STUDENT ACCOUNTANT
APRIL 2013

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INCLUDING EXAMINERS' FEEDBACK AND EXAMINABLE DOCUMENTS

RELEVANT TO PAPERS F4 TO F9

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ALL YOU NEED TO KNOW FOR THE JUNE 2013 EXAMS

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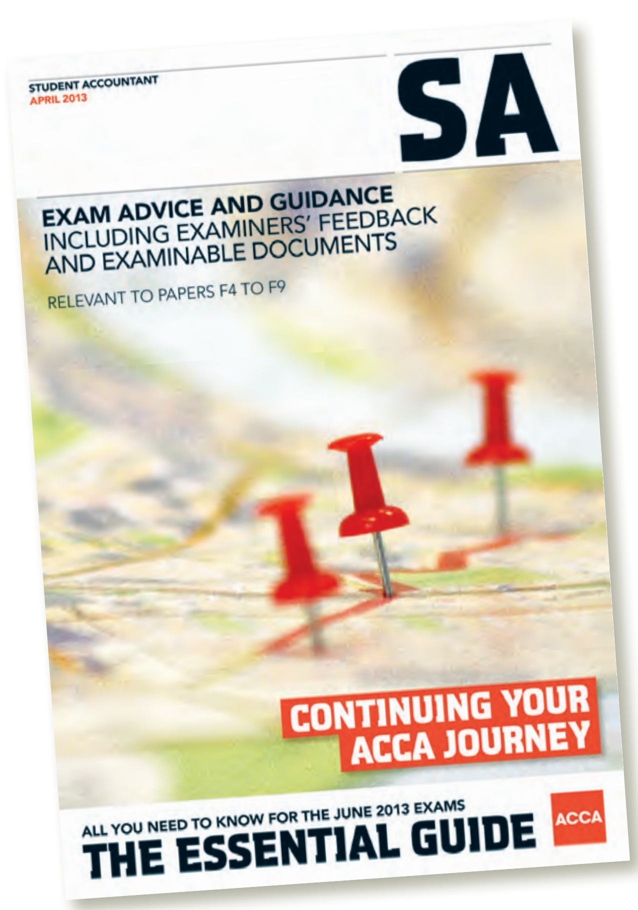
EDITOR'S CHOICE

Welcome to the latest issue of *Student Accountant* Essential Guide

This issue is focused on exam-related information that you need to support your studies towards Papers F4 to F9.

We include examiner feedback from the Fundamentals level exams taken in December 2012. This advice looks at overall performance and outlines areas where candidates obtained both high and low marks. Reading the examiner feedback together with the past exam questions and answers from the latest exam session can help you identify where students have gone wrong in the past, and how to develop your answers to achieve the best marks possible – it is one of the key resources to use in exam preparation.



As well as examiner feedback, this issue contains the examinable standards and information relevant to Papers F4, F6 (UK), F7 and F8. Use this information to guide your exam preparation and take note of the areas that you could be examined on.

The Exam Toolkit section contains a range of information and advice to help you perfect your exam technique.

In Noticeboard, you can view the exam timetable for June 2013, and access details on the exam rules and regulations that you need to be aware of, as well as information on entering for exams.

We've produced this magazine to be as helpful to you as possible in the lead up to the June 2013 exams. We have also produced two other tailored magazines for students taking the Foundation level/Papers F1, F2 or F3 exams and the Professional level exams. These can be accessed at www.accaglobal.com/studentaccountant.

I hope that you find this magazine useful in your exam preparation. Email me at studentaccountant@accaglobal.com with your feedback on this issue.

Victoria Morgan
Editor, *Student Accountant* magazine

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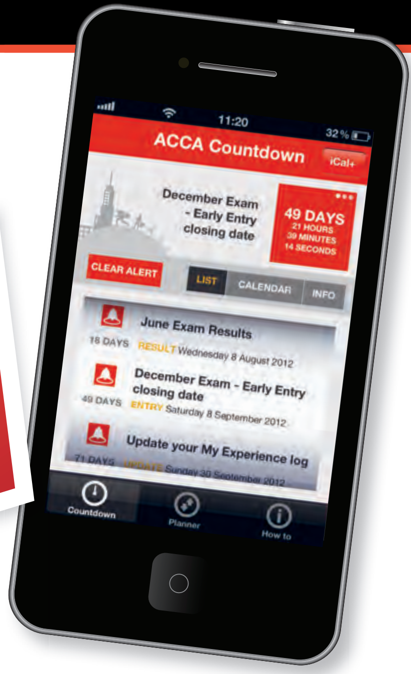

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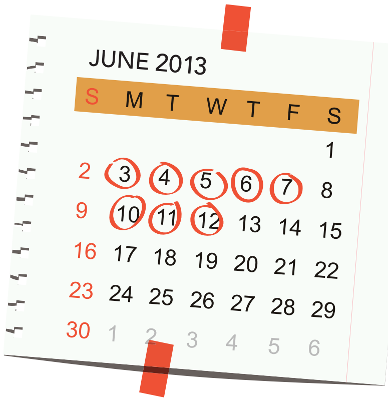

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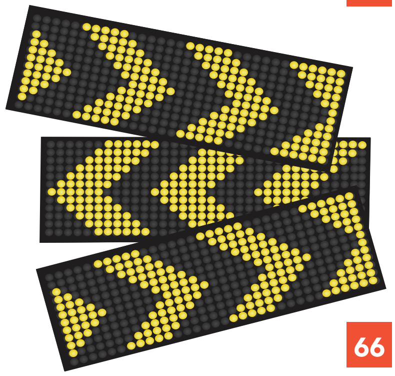

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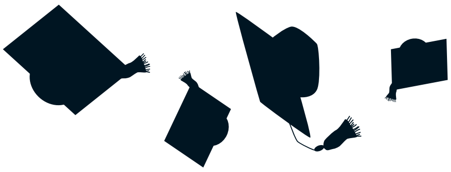

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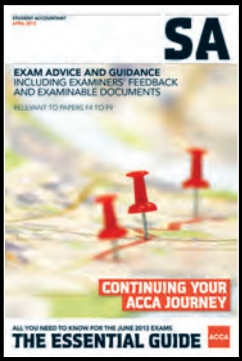

EDITORIAL TEAM
Victoria Morgan | **Editor**
Glen Patterson | **Deputy editor**
Jackie Dollar | **Art editor**
Jane C Reid | **Designer**

WWW.ACCAGLOBAL.COM
Jamie Ambler | **Digital editor**

29 Lincoln's Inn Fields London
WC2A 3EE
United Kingdom

tel: +44 (0)20 7059 5700
email: info@accaglobal.com
www.accaglobal.com

ADVERTISING
Adam Williams | **Publisher**
Anthony Kay | **Production manager**

For all advertising-related matters please contact **Nick Willmer**
tel: +44 (0)20 7902 1673
email: nickw@acca-media.com

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FEEDBACK

EXAMINER FEEDBACK

FROM THE DECEMBER 2012 EXAM SESSION

Examiners' feedback provides guidance on past ACCA exam performance and suggests ways in which students can achieve higher exam results

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EXAM RESOURCES

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Access examiner interviews and past examiner feedback on the ACCA website at www.accaglobal.com/examinerfeedback

EXAM FEEDBACK

PAPER F4
CORPORATE AND BUSINESS LAW (ENG)

There was a significant drop in the number of candidates passing this exam. This fact has to be considered in the context of an apparently wide divide in the level of performance between well-prepared candidates who scored well and, indeed, very highly in many cases and the inadequate performance of many candidates who appear simply not to have prepared sufficiently for this exam.

The structure of the paper, as usual, consisted of 10 compulsory questions, each carrying 10 marks. The first seven questions were essentially knowledge-based, while the last three were problem-based scenarios requiring both legal analysis and application of the appropriate law. As in the recent past, the questions tended to be subdivided into smaller subsections in the belief that such subdivision would help candidates to structure their answers.

As in recent examiner reports, it is worth noting the continued improvement in the response to the tort question in this paper. However, this was undermined by an inadequate performance in the contract question, with many candidates treating it as a tort question. This clearly suggests that at least some candidates remain unsure as to the nature of the different aspects of the law of obligations.

However, the three problem scenario-based questions continue to provide grounds for concern. Too many candidates were let down by their performance in these questions, which continues to suggest a general lack of analysis and application skills, if not general knowledge.

It also appears that there has been an increase in the number of candidates engaging in question spotting, with the result that many of the answers were simply inappropriate to the questions actually asked.

What follows will consider the individual questions and candidates' responses.

SPECIFIC COMMENTS
QUESTION 1

This question was on the main sources of English law.

On the whole this was very well done with many candidates gaining good marks, if not full marks. Some candidates were confident discussing common law, equity, the doctrine of precedent and legislation. Full marks could be gained even if answers did not mention all sources of law but tended to focus on either precedent or legislation.

However, a large number of candidates clearly were unsure of what exactly was meant by the word 'sources' and elected to discuss the difference between civil and criminal law and the remedies available in each of these fields of law. Others focused on statutory interpretation, which although it could have been an aspect of a good answer, was certainly not central to the question asked.

This relatively unsatisfactory performance in the question would seem to suggest that those candidates who answered incorrectly did not read the question properly and instead produced prepared answers on inappropriate topics.

QUESTION 2

This was a contract question, referring to the specific remedy of damages. It was divided into two parts each of which referred to a key aspect of damages and each of which carried five marks.

Part (a) related to concept of remoteness of damage and Part (b) to the measure of damages. Once again, answers to Part (a) were mixed. Some candidates acknowledged that this was a question on breach of contract damages and showed an in-depth understanding of the principles established in Hadley v Baxendale and Victoria Laundry. However, a significant number of candidates took the tort approach and there were many answers that discussed remoteness of damage, causation and the case of The Wagon Mound. Although similar, the tests are not the same and to use tort examples to explain contract law was simply wrong. This was particularly unsatisfactory as the question specifically stated that it was to be answered within the context of contract law. How well candidates did on Part (b) tended to follow from their performance in Part (a). Those candidates who adopted the correct approach in Part (a) also scored well in Part (b) by outlining the main principles in computation of damages in terms of compensation, financial loss and duty to mitigate. Some candidates continued to refer to remoteness, and the remoteness test. Indeed, a number of candidates considered remoteness under Part (b) and even more considered measures in Part (a), showing a lack of understanding of the distinction between the two elements of the question. A not inconsiderable number of answers even discussed the differences between breach of condition and breach of warranty. Once again, not only was this not relevant, but showed a lack of understanding as to the precise scope of the question and a falling back on inappropriate prepared answers.

QUESTION 3

This was a tort question in three parts. In Part (a) most candidates were able to acknowledge that a tort was a civil wrong where no contractual relationship needed to be present. However, some candidates thought that tort was an actual breach of contract and, in the extreme case, tort was a crime.

Part (bi) was done relatively well, with many candidates using the Donoghue v Stevenson neighbour principle. The higher scoring answers discussed the defences and also negligence in relation to economic loss. There was frequent reference to the standard of care expected and the thin skull rules, which were irrelevant in this type of question.

For those candidates who understood the meaning of the tort of passing off, Part (bii) produced some sound answers. A significant number of candidates hazarded a guess at this and quite often got passing off mixed up with trespass, battery or even more unrelated ideas.

QUESTION 4

This was a three-part question requiring candidates to explain the content of the various documents required when registering a company.

Part (a) was designed to test that candidates were actually aware of the changes introduced by the Companies Act 2006. There was no reason why a well-prepared candidate should not have received full marks. However, a number of candidates still thought that the memorandum was part of a

THERE HAS BEEN AN INCREASE IN THE NUMBER OF CANDIDATES ENGAGING IN QUESTION SPOTTING, WITH THE RESULT THAT MANY OF THE ANSWERS WERE SIMPLY INAPPROPRIATE TO THE QUESTIONS ACTUALLY ASKED

company's constitution and contained the objects clause.

In relation to Part (b), the question allowed a large diversity of answers. Even candidates who did unsatisfactorily in Part (a) usually managed to pick up some marks in this part.

In Part (c), some candidates thought that the articles of association were an external document, while others thought they were a specific contract in relation to the directors. A significant number of candidates scored full marks on this part. However, only a small number developed the discussion and considered the position of third parties, using case law such as Eley v Positive Life to support their answer. Once again, the fact that there were many potential points that could be made served candidates well.

QUESTION 5

This question was divided into two parts. Part (a), for four marks, referred to the topic of capital maintenance generally and Part (b), for six marks, required a consideration of the means for by which both private and public companies could reduce their capital.

The answers to Part (a) of the question varied quite dramatically. A significant number of candidates thought that the whole question centred on the general differences between private and public companies, so discussed in great detail the share capital, directors and company secretary requirements. Others stated that share capital had to be maintained to pay suppliers. Candidates tended exclusively to apply knowledge that had no relevance to the syllabus whatsoever.

Some answers, however, acknowledged that capital maintenance is designed to protect shareholders and creditors and that 'buffers' should be kept, and provided some explanation of the nature of those buffers and the legal rules put in place to ensure their operation.

How well candidates did in Part (b) tended to be dictated by how they answered Part (a). There were some sound answers that displayed a solid grasp of the subject area and an understanding of the various ways in which companies may reduce capital and how this could be done. Other answers were very brief and focused on there being no requirement in private companies for a minimum amount of share capital, but in public companies £50,000 is the minimum. Yet other answers attempted to answer the question from first principles without any apparent knowledge of the appropriate legal provisions.

The structure of the question implied that there was some distinction between private and public companies, but some candidates assumed that the difference lay in the nature of the resolution required to approve the capital reduction.

QUESTION 6

This question concerned companies in financial difficulty generally and specifically required an explanation of the procedure of administration.

Overall, it was done quite well. There was a little confusion and some candidates believed the process of administration was concerned with compulsory liquidation. There was also much discussion about floating and fixed charge holders. However, in general, candidates recognised that administration is a process by which there is an attempt for the company to be rescued and for creditors to achieve a better outcome.

QUESTION 7

This question was in two parts, each carrying five marks, and dealt with the issue of when dismissals may be fair (Part (a)) and automatically unfair (Part (b)). It has to be said that it was not done as well as recent employment law questions.

Quite often, full marks were awarded for Part (a) and candidates appeared to be well prepared. There were some candidates who had clearly not revised and attempted to offer an extended list of reasons such as negligence, non-attendance and prolonged sickness absence, and any number of examples of misconduct, as reasons for fair dismissal. It should be said that even some candidates who did reasonably well wasted time in giving numerous examples of misconduct. There was also a habit of discussing redundancy payment entitlement, which, in a question such as this, was not required.

Most candidates were able to get some marks for Part (b), but felt the need to discuss the remedies for unfair dismissal. This was not required and wasted time.

A number of candidates decided that, as constructive dismissal had not been examined for some time, it must be due a turn. Consequently, they produced totally inappropriate answers on that topic rather than focusing on what was actually asked.

QUESTION 8

This was a contract scenario on the rules relating to the formation of contracts. The question was subdivided into four distinct elements in an attempt to guide candidates into focusing on what was being examined.

The discussion in Part (a) on the difference between offers and invitations to treat (ITT) was overall very well done. Relevant case law was discussed. The problem was, however, that many candidates concluded that the advert was an ITT, despite having discussed Carlill and after having wasted lots of time, unnecessarily, discussing the main elements required to form a contract. This displayed an inability to apply only relevant knowledge to the various scenarios. Candidates need to tailor their approach to these types of questions in the future.

In Part (b), most candidates produced very detailed discussions on the postal rule, although a high number concluded that it was an appropriate mode of acceptance and a contract was therefore formed. This merely revealed that these candidates might know the rules in abstraction but lacked the ability to apply the law in practice.

In Part (c), only a small number of candidates acknowledged that this was a counter-offer. However, the majority of candidates did correctly conclude that there was no contract in place as the mode of payment offered varied from the one advertised.

Part (d) produced some very confused answers. The majority of candidates concluded that there was a valid contract between Al and Das, but did not know the reason why. Others correctly approached the question by considering that an offer can be revoked at any time and whether consideration had actually been provided. This part demonstrated confusion in applying the rules to certain situations.

QUESTION 9

This question related to directors' duties and the breach thereof.

On the whole, the question was inadequately answered and was by far the worst answered question on the paper.

The first point to make is that despite the fact that the question explicitly stated that the Bribery Act 2010 could be ignored, a number of candidates focused their whole answer on the fact that Fay had been bribed, which clearly was the incorrect approach to take.

Many candidates thought that this question related to insider dealing,


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so spent a significant amount of time discussing that. As Question 10 specifically referred to insider dealing, it is simply not possible that two questions on insider dealing would be asked in the same paper.

Other candidates thought that the business agreement was a partnership and discussed the role of agency and the fact that Fay could be removed from the partnership. There was also a lot of discussion in relation to private companies, lifting the veil and fraudulent and wrongful trading. All of which was irrelevant.

Where candidates did understand what the question was about, there were varying degrees of answers produced. Some candidates referred to the fiduciary duties of directors, without acknowledging that the Companies Act 2006 had codified the duties. Others did discuss the correct duties but then concluded that Fay was in breach of the Company Directors Disqualification Act 1986 – this appeared very frequently. There were also lengthy discussions on the different types of directors, which was further evidence of candidates attempting to make the question fit the answers they had prepared.

Directors' duties are a fundamental company law topic and it was unsatisfactory that answers were not of a higher standard.

QUESTION 10

This was a problem scenario on insider dealing.

This question was answered very well, with candidates producing answers on primary and secondary insiders and considering the defences available. Not many candidates, however, were aware of the penalties and sanctions and it was very rare that the correct term of a maximum of seven years' imprisonment was seen.

Given how inadequately this topic has been answered in the past, there was an improvement in performance.

Nonetheless, it still has to be stated that some candidates attempted to answer the question using employment law and/or fiduciary duties.

PAPER F4
CORPORATE AND BUSINESS LAW (GLO)

There was a drop in the number of candidates passing this exam. This fact has to be considered in the context of an apparently wide divide in the level of performance between well-prepared candidates who scored well and, indeed, very highly in many cases and the inadequate performance of many candidates who appear simply not to have prepared sufficiently for this exam.

The structure of the paper, as usual, consisted of 10 compulsory questions, each carrying 10 marks. The first seven questions were essentially knowledge-based, while the last three were problem-based scenarios requiring both legal analysis and application of the appropriate law. As in the recent past, the questions tended to be subdivided into smaller subsections in the belief that such subdivision would help candidates to structure their answers. There was a significant reduction in the preparedness of those taking the exam.

However, the three problem scenario-based questions continue to provide grounds for concern. Too many candidates were let down by their performance in these questions, which continues to suggest a general lack of analysis and application skills, if not general knowledge.

It also appears that there has been an increase in the number of candidates engaging in question spotting, with the result that many of the answers were simply inappropriate to the questions actually asked.

What follows will consider the individual questions and candidates' responses to the individual questions.

SPECIFIC COMMENTS
QUESTION 1

Part (a), on the legal system, required an explanation of the sources of English law and Part (b) gave a choice of an explanation of sources in either Sharia law or civil law.

On the whole this was very well done, with many candidates gaining marks, if not full marks. Part (b) tended to be done better than Part (a) but, even there, some candidates were confident discussing common law, equity, the doctrine of precedent and legislation.

However, there was some evidence of candidates relying on prepared answers: some gave answers on the distinction between common law and equity or the difference between civil law and criminal law.

As previously, where an option has been given in relation to Part (b), a number of candidates provided answers to both elements.

QUESTION 2

This was essentially a contract question requiring knowledge of the provisions in the UN Convention on Contracts for the International Sale of Goods (UNCISG). It specifically focused on the remedy of damages. It has to be said that the performance in this question was inadequate. As UNCISG is core to the syllabus, and damages are core within UNCISG, it was expected that candidates would be well-prepared in this area. Unfortunately, this was not the case and among the errors perpetrated by candidates, the following were well represented:

- Treating 'damages' as relating to physical damage to goods.
- General discussion of UNCISG – or even of the UN as a whole.
- General discussion of formation of contract.
- General discussion of obligations of buyer and seller.
- General discussion of remedies
- For those candidates in the right area, some were of the view that damages can only be claimed in the event of fundamental breach.

Very few candidates understood the need for damages to be foreseeable.

The foregoing are weaknesses in relation to specifics of the law relating to UNCISG, but of perhaps even more concern was the number of candidates who took the question as an invitation to provide an answer on arbitration. Perhaps candidates were misled by the mention of award in the question? However, it is more likely that these candidates had studied previous exams where arbitration had been set as the topic being questioned and simply regurgitated a prepared answer in that topic.

QUESTION 3

This question was related to company names and their protection. It was divided into three parts carrying four, four and two marks respectively.

Part (a) on limitations on company names was, on the whole, well done with the large majority of candidates gaining satisfactory marks.

Part (bi) was on the tort of passing off and, for those candidates who understood its meaning, this was a question that produced some sound answers. A significant number of candidates hazarded a guess at this and quite often got passing off mixed up with unrelated criminal activity.

QUESTION 4

This was a three-part question requiring candidates to explain the content of the various documents required on registering a company.

SOME CANDIDATES THOUGHT THAT THE ARTICLES OF ASSOCIATION WERE AN EXTERNAL DOCUMENT, WHILE OTHERS THOUGHT THEY WERE A SPECIFIC CONTRACT IN RELATION TO THE DIRECTORS

Part (a) of this question was designed to test that candidates were actually aware of the changes introduced by the Companies Act 2006. There was no reason why a well-prepared candidate should not have received full marks. However, a number of candidates still thought that the memorandum was part of a company's constitution and contained the objects clause.

In relation to Part (b) the question allowed a large diversity of answers. Surprisingly, even candidates who did unsatisfactorily in Part (a) usually managed to pick up some marks in this part.

In Part (c), some candidates thought that the articles of association were an external document, while others thought they were a specific contract in relation to the directors. However, a significant number of candidates scored full marks on this part. However, only a small number developed the discussion and considered the position of third parties, using case law such as Eley v Positive Life to support their answer. Once again, the fact that there were lots of potential points that could be made served candidates well.

QUESTION 5

This question was divided into two parts. Part (a), carrying four marks, referred to the topic of capital maintenance generally and Part (b), for six marks, required a consideration of the means for by which both private and public companies could reduce their capital.

The answers to Part (a) again varied quite dramatically. A significant number of candidates thought that the whole question centred on the general differences between private and public companies, so discussed in great detail the share capital, directors and company secretary requirements. Others stated that share capital had to be maintained to pay suppliers. Overall, this question demonstrated a lack of understanding of the subject matter. Candidates tended exclusively to apply knowledge that had no relevance to the syllabus whatsoever.

Some answers, however, acknowledged that capital maintenance is designed to protect shareholders and creditors and that 'buffers' should be kept, and provided some explanation of the nature of those buffers and the legal rules put in place to ensure their operation.

Again, as in Question 2, how well candidates did in Part (b) tended to be dictated by how they answered Part (a). There were some sound answers that displayed a solid grasp of the subject area and an understanding of the various ways in which companies may reduce capital and how this could be done. Other answers were very brief and focused on there being no requirement in private companies for a minimum amount of share capital, but in public companies £50,000 is the minimum. Yet other answers attempted to answer the question from first principles without any apparent knowledge of the appropriate legal provisions.

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Overall, it was done quite well. There was little confusion and some candidates believed the process of administration was concerned with compulsory liquidation. There was also much discussion about floating and fixed charge holders also. However, in general, candidates recognised that administration is a process by which there is an attempt for the company to be rescued and for creditors to achieve a better outcome.

QUESTION 7

This question required an explanation of the meaning and effect of three specific ICC Incoterms. On the whole, and ignoring the many strange explanations of the actual meaning of the terms, this was done very well and was easily the highest scoring question on the paper with many candidates gaining full marks.

QUESTION 8

This was a contract scenario on the rules relating to the formation of contracts under UNCISG. The question was subdivided into four distinct elements in an attempt to guide candidates into focusing on what was being examined.

The discussion in Part (a) on the difference between offers and invitations to treat (ITT) was well done overall. The problem was, however, that many candidates concluded that the advert was an ITT; an example of too many candidates not reading the question properly.

For example:

- It was not an offer because quantity not specified. (The possibility of a language issue has been raised in this regard – were candidates looking for a number and not picking up that indefinite article equals one?)
- Too many candidates stated that it cannot be an offer if made to more than one person.
- Too many candidates wasted lots of time unnecessarily discussing the main elements required to form a contract.

Parts (b)–(d) related to counter-offers and their effects.

While all three were examples of counter-offers, only some candidates followed the logic of their legal analysis, with a number deciding on spurious distinctions to separate the three elements.

QUESTION 9

This question related to directors' duties and the breach thereof.

On the whole, the question was inadequately answered and was by far the worst answered question on the paper.

The first point to make is that despite the fact that the question explicitly stated that the UK Bribery Act 2010 could be ignored, a number of candidates focused their whole answer on the fact that Fay had been bribed, which clearly was the incorrect approach to take.

Many candidates thought that this question related to insider dealing, so spent a significant amount of time discussing that. As Question 10 specifically referred to insider dealing, it is simply not possible that two questions on insider dealing would be asked in the same paper.

Other candidates thought that the business agreement was a partnership and discussed the role of agency and the fact that Fay could be removed from the partnership. There was also much discussion in relation to private companies, lifting the veil and fraudulent and wrongful trading, all of which was irrelevant.

When candidates did understand what the question was about, there were varying degrees of answers produced. Some candidates referred to the fiduciary duties of directors, without acknowledging that the Companies Act 2006 had codified the duties. Others discussed the correct duties but then concluded that Fay was in breach of the Company Directors Disqualification Act 1986 – this appeared very frequently. There were also lengthy discussions on the different types of directors, which was further evidence of candidates attempting to make the question fit the answers they had prepared.

Directors' duties are a fundamental company law topic and it was unsatisfactory that answers were not of a higher standard.

QUESTION 10

This question was a problem scenario on insider dealing.

This question was answered very well, with candidates producing answers on primary and secondary insiders and considering the defences available. Not many candidates, however, were aware of the penalties and sanctions and it was very rare that the correct term of a maximum of seven years' imprisonment was seen.

Given how inadequately this topic has been answered in the past, there was an improvement in performance.

Nonetheless, it still has to be stated that some weaker candidates attempted to answer the question using employment law and/or fiduciary duties.

PAPER F5 PASS RATE: 37%
PERFORMANCE MANAGEMENT

The exam consisted of five compulsory questions worth 20 marks each.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure, although occasionally a candidate would state that they had run out of time.

Many candidates started with Question 5 at the December 2012 sitting. This was the question on activity-based costing and was, overall, one of the better answered questions on the paper, particularly Parts (a) and (b), the numerical parts of the question. Question 1 on cost-volume-profit analysis was often left until last, and the lower quality of the answers suggested that this was because of a lack of knowledge of this area of the syllabus.

Generally speaking, candidates performed well on Questions 2(a), 3, and 5(a) and 5(b). The questions candidates found most challenging were the whole of Question 1, 2(b) and (c), the whole of Question 4 and 5(c). This is mainly due to candidates not understanding core syllabus areas well enough, a lack of technical knowledge and a failure to read question requirements carefully. Question 1 was newer to the syllabus than the other topics examined, but there was an article on this in *Student Accountant* which should have helped in answering this question.

A number of common issues arose in candidate's answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers that scored few, if any, marks.
- Poor time management between questions; some candidates wrote far too much for some questions and this put them under time pressure to finish remaining questions.
- Not learning lessons from earlier examiner reports and, hence, making the same mistakes.
- Illegible handwriting and poor layout of answers. The handwriting in candidates' answers is sometimes so bad that no marks can be awarded at all because it is simply not possible to read it.

SPECIFIC COMMENTS
QUESTION 1

Part (a) of this question required candidates to calculate the weighted average contribution to sales ratio for Hair Co. Using the most simple approach for this, it was necessary to calculate the individual contribution for each of the products. From this, the total contribution could be calculated by applying the sales volumes to the unit contributions. Then, the total sales figure could be calculated, finishing with the calculation of the ratio by dividing the first figure by the second.

The majority of candidates were able to calculate the unit contributions, which is obviously a very basic Paper F2 skill. However, many seemed unclear where to go from here. The most common error was that candidates then simply added together the three unit contributions, added together the three unit selling prices, and divided the former by the latter, giving a contribution to sales ratio of 36.9%. The problem with this calculation is that it does not take into account the relative sales volume of each product and it is not therefore a weighted average contribution to sales ratio, but rather just an average contribution to sales ratio.

Part (b) asked candidates to calculate the break-even sales ratio for the company. This is a very simple calculation and was answered correctly by about half of candidates. Follow-on marks were given for using the ratio calculated in Part (a), even if this ratio was incorrect. All that needed to be done to calculate the break-even sales revenue was for the fixed costs of $640,000 to be divided by the ratio. There is a far more complicated method of performing this calculation but it takes a ridiculously long time to perform and I am not sure why anyone would use it when there is such a simple way to calculate the required figure. Some candidates did attempt to use it though, but it is not to be recommended, given the length of time it takes and the complexity of the calculation itself. Hence, I am not going to describe it here.

Part (c) examined break-even charts. This was poorly answered by the majority of candidates, with very few scoring full marks. There seemed to be two main problems. First, despite the recent *Student Accountant* article, which described all the different charts that could be examined, there seemed to be a lack of knowledge about what a break-even chart looked like. Many candidates drew profit-volume charts, which are different. Second, in order to plot the lines, candidates needed to do some preliminary calculations for cumulative profit and revenue. Many missed this point and were therefore unable to plot the lines. This area needs to be revised for future sittings as there is clearly a knowledge gap here.

SOME CANDIDATES WROTE FAR TOO MUCH FOR SOME QUESTIONS AND THIS PUT THEM UNDER TIME PRESSURE TO FINISH REMAINING QUESTIONS

CANDIDATES NEEDED TO CONSIDER THE RELATIONSHIP BETWEEN THE DATA AND CALCULATIONS WITH THE INFORMATION GIVEN IN THE QUESTION

Part (d) asked candidates to comment on their findings for three marks. Answers to this were weak. The main point to identify was the fact that the company would break even earlier if it sold products in order of their CS ratios first. The reality is, however, that the company would neither sell the products in a constant mix or in order of their profitability – therefore the true break-even point would really lie somewhere in the middle of the two.

QUESTION 2

This was a straightforward variance question. It should have been well answered but it wasn't, apart from Part (a). In Part (a), the requirement asked for calculations of the total labour rate and total efficiency variances. These were very simple calculations where around half of candidates scored full marks. The most common error that occurred was that candidates used a standard cost of $6 an hour rather than the correct standard cost of $12 per hour. The $6 given in the question was the standard cost of labour for each batch, but given that a batch only takes half an hour, it was necessary to identify that this figure needed to be doubled to arrive at the standard cost per hour rather than per batch. It is really important to read the question carefully to pick up key information.

Part (b) was more difficult, with a requirement to analyse each of the variances from Part (a) into component parts for planning and operational variances. There were some poor attempts here, with a substantial number of candidates writing about planning and operational variances rather than performing the calculations. This was surprising, given that the requirement was very clear as to what was expected. Only a very small minority of candidates attempted to produce a total planning variance and a total operational variance, without splitting it between rate and efficiency as the question required.

There are two main ways of calculating the labour rate planning variance and the labour efficiency operational variance tested in Part (b). The first one is the method I have used in my suggested solution, whereby the actual labour hours are used for the labour rate planning variance and the actual labour rate is used for the labour efficiency operational variance. I like this method because it enables us to reconcile the planning and operational variances back to the total variances for rate and efficiency. However, an equally valid method is to use the revised labour hours for the labour rate planning variance and the revised labour rate for the labour efficiency operational variance. Either approach will score you full marks, but if you use the former method, you should use it for both variances, and if you use the latter method, you should also use it for both variances. Both the labour rate operational variance and the labour efficiency planning variance remain the same with either method.

Part (c) was the discussion part of the question where candidates had to assess the performance of the production manager. Marks were given for a discussion that followed on from the number calculated in Parts (a) and (b) or, where calculations hadn't been performed, marks were still available for sensible discussion following on from the data given in the question.

QUESTION 3

This was a classic performance management question and was generally well answered by candidates compared to other questions on the paper. The company in the question had made certain changes and introduced some incentives in order to boost sales and the requirement asked for a discussion of whether these changes and incentives had been effective. As usual, it was necessary to do some preliminary calculations in order to assess performance and candidates should be reminded that absolute figures are rarely useful and percentage changes are far more informative.

The most common weakness in answers was the classic commentary stating that, for example, 'Sales have gone up, which is good'. Comments such as these simply won't score marks. Candidates needed to consider the relationship between the data and calculations with the information given in the question, in this case relating to the changes and incentives introduced. If this link is not being made, rarely will comments score marks.

Good candidates identified that, although sales had increased by 25%, net profit had decreased by 33%, but this was due to the mass of expenses that had been incurred in bringing about the changes. Consequently, the benefits of these changes would be expected to continue for some time, and it would certainly be useful to see quarter three's results when these were available.

Poorer candidates seemed to think that the decrease in net profit margin was a sign that things were going wrong and cost of sales must be increasing dramatically. Again, I would emphasise that, at this level, candidates are expected to link the information in the scenario with the data and their calculations in order to draw valid conclusions. The candidates producing weaker answers appeared almost not to have read the scenario and simply to have read the data. In a question like this, it is really useful to annotate the written parts of the scenario and where, for example, it states that $200,000 has been spent on advertising, note down next to it the calculations that might help to analyse the effect of that (NPM, increase in sales.) Then, when writing answers, the link has already been noted down and is ready to be discussed.

As far as the calculations go, it is useful to produce a small schedule either at the beginning or end of the answer with all workings on. This makes it easy to mark and see where the calculations have come from, so that credit can still be given even where minor errors have been made.

QUESTION 4

Answers to this question were weak in parts. Part (a) asked candidates to explain what a monthly rolling budget was and how it would operate at Designit. The question was looking for a few key points – the budget covers a 12-month period; it is updated monthly; one month is added while another is removed; the first month is prepared in a lot of detail compared to the other months. The most common problem with answers was that they talked about quarterly budgets and how they would operate, rather than monthly budgets. Again, I think this must be due to inadequate reading of the question.

In Part (b), candidates were asked to discuss the problems that might occur if rolling budgets and the new bonus scheme outlined in the scenario was to

MANY CANDIDATES APPEARED TO BE RUSHING AND MAKING BASIC MISTAKES

be introduced. Answers here were not bad on the whole, with most candidates identifying that time pressure, increased costs and demotivation would all be a problem.

Part (c) asked for a discussion of the problems with the current bonus scheme and a suggestion of an alternative, more effective one. Many candidates identified the fact that, in the current scheme, the first target was too easy and the second target was too hard, meaning that the managers were not motivated to work hard. However, only a minority of candidates were able to discuss a feasible alternative scheme. The question wasn't looking for complicated suggestions, just commonsense answers suggesting perhaps a scheme with a number of different bonus rates over narrower bands of sales.

Finally, Part (d) was supposed to provide the opportunity to gain some easy marks discussing the risk of using spreadsheets for budgeting. Answers to this tended to miss the key points, unfortunately – the risk of errors arising from the input of incorrect formulae, for example, or the problems caused by lack of audit trail.

QUESTION 5

The last question on the paper covered activity-based costing and was definitely the question that students liked best. Part (a) was a simple calculation of transfer prices using traditional absorption costing, and there were plenty of correct answers here. Part (b) asked for a recalculation of the transfer prices using activity-based costing to allocate the overheads. Many candidates scored full marks, although when errors were made, the main ones were to use machine hours as the driver for machine set up costs and the number of set ups as the driver for machine maintenance costs. This error always seems to occur with these two categories of costs and I don't really understand why. I can only put it down to poor reading of the question.

In Part (c), candidates had to calculate last month's profits for each division, showing it for each product and in total. Full follow-on marks were given for profit figures based on the candidates own transfer prices in Part (b). One of the biggest problems was that some candidates didn't split the profits between the two products. This was a problem because it then made it difficult for them to earn all of the marks available in Part (cii).

Part (cii) required a discussion of whether activity-based costing should be implemented, considering it from the view of each of the divisional managers. Stronger candidates set their answer out using two headings – one to consider the decision from the point of view of the assembly division's manager and one to consider it from the retail division manager's viewpoint. The key point that the question was getting at was that the transfer prices set using machine hours as a basis for apportionment actually solve the problem of reducing R's transfer price so that its external selling price can be reduced, without needing to resort to using activity-based costing. What would be the point of using activity-based costing, which is time consuming and expensive, when resolution can be found simply by apportioning costs on the basis of machine hours? Although only the strongest candidates identified this point, many candidates scored enough marks to still gain a pass on this part of the question.

PAPER F6 (UK) TAXATION

The exam consisted of five compulsory questions. Question 1 for 25 marks, Question 2 for 30 marks, and three further questions of 15 marks each.

The vast majority of candidates attempted all five questions, but Question 4 was often left to last and answered under time pressure. This problem often arose because the workings for Questions 1(a) and 2(a) were far too detailed.

Question 4 was the most difficult of the three 15-mark questions, although the calculations themselves were quite straightforward. What candidates needed to do with this question was to spend several minutes thinking their answer through and making sure that basic concepts were not overlooked. Many candidates appeared to be rushing and making basic mistakes, such as calculating NIC in respect of dividend income.

Candidates performed particularly well on Questions 1(a), 1(bi), 1(bii), 2(a), 2(ci), 3(a), 3(b), 5(a), 5(b) and 5(c). The questions candidates found most challenging were Questions 2(bi), 2(bii), 2(cii) 2(b), 4(a) and 4(b).

A number of common issues arose in candidates' answers:

- Failing to read the question requirement clearly. For example, calculating the CGT liability in Question 3(b) despite being told that only chargeable gains were required.
- Poor time management. For example, the one mark requirement for Part 2(bi) needed just a date, so time was wasted by writing a whole paragraph.
- Poor use of workings. The workings for Questions 1(a) and 2(a) were often far too detailed. Many of the calculations could have been included within the main computation, and once something such as the exempt premium bond prize was shown, there was no need for further explanation. However, when it came to the share pool in Question 3(b), there was often a complete lack of workings for the indexation calculations – making marking extremely difficult.

SPECIFIC COMMENTS
QUESTION 1

This 25-mark question was based on Josie Jones, who ceased self-employment as a graphic designer on 30 June 2011, and commenced employment with Typo plc as a creative director on 1 August 2011. The question also included property income.

Part (a) for 20 marks required candidates to calculate the income tax payable by Josie for 2011–12. For the self-employment it was necessary to calculate capital allowances for the final two periods of trading, and to take account of unused overlap profits. As part of her employment package Josie was paid £11,600 towards her relocation costs (of which £8,000 was exempt), provided with an interest free beneficial loan, provided with free meals in Typo plc's staff canteen and provided with a company motor car. Josie owned two let properties – the first property qualified as a trade under the furnished holiday letting rules (and made a loss), and the second property was let out unfurnished (and made a profit). Josie also received building society interest, dividends and a premium bond prize. Her basic and higher rate tax bands were extended in respect of gift aid donations. This section was generally very well answered. One common error was to apportion the trading profits,

THE ONLY ASPECT THAT CONSISTENTLY CAUSED PROBLEMS WAS THE LOAN INTEREST WITH VERY FEW CANDIDATES APPRECIATING THAT THIS IS ASSESSED ON A RECEIVABLE BASIS

and this sometimes resulted in a trading loss. It should be clear that if a question makes no mention of a loss then there should not be a loss.

Part (b) was for a total of five marks. The first requirement for three marks was to calculate Josie's balancing payment for 2011–12 and her payments on account for 2012–13, stating the relevant due dates. This was on the assumption that no claim was made to reduce the payments on account. The second requirement for two marks was to explain why Josie would probably be able to make a claim to reduce her payments on account for 2012–13. Since she expected to remain employed throughout 2012–13, a claim could be made because the majority of her income tax would be collected under PAYE. The first requirement was answered reasonably well, but the due dates were often a problem. With the second requirement, it was often not appreciated that payments on account could be reduced not because of less income, but because more income would be taxed at source, being collected under PAYE, meaning payments on account could be reduced to just cover the remaining tax payable.

QUESTION 2

This 30-mark question was based on Clueless Ltd. The managing director of the company had prepared a corporation tax computation for the year ended 31 March 2012 that contained a significant number of errors. The question also included aspects of corporation tax self-assessment, together with the valued added tax (VAT) marks for this paper.

Part (a), for 16 marks, required the preparation of a corrected version of Clueless Ltd's corporation tax computation for the year ended 31 March 2012. This included the adjustment of trading profits, a detailed capital allowances computation, an appreciation of which dividends are included as franked investment income, and the ability to calculate a corporation tax liability where marginal relief is applicable. This section was generally very well answered. The only aspect that consistently caused problems was the loan interest, with very few candidates appreciating that this is assessed on a receivable basis.

Part (b) was for a total of four marks. The first requirement for one mark was to state the date by which Clueless Ltd's self-assessment corporation tax return for the year ended 31 March 2012 should be filed. The second requirement for three marks was to explain the options available to Clueless Ltd regarding the production of accounts and tax computations in the inline eXtensible Business Reporting Language (iXBRL) format. It was surprising that only a few candidates were aware of the filing date for a self-assessment corporation tax return, with far too many candidates giving a 31 January date. Despite being covered in the recent Finance Act 2011 article in *Student Accountant*, hardly any candidates were able to provide relevant details regarding the production of accounts and computations using iXBRL.

Part (c), for a total of 10 marks, dealt with various VAT issues. The first requirement for six marks required an explanation as to why Clueless Ltd was entitled to use both the VAT cash accounting scheme and the VAT annual accounting scheme, and why it would probably be beneficial for the company to use both schemes. It was necessary to make use of the information provided in the question. The second requirement, for four marks, involved the planned purchase of some new machinery. It was necessary to explain when and how Clueless Ltd would have to account for VAT in respect of the new machinery if it was purchased from (1) a supplier situated outside the European Union, or (2) a VAT registered supplier situated elsewhere within the European Union. The first requirement was reasonably well answered, although candidates had a tendency to write everything they knew about the two schemes rather than tailoring their answers to the information given in the question. The second requirement caused more problems, and there was little appreciation that the two alternatives would effectively leave Clueless Ltd in the same overall financial position.

QUESTION 3

This 15-mark question covered relief for capital losses and Acebook Ltd, a company that had sold various assets during the year ended 31 December 2011.

Part (a), for three marks, required an explanation as to how limited companies can obtain relief for capital losses. Although there were many perfect answers to this section, a number of candidates discussed trading losses, explained that capital losses could be utilised in a similar manner to trading losses, covered the rules for individuals rather than companies, or discussed groups – despite being told not to do so.

Part (b), for 12 marks, required a calculation of Acebook Ltd's chargeable gains for the year ended 31 December 2011. The company had sold (1) its entire shareholding of ordinary shares in Oogle plc (the calculation involved a bonus issue, a rights issue and indexation), (2) three acres of land (this was a part disposal, and it was also necessary to apportion enhancement expenditure), and (3) an investment property that was destroyed in a fire with insurance proceeds being received (the insurance proceeds were not fully reinvested, so there was an immediate chargeable gain). This section was generally very well answered, and there were many high scoring answers. One common mistake with the ordinary shares was to index the share pool prior to the bonus issue. Despite being told that the entire shareholding was disposed of, some candidates complicated the calculation by making a part disposal. Many candidates wasted time by calculating the CGT liability (often for an individual rather than a company), despite being instructed to only calculate chargeable gains.

QUESTION 4

This 15-mark question involved Sophia Wong, a self-employed lawyer, who was considering incorporating her business on 6 April 2011. Figures were given for Sophia's total income tax liability and NICs if she were to continue to trade on a self-employed basis, and the taxable total profits of the new limited company would be the same as her forecast profit if she were to remain self-employed.

Part (a) was for a total of 11 marks, and required advice as to whether or not there would be an overall saving of tax and NIC for the tax year 2011–12 if Sophia incorporated her business on 6 April 2011. The first

requirement, for six marks, was on the basis that Sophia withdrew all of the profits from the new company as director's remuneration. The amount of gross director's remuneration, after allowing for employer's Class 1 NIC, was given. The second requirement, for five marks, was on the basis that Sophia withdrew all of the profits from the new company as dividends. The amount of net dividends, after allowing for corporation tax, was given. For both alternatives, it was necessary to calculate the corporation tax liability (if any) of the new limited company for the year ended 5 April 2012, the income tax payable by Sophia, and the Class 1 NIC (if any) payable by Sophia and the new company. This question as a whole was very badly answered, often as a result of being attempted last with inadequate time remaining. Many candidates did not seem to notice that they had been given some of the information (employer's NIC when withdrawing profits as director's remuneration, and corporation tax when withdrawing profits as dividends) and wasted time trying to calculate the figures themselves. As regards withdrawing profits as director's remuneration, very few candidates appreciated that there would be no taxable profit and, hence, no corporation tax liability. As regards withdrawing profits as dividends, far too many candidates did not appreciate that no NIC would be payable. Some candidates even attempted to answer this section with just one calculation combining the director's remuneration and dividend, and very few marks were available with this approach.

Part (b), for a total of four marks, covered the CGT aspects of Sophia incorporating her business. The only chargeable asset of the business was goodwill with a nil cost. Sophia made no other disposals during 2011–12, and had unused capital losses brought forward. The first requirement, for two marks, required a statement of the CGT consequences if Sophia transferred her business to a new limited company on 6 April 2011 in exchange for ordinary shares. The second requirement, for two marks, required an explanation as to why it would be beneficial if the consideration for the transfer of Sophia's business instead consisted of £50,000 in cash and £100,000 in £1 ordinary shares. This arrangement meant that Sophia's brought forward capital losses and her annual exempt amount for 2011–12 would be fully utilised, so that £50,000 of the consideration was taken tax free. As regards the first requirement, very few candidates appreciated that there was no CGT liability. With the second requirement, even the candidates who correctly calculated the chargeable gain did not then appreciate that this would exactly use the available capital losses and annual exempt amount.

QUESTION 5

This 15-mark question involved three taxpayers, Rosie Rohan, Sam Shire and Tom Tirith. Rosie was a managing director, and wanted advice regarding personal pension contributions for 2011–12, given that she had not fully used her annual allowances for previous tax years. Sam wanted advice regarding a stocks and shares ISA, having already invested in a cash ISA during 2011–12. Tom had made a cash gift of £200,000 on 20 December 2010, and was now going to make a further gift to a trust.

Part (a), for six marks, required advice as to the total amount of pension scheme annual allowances that Rosie had available for 2011–12, the method by which tax relief would be given for any personal pension contributions that she made during that year, and the tax implications if she made contributions in excess of the available annual allowances. The unused annual allowance for 2007–08 could not be brought forward as this was more than three years prior to 2011–12. However, the full annual allowance for 2010–11 was available, despite no pension contributions being made, as Rosie was a member of a pension scheme for this year. This section was generally well answered, with many candidates correctly calculating the amount of available annual allowances. However, it was often not appreciated that basic rate tax relief is given by contributions being made net, and also that an annual allowance charge is subject to tax at the taxpayer's marginal rate.

Part (b), for two marks, required candidates to advise Sam of the maximum possible amount that he could invest into a stocks and shares ISA for 2011–12, and the tax advantages of holding stocks and shares within an ISA. Since Sam had invested £4,000 into a cash ISA for 2011–12, he could invest a further £6,680 into a stocks and shares ISA. This section was also well answered. Surprisingly, very few candidates stated that ISAs offer exemption from both income tax and CGT – only mentioning one or the other.

Part (c) was for a total of seven marks. The first requirement for three marks required a calculation of the lifetime IHT that would be payable in respect of Tom's gift to a trust if (1) the trust paid the tax arising from the gift, or (2) Tom paid the tax arising from the gift. Although not affecting the calculation of the lifetime IHT, the PET utilised the annual exemption for 2010–11. The second requirement, for four marks, required a calculation of the additional IHT that would be payable in respect of the gift to the trust if Tom were to die on 30 June 2016. This was on the assumption that Tom paid the tax arising from the gift, involving awareness that the PET would utilise some of the nil rate band plus the availability of taper relief. Most candidates answered this section extremely well, often gaining all of the available marks. However, the PET was sometimes incorrectly included in the workings for the first requirement, not only losing marks, but also complicating the otherwise straightforward calculations.

PAPER F7 PASS RATE: 53%
FINANCIAL REPORTING

I am pleased to report that candidates' performance at the December 2012 sitting was much improved compared to previous sittings, with a pass rate of over 50%. The paper was regarded by most commentators as a fair test where a well-prepared candidate would readily succeed. There appeared to be very little evidence of time constraint problems.

Maintaining the familiar trend, the best answered questions were the consolidation in Question 1 and financial statements preparation in Question 2. Question 3 on the calculation and analysis of ratios was more mixed, with candidates being weaker on the interpretation aspect. Answers to Questions 4 and 5 (relating

PET WAS SOMETIMES INCORRECTLY INCLUDED IN THE WORKINGS FOR THE FIRST REQUIREMENT – NOT ONLY LOSING MARKS, BUT ALSO COMPLICATING THE OTHERWISE STRAIGHTFORWARD CALCULATIONS

to the wider syllabus areas) were also mixed, reflecting whether candidates had studied the wider syllabus topics. There were many very good scripts scoring around 70%, and even some featuring really impressive answers scoring over 80%.

As usual, I have to raise some exam technique issues, almost all of which I have commented on in previous reports:

- Not reading the question properly was a problem, particularly in Question 3(b) where many candidates treated the 'sector average' ratios as being the previous year's ratios of the company being appraised. Such misreading rendered many of the points made by candidates meaningless.
- Several figures worth a high number of marks had no workings, making it impossible for markers to know how the figures have been derived. Thankfully, this was an issue for only a minority of scripts, but where this occurred, it was difficult to award marks.
- Many answers were a repeat of rote learned material and not applied to the question asked. For example, Question 3(c) asked for the limitations of the usefulness of comparing a company's own ratios with the 'sector averages'. Many, indeed most, answers to this were an iteration of the general limitations of ratio analysis and not those related specifically to a sector average comparison.
- Yet again, poor handwriting was an important concern for many markers (particularly for the written elements). If markers cannot read what a candidate has written, no marks can be awarded.
- Much time is wasted by needless repetition of points and providing unnecessary numbered workings for the simplest of calculations/adjustments where inset figures would be quicker for candidates and easier for markers to assess. The format and style of the answers published on the ACCA website provides a useful guide as to the amount of detail required for a successful answer.

The composition and topics of the questions was such that, at this exam session, there was very little difference between the International paper (the primary paper) and all other variant papers – thus, these comments generally apply to all streams.

YET AGAIN, POOR HANDWRITING WAS AN IMPORTANT CONCERN FOR MANY MARKERS (PARTICULARLY FOR THE WRITTEN ELEMENTS). IF MARKERS CANNOT READ WHAT A CANDIDATE HAS WRITTEN, NO MARKS CAN BE AWARDED

SPECIFIC COMMENTS

QUESTION 1

The main part of the question (Part (b)) required the preparation of a consolidated income statement (statement of profit or loss) for a parent and a subsidiary that was acquired three months into the reporting year. This was preceded by the calculation of consolidated goodwill as at the date of acquisition and followed by a small written section testing how a fair value increase in leased property should be treated on acquisition, together with any post-acquisition increase in its value.

Further adjustments required the elimination of intra-group sales and unrealised profit (URP), impairment to goodwill and additional depreciation from the fair value adjustments.

Most candidates scored very well on the calculation of the goodwill, and many scored full marks. Where problems arose, they were mainly not discounting the deferred consideration (and consequently not charging an additional finance cost in the income statement (statement of profit or loss)), ignoring the non-controlling interest and not taking account of the pre-acquisition movement in profit since the beginning of the year. On this latter point, a number of candidates took the retained earnings at the start of the year as being the year end retained earnings despite the fact that the start of the year date was typed in bold in the question. Also, a significant number of candidates incorrectly included post-acquisition items (additional depreciation and URP) and omitted (or incorrectly signed) the contingent liability as a fair value adjustment in the calculation of goodwill.

The main consolidation was also done well with the vast majority of candidates clearly having a good working knowledge of consolidation techniques. Though, as might be expected, it was the more complex aspects where errors occurred:

- Incorrect calculation of the URP and additional depreciation adjustments (particularly not time apportioning the depreciation).
- Not eliminating the dividend of the associate.
- Time apportioning the investment income from the associate (the question stated this had been held for several years).
- Not time apportioning the additional finance cost, or ignoring it altogether
- Not adjusting the non-controlling. interest calculation for the additional depreciation and goodwill impairment.

Some candidates did not realise that the subsidiary's results must be included on a time apportioned basis (ie for only nine months) and a small number of candidates continued to apply proportional consolidation to the subsidiary's results.

Several candidates wasted considerable time calculating the retained earnings and non-controlling interests as they would appear in the statement of financial position. The question did not require these items.

The main source of problems in Question 1 was Part (c), the treatment of increases in the fair value of a subsidiary's leased property on consolidation. The question asked how a fair value increase at the date of acquisition should be treated followed by the treatment of any subsequent increases. Bizarrely, a significant number of candidates thought this was a question about whether a lease was a finance lease or an operating lease. Others did not distinguish between pre-acquisition and post-acquisition increases. Most did identify that the fair value increase should be reflected in the carrying amount of property, plant and equipment and some referred to additional subsequent depreciation, but not many stated the effect on consolidated goodwill and that (where group policy requires) post-acquisition increases are reported in other comprehensive income (OCI), create a revaluation reserve and will impact on the non-controlling interest if the subsidiary is not wholly-owned.

Despite the above errors there were many high marks for this question.

QUESTION 2

This question was a familiar preparation of financial statements from a trial balance combined with several adjustments, including the exclusion of deferred service income from revenue, issue of a loan note, accounting correctly for an equity dividend, revaluation of land and buildings, a fair value movement in an equity financial asset, and the usual accounting for current and deferred tax.

As with Question 1, this was very well answered, with most candidates showing a sound knowledge of preparing financial statements in this format. Also, as usual, it was the adjustments that caused most of the errors:

- Only a minority of candidates correctly accounted for the deferred service income; many just used the cost of $600,000 (rather than include the profit element of a further $200,000), some took one or three years (the two years outstanding was correct) and most failed to account for the deferred income in the statement of financial position. Many candidates deducted the cost of the servicing from cost of sales, even though those costs had not yet been incurred.
- A majority of candidates had problems with the finance costs and the loan note, specifically: not deducting the issue cost before calculating interest; not using the effective rate of 8%; and not following through the addition of accrued interest (the difference between the correct finance cost charge and the interest actually paid) to the carrying amount of the loan as a single (non-current) liability.
- There were many errors in the calculation of tax – wrong signing of the adjustments and deducting the year end provision for deferred tax (rather than the movement in the provision).
- Most candidates calculated the revaluation of the land and buildings correctly and included it in other comprehensive income but, within the statement of changes in equity of Part (b), only a few included the transfer to realised profit in respect of the realisation of excess depreciation. A significant number of candidates incorrectly transferred the whole of the revaluation reserve to retained earnings. It was also common (but wrong) to include in OCI the loss on the equity financial asset investment (the default treatment is to include this in profit or loss).

Most answers to the statement of changes in equity were very good although the dividend was often incorrectly calculated (not realising the shares were 25 cents each) or ignored. Weaker candidates included the loan note and/or (more commonly) the equity financial asset investment as part of equity, showing a worrying lack of basic knowledge of what constitutes 'equity'.

The statement of financial position was generally very well prepared with most errors being a follow through of errors made when calculating profit or loss items. Generally, such errors are not penalised as ACCA adopts a 'method marking' principle, which means the same error is not penalised twice. That said, both current and deferred tax were often incorrect, current tax incorrectly included the previous year's under provision and deferred tax was stated as the temporary difference (of $5m) instead of the liability itself (20% of $5m).

I am pleased to say that after many years of reporting candidates' poor ability in dealing with property revaluations, in this session most candidates appeared to have practised past questions and mastered the topic. That said, a number of candidates did (incorrectly) depreciate the land.

This was a well-answered question overall.

QUESTION 3

This was a three-part question. Part (a) required the calculation of eight ratios equivalent to the sector average ratios given in the question. The main Part (b) was to assess the relative performance of the company compared to the sector average, and finally a four-mark section on the limitations of the use of sector averages.

Although many candidates scored well on the calculation of the ratios, many made mistakes in this part. It was common to see a calculation of the return on equity (ROE) rather than the return on capital employed (ROCE) and many other errors were, I believe, simply careless:

- Calculating the profit after tax margin (rather than the operating profit margin).
- Inventory days rather than inventory turnover, or using closing inventory instead of average inventory, or inventory turnover based on revenue rather than of cost of sales.
- Trade payables period based on cost of sales rather than purchases.
- Debt/(debt + equity) instead of debt/equity.

While many of the incorrectly given ratios may be useful ratios in themselves, it invalidates the comparison to the sector average ratios (required in Part (b)) if precisely the same ratios are not used.

The assessment of financial performance required in Part (b) was quite disappointing with many of the usual weaknesses of past answers on this type of question. Some answers simply stated whether the ratios were higher or lower than the sector average (without even saying which was good or bad). Such an approach gains few, if any, marks – it is simply not interpretation. A good answer requires candidates to identify comparative strengths or weakness and gives a plausible explanation of why they may have occurred. As mentioned earlier, several candidates did not read the question properly and thought that the sector average ratios given in the question were the previous year's ratios of the company under assessment.

Common errors were to attribute a fall in the operating profit margin to the high finance costs (which is not the case as this ratio does not include finance costs) and arguing that an increase in the average inventory turnover was an indicator of a deteriorating situation (possibly obsolete inventory, etc) due to high inventory levels. The opposite of this is the case; I assume candidates confused the increase in inventory turnover with an increase in inventory holding period, which would indicate higher inventory levels. Many candidates commented that the lower gross profit margin was a consequence of the high level of purchases, when what, I suspect, they really meant was that the cost of the purchases was high. Very few candidates noticed that the company's operating costs, as a percentage of revenue, were lower than the sector average as they did not take into account the lower gross margin. It was the case that the company's operating margin was below the sector average,

SEVERAL CANDIDATES DID NOT READ THE QUESTION PROPERLY AND THOUGHT THAT THE SECTOR AVERAGE RATIOS GIVEN IN THE QUESTION WERE THE PREVIOUS YEAR'S RATIOS OF THE COMPANY UNDER ASSESSMENT

MOST CANDIDATES FAILED TO DISTINGUISH THE CHANGE IN ACCOUNTING ESTIMATE FROM A CHANGE OF ACCOUNTING POLICY MAINLY BECAUSE THEY DID NOT ATTEMPT TO IDENTIFY WHAT THE ACCOUNTING POLICY WAS

but this was due to poor gross margins and not poor control of operating costs.

Part (c) was the worst answered section. It seemed candidates gave little thought to what was being asked. Rather than consider what might be the inherent problems when comparing an individual company's ratios to the averages of its competitors, many answers just reeled off rote learned limitations of ratio analysis in general. Issues such as distortion due to inflation (rising prices), use of historical cost figures and year end balances not (necessarily) being representative of average values are common limitations to both the individual company and the sector as a whole. Relevant points would be the use of differing accounting policies/estimates, different year end (a clue to this was in the question) and possible differences (or misunderstanding) of how the ratios should be calculated.

Overall, despite relatively easy marks available for the ratio calculations, the performance on this question suffered from the problems explained above relating to the interpretation element.

QUESTION 4

This question opened with a section on two of the Conceptual Framework's characteristics – those of understand ability and comparability and linking consistency to the concept of comparability.

Part (b) required candidates to calculate financial statement figures for the second year of a construction contract where the company had changed its method of calculating the percentage of completion. The final part asked candidates to explain why the change in Part (bi) was a change of accounting estimate rather than a change in accounting policy.

Most candidates scored two to four marks on Part (a) showing a reasonable understanding of the topic. My main criticism was that the lower scoring answers were too simplistic along the lines of 'understand ability means that financial statements should be in a form that users can understand'. Such answers failed to mention that users should have a reasonable accounting knowledge and be prepared to study the financial statements or take advice, and that management should not 'clutter' the financial statements with so much detail as to obscure the underlying performance. There was also much repetition in many answers to the comparability/consistency section. The better answers did not quite score full marks mainly because they did not cover enough points – there were six marks available for this section.

Part (b) was well answered by those making a serious attempt. The main errors were not deducting the first year's figures when arriving at the profit or loss figure for the second year – in effect their income statement (statement of profit or loss) contained the cumulative results. Some candidates tried to restate the previous year's results as if the question was based on a change in accounting policy. The statement of financial position answers were generally very good after allowing marks for some incorrect own figures from the income statement (statement of profit or loss).

In Part (bii), most candidates said that changing the method of estimating the percentage of completion was a change in accounting estimate (which, in fact, the question told them), but did not really explain why. Most candidates also failed to distinguish the change in accounting estimate from a change of accounting policy mainly because they did not attempt to identify what the accounting policy was.

QUESTION 5

In Part (a), this question tested candidates' knowledge of a 'compound' non-current asset whose components required separate depreciation, together with a related government grant and environmental provision. Part (b) required candidates to advise on whether a provision was required for future environmental costs (fitting anti-pollution filters) and whether an existing provision should be reduced immediately as a consequence of the requirement for the new filters to be fitted.

Most candidates who attempted this question scored very well on Part (a) – indeed, many scored full marks. The most common errors were discounting (rather than compounding) the environmental provision and failing to include either the deferred government grant or the finance cost of the provision in the income statement (statement of profit or loss).

Part (b) was less well answered. The majority of candidates believed that because the legislation requiring fitting of the filters was enacted within the current year, this meant a provision should be made immediately. This view ignored the fact that the legislation did not come into force for two years and, perhaps surprisingly, even then it would not constitute a liability (as the costs could be avoided). It follows that if there should be no provision for fitting the filters, the existing environmental provision should not be reduced immediately. Where candidates had argued that the provision for fitting the filters should be made and, as a consequence, the environmental provision could be reduced, credit was given for the consistency of the argument.

CONCLUSION

Overall, this was a solid performance with candidates scoring better on the wider topic areas of Questions 4 and 5, although the interpretation required in Question 3 was disappointing.

Many of the above comments on the individual questions focus on where candidates made errors. This is intended to guide candidates' future studies and to highlight poor techniques with a view to improving future performance. This should not detract from the many excellent papers where it was apparent that candidates had done a great deal of studying and they were rewarded appropriately.

PAPER F8 PASS RATE: 34%
AUDIT AND ASSURANCE

The exam consisted of five compulsory questions. Question 1 for 30 marks, Question 2 for 10 marks and three further questions of 20 marks each.

The performance of candidates across the paper as a whole was unsatisfactory. Candidates performed well on Questions 1, 2 and 4(a) but struggled with Questions 3, 4(b) and 5.

Candidates performed particularly well on Questions 1(a), 1(cii), 1(ciii), 2(a) and 4(a). The questions candidates found most challenging were Questions 1(b), 1(ci), 2(c), 3(a), 3(b), 3(c), 4(b), 5(a) and 5(b).

This is mainly due to candidates not understanding core syllabus areas well enough, a lack of technical knowledge and also a failure to read question requirements carefully.

It was evident at this sitting that many candidates had learnt generic tests and standard answers for topic areas. They made little effort to apply these answers to the scenario or the actual question requirement, and so provided irrelevant answers. For example, Question 1(b) covered procedures to be undertaken during the inventory count. Candidates had learnt inventory tests and so listed these out, failing to recognise that the question only wanted tests during the count. They provided tests that would be undertaken before and after the count and so failed to score more marks. Candidates must apply their knowledge rather than just learning and then listing standard points.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

A number of common issues arose in candidates' answers:

- Failing to read the question requirement carefully and therefore providing irrelevant answers that scored few, if any, marks. Candidates must remember to answer the question asked and not the question they wish had been asked.
- Poor time management between questions. Some candidates wrote far too much for some questions such as 1(a), 2(a) and 2(b) and this put them under time pressure to finish remaining questions.
- Failure to fully understand the requirement verbs such as 'describe', 'recommend' or 'explain' – hence, not providing sufficient depth to their answers.
- Providing more than the required number of points, especially in Question 1(a) and 2(a).
- Poor layout of answers, including not using columns for questions such as 1(a) and 3(b) when this would have helped to maximise marks.

SPECIFIC COMMENTS

QUESTION 1

This 30-mark question was based on a glass manufacturer, Lily Window Glass Co (Lily), and tested candidates' knowledge of internal controls, procedures undertaken by the auditor during an inventory count and computer assisted audit techniques (CAATs).

Part (a), for 12 marks, required candidates to identify and explain, for the inventory count arrangements of Lily, six deficiencies and suggest a recommendation for each deficiency.

Most candidates performed very well on this part of the question. They were able to confidently identify six deficiencies from the scenario. However, some candidates did not address the question requirement fully as they did not 'identify and explain'. Candidates identified but did not go on to explain why this was a deficiency. For example, 'additional inventory sheets are not numbered' would receive a half mark. However, to obtain the other half mark candidates needed to explain how this could cause problems during the inventory count – such as 'the additional sheets could be lost resulting in understated inventory quantities'.

The requirement to provide controls was also well answered. Most candidates were able to provide practical recommendations to address the deficiencies. The main exception to this was with regards to the issue of continued movements of goods during the count. The scenario stated that Lily undertakes continuous production. Therefore, to suggest 'that production is halted for the inventory count' demonstrated a failure to read and understand the scenario. The scenario is designed to help candidates, and so they should not ignore elements of it.

Some candidates incorrectly identified deficiencies from the scenario, demonstrating a fundamental lack of understanding of the purpose of an inventory count. For example, a significant minority believed that inventory sheets should contain inventory quantities when, in fact, this is incorrect, as this would encourage markers to just agree the stated quantities rather than counting properly. In addition, candidates felt that counters should not use ink on the count sheets as pencil would be easier for adjustments. Again, this is incorrect, as if the counts are in pencil, then the quantities could be erroneously amended after the count. Also, candidates felt that there should be more warehouse staff involved in the count, despite the self-review risk.

Many candidates set their answer out in two columns – these being deficiency and recommendation. However, those who explained all of the deficiencies and then separately provided all of the recommendations tended to repeat themselves and possibly wasted some time. In addition, the requirement was for six deficiencies; it was not uncommon to see candidates provide many more than this.

Part (b), for six marks, required procedures the auditor should undertake during the inventory count of Lily. Performance was unsatisfactory on this part of the question.

The requirement stated in capitals that procedures DURING the count were required; however, a significant proportion of candidates ignored this word completely and provided procedures both before and after the count. Many answers actually stated 'before the count…'. Candidates must read the question requirements properly.

Those candidates who had read the question properly often struggled to provide an adequate number of well-described points. The common answers given were 'to observe the inventory counters', although candidates did not make it clear what they were observing for, or 'undertake test counts' but with no explanation of the direction of the test and whether it was for completeness or existence. Some candidates provided all possible inventory tests, in particular focusing on NRV testing. This demonstrated that candidates had learnt a standard list of inventory tests, and rather than applying these to the question set just proceeded to list them all. This approach wastes time and does not tend to score well as, of the six answers provided, very few tended to be relevant.

Part (ci), for four marks, required a description of four audit procedures that could be carried out for inventory using CAATs. Performance on this question was unsatisfactory.

Candidates needed to apply their knowledge of CAATs to inventory procedures, but many failed to do this. Again, many candidates did not read the question properly and so, despite

CANDIDATES MUST REMEMBER TO ANSWER THE QUESTION ASKED AND NOT THE QUESTION THEY WISH HAD BEEN ASKED

MANY CANDIDATES APPEAR NOT TO ACTUALLY UNDERSTAND WHAT CAATS ARE, WHO USES THEM AND HOW THEY WORK

the requirement to apply their answer to inventory, they proceeded to refer to tests on receivables and payables. Also, many candidates appear not to actually understand what CAATs are, who uses them and how they work. Therefore, many answers focused on the company using CAATs rather than the auditor, and many procedures given were not related to CAATs – for example, 'discuss inventory valuation with the directors' or 'agree goods received notes to purchase invoices'.

Those candidates who scored well tended to mainly focus on analytical review procedures for inventory that could be undertaken as part of audit software tests.

Part (cii), for four marks, required an explanation of the advantages of using CAATs. This question was, on the whole, answered well.

Candidates were able to identify an adequate number of advantages to score well on this part of the question. The main advantages given related to saving time, reducing costs, improving the accuracy of testing and the ability to test larger samples. A minority of candidates failed to explain their advantages – answers such as 'saves time' were commonly provided, but this is not an explanation and so would not have scored well.

Part (ciii), for four marks, required an explanation of the disadvantages of using CAATs. Again, this part of the question was answered well.

As with Part (cii), candidates were able to identify an adequate number of points to score well. The main disadvantages given related to increased costs, training requirements and the corruption of client data. It was apparent here and for Part (cii) that candidates had learnt a standard list of points for CAATs. However, some candidates did try to apply their knowledge of standard advantages and disadvantages to inventory.

QUESTION 2

This 10-mark question covered the topics of auditor rights, internal control activities and limitations of external audits.

Part (a), for three marks, required candidates to state three rights of an auditor excluding those related to resignation and removal. This question was answered well by almost all candidates with many scoring full marks.

Candidates were able to confidently state three rights and most scored full marks. Some gave far more than three rights. As the requirement was only to state three, this was unlikely to have caused too much additional time pressure. Many candidates provided irrelevant answers such as 'the auditor has a right to be paid a fee' or 'the auditor has a right to request information from third parties'. A common misunderstanding was with regards to meetings the auditors can attend – they have the right to attend shareholder or general meetings but not board meetings.

Part (b), for four marks, required an explanation of four control activities to prevent and detect fraud and error. This was answered satisfactorily by many candidates.

Most candidates were able to provide an adequate number of controls that would prevent and detect fraud and error, with many identifying activities such as segregation of duty, authorisation and physical controls. However, some candidates misunderstood the question and gave internal control components rather than activities, such as risk assessment process and information processing. In addition, some candidates failed to explain the controls, instead just stating 'segregation of duties' rather than explaining what this means, or providing an example segregation of duties control.

Part (c), for three marks, required a description of three limitations of external audits. Performance was inadequate on this question.

This question was left unanswered by a significant minority of candidates. Those who attempted it were often unable to provide more than one relevant answer; the most common correct answer given was with regards to auditors needing to sample rather than testing all transactions.

Some candidates seemed to think the question wanted disadvantages of having an audit, rather than the limitations of an audit, but these are two different requirements. The most common incorrect answers given were related to the cost of an audit, ethical threats such as confidentiality and the auditor not understanding the entity.

QUESTION 3

This 20-mark question was based on Sunflower Stores Co (Sunflower), which operated 25 food stores. The question tested the areas of understanding an entity, audit risks and responses and internal audit.

Part (a), for five marks, required a list of five sources of information for gaining an understanding of Sunflower and what each source would be used for. Candidates' performance on this question was unsatisfactory.

A significant proportion of candidates did not seem to understand what was required from them for this question. They did not seem to understand what a 'source of information' was and so failed to list where they would obtain information from such as prior year financial statements or last year's audit file. Some were able to explain what they would want to gain knowledge on – for example, audit risks or accounting policies – but did not tie this into the source of information.

In addition, the question requirement related to gaining an understanding of Sunflower – this is part of the planning process. However, a significant proportion of candidates gave sources of information relevant to carrying out the audit fieldwork, such as bank letters, written representations or receivables circularisation.

Most candidates' confused requirements 3(a) and 3(b) and so gave sources of information relevant to auditing the risks from requirement 3(b). These points were not relevant to gaining an understanding of Sunflower and, hence, scored no marks.

Part (b), for 10 marks, required a description of five audit risks from the scenario and the auditor's response for each. Performance on this question was mixed, although slightly better than December 2011 when audit risk was last tested.

The scenario contained many more than five risks and so many candidates were able to easily identify enough risks. They then went on to describe how the point identified from the scenario was an audit risk by referring to the assertion and the account balance impacted. There seemed to be a higher proportion of candidates this session who described the audit risk adequately.

Some candidates tended to only identify facts from the scenario, such as 'Sunflower has spent $1.6m in refurbishing all of its supermarkets' but failed to explain how this could impact audit risk. This would only have scored half marks. To gain one mark, they needed to refer to the risk of the expenditure not being correctly classified between capital and repairs resulting in misstated expenses or non-current assets. Additionally, candidates were able to identify the fact from the question but then focused on categorising this into an element of the audit risk model, such as inherent or control risk. The problem with this approach is that just because they have stated an issue could increase control risk does not mean that they have described the audit risk, and so this does not tend to score well.

The area where most candidates performed inadequately is with regards to the auditor's responses. Some candidates gave business advice such as, for the risk of the finance director (FD) leaving early, 'the auditor should ask management to replace the FD quicker'. This is not a valid audit response. Other responses focused more on repeating what the appropriate accounting treatment should be. Therefore, for the risk of inventory valuation due to the policy of valuing at selling price less margin, the response given was 'inventory should be valued at the lower of cost and NRV'. Again, this is not a valid audit response.

Responses which start with 'ensure that…' are unlikely to score marks as they usually fail to explain exactly how the auditor will address the audit risk. Also, some responses were too vague such as 'increase substantive testing' without making it clear how, or in what area, this would be addressed. Audit responses need to be practical and should relate to the approach the auditor will adopt to assess whether the balance is materially misstated or not.

A significant minority of candidates misread the scenario, and where it stated that it was the first year on this audit for the senior, candidates seemed to think that it was the first year for the firm as a whole and so identified an audit risk of Sunflower being a new client with higher detection risk. This scored no marks as it was not the first year of the audit. Candidates must read the scenario more carefully.

Most candidates presented their answers well as they adopted a two-column approach, with audit risk in one column and the related response in the other column.

Part (c), for five marks, required candidates to describe factors the finance director should consider before establishing an internal audit (IA) department. Performance was unsatisfactory on this part of the question.

Many candidates were able to gain a few marks with points on considering the cost and benefits of the IA department, and whether it should be outsourced or run in house. However, this seemed to be the limit of most candidates' knowledge in this area. Unfortunately, many candidates strayed into the area of to whom IA should report and the qualifications and independence of the department. These are factors to consider when running IA as opposed to whether or not to establish an IA department. Once again, candidates must answer the question set and not the one they wish had been asked.

QUESTION 4

This 20-mark question was based on Rose Leisure Club (Rose) and tested candidates' knowledge of ethical principles and substantive procedures.

Part (a), for five marks, required the identification and explanation of five fundamental ethical principles. This question was unrelated to the scenario and was knowledge-based. Candidates performed very well, with many scoring full marks.

Ethics questions are usually popular and well answered by candidates. The vast majority of candidates confidently identified the five principles. Where they did not score full marks was normally due to a failure to adequately explain the principles or because they gave incorrect explanations. Often the principle of integrity was explained with the objectivity explanation and vice versa; this would have not scored well. In addition, a small minority of candidates gave ethical threats such as self-review and self-interest rather than the principles. This may have been due to a failure to read the question properly.

Part (bi), for six marks, required substantive procedures for an issue on trade payables and accruals with regards to an early cut off of the purchase ledger resulting in completeness risk. Performance on this question was unsatisfactory.

Candidates were unable to tailor their knowledge of general substantive procedures to the specific issue in the scenario. Most saw that the scenario title was trade payables and accruals and proceeded to list all possible payables tests. This is not what was required and, hence, did not score well. The scenario was provided so that candidates could apply their knowledge. However, it seems that many did not take any notice of the scenario at all. What was required was tests to specifically address the risk of cut off and completeness due to the purchase ledger being closed one week early.

Common mistakes made by candidates were:

- Providing procedures to address assertions such as rights and obligation – for example, 'review year end purchase invoices to ensure the company name'.
- Giving objectives rather than procedures 'ensure that cut off is correct'. This is not a substantive procedure and so would not score any marks.
- Lack of detail in tests such as 'perform analytical procedures over payables'. This would score no marks as the actual analytical review procedure has not been given.
- Believing that 'obtaining a management representation' is a valid answer for all substantive procedure questions.
- Not providing enough tests. Candidates should assume one mark per valid procedure.

Part (bii), for five marks, required substantive procedures for an issue on trade receivables circularisations with regards to non-responses and responses with differences. Performance on this question was also unsatisfactory.

As above, candidates failed to identify the specific issue from the scenario and instead provided a general list of receivables tests. Some candidates failed to recognise that analytical review procedures were unlikely to be of any benefit as Rose's receivables had changed significantly on the prior year

ETHICS QUESTIONS ARE USUALLY POPULAR AND WELL ANSWERED BY CANDIDATES. THE VAST MAJORITY OF CANDIDATES CONFIDENTLY IDENTIFIED THE FIVE PRINCIPLES

SUBSTANTIVE PROCEDURES ARE A CORE TOPIC AREA AND FUTURE CANDIDATES MUST FOCUS ON BEING ABLE TO GENERATE SPECIFIC AND DETAILED TESTS WHICH ARE APPLIED TO ANY SCENARIO PROVIDED

due to a change in the business model. Also, Rose was a leisure club and so provided services rather than goods. However, candidates still recommended 'reviewing goods dispatch notes for cut off'. This again demonstrates that candidates are learning generic lists of procedures and just writing them into their answers with little thought or application to the scenario. This approach will score very few if any marks at all.

Part (biii), for four marks, required substantive procedures for an issue on a reorganisation announced just before the year end. Performance on this question was also unsatisfactory; a significant minority did not even attempt this part of the question.

Those candidates who scored well focused on gaining evidence of the provision, therefore they provided valid procedures like 'recalculating the provision', 'discussing the basis of the provision with management', 'obtaining a written representation confirming the assumptions and basis of the provision' and 'reviewing the board minutes to confirm management have committed to the reorganisation'.

Some candidates failed to read the question properly and assumed that the reorganisation had already occurred as opposed to being announced just before the year end. Therefore, many provided answers aimed at confirming that assets had been disposed of and staff had been retrained. In addition, some candidates focused on whether the company was making the correct business decisions by reorganising.

Many procedures also lacked sufficient detail to score the available one mark per test. This commonly occurred with tests such as 'reviewing board minutes' and 'obtain written representation'. These procedures need to be phrased with sufficient detail to obtain credit. Let's consider the following candidate answers:

- 'Obtain a written representation from management' – this would not have scored any marks as it does not specify what the representation is for.
- 'Obtain a written representation from management in relation to the provision' – this would have scored half marks as it did not specify what element of the provision we wanted confirmation over.
- 'Obtain a written representation from management confirming the assumptions and basis of the provision' – this would have scored one mark as it clearly states what is required from management, and in relation to which balance and for which element.

As stated in previous examiner reports, substantive procedures are a core topic area and future candidates must focus on being able to generate specific and detailed tests, which are applied to any scenario provided.

QUESTION 5

This 20-mark question was based on an audit firm Violet & Co (Violet) and its two clients Daisy Designs Co (Daisy) and Fuchsia Enterprises Co (Fuchsia), and tested candidates' knowledge of written representations, evidence and audit reports.

Part (a), for five marks, required an explanation of the purpose and procedures for obtaining written representations. This question was unrelated to the scenario and was knowledge-based. Performance was unsatisfactory on this question.

A majority of candidates were able to provide answers on the purpose of a written representation. However, a significant minority strayed from the question requirement and focused on what the audit report implications were if management refused to provide a representation. This was not required and scored no marks.

Candidates seemed to confuse written representations with third party confirmations such as bank letters and receivables circularisations. Therefore, when discussing the procedures for obtaining a representation, these candidates were unable to provide valid answers.

Part (b) for three marks required a description of the relevance and reliability of an oral representation given by management for the completeness of the bank overdraft balance. Performance was unsatisfactory on this question.

Many candidates were able to apply their knowledge of relevance and reliability of evidence to the specific example given. Many of these easily scored two marks by discussing oral versus written evidence and client generated versus third party or auditor generated evidence. However, very few adequately considered whether a representation on completeness would be relevant for a liability balance. Some candidates ignored the requirement to focus on relevance and reliability, and so provided general points on representations, despite having already done this in Part (a).

Part (c), for 12 marks, required a discussion of some issues: an assessment of the materiality of each, procedures to resolve each issue and the impact on the audit report if each issue remained unresolved. Performance was mixed on this question. There were a significant minority of candidates who did not devote sufficient time and effort to this question, bearing in mind it was worth 12 marks.

The requirement to discuss the two issues of Daisy's corrupted sales ledger and Fuchsia's going concern problem was, on whole, answered well by most candidates. In addition, many candidates correctly identified that each issue was clearly material. A significant minority seemed to believe the corruption of the sales ledger was an adjusting event, and so incorrectly proceeded to focus on subsequent events.

With regards to procedures to undertake at the completion stage, candidates seemed to struggle with Daisy. Given that the sales ledger had been corrupted procedures such as 'agree goods dispatch notes to sales invoices to the sales ledger' or 'reconcile the sales ledger to the general ledger' were unlikely to be possible. Most candidates correctly identified relevant analytical review procedures and a receivables circularisation. Candidates performed better on auditing the going concern of Fuchsia. However, some candidates wasted time by providing a long list of going concern tests when only two or three were needed.

Performance on the impact on the audit report if each issue remained unresolved was unsatisfactory. Candidates still continue to recommend an emphasis of matter paragraph for all audit report questions. This is not the case and it was not relevant for either issue. Candidates need to understand what an emphasis of matter paragraph is and why it is used.

A significant number of candidates were unable to identify the correct audit report modification, suggesting that Daisy's should be qualified or adverse, as opposed to disclaimer of opinion. Also, some answers contradicted themselves with answers of 'the issue is not material, therefore qualify the opinion'. Additionally, many candidates ignored the question requirement to only consider the audit report impact if the issue was unresolved. Lots of answers started with 'if resolved the audit report...' this was not required. In relation to the impact on the audit report, many candidates were unable to describe how the opinion paragraph would change and so failed to maximise their marks.

Once again, future candidates are reminded that audit reports are the only output of a statutory audit and, hence, an understanding of how an audit report can be modified, and in which circumstances, is considered very important for this exam.

PAPER F9 FINANCIAL MANAGEMENT PASS RATE: 43%

The overall performance in December 2012 was good and most candidates answered four full questions. Please read this report carefully if you were not successful in passing the paper at this sitting, as it indicates areas where answers in general could be improved, as well as indicating where candidates did well. It is also recommended that this report should be read in conjunction with the detailed suggested answers written by the examiner.

Overall, the highest marks were usually gained on Question 1, while roughly equal marks were gained on Questions 2, 3 and 4.

SPECIFIC COMMENTS

QUESTION 1(A)

This question called for the calculation of the net present value (NPV) of a construction project for BQK Co and then a comment on its financial acceptability. Many candidates gained high marks on this part of question.

A nominal terms evaluation had to be undertaken because tax on profits was being paid one year in arrears, and because specific inflation rates were linked with selling price, variable cost and infrastructure costs. The nominal after-tax cost of capital of 12% was given in the question. Some answers mistakenly used the real after-tax cost of capital of 9%, or tried to calculate another discount rate altogether using the Fisher equation, but all that was needed was to use the 12% rate provided.

Although the question stated that two types of houses were to be built on the development site, some candidates mistakenly treated large houses and small houses as two separate investment projects. Some candidates chose to ignore the fixed infrastructure costs which the question stated were for new roads, gardens, drainage and utilities, arguing that fixed costs were not relevant in investment appraisal, but a housing development without roads, drainage and so on would not be a practical investment.

Most answers calculated correctly the nominal values of sales income, variable costs and fixed costs, and then calculated correctly and timed correctly in arrears the tax liabilities on the before-tax cash flow. The question said that capital allowances on the purchase cost of the development site were on a straight-line basis over the four-year construction period. Most answers calculated correctly the associated capital allowance tax benefits, although some candidates lost marks by calculating capital allowances on a 25% reducing balance basis.

Having calculated nominal after-tax cash flows, some candidates chose mistakenly to discount them with the real after-tax cost of capital of 9%. Nominal after-tax cash flows must be discounted with a nominal after-tax cost of capital (this is the nominal terms approach).

Some answers chose not to comment on the financial acceptability of the investment project, and so lost a relatively straightforward mark. A small number of answers wasted valuable time by commenting at length on financial acceptability – for example, by discussing critically the merits of NPV as an investment appraisal method.

QUESTION 1(B)

Candidates were asked here to calculate the before-tax return on capital employed (ROCE) of the investment project on an average investment basis and to discuss briefly its financial acceptability.

Many candidates did not gain full marks here because they were not sure of how to calculate ROCE for investment appraisal purposes. The definition of ROCE in this case is average annual accounting profit as a percentage of average annual investment. Since the NPV evaluation was in cash flow terms, accounting profit had to be calculated by subtracting depreciation from investment project cash flows, a point overlooked by some candidates. Some candidates were also not aware that average annual accounting profit, rather than total accounting profit, was needed.

Some candidates incorrectly chose to calculate internal rate of return (IRR), perhaps because they were confusing ROCE with IRR. It is also possible that this error was partly due to the fact that both ROCE and IRR are relative measures of investment worth.

QUESTION 1(C)

The requirement here was to discuss the effect of a substantial rise in interest rates on the financing cost of the construction company and its customers and on the capital investment decision-making process. This question allowed students to show their understanding of how a company might be affected by its economic environment and many candidates gained credit for making relevant points. For example, the increased cost of customer borrowing might lead to a reduction in forecast demand for housing that could be countered in part by a change in product mix, increasing the proportion of small houses expected to be built.

Candidates who lost marks tended to do this in one of two ways. First, some candidates spent time explaining why interest rates might increase in an economy, something that was not required by the question and so did not gain any credit. Second, some candidates explained, occasionally at length, the stages in the investment appraisal process. Again, since this had not been asked for, such explanations did not gain any credit.

A SMALL NUMBER OF ANSWERS WASTED VALUABLE TIME BY COMMENTING AT LENGTH ON FINANCIAL ACCEPTABILITY – FOR EXAMPLE, BY DISCUSSING CRITICALLY THE MERITS OF NPV AS AN INVESTMENT APPRAISAL METHOD

SOME ANSWERS DID NOT GAIN FULL CREDIT BECAUSE THEY DID NOT COMMENT ON THE ASSUMPTIONS MADE BY THEIR CALCULATIONS

QUESTION 2(A)

The requirement here was to calculate the net benefit or cost of proposed changes in receivables policy, commenting on findings. The cost of an early settlement discount had to be calculated, as well as the decrease in financing cost arising from a reduction in the trade receivables balance.

Candidates were expected to recognise that although current trade terms allowed credit customers to pay after 30 days, they were in fact paying on average after 60 days, as shown by a comparison between credit sales and the level of trade receivables. The average trade receivables period after introducing the proposed changes in receivables policy was 40.5 days, leading to a lower level of trade receivables and a lower financing cost.

Weaker answers showed a lack of understanding of how the receivables days' ratio links credit sales for a period with the trade receivables balance at the end of the period. Some answers, for example, tried to calculate the revised trade receivables balance by applying changed receivables days ratios to current receivables, instead of applying them to credit sales.

QUESTION 2(B)

Candidates were asked here to calculate whether an offered bulk purchase discount was financially acceptable, commenting on assumptions made by the calculation.

Perhaps because information on holding cost and order cost was provided in the question, many candidates calculated the economic order quantity (EOQ). The question made no reference to the EOQ and an EOQ calculation was not necessary. In fact, what was needed was a comparison between the current ordering policy and the ordering policy employing the bulk discount. Candidates who wasted time calculating the EOQ found that the company was already using an EOQ approach to ordering inventory.

Some answers did not gain full credit because they did not comment on the assumptions made by their calculations. Credit was also lost by candidates who could not calculate order cost, or holding cost, or both.

QUESTION 2(C)

The requirement here was to identify and discuss the factors to be considered in determining the optimum level of cash to be held by a company. A number of answers gained marks for identifying and discussing the reasons for holding cash (transactions need, precautionary need and speculative need), the availability of finance, the need to balance profitability and liquidity, the opportunity cost of funds held in liquid form, and so on. The marking scheme gave space for 'other relevant discussion' here, and marks were awarded accordingly.

However, many answers failed to gain reasonable marks because they did not discuss factors. For example, some answers explained the workings of the Baumol and Miller-Orr cash management models. The question did not ask for a discussion of these models, and such answers gained little or no credit. Where such answers discussed factors included in the models, such as the demand for cash, the volatility of cash flows, and so on, credit was given.

QUESTION 3(A)

The requirement here was to discuss the reasons why small and medium-sized enterprises (SMEs) might experience less conflict between the objectives of shareholders and directors than large listed companies. The question was looking for an understanding of why conflicts arise between the objectives of shareholders and directors.

One approach is look at why directors may not maximise shareholder wealth in the case of large listed companies (the agency problem) and why this failure might arise (for example, through the separation of ownership and control). Considering an SME, it can be argued that there is less conflict between the objectives of the two parties because the extent of the separation of ownership and control is smaller, or eliminated altogether, in the case of owner-managed SMEs.

QUESTION 2(D)

This question asked candidates to discuss the factors to be considered in formulating a trade receivables management policy. Many answers gained high marks and covered a number of key factors relating to credit analysis, credit control and receivables collection.

Weaker answers failed to focus on receivables collection, discussing instead a range of working capital management topics such as working capital financing policy, the analysis of current assets, trade payables policy, inventory management policy and so on.

QUESTION 3(A)

The requirement here was to calculate the market value after-tax weighted average cost of capital (WACC) of a company, explaining any assumptions made. Answers were of variable quality and although some answers gained full marks, some answers gained very little credit.

Most answers were able to apply correctly the capital asset pricing model (CAPM) in calculating the cost of equity, although some answers made arithmetic errors.

Fewer answers were able to calculate correctly the cost of the preference shares and some answers chose to use the dividend percentage relative to nominal as the cost of capital, or to assume a value for the cost of capital. Some answers mistakenly calculated the after-tax cost of the preference shares. As preference shares pay a dividend, which is a distribution of after-tax profit, they are not tax-efficient.

The calculation of the after-tax cost of debt of the convertible bonds needed the current market value of the bond, the after-tax interest payment on the bond and the conversion value of the bond. While some candidates calculated all three values correctly, and went on to use linear interpolation to calculate the after-tax cost of debt, other candidates made errors with some or all of these values. A common error was to mix bond-related values (such as the $4.90 after-tax interest payment) with total debt-related values (such as the $21m market value of the bond issue), producing some very high values in the linear interpolation calculation. Some candidates were unable to calculate the future share price as part of the conversion value calculation.

Most candidates were able to calculate a WACC value, although some omitted the cost of preference shares from the calculation.

An important point to consider was whether the overdraft should be included in the WACC calculation. After all, the overdraft was bigger in size than the preference share issue. Some answers considered this point and made an assumption about whether or not to include the overdraft.

QUESTION 3(B)

The requirement here was to discuss why market value WACC was preferred to book value WACC when making investment decisions. Many answers were not of a high standard and tried to make some general points about market efficiency or about the window-dressing of financial statements. The important point here is that the weightings used in the WACC calculation need to reflect the relative importance of the different sources of finance used by a company if the WACC is to be used in investment appraisal. The market value of equity is usually much higher than its book value, so using book value weighting would underestimate the contribution of the cost of equity to WACC and therefore underestimate WACC itself, leading to sub-optimal investment decisions.

QUESTION 3(C)

Candidates were asked to comment on the interest rate risk faced by the company and to discuss briefly how this risk could be managed.

Looking first at the interest rate risk faced by the company, many answers did not focus on the possible future changes in interest rates. While the question stated that the variable overdraft interest rate was 4% one year ago and currently stood at 6%, it was the company's expectation of a further increase in the near future that was important. The company was exposed to interest rate risk in this case through this variable interest rate exposure.

To manage the interest rate risk, the company could either reduce its variable interest rate exposure by reducing its overdraft, or it could hedge the interest rate exposure either internally or externally. Answers therefore needed to discuss how to raise finance to reduce the overdraft and to discuss some of the hedging methods available to the company. It is worth remembering that the question asked for a brief discussion of hedging methods.

QUESTION 3(D)

This part asked for a discussion of the attractions of convertible debt compared to a bank loan of similar maturity. Since the question asked for a discussion of the relative merits of two kinds of debt, no credit was given for discussion of the relative attractions of debt and equity. Several points that could have been discussed are covered in the suggested answer to this question, such as self-liquidation, lower interest rate and increase of debt capacity on conversion. Answers that failed to gain good marks on this question were those that did not show an understanding of such points.

QUESTION 4(A)

This part asked candidates to calculate the value of a company using four different methods.

Most candidates were able to calculate correctly the market capitalisation (equity market value) of the company by calculating the number of shares and multiplying this total by the market value per share. Occasional errors that arose were incorrect calculations of the number of shares and adding the value reserves to the calculated market capitalisation.

Many candidates were not able to calculate correctly the net asset value on a liquidation basis. Some answers calculated the net asset value from the current statement of financial position information, rather than on a liquidation basis. A common error was to fail to subtract non-current liabilities, or current liabilities, or both from the revised figure for total assets.

The price/earnings ratio valuation method was often calculated correctly, although some answers began by dividing earnings by the number of shares to give earnings per share, and ended by multiplying share price by number of shares to give company value, representing an unnecessary dip into and out of share-based values.

Some candidates had difficulty calculating the average historical dividend growth rate, although either the arithmetic or geometric average would have been accepted. Most answers were able to offer a dividend growth model value, even when the calculated growth rate was incorrect.

The second dividend growth model valuation required the dividend growth rate to be calculated using Gordon's growth model, as the product of the retention ratio and the return on equity. It was common to see the retention ratio calculated correctly, only to be multiplied by the cost of equity instead of the return on equity.

QUESTION 4(B)

This question asked for a discussion of the relative merits of the valuation methods from Part (a) in determining the purchase price for a company. Many candidates struggled to gain good marks here.

Some answers did not go beyond outlining how each business valuation method worked – ie the steps followed in calculating a company value. Better answers looked to identify the relative merits of each business valuation method by identifying differences between them – for example, asset-based or revenue-based methods, cash-based or profit-based methods, and discounted or non-discounted methods.

QUESTION 4(C)

Candidates were asked to calculate three values: the before-tax market value of a bond, book-value debt/equity ratio and market value debt/equity ratio, and to discuss the usefulness of the debt/equity ratio in assessing financial risk.

The before-tax market value of the bonds was often calculated correctly as the sum of the present values of the future interest payments on the bond and the present value of the redemption value of the bond. Occasional errors were made by selecting the wrong discount rate for the bond, or by using the wrong maturity period.

Book value debt/equity ratio was more frequently calculated correctly than market value debt/equity ratio. Errors in the calculation of both ratios were sometimes made by including current liabilities in the numerator with the debt. Book value debt/equity ratio includes reserves, while market value debt/equity ratio excluded reserves, and some calculations made mistakes in this area.

Discussions of the usefulness of the debt/equity ratio in assessing financial risk were often disappointing. Many discussions did not explain the nature of financial risk and showed a lack of awareness that a calculated debt/equity ratio needs a basis of comparison to have meaning. Few discussions noted that financial risk could also be assessed by interest cover.

MOST ANSWERS WERE ABLE TO OFFER A DIVIDEND GROWTH MODEL VALUE, EVEN WHEN THE CALCULATED GROWTH RATE WAS INCORRECT

CHOOSING THE BEST WAY TO STUDY

Choosing how you are going to study will be one of the most important decisions you make during your time preparing for your exams. Will you study with a tuition provider, or at home? How do you decide, from all the institutions offering tuition, which will be most suitable for your needs?

There are numerous tuition providers and a wide variety of different study methods, so selecting the one that is right for you can be difficult. Taking recommendations from friends and colleagues can provide some guidance, but what is suitable for one individual may not be the best option for another.

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If you choose to study with a tuition provider, ACCA strongly recommends you opt for one that is approved under ACCA's Approved Learning Partner – Student Tuition programme, as you can be sure:

- they have been assessed against ACCA's widely recognised and highly-regarded global best practice benchmarks
- they have access to a range of development opportunities and tools provided by ACCA
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- Qualifications and courses offered – does the tuition provider offer a course for the qualification and paper(s) that you are studying for? Will you be able to take subsequent papers with the same tuition provider?
- Modes of study offered – are you looking for a full-time, part-time or revision course? Do you want to attend a tuition provider who offers face-to-face tuition, or would a distance learning package be more suited to your needs?
- Variants and adapted papers – does the tuition provider offer tuition for the variant or adapted paper that you are studying for?
- Computer-based exams – if you are studying towards Foundations level papers or the Knowledge module of the ACCA Qualification, will you be able to take computer-based exams with the same tuition provider?
- Facilities – if you intend to drive to your chosen tuition provider, are there car parking facilities available? If you do not have access to a computer or the internet, does the tuition provider have computers available for students' use? Do you require disabled access?

You can search for a tuition provider using ACCA's Tuition Provider database at www.accaglobal.com/en/student/Learning-providers0/Search-for-a-tuition-provider.html.

IF YOU CHOOSE TO STUDY WITH A TUITION PROVIDER, ACCA STRONGLY RECOMMENDS YOU OPT FOR ONE THAT IS APPROVED UNDER ACCA'S APPROVED LEARNING PARTNER – STUDENT TUITION PROGRAMME

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ITY, EMPLOYABILITY

TIME TABLE*

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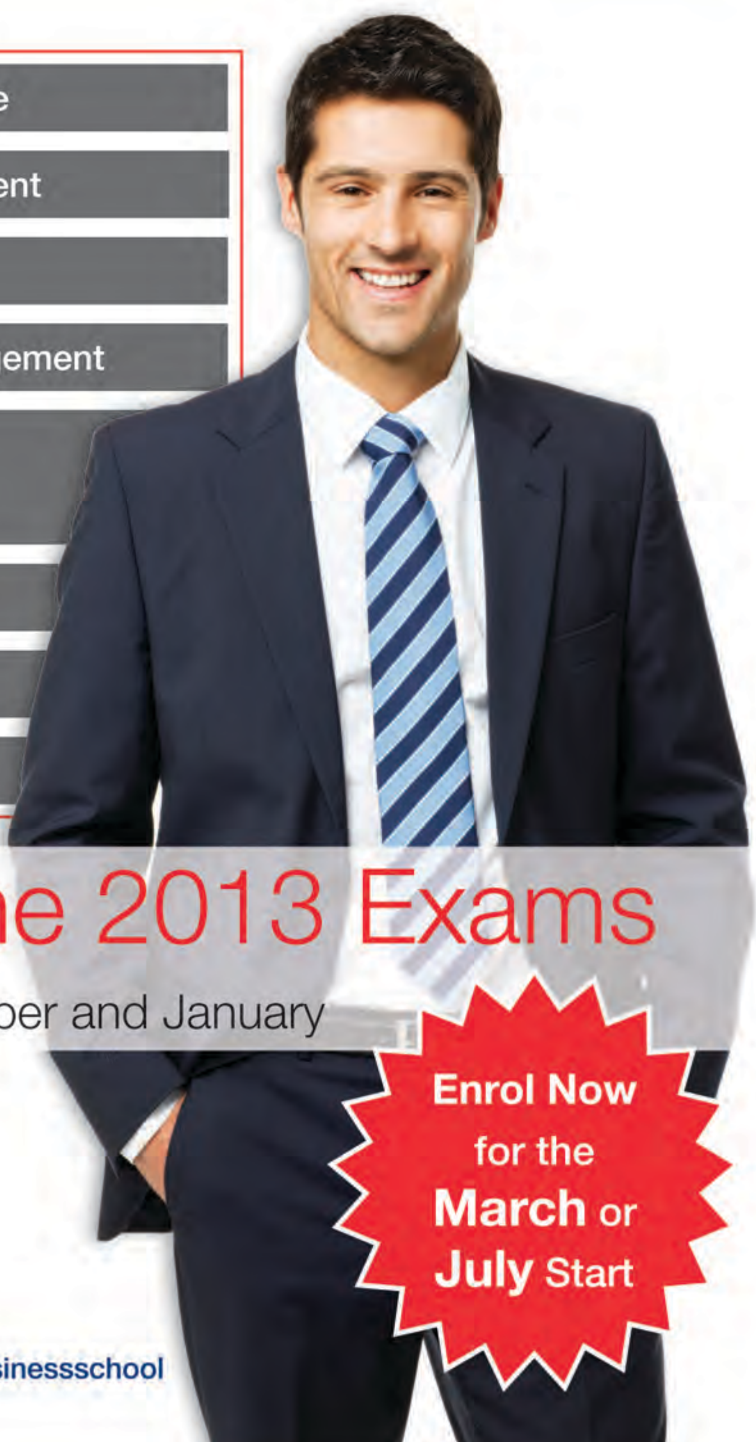
	P4 Advanced Financial Management
	P5 Advanced Performance Management
	P6 Advanced Taxation
aw	P3 Business Analysis
	P2 Corporate Reporting
	P1 Governance, Risk and Ethics



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