number of issues, some of which may be addressed by the use of non-executive directors.

Mrs Chan's conclusions noted that the board *lacked independent scrutiny*. One of the most important purposes of any non-executive appointment is to bring an outside perspective (sometimes acting as a 'corporate conscience') on what can at times be an insular executive culture. In the case of Sea Ships, a number of important internal control issues went unchallenged and a strong non-executive presence could have helped that.

Also mentioned by Mrs Chan was the fact that the board *lacked nautical and technical expertise*. This is a disturbing finding as some detailed knowledge of a company's products or operations is very important in guiding discussions about those parts of the business. *The non-executive appointment of serving or retired senior ferry operating personnel from other companies would rectify this* and bring the requisite level of expertise.

The Combined Code in the UK (based on the Smith Report) and other statutory and advisory codes of corporate governance, specify that every listed company should have an audit committee made up entirely of non-executive directors. The functions of the committee, according to the Combined Code, include reviewing *'the company's internal control and risk management systems'* and monitoring and reviewing *'the effectiveness of the company's internal audit function'*. *Both of these are deficient at Sea Ships* and so an effective audit committee would be a major contribution. We are not told if the company currently has one but we can assume that if it has, it is ineffective.

There are *legal compliance issues at Sea Ships*, including a failure to enforce the observation of maritime speed limits among its senior ships' officers. One of the advantages of any independent non-executive presence is the enforcement of regulatory and legal rules on company boards with the knowledge that all directors, including *non-executives, can be held legally accountable for non-compliance*.

(d) Memo

(i) Importance of information on operational internal controls and risks

From: Wim Bock (CEO)

To: all Sea Ships senior officers

Date: 14 December 2009

Re: information on internal control and risks following the loss of the Mary Jane

Colleagues,

I know you all share with me and the other directors our heartfelt sorrow at the sinking of the Mary Jane with so many lives being lost. Our deepest sympathies go out to the families and friends of all those involved. In the light of the tragic loss, the board felt it vital to write to you all at this time to remind you all of a number of crucial aspects of internal control and risk.

First, I wanted to make clear to you all why the flow of information upwards to the board on matters of internal control and risk is so important. We feel that one contributory factor in the loss of the Mary Jane was a lack of information flow on relevant issues hence my writing to you about this at this time.

In the first instance, the information provided enables the board to *monitor the performance* of the company on the crucial issues in question. This includes compliance, performance against targets and the effectiveness of existing controls. We, the board, need to know, for example, if there are issues with internal controls on board our ships, in ports or in any other area of ships' operations. By being made aware of the key risks and internal control issues at the operational level, we can work with you to address them in the most appropriate way.

We also need to be aware of the business impact of operational controls and risks to enable us at board level to *make informed business decisions* at the strategic level. If we are receiving incomplete, defective or partial information then we will not be in full possession of the necessary facts to allocate resources in the most effective and efficient way possible.

You will be aware that at board level we have the responsibility to *provide information about risks and internal controls to external audiences*. Best practice reporting means that we have to provide information to shareholders and others, about our systems, controls, targets, levels of compliance and improvement measures and we need quality information to enable us to do this. This brings me to the second purpose of this memo.

(ii) Qualitative characteristics of information needed

Secondly, I want to write to you about the most helpful ways in which to convey this crucial information to us. The information we receive on risks and internal controls should be high quality information. This means that it enables the full information content to be conveyed to the board in a manner that is clear and has nothing in it that would make any part of it difficult to understand. In particular I would ask that you consider that your communications should be reliable, relevant and understandable. They should also be complete.

By *reliable* I refer to the trustworthiness of the information: the assumption that it is 'hard' information, that it is correct, that it is impartial, unbiased and accurate. In the event that you must convey bad news such as some of the issues raised by the loss of the Mary Jane, we expect you to do so with as much truthfulness and clarity as if you were conveying good news.

By *relevant* I mean not only that due reports should be complete and delivered promptly, but also that anything that you feel should be brought to the board's attention, such as maritime safety issues, emergent risks, issues with ports, etc. should be brought to our attention while there is still time for us to do something about it. In the case of the Mary Jane there were technical issues with the fit of the ship with her berth at Eastport that were important and we should be made aware of such problems as soon as possible.

Not all directors of Sea Ships possess the technical and nautical knowledge of senior operating personnel on board the ferries. It is therefore particularly important that information you convey to us is *understandable*. This means that it should contain a minimum of technical terms that have obvious meaning to you on board ships, but may not be understandable to a non-marine specialist. All communication should therefore be as plain as possible within the constraints of reliability and completeness. This brings me to my final point.

By *complete*, I mean that all information that we need to know and which you have access to, should be included. Particularly with relevance to on-board accidents or risks, you must convey all relevant information to us regardless of the inconvenience that it may cause to one or more colleagues.

As we have learned at the highest cost to those involved in the loss of the Mary Jane and to ourselves commercially, the flow of information on controls and risks is of vital importance to us. Timely receipt of, and appropriate response to, high quality information is not only important to the safe operation of the ships but also to the company itself.

Thank you very much for your understanding and full co-operation on behalf of Sea Ships.

Wim Bock
Chief executive

[Tutorial note: candidates may express similar information qualities in different ways in part (ii).]

2 (a) Director's induction programme

The overall purpose of induction is to minimise the amount of time taken for the new director to become effective in his or her new job. There are four major aspects of a director's induction.

To *convey to the new starter, the organisation's norms, values and culture*. This is especially important when the new employee is from a different type of culture. Because Sam moved from a different country to join Ding Company, he had to adjust to a new national culture as well as a new corporate culture. There is evidence from the case that he *misunderstood some of the cultural norms* in that it was alleged that he made what he considered normal but what was perceived as an inappropriate remark to a young female employee. An induction programme including content on culture and norms may have prevented this situation from occurring.

To *communicate practical procedural duties to the new director including company policies* relevant to a new employee. In Sam's case this would involve his orientation with his place in the structure, his reporting lines (up and down), the way in which work is organised in the department and practical matters. In the case scenario, Sam *made a simple error in the positioning of his office furniture*. Again, this is an entirely avoidable situation had the induction programme provided him with appropriate content on company policy in this area.

To convey an understanding of the nature of the company, its operations, strategy, key stakeholders and external relationships. For a new director, an early understanding of strategy is essential and a sound knowledge of how the company 'works' will also ensure that he or she adapts more quickly to the new role. In the case of a financial controller such as Sam, key external relationships will be with the company's auditors and banks. If Sam is involved in reporting, the auditor relationship will be important and if he is involved in financing, the banks and other capital providers will be more important.

To establish and develop the new director's relationships with colleagues, especially those with whom he or she will interact on a regular basis. The importance of building good relationships early on in a director's job is very important as early misunderstandings can be costly in terms of the time needed to repair the relationship. It is likely that Sam and Annette will need to work together to repair an unfortunate start to their working relationship as it seems that one of her first dealings with him was to point out his early misunderstandings (which were arguably due to her failure to provide him with an appropriate induction programme).

(b) Critically evaluate Annette's belief

Countries differ in their employment of various types of board structure. Companies in the UK and US have tended towards unitary structures while Japanese companies and some European countries have preferred two-tier or even multi-tier boards. The distinction refers to the ways in which decision-making and responsibility is divided between directors. In a unitary structure, all of the directors have a nominally equal role in board discussions but they also jointly share responsibility (including legal responsibility) for the outcome of those discussions. On a two tier board, the senior board acts as a 'kitchen cabinet' in which decisions are concentrated whilst other directors, typically departmental managers, will be on the 'operating board' and brought into board discussions where the senior (upper tier) board deem it appropriate.

There are some arguments in favour of the adoption of a two-tier structure in turbulent environments. As the case implies, turbulent and dynamic environments change often and strategic leadership is partly about continually adjusting strategy to optimise the company's fit with its environment. A smaller board can act quick and decisively in a way that larger and more cumbersome boards cannot. This is because meetings of larger numbers of people require excessive consultation, discussion and debate before a decision can be reached. When a decision needs to be taken quickly, this can be inconvenient. The meeting of a small number of people is therefore easier, cheaper and quicker to arrange because there are fewer diaries to match. As these arguments focus on both the efficiency and effectiveness of strategic decision-making, Annette has a strong case for supporting two-tier boards.

The arguments against two-tier boards are as follows. In any complex situation where finely balanced judgments are made, such as making strategic decisions in turbulent environmental conditions, input from more people is likely to provide more views upon which to make the decision. Where, say, technical, detailed financial or operational details would be of benefit to the decision then a larger board would be likely to provide more feedback into the decision making process. The second reason is that decisions taken by a corporate board with little or no consultation with the operating board may not enjoy the full support of those key departmental directors who will be required to implement the decision. This, in turn, may cause friction, discord and resentment that will hinder good relations and thus impede the implementation of the strategy. Additionally, without a full understanding of operations, an inappropriate decision may be taken by the corporate board and unworkable procedures implemented. Finally, Annette is quite an autocratic personality and the two-tier board may be little more than a device to grant her excessive powers over company strategies and activities.

(c) Arif Zaman's understanding of his role

The first observation to make is that overall, Arif Zaman has a poor understanding of his role as chairman and poorly represents the interests of Ding's shareholders. He doesn't seem to understand his role as intended by Cadbury, Sarbanes Oxley and other influential codes on corporate governance.

It appears from the case that he cedes too much power to Annette. One of the purposes of having a separate chairman is to avoid allowing the chief executive to operate without recourse to the chairman. The chairman, along with the non-executive directors, should hold the chief executive to account.

Arif allowed Annette's views to take effect on matters such as board structure. Arif is legally head of the board and not Annette. Ding's shareholders have a reasonable expectation that Arif will personally ensure that the strategic oversight of the board will be a matter for the chairman who is, notionally at least, an independent non-executive director.

Being old friends with Annette threatens Arif's independence as chairman. Is he acting as a representative of the shareholders or as Annette's friend? He seems to be doing the job as a favour to Annette and seems to see no intrinsic value in his role in terms of acting to provide checks and balances on the activities of the executive board and the chief executive in particular.

Arif seems to view the chairing of board meetings as optional. He said that he saw his role as 'mainly ceremonial' and that he 'chaired some board meetings when he was available'. Both of these attitudes are inappropriate and demonstrate an underestimation of the importance of the chairman in leading the company and its strategy.

3 (a) Integrity

The IFAC code of ethics (2005) s.110.1 explains integrity as follows:

The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness.

Integrity is therefore a steadfast adherence to strict ethical standards despite any other pressures to act otherwise. Integrity describes the personal ethical position of the highest standards of professionalism and probity. It is an underlying and underpinning principle of corporate governance and it is required that all those representing shareholder interests in agency relationships both possess and exercise absolute integrity at all times.

In terms of professional relationships, integrity is important for the following reasons:

It provides *assurance to colleagues of good intentions and truthfulness*. It goes beyond any codes of professional behaviour and describes a set of character traits that mean a person of integrity can be trusted. For auditors such as Potto Sinter, integrity means not only observing the highest standards of professional behaviour but also maintaining the appearance of integrity to his own staff and also to the client.

It *reduces time and energy spent in monitoring* when integrity and openness can be assumed (the opposite of an audit situation where the professional scepticism should be exercised). Costs will be incurred by Miller Dundas if colleagues feel that Potto Sinter is untrustworthy.

It *cultivates good working relationships* in professional situations. It encourages a culture of mutual support that can have a beneficial effect on organisational effectiveness. John Wang's professional relationship with Potto is very important to Miller Dundas. It is important, therefore, that Potto has personal integrity.

[Tutorial note: other professional relationships may also be discussed.]

(b) Criticise Potto Sinter's ethical and professional behaviour

The first criticism of Potto's behaviour in the case is that it gives rise to the *appearance of unprofessionalism and possibly of corruption*. \$100,000 is a substantial amount but notwithstanding the amount, the allocation of company funds on what appears to be a home improvement on a director's house should be robustly challenged. It is possible that Potto is acting without integrity in this matter.

Potto's failure to act on the information strongly suggests that he has *failed in his duty to other shareholders of Mbabo and to tax and other state authorities*. The audit is for the benefit of several parties including shareholders and government/tax authorities and it is therefore vital that the information signed off is fairly presented ('true and fair' in the UK). Being fairly presented is normally evidenced by following all accounting standards. Other shareholders might be very intrigued to know why one director, even though a shareholder himself, has used company funds for his own private purposes.

The comment on the clearance document appears to be evidence that Potto *accepted a weak explanation from Mr Mbabo* or was prepared not to put any pressure on Mr Mbabo for other reasons (perhaps for reasons of an ethical threat such as familiarity, intimidation or self-interest threat or similar). Potto gave the appearance of a lack of objectivity in his actions, possibly as a result of the threats to independence. Auditors should be objective at all times.

Potto *failed to satisfy the queries of, and to work well alongside, other important members of the audit team*. Being able to be a leader of, and a member of, a team of people is an important part of professional behaviour and Potto's summary dismissal of Lisa's question after the sign-off was unprofessional and unhelpful.

As a senior member of the firm, Potto set a *poor example to junior colleagues*, such as Lisa, in his behaviour. Not only did he show evidence of poor audit practice but he also failed to satisfy Lisa's entirely justified curiosity over the matter.

Potto is complicit in a probable *breach of IAS 24/FRS 8 on related party transactions*. There is a disclosure requirement of all related party transactions regardless of value, and concealment of this is both unprofessional and technically irregular. Lack of disclosure should have led to a qualified opinion, a disagreement, on the audit report.

[Tutorial note: some candidates may refer to IAS 24/FRS 8 on related party transactions. Candidates may refer to a disagreement leading to a qualified opinion on the audit report. It is possible to get full marks on this part without referring to IAS 24/FRS 8 but reward appropriate reference up to 2 marks. Knowledge of IAS 24/FRS 8 is not necessary but is allowable.]

(c) John Wang's ethical dilemma

John Wang may attempt to resolve his ethical dilemma in the following two ways. The two alternatives are:

To *confront Potto* directly to see if the matter can be resolved in a professional manner between themselves. If Potto doesn't respond to this, John should take the matter higher up the organisation. John would be *complying with the professional behavioural standards* set out in the ACCA code of ethics and elsewhere, and, indirectly, insisting that Potto does the same.

To *take no further action and 'let it drop'*. He would decide that the information provided by Lisa should not go any further and that any knowledge he had gained from her and her achievement log should be kept confidential.

The evaluation should make reference to the following four issues that may be used to argue in either direction.

All professional accountants are required to *comply in detail with the highest professional and ethical standards*. In addition to the ACCA and other professional codes of ethics, most audit decisions are underpinned by regulation and, in some cases, legislation. There are also issues relating to quality control within Miller Dundas that need to be adhered to as best professional practice.

John Wang's *leadership position in his role as training manager, partner and professional accountant*. His decision would be an important signal to Lisa over the acceptability of Potto's behaviour in a professional situation and the importance placed on the complaints of junior staff such as herself. Assuming that John recognised the non-compliance issue, this would also be a form of professional negligence on his part to ignore it.

His *confronting Potto would probably compromise their friendship and future professional relationship*. It may also have an impact on John's future career at Miller Dundas. These factors may conflict, in John's mind, with his duty of objectivity. It is important to develop harmonious relationships in professional situations as far as possible as they can be of benefit to both people involved and to the organisation itself but never at the expense of professional objectivity. Whistleblowers, whether internal or external, rarely have a stress free experience and John could possibly expect a certain amount of personal stress if he were to report Potto.

There is an issue over *how determined Lisa Xu is to take the matter further*. To confront Potto would *mitigate any risk that Lisa might take it further and compromise both Potto and John*. Lisa could, for example, approach the managing partner or even an outside body and implicate John as well as Potto: Potto for the unprofessional behaviour and John Wang for knowing about it but doing nothing.

Although there are two theoretical alternatives in this dilemma, John's required course of action is clear. He should confront Potto with the allegation and then pursue whatever course of action may ensue to satisfactorily resolve the situation.

[Tutorial note: the pros and cons of each option can be used in evaluating either option depending on how the candidate approaches the question. Allow consultation with a third party, such as a professional body, as an alternative.]

4 (a) Embedding risk

Good internal controls start with a full risk assessment and this control should be introduced and amended to respond to changes in the risk profile as appropriate on an ongoing basis. To have risk awareness and risk systems embedded implies a number of things. It means that risk management is *included within the control systems of an organisation*. The case refers to Saltoc's budgetary control system which will need to reflect the risk metrics in the embedded system.

When risk is embedded, the budgetary control and reward systems would recognise the need for risk awareness in them by including risk-related metrics. When embedded, risk is *interconnected with other systems* so that risks must be taken into account before other internal controls will work effectively. So a given job description, for example, might have a particular risk check included in it which is then assessed annually in the job-holder's appraisal. This would typically be a part of an operation manager's job description (Harry Ho at Saltoc) where, for example, the accident rate could be a metric built into his annual appraisal.

In an embedded risk system, risk is *not seen as a separate part of internal control but is 'woven in'* to other internal controls and is a *part of the organisation's culture*. The cultural norms in the IT department, for example, would be an implicit understanding that sensitive data is not transferred to portable laptops and that laptops are not left in unattended cars. This is a part of the taken-for-grantedness of embedded risk systems when woven into culture.

Finally, the management of risk is *'normal' behaviour at all levels*. Behaviour concerned with risk management is never seen as 'odd' or 'interfering' but as much a part of the normal business activity as trading and adding shareholder value.

[Tutorial note: italics are general description, underline is application to Saltoc.]

(b) Saltoc's management culture and implementing embedded risk systems

On the evidence of the case, the existing management culture at Saltoc would not be suitable for the introduction of embedded risk systems for four reasons.

There is evidence of a *lack of unity and some mutual distrust within the board*. Some of the members plainly dislike one another and the lack of trust in colleagues is likely to frustrate efforts to change systems and culture throughout the whole organisation. The fact that Peter believes Harry and Laura should be removed is ample evidence of the discord that exists.

Linked to this is the *blame culture*. Rather than seek to resolve the risk problems at Saltoc, the board's first instinct appears to have been to blame others for the problems. Peter blamed Harry and Laura whilst they blamed Peter for his budgetary allocations to their departments. There is no evidence of a consensus, or even a willingness to work together on new systems.

There is a *lack of leadership and understanding from CEO Ken Tonno*. He is clearly most concerned with short term financial measures and cash flow. The tone of his remarks is sceptical, referring as he did to 'even more' administration on risks and controls. It seems unlikely that he would personally lead an effort to redesign structures, systems and culture to embed risks at Saltoc.

The case makes reference to *problems with departmental leadership* among board members. Any change to systems or practice needs departmental directors to be able to lead their departments and this may not be possible if respect is lacking.

[Tutorial note: allow cross-marking of points between parts (a) and (b).]

(c) What external risk auditing contains and the case for an external risk audit at Saltoc Company

External risk auditing is an *independent review and assessment of the risks*, controls and safeguards in an organisation by someone from outside the company. Internal risk auditing also occurs in many organisations. It involves an *identification of the risks* within given frames of reference (the whole company, a given area of activity, a given department or location) and *advice on managing those risks in terms of a risk assessment*.

The first argument in favour of an external risk audit at Saltoc Company is the *'fresh pair of eyes' effect* that applies to the use of any external consultant. It seems evident that the existing management is unaware of all of the risks faced by the company and a new person coming in might identify new risks.

An external person would *take responsibility away from the squabbling directors* who are unlikely to work together on it. There is obviously enough tension and discord among board members to threaten any audit where collaboration would be needed to provide information and implement any recommendations.

An external risk auditor would provide an *unbiased view of the causes of poor risk management* in Saltoc and hence be able to give advice on where things can be improved. This will be important when recommending changes to systems to account for risks as it may impact some departments more than others. If there is any validity to Peter's claims about Harry and Laura then their departments may be disproportionately affected and an independent auditor would be able to comment on this from an objective viewpoint.

In some countries, (i.e. under Sarbanes Oxley), an element of independent assessment is necessary for compliance. In any event, encouraging independent scrutiny is good practice and *reassures external stakeholders (such as shareholders)* in the same way that an external financial audit does. At a time when the effectiveness of internal risk controls have been questioned (such as recently after the fire and the laptop theft), investor confidence is especially important.

Saltoc needs to demonstrate a robust response to the incidents in order to *restore customer confidence*. They have already lost some customer confidence and so the implementation of risk systems following the risk audit, might assume strategic importance. The appointment of an external risk auditor would help in this regard.

- 1** (a) 1 mark for recognition and evidence of understanding of each question (half mark for identification only). Allow maximum of 3 marks for step 6 (evaluation of consequences). 1 mark for correct application of each point to case.
(Maximum 14 marks)
- (b) 1 mark for identification of each internal control failing. 1 mark for analysis of the point.
(Total 12 marks)
- (c) 1 mark for recognition of the areas where NEDs could improve. 1 mark for application to case.
(Total 8 marks)
- (d) (i) 1 mark for each point on importance. 1 mark for application to case.
(Total 6 marks)
- (ii) Half mark for recognition of each quality of information: 1 for development of the quality based on the content of the case. Maximum of 1.5 marks per quality recognised and developed. Maximum of 2 marks for recognition of points.
(Total 6 marks)
- An additional 4 professional marks are available for the layout, logical flow, persuasiveness and tone of the memo.
(Total 4 marks)
- 2** (a) 1 mark for each relevant point recognised and explained. Half mark for identification only to a maximum of 2. 1 mark for development of point or assessment with regard to Sam in the case.
(Total 8 marks)
- (b) 2 marks for evidence of understanding the meaning of ‘unitary’ and ‘two-tier’ boards (which could be in any part of the answer)
1 mark for each relevant point made in favour of Annette’s belief to a maximum of 4.
1 mark for each relevant point made against Annette’s belief to a maximum of 4.
(Maximum 8 marks)
- (c) 1 mark for each relevant point of criticism recognised and 1 for development and application.
(Total 9 marks)
- 3** (a) 2 marks for explanation and meaning. 1 mark for each explanation of importance up to a maximum of 3 marks.
(Total 5 marks)
- (b) 1 mark for each criticism identified in the context of the case. 1 mark for development of the criticism with reference to practice or application.
(Total 10 marks)
- (c) 1 mark for recognition of each option.
2 marks for each relevant argument for or against either alternative.
(Total 10 marks)
- 4** (a) 1 mark for each relevant point describing embeddedness to a maximum of 3 marks.
1 mark for each relevant point of application to case to a maximum of 3 marks.
(Total 6 marks)
- (b) 2 marks for each issue identified and discussed in context (1 for recognition only)
(Total 8 marks)
- (c) 1 mark for each point of explanation of external risk auditing up to a maximum of 3.
2 marks for each relevant point in the construction of the argument (1 for recognition, 1 for development and application to the case).
(Total 11 marks)