

RELEVANT TO ACCA QUALIFICATION PAPER P4

Studying Paper P4

Performance objectives 15 and 16 are relevant to this exam

EXAMINER'S APPROACH TO PAPER P4, ADVANCED FINANCIAL MANAGEMENT

RELEVANT FROM JUNE 2011

This article highlights the main changes to the Paper P4 exams from June 2011. It starts by explaining the overall aims of, and main capabilities required for Paper P4; it highlights the main changes to the Paper P4 syllabus and changes to the formulae given in the exam; it highlights the changes to the structure and layout of the exam paper; it makes suggestions about how candidates should approach their preparation and bad habits to avoid; finally there is a short section on possible syllabus changes in the future.

AIM AND MAIN CAPABILITIES

The aim of Paper P4 is to enable candidates to demonstrate application of relevant knowledge, techniques and skills, and to exercise professional judgment, in recommending or taking decisions relating to the financial management of a business. The overarching aim of such recommendations and decisions is to add value to a business, paying due regard to the impact on the reputation of the business; and to ethical, environmental and stakeholder concerns.

The exercise of professional judgment in making sound decisions requires the need for careful weighing up of evidence that is often partial and incomplete. The right decision must often be made without the help of a simple algorithm, and in the face of an array of criteria – some technical and some ethical – which may be in conflict and not entirely clear cut. Hence, Paper P4 requires candidates to display analytical and evaluative skills, skills of judgment where alternatives are considered, and discuss the limitations of techniques used. Presentation skills are also important and answers should be clear and well-structured.

Analytical techniques and discussion should be applied in relation to the context of the scenario in the question and related to the real world where applicable. It is not sufficient to apply techniques or to conduct discussions without considering whether or not these apply to the question asked. It is also important that candidates are up-to-date in their understanding of the current global economic and financial environment.

The principles underpinning Paper P4 are introduced and developed in Paper F9, *Financial Management*. In Paper F9, essential elements have been developed: financial environment, investment appraisal, cost of capital, estimation and decisions on capital structure, sources of finance, dividend policy, working capital management, risk management and business valuation. Paper P4 explores these areas, but at a more advanced level, and considers problems and issues (many derived from real situations) relevant to the highest-level financial management of an organisation. New areas include responsibility towards stakeholders, acquisitions and mergers, corporate

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reconstruction and re-organisation, multinational organisations and emerging issues.

To be successful at this level, candidates must be able to demonstrate an integrated understanding of the subject. Therefore, it is essential that candidates are able to draw upon the knowledge, techniques and skills gained in Paper F9, and apply these to Paper P4. Also knowledge gained from the other Fundamentals level papers and from the essential Professional level papers will be useful in helping candidates demonstrate an integrated approach.

PAPER P4 SYLLABUS

Paper P4's relational diagram, *Syllabus* and *Study Guide* give a comprehensive detail of the main areas of the Paper P4 syllabus. The intention is to test the entire range of the Paper P4 syllabus areas. It is important that candidates have a sound knowledge of all the parts of the syllabus and are able to apply the knowledge to a variety of different business situations. It is also important that candidates bring forward their knowledge of Paper F9 and understand how the Paper P4 syllabus develops these areas.

Candidates should be aware that exam questions will come from the entire range of the syllabus. In Section A of the paper especially, but not exclusively, the questions may require candidates to draw on knowledge and techniques from different parts of the syllabus. Therefore, candidates should not expect each question to be related to only one part of the syllabus.

It is likely that exams will be substantive and analytically complex. The scenarios may sometimes be detailed and require in-depth analysis, evaluation and discussion. The ability to relate requirements to the scenario is important.

SYLLABUS CHANGES AND CHANGES TO THE FORMULAE

Overall there are only a few changes made to the new syllabus when compared with the old syllabus. The *Syllabus* and *Study Guide* have been made a little more streamlined, with a few topics added and a few removed.

Section B of the syllabus used to be Section F in the 'old' syllabus. The change reflects the fact that multinational economic and corporate issues will affect any organisation operating internationally. Therefore, the issues discussed here can impact all the other areas of the syllabus. Hence the relational diagram reflects this change.

Section C of the syllabus has been made more substantive and follows on from the topics introduced in Paper F9 and builds on these. The emphasis is on investment, valuation, financing and options thinking in these areas.

Key additions to the syllabus

The following additions have been made to the Paper P4 syllabus and are examinable from June 2011.

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Some of the additions detailed below were present in other parts of the syllabus or knowledge of these was expected implicitly as part of the overall knowledge of that area. The additions make the expected knowledge explicit and also highlight areas where the additions fit better.

Syllabus Area A: Role and Responsibility Towards Stakeholders

A2a) Assess corporate performance using methods such as ratios, trends, EVATM and MVA

A2d) Explain the theoretical and practical rationale for the management of risk

A2e) Assess the firm's exposure to business and financial risk including operational, reputational, political, economic, regulatory and fiscal risk [Some of this is from the old *Study Guide* section E4a)]

A2f) Demonstrate risk diversification through the application of portfolio theory

Syllabus Area C: Advanced Investment Appraisal

C1a)(ii) the new syllabus includes the words 'including capital allowances and tax exhaustion'

C1a)(iv) Probability analysis and sensitivity analysis when adjusting for risk and uncertainty in investment appraisal

C2a) Apply the Black-Scholes Option Pricing (BSOP) model to financial product/asset valuation

C2d) Apply the BSOP model to estimate the value of equity of a firm and discuss the implications of the change in value

C3a) Assess the appropriateness and price of the range of sources of finance available to a firm including equity, debt, hybrids, lease finance, venture capital, business angel finance, private equity, asset securitisation and sale

C3b) Assess a firm's debt exposure to interest rate changes using the simple Macaulay duration method

Syllabus Area F: Treasury and Advanced Risk Management Techniques

F1d)(iv) Risks such as delta, gamma, vega, rho and theta, and how these can be managed

F2a) Assess the impact on a firm to exposure in translation, transaction and economic risks and how these can be managed

Syllabus Area G: Emerging Issues in Finance and Financial Management

G1 This includes the impact of the recent financial crisis, and growth and impact of dark pool trading

Key movements in the syllabus

The following have been moved from another part of the previous syllabus

Syllabus Area A: Role and Responsibility Towards Stakeholders

Sections A4c) and A4d) are from the old sections A1d) and A1e)

Syllabus Area C: Advanced Investment Appraisal

C3c) and C3d) are moved here from E4b) and E4c) of the previous *Study Guide*.

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C3g) Assess the impact of a significant capital investment project upon the reported financial position and performance of the firm taking into account alternative financing strategies. [This is in part from the old *Study Guide* section B5a.]

Syllabus Area F: Treasury and Advanced Risk Management Techniques
F1d) was E2a) previously

Key deletions from the syllabus

The following have been removed from the Paper P4 syllabus and will not be examined.

A2f) Prepare advice on personal finance to individual as well as groups of investors covering areas such as investment and financing.

D1a) and D1b)

a) Assess the risk of corporate failure within the short to medium term using a range of appropriate financial evaluation methods (this will require an ability to use multivariate techniques such as the Z and Zeta score models).

b) Advise on the application of financial distress models to firms in emerging markets given local regulatory and financial market conditions.

G2 Financial engineering and emerging derivatives.

Changes to the formulae

In the new formulae layout, the put-call parity relationship has been moved to under the Black-Scholes option pricing (BSOP) model.

The FOREX modified BSOP model has been removed. Any alterations to the standard BSOP model will be given in a question if required.

STRUCTURE AND LAYOUT OF THE EXAM PAPER FROM JUNE 2011

Up to December 2010, Section A of the exam paper consisted of 60 marks in total and Section B consisted of 40 marks in total, with each Section B question being 20-marks long.

From June 2011 the structure and layout of Paper P4 will change. The total marks allocated to Section A will be between 50 marks and 70 marks in total, with each of the two Section A questions containing between 25 marks and 40 marks. Both questions in Section A will continue to be compulsory questions.

The total marks allocated to Section B will be between 30 marks and 50 marks, with each question containing between 15 marks and 25 marks. As before there will be three questions contained in Section B and students will be required to choose two out of three questions. Normally there will be at least one wholly written question in Section B, which will be Question 5.

Professional marks will continue to be allocated to one or both the questions in Section A. These marks will be awarded on the basis of the clarity and structure of the answer. They may also be awarded for answers that are presented in the required format. So, for example, if a report is required, in

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order to gain the professional marks, the answer should be in a report format and consist of a title, an introduction, other features as appropriate, a conclusion and make appropriate use of appendices.

An example pilot question containing professional marks, suggested answer and marking scheme have been published in *Student Accountant* in 2010. This question was in the form of a substantial 40-mark, Section A type-question, and should provide candidates with an indication of the style and complexity of questions that are likely to be asked.

ELEVEN RECOMMENDATIONS WHEN PREPARING FOR AND DOING PAPER P4 EXAM TO FORM GOOD HABITS

Paper P4 is a challenging exam. Adopting these recommendations or good habits will ensure that you give yourself the best chance of being successful and gaining a good pass.

- Develop a sound knowledge of the entire Paper P4 syllabus. Augment studying the manuals with wider reading of the financial press, finance textbooks, articles in *Student Accountant* and financial journals.
- You should expect and be prepared for questions from a range of syllabus areas and sometimes more than one area will be tested in a single question. Be prepared for questions which require you to consider a number of areas of the syllabus within one question.
- Use the 15-minute reading time at the beginning of the exam effectively. It is likely that the questions will contain a substantial amount of information which you will need to sort out and apply properly. Also this time should help you decide which optional questions to select.
- It is very important that the optional questions in Section B are chosen with care. Ask yourself questions like: Can you answer all the parts of the question? Are you able to attempt the whole question in the time allocated for it? Starting a question and then deciding you would like to do another, just wastes time needlessly.
- In your exams, good time management techniques and habits are essential in ensuring success. Make sure that you are able to answer all parts of each question and manage your time effectively so that you make a reasonable attempt at each part of each question. Remember it is much easier to get the first few marks in a question than the last few marks. Good time management skills are essential.
- Often parts of a requirement may ask for more than one aspect. Make sure that you can answer, and do answer, everything each part of each requirement is asking for.
- Make sure you answer the requirements correctly. For example if the question asks you to explain, it is not enough just to list. If the question asks you to assess, it is not enough just to explain.
- For the written parts of any question, remember it is generally a mark for each relevant point. Repeating a point does not get you any extra marks and it wastes time. Avoid repetition.
- Your answer must relate to the scenario in question. Context is very important for higher level papers. General answers will gain fewer or even no marks.

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- The presentation of your answers is critical. It is very important to pay regard to neatness, organisation and structure of your answers. Professional exams are extremely time-pressured but giving your answers structure will help you organise your thoughts and work more effectively.
- Work through the past exam questions under examination conditions and to time. Doing past questions will help you build efficiency in answering questions and help you build knowledge of how to make your answer relevant to the scenario in the question.

AND THREE THINGS TO AVOID: DO NOT FORM BAD HABITS

- Don't use past exam questions to try to pick topic areas from the syllabus or rely on certain areas coming up, for three reasons: first, you may get it wrong; second, the question may be an option but a really difficult one; finally, the topic you picked is part of a question but the rest of the question relates to a topic you decided not to study. The risk is far too high.
- Don't disregard what you learnt in Paper F9 and other papers. You will probably need the knowledge (and techniques).
- Don't use incomplete sentences when making a point. Marks are awarded for complete points made in full sentences. However, you can use bullet points and numbered paragraphs, and headings when appropriate, to structure an answer to a question. But points made should be in complete sentences.

IN THE FUTURE

No major changes are expected to the *Syllabus* and *Study Guide* in the near future, although any changes will be explained in articles in *Student Accountant*.

It is likely that the area of Islamic finance will be added to Section G in the future, following its introduction in Paper F9 syllabus. Section G will continue to be developed in the light of changes in the international financial markets and to international business and trade.

In summary, applying correct techniques and knowledge to differing and complex scenarios, adopting an integrative approach, demonstrating sound evaluative skills, displaying good presentation skills, and making considered decisions, are the factors that will lead to success in the Paper P4 exam.

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