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Serial No.....

Institute of Certified Management Accountants of Sri Lanka
Strategic Level
November 2012 Examination

Examination Date : 24th November 2012 **Number of Pages :** 05
Examination Time: 9.30 a.m. – 12.30 p.m. **Number of Questions:** 05

Instructions to Candidates

1. Time allowed is **three (3) hours**.
2. Total: **100** Marks.
3. Answer **all** questions in Part I and **three (3)** questions from Part II.
4. The answers should be in **English Language**.

<u>Subject</u>	<u>Subject Code</u>
Risk & Control Strategy and Policy	(RSP / SL 4 – 404)

PART I

Answer **all** questions

Question No. 01 (40 Marks)

Background

MAP is a manufacturer of automotive products and a supplier to some of the major motor vehicle assembly plants. It has gain a solid brand name in the industry due to the reliability and quality of its products. MAP operates in a Just In Time (JIT) environment and uses sophisticated manufacturing technology for efficient production. MAP has adopted lean manufacturing philosophy and has extended this to lean management accounting. The Company's emphasis is on the elimination of waste and cost control on both manufacturing and support functions and generating continual incremental improvements in all that it does.

Use of Information Technology

MAP uses a Strategic Enterprise Management system (SEM) which integrates strategic, financial and operational information and is linked to MAP's Executive Information System (EIS) which enables senior managers to evaluate information about the organisation and its environment. The EIS incorporates a drill down facility to move from summarized to more specific and detailed operational and financial information.

Operations at MAP

MAP is organized around production, sales, design and accounting functions that are brought together in a number of semi-autonomous work groups. Each work group is focused on several similar products. Each MAP employee has a matrix reporting relationship, to its work group and to the functional hierarchy (production, sales, design, and administration).

Although it is committed to waste reduction, MAP recognizes that standardization in its manufacturing is essential for the maintenance of quality and customer satisfaction. It has carried this philosophy over in to its support functions where it has established a strategic planning process focused on short term profits and shareholder value, and policies and procedures for most supporting activities including Human Resource Management (recruitment, training and appraisal etc.). There is also a profit sharing bonus scheme linked to MAPs overall performance.

Accounting based control system

The accounting based control systems used by MAP include capital investment appraisal using discounted cash flow techniques with high hurdle rates for all decisions to increase manufacturing capacity. Budgets are extensively used as methods of controlling costs and ensuring that the revenue targets are achieved. The Chief Executive relies on the Financial Director for accounting advice and the Finance Director is committed to capital investment and budget techniques. A suite of non financial performance measures is also used to measure for example quality, on time delivery, production efficiency, customer satisfaction and employee morale.

CEO of MAP

The Chief Executive officer of MAP is an Engineer by profession, a dominating individual, with a controlling interest on the company. He is obsessed with reducing waste and cutting costs to improve reported profits and most of the changes in philosophy, production technology, IT system, reporting have been introduced by him. The Chief Executive uses the EIS to focus on work groups that need to improve their performance or that of their group of products. However the management hierarchy is relatively flat and most managers are in staff positions rather than supervising production operations.

MAP's customer relationships

MAP is in a relatively stable business and its technological lead has assured it of long contractual relationships with its customers. It is a risk adverse business, evidenced by its strict controls, sophisticated information system and the hands on role of the Chief Executive.

Culture of MAP

The culture of MAP is one of the technological excellence and commitment to customer service although the perspective taken by employees is a long term one. There is a relatively low staff turnover and high morale. The teams tend to carry out health competition between each other to see which team can produce the best performance each month.

However surveys have shown that staff tends to be unhappy about the methods by which targets are set and believe that these are too demanding, which in term affects their profit related bonuses. They are also unhappy about the strict control over expenses and the way in which some of the non financial performance measures are calculated. Many employees think that MAP has become too obsessive about cost and waste reduction.

Over the last year the Chief Executive has become overly concerned as to whether he can rely on some of the financial and non financial information ha has been receiving.

You are required to:

- (a) What type of management controls are adopted by MAP? **(05 Marks)**
 - (b) Explain briefly cybernetic forms of management controls in operation in MAP and how non cybernetic controls could apply as part of management control. **(10 Marks)**
 - (c) Explain how different type of management controls applied in above company. **(10 Marks)**
 - (d) Evaluate effectiveness of Risk Management Strategy to mitigate risks profile of MAP. **(15 Marks)**
- (Total 40 Marks)**
End of Part I

Part II

Answer any **three (3)** questions

Question No. 02 (20 Marks)

You are the newly appointed senior manager of internal audit in a large organization. The organisation is in the verge of setting up and Internal Audit department. As this is the first time the organisation is going to have an internal audit department there are some ambiguity within the board between the role of internal auditors and external auditors, the tasks performed by them, whether it is really necessary to have an internal audit division within the organisations etc.

Requirements:

You as the newly appointed senior manager of the internal audit department write a report to the Board addressing;

- (a) Compare briefly the role of the external audit to that of the internal audit. **(06 Marks)**
 - (b) Describe the steps the external auditors need to take to be able to rely on specific internal audit work. **(06 Marks)**
 - (c) Discuss whether the existence of an internal audit function simplifies the job of the external auditors. **(08 Marks)**
- (Total 20 Marks)**

Question No. 03 (20 Marks)

FDS is a large diversified company whose information technology and information management activities are carried out by a shared service centre. FDS25 is one of many business units operating as an investment centre within the FDS. FDS25 has developed a new business strategy which requires a major new investment in information technology to support its business strategy. FDS25 needs to implement the new system as quickly as possible and within budget in order to meet its objectives.

- (a) Recommend the controls that could be implemented by a business unit like FDS25 to mitigate against risk at each stage of information system design and implementation. **(10 Marks)**
 - (b) From the perspective of FDS25, identify the risk management advantages and disadvantages of each of:
 - (i) Utilizing the standard service centre; and
 - (ii) Outsourcing for the design and implementation of a new information system.
- (10 Marks)**
(Total 20 Marks)

Question No. 04 (20 Marks)

Mango Plc is a UK based manufacturer of electrical equipments. The company exports regularly to countries in the euro zone, Switzerland and South Africa denominated in the currency of the consumer.

You are required to:

- (a) Discuss the foreign exchange risks that Mango Plc might face in its operations. **(06 Marks)**
- (b) Assume the following information is available.

Spot rates against the pound

Country (Currency)	Spot rate at today	Expected spot rate in 6 months
Euro zone (Euro)	1.4955	1.4565
Switzerland (SFR)	2.3283	2.2328
South Africa (Rand)	11.5831	12.0815

Explain the theory of purchasing power parity (PPP). Based on this theory would you expect the 1 year inflation rates of the countries above to be higher or lower than UK inflation rates (No calculations are required). **(06 Marks)**

- (c) How does the change in exchange rates in (b) above, affect Mango Plc? **(08 Marks)**
- (Total 20 Marks)**

Question No. 05 (20 Marks)

As a CMA member you have recently been appointed as the Head of internal audit for SPQ, a multinational listed that carries out a large volume of internet sales to customers who place their orders using their home or work computers. You report to the Chief Executive although you work closely with the Finance Director. You have direct access to the chair of the audit committee whenever you consider it necessary.

One of your internal audit teams has been conducting a review of IT security for a system which has been in operation for 18 months and which is integral to internet sales. The audit was included in the internal audit plan following a request by the chief accountant. Sample testing by the internal audit team has revealed several transactions over the last three months which have raised concerns about possible hacking or fraudulent access to the customer order database. Each of these transactions has disappeared from the data base after deliveries have been made but without sales being recorded or funds collected from the customer. Each of the identified transaction was for a different customer and there seems to be no relationship between any of the transactions.

You have received a draft report from the internal audit manager responsible for this audit which suggests serious weaknesses in the design of the system. You have discussed this informally with the senior manager of who have told you that such a report will be politically very unpopular with the chief executive as he was significantly involved in the design and approval of the new system and insisted it be implemented earlier than the IT department considered was advisable. No post implementation review has taken place.

You have been informally advised by several senior managers to lessen the criticism and work with the IT department to correct any deficiencies within the system and to produce a report to the Audit Committee that is less critical and merely identifies the need for some improvement. They suggest that these actions would avoid criticism of the chief executive by the board of SPQ.

You are required to:

- (a) Explain the ethical principles that you should apply as the head of internal audit for SPQ when reporting the results of this internal review. **(10 Marks)**
- (b) Explain how any ethical conflicts should be resolved. **(10 Marks)**

(Total 20 Marks)

End of Part II

Present value table

Present value of 1.00 unit of currency, that is $(1 + r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149

Periods (n)	Interest rates (r)									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.079	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026

End of Question Paper