- Module

Governance, risks and ethics

Time allowed: 15 minutes for reading and planning

3 hours for writing

June 30 – 2026

Do not open this paper until instructed by the supervisor.

This question paper must not be removed from the

The Accountancy & Audit Profession Org. Council - Sudan

Paper p1

AAPOC

بسم الله الرحمن الرحيم

Paper p1: Governance, risks and ethics

All questions are compulsory

Section (A)

(P1) question one:

In the 2009 results presentation to analysts, the chief executive of ZPT, a global internet communications company. announced an excellent set of results to the waiting audience. Chief executive Clive Xu announced that, compared to 2000, sales had increased by 50%, profits by 100% and total assets by 80%. The dividend was to be doubled from the previous year. He also announced that based on their outstanding performance, the executive directors would be paid large bonuses in line with their contracts. His own bonus as chief executive would be $20 million. When one of the analysts asked if the bonus was excessive, Mr Xu reminded the audience that the share price had risen 45% over the course of the year because of his efforts in skillfully guiding the company. He said that he expected the share price to rise lurther on the results announcement, which it duly did. Because the results exceeded market expectation, the share price rose another 25% to $52.

Three months later, Clive Xu called a press conference to announce a restatement of the 2009 results. This was necessary, he said, because of some 'regrettable accounting errors'. This followed a meeting between ZPT and the legal authorities who were investigating a possible fraud at ZPT. He disclosed that in fact the figures for 2009 were increases of 10% for sales, 20% for profits and 15% for total assets which were all significantly below market expectations. The proposed dividend would now only be a modest 10% more than last year. He said that he expected a market reaction to the restatement but hoped that it would only be a short-term effect.

The first questioner from the audience asked why the auditors had not spotted and corrected the fundamental accounting errors and the second questioner asked whether such a disparity between initial and restated results was due to fraud rather than 'accounting errors. When a journalist asked Clive Xu if he intended to pay back the $20 million bonus that had been based on the previous results, Mr Xu said he did not. The share price fell dramatically upon the restatement announcement and, because ZPT was such a large company, it made headlines in the business pages in many countries.

Later that month, the company announced that following an internal investigation, there would be further restatements, all dramatically downwards, for the years 2006 and 2007. This caused another mass selling of ZPT shares resulting in a final share value the following day of $1. This represented a loss of shareholder value of $12 billion from the peak share price. Clive Xu resigned and the government regulator for business ordered an investigation into what had happened at ZPT. The shares were suspended by the stock exchange. A month later, having failed to gain protection from its creditors in the courts, ZPT was declared bankrupt. Nothing was paid out to shareholders whilst suppliers received a fraction of the amounts due to them. Some non-current assets were acquired by competitors but all of ZPT's 54,000 employees lost their jobs, mostly with little or no termination payment. Because the ZPT employees' pension fund was not protected from creditors, the value of that was also severely reduced to pay debts which meant that employees with many years of service would have a grey reduced pension to rely on in old age.

The government investigation found that ZPT had been maintaining false accounting records for several years. This was done by developing an overly-complicated company structure that contained a network of international branches and a business model that was difficult to understand. Whereas ZPT had begun as a simple telecommunications company, Clive Xu had increased the complexity of the company so that he could hide losses and mis-report profits. In the company's reporting, he also substantially overestimated the value of future customer supply contracts. The investigation also found a number of significant internal control deficiencies including no effective management oversight of the external reporting process and a disregard of the relevant accounting standards.

In addition to Mr Xu, several other directors were complicit in the activities although Shazia Lo, a senior qualified accountant working for the financial director, had been unhappy about the situation for some time. She had approached the finance director with her concerns but having failed to get the answers she felt she needed, had threatened to tell the press that future customer supply contract values had been intentionally and materially overstated (the change in fair value would have had a profit impact). When her threat came to the attention of the board, she was intimidated in the hope that she would keep quiet. She finally accepted a large personal bonus in exchange for her silence in late 2008.

The investigation later found that Shazia Lo had been continually instructed, against her judgement, to report figures she knew to be grossly optimistic. When she was offered the large personal bonus in exchange for her silence, she accepted it because she needed the money to meet several expenses related to her mother who was suffering a long-term illness and for whom no state health care was available. The money was used to pay for a lifesaving operation for her mother and also to rehouse her in a more healthy environment. Shazia Lo made no personal financial gain from the bonus at all (the money was all used to help her mother) but her behaviour was widely reported and criticised in the press after the collapse of the company.

The investigation found that the auditor, JJC partnership (one of the largest in the country), had had its independence compromised by a large audit fee but also through receiving consultancy income from ZPT worth several times the audit fee. Because ZPT was such an important client for JJC, it had many resources and jobs entirely committed to the ZPT account. JJC had, it was found, knowingly signed off inaccurate accounts in order to protect the management of ZPT and their own senior partners engaged with the ZPT account. After the investigation, JJC's other clients gradually changed auditor, not wanting to be seen to have any connection with JJC. Accordingly. JJC's audit business has since closed down. This caused significant disturbance and upheaval in the audit industry. Because ZPT was regarded for many years as a high performing company in a growing market, many institutional investors had increased the number of ZPT shares in their investment portfolios. When the share price lost its value, it meant that the overall value of their funds was reduced and some individual shareholders demanded to know why the institutional investors had not intervened sooner to either find out what was really going on in ZPT or divest ZPT shares. Some were especially angry that even after the first restatement was announced, the institutional investors did not make any attempt to intervene. One small investor said he wanted to see more 'shareholder activism', especially among the large institutional investors.

Some time later, Mr Xu argued that one of the reasons for the development of the complex ZPT business model was that it was thought to be necessary to manage the many risks that ZPT faced in its complex and turbulent business environment. He said that a multiplicity of overseas offices was necessary to address exchange rate risks, a belief challenged by some observers who said it was just to enable the ZPT board to make their internal controls and risk management less transparent.

Required

Because of their large shareholdings, institutional investors are sometimes able to intervene directly in the companies they hold shares in.

(a) (1)Explain the factors that might lead institutional investors to attempt to intervene directly in the management of a company. (6 marks)

(2) Construct the case for institutional investors attempting to intervene in ZPT after the first results restatement was announced. (6 marks)

Distinguish between absolutist and relativist approaches to ethics and critically evaluate the behavior of Shazia Lo (the accountant who accepted a bonus for her silence) using both of these ethical perspectives. (10 marks)

The ZPT case came to the attention of Robert Nic, a senior national legislator in the country where ZPT had its head office. The country did not have any statutory corporate governance legislation and Mr Nie was furious at the ZPT situation because many of his voters had been badly financially affected by it. He believed that legislation was needed to ensure that a similar situation could not happen again. Mr Nie intends to make a brief speech in the national legislative assembly outlining the case for his proposed legislation and some of its proposed provisions.

Required

Draft sections of the speech to cover the following areas:

(b) (i) Explain the importance of sound corporate governance by assessing the consequences of the corporate governance failures at ZPT. (10 marks)

(ii) Construct the case for the mandatory external reporting of internal financial controls and risks. (8 marks)

(iii) Explain the broad areas that the proposed external report on internal controls should include, drawing on the case content as appropriate. (6 marks)

Professional marks will be awarded in part (c) for the structure, flow, persuasiveness and tone of the answer. (4 marks)

(P1) Question (2):

David Hunter is currently serving as a non-executive director on the board of a nationalized concern, The Electricity Provision Corporation (EPC), in a country in Asia. EPC operates a number of coal-fired power stations and transmits energy through a national grid which it controls. The electricity generated is then sold to the general public by private sector electricity distribution companies.

David Hunter is concerned about the ethical implications of a couple of issues that were discussed at EPC's most recent board meeting which was held yesterday. As a non-executive director, he believes he has a particular responsibility to consider ethical issues carefully.

a. A general election campaign has recently begun in this country. The governing party has indicated that it intends to maintain EPC as a nationalised industry if it wins the general election, although it will be seeking efficiency improvements. The opposition party has indicated that it intends to privatise all industries that are currently nationalised. Early yesterday morning before the board meeting, EPC's Managing Director was suddenly asked by senior civil servants in the Ministry of Energy to provide a major commitment to cost cutting in the next ten days. The Managing Director is aware that the Minister of Energy will be making a major election speech in a fortnight's time.
b. A recent United Nations report ranked EPC's home country in the Top 10 of its worst polluters, as measured by CO2 emissions per head of population. This report has been seized upon by environmental groups who have called for a month of action during the general election campaign. They wish to highlight the environmental damage being

caused by the government's environmental policies and to highlight the need to switch to alternative technologies such as wind power generation.

c. In the last few days small groups of protestors have broken through perimeter fences at two of EPC's power stations and managed to delay deliveries of coal by chaining themselves across railway tracks. There have been some reports in the press of heavy handed treatment being meted out by the security firm hired by EPC to deal with the protests. EPC's Managing Director has dismissed these reports, saying the protestors' solutions are impractical, they have no rights of access, and that EPC is entitled to take whatever action is required against the protestors to protect its property and maintain electricity supplies.

Required:

(a) Using the American Accounting Association model to support, recommend to Cavid hunter the course of action the board should take in responding to the civil servants request for information. (15 marks)

(b) Using Tucker's model for decision- making, assess the factors EPC's board should consider when dealing with current protests by environmental groups.

(10 marks)

<u>Question (3):</u>

At a recent conference on corporate social responsibility, one speaker (Professor Cheung) 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 Cheung 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) Critically evaluate Professor Cheung's views on codes of professional ethics. Use examples of ethical codes, where appropriate, to illustrate your answer.

(12 marks)

b) With reference to Professor Cheung's comments, explain what is meant by 'integrity' and assess its importance as an underlying principle in corporate governance.

(7 marks)

c) Explain and contrast a deontological with a consequentialist based approach to business ethics. (6 marks)

Question (4):

During the three years, Cerberus, a large defence contractor, has been adversely affected by a series of internal control failures. These incidents resulted in major losses being incurred and brought the company to the brink of collapse. Although the threat of company failure now appears to have receded, the shareholders, who have seen their investment in the company decrease dramatically, recently replaced the board of directors. The new board is determined to ensure that the company avoids any such problem in the future and believes that this has to be done by the board demonstrating greater concern about the operation of internal controls and fulfilling relevant corporate governance requirements.

One particular problem Cerberus has had over the last couple of years is a total failure of its information systems. The new directors realise that if they are to review controls fairly, better information systems will be required. They have also noted the previous directors apparently heard nothing about employee concerns with the systems through the company's informal grapevine. The previous directors were only notified and took action after the control failures had occurred, which was too late.

The new board also wishes to focus on how Cerberus deals with changes in the risks that affect the company, since this has been a particular concern of its shareholders.

Required

(a) Advise the new board of the key responsibilities of board members in relation to ensuring the effectiveness of internal controls. (7 marks)

(b) Explain the methods used to assess the effectiveness of controls and advise the board on the information required to support a fair assessment. (12 marks)

(c) Explore how the board should ensure that Cerberus is responsive to significant changes in the risks that it faces. (6 marks)