Rationale
This question is based on both the common pre-seen scenario and the unseen scenario. Part (a) deals with the risks associated with making a public commitment to investigate and penalise the abuse of performance enhancing drugs in a sporting tournament. Part (b) deals with the conduct of a post-completion audit of a building project that has failed to an extent. Part (c) deals with the management of the political risks that could lead to the loss of a major competitor, thereby undermining the credibility of the Games.

Part (a) draws mainly on section B of the syllabus (Risk and Internal Controls).
Part (b) draws mainly on section C of the syllabus (Audit and Audit of Control Systems).
Part (c) draws mainly on section D (Management of Financial Risk).

Suggested Approach
Part (a) asks candidates to think about the threats associated with making a commitment to deal with the abuse of performance enhancing drugs. This is a topical area, with a number of high-profile cases having occurred in the recent past. The Games organisers are effectively committing themselves to dealing with an offence that is very difficult to detect. There is a risk that an offence will not be discovered during the Games, but will come to light when cheating is discovered during a later competition. There is also a conflict because the discovery of this type of abuse will almost certainly attract a great deal of adverse publicity. Furthermore, any undue focus on this form of cheating will also undermine the credibility of the Games.
Part (b) requires some common sense about the management of a building project. Decisions were taken during the construction of a swimming pool that will ensure its readiness for the Games themselves, but that have also affected its suitability for conversion to a public amenity for the local community. As with any post-completion audit, there is a risk that managers may be deterred from acting in the future and that future decision-making will become defensive.

Part (c) focusses on the threatened response to the broadcast of a critical television documentary. The concern is that the subject of the documentary will withdraw from the Games, thereby reducing their perceived success. The organisers of the Games face a delicate diplomatic challenge in persuading the government which claims to have been defamed to respond in some way other than banning its athletes from participating in the Games.

(a)

(i) It will not be practical to test every competitor because of the cost and limited capacity in the laboratory. The testing system may operate on a risk-based approach that targets samples in order to make the greatest use of scarce resources.

After an event has been completed the judges should consider the possibility that the medal winners may have cheated. That could involve reviewing their times or scores to ensure that they are credible. For example, a new world record that is significantly better than the previous one or an athlete setting a personal best that is suspiciously better than his or her previous result should be regarded as cause for conducting a test.

There should be a random sample of tests on scores that are not suspicious, if only to deter cheating. In any case, small improvements may be difficult to obtain without the abuse of banned substances. The selection of cases should be made as quickly as possible after the event and the samples taken immediately in order to deal with the threat of a substance that does not linger in the body.

There is relatively little point in testing competitors who were unsuccessful because their cheating will not have affected the result.

Tests should be conducted privately, with the fewest possible number knowing that this is happening, otherwise the competitors may feel that their reputations are being tarnished unfairly.

The competitor’s identity should be checked by the nurse who is to draw blood to avoid a cheat sending an accomplice to take the test.

In the event of a positive result the test should be repeated using a different technician and, preferably, using different equipment in order to avoid the risk of errors or contamination of the original specimen causing a false accusation. The results should then be passed to the judges who will be responsible for deciding whether the competitor has cheated.

The competitor should be given a small amount of each of the positive blood samples, so that they can conduct their own tests independently in the event of an appeal.

Positive results should be documented carefully and passed to the relevant sport’s governing body in order for an appropriate penalty to be determined. Cheating athletes are usually banned from future competitions on a temporary or a permanent basis.

 Athletes will be unlikely to take drugs because of the publicity the Games drug testing policy has had and also because of the new testing equipment.
(ii) It could be argued that GAMESCO has very little real cause for concern. In the event that the drugs testing procedures miss any evidence of cheating there is a strong possibility that the oversight will not be discovered. The fact that any cheating competitors may be able to profit will be unacceptable from a sporting point of view, but it is highly unlikely that GAMESCO will be found wanting during the course of the Games. If an athlete is subsequently caught cheating during a later competition then GAMESCO will have been wound up by the time that the story breaks. There will not necessarily be any evidence that the athlete had taken any drugs prior to the Games even if there is a later scandal.

Press coverage of cheating competitors tends to focus on the athlete’s dishonesty rather than the failure of competition organisers to detect the fraud. That further reduces the threat to GAMESCO’s reputation concerning failure to detect cheating. Furthermore, the public’s sympathy may be with the organisers because new forms of cheating will always be developed and it may be unrealistic to expect tests to detect an unknown substance.

Paradoxically, the detection of cheating may prove a bigger problem than failure to detect it. The tests are unlikely to occur until after an event and so the winner will already have been announced. It will be impossible to conceal the disqualification of a medal winner and the press will almost certainly report the facts. There is considerable public disenchantment with sport because of a spate of prominent cases involving supposedly successful athletes being caught cheating with banned substances and so the publicity will reflect badly on the integrity of the Games. That could overshadow the perceived success of the Games as a sporting and media event. Even that will have very little direct impact on GAMESCO because by that stage the tickets and broadcast rights will have been sold.

GAMESCO could get into difficulty if it makes any form of accusation on the basis of a laboratory error. For example, a false positive could be triggered by a competitor having taken a prescription medicine or even having eaten certain foods which leave traces in the bloodstream that trigger the tests.

(b)

(i) At first sight, this project appears to have been badly managed. The costs were liable to overrun and the contractor responded by not working to the plan. There could be similar issues arising from other projects that are presently under way and that might be subject to the same difficulties. The issues with the stability of the site could affect a wider area than just the swimming pool and it would be desirable to prevent a recurrence.

It may be possible for GAMESCO to recover some of the cost of the swimming pool project if the post completion audit can determine who is to blame for the revised building plan. If it can be demonstrated that the builder had not properly consulted the project manager then the decision to deliver a completed project that is not to the correct specification could be grounds for liability.

A clear understanding of the issues may be useful to GAMESCO’s senior management because mismanagement of such projects is often commented on in the press. It may be too late for an audit to deal with similar problems elsewhere because the other major projects are likely to be well under way. It may be too late to change the direction of a project once the basic structure of a building has been put in place and so the audit might prove a waste of time and effort.

The fact that an audit is being commissioned could disrupt the relationship between GAMESCO and the builders, possibly delaying the completion of the Games Park. Regardless of the outcome of the audit the swimming pool was completed on time and within the 10% overrun on cost that was permitted. The builder appears to have acted in good faith in removing a secondary facility from the building because it would otherwise have been impossible to complete at an acceptable cost. An audit may provoke a defensive response from the building teams on other projects that are under way.
(ii) It seems likely that the issue that will be material in this audit is the fact that the completed building has not been built to plan. The auditor should start with a detailed study of all of the correspondence between the builder and GAMESCO’s project manager, starting from the discovery of the problems with the foundation. The crucial issue is the question of how changes to the plan were dealt with after the problem with the soil structure was discovered. If the builder brought this to the project manager’s attention and received permission to reroute the ducting then that makes GAMESCO responsible for the failure to meet the plan.

The auditor needs to fully understand the manner in which the setback with the foundation was managed. The discovery of the problem with the site suggests that the plan and the contract should have been revisited. The potential for a 10% overrun on costs seems to have been put in place for dealing with much less serious problems. It seems somewhat reckless to have spent the whole of this contingency reserve (and more) on foundations, leaving insufficient in the budget to complete the building to plan.

The auditor should obtain the formal plans or blueprints that were used by the contractor who fitted the ducting. The authorship of those plans should be indicated on the document and the plans themselves can be checked back to determine who signed them off as acceptable. These plans will almost certainly establish who made the final decision on the routing of the ducts.

The auditor should also review the schedule of site visits by the project manager and any other independent reviewers to establish whether there were problems with the oversight at that level. This is an important compliance test because it will establish the extent to which the project management team was supervising the build on GAMESCO’s behalf. If these reviews were ineffective then the builders could almost be excused for taking shortcuts.

The auditor should also review the contract. If the completion of the work to plan was the responsibility of the builder, without any consideration of the fact that unforeseen problems had arisen, then the builder may still be responsible for the costs of rectifying this problem.

(c) GAMESCO should put contingency plans in place before the programme is broadcast because governments often protest in symbolic ways and international sporting competitions are frequently used to political ends. There is a significant possibility that Country D’s government will pull out of the competition in protest at the broadcast of this programme. Having said that, it is possible that Country D will make a symbolic withdrawal from the Games immediately after the broadcast and will then reverse that decision once the protests have been noted. Thus, GAMESCO should work to ensure that it exerts the right sort of pressure on Country D to ensure that its athletes compete.

GAMESCO should start by seeking the support of the government of Country C and also the international political community. It should be stressed that sporting links between nationalities provide an opportunity for peaceful engagement. It seems very likely that the press in Country C will be seeking comments from C’s government. GAMESCO should persuade the ministers who are most likely to be asked to avoid making the situation worse by repeating accusations. The countries which compete in the Games already share links because they all come from the same region and so it would be reasonable for C to be as conciliatory as possible.

GAMESCO should work with the Regional Games Committee to lobby the government of Country D directly. The fact that the Games are a popular sporting event will mean that the withdrawal will be viewed badly by D’s population. The press in D should be encouraged to carry stories about local athletes who have good prospects of winning medals in the Games and the athletes themselves should be urged to speak out in favour of competing.
If Country D wishes to demonstrate that the allegations against it are untrue then participating in the Games will be a positive symbol for the international community. From a public relations point of view, the government of D will do far more to play down allegations of human rights abuses by having a successful team at the Games. GAMESCO should do as much as possible to publicise the idea that failing to compete will be viewed as confirming some of the impressions created by the documentary, whereas participating will make D appear more open and friendly.

The Games are an important symbol of unity and cooperation in the region and D’s withdrawal will be a potentially disproportionate response to a single television broadcast. GAMESCO could find a subtle way to communicate the possibility that D’s leaders could leave themselves open to personal criticism and even ridicule if they withdraw for what might appear to many as a relatively insignificant slight.
SECTION B

Answer to Question Two

Rationale
Question 2 draws on section A (*Management and Control Systems*).

The question deals with the monitoring and feedback system for supervising a television programming department. This department must make some fairly long-term purchasing decisions that may leave the entity forced to pay for a product that has little value. This decision has parallels in other entities, such as the purchase of patents or the investment in product development.

Suggested Approach
Part (a) asks candidates to think about the relevance of one of the performance measures used to evaluate the public’s response to the programmes that the company broadcasts.

Part (b) asks candidates to consider the potential impact of focussing on negative feedback, with the associated focus on decisions that subsequent events have been shown to have had a poor outcome.

Part (c) asks for arguments concerning the possibility of switching to a positive feedback to reinforce successes rather than highlight failures.

(a) Viewers’ satisfaction could reflect the extent to which their viewing decision was based on the lack of an acceptable alternative. Viewers could have watched J because the programmes being broadcast on the other channels were inferior and so J was not actually attracting anybody. If satisfaction figures are low then the audience could decline if a competitor broadcasts a superior show at that time in the future.

J should also be aware of the satisfaction figure in case viewers are starting to get bored with a particular programme. It would make little sense to buy further series once a particular show reaches the end of its run if viewers’ satisfaction is declining.

It may be necessary to exercise some caution. If viewing figures are acceptable then advertisers’ needs are being met, which is J’s most important consideration. Viewers’ responses could have been motivated by embarrassment if a particular show is popular despite bad reviews from the critics.

(b) The excessive use of negative feedback could lead to dysfunctional behaviour on the part of the programming department. A series of programmes will be purchased in advance. If a new programme proves to be unpopular then it may lead to a failure to achieve targets on several evenings. Rather than risk that, the programming department might concentrate on low-risk programmes that are likely to attract an acceptable audience share without necessarily being likely to attract a substantial audience or break new ground.

The programming department might also argue that J should overpay for programmes that will definitely attract good viewing figures. However, the cost of such programming could outweigh the additional advertising revenue that it attracts.

The negative feedback could be demotivating. Viewing figures are affected by the programmes broadcast by competitors. The programming department could develop a good range of programmes that is as good as the company can afford but that might fail because competing companies could have superior shows.
The programming department could lose competent staff who are unhappy because of the blame culture. They could be open to approaches from competitors which offer a more supportive environment.

(c) The biggest advantage is that positive feedback is consistent with J's business model. If J identifies an opportunity to attract a larger audience then it may be able to offer advertisers the opportunity to reach a very high proportion of the viewing audience for at least part of a typical week.

The programming department will be focussed on attracting large numbers of viewers rather than avoiding poor viewing figures. It may be willing to take calculated risks that could lead to the discovery of very successful programmes, albeit at the risk of buying an unknown programme that turns out to be unpopular.

If the programming department is encouraged to concentrate on popular programmes then it might focus on locking in successes. For example, if a new programme has a good viewing rate then the programming department could negotiate the purchase of later series before its competitors act.

The programming department could be encouraged to be a little more creative, perhaps by commissioning shows that have the same basic format as successful programmes. J could then develop a reputation for broadcasting programmes that fall within a particular niche and so its viewers' loyalty could be strengthened. Any such successes can generate revenues from the resale of the programme to other countries.

There is still some role for negative feedback. The programming department should be permitted to make mistakes, but it should not be allowed to be complacent and so major disappointments should at least be discussed and investigated.
Answer to Question Three

<table>
<thead>
<tr>
<th>Rationale</th>
<th>Question 3 draws on section E (Risk and control in information systems). It deals with the implications of staff fraud in conditions where segregation of duties is impossible.</th>
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<td>Suggested Approach</td>
<td>Part (a) focuses on the use of a database expert to search for suspicious transactions. Candidates need to consider the need to conduct a thorough investigation without wasting valuable resources such as programming and processing time. PART (b) deals with the need to evaluate the threat associated with a potential loophole in the system. Controls have to be cost effective in order to be in the entity's best interests. Part (c) asks for procedures that could address the threat created by the loophole. Suggestions should be practical in that they will deter fraud without interfering with the service offered to customers.</td>
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(a) Firstly, the database queries will take programmers’ time to write. The programmers will be full-time employees, but they will be distracted from their regular duties while they are involved in this investigation. The searches should be designed carefully so that the internal auditor can draw the clearest possible conclusion without repeating the search.

The searches should be designed to minimise the impact on the system. Bank customers may be affected if the system slows down for the duration of a long search. It may not be possible to avoid any impact on the system’s response times when running non-standard queries, but the programmers may be able to reduce the problem by choosing search parameters that make the search more efficient.

The searches must minimise the number of false positives. It will waste the internal audit department's time if too many accounts are highlighted without good reason.

The manner in which the search is conducted must take account of the laws of evidence. If the clerk is accused of a crime and details are passed to the police then the manner in which the search was conducted may be challenged by the defence. Great care will have to be taken to ensure that the very search process cannot be said to have changed the data collected so that the clerk is blamed for transactions that were actually conducted by somebody else.

(b) The first step is to determine the number of dormant accounts that the bank has. If there are very few then the bank may decide that it would not be cost-effective to introduce a control. Similarly, the sizes of the balances in dormant accounts should be considered. If the total value of the funds at risk is small then it might be cheaper for the bank to compensate the victims of staff fraud.

If the potential risk is high then the bank could consider checking whether the account holders are checking their balances. The best way to do this would be to contact the account holders by telephone to ask whether they would be interested in moving to a more efficient savings strategy. If the account holder is alive and well and aware of the balance then any fraudulent withdrawal will be reported and so there is very little risk. Contacting the customers in this way will also give the bank the opportunity to earn some commission from the sale of savings products.
(c) This will require a change to the bank’s software. Every account should be tagged with the date of the most recent deposit or withdrawal. If an account has not had a transaction for, say, two years any subsequent deposit or withdrawal should be flagged. If a transaction is flagged then the clerk should be required to seek authorisation from a supervisor before proceeding. This procedure need not delay the transaction by more than a few minutes while the authorisation is sought and so the customer need not be inconvenienced.

Deposits have to be flagged in the same manner as withdrawals, otherwise a fraudulent clerk could make a small deposit in order to rid an account of its dormant status.

The software could record the number of flagged transactions processed in each branch or by each counter clerk. Large numbers of transactions occurring in any given branch or by any given member of staff could be viewed as suspicious. In that case, it would be worth following up the transaction with the customer in order to confirm its validity.

The fact that these procedures have been introduced should be publicised within the bank. This type of fraud is not difficult to design or to perpetrate. If bank staff realise that C Bank is aware of the threat and is controlling for it then they may be less inclined to risk stealing in this way.
Answer to Question Four

Rationale
Question 4 draws on section D (Management of Financial Risk). Part (a) asks for the preparation of a forecast using economic indicators provided in the question. Part (b) asks about transfer pricing. Part (c) asks about the political risks associated with moving production offshore.

Suggested Approach
Part (a) asks candidates to apply their logic to combining some economic indicators to predict a cost in the medium term future. The question asks for some assumptions to be made and offers the opportunity to score marks by articulating those assumptions and commenting on their validity.

Part (b) requires some thought about the difference between importing raw materials and finished goods. At present the entity imports raw materials that have been purchased from third parties. How will the regulation and supervision of the entity’s business change if it establishes a foreign subsidiary and imports finished goods instead? Transfer prices will come under much closer scrutiny.

Part (c) asks for a discussion of the political issues associated with moving jobs offshore.

(a)

(i) The forecast hourly rate is assumed to grow in line with the rate of inflation in the proposed host country. We assume that the inflation rate will remain constant for five years.

Over five years, the inflation rate will compound by \((1.047)^5 = 25.8\%\). The forecast hourly rate is \(2.75 \text{ RTD} + 25.8\% = 3.46 \text{ RTD}\).

We assume that the exchange rates will move in line with the differences in the interest rates. We assume that those rates will remain constant.

Over five years the rates will change as follows \((1.09/1.05)^5 = 1.21\).

The exchange rate will be \(1 \text{ BND} = 2.50 \times 1.21 = 3.025 \text{ RTD}\).

The hourly rate in BND = \(3.46/3.025 = 1.14 \text{ BND}\).

(ii) The first assumption is that wages will move in line with inflation in the host country. Given that prices are rising it seems likely that L will have to pay more for wages. The actual rises that will be granted will vary in accordance with the bargaining power of the employees and so it is unlikely that the actual rises will closely match the rate of inflation.

Given that L is a multinational operating in a developing country, it may have to pay rises that exceed the rate of inflation in order to avoid claims of exploitation.

Interest rate parity suggests that the expected exchange rates will move very closely in line with the differential interest rates. That does not mean that the actual rates will turn out in accordance with expectations. The governments of either country may decide to manage their interest rates in order to strengthen or weaken their exchange rates.

(b) It could be argued that a kilo of fibre will cost a specific number of USD regardless of whether it is imported to the home country or the host. Basic costing suggests that the value is irrelevant, particularly when transportation does not affect pricing.
Unfortunately, things are more complicated because L will be importing finished paper, which contains flax fibre, rather than flax fibre itself. Transfer pricing arrangements will mean that the paper will have to be sold to L’s trading subsidiary in the home country at the open market price for paper. Changes in the price of the underlying raw materials may not directly affect the market price in a linear manner and so the price of flax fibre could change the taxable profits in the two countries.

(c) The most immediate problem is that L will make its present employees redundant. That will undermine the company’s reputation. Customers may buy their paper from other suppliers rather than be associated with L. The home government may also be concerned that L has exported jobs and may take sanctions against the company. It could, for example, grant contracts to other companies.

L will also come under suspicion for operating in a developing country. Activists in the home country may feel that L is exploiting badly paid workers in the developing country. Even if such accusations are unfounded L may suffer responses ranging from negative press comment to demonstrations at its remaining locations.