

Examiner's report

P1 Professional Accountant
December 2010



General Comments

December 2010 was another successful diet for paper P1 with many candidates passing and with some exceptional performances by individual candidates. As always, I would like to convey my congratulations to all successful P1 candidates and their tutors. The December 2010 P1 paper was similar in level and 'feel' to all the previous P1 papers and it is my hope that candidates and tutors know what to expect in terms of approach even if they don't know what will be on the paper in terms of content.

Before I go on to discuss the individual questions. I have a few general remarks to make. First, there is still evidence that candidates are not correctly or fully reading the questions. I will discuss the specifics below but in, for example, Q1(c)(i) and also Q3(c), many candidates seemed not to realise what the question was actually asking. Perhaps some candidates answered the question they wish had been asked rather than the actual question set.

Second, it was frustrating to see that many candidates were unable to bring the content of one of my technical articles into their answers when it was appropriate to do so. The content on environmental auditing for Q2 (b) was covered in a technical article in Student Accountant that I wrote in March 2009. The answer to this question (the stages in an environmental audit) was clearly discussed in the technical article. Perhaps the fact that the article was published some time ago made some candidates think the content would not be covered. This should be salutary to future P1 candidates. Technical articles should be studied carefully by all P1 candidates including those written by the examiner and by other authors.

Third, there is ample scope for improvement in the development of level 3 intellectual outcomes like 'construct' and 'criticise' (such as in Q1(c) (ii), Q2 (a) and Q4 (d)). Being able to operate at 'level 3' is important at the professional level in ACCA exams (and in professional life) and there was evidence that some candidates lacked an insight into what these verbs meant.

There was an approximately even distribution of section B questions in terms of 'popularity'. All section B questions were done very well by some and very poorly by others. I will explain some of the common errors in the comments below.

Specific Comments

Question One

The case in section A (question 1) was about ZPT, an internet communications company, which was involved in a number of false accounting and fraudulent activities. The auditor, JJC, was complicit in the situation. A similar situation happened in 'real life' some years ago and so some candidates may have been familiar with some of the issues already. This does show the value of studying current cases from the business news in preparing for P1 exams as 'real life' themes are sometimes borrowed in framing exam case studies.

Part (a) contained two components, parts (i) and (ii). The first was a bookwork task to explain the factors that might lead institutional investors to seek to intervene directly in a company they hold shares in. This was not a requirement to define 'institutional shareholders' as some candidates did (scoring nothing for their efforts in doing so). The content should have been well-known to any well-prepared candidate. Many were able to gain some marks for part (a) even if they couldn't get all six marks. For part (a)(ii), candidates had to study the case to see which factors applied to ZPT. There were three such factors mentioned in the case and candidates had to use these to 'construct the case' which means to produce arguments in favour of investor intervention because of the identified weaknesses.

Part (b) asked about absolutist and relativist ethics. I often put a substantive ethics requirement from section E of the study guide into question 1 and this paper was no exception. Shazia Lo was an accountant at ZPT who



accepted a bribe to keep quiet about the company's fraudulent accounting. The question asked candidates to distinguish between absolutism and relativism and then to critically evaluate Shazia Lo's behaviour from these two perspectives for a total of 10 marks. This means that both perspectives had to be discussed in considering Shazia Lo's behaviour. From an absolutist perspective, it is obvious that no accountant should ever be complicit in bribery, fraud or mis-statement. From a relativist perspective and this is where the case raises an interesting ethical conundrum, it maybe right in some circumstances to show compassion and to carefully consider the consequences of actions, not merely their legality. Shazia used the money not to enrich herself but to pay for medical treatment for her mother. This in no way excuses her actions but it does raise the issue of trading one ethical good (upholding her professional and legal duties) against another (assisting in the medical care of her mother).

There were three requirements in part (c) and all parts were done poorly overall. What surprised me about this is that all parts are clearly 'core' areas in the P1 study guide and whilst some candidates addressed the questions correctly and scored highly, many did not. Just to clarify what the questions meant, (a) was about the consequences of bad governance, (b) was about the case in favour of mandatory (rather than voluntary) IC reporting, and (c) was about the contents of an internal control report. None of these should have been a struggle for a well-prepared P1 candidate.

In part (c)(i), it seems that many candidates saw the first part of the requirement but ignored the second part. So they described the nature of 'sound corporate governance' whilst neglecting the second part which was to do this 'by assessing the consequences of the corporate governance failures ay ZPT'. This question is essentially probing the main purpose of corporate governance: without sound corporate governance, companies go bust, employees lose their jobs, investors lose their investments and can be financially ruined, and a number of other terrible outcomes. So the 'consequences of CG failure' was often overlooked by candidates, which meant that they failed to gain those marks.

Part (c)(ii) was concerned with the debate over the mandating of internal control reporting. Some candidates correctly identified that this debate had taken place in the United States some years ago over section 404 of Sarbanes Oxley (although it wasn't necessary to know this to gain the marks). The point of having this requirement in the question was to highlight that poor internal controls were in part responsible for the situation at ZPT and that mandatory reporting to an agreed reporting framework would have made it much more difficult for the IC failures to have occurred. The accountability created by having to report on internal controls could have made it much more difficult for the ZPT management to have got away with the bad practice that they did.

Part (c)(iii) was about the contents of such a report. The marking team allowed some latitude here but the essential components should have included, in all cases, an acknowledgement statement (whose job is it?), a description of the processes (how is IC done?), it should be accurate and reliable, and, specifically, it should explain any particular IC weaknesses.

The professional marks were awarded for framing the answer to the three components of part (c) in the form of a speech by a legislator. There was some evidence of improvement in candidate's taking this seriously and setting out their answer accordingly, but others made errors like setting it out as a memo or letter, or else by using bullet points (in a speech?) or unlinked statements. I would again reinforce the importance of being prepared to answer in a variety of ways because these four marks really can make a difference between a pass and a fail.

Question Two

This question was mainly concerned with sustainability and environmental themes although part (c) introduced some content on risk. Many candidates did well on part (a) which was pleasing to see. Explaining what 'sustainability' meant was straightforward for well-prepared P1 candidates although some could not see the way in which the finance director had misunderstood the term. He thought it meant going concern and so equated



sustainability with the business being financially sustained rather than the environmental sustainability of the company.

Part (b) was about environmental auditing. I addressed this topic in detail in a technical article for *Student Accountant* in March 2009 so was surprised that this question was not answered well by the majority of candidates. Environmental auditing is an important element of environmental management and in reassuring investors and other stakeholders concerned with an organisation's environmental risk. It is important that candidates and tutors carefully study technical articles – they may contain content relevant to exams!

Part (c) was done better overall. The 'strategic/operational' risk distinction has appeared before and there was a technical article on this by Nick Weller in September 2008. The final task, to explain why the environmental risks at JGP are strategic, was less well done although a careful analysis of the facts of the case should have enabled an answer to be arrived at if the candidate knew what strategic risks are.

Question Three

This was a question focussing on issues of non-executive directors but, in part (c), asking about corporate governance reporting and its importance in investor information provision. The case was about KK Company and its need to fill a vacant non-executive directorship. Issues were raised because the nominee was less than ideal because of a number of conflicts of interest.

Part (a) asked candidates to explain what a conflict of interest was and then to discuss the conflicts of interest that would arise if John Soria, the nominee for the position, became the NED of KK Company. This was done well overall, with many candidates scoring well on both tasks.

There was a difference in part (b) between candidates who attempted to analyse the case and carefully consider what the question was actually asking, and those who seemed to think that questions asking about the non-executives should be answered in terms of the four general roles (people, risk, strategy, scrutiny). The question asked specifically about how NEDs would benefit the KK board during a period of growth and this required candidates to carefully consider the particular circumstances in question. Those candidates that carefully considered the case and the particular advantages that NEDs could bring during a period of rapid growth achieved the highest marks on this question.

Part (c) was actually asking something quite straightforward: what would a good corporate governance section of an annual report contain. In many countries, a substantive CG section is either mandatory or prescribed under listing rules. Reports in the UK and other developed and developing economies, for example, often have several pages of content called 'corporate governance' or similar. These are intended to allow the company to report on each of the measures that are important for ensuring the sound stewardship of company value. This underlines the importance of candidates being aware of a range of reporting issues. Inspecting the annual reports of most large companies would be a way of becoming familiar with corporate governance reports.

One common error was to answer as if the question was asking about the contents of an annual report (chairman's statement, income statement, etc.). It was asking about the corporate governance section in an annual report and not about the annual report in its entirety.

Question Four

Question four was mainly about risk with part (d), for five marks, asking about social responsibility. The case was about a manufacturer (this was important for answering part (a)) with a voluntary supplier payment policy and a number of internal pressures on working capital serving to increase liquidity risk. Most candidates were able to define liquidity risk in part (a) but fewer were able to explain its particular significance to UU (the company in the case). A careful reading of the case would have alerted a well-prepared candidate to the reasons for UU's



particular vulnerability to liquidity risk. Included in this was the fact that it was manufacturer with inventory levels not present in service industry companies.

Part (b) raised the issue of embedding risk into systems and culture, a subject that has been examined before on a P1 paper. This part was done quite well by many candidates whereas part (c) was less well done. Part (c) involved a careful analysis of the case to bring out the various factors that would make it difficult to embed liquidity risk management at UU. It was specifically about liquidity risk management and not risk management in general. The obstacles were relatively straightforward to find in the case and the highest marks were gained by those most able to show how the different attitudes of the company's managers put pressure on the different aspects of the company's working capital.

For five marks, part (d) asked candidates to criticise the voluntary supplier payment policy as a means of demonstrating CSR. This means candidates had to point out why it wasn't a very good means of demonstrating CSR. The case contained a number of issues associated with the policy which the better-prepared candidates picked up on. Poor answers receiving few or no marks were those that simply defined CSR or used a textbook framework (such as Carrol's framework) in an attempt to answer the question.