# Examiners' report

# P1 Professional Accountant December 2008



#### Introduction

This was the third 'live' P1 paper. As in previous diets, the format consisted of two sections, A and B, with section A containing the one compulsory question for 50 marks and section B containing three questions from which the candidate had to select two. Each question in section B was worth 25 marks with each being divided into several parts.

As in previous P1 diets, question 1 sampled the P1 study guide broadly, drawing content from several areas. Each of the questions in section B examined one of the major areas of the study guide in rather more detail.

I am happy to report that many candidates passed paper P1 in the December 2008 diet and I would like to congratulate successful candidates and their tutors. Many others did not pass the paper, however, and I hope that my remarks below will help candidates attempting future P1 papers. It is very important that all candidates study carefully all previous papers along with the answers. Examiner's reports enable candidates and tutors to see the areas that were done well and not so well by candidates. I hope my remarks below are helpful in this regard.

Before I go on to discuss the paper in detail I would like to make two overall points. First, and repeating a point made in previous P1 examiner's reports so far, there is still ample evidence that some candidates are yet to learn the importance of the verb used in the question. Second, some candidates underachieved in the exam because of a failure to read the questions carefully enough. In some cases, candidates answered the question they wished had been set rather than the one that was actually set. I will return to these issues at various points below.

#### Question 1

The scenario for this question was based on a company whose research scientists had made a potentially industry-changing discovery. The discovery concerned a change to a production process that was capable of providing the company (SHC) with an unassailable competitive advantage but at the same time placing the management in an ethical quandary. The dilemma was over whether to pursue an option involving licensing the technology to competitors thereby gaining a flow of royalties and allowing competitors to survive, or a 'secrecy option' denying use by competitors and probably putting them all out of business. Each option had its own risks and benefits.

Part (a) asked candidates to evaluate the secrecy option using Tucker's framework. This involved interrogating the option using five criteria with each one requiring reference back to the case study as well as a sound knowledge of the Tucker framework itself. This was the question that candidates did the best on with many achieving all ten marks. I included an article on this framework in Student Accountant early in 2008 and it is gratifying that many performed well on this part. Some candidates failed to gain high marks because of a failure to relate the answer to the case or by misunderstanding one or more of the criteria. Some, for example, wrongly construed 'sustainable' as referring to the continuance of the SHC business rather than the environmental implications of the option.

Part (b) asked candidates to distinguish between strategic and operational risks and then explain why the secrecy option would be a source of strategic risk. The marking scheme allowed a maximum of six marks for the theoretical component of this question with the remaining four being reserved for explaining the 'why' question with reference to the case. There was a recent article in *student accountant* on this issue by Nick Weller so it was good to see many candidates achieving good marks on understanding strategic and operational risks.

It was disappointing to see that many candidates were less able to use their theoretical knowledge of strategic risk by relating it back to the case. In order to attract maximum marks, candidates had to show how the secrecy



option would be a *strategic* risk and not just general risk. Some candidates discussed the general risks associated with the option without distinguishing between the strategic and the operational and those answers were not well rewarded.

Part (c) was the most ambitious component of question 1. In it, candidates had to not only construct arguments in favour of both options, but they also had to write their answers in the manner of a management narrative in an annual report. Each part (i and ii) asked for a convincing business case for one of the options and also an ethical case. The question specified that the ethical case should be made from the pristine capitalist perspective in favour of the secrecy option and from the wider stakeholder perspective for the licensing option. Candidates therefore had to be aware of what each ethical perspective was 'about' and also to apply it to the case.

This application of ethical theory to the case proved difficult for many candidates. A common approach was to attempt to make the business case for the two options and then to include a paragraph briefly providing the candidate's understanding of the two ethical stances but failing to develop those by referring to the case. Again, it is the application of theory to the case that was the reason why many candidates did not perform well in part (c).

The application of ethical theory was not well done overall. It is not enough to understand ethical perspectives. Candidates will usually be required to apply them in some way to get the majority of marks in P1 ethics questions.

Part (c) also contained 4 professional marks. Professional marks are a part of all professional level ACCA papers and examiners can choose a range of ways to examine these. In each case, however, candidates must present their answers in the manner prescribed and it follows that candidates must know how to write in the prescribed manner to gain the 4 professional marks. Accordingly, I strongly advise tutors to ensure that candidates are familiar with the common types of presentation format. Similarly, candidates studying the subject alone would ensure they are familiar with formats including letters, presentations, briefing notes, management reporting narratives (such as was asked for in this diet), press statements, memos and the like. Some candidates, for example, wrote a letter from chief executive Nelson Cobar while in other cases the answer was more like a memo. Neither of these incorrect approaches was rewarded with professional marks.

Issues concerning the contents of annual reports continued in part (d) of question 1. Reporting is a crucial part of corporate governance and business accountability. Part (d) sought to explore issues in that regard. Part (d)(i) asked candidates to distinguish between mandatory and voluntary disclosures with examples and it wasn't surprising that most candidates were able to do that to some extent. Part (d)(ii) was a little more challenging as many candidates were unsure as to the link between voluntary disclosure and accountability. The link between disclosure and accountability is an important one and addresses one of the key themes of the whole P1 study guide. Once an item is disclosed it means that stakeholders gain information on which to hold the business to account. Again, a sound understanding of accountability was helpful to candidates who scored highly in this part of question 1.

### Question 2

This question was attempted by the majority of candidates and was the best done in section B. It was centred around the risk sections of the study guide but also included elements on corporate governance, especially about non-executive roles.

The scenario gave some information about Chen Products. It was a company that made four products and one of them (Product 2) had some problems in that it had failed while being used by customers. The tasks contained a mixture of book work (which reward thorough revision) and application to the case.

Part (a) asked candidates to describe the typical roles of a risk management committee. Some candidates failed to observe the verb ('describe') and produced a list (more like 'identify') thereby failing to achieve full marks.



Others, perhaps misinterpreting the task, wrote about the purposes of risk management which is a slightly different thing. For five marks, the time budget of nine minutes should have been enough to write two or three sentences on each role by way of description. Again, I would remind candidates to obey the verb. If a question asks candidates to describe or explain, a bullet list of points in not an appropriate response.

Part (b) appeared to be straightforward but also required application to the case to gain maximum marks. The TARA framework of risk management options (transfer, avoid, reduce, accept) has appeared in a previous P1 paper and candidates gained some marks for correctly identifying and explaining each point. To gain the full 10 points, however, candidates had to consider how each option might be applied to Product 2 and this was where some failed to gain marks.

There were two sub-sections of part (c). For two marks, candidates had to simply distinguish between executive and non-executive directors. This is a fundamental and core area of the P1 syllabus so it wasn't surprising that most candidates were able to do this. The more challenging task was part (c)(ii).

Part (c)(ii) asked candidates to 'evaluate the relative advantages and disadvantages of Chen's risk management committee being non-executive rather than executive in nature'. Clearly then, it was a question drawing on content from the exec/NED sections of the study guide. What some candidates missed, however, was its specific relevance to risk committees. It was not asking about the pros and cons of NEDs in general. Rather it was asking candidates to consider the pros and cons of the placement of NEDs on a particular committee (the risk management committee) and this raised slightly different issues than the general pros and cons covered elsewhere in the study guide. A typical approach taken by some candidates was to discuss the general advantages and disadvantages but to then fail to develop these into the more specific case of risk committees. Again, it is important to study what the question is really asking rather than assume that the sense of the task can be conveyed in a cursory glance at the key words in the question.

## **Question 3**

The case scenario for this question concerned a new NED joining a board and discovering a number of poor practices in relation to internal control and internal audit. Clearly then, these were the core themes in this question.

The first ten marks, parts (a)(i) and (a)(ii), were both level 2 verbs asking about what should have been core knowledge for any well-prepared candidate. I draw attention to the level of the verb because it was on misjudging this that some otherwise well-prepared candidates failed to gain marks. As with Q2(a), it was insufficient to merely identify the content requested in Q3(a).

It was frustrating for markers, who always seek to award marks and give the benefit of the doubt where possible, to see an answer from a candidate clearly knew the answers to these parts but then failed to develop their answers according to the verb. Some candidates demonstrated their knowledge using a bullet list or a single paragraph. The following was an answer given by one candidates for Q3(a)(i):

The five objectives of internal control are safeguarding the assets, timely preparation of financial information, prevention and detection of fraud, accuracy and completeness of accounting records and the orderly and timely conduct of the business.

It is evident that this candidate knows what the objectives on internal control are as he or she has quite correctly identified them in their answer. Clearly though, this answer is an identification of the main objectives rather than a description. For five marks, a further sentence of description for each point was required.

Part (b) was the core of question 3 and employed the verb 'criticise'. In order to produce a criticism of something, the critic must know what good and bad practice is. Importantly, to criticise does not involve simply



regurgitating the points in the case that were evidence of poor practice. That is only part of the answer. Candidates who merely listed the main negative points received only some of the available marks.

If I criticise a film I have just watched, I don't just make a list of the things I didn't like about it. To produce a critique, I have to discuss each point, perhaps in the context of other things (like reasonable expectations or, in the case of the exam scenario, regulations and code provisions) and why each point is important. It would be a poor criticism, for example, if I were to criticise a film by merely saying 'poor acting'. I would need to say much more about the acting other than my belief that it was 'poor' in order for it to be a useful critique.

One valid point of criticism in the case scenario, for example, was that the audit committee chairman considered only financial controls to be important. So the criticism begins with recognising that fact. In order to gain other marks, however, it is important to add why the criticism is valid. In this case, the audit committee chairman has failed to recognise the importance of other control mechanisms such as technical and operational controls.

Part (c) drew upon the 'types of risk' section of the study guide (C2b). It asked candidates to define market risk and then explain how an ineffective audit committee can increase market risk. I was surprised to see a lot of candidates unable to define market risk and I can offer no explanation for this as it is clearly listed in the study guide as an examinable area. This part of Q3 contained two verbs, one at level 1 (define) and one at level 2 (explain). It was obviously difficult for candidates to explain its importance if they were unable to produce a correct definition. I would remind candidates and tutors that any part of the study guide may be examined and that all of it should be taught, learned and revised prior to the exam.

#### Question 4

Question 4 was the least frequently attempted question on the paper and also the poorest done in terms of marks. It was firmly placed within the ethics area of the syllabus and concerned a range of ethical issues around a corporate code of ethics, child labour in some countries and the use of ethics as part of a company's strategic positioning. The poor quality of many answers to this question suggests that candidates may have some difficulty with this section of the syllabus and this should be a challenge for future candidates and their tutors.

Part (a) was about corporate codes of ethics, which, importantly, are different from codes of professional ethics. The content for this part is clearly covered in both approved texts (10.1 in BPP and Chapter 13 of the Kaplan text) so I was surprised that candidates overall did poorly on it. There were two tasks: to describe the purposes and also the typical contents of a corporate code of ethics. This was a 'bookwork' question and so should have been well done by any well-prepared candidate. Some candidates confused corporate with professional ethics and introduced the elements of professional ethical behaviour (integrity, etc.) in place of the contents of corporate codes of ethics (policies towards suppliers, customers, etc.).

Part (b) introduced the notion of 'strategic positioning'. The question defined the term briefly although most candidates will already be aware of it from other studies within the ACCA professional examination scheme (especially from F1 and P3). Many candidates who attempted this part showed some misunderstanding of the term in question ('strategic positioning') despite it being briefly explained in the question itself. The question was referring to the ways in which some organisations use ethical behaviour and ethical reputation as a key part of the way they are perceived by their stakeholders. In the case scenario, a clear message that the company does not use child labour would be a key component of the supply chain ethics of the company itself and anybody who bought from it in Europe.

The final part, part (c), covered the themes of deontology and consequentialism. The requirement was to 'assess' a particular belief (that employing child labour is 'always wrong') from deontological and teleological (consequentialist) ethical perspectives. It was therefore necessary to know what the two ethical perspectives were and also to be able to apply them to the particular belief.



It is fair to say that where candidates did attempt this question, many answers consisted of a page or so of notes containing semi-remembered definitions of the two terms. The fact that some candidates entered into definitions of consequentialism by detailing 'egoism' and 'utilitarianism' demonstrated that the question was either misunderstood or that those candidates were unprepared for this question. Again, I would like this to represent a general challenge to tutors and future candidates to increase the emphasis on the ethics parts of the study guide and the ethical reasoning capabilities in particular. Well-prepared candidates should not only be aware of the ethical theories but also to use them and apply them. It will not be sufficient to merely define: an ability to adapt and apply is also essential.