

Examiner's report

FFM Foundations in Financial Management

December 2012



General Comments

The examination consisted of ten objective testing questions in Section A, worth 20 marks overall, and six questions in Section B, one worth 20 marks, three 10 mark questions and two 15 mark questions. All questions were compulsory.

The majority of candidates attempted all of the questions, showing little evidence of time pressure. Where questions were not answered, this appeared to be through lack of knowledge. As I commented in my last examiner's report, it is imperative that candidates study the whole syllabus, and do not try and 'question spot'.

There were instances where the requirement was read incorrectly by candidates. It is imperative that candidates read the requirement carefully and answer the question set.

Presentation varied from script to script, but generally layout and legibility was acceptable. Workings were generally clearly laid out, which is imperative if method marks are going to be awarded to answers where the final answer is incorrect.

Specific Comments – Section A

I reiterate here what I have said in past examiner's reports, that it is imperative that candidates practice the MCQ style questions, as a good mark here provides a solid base from which to attempt Section B.

Specific Comments – Section B

Candidates scored well on questions 1,3 and 4. The questions candidates found most challenging were 2,5 and 6.

Question One

Question 1 required candidates to calculate the working capital requirement for Frame Co, and then tested candidates knowledge of the just in time (JIT) inventory management system. This was the best answered question in Section B.

Part (a) has been examined before and candidates showed that they had studied this area of the syllabus. There was a slight twist, in that candidates had to calculate the variable cost per unit, but on the whole candidates coped well with this, or made an assumption, and carried on with the rest of the calculation. Common errors that were made included:

- Not including lenses in the raw material calculation.
- Correctly calculating the variable overheads as \$12.50 per unit, multiplying by the expected output of 25,000, but then incorrectly adding back in the fixed overheads of \$50,000.

Clear presentation was key to gaining method marks in this question, and in the vast majority of scripts, workings were clear and referenced into the main calculation.

Part (b) was a test of candidates' knowledge of (JIT). Where most candidates could explain the JIT system, fewer gained marks on the second part of the requirement, the conditions required for a JIT approach to work. Many candidates wrote about the advantages and disadvantages of JIT, or the possible effects on the business using JIT, and so did not answer the question set. As I have said previously, it is important to read the requirement and answer the question that is set.

Question Two

This 10-mark question covered investment appraisal and financing for SME's.



Part (a) required candidates to calculate some simple cash flows for a project and then to calculate the internal rate of return. Many candidates calculated the cash flows correctly, but the internal rate of return calculation was not attempted very well at all. Candidates either did not attempt it, calculated the accounting rate of return, or having discounted their cash flows at two different discount rates, got the internal rate of return formula incorrect. Only a small minority of candidates had a good attempt at the proper calculation.

Part (b) asked candidates to define the term 'business angel' and state one disadvantage of this type of financing. The majority of candidates could define the term, but fewer could state the disadvantage, showing a lack of knowledge here.

Question Three

This 10 mark question was discursive looking at the functions of a treasury department. It was purely a test of knowledge and if candidates knew this part of the syllabus, it should have represented 10 easy marks.

A common problem with this question was that candidates misread the requirement and wrote about the advantages of a centralised treasury function. Those that answered the question set, often gained half or just over half marks, for discussing a couple of valid functions such as foreign exchange management, and liquidity management. However few showed enough breadth or depth of knowledge to score really highly on a question that should have provided easy marks.

Question Four

Question four was again a 10 mark discursive question, this time looking at receivables.

Part (a) asked for definitions. A substantial minority confused invoice discounting with early settlement discount, but answers to the factoring part of the requirement were much better. Some candidates confused with and without recourse factoring, but on the whole they had a good attempt at the question.

Part (b) looked at terms required in a contract for a cash customer who is going to be allowed credit for the first time. A substantial number of students latched onto the word 'contract' in the requirement and wrote about the elements of a contract, form, offer, acceptance etc. This gained no marks, and again shows the importance of reading the requirement carefully.

Question Five

This was the least well answered question on the paper. The requirement asked candidates to prepare a schedule of relevant costs for a project. Relevant costing is commonly examined as part of a larger investment appraisal question, where candidates would have to pick out the relevant costs from a scenario before using them, for example, to calculate the net present value. Being asked to complete the relevant cost schedule seem to throw candidates and they made mistakes such as including depreciation, basic errors, that candidates rarely make in full net present value calculations.

The requirement also asked for an explanation of the treatment of each item in the question, including those that were considered irrelevant. Irrelevant costs were often just omitted from answers, and no explanation given as to why. This again shows the importance of reading the requirement carefully.

The approach candidates should have taken was to work through the scenario item by item, calculate the relevant cost for each item (showing workings and stating why any costs were irrelevant), put the relevant cost into a schedule, and then total up the relevant costs, as the requirement asked candidates to state the minimum price, i.e. the total.

Common errors:

- Including fixed overheads, cost of preparation and profit margin as relevant costs.
- Incorrectly calculating the relevant cost of the fabric and wood.
- Only including labour at \$5 per hour, being the contribution lost, and not including the labour cost of \$10 per hour.
- Including two weekly hiring fees totalling \$400 in the relevant cost, and ignoring the minimum hiring fee of \$450.

Question 6

This question covered capital gearing and interest cover, looking mainly at the use of the ratios when raising finance, but also how the gearing ratio can be used to help set the credit limit for a new customer.

Performance on this question was mixed.

Most candidates could explain what capital gearing was in part (a) and perform the gearing calculation in part (c). Quite a high percentage of candidates could not apply the theory of gearing to explain why a finance provider, or a credit controller might find the gearing information useful (part (b)). In part (b) (ii) candidates picked up on the words 'information to set a credit limit' and based their answers around what a credit controller would do in general terms before granting credit, i.e. obtain credit references etc, rather than answering the question set.

Part (d) provided mixed answers. Some candidates knew what interest cover was and provided comprehensive answers. A sizeable minority thought that interest cover was the profit margin to a finance provider on a loan.

Conclusion

This was a paper that a candidate who had studied the whole syllabus, and took care when reading the requirements could have passed. Those that did not pass, showed a lack of knowledge, or did not read the requirement carefully enough.