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CIMA

BUILDING

Paper P3

# Management Accounting Risk and Control Strategy

Relevant for **May & November 2005** examinations



Jasper Robertson & Jason Saliba

CERTIFICATE | MANAGERIAL | STRATEGIC

CIMA Exam Practice Kit

# **Management Accounting Risk and Control Strategy**

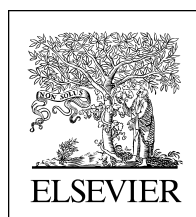


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# **Management Accounting Risk and Control Strategy**

**Jaspar Robertson**



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# About the Author

**Jaspar Robertson:** During his time with one of the country's leading Financial Services providers it became obvious to him that there was a need to improve management education and understanding. Determined to ensure that future managers are as professionally prepared as possible, Jaspar now runs his own company, S2C Ltd, delivering courses in both the national and international markets.

Jaspar lectures and examines for a range of professional qualifications, specialising in Business and Information Strategy, Human Resource Management and Marketing for CIMA, ACCA and CIM.





# Introduction

Welcome to the new CIMA Exam Practice Kit which has been launched to coincide with a major change in the syllabus where new examinations will take place from May 2005.

This Kit has been designed with the needs of home study and distance education candidates in mind and it is also ideal for fully taught courses or for students resitting papers from the old syllabus.

These hints, questions and answers have been produced by some of the best-known freelance tutors in the United Kingdom who have specialised in their respective papers and the questions and topics selected are relevant for the May 2005 and November 2005 examinations.

The exam practice kits will complement CIMA's existing study manuals with the Q&A's from May 2005 published in the next edition of the CIMA study manual and the Q&A's from November 2005 examination published in the 2006 edition of the Exam Practice Kit.

Good luck with your studies.



# Syllabus Guidance, Learning Objectives and Verbs

## **A The syllabus**

The syllabus for the CIMA Professional Chartered Management Accounting qualification 2005 comprises three learning pillars:

- Management Accounting pillar
- Business Management pillar
- Financial Management pillar.

Within each learning pillar there are three syllabus subjects. Two of these subjects are set at the lower 'Managerial' level, with the third subject positioned at the higher 'Strategic' level. All subject examinations have a duration of 3 hours and the pass mark is 50%.

*Note:* In addition to these 9 examinations, students are required to gain 3 years relevant practical experience and successfully sit the Test of Professional Competence in Management Accounting (TOPCIMA).

## **B Aims of the syllabus**

The aims of the syllabus are

- to provide for the Institute, together with the practical experience requirements, an adequate basis for assuring society that those admitted to membership are competent to act as management accountants for entities, whether in manufacturing, commercial or service organisations, in the public or private sectors of the economy;
- to enable the Institute to examine whether prospective members have an adequate knowledge, understanding and mastery of the stated body of knowledge and skills;
- to complement the Institute's practical experience and skills development requirements.

## C Study weightings

A percentage weighting is shown against each topic in the syllabus. This is intended as a guide to the proportion of study time each topic requires.

All topics in the syllabus must be studied, since any single examination question may examine more than one topic, or carry a higher proportion of marks than the percentage study time suggested.

The weightings *do not* specify the number of marks that will be allocated to topics in the examination.

## D Learning outcomes

Each topic within the syllabus contains a list of learning outcomes, which should be read in conjunction with the knowledge content for the syllabus. A learning outcome has two main purposes:

- 1 to define the skill or ability that a well-prepared candidate should be able to exhibit in the examination;
- 2 to demonstrate the approach likely to be taken by examiners in examination questions.

The learning outcomes are part of a hierarchy of learning objectives. The verbs used at the beginning of each learning outcome relate to a specific learning objective, for example, evaluate alternative approaches to budgeting.

The verb 'evaluate' indicates a high-level learning objective. As learning objectives are hierarchical, it is expected that at this level, students will have knowledge of different budgeting systems and methodologies and be able to apply them.

A list of the learning objectives and the verbs that appear in the syllabus, learning outcomes and examinations follows:

<i>Learning objectives</i>	<i>Verbs used</i>	<i>Definition</i>
<b>1 Knowledge</b>		
<i>What you are expected to know</i>	List	Make a list of
	State	Express, fully or clearly, the details of/facts of
	Define	Give the exact meaning of
<b>2 Comprehension</b>		
<i>What you are expected to understand</i>	Describe	Communicate the key features of
	Distinguish	Highlight the differences between
	Explain	Make clear or intelligible/State the meaning of
	Identify	Recognise, establish or select after consideration
	Illustrate	Use an example to describe or explain something

**3 Application**

*How you are expected to  
apply your knowledge*

Apply	To put to practical use
Calculate/compute	To ascertain or reckon mathematically
Demonstrate	To prove with certainty or to exhibit by practical means
Prepare	To make or get ready for use
Reconcile	To make or prove consistent/ compatible
Solve	Find an answer to
Tabulate	Arrange in a table

**4 Analysis**

*How you are expected to  
analyse the detail of  
what you have learned*

Analyse	Examine in detail the structure of
Categorise	Place into a defined class or division
Compare and contrast	Show the similarities and/or differences between
Construct	To build up or compile
Discuss	To examine in detail by argument
Interpret	To translate into intelligible or familiar terms
Produce	To create or bring into existence

**5 Evaluation**

*How you are expected to  
use your learning to  
evaluate, make decisions  
or recommendations*

Advise	To counsel, inform or notify
Evaluate	To appraise or assess the value of
Recommend	To advise on a course of action



# Learning Outcomes, Syllabus Content and Examination Format

## **Paper P3 – Management Accounting Risk and Control Strategy**

### **Syllabus outline**

The syllabus comprises:

#### *Topic and study weighting*

- A Management Control Systems 15%
- B Risk and Internal Control 20%
- C Review and Audit of Control Systems 15%
- D Management of Financial Risk 30%
- E Risk and Control in Information Systems 20%

#### *Learning aims*

Students should be able to

- evaluate and advise on management and internal control systems for a range of risks;
- plan a review process, including an internal audit, of such systems;
- evaluate alternatives and advise on the management of financial risks;
- advise on the development of information systems that support the risk control environment.

#### *Assessment strategy*

There will be a written examination paper of 3 hours, with the following sections.

#### **Section A – 50 marks**

A maximum of four compulsory questions, totalling 50 marks, all relating to a single scenario.



**Section B – 50 marks**

Two questions, from a choice of four, each worth 25 marks. Short scenarios will be given, to which some or all questions relate.

**A – Management control systems – 15%**

*Learning outcomes*

On completion of their studies students should be able to

- 1 evaluate and recommend appropriate control systems for the management of organisations;
- 2 evaluate the control of activities and resources within the organisation;
- 3 recommend ways in which the problems associated with control systems can be avoided or solved;
- 4 evaluate the appropriateness of an organisation's management accounting control systems and make recommendations for improvements.

*Syllabus content*

- The ways in which systems are used to achieve control within the framework of the organisation (e.g. contracts of employment, policies and procedures, discipline and reward, reporting structures, performance appraisal and feedback).
- The application of control systems and related theory to the design of management accounting control systems and information systems in general (i.e. control system components, primary and secondary feedback, positive and negative feedback, open and closed-loop control).
- Structure and operation of management accounting control systems (e.g. identification of appropriate responsibility and control centres within the organisation, performance target setting, avoiding unintended behavioural consequences of using management accounting controls).
- Variation in control needs and systems dependent on organisational structure (e.g. extent of centralisation versus divisionalisation, management through strategic business units).
- Assessing how lean the management accounting system is (e.g. extent of the need for detailed costing, overhead allocation and budgeting, identification of non-value adding activities in the accounting function).
- Cost of quality applied to the management accounting function and 'getting things right at the first time'.

**B – Risk and internal control – 20%**

*Learning outcomes*

On completion of their studies students should be able to

- 1 define and identify risks facing an organisation;
- 2 explain ways of measuring and assessing risks facing an organisation, including the organisation's ability to bear such risks;
- 3 discuss the purposes and importance of internal control and risk management for an organisation;
- 4 evaluate risk management strategies;

- 5 evaluate the essential features of internal control systems for identifying, assessing and managing risks;
- 6 evaluate the costs and benefits of a particular internal control system;
- 7 discuss the principles of good corporate governance for listed companies, particularly as regards the need for internal controls.

### *Syllabus content*

- Types and sources of risk for business organisations: financial, commodity price, business (e.g. fraud, employee malfeasance, loss of product reputation), technological, external (e.g. economic and political) and corporate reputation (e.g. from environmental and social performance) risks.
- Risks associated with international operations (e.g. from cultural variations and litigation risk, to loss of goods in transit and enhanced credit risk). (*Note: No specific real country will be tested.*)
- Quantification of risk exposures (impact if an adverse event occurs) and their expected values, taking account of likelihood. Minimising the risk of fraud (e.g. fraud policy statements, effective recruitment policies and good internal controls, such as approval procedures and separation of functions, especially over procurement and cash).
- Fraud related to sources of finance (e.g. advance fee fraud and pyramid schemes).
- Minimising political risk (e.g. by gaining government funding, joint ventures, local finance).
- The principle of diversifying risk. (*Note: Numerical questions will not be set.*)
- Purposes of internal control (e.g. safeguarding of shareholders' investment and company assets, facilitation of operational effectiveness and efficiency, contribution to the reliability of reporting).
- Issues to be addressed in defining management's risk policy.
- Elements in internal control systems (e.g. control activities, information and communication processes, processes for ensuring continued effectiveness, etc.).
- Operational features of internal control systems (e.g. embedding in company's operations, responsiveness to evolving risks, timely reporting to management).
- The pervasive nature of internal control and the need for employee training.
- Costs and benefits of maintaining the internal control system.
- The principles of good corporate governance for listed companies (the Combined Code) (e.g. separation of chairman and CEO roles, appointment of non-executive directors, transparency of directors' remuneration policy, relations with shareholders, the audit committee). Examples of recommended good practice may include The King Report on Corporate Governance for South Africa, Sarbanes-Oxley Act in the USA, The Smith and Higgs Reports in the UK, etc.
- Recommendations for internal control (e.g. The Turnbull Report).

## **C – Review and audit of control system – 15%**

### *Learning outcomes*

On completion of their studies students should be able to

- 1 explain the importance of management review of controls;
- 2 evaluate the process of internal audit;
- 3 produce a plan for the audit of various organisational activities including management, accounting and information systems;

- 4 analyse problems associated with the audit of activities and systems, and recommend action to avoid or solve those problems;
- 5 recommend action to improve the efficiency, effectiveness and control of activities;
- 6 discuss the principles of good corporate governance for listed companies, for conducting reviews of internal controls and reporting on compliance;
- 7 discuss the importance of exercising ethical principles in conducting and reporting on internal reviews.

*Syllabus content*

- The process of review (e.g. regular reporting to management on the effectiveness of internal controls over significant risks) and audit of internal controls.
- Major tools available to assist with such a process (e.g. audit planning, documenting systems, internal control questionnaires, sampling and testing).
- Detection and investigation of fraud.
- Role of the internal auditor and relationship of the internal audit to the external audit.
- Operation of internal audit, the assessment of audit risk and the process of analytical review, including different types of benchmarking, their use and limitations.
- The principles of good corporate governance for listed companies, for the review of the internal control system and reporting on compliance.
- Relationship of the above to other forms of audit (e.g. value-for-money audit, management audit, social and environmental audit).
- Particular relevance of the fundamental principles in CIMA's Ethical Guidelines to the conduct of an impartial and effective review of internal controls.
- Application of CIMA's Ethical Guidelines on the resolution of ethical conflicts in the context of discoveries made in the course of internal review.

## **D – Management of financial risk – 30%**

*Learning outcomes*

On completion of their studies students should be able to

- 1 identify and evaluate financial risks facing an organisation;
- 2 identify and evaluate appropriate methods for managing financial risks;
- 3 evaluate the effects of alternative methods of risk management and make recommendations accordingly;
- 4 calculate the impact of differential inflation rates on forecast exchange rates;
- 5 explain exchange rate theory;
- 6 recommend currency risk management strategies.

*Syllabus content*

- Sources of financial risk, including those associated with international operations (e.g. hedging of foreign investment value) and trading (e.g. purchase prices and sales values).
- Transaction, translation, economic and political risk.
- Minimising political risk (e.g. gaining government funding, joint ventures, obtaining local finance).
- Quantification of risk exposures and their expected values.

- Operation and features of the more common instruments for managing interest rate risk: swaps, forward rate agreements, futures and options. (*Note: Numerical questions will not be set involving FRAs, futures or options. See the note below relating to the Black Scholes model.*)
- Illustration and interpretation of simple graphs depicting cap, collar and floor interest rate options.
- Theory and forecasting of exchange rates (e.g. interest rate parity, purchasing power parity and the Fisher effect).
- Operation and features of the more common instruments for managing currency risk: swaps, forward contracts, money market hedges, futures and options. (*Note: The Black Scholes option pricing model will not be tested numerically; however, an understanding of the variables which will influence the value of an option should be appreciated.*)
- Principles of valuation of financial instruments for management and financial reporting purposes (IAS 39), and controls to ensure that the appropriate accounting method is applied to a given instrument.
- Internal hedging techniques (e.g. netting and matching).

## **E – Risk and control in information – 20%**

### *Learning outcomes*

On completion of their studies students should be able to

- 1 evaluate and advise managers on the development of IM, IS and IT strategies that support management and internal control requirements;
- 2 identify and evaluate WIT systems appropriate to an organisation's needs for operational and control information;
- 3 evaluate benefits and risks in the structuring and organisation of the WIT function and its integration with the rest of the business;
- 4 evaluate and recommend improvements to the control of information systems;
- 5 evaluate specific problems and opportunities associated with the audit and control of systems which use information technology.

### *Syllabus content*

- The importance and characteristics of information for organisations and the use of cost-benefit analysis to assess its value.
- The purpose and content of IM, IS and IT strategies, and their role in performance management and internal control.
- Data collection and IT systems that deliver information to different levels in the organisation (e.g. transaction processing, decision support and executive informative systems).
- The potential ways of organising the IT function (e.g. the use of steering committees, support centres for advice and help desk facilities, end-user participation).
- The arguments for and against outsourcing.
- The criteria for selecting outsourcing/Facilities Management partners and for managing ongoing relationships, service level agreements, discontinuation/change of supplier, hand-over considerations.
- Methods for securing systems and data back-up in case of systems failure and/or data loss.
- Minimising the risk of computer-based fraud (e.g. access restriction, password protection, access toggling and automatic generation of audit trail).