



Examiner's report

Foundations in Financial Management (FFM) December 2018

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

General Comments

The examination paper was divided into two parts, both of which were compulsory. Section A consisted of ten multiple choice questions (MCQs) worth 20% of the marks available. In this Section, there were eight questions worth 2 marks each, one question worth 3 marks and one question worth 1 mark. Section B consisted of one scenario-based question worth 20 marks, two scenario-based questions worth 15 marks each and three largely knowledge-based questions each worth 10 marks. The scenario-based questions were mainly calculative with commentary required on the calculation produced or the technique examined.

The majority of candidates made a good attempt at all of the questions, and there was little evidence of time pressure during this examination. Where sections of questions were left unanswered by candidates, it appeared to be due to a lack of knowledge as opposed to time pressure.

Overall this examination was answered very well by many candidates, with some exceptionally good answers. Candidates seem to be well prepared for this examination and are able to attempt questions from a wide range of subjects. Almost all candidates presented legible paper that was clearly referenced.

Comments about Section A performance

The majority of candidates attempted all questions in this section with many, although not most, achieving a pass mark. Since Section A is MCQ based, there were no discernible issues or problems associated with examination technique.

As section A is worth 20% of the final marks, it is vital that candidates spend time practising the MCQ style questions in preparation for the real examination. MCQs are not easy as all distractors are designed to be plausible. Candidates should approach this section systematically: work through each question in order leaving any questions that they are unsure about until last. When returning to these questions candidates should eliminate any answer that they know is wrong before choosing the most likely answer. It is worth reminding future candidates that marks are never deducted for a wrong answer so put in an answer for all MCQs, even if it is an educated guess.

This section of the report discusses a question in Section A with which candidates experienced difficulties.

A company is considering two mutually exclusive projects. The cash flows for each project are as follows:

Year	0	1	2	3
Project X	\$(15,000)	\$8,000	\$8,000	\$8,000
Project Y	\$(15,000)			\$26,000

The company evaluates projects using the net present value method and uses a cost of capital of 10%.

Which project(s) should the company undertake?

- A Both projects
- B Project X only
- C Project Y only
- D Neither project

In this question, the first thing candidates should note is that the projects are mutually exclusive. This means that either Project X, or Project Y, or neither project can be undertaken, but not both projects. This therefore discounts option A (both projects) straight away. This was actually the option picked by the majority of candidates implying that candidates did not read the question with enough care.

Candidates are now left to choose between options B, C and D. To do this the method of project appraisal needs to be found, and in this case we are told that the company uses the net present value method to appraise projects with a cost of capital of 10%. The candidate therefore needs to calculate the net present value of both projects:

$$\text{NPV of X} = (\$15,000) + 2.487 \times \$8,000 = \$4,896$$

$$\text{NPV of Y} = (\$15,000) + 0.751 \times \$26,000 = \$4,526$$

Note that in doing the calculation, I have used annuity factors, which are a valuable tool when answering questions under exam time pressure, and yet this is a technique few candidates generally use in Section B questions

This shows that both projects have a positive net present value, and so in an ideal world, the company would accept both projects. However, as the projects are mutually exclusive, only one project can be undertaken. Therefore, selecting the project with the higher net present value, gives Project X, and hence the answer is B.

Comments about Section B performance

Although many candidates performed well in this examination it is wise to understand the errors that prevented candidates achieving higher marks in this section, in order to avoid them in future. Common errors in this section were:

- A lack of workings detailing how an answer had been calculated. This means that it was often not possible to determine if answers had merit or not. It is imperative that all workings are shown, particularly when the calculation is complex. When workings are shown, and an

error has been made, it is often possible to award the majority of the marks on a follow through basis. This is not possible where no workings are submitted.

- Failing to read the question requirement carefully enough. Some, obviously very able, candidates' submitted answers that were awarded no marks because they did not read the requirement properly. An example of this was where a requirement asked for "non-financial" consequences of a particular credit control policy. Approximately 80% of candidates cited either loss of discount. Loss of profit or increased costs, all obviously financial consequences and worth no marks.
- Failing to apply common sense. Although FFM is a technical paper there are often marks available for some application of knowledge. For example, with the credit control question mentioned above, some candidates stated that the change in credit policy would estrange suppliers as they were being paid earlier than at present. Of course, marks were awarded to those who explained that relationships with suppliers might improve when they were paid on time.
- Providing more points than were asked for specifically in the requirement. This led to lengthy answers that reduced the time available for other parts of the examination. Marks can only be awarded for the answers contained within the number of points required.

Overall, as in June 2018, candidates produced much stronger answers to the calculation questions than to the narrative questions. Written answers often lacked depth and detail. If the requirement asks a candidate to, "explain", a method or a technical point or, "interpret" a situation, a three-word bullet answer cannot earn full marks. Many candidates made bold assertions without expanding and explaining why this statement was true. A good tip when asked to explain something is to use the word, "because". For example, stating, "It is better", is usually not enough for any credit whereas, "it is better because.....", compels a candidate to explain why it is better.

One question that was answered less than well in this examination asked for the calculation of the accounting rate of return (ARR). Many candidates failed at the first hurdle because they did not know what ARR was. They confused the ARR with the internal rate of return (IRR) and produced lengthy net present value calculations. Candidates must understand all the various different investment techniques in the FFM syllabus if they are to pass this examination. Those candidates who did understand ARR still made some fundamental errors. Firstly, they often calculated the average investment in the new machine by dividing by the eight years useful economic life of the machine rather than by 2. They also either ignored the residual value of the machine altogether or deducted it from the purchase price rather than adding it to calculate the average investment. The purchase of this machine meant that the company no longer had to hire other equipment, most candidates did not appreciate that this cost saving formed part of the relevant cash flow (and therefore profit) of the proposed investment. Of more concern were the candidates that did not seem to know that depreciation should have been deducted from the cash flows to calculate profit.

The second part of the question required candidates to calculate the payback period of the investment in the machine. This should have been an easy question, especially as all the relevant cash flows had already been calculated previously for the ARR. However, many candidates did not even use the cash flows calculated in the earlier part of the question and calculated the payback using the annual revenue figures. Most of the cumulative cash flows presented showed that the payback (on own figures) occurred between the end of years 4 and 5, but an overwhelming number of candidates stated that payback occurred after five years and 3 months. Most

candidates did not conclude that the company should / should not invest in the machine given that it required all capital investments to pay back within five years. Payback is a simple investment technique and it was disappointing that the marking team were unable to award higher marks for this part of the examination.

Conclusion

The FFM paper has a broad syllabus, and it is imperative that candidates study and prepare well for all learning outcomes in the syllabus and not just a select few. Candidates must bear in mind that questions in the examination will include questions from all areas of the syllabus and that equipping themselves with adequate knowledge of all topics will maximise their chance of passing future examinations. Thus, candidates are advised to plan their revision timetable so that they have time to revise the subjects in sufficient breadth and depth. Candidates should also ensure that they study articles in the Student Accountant and/or published on ACCA's website. Finally, candidates should ensure that they read the requirements carefully during the examination.