

WEAKER ANSWERS FAILED TO FOCUS ON WORKING CAPITAL RATIOS (FOR EXAMPLE BY CALCULATING AND DISCUSSING RATIOS SUCH AS INTEREST COVERAGE, OR DIVIDEND PER SHARE), OR OFFERED ONLY GENERAL DISCUSSIONS OF AREAS OF WORKING CAPITAL MANAGEMENT (SUCH AS HOW INVENTORY CONTROL OR CREDIT MANAGEMENT COULD BE IMPROVED).

Many had difficulty calculating the capital gearing on a market value basis either calculating capital gearing using book values, calculating the market values of the two bonds using the book value of equity, or incorrectly adding the value of reserves to the equity market value of the company.

Many candidates made a good attempt at calculating the market value weighted average cost of capital (WACC) of the company. Even though the cost of debt of the second bond was provided, some wasted time calculating it again using linear interpolation. Others calculated a WACC that was higher than the highest cost of capital, or used an average cost of debt by adding together the costs of debt of the two bonds and dividing by two.

Part (d) asked for a discussion of whether a change in dividend policy would affect the share price of the company. Many students clearly had not studied this part of the syllabus, and simply stated that if the dividend went up, the share price went up, and vice versa. Better answers referred to key issues in the debate on dividend relevance and dividend irrelevance, such as the clientele effect, and the perfect capital market based view of Miller and Modigliani.

QUESTION 3

Part (a) required candidates to calculate the theoretical ex rights price per share for a new equity issue.

The question stated that the rights issue needed to provide €6.5m. Since the issue was in dollars and the exchange rate was 1.3000 €/\$, the rights issue needed to raise \$5m. Since issue costs were \$312,000, the rights issue needed to raise \$5.312m. The rights issue price was \$3.32 per share, meaning that 1.6m shares needed to be issued.

Main errors were:

- ❑ not converting euros into dollars
- ❑ using the exchange rate incorrectly, so that the dollar amount was greater than the euro amount
- ❑ incorrectly calculating the number of new shares to be issued and assuming a form for the rights issue (such as a 1 for 1 issue)
- ❑ ignoring issue costs

- ❑ using a rights issue to raise all of the finance needed, even though the question said that 50% of funding was through debt.

Part (b) asked candidates to evaluate the effect of the European investment on the earnings per share of the company and on the wealth of its shareholders.

Many candidates ignored the 20% return on investment before interest and tax, and discussed the position of the company after the rights issue; many were also unable to calculate the current earnings per share of the company, even though the question gave its current price earnings ratio and share price.

Candidates needed to calculate the earnings per share after the new funds had been raised, taking into account the return on the new funds raised. This could be done in euros or in dollars, provided that the revised earnings per share was expressed in the home currency of the company, which was dollars. Once the revised earnings per share had been calculated, multiplying by the price earnings ratio gave the revised share price.

Part (c) asked candidates to explain the difference between transaction risk and translation risk, illustrating their answers using the information given in the question. Candidates who missed marks did not distinguish clearly between the two forms of risk, or provide the illustrations.

Part (d) asked candidates to identify and briefly discuss hedging methods that could be used by the company, and provide two illustrations. Students missed marks by:

- ❑ confusing exchange rates with interest rates
- ❑ discussing forward rate agreements, rather than forward exchange contracts
- ❑ using calculations without explanations
- ❑ listing hedging methods (ie futures, options, swaps) without explaining how these could help the company.

QUESTION 4

Part (a) asked candidates to discuss the role of financial intermediaries in providing short-term finance for business organisations. Better answers covered the links between investors and borrowers,

aggregation of invested funds, maturity transformation, and risk transformation.

Weaker answers often discussed short-term sources of finance (products), and the range and type of financial intermediaries (providers).

Part (b) required candidates to prepare a forecast income statement and a forecast statement of financial position.

Some candidates ignored the forecast financial ratios and applied the expected turnover growth rate to cost of sales and other expenses. Others showed a lack of knowledge of the structure of the income statement by calculating the tax liability before subtracting the interest payments.

Part (c) asked for an analysis and discussion of the working capital financing policy of the company. Many students were clearly unaware of the conservative, aggressive and matching approaches to working capital financing policy.

Analysis of the statement of financial position shows that 89% of the current assets of the company are financed from a short-term source, while only 11% are financed from a long-term source. Noting this, good answers discussed the aggressive nature of the company's working capital financing policy and associated risks.

Weaker answers discussed conservative and aggressive approaches to the level of investment in working capital, or focused on the cash conversion cycle (operating cycle) of the company, or combined Parts (c) and (d).

Part (d) asked for a discussion of the forecast financial performance of the company in terms of working capital management. Better answers compared the current position with the forecast position and showed that a deterioration in financial performance was expected. Weaker answers failed to focus on working capital ratios (for example by calculating and discussing ratios such as interest coverage, or dividend per share), or offered only general discussions of areas of working capital management (such as how inventory control or credit management could be improved).

**PAPER P1
PROFESSIONAL ACCOUNTANT**

Paper P1 comprises Section A, containing one compulsory question worth 50 marks, and Section B, containing three questions worth 25 marks each from which candidates had to answer two. All questions were based on case scenarios.

QUESTION 1

This compulsory question was based on an extended case study concerning the

sinking of a ship (the *Mary Jane*), and the consequences for its owner, Sea Ships Company. The central event of the case was the loss of a ship, the *Mary Jane*, in a storm but the case explains that the ship sank because of a series of internal control failures both on board the ship itself while the company's future was threatened because of other internal control failures at the Sea Ships head office. Because of the loss of life on the *Mary Jane*, the government held an inquiry which identified and highlighted a range of failures leading to the loss. This scenario, drawn from a range of real maritime disasters, shows the importance of risk management and internal controls in business operations. Lives can and do depend on them, and internal control failures can also threaten the viability of companies.

Question 1 contained an ethical reasoning task using the seven-step American Accounting Association (AAA) model (in Part (a)). The company had evidence from an independent consultant that a range of structural changes to the *Mary Jane* would have prevented it from sinking but the changes had not been carried out due to cost constraints. The task, in Part (a), was to use the AAA model to consider the ethical dilemma of whether or not to publicly disclose the fact that the report had been received but not acted upon. Candidates recalling some of the seven steps did receive some recognition, but it was disappointing that some candidates reproduced the seven steps but then either ignored or misinterpreted the ethical dilemma. The requirement was to consider 'whether or not to disclose this information [about the independent consultant's report] publicly', but some failed to recognise that this was the dilemma to be considered and thereby did not achieve high marks.

Part (b) was an 'identify and analyse' task where candidates had to study the case and draw out the internal control failure both at Sea Ships Company and on the *Mary Jane* itself; these were relatively clear to many candidates. Some candidates missed out on some of the internal control failures at the Sea Ships Company itself (such as the failure to ensure adequate insurance cover). This type of question tests both

understanding (identifying the internal control failures) and analysis (saying why the identified issues are important and their implications) and it tests candidates on a range of topics from the Paper P1 *Study Guide*. A similar approach was taken, using different verbs, in Question 2 Part (c) and Question 3 Part (b). It is not possible to perform well on these questions without a careful scrutiny of the case scenario.

Part (c) asked how non-executive directors (NEDs) might have helped in improving the governance at Sea Ships Company. The issues highlighted by the government inquiry were useful starting points, but disappointingly, many candidates automatically wrote about the four general roles of NEDs. Candidates who based their answers on the unique governance situation at Sea Ships were rewarded while those who reproduced an auto-response ('strategy, scrutiny, risk and people') tended to achieve few or no marks. Again, it was important to analyse the case and read the question carefully. The question was not asking about the roles of NEDs but rather the contribution they (rather than executive directors) could make given the governance failures at Sea Ships Company.

Part (d) contained two linked requirements that had to be answered within the same 'flow' of narrative. Four professional marks were available for correct presentation. Part (d)(i) and (ii) were poorly done overall with some candidates refusing to attempt them, possibly because they did not understand the question or read it properly.

Part (d)(i) asked candidates to assess the importance of information on controls and risks, but that some candidates misinterpreted its meaning. The key words were 'importance of information' or, in other words, 'why does the board of Sea Ships need information on controls and risks'? The importance of information is covered in the Paper P1 *Study Guide*, section B4a, and in other ACCA papers, so candidates should have been aware of this area.

Part (d)(ii) was also done poorly overall, but was also a relatively straightforward requirement. Following on from the importance of information, this part asked about the nature of the information itself. A good answer explained that

good information was reliable, relevant, understandable and complete, although markers accepted other relevant qualitative characteristics. The six marks available for Part (d)(ii) should have been relatively straightforward to achieve so it was disappointing that many candidates failed to understand what the question was asking. Again, a careful reading of the question is crucial.

Disappointingly, there were many poor attempts to gain the professional marks available for Part (d). The question required the answers to both Parts (d)(i) and (ii) in the form of a memo. This was worth four marks which few managed to gain. Paper P1 candidates must learn the various forms of narrative communication; it was evident that candidates were unsure of how to draft a memo to management and this was reflected in the professional marks awarded. A common error was to write the answer in the form of a letter.

QUESTION 2

The question was set in the context of a newly appointed director at Ding Company. Drawing on themes from the corporate governance sections in the Paper P1 *Study Guide*, this question examined a director's induction, unitary versus two-tier boards, and the roles of a non-executive chairman. It was necessary to study the case in detail in order to gain high marks.

Part (a) had two tasks: to explain the content of a director's induction programme, and to assess the advantages of an induction programme for Sam Mesentery, the new director who was the subject of the case. The first task was usually done better than the second. The marks for 'explain the content' were mainly bookwork but it was necessary to study the problems with Sam Mesentery to gain the 'assess the advantages' marks. Candidates should closely examine case scenarios as answers often require the placing of case evidence into a theoretical context.

Parts (b) and (c) were less well done. Both required level 3 intellectual level abilities and a very careful analysis of the case. Part (b) required a knowledge of unitary and two-tier boards in order to critically evaluate Annette Hora's belief that companies in turbulent environments (ie when environmental factors are highly changeable), should have two-tier boards. The task in Part (b) was to provide arguments for and against this belief. This, then, was not just about the pros and cons of one type of board structure over another, but rather about their suitability in different environmental conditions, therefore this was an application question. Candidates had to take what they knew about unitary and two-tier boards and

THE SIX MARKS AVAILABLE SHOULD HAVE BEEN RELATIVELY STRAIGHTFORWARD TO ACHIEVE, SO IT WAS DISAPPOINTING THAT MANY CANDIDATES FAILED TO UNDERSTAND WHAT THE QUESTION WAS ASKING. AGAIN, CAREFUL READING OF THE QUESTION IS CRUCIAL.

apply that knowledge to something they may not have considered – how different environments might favour different types of board.

Some candidates did not adequately read Part (c), about the non-executive company chairman, Arif Zaman, and the remarks he made about his job. The task was to assess Arif's understanding of his role based on these remarks. It was necessary to know the roles of a non-executive chairman in order to compare Arif's views with those roles. The question did not ask for a list of the roles of a non-executive chairman, and the most common error was to provide such a list rather than to analyse what Arif had said.

QUESTION 3

This was a question about an irregular transfer of company funds for private use which gave rise to an ethical dilemma for John Wang, the training manager of the company's auditor. It raised issues of professional relationships, the role of auditors, and personal loyalties and friendships.

Part (a) was relatively straightforward, and asked for an explanation of 'integrity' and of its importance in professional relationships. Although it referred to the professional relationships between the people in the scenario, explanations concerning other professional relationships were rewarded. Most candidates could define integrity but fewer could apply that knowledge to the case and therefore did not gain marks for applying integrity to professional relationships.

Parts (b) and (c) were less well done overall. Both employed level 3 verbs and required a careful analysis of the case. In Part (b), candidates were asked to criticise Potto Sinter's ethical and professional behaviour. Five clear ethical and professional 'issues' could be attributed to Mr Sinter and it should have been straightforward to pick these out. When I use 'criticise' in a Paper P1 question, candidates must carefully scrutinise the case, identify the behaviour which is wrong or inappropriate, and discuss why the behaviour is wrong. In order to do this, candidates must know what right and wrong behaviour is before they can apply that knowledge. In this case, it should have been straightforward to identify Mr Sinter's shortcomings. This question was not done well overall, perhaps because candidates felt too time-pressured to read the case in detail even though this was necessary to answer the question correctly. Where case analysis is essential for gaining marks, it is better to invest time studying the case rather than writing a long but unfocused answer that fails to address the question.

The same point can be made for Part (c). It was necessary to know what John Wang's alternatives were before they could be evaluated. A dilemma, by definition, is a choice between two options. In recognising that some other options were theoretically possible (such as consulting a third party for advice), markers allowed some latitude in the options that candidates discussed. Confronting Potto Sinter with his ethical and professional failures was the correct option in context and disappointingly, some candidates failed to recognise this.

QUESTION 4

This question, about risk, contained three requirements. The notion of 'embedding' risk in organisations is an important one in risk management and was examined in Part (a), which asked candidates to describe the concept, and in Part (b), which required an analysis of the case study to assess how easy it would be to embed risk management into the company in the case (Saltoc).

Part (a) asked for a description of embeddedness, however, also specifically mentioning 'with reference to the Saltoc Company', and so candidates had to describe the term and then give examples of how it could be implemented in Saltoc. The first part was generally done quite well but many candidates failed to gain the application marks. I would again emphasise the importance of carefully reading the question. The 'with reference to Saltoc' indicated that some marks were allocated for doing this.

The case about Saltoc included some descriptions of key personnel and issues with the corporate culture. Candidates had to draw on these to answer Part (b), which asked whether the Saltoc culture was able to implement embedded risk systems. This obviously required study of the Saltoc culture, and time spent scrutinising the case usually resulted in better answers. High marks could not be gained without such study. Some candidates attempted a general discussion about culture or the importance of risk embeddedness, but neither of these were well rewarded.

Part (c), worth 11 marks, was about external risk auditing. I wrote an article about this in the March 2009 issue of

Student Accountant and so candidates should have been aware of the essentials. Part (c) asked candidates to explain what risk auditing contains and to construct the case for external (rather than internal) risk auditing at Saltoc. Many candidates gained the 'contains' marks but did less well on making the case for risk auditing at Saltoc. Given that I had written an article on this, I was surprised that some candidates could not recall the four stages in risk auditing. The level 3 intellectual level task in this requirement was to construct the case for an external risk audit. Candidates had to study the case in order to make a convincing argument for external risk auditing. So, again, detailed case analysis was necessary to gain the highest marks.

PAPER P2 CORPORATE REPORTING

The paper dealt with a wide range of issues and accounting standards. The paper was quite testing but candidates responded well resulting in a pleasing pass rate. The results reflect the benefit of the publication of articles in *Student Accountant* on specific topics and the increasing expansion of the knowledge base in certain subject areas, particularly IFRS 3 (Revised) and financial instruments. Candidates also seem to have applied good exam techniques in answering the paper. There was less evidence of candidates only answering two questions rather than the three questions required. Finally, candidates seem to be answering the 50-mark question better particularly with regards to the ethics question.

QUESTION 1

Part (a) required candidates to calculate a gain or loss on the disposal of an equity interest in a subsidiary, to prepare a consolidated statement of financial position, and to discuss the relationship between ethical behaviour and professional rules. The calculation of the loss arising on the disposal of the equity interest was extremely well answered with many candidates scoring full marks. Part (b) dealt with an acquisition of a further interest in a subsidiary and the disposal of a partial interest in a subsidiary, as well as the treatment of contingent liabilities on consolidation, investment property,

THE LEVEL 3 INTELLECTUAL LEVEL TASK REQUIREMENT WAS TO CONSTRUCT THE CASE FOR AN EXTERNAL RISK AUDIT. CANDIDATES HAD TO STUDY THE CASE IN ORDER TO MAKE A CONVINCING ARGUMENT FOR EXTERNAL RISK AUDITING. DETAILED CASE ANALYSIS WAS NECESSARY TO GAIN THE HIGHEST MARKS.

provisions for environmental claims, restructuring provisions and impairment. The breadth of topic areas was quite large, and key issues related to the calculations of the negative and positive movements in equity arising from the sale and purchase of equity holdings. Additionally, the calculation of post-acquisition reserves was quite complex and candidates did not always score well. However, although candidates found it difficult to calculate post-acquisition reserves, markers gave credit for method and workings. The treatment of the non-consolidation adjustments (investment property, provisions for environmental claims, restructuring provisions, etc) was generally well answered although a major failing involved the non-recognition of the restructuring provision, as a constructive obligation did not exist.

Part (c) required candidates to discuss the relationship between ethical behaviour and professional rules. Candidates had to comment on the ethical behaviour of a director where the director possessed confidential information. Candidates performed well here but must remember to refer to the information in the question when writing the answer.

QUESTION 2

This question dealt with the subject of impairment. Candidates were asked to discuss the main considerations which an entity should take into account when impairment testing non-current assets in a climate where there were credit limitations. Part (b) required candidates to set out how to account for any potential impairment in given circumstances. Part (a) was very well answered although many candidates simply set out the rules of impairment testing without relating it to the economic climate mentioned. Part (b) was quite well answered. Candidates had some difficulties in discounting future cash flows and in the treatment of the impairment loss and revaluation gain. Many did not discuss the key issues in sufficient depth, as asked, instead simply calculating the accounting adjustments.

QUESTION 3

This question was on a company in the oil industry, and required knowledge of revenue recognition principles, events after the reporting period, inventory, accounting for jointly controlled entities, decommissioning costs, and intangible assets. Candidates set out the principles of revenue recognition quite well, but their application of knowledge was not so good. Part (b) required candidates to determine the relationship between the entity and another entity. Even though the interest

THERE WAS SOME EVIDENCE OF POOR TIME MANAGEMENT, PERHAPS CAUSED BY CANDIDATES SPENDING TOO MUCH TIME ON QUESTION 1 PART (A). HOWEVER, THIS MIGHT ALSO REFLECT THE FACT THAT CANDIDATES WERE MORE FAMILIAR WITH PORTER RATHER THAN PROJECT MANAGEMENT.

in the entity was an equity interest, many candidates thought that the entity was jointly controlled and that proportionate consolidation could be used instead of equity accounting.

The accounting for decommissioning costs was quite well answered, with many students correctly identifying the decommissioning liability. Part (d) required candidates to apply IAS 38, *Intangible Assets*, to a scenario. Again, answers were good although the main weakness was in the application of the knowledge.

QUESTION 4

Part (a) required candidates to discuss the measurement issues relating to financial instruments and how these issues would be alleviated if fair value were used for all financial instruments. Part (b) asked candidates to compare two loans which would result in almost identical payments in the future but which were being carried at different amounts currently. Candidates answered the question quite well, although many simply quoted the measurement rules relating to financial instruments without setting out how these rules created confusion and complexity for users. In addition, many candidates simply set out the advantages and disadvantages of fair value accounting rather than discussing how the use of fair value might result in less complexity in financial statements. The calculations in Part (b) were quite well done although very few candidates saw that the redemption amounts were the same but the carrying amounts were quite different.

PAPER P3 BUSINESS ANALYSIS

The pass rate on this paper was slightly lower than in previous sessions. This was primarily due to relatively poor candidate performance in Section B, where Questions 3 and 4 were not well answered. A significant number of candidates only answered two questions; the compulsory question one and the optional Question 2. This seems to suggest that candidates are unfamiliar with quality and project management, two significant parts of the syllabus. Furthermore, the Paper P3 *Study Guide*

explicitly builds on knowledge gained in Paper F1. Candidates exempt from this earlier paper are encouraged to review the content of the Paper F1 syllabus. In this exam, candidates were able to use Mendelow's power/interest grid, examined at recall level in Paper F1, but assessed by application in Paper P3.

There was some evidence of poor time management, perhaps caused by candidates spending too much time on Question 1 Part (a). However, this might also reflect the fact that candidates were more familiar with Porter rather than Project Management. Overall, this paper highlighted important gaps in knowledge and application which must be addressed.

QUESTION 1

This was a three-part question worth 50 marks based on an extended case study scenario about an organisation, ABCL, who was considering entering the business analysis certification (BACTI) market in the neighbouring country of Erewhon. This compulsory question was answered relatively well, with good use of the case study material.

Part (a) asked candidates to use Porter's framework to analyse the BACTI industry in Erewhon and to assess whether it was an attractive market for ABCL to enter.

Most candidates answered this question relatively well, showing an understanding of Porter's framework and how to apply it to the case study scenario. Although the scenario explicitly stated that Xenon analyses an industry by using Porter's five forces framework, some candidates elected to use his 'diamond' analysis instead. The two frameworks overlap to some extent and so candidates using this approach gained some marks, although there was probably insufficient information in the case study to get a pass mark using this approach.

Part (b) assumed that ABCL had decided to enter the BACTI market by acquiring one of three big companies. Ecoba Ltd had been identified as the most appropriate target and candidates had to write a short report evaluating Ecoba Ltd, analysing whether it was the most appropriate of the three possible acquisition targets.

Overall, candidates answered this part relatively well, calculating and using financial information that had been signposted in the scenario. Some candidates took the 'suitability, feasibility, acceptability' approach, which sometimes led to answers with little reference to the case study scenario. A straightforward financial evaluation would have been more appropriate. Furthermore, some candidates questioned the attractiveness of the marketplace as a whole. This had already been considered in the first part of the question.

Part (c) asked candidates to identify and analyse the stakeholders in Ecoba Ltd and analyse how ABCL could successfully manage them during the ownership transition. Markers interpreted stakeholders quite widely and included some not identified in model answers. Most candidates answered this part relatively well, with appropriate use of the Mendelow matrix often leading to high marks.

QUESTION 2

Question 2 concerned an organisation called Independent Living (IL), a charity providing living aids. Part (a) required candidates to analyse the primary activities of the value chain for the product range at IL. Most candidates answered this fairly well, recognising that there were two value chains, one concerned with manufactured goods and the other with 'bought in' products. However, many candidates were not familiar with the terminology and structure of the value chain, especially the 'service' element. Part (b) asked candidates to evaluate what changes IL might consider to the primary activities in the value chain to improve their competitiveness, while continuing to meet their charitable objectives. This was also answered fairly well although some solutions were less appropriate for a charity. Charities are an important part of the 'not-for-profit' sector and their structure and objectives should be understood by candidates.

QUESTION 3

Question 3 concerned a bank that had acquired a smaller rival. The scenario described a number of ways in which good project management had contributed to a successful subsequent branch rationalisation project. Candidates were asked to identify and analyse the elements of good project management that had helped make this project successful. Part (a) was poorly answered in two ways. First, many candidates discussed project management in general and did not refer to the scenario, although links were relatively easy to make.

PART (B) WAS DONE WELL WITH MANY CANDIDATES DISCOUNTING THE ANNUAL CASH FLOWS AND ADDING THE TERMINAL VALUE TO THESE TO OBTAIN AN ESTIMATE OF THE VALUE OF THE BUSINESS.

Second, many candidates constructed theoretical answers around aspects of project management which were irrelevant or inappropriate to the case study, often seeming to answer a different question to the one set. Candidates need to understand the principles of project management and, more importantly, how apply them to a case study. The link between theory and application was very poor.

Part (b) asked candidates to explain the principles of Paul Harmon's process-strategy matrix and apply them to three process initiatives at the bank. This part was answered slightly better, although suggested solutions were often unjustified and very brief. With three marks on offer for each solution, answers such as 'buy a software package' or 'outsource to a specialist' are clearly insufficient.

QUESTION 4

Question 4 concerned the production of high quality aircraft engine monitoring software. Part (a) asked candidates to identify the characteristics of software quality and explain the appropriateness of each characteristic to the engine monitoring software. Part (b) required candidates to explain the principles of the V model and evaluate its use in defining and testing changes to the company's established software solution. This was not a popular question and was not answered well.

Candidates often failed to pick up clues from the scenario (ie reliability is needed in such a critical environment, usability is an issue after a recent accident) and this compounded a lack of knowledge. Many aspects of software quality were misunderstood and most answers were insufficient to gain the marks on offer. In Part (b), some candidates drew the V model but few applied it to the case study environment.

Marks for this question were very low – candidates had clearly studied the subject, but not in sufficient depth to answer a 25-mark case study question.

PAPER P4 ADVANCED FINANCIAL MANAGEMENT

The paper comprised two compulsory questions in section A, totalling 60 marks, and three 20-mark questions in section B, from which candidates had to choose two.

QUESTION 1

Part (a) required candidates to prepare a three-year cash flow forecast, apply correct annual inflation figures, calculate the depreciation correctly, and estimate the annual incremental working capital and taxation. In Part (b) candidates were asked to estimate the value of the business by obtaining the present value of the cash flows and the terminal value. In Part (c), candidates had to advise the directors of the assumptions and uncertainties in the valuation, and, in Part (d), describe how option pricing theory could be applied to give an alternative value to the business.

A tabular format for Part (a), with a structure going from profit to cash flows, enabled many candidates to obtain high marks. Part (b) was done well with many candidates discounting the annual cash flows and adding the terminal value to these to obtain an estimate of the value of the business. For Part (c), many candidates referred to the estimates made but fewer considered the adequacy of the required rate of return. Answers to Part (d) were variable. Many candidates understood the principles of limited liability and of options, but failed to put them together in a coherent explanation.

QUESTION 2

This question considered the risks the acquirer should consider when assessing an acquisition (Part (a)), the performance of the target company (Part (b)), the impact of the acquisition on the acquirer's equity investors' rate of return (Part (c)), and whether or not the target was undervalued and therefore a suitable target for acquisition (Part (d)).

For Part (a), suitable answers were given on strategic fit and valuation, but few candidates considered regulatory and disclosure related risks. Many candidates demonstrated some understanding of EVA™ and other ratios in Part (b) without being able to determine these correctly. Many also had difficulty estimating the relevant cost of capital for the purposes of the EVA™ calculation. Errors in the numbers used in the ratio formulae meant that fewer marks were gained. Likewise, many candidates understood the principles of un gearing and re gearing betas for Part (c), but could not apply these to the scenario.

Only a few candidates could evaluate whether or not the company was

undervalued with reference to the efficient market hypothesis, and therefore assess how Polar (and Anchorage) would benefit from the acquisition. A minority discussed systematic risk, misunderstanding the requirement.

This question had four professional marks. Given that many candidates only fail marginally, gaining these marks could be highly beneficial. Unfortunately, some assumed that simply giving a suitable title was sufficient, which was not the case. Higher professional marks were awarded to answers that gave due care to the structure of the report and the presentation of the answer.

QUESTION 3

This question considered the value of a mezzanine issue of fixed rate notes with warrants, and whether such an issue was appropriate to the scenario. Part (a) asked candidates to calculate the value attached to warrants using the Black–Scholes Option Pricing formula, and to give the assumptions of the valuation formula used. Most applied the formula correctly, although the exercise price and the underlying share price were sometimes not identified correctly. Some candidates worked out the value of an option on one share but forgot that as the warrant consisted of 100 shares the price needed to be multiplied by 100. Many candidates did not identify the assumptions and therefore did not get these marks. A few candidates made errors in the calculation of d_1 and d_2 , although the input numbers were correct.

Part (b) asked candidates to identify the coupon rate of the fixed rate notes if the required rate of return was 13%. Candidates had to find the equivalent amount of the present value of the coupons and the final amount redeemed when compared to the current value of the fixed rate notes. They also had to take account of the fact that the current value of the notes had to be reduced by the value of the option attached to the warrants. Few candidates attempted this successfully.

In Part (c), some candidates produced good answers to the advantages and disadvantages of mezzanine debt, applying it to the scenario, but most talked about the advantages and disadvantages of debt finance generally, therefore gaining fewer marks.

QUESTION 4

Part (a) required candidates to discuss the factors banks would consider when assessing the issue of a substantial loan. Most candidates gave good answers and those who discussed the importance of

collateral, credit rating, and financial history and performance, achieved high marks.

Part (b) produced mixed answers. Those candidates who did not understand what a loan syndicate was gained few marks because of a lack of detail in the answers.

Answers to Part (c) tended to lack detail. Only a minority discussed the significance of the real option to delay.

QUESTION 5

Part (a) asked candidates to consider the choices a company could make when managing its interest rate exposure. Most focused on alternative derivative instruments that could be used to manage interest rate risk but did not consider the wider possibilities of managing risk. Also, few answers made any meaningful recommendations, with justifications, for a possible course of action and so gained few marks.

Part (b) required candidates to calculate an effective annual rate based on the six monthly interest rate, once the swap had been agreed. Candidates needed to first calculate the effective interest rate payment once the swap of payments, based on LIBOR to a fixed rate, based on a six monthly payment, had taken place. Candidates then had to convert the six-monthly rate into an effective annual rate. Some candidates could undertake the swap calculation, but many did it on a yearly instead of the required six-monthly basis. Even fewer candidates then worked out the six-monthly rate and the effective annual rate.

Part (c) asked candidates to estimate the VAR based on a 95% confidence level and a volatility of 150 basis points, and then to comment on the result. Very few candidates could calculate the VAR; many had clearly had not studied this area well and therefore could not apply the standard formula to the scenario. A few candidates did comment on the result but the answers tended to be general and not specific to the scenario.

PAPER P5 ADVANCED PERFORMANCE MANAGEMENT

The exam paper comprised Section A, consisting of two compulsory questions for 30

marks each, and Section B consisting of three optional questions for 20 marks each from which candidates had to answer two.

Many candidates continue to display their answers poorly, with a lack of clear labelling to indicate which questions are being attempted. Hence, many candidates would benefit by giving more thought to the presentation of their answers. This would not only improve the organisation of their answers but would also assist the marker by ensuring that they commence each question on a new page within their answer booklet.

Many candidates would clearly benefit from planning their answers to discursive parts of questions. For example, in their answers to Question 5 a number of candidates discussed the mission statement of CFD in Part (a)(i) although this was in fact a requirement of Part (a)(ii).

It was noticeable that many candidates begin their answers to discursive parts of questions by rewriting the requirement of the question and in doing so waste valuable time.

Many candidates had clearly memorised solutions to past exam questions and were determined to include them in their answers to questions on the paper. Question 5 was the most common place for this to happen, eg using a past question on hotels as a template for dog kennels and suggesting surveying the dogs on quality of meals and room cleanliness.

QUESTION 1

In general, answers to Part (i) were satisfactory, with a number of candidates gaining maximum marks. However, many candidates were unable to flex the budget of BEC correctly. There was a significant variation in the quality of answers to Part (ii), with poorer answers offering little 'assessment' and limiting their analysis to 'this has gone up', 'this has gone down', etc.

This was the same for Part (iii), with poorer answers discussing performance measurement systems very generally with very little, if any, discussion of the issues that might restrict the extent to which a performance measurement system is accepted and supported by management and employees.

SOME CANDIDATES PRODUCED GOOD ANSWERS TO THE ADVANTAGES AND DISADVANTAGES OF MEZZANINE DEBT, APPLYING IT TO THE SCENARIO, BUT MOST TALKED ABOUT THE ADVANTAGES AND DISADVANTAGES OF DEBT FINANCE GENERALLY, THEREFORE GAINING FEWER MARKS.

QUESTION 2

There were significant variations in the quality of candidates' answers to this question. Many provided good answers to Part (a) and in doing so achieved very high marks, but others knew little of 'Beyond Budgeting', providing answers that lacked depth and were far too brief given that 14 marks were available. Many candidates provided very good answers to Part (b)(i) and consequently achieved very high marks. In general, answers to Part (b)(ii) were satisfactory with most candidates providing some relevant discussion of the potential benefits from the KPI and bonus approach both for Alpha division and throughout the RRR group.

QUESTION 3

This question was the least popular of the optional questions. There were some very good answers to Parts (a)(i) and (a)(ii) which achieved very high marks. However, in Part (a)(i), many candidates did not recognise that Division A had spare production and consequently was unable to provide a correct solution. Some candidates were also unable to correctly identify which products yielded the lowest contribution. In general, answers to Part (a)(ii) were satisfactory but there were a significant number of poor answers to Part (b). Some candidates confused themselves by applying the 30% discount to the market price of the buying division (B), not the selling division (A).

QUESTION 4

In general, this question was well done with most candidates using the scenario well. Many candidates achieved maximum marks by providing a very good evaluation of the financial performance of CAP. However, a significant number did not recognise that CAP would need to redeem preference shares in 2010 and would require additional finance of \$110m in order to do so. Poorer answers were simply confined to ratio analysis with very little, if any, evaluation of financial performance.

In general, answers to Part (b) were acceptable, but showed that many candidates assumed that retained earnings were available to finance the redemption of preference shares or the proposed expansion into Robland, which

is a major conceptual misunderstanding and worrying at this stage of the ACCA Qualification.

QUESTION 5

In general, this question was well answered. Many candidates provided very good answers to Part (a)(i) but there was significant variation in the answers to Part (a)(ii). Poorer answers completely ignored the scenario, which asked candidates to 'advise the directors of CFD of the appropriateness of its mission statement'.

There were many good answers to Part (b) and, in general, the majority of answers to Part (c) were satisfactory. That said, a significant number of candidates ignored the scenario, choosing instead to simply list a number of performance measures irrelevant to CFD.

**PAPER P6 (UK)
ADVANCED TAXATION**

There was a continued improvement in candidates' approach to the exam with many candidates covering all aspects of four questions while keeping their answers brief and to the point. The most significant issue for weaker candidates was a lack of thought resulting in both wasted time and a failure to identify all of the relevant issues. Candidates need to be willing to think more and write less.

The exam comprised Section A, containing two compulsory questions worth a total of 62 marks, and Section B, where candidates had to answer two from three questions worth 19 marks each.

Candidates should pay particular attention to the following in order to maximise their chances of success in the exam in the future.

Know your stuff

- ▣ Successful candidates are able to demonstrate sufficient, precise knowledge of the UK tax system.
- ▣ This knowledge must be up to date. Candidates sitting the exam in 2010 must familiarise themselves with the changes introduced by the Finance Act 2009 as summarised in the Finance Act article published in *Student Accountant* and on the ACCA website.

Practise questions from past exams and the *Pilot Paper* with the aim of adopting the style of the model answers.

Address the requirement

- ▣ Read the requirement carefully – in the Section A questions you will need to identify the various tasks from the documents provided; instructions may be provided by both the 'client' and the 'manager'. It may be helpful to list them out and tick them off as you address them. Marks are awarded for satisfying the requirements and not for other information even if it is technically correct.
- ▣ The requirements of each question are carefully worded in order to provide you with guidance as regards the style and content of your answers. You should note the command words (calculate, explain, etc), any matters which are not to be covered, and the precise issues you have been asked to address.
- ▣ You should also note any guidance given in the question regarding the approach you should take when answering the question.
- ▣ Pay attention to the number of marks available – this provides you with a clear indication of the amount of time you should spend.

Don't provide general explanations or long introductions

- ▣ There is no need to explain what you are going to do before you do it; just get on with it.
- ▣ Think before you write. Then write whatever is necessary to satisfy the requirement.
- ▣ Apply your knowledge to the facts by reference to the requirement.

Think before you start and manage your time

- ▣ Ensure that you allow the correct amount of time for each question.
- ▣ Think about the issues before you start and identify a strategy to solve the problem set.

If you are preparing to re-sit the exam, think about the number of additional marks you need and identify a strategy to earn them. For example:

- ▣ Identify those areas of the syllabus where you are weakest and work to improve your knowledge in these areas.
- ▣ Ask yourself whether you could improve the way you manage your time in the exam and whether you address all of the parts of all four questions or whether you waste time addressing issues which have not been asked for.

THE MOST SIGNIFICANT ISSUE FOR WEAKER CANDIDATES WAS A LACK OF THOUGHT RESULTING IN BOTH WASTED TIME AND A FAILURE TO IDENTIFY ALL OF THE RELEVANT ISSUES. CANDIDATES NEED TO BE WILLING TO THINK MORE AND WRITE LESS.

THE MOST SIGNIFICANT ISSUE FOR WEAKER PAPER P6 CANDIDATES WAS A LACK OF THOUGHT RESULTING IN BOTH WASTED TIME AND A FAILURE TO IDENTIFY ALL OF THE RELEVANT ISSUES. CANDIDATES NEED TO BE WILLING TO THINK MORE AND WRITE LESS.

- Make sure that you earn the professional skills marks and that you are prepared to address the ethical issues that may be examined.

Marks available in respect of professional skills
Marks were available for professional skills in Questions 1 and 2. In order to earn these marks candidates first had to satisfy the requirement in relation to the format of the document requested. Further marks were then available for addressing the specifics of the question (rather than generalising), for directing the answer towards the needs of the particular client, for structuring the answer in a sensible manner and for the ease with which the answer could be reviewed by a client. The performance of candidates in this area was good with the majority of candidates producing well-structured documents in a style that was easy to follow.

QUESTION 1

This question asked candidates to prepare paragraphs for inclusion in a letter to be written by a manager in connection with corporation tax and VAT. Part (i) concerned the acquisition of the trade and assets of a company, Chase Ltd. The client proposed to form a new company, Falcon Ltd, to acquire the trade and assets and to own the company personally so as 'not to affect the rate of corporation tax' paid by another company, Automatic Ltd, that she also owned. Candidates had to respond to her proposals and summarise the corporation tax advantages and disadvantages of Falcon Ltd being owned by Automatic Ltd rather than by the client. Many candidates failed to recognise that this was a purchase of a trade, as opposed to a purchase of shares, but most recognised that the question related to the rules concerning associated companies and their effect on the rate of corporation tax payable. However, many did not have sufficient knowledge of the rules in order to score well. Performance in relation to the advantages and disadvantages of forming a group was good.

Part (ii) required candidates to summarise the circumstances that can give rise to a degrouping charge and an explanation of how the charge is calculated. Degrouping charges are not easy to explain and many candidates

would have benefited from thinking before writing. There was some confusion regarding the purchase of shares versus the purchase of assets, and only a few candidates could state that a degrouping charge could not arise as, because it was the purchase of a trade, no company was leaving a group.

In Part (iii), candidates had to consider the VAT implications of the acquisition of the trade and assets. Most candidates missed the fact the transaction was likely to be a transfer of a going concern and therefore outside the scope of VAT. Many compensated for this by setting out various aspects of VAT rules including registration and the ability to recover input tax. Such candidates should have reviewed their knowledge of VAT and found something relevant to the transfer of a going concern. Fortunately, most candidates gained the marks relating to the VAT treatment of the sale of the building.

The final part required an amended corporation tax computation based on the assumption that a group was formed. This was relatively straightforward for most candidates. Only a minority identified the possibility of group rollover relief and the availability of the tax relief in respect of the purchase of the corporate venturing scheme shares.

QUESTION 2

Part (a) required a memorandum concerning a number of personal tax issues relating to Grifter, who was considering two possible strategies to reduce his mortgage. The question included a letter from Grifter about his financial position and the two options to be considered. There was also an email from the candidate's manager, which set out how to evaluate the two options. Most candidates followed the instructions carefully and many scored high marks.

The memorandum was in two parts. Part (i) required calculations of the income tax due in respect of undeclared income relating to an overseas investment property, and calculations of the inheritance due in respect of the property following the death of the person who gave it to Grifter. It also required candidates to comment on the client's behaviour in relation to a tax refund that he had received.

This first part was done well by most

candidates. The most common error was the failure to gross up the income in respect of the tax suffered overseas. Most candidates noted that Grifter should determine whether or not the tax refund had been received in error and to refund it to the tax authorities if necessary. The second part of the memorandum concerned the two possible ways of Grifter reducing his mortgage; either by selling a number of motor cars or his house. The sale of the motor cars was not handled as well. While many candidates pointed out, correctly, that motor cars were exempt from capital gains tax, many then calculated this capital gains tax as if the rules did not apply. A number of candidates also failed to include the 'detailed explanation' of the tax treatment of the sale of the cars as requested by the manager, which required consideration of the badges of trade.

This was not technically difficult and most candidates would probably have made a good job of it if they had taken sufficient care to identify the need to do so.

In questions of this type, candidates need to start by identifying all of the tasks they have been asked to carry out by both the client and the manager. They should then ensure that all of these tasks are addressed in the time available. Sufficient time will be available provided candidates do not allow themselves to be sidetracked into discussing irrelevant issues.

The sale of the house was handled quite well with the majority recognising the relief available because the property was Grifter's principal private residence. The only common mistake here was to allow three years of the period of absence as deemed residence. This was not available as the period of absence was not preceded by a period of actual occupation.

Despite many candidates scoring well on this question, two general observations:

- Save time by only providing the explanation asked for. In his email, the manager requested candidates to 'keep any narrative to a minimum unless I have specifically asked for it'. Unfortunately, many candidates provided time consuming step-by-step explanations of the calculations they were about to perform. A requirement to calculate means just that.
- Recognise the commercial aspect of the tasks. This question required candidates to think in terms of after tax proceeds, ie the cash proceeds less any tax liabilities rather than (in the case of Grifter's house) the taxable gain less the tax liability (which was a meaningless figure).

This led some candidates to conclude that the Porsche should not be sold because 'it would result in a loss' whereas, of course, the Porsche should be sold because it would raise £62,560 (£68,000 x 92%).

Part (b) required a briefing note on the remittance basis. This area of the tax system has recently undergone significant changes and candidates were clearly well prepared. Exam technique let some down in that they often explained the rules more than once. In addition, many candidates wasted further time by explaining the meaning of residence, ordinary residence and domicile which was not required.

QUESTION 3

This question concerned the late submission of an income tax return and the capital gains tax and inheritance tax implications of making a gift of a farm. Part (a) required a list of the consequences of the late submission of an income tax return and the late payment of the individual's income tax liability. The list should have included four separate consequences whereas most candidates only included two. In particular, few candidates considered the availability of a reasonable excuse for the client's behaviour despite the fact that the client's husband had recently died. Candidates should think about the consequences before writing rather than writing about one or two points in great detail.

Part (b) concerned the inheritance tax and capital gains tax implications of the gift of a farm.

Part (b)(i) required a reasoned explanation of the availability of both agricultural property relief and business property relief in respect of the gift. This part was answered well.

Part (b)(ii) required calculations of the capital gains tax and inheritance tax payable in respect of the gift, together with the due dates of payment. Answers to this part varied considerably, with weaker candidates confusing the two taxes and the reliefs and exemptions available by, for example, including agricultural property relief in the capital gains tax computation. They also failed to include the dates asked for. Most candidates missed the fact that a proportion of the husband's nil rate band could be transferred to the widow.

QUESTION 4

This question concerned three possible ways by which an individual, Fedora, might improve his financial position. Part (a) concerned the repayment of a loan by Fedora to his wholly-owned company,

WHEN ANSWERING QUESTION 3, FEW CANDIDATES CONSIDERED THE AVAILABILITY OF A REASONABLE EXCUSE FOR THE CLIENT'S BEHAVIOUR DESPITE THE FACT THAT THE CLIENT'S HUSBAND HAD RECENTLY DIED. CANDIDATES SHOULD THINKING ABOUT THE CONSEQUENCES BEFORE WRITING RATHER THAN WRITING ABOUT ONE OR TWO POINTS IN GREAT DETAIL.

Smoke Ltd. Most candidates identified Smoke Ltd as a close company and went on to point out that the 25% charge paid when the loan was made would be refunded once the loan had been repaid. Stronger candidates then pointed out that there would no longer be an income tax liability for Fedora in respect of the employment benefit that, consequently, there would no longer be a Class 1A liability for Smoke Ltd. Part (b) required calculations of the tax implications of Smoke Ltd employing Fedora's wife. It was clear that Fedora was a higher-rate tax payer and therefore, the tax saved if his salary was reduced by £20,000 would be £8,000 together with National Insurance of £200 (at 1%). Many candidates prepared a page or more of calculations of the income tax and National Insurance due on the both the old and the new salaries in order to arrive at the difference of £8,200. This was a waste of valuable time as the figure of £8,200 was only worth one mark.

Part (c) required the calculation of the gain on a part disposal of land and a detailed explanation of the relief available. The majority of explanations were not detailed and did not consider a sufficient number of the relevant rules. In particular, many failed to identify that the engineering machinery would be a depreciating asset for the purposes of rollover relief.

QUESTION 5

This question required advice to a sole trader on his choice of accounting date and a possible change of accounting date together with explanations of certain aspects of the flat rate scheme. Part (a) concerned the various aspects of the trader's year end.

Part (a)(i) required calculations of the difference in the trader's tax liability depending on the year end adopted. Many candidates failed to give the annual investment allowance on the vans and were also unable to apply the opening year rules to the facts of the question. Also, the trader was a higher-rate taxpayer so it was not necessary to prepare any income tax computations, only to calculate the difference in the taxable profits by

reference to each of the two year ends and then to multiply by 41%.

Part (ii) required explanations of the tax implications of a change of accounting date. Candidates needed to think rather than write in order to come up with sensible points. Most were unable to explain the implications well.

Part (b) concerned VAT and the flat rate scheme and required some thought in order to solve the problem. Many candidates wrote down everything they knew about the scheme, rather than trying to answer the question set.

PAPER P7 ADVANCED AUDIT AND ASSURANCE

This paper tested topics from across the Paper P7 syllabus, including analytical procedures, financial statement risk assessment, quality control, money laundering, procedures relevant to an audit engagement and a prospective financial information (PFI) assurance engagement, the International Audit and Assurance Board (IAASB) Clarity Project, and subsequent events. The paper contained detailed scenarios on which many of the requirements were based.

The exam comprised two compulsory questions in Section A, both worth 34 marks; and in Section B, three questions, each for 16 marks. A surprising number of candidates only attempted one Section B question, thereby limiting their marks.

The overall pass rate continues to be disappointing. The factors contributing to the poor pass rate for this sitting include:

- ❑ failing to answer the specific question requirements
- ❑ providing answers that are not relevant to the question scenario
- ❑ not explaining points in sufficient detail
- ❑ making too few comments given the mark allocation of a requirement
- ❑ lack of knowledge on certain syllabus areas
- ❑ illegible handwriting.

QUESTION 1

This question focused on audit planning for a listed company which operates a chain of supermarkets, and had expanded

during the year, geographically, and by establishing a financial services division. The question requirement focused on analytical procedures and an evaluation of financial statement risk and was answered inadequately by most candidates. Many lacked a basic understanding of the use of analytical procedures in audit planning. On the financial statement risks, many answers were vague, and despite being lengthy, did not address the requirement.

Part (a) concerned analytical procedures as part of risk assessment, and their limitations in audit planning. Most candidates suggested that analytical procedures should help to identify risks, as suggested in the question, but fewer said they would help the auditor to develop business understanding. Most candidates used examples, as required, but these were often weak and did not help to explain why the procedure was being carried out. The answers to the second part of the requirement were disappointing, with many failing to discuss the limitations of analytical procedures at the planning stage of the audit. This led to answers discussing general problems, often focusing on the limitations of analytical procedures as a substantive procedure.

A final comment on Part (a) – many answers were too long for the marks available, resulting in rushed answers to the other requirements. Part (b) concerned the terms ‘audit strategy’ and ‘audit plan’. Some candidates performed well here, but others mixed up or failed to differentiate between the terms. Many also re-used wording from the requirement, for example ‘the audit strategy is the strategy for the audit’. This earns no credit.

Part (c) was based on the scenario, and asked candidates to explain the information required in order to perform analytical procedures during the planning of the audit of Papaya Co. The majority of candidates failed to apply their knowledge to the scenario, and instead produced vague bullet points relevant to the planning of any audit. Most candidates listed prior year accounts, management accounts, a cash flow statement, and little else. Some explained the need for segmental information, and the importance of budgets and industry comparisons for the newly established financial services

division. Others gave procedures rather than information required.

Part (d) asked for an assessment of financial statement risks, produced in the form of briefing notes. Those who performed well produced briefing notes that identified and explained the specific financial statement risks for Papaya Co, and prioritised these risks to reach an overall conclusion to the risk assessment. The financial statement risks created by brand names, segmental reporting, land impairment, and provisions for penalties were identified by most candidates, but not always well explained. Some identified the risk, but gave no further comment other than ‘it should be treated in accordance with the relevant accounting standard’. Candidates’ understanding of the relevant accounting standard was sound for provision, impairment, intangible assets and foreign exchange issues from the overseas division, but not for inspection costs, and the forward exchange contract.

When asked for financial statement risks, some candidates incorrectly focused on business risks. Irrelevant comments were made regarding Papaya Co’s business strategy (‘can they afford the inspection costs?’), or were pure speculation (‘they may have bribed officials overseas’).

Some candidates wrote too much for Part (d) making points which were either irrelevant, technically incorrect, or did not explain the risk to the auditor. Many candidates provided numerous examples of substantive procedures or audit impacts, again not relevant to the requirement.

Regarding professional marks, the best candidates used a proper format, separated their notes into sections, used clear headings, and provided a conclusion which summarised the assessment of risk. However, many made no attempt at a format, simply producing bullet points as their answer.

Professional marks are awarded partly for the quality of language, and this requirement asked for briefing notes for a meeting with your audit team. Comments such as ‘the company might be going down the drain [sic]’, would not appear in a professional document and detract from the quality of the answer.

QUESTION 2

This question featured an audit engagement for Banana Co, a manufacturer of equipment used in the construction industry. Part (a) asked for the matters that should be considered, and the evidence that should be found, in a file review, you being the audit manager in the scenario. The requirement concerned some training costs incorrectly capitalised into property, plant and equipment, and a trade receivables balance seemingly irrecoverable as a result of an event after the year end.

Most candidates discussed the relevant accounting treatments with confidence, determined materiality, and came up with several specific pieces of audit evidence. However, some answers:

- in Part (a)(i), focused on evidence relating to the purchase of the machinery, rather than the training costs
- in Part (a)(i), discussed irrelevant matters such as related parties
- in Part (a)(ii), contained a contradiction – saying that the event after the year end was non-adjusting, but that the receivables should be written off
- for both parts, incorrectly calculated materiality, or only calculated it in reference to assets, rather than profit.

Approximately 10% of answers agreed with the accounting treatment for the capitalised training costs, which is not allowed. Few candidates considered any inventory held by Banana Co in relation to its insolvent customer, which would need to be considered in terms of obsolescence.

Part (b) focused on the poor management of an audit, and the related quality control issues. Candidates had to evaluate the comments of an audit junior, describing the problems encountered on the audit of Banana Co. Most answers were sound, and almost all candidates identified some, if not all, of the quality control issues. Some also considered the overall impact on the audit, and went beyond repeating points from the scenario. However, others failed to evaluate the quality control issues, and simply copied parts the question, providing little explanation and development of the issue identified.

It was encouraging that a high proportion of candidates did provide a proper conclusion to their evaluation.

Part (c) was on money laundering. Well-prepared candidates performed very well, but while most could at least define money laundering, a significant minority attempted this requirement inadequately, if at all. Money laundering is a crucial issue that auditors must consider with every client engagement, and the anti-money laundering rules are an important part of the syllabus.

SOME CANDIDATES WROTE TOO MUCH, MAKING POINTS WHICH WERE EITHER IRRELEVANT, TECHNICALLY INCORRECT, OR DID NOT EXPLAIN THE RISK TO THE AUDITOR. MANY CANDIDATES PROVIDED NUMEROUS EXAMPLES OF SUBSTANTIVE PROCEDURES OR AUDIT IMPACTS, AGAIN NOT RELEVANT TO THE REQUIREMENT.

Part (c)(i) asked for an explanation of the term 'money laundering', and examples of offences; Part (c)(ii) asked for an explanation of the policies and procedures that firms should adopt in relation to money laundering.

Some weaknesses:

- ▣ in Part (c)(i), failing to provide offences that could be committed by the accountant, or providing one long example of a money laundering scheme
- ▣ in Part (c)(i), not understanding the term 'tipping off' and suggesting that auditors must report instances of money laundering to management of their client
- ▣ in Part (c)(ii), only discussing client due diligence procedures in great detail
- ▣ in Part (c)(ii) discussing the requirement of ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, which is not relevant to the question requirement
- ▣ in Part (c)(ii), showing no understanding of the need for policies and procedures.

Two professional marks were available for Part (c). Approximately half of candidates attempted to use an appropriate format for briefing notes, but many made no attempt to gain these marks.

QUESTION 3

Question 3 was based on an engagement to provide an assurance report on prospective financial information, in the form of a three-month cash flow projection. Part (a) asked candidates to recommend the procedures that should be performed on the cash flow projection. Candidates that approached the answer logically and worked through each item on the cash flow forecast to derive appropriate procedures performed very well.

However, some answers were limited to enquiry with management, which restricted the marks available. Some procedures were too vague to gain credit, eg 'check for payment of licence'. Some recommended impossible procedures, not appreciating that a forecast is of transactions that have not yet occurred, eg 'agree dividend payment to bank statement, cannot be done as the payment is forecast to occur in the future.'

REGARDING PROFESSIONAL MARKS, THE BEST CANDIDATES USED A PROPER FORMAT, SEPARATED THEIR NOTES INTO SECTIONS, USED CLEAR HEADINGS, AND PROVIDED A CONCLUSION WHICH SUMMARISED THE ASSESSMENT OF RISK. HOWEVER, MANY MADE NO ATTEMPT AT A FORMAT, SIMPLY PRODUCING BULLET POINTS AS THEIR ANSWER.

Part (b) asked for an explanation of the main contents of the assurance report that would be provided. Most candidates listed the contents, but few provided sufficient further explanation. Some answers compared an audit and an assurance report, which was not asked for. Most answers were too brief for the marks available.

QUESTION 4

The question focused on the IAASB's Clarity Project, and on ethical and professional issues.

Part (a) tested candidate's knowledge and understanding of prescriptive and principles-based approaches to auditing. Generally, this requirement was answered well, but when identifying the arguments for and against the prescriptive approach, some points were not well explained. Unfortunately, a minority of candidates discussed prescriptive rules in relation to financial reporting rather than auditing, and some confused auditing regulations with corporate governance regulations.

Part (b) contained three sub-requirements, testing candidates' understanding of the terms 'intimidation threat' and 'lowballing', and the advertising rules which auditors should abide by. Most candidates knew the basic facts about each, but generally did not explain their points in sufficient detail to score a high mark. It was pleasing that the requirement on advertising rules was well answered, given that this is a relatively peripheral area of the syllabus.

Unusually for the ethics question, this was the optional question in which candidates scored the highest mark.

QUESTION 5

Question 5 focused on the auditor's responsibility in relation to subsequent events, and provided a brief scenario dealing with a potentially significant subsequent event. Part (a) asked for an explanation of the auditor's responsibility in relation to subsequent events. Those that had studied ISA 560, *Subsequent Events*, performed well. However, the majority clearly knew very little about ISA 560 leading to answers which almost exclusively focused on the financial reporting requirements of IAS 10, *Events*

FURTHER READING

The ACCA Qualification section of the ACCA website includes exam notes, examiner reports, *Syllabus and Study Guides*, past papers, examinable documents and technical articles which provide guidance for ACCA Qualification students. Visit www.accaglobal.com/students/acca/exams/

After the Reporting Period, while other answers listed the various types of audit reports that could be issued in relation to a variety of subsequent events. Although half of candidates could define the terms 'active duty' and 'passive duty', the terms were not well explained and often attached to the wrong time period. Few provided examples of the types of procedures that auditors should use in relation to subsequent events. Finally, a common misunderstanding was that it is the auditor's responsibility, rather than management's, to amend to the financial statements.

Part (b) was based on the scenario. Part (b)(i) required candidates to comment on the financial reporting implications and advise further audit procedures in relation to a significant restructuring, announced three days before the planned issue of the audit report.

Few performed well on this requirement. The main problems were:

- ▣ incorrect or absent materiality calculations
- ▣ identifying the event as both adjusting and non-adjusting according to IAS 10
- ▣ failing to provide any audit procedures at all, other than 'discuss with management'
- ▣ writing at length about going concern issues – the question clearly stated that the factory was being closed and relocated, so the company might be insolvent or operations likely to cease.

Part (b)(ii) asked candidates to recommend the actions to be taken by the auditor if the financial statements were not amended. Many candidates listed every possible type of modification or qualification to the audit report, showing a complete lack of understanding of the impact of non-amended financial statements, and poor professional judgment skills.

Some candidates correctly identified the qualification on the grounds of disagreement as the most appropriate course of action, and that the matter should be discussed with those charged with governance, and raised with shareholders at the company general meeting.