General Comments

Overall, performance was reasonable. Well-prepared candidates were capable of obtaining clear passes. Weaker candidates tended to avoid the requirements of the question, either through a failure to grasp what was required or as an attempt to obtain marks for repetition of memorised facts and information.

Generally, where candidates did not achieve a pass, the main problems were a failure to apply their knowledge to the scenario and a failure to answer what was asked. When information is given in the scenario candidates are expected to use it to illustrate the main issues in their answer.

Using the reading time wisely can be of huge benefit; candidates should always plan their answers and ensure they read the questions carefully before starting the paper. Candidates who answer the specific question asked could achieve high marks. Candidates waste valuable time if they fail to be specific in their answer, as only the points which answer the question will get marks.

One of the main problems in this sitting was that a significant numbers of candidates missed out parts of questions. The questions were all within the syllabus so candidates are not well prepared in all areas of the syllabus. There is less choice in the new syllabus so it is even more important that candidates learn all areas of the syllabus. Financial risk has become an even more important part of the syllabus and candidates must be prepared to do questions on this topic. It will inevitably be a part of question 1.

Parts (b) and (c) of question 1 were answered more poorly than expected. All optional questions were equally popular. Question 2 was about banks and bank salaries and controls. This was answered fairly well. Question 3 was about financial risk and foreign currency. Parts of this were done well but others were very poor. Candidates should revise economic risk for future diets. Financial risk is now 35% of the paper and there is less choice therefore candidates must know this area of the syllabus. Question 4 was about risks and controls in an IT setting and was done fairly well.

Note that the attached marking scheme often makes more marks available than indicated on the question paper. This reflects the fact that questions at this level can often be approached in more than one way and that there is no single “perfect” answer. In applying this marking scheme, marks are always restricted to the total offered by the question and so there is no advantage to be gained from over-developing the answer to one question at the expense of another that may appear more difficult.
### Question 1

**a)** Identify and evaluate FIVE risks affecting DEC's new African subsidiary. 

(15 marks)

**b)** Discuss, in respect of the extension to the factory and the new African subsidiary, the strengths and weaknesses of DEC’s management information system. 

(9 marks)

**c)**

(i) Discuss the methods DEC and the African subsidiary could use to mitigate the foreign exchange risk when trading with other foreign countries. 

(10 marks)

(ii) Discuss the accounting implications for both DEC and the African subsidiary of each method identified in (i). 

(6 marks)

**d)** Discuss the safeguards that should exist within any company to prevent the unethical manipulation of transactions. (You should refer to examples from DEC in your answer.)

(10 marks)

*(Total for Question One = 50 marks)*

### Rationale

This question is based on a pre seen case study and on an unseen case study. Answers could draw on both.

The unseen scenario is about an African subsidiary of the company discussed in the pre seen case study. The subsidiary faces many problems not least an information system which is poor. There are of course many risks involved in setting up a subsidiary in another country and the answer requires expansion of those.

The subsidiary trades with other countries so there are issues of foreign currency exchange and hedging. There are also ethical issues with toxic substances and suggestions of inflated invoices.
Suggested Approach
This question takes the Aybe scenario forward to show the impact amongst other things of opening a new subsidiary.

Part (a) requires candidates to evaluate different risks facing Aybe and the DEC subsidiary – allowing candidates to draw on the pre-seen for some risks but then the unseen for the majority of the marks.

Part (b) assumes knowledge of a management information system and requires candidates to show the good and bad points of this system.

Part (c) is a question on foreign exchange transaction risk facing an international company. Most of normal hedging methods are considered to be inappropriate because of the group situation. Reward is therefore given for considering practical methods of risk mitigation.

Part (d) focuses on ethics – with the complication of what can be considered a practical method of remitting funds from a subsidiary.

Marking Guide

<table>
<thead>
<tr>
<th>Marking Guide</th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Max of 1 for identifying each risk and max 3 for evaluating each of those risks Could include currency risks, inflation risk, logistics, transport etc, quality and problems with the joint venture with the government.</td>
<td>15 marks</td>
</tr>
<tr>
<td>(b) Maximum of 5 for each of factory extension and African subsidiary. There are very few strengths apparent, so there should be no upper limit on weaknesses.</td>
<td>9 marks</td>
</tr>
<tr>
<td>(c) (i) 1 mark for any reasonable point on mitigating foreign exchange risk. Could be countertrade, paying in local currency, futures, options etc. Must be a discussion.</td>
<td>10 marks</td>
</tr>
<tr>
<td>(c) (ii) 1 mark per reasonable point on accounting issues. Should mention IAS 39 and problems of fair values</td>
<td>6 marks</td>
</tr>
<tr>
<td>(d) 1 mark per reasonable point on ways of decreasing the risk of unethical transactions. For example, good control environment, good internal controls, ethical code, disciplinary action if found out, good salaries and working conditions, performance related pay must be awarded with care so no temptation to be unethical.</td>
<td>10 marks</td>
</tr>
</tbody>
</table>

Examiner’s Comments
Marks for Q1 were reasonable.

Part (a), (c)(i) and (d) were done reasonably well which was encouraging.

Parts (b) and (c)(ii) were not answered as well as expected.

The main problem was lack of knowledge especially in part (c)(ii)
Common Errors

In part (b) some candidates failed to discuss the capital budget overspend which was not noticed until very late. This would suggest that the system is not very helpful. The inventory system is very good but does not link to sales so its use is limited. A discussion around these issues would have gained a good mark.

Part c(ii) was answered very badly by all candidates, some discussion of IAS 39 was required and also a discussion of fair value. This was covered in F2 as well as this P3 syllabus. The candidates showed no knowledge of this area at all which was very disappointing. This area requires revision before the next attempt.

There will almost always be a financial risk element in question 1 as it forms 35% of the syllabus. It is impossible to avoid financial risk with this syllabus so it is very important that candidates study it and can do the associated calculations.
SECTION B – 50 MARKS
ANSWER TWO QUESTIONS ONLY

Question 2

(a) Evaluate the proposal made by the governor of the central bank.

(10 marks)

(b) Evaluate the risk management strategy in B Bank (except for consideration of directors’ remuneration). Your evaluation should include recommendations for changes that will lower the bank’s exposure to risk.

(15 marks)

(Total for Question Two = 25 marks)

Rationale

This question focuses on the banking industry, just before the banking crises of 2007/08. The aim is not to analyse the crisis itself, but to identify areas where risk management may have been weak at the time. Elements of the UK banking industry may be seen in the scenario, although this is not necessary to answer the question as areas of poor risk management strategy are noted in the scenario. The issue of directors’ remuneration in (a) is potentially novel and designed to provide a “twist” on standard questions in this area.

Suggested Approach

The question of whether directors paying a fee for a seat on the board is a reasonable suggestion should be discussed, it is likely that candidates will find few merits in this proposal, we are looking for a reasoned argument.

Risks should be identified and discussed; there are several possible risks that could be mentioned. The main area of concern is mortgage lending and candidates are likely to mention the banking crisis in their answers.

Marking Guide

(a) 1 mark per reasonable point. Points may include:

The nature of the banking industry is that bank profits are affected by factors that are not necessarily within the directors’ control. Interest rates rise and fall in line with economic indicators, as does the demand for finance. There is not necessarily a clear and objective basis against which to measure the performance of the bank’s board or of the individual directors. The only people who would be willing to work on this basis would be risk-seeking individuals. Failure will cost them very little. Short term outlook They may also be tempted to indulge in dishonest or manipulative reporting for the sake of their bonus. The recent bad publicity attached to bank directors and their bonuses may make it seem attractive to pay directors in a manner that appears to force them to justify their remuneration.

2(a) max 10 marks
There are many different ways of answering this question. Points should be awarded for sensible alternative arguments.

1 mark per sensible point. Points may include:

- Suggest that strategic reviews should be conducted rather more frequently than once every four years.
- It is also unsatisfactory that non-executives do not normally challenge the executive directors’ strategic decisions.
- The bank’s lending policy appears to be very risky.
  - In the event of a major downturn in the economy, there could be repossessions.
  - It will end up owning large amounts of property that will have declined in value.
  - The only real protection the bank has against this scenario is an economic forecast that predicts that house prices will rise at a rate well in advance of the general rate of inflation.
  - The bank faces risks in the form of long term revenues. If house prices do continue to rise much faster than wages then it will become increasingly difficult for customers to be able to afford houses.
  - That will cause mortgage applications to dry up and the bank will either have to find other outlets for lending or rely on interest from existing loans.
- The bank should, perhaps, consider alternative products that could be used to generate returns without undue risk. These could include shorter-term loans.
- Unrealistic expectations in the past have been met by extreme risk-taking by the banking industry.

Examiner’s comments

This question was done reasonably well. Candidates did not tend to go into enough detail in either part of the question but although they did not get high marks they often passed.

Most candidates managed to come up with reasonable answers based on the worldwide banking crisis which was good. The benefit of reading the financial press was clearly demonstrated with this question.

Common Errors

The most common error was a lack of depth in the answers.

Overseas candidates possibly did not perform as well as UK candidates in this question mainly due to less awareness of the current financial crisis.

Part (a) was answered slightly better than part (b).

Part (a) was done reasonably however some candidates missed the point that risk seeking individuals could be attracted by the idea rather than non risk seekers. It would not be to a bank’s advantage to have risk seekers as directors or people who were only interested in their own gain.

Part (b) was done less well by some candidates. Some candidates did not discuss the mortgage policy at all which was poor. Reading the financial press would have been very useful for answering this part of the question as the financial crisis has been linked to risky mortgages in the US market.

If the mortgages were not mentioned at all it was difficult to pass this question.
Question 3

(a)

(i) Discuss the advantages and disadvantages of the use of a forward contract by N, and

(8 marks)

(ii) Calculate for N whether, in retrospect, purchasing a forward contract was actually beneficial for the company.

(4 marks)

(b)

(i) Explain why N’s competitive position could be exposed to movements on the US$.

(4 marks)

(ii) Discuss why exposure to economic risk as a result of exchange rate fluctuations is hard to quantify.

(9 marks)

(Total for Question Three = 25 marks)

Rationale

This question is based on a company making its first major foreign currency hedge and tests candidates’ knowledge of basic hedging through to more complicated techniques (and why these are not required in this situation).

Part (a). This is a question asking for a fairly simple forward exchange contract although with the slight twist in that the amount is to be received from a customer in the customer’s home currency rather than the currency of the selling company. Clear thinking is necessary to ensure that exchange rate movements are correctly interpreted in this situation.

Part (b). Is again relatively straightforward, asking for an understanding of the reasons for currency fluctuations and an understanding of economic risk.

Suggested Approach

This question starts with a discussion on the use of forward contracts and then a straightforward calculation has to be carried out.

Part (b) is a discussion of economic risk and currency fluctuations.
The Chartered Institute of Management Accountants

Paper P3 – Management Accounting – Performance Strategy
Post Exam Guide
May 2010 Exam

<table>
<thead>
<tr>
<th>Marking Guide</th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)(i) 1 mark per relevant point. Points could include the following:</td>
<td>3a(i) max 8 marks</td>
</tr>
<tr>
<td>The biggest advantage is that N will receive a known £ amount for the $ that it will receive. N will be able to determine the overall profit that it will make from this sale after allowing for the cost of the forward contract itself. Once the contract has been agreed the arrangement is relatively simple to manage. The biggest disadvantage may be that it could be difficult for a small company to arrange a forward contract for such a small amount. The arrangement is also binding on N. If the customer defaults or pays late then N will still be required to sell the $ amount and that could prove expensive and inconvenient. Overall, the risk is unlikely to justify the time and fees involved.</td>
<td></td>
</tr>
<tr>
<td>(ii) 1 mark for each part of calculation</td>
<td>3(a)(ii) max 4 marks</td>
</tr>
<tr>
<td>(b)(i) 1 mark per relevant point</td>
<td>3b(i) max 4 marks</td>
</tr>
<tr>
<td>The following points could have been made-</td>
<td></td>
</tr>
<tr>
<td>Even if N has no direct dealings with US suppliers or customers it will be exposed to movements in the $. If the £ strengthens against the $ then it will become cheaper for N’s UK customers to import competing products from the US. N may use materials or components that are sourced from the US. The cost of those components will fluctuate in line with the $. N’s ambitions to export to the US will be directly affected by exchange rates. If the £ strengthens then US customers will have to pay more $ for a product and so N will find it harder to compete]. The only alternative would be to fix the price in $ and for N to bear the risk.</td>
<td></td>
</tr>
<tr>
<td>(ii) 1 mark per reasonable point.</td>
<td>3b(ii) max 9 marks</td>
</tr>
<tr>
<td>Some of the points which could have been made are as follows:</td>
<td></td>
</tr>
<tr>
<td>Economic exposure is very difficult to quantify because the relationships are not always obvious. For example, imported parts or materials could be sourced from local suppliers and so it will not always be clear that they will be more expensive if, say, the $ strengthens. Some products will have alternatives that could come from different countries and so the impact of a currency change could be mitigated by moving to a slightly more expensive supplier from a different country and so the cost might not be linear. Currency movements can reduce competitor’s selling prices, but some markets might not be particularly price sensitive. In some cases the competitor might not cut selling prices in pursuit of volume and could be happy to accept existing market share and simply take a larger profit from each sale. In some cases there could be market imperfections that make it difficult for price changes to have an impact.</td>
<td></td>
</tr>
</tbody>
</table>
Examiner’s Comments

Part (a) was done reasonably well by most candidates who chose this question but part (b) was done very badly. Part (a)(i) was done very well with most candidates showing an excellent understanding of forward contracts that was borne out by the fact that so many did well in the calculation in a(ii). It was good to see the calculation being done so well by almost all candidates.

Part (b) (i) was poor as was part b(ii). In b(i) many candidates did not answer the question which was about the effect on a company’s competitive position. Most candidates just ignored that and wrote about currency risk. Part b(ii) was disappointingly poor. The candidates showed little knowledge of economic risk.

Common Errors

Part b(i) was poor. Many candidates did not mention competitive position at all which was what the question asked about. Candidates must make sure they answer what is asked or they will get very few marks.

The main error was in part (b) where candidates showed very little knowledge of economic risk. Economic risk is wide ranging but this was not brought out in candidates’ answers at all. Candidates should revise this before the next attempt as this area will be examined again in the future. It is very important with less question choice available in the examinations under the new P3 syllabus, that candidates study all parts of the syllabus. Financial risk is not an area which can be avoided.
**Question 4**

(a) Discuss FIVE factors that the external auditors should consider when performing a risk assessment of K’s IT systems.

(15 marks)

(b) K has been told by a major credit card company that several hundred of its customers had complained that fraudulent charges had been made to their credit card accounts for downloads from K’s site. Initial investigations in K have been unable to determine either the validity of these claims or why additional charges may have been made.

Evaluate the risks to K of such complaints explaining how those risks could be alleviated.

(10 marks)

*(Total for Question Four = 25 marks)*

**Rationale**

This question is based on an Internet music download company such as “Napster”, although with a few variations.

Part (a). This question focuses on the audit of IT systems, with an emphasis on the problems that IT can cause auditors. There is a detailed scenario from which many valid points can be drawn. So while the question may not be within the practical skill set of most candidates, the scenario itself will provide points to include in the answer.

Part (b). This question asks candidates to link information technology to business strategy and show how the former can support the latter. Again, the scenario provides sufficient examples for a well-prepared candidate to accumulate a pass standard.

**Suggested Approach**

In the first part, candidates need to explain what external auditors would be looking for when they first look at the risks of the system in an online environment.

In the second part the candidates have to think about the effects of a possible online credit card fraud on the company. Specifically how the customer complaints could affect the business.
The marking guide for the exam question is as follows:

<table>
<thead>
<tr>
<th>Marking Guide</th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) 1 mark per relevant point</td>
<td>4(a) max</td>
</tr>
<tr>
<td>Up to 4 marks per risk discussed</td>
<td>15 marks</td>
</tr>
</tbody>
</table>

Some relevant points are:

- K’s dependence on IT is a major factor.
- The company cannot generate revenue and could even fail if it is deprived of its systems for any length of time.
- The auditor will be keen to see that K’s management understands the risks that are involved.
- K should have taken adequate precautions in the form of security and backup of the main system.
- Systems maintenance will be a significant issue.
- The technology used by consumers, both hardware and software, will be changing over time.
- K’s system has valuable data that could be of immense value.
- Apart from the payments being made the system has customers’ personal details which are valuable for committing identity fraud.
- The system is online and is, therefore, a potential target for hackers.
- The auditor’s expertise should also be considered.

Any five risks are acceptable, up to four marks per risk to a max of 15 marks.

(b) 1 mark per relevant point

Examples of points which could have been discussed are:

- There is a huge reputation risk.
- This type of fraud may attract press attention and K’s name will be associated with dishonest behaviour.
- There is an even greater risk that the credit card companies will refuse to permit payments to K.
- If a sale is made that is subsequently discovered to be fraudulent then that address should be blocked from making further payments.
- Paypal or similar could be used for payments.
Examiner's Comments

This question was done quite well by many candidates although part (a) was done less well than part (b). The fact that the question mentioned external auditors seemed to cause some candidates problems, however this question could equally have applied to internal auditors and candidates should have thought of what any auditor would do when identifying risky areas of a business.

Part (b) was done reasonably well.

Common errors

Candidates did not seem to have much idea of how auditors might view risk. Whether internal or external the auditors tend to view things in the same way. A high dependence on IT would suggest that the auditors would check that management had plans in place in case of a disaster, that they had maintenance in place and they were generally aware how vulnerable they could be if there was a problem with the system. Adequate security must be in place so the system is not vulnerable to viruses or hackers. The system must be available at all times or sales could be lost. These points should have been discussed in depth.

Part (b) was done well on the whole with candidates managing to come up with credible ideas.