



# Examiners' report

## P1 Professional Accountant

### December 2007

#### General comments

December 2007 was the first P1 paper. As the examiner, I am very happy to report a good overall performance and that many people passed the paper. Some of those that passed were outstandingly good. Congratulations, then, to all who passed and also to the tutors who worked so hard with the candidates to prepare them for the exam. In this, my first Examiner's Report, I hope to be able to help candidates preparing for future P1 exams by looking at the questions on the December 2007 P1 paper. I will point to the ways in which the questions were well answered and highlight typical errors for candidates to be aware of in future P1 papers.

Paper P1 consists of two sections. Section A contains one question (Question 1) which is compulsory and worth a total of 50 marks. It can generally be assumed that this question will examine topics on several areas of the P1 study guide. Section 2 contains three questions, all worth 25 marks each, and candidates must do two from those three. Each of the three questions in Section B will focus in a little more detail on one area of the study guide.

Candidates that performed well in the exam were those who, in addition to having studied and revised the syllabus in depth, were able to answer at the levels of the verbs used in the questions. Because P1 is a professional level paper, many verbs were at cognitive level 3 – verbs like assess, evaluate, critically evaluate and construct. Candidates that achieved good marks in the paper were those able to demonstrate these skill levels when required in the exam. Candidates that were expecting to be able to answer the questions of the exam using 'book work' or 'rote learning' knowledge generally failed to address the level 2 and level 3 skill requirements and thereby failed the exam.

#### Question 1

The case scenario for Question 1 was based around a company (Worldwide Minerals) faced with a difficult situation arising from an inaccurate estimate of a crucial mineral inventory in a recently purchased mine. The length and complexity of the scenario is typical of what candidates can expect in future P1 section A cases.

In the December 2007 paper, Question 1 consisted of four parts. Part (a) asked about one of the key underlying concepts in corporate governance and 10 marks were available for a definition of the term 'transparency' followed by an evaluation. Candidates were asked to evaluate the importance of transparency in financial reporting with reference to the case. The case was about the board of Worldwide Minerals (WM) considering how it should behave having discovered a value-material overestimate of a key mineral inventory in a mine. Most candidates were able to define the term and explain its relevance to the case of WM but fewer were able to perform the evaluation, which, in this case, involved a consideration of the issues surrounding fully reporting the error to shareholders. Many candidates made the case as to why WM should disclose the error but very few candidates went as far as explaining the opposite argument. There are times when full disclosure is not appropriate and a full evaluation would have brought that out. It is very important that the verb used in the question is used as the basis for the answer.

Part (b) was answered well overall. The first part of part (b) was an explanation of Kohlberg's three levels of moral development and this was done well by most well-prepared candidates. The second part about identifying the levels of the three people in the case was answered less well with some candidates failing to interpret the evidence in the case scenario correctly.

Part (c) was a near-repeat of a question in the pilot paper on the principal roles of non-executive directors (NEDs) and candidates should therefore have been familiar with how to address the question. Most of the marks were awarded for a description of the roles with some also being available for the more challenging task of an explanation of the tensions that WM's NEDs might experience in the case scenario. This second part was not answered well overall with many answers containing descriptive content rather than serious efforts to consider the difficult situation that the NEDs were in at WM.

Part (d) was the most ambitious component of question 1. A question requiring the demonstration of professional presentation skills will be a part of future P1 papers and in the case of this first paper, the question required writing a letter from Tim Blake, the chairman of WM, to its shareholders. Most candidates made some attempt to present the answer in the form of a letter but many didn't pick up as many professional marks as they might have because:

- The answer did not read like a letter (perhaps more like a memo)
- It was not in the form of a formal letter to shareholders which would typically have a beginning and an end with a logical flow of content in the 'middle'.
- It was addressed to the wrong audience ('Dear Mr Blake')
- It used bullet points and short, unconnected paragraphs with no sense of 'flow' between them.

There were four professional marks available. In terms of marks allocation, one professional mark was available for the basic form of a letter meaning it was correctly headed, finished, addressed and physically laid out. The other three were awarded for the composition, flow and persuasiveness of the narrative itself. The letter was from a company chairman to the company's shareholders and those gaining all four professional marks were those that read most like a letter of its type would read in 'real life'. A good answer contained an explanatory introduction, a discussion in the form of narrative (rather than bullet points) of the content of parts (i) and (ii) of the question finished off with a brief paragraph drawing the threads together. Future P1 papers will ask candidates to 'draft' or 'write' content in the form of various types of written communication. Candidates are advised to pay attention to the professional marks as the four marks available could make the difference between a pass and a fail. Four marks are worth approximately seven minutes in time (4% of 180 minutes), which should give candidates some idea of how much investment to make in the professional marks.

In terms of the content of Q1 (d), part (i) asked candidates to explain why they believed internal controls to be important. This was intended to convey Mr Blake's competence to WM's shareholders and to reassure them that despite the recent problem with the mallerite measurement, they should continue having full confidence in him as chairman. Part (ii) invited candidates to put themselves in Mr Blake's position and suggest the types of measures that WM might introduce to improve things. Part (i) was not done well overall despite it being, in cognitive level terms, 'lower' than the task in part (ii). Some candidates introduced the letter and then misinterpreted the 'importance of' internal controls to mean 'components of' and such answers obviously were not well rewarded. The marking team allowed for a range of reasonable interpretations of part (ii) and answers making a serious attempt to address the types of changes that WM might make were rewarded to some extent.

## **Question 2**

Question 2 was a 'risk' question with elements of executive pay introduced in part (c). The case concerned the risk committee at Southern Continents Company (SCC) considering the risks associated with a new manufacturing investment it had made. The case identified three risks and part (a) asked candidates to describe four risk strategies and then to identify an appropriate strategy from those four for the management of each of the three risks. The first part of this was well done by most candidates by identifying and describing the four 'TARA' strategies of transference, avoidance, reduction and acceptance. The second part, which required candidates to apply the strategies to the risks in the case, was less well answered overall and should act as a reminder that application of answers to the case will often be an important source of marks in professional level papers.

Part (b) addressed material from study guide section D2b but seemed to catch many candidates by surprise. The point here was to explain that embedding risk involved establishing risk awareness and management in a company's culture, systems, procedures, protocols, reward and human resource systems, training, etc. To have risk embedded is similar to having quality embedded in that the tone is set at the top and is then supported throughout using the cultural and systemic architecture of the whole organisation.

Some candidates sought to use this answer to make recommendations to SCC of how to manage its risk with phrases such as 'SCC should...' or 'perhaps SCC might consider...'. Others interpreted the question to be asking

what 'risk awareness' meant. Both of these approaches were incorrect. The question as it was set was to explain what embedding risk in culture meant (and nothing else).

Part (c) was a departure from the risk theme in an otherwise risk-based question and should serve to remind candidates that the questions in section B of paper P1 will often not be entirely located within a single area of the study guide. It took a particular theme from the case and asked candidates to explain the benefit of performance related pay and then to critically evaluate the pay package awarded to Choo Wang, the chief executive of SCC. This question therefore had two parts (based on the 'rule of and'): one based on what candidates will have learned from the course materials and one in which they were required to apply the learning to the scenario. Most candidates could explain some of the benefits of performance related pay but fewer were able to pass comment on Mr Wang's reward package.

### Question 3

This question drew from the main corporate governance sections of the study guide. The answers to the question showed that whilst most had a basic knowledge of the content area in question, the less-prepared candidates struggled when it came to responding to the higher level verbs used in parts (b) and (c).

Part (a) was, at first sight, a fairly simple task to explain the roles of a chairman in corporate governance. It is when answering questions like this one that candidates have to pay special attention to the cognitive level of the verb in the question. The question specifically asked candidates to 'explain' the roles. Accordingly, answers that merely 'identified' the roles did not receive good marks. Short bullet lists of 'identified' roles received less than a pass (i.e. less than 3 out of 5) because they did not answer at the required cognitive level. An 'explanation' differs from an 'identification' in that it offers some evidence of understanding of the role over and above a mere identification. This need not be a long explanation but something rather more than a brief bullet list.

Part (b) was the most substantive part in Question 3 and asked two questions about the separation of the roles of chairman and chief executive. The first task was to assess the benefits of separating the roles. The idea of separating the roles was formally proposed in the UK by the Cadbury code back in 1992. Although there are other reasons for the separation of roles, Cadbury's proposals took place in the wake of a number of 'scandals' in which the abuse of power at the top of a company was a major cause. The report said (s. 4.9):

"If the two roles are combined in one person, it represents a considerable concentration of power. We recommend, therefore, that there should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision."

Good answers usually contained a clear statement on the increased accountability arising from the separation of roles reducing the 'unfettered power' of a single, powerful individual. In order to score highly on part (b), however, a second task was to explain how the separation of roles led to increased accountability to shareholders. Fewer candidates did as well on this as on the first task, perhaps because it was a little unexpected. Candidates should be aware, though, the questions on Paper P1 will often ask candidates to think about something in the exam that they may not have read directly in the study guides or been taught in class. The structure of Q2 (b) is one that candidates should expect in future P1 papers.

### Question 4

This was the section B question that caused candidates the most problems. The content of the question was drawn from parts of the study guide concerned with stakeholders, ethical perspectives and the arguments about extending corporate responsibility beyond the duties to shareholders. In each case, the reason why candidates underperformed was, again, because they failed to answer the question as it was actually set. It may be tempting to answer the question you wish was being set but unfortunately that will sometimes not achieve very many marks.

Part (a) asked candidates to define stakeholder (which most candidates got right) and then to ‘explain the importance of identifying stakeholders...’. It was the second task that confused many candidates. It might be worth noting what this part did NOT ask candidates to do. It did NOT ask candidates to:

- Identify the stakeholders (so lists of stakeholders did not attract marks)
- Describe the Mendelow framework
- Describe each stakeholder’s position on the Mendelow matrix
- Explain each stakeholder’s claim on the stadium project.

Most poor answers followed one or more of these paths.

Some marks would have been available for stating that one of the main purposes of identifying all stakeholders is to take into account the relative power and influence of stakeholder groups when planning for and communicating about the stadium project. However this was not specifically a ‘Mendelow’ question. The correct approach required candidates to ‘take a step back’ and place themselves in the position of the board of the football club, considering all the benefits of knowing who the stakeholders and their different claims were? That is what the question was probing.

Part (b) invited candidates to apply an important area of ethical theory to the case. Gray et al.’s ‘seven positions’ describe the possible perspectives that people can adopt in respect of the ethical role of business. The question specifically mentioned two of these – the pristine capitalist position and the social contractarian position. Again, it is worth noting that the question did not ask candidates to list the seven positions nor to explain any of the other five.

There were two tasks in part (b). The first was to compare and contrast the two positions. This involved recognising that the pristine capitalist position recognised only a responsibility to shareholders whilst the social contractarian position sees a ‘deal’ being done between an organisation and the society in which it operates. In the ‘social contract’, the organisation agrees to act in line with the norms of the society in which it operates in exchange for the support of that society in allowing it to survive and prosper. The second part was to explain how adopting each position as an ethical stance would affect how the football club responded to the stakeholder concerns. The way that many candidates answered this question was to correctly describe the two ethical positions but then to fail to adequately apply them to the situation facing the football club. It was this failure to apply, both in this question and elsewhere in the paper, that explains why many candidates did not achieve higher marks than they did. Again, it is not enough to rely on the ‘book knowledge’ learned from the study texts or classes. An ability to apply that knowledge to the case is essential in achieving higher marks.

The final part of question 4, part (c), also asked for some evidence of understanding and then some application. In addition to explaining what ‘fiduciary responsibility’ meant, candidates were also invited to ‘construct’ a case for something. To ‘construct’, or ‘synthesise’, is a level 3 verb alongside others like assess or evaluate. It requires candidates to prepare an argument in favour of a particular position or course of action (or against, of course, depending on the question). Candidates do not need to personally believe in that position, of course, but to prepare the main points of a convincing case in support of the position stated.

In this case, the task was to prepare a case in favour of extending the fiduciary responsibility toward stakeholders other than the club’s shareholders. The limit of accountability of a business organisation is one of the key arguments in the debate over the social responsibility of business and this case probed some of the issues involved in that debate. This part was not done well overall. For many candidates it was the final part of the examination itself and there was evidence in some exam papers of time pressure compromising the quality of the answers but it was also true that many candidates struggled with the task of constructing an argument. This should represent a challenge to candidates sitting the P1 paper in future.