



Examiner's approach

Paper F9

The aim of Paper F9, *Financial Management*, is to develop the knowledge and skills expected of a finance manager – in relation to investment, financing, and dividend decisions. The syllabus is designed to equip candidates with the skills that would be expected from a finance manager responsible for the finance function of a business.

From a relational point of view, Paper F9 builds on knowledge gained through studying Paper F2, *Management Accounting*, and also prepares candidates for further study of financial management in Paper P4, *Advanced Financial Management*. Students who are exempt from Paper F2 should ensure that they are familiar with its content by referring to its *Syllabus* and *Study Guide*.

Syllabus and Study Guide

The first two sections of the syllabus consider the role and purpose of the finance manager, and the financial management environment. As financial management decisions support the achievement of business objectives, the syllabus explores the link between objectives, strategy, and stakeholders. Financial management decisions are influenced by factors external to the organisation, so the syllabus also considers the impact of government economic policy in key areas such as interest rates and exchange rates, as well as the nature and role of financial markets and institutions.

The next three sections of the syllabus look at working capital management, investment appraisal, and sources of business finance. Managing working capital is a key concern of the finance manager, who must balance the conflicting objectives of profitability and liquidity. Investment decisions constitute one of the three decision areas of financial management, and the finance manager must be able to identify relevant cash flows, and evaluate a proposed investment and its effect on the organisation. Financing decisions, another of the three decision areas, are considered in the business finance section of the syllabus. A finance manager must be able to identify and evaluate the most appropriate sources of finance to meet organisational financing needs.

One of the key relationships in financial management is that between risk and return, and the sixth section of the syllabus looks at the cost of capital and the influence of capital structure on the average cost of capital. Candidates must be able to calculate the cost of individual sources of finance and the average cost of organisational finance, and critically discuss whether financing choices can reduce the average cost of capital and thereby increase the value of the organisation as a whole.

The next section of the syllabus looks at business valuation. Candidates must be able to value financial assets, such as ordinary shares and bonds, and a business as a whole. Evaluation of financial choices is a key theme here and candidates are expected to be able to discuss, as well as apply, a range of valuation methods. The final section of the syllabus looks at risk management in relation to foreign currency risk and interest rate risk. Candidates should have an awareness of the different types of foreign currency and interest rate risk, and of the possible reasons why these arise.

Candidates will need to be able to evaluate and apply both internal and external risk management (hedging) methods, using the methods identified in the syllabus. Note that evaluation of derivative-based hedging methods – such as those using futures, options, and swaps – is not required.

Main capabilities

The main capabilities are described in the *Syllabus*. Candidates who successfully pass the Paper F9 exam will be able to:

- discuss the role and purpose of the financial management function
- assess and discuss the impact of the economic environment on financial management
- discuss and apply working capital management techniques
- carry out effective investment appraisal

- identify and evaluate alternative sources of business finance
- explain and calculate cost of capital and the factors that affect it
- discuss and apply principles of business and asset valuations
- explain and apply risk management techniques in business.

You will recognise that these eight capabilities reflect the eight sections of the syllabus.

Format of the exam

The three-hour exam consists of four questions, all of which are compulsory and of equal length. Each question is worth 25 marks.

This format is commonly adopted by other papers at this level and means that candidates will not need to spend time choosing which question to answer. An extra 15 minutes of reading and preparation time is given at the start of the exam.

Each question will have both discussion and calculation elements. The balance between discussion and calculation will be similar to the balance in the *Pilot Paper*. The topic areas covered by each question are not fixed and all areas of the syllabus are examinable.

No sections of the syllabus should be neglected during study, since no one section is more important than another.

Each exam paper will contain tables of discount factors and annuity factors, together with a formulae sheet, as in the *Pilot Paper*. Candidates must ensure that they are familiar with the formulae given in the formulae sheet.

The Pilot Paper

The *Pilot Paper* illustrates the kind of questions that will be set. A feel for my style of writing can be gained by reviewing Paper 2.4, *Financial Management and Control* exam questions from 2003 onwards.

Question 1 in the *Pilot Paper* requires calculation of the weighted average cost of capital (WACC) of a listed company, and a discussion of whether, theoretically, a minimum WACC can be found. It also requires an evaluation of the effect of a loan note issue on three key ratios.

Question 2 requires a discussion of the types of foreign currency risk and an explanation of how inflation rates can be used to forecast exchange rates. It also requires a comparative evaluation of a money-market hedge and a forward market hedge, and an explanation of how currency futures can be used to hedge foreign exchange risk.

Question 3 requires an evaluation of a proposed change in credit policy, application of the Miller–Orr model, and an explanation of the key areas of accounts receivable management. It also requires a discussion of the key factors influencing working capital funding policy.

Question 4 requires calculation of net present value and return on capital employed, as well as a discussion of the strengths and weaknesses of the internal rate of return method.

Conclusion

In order to pass this paper, candidates should:

- clearly understand the objectives of Paper F9, as explained above, and in the *Syllabus* and in the accompanying *Study Guide*



- read and study thoroughly a suitable financial management textbook
- read relevant articles in *student accountant*
- practise exam-standard and exam-style questions on a regular basis
- be able to communicate their understanding clearly in an exam context.

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