



Think Ahead

# Foundations in Financial Management (FFM) December 2020 Examiner's report

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

## Contents

General Comments .....	2
Section A.....	3
Example 1 .....	4
Question 2.....	5
Question 3.....	5
Section B.....	6
Conclusion .....	7



This was the third sitting of the new syllabus and computer based examination (CBE) format.

## General Comments

The two-hour examination was divided into two sections.

Section A consisted of 15 multiple choice questions (MCQs) each worth two marks. Each MCQ had four possible answers of which only one was correct. Section A was weighted at 30% of the total marks and marked by computer.

Section B consisted of seven questions: one worth 20 marks, two worth 15 marks each and four worth five marks each. Section B was weighted at 70% of the total marks and marked by a specialist team of markers.

All questions in this examination were compulsory. Future FFM examinations will be set in the same format.

Most candidates used the technology provided for the CBE efficiently and effectively. However, a number of candidates simply typed their final answer into the spreadsheet cell without showing any workings. This approach is a risky one as marks can then only be awarded if the answer is 100% correct. Candidates **MUST** show their workings when answering numerical questions. Workings can be typed as narrative in a spreadsheet, but it is probably easier and faster if the working is performed within the spreadsheet cell. The marking team check all workings within a candidate's answer and will reward all correct follow-through marks. This can make the difference between a safe pass and failure on a numerical question.

For example, a question required the calculation of a cash budget. A candidate who made a single calculation error on the production budget would have lost 0.5 a mark but would have earned 100% of the remaining marks available if this incorrect figure had then been used correctly to calculate the material usage, material purchasing and cash payments budget. Any further calculation errors would have lost 0.5 for each. Thus, an answer with three calculation errors might still have scored 12.5 marks out of the 14 marks on offer, **but only if workings had been shown**. Without workings the logic of the answer presented can be almost impossible to follow. If the marking team cannot tell what calculations a number represents, they cannot determine if this number has any merit and therefore cannot award any marks. The marking team invest time and effort into trying to award marks and will always follow the workings through logically.

Future candidates should be aware that the majority of marks for the calculative elements of section B are for method and failing to show workings is likely to lead to minimal marks. The marking team cannot assume a correct methodology without workings. It is the candidate's responsibility to show all workings.

As in Section A, most candidates attempted a full quota of questions in Section B. As in previous diets, the calculation elements were answered better than the discussion elements, but the difference was much closer than usual. Indeed, there were some outstanding written answers. An excellent answer is technically correct, addresses the

requirement exactly and includes the facts presented within the scenario. Answers that achieve these points score high marks. This sitting there were a few candidates who appeared to answer a different question to the one set, often one set in a previous examination. While these answers demonstrated some knowledge, it is difficult to award high marks as they do not answer the question properly. In this examination there were table templates provided for most of the written questions. Candidates are strongly advised to use these templates as they can help ensure that the answer is complete and that it addresses the requirement.

Future candidates should be aware of the use of sub-divisions within questions. These are usually identified as a(i), a(ii) and so on. Where longer form questions are subdivided like this it is normally intended to help candidates approach the calculations in the correct order. Unfortunately, some candidates ignored a(i) altogether thus depriving themselves of easy marks, while others correctly calculated a(i) of these questions and then used an entirely different figure to answer part a(ii).

There was no evidence that candidates ran out of time during this examination and it appears that the use of the spreadsheet and word processing applications significantly helping with this aspect of examination pressure.

## **Specific Comments**

### **Section A**

The vast majority of candidates answered all of the questions in Section A, the few that did not should be reminded that an educated guess is better examination technique than leaving a MCQ unanswered. There is no negative marking for any part of this examination and all MCQs score either 0 or 2 marks.

On average this section should take candidates 36 minutes to answer the 15 multiple choice questions. As in previous diets candidates completed their answer to this section in less time than allowed.

Success in this section be achieved by not only possessing good knowledge and understanding, but also from the good exam technique. Good examination technique answering MCQs is only possible if a candidate takes time to practise prior to the live examination. As has been stated in previous examiner's reports; this section is difficult as questions often cover a wide range of subjects. Therefore, answering questions correctly requires an agile mind.

When reading a MCQ, candidates should always read the requirement first, this will be in bold. Candidates should be sure of what is being asked of them before they read the body of the question (if there is one) or the answer options. If the question is a narrative MCQ candidates should eliminate any obviously wrong options and then read the requirement again carefully, before selecting the most likely option. If the question is a calculation question, candidates should perform the calculation and then look at the options. All options that are not the correct answer are called distractors; they are designed to be plausible and are based on errors candidates make most frequently. For this reason, candidates should always double check their answers.

The three most poorly answered questions that are detailed below all contained convincing distractors that steered candidates into selecting the wrong answer.

### **Example 1**

The question least well answered in this section tested an understanding of how a company's interest cover ratio is affected by changes to some of its financing components. The Question was presented as follows:

A company earns profit before interest of \$10m. Its interest cover ratio is 5:1. It is considering taking out a loan of \$8m at 4% per year to pay off its overdraft which currently costs 3% per year.

**What would its interest cover ratio change to?**

- A 4.81:1
- B 4.31:1
- C 4.46:1
- D 4.85:1

It is easiest to answer this question if it is broken down into discrete steps.

The first step is to establish the interest charge BEFORE taking out the loan. The question states that the interest cover is 5:1 and that profit before interest is \$10m and therefore interest is  $\$10\text{m}/5 = \$2\text{m}$ .

The second step is to calculate the interest on the new loan AND the saving of interest on the overdraft. The interest on the new loan will be  $\$8\text{m} \times 4\% = \$0.32\text{m}$  and the saving of overdraft interest is  $\$8\text{m} \times 3\% = \$0.24\text{m}$ . The net effect on interest is an increase of  $\$0.32\text{m} - \$0.24\text{m} = \$0.08\text{m}$ . (a quicker way of calculating this is  $\$8\text{m} \times 4\% - 3\% = \$0.08\text{m}$ ).

The final step is to calculate the interest cover once the loan has been taken out. The interest has increased by \$0.08m from \$2m to \$2.08m. As there has been no change in the profit before interest figure of \$10m we can simply divide this by \$2.08 to get 4.81 which is **option A**.

The majority of candidates chose one of the other three options. Taking each of these in turn:

**Distractor B.** This option failed to account for the decrease in interest due to the repayment of the overdraft. Candidates therefore increased the interest by  $\$8\text{m} \times 4\%$  to \$2.32m which equates to an interest cover of  $\$10\text{m}/ \$2.32 = 4.31$

**Distractor C** This option increased the interest by 3% ( $\$10\text{m}/ (\$10\text{m}/5 + \$8\text{m} \times 0.03)$ )

**Distractor D** This option increased the interest by \$0.08m, but also increased the profit before interest by the same amount ( $\$10\text{m} + \$0.08\text{m}/2.08\text{m}$ ).

## Question 2

The second least well answered question was presented as follows:

**Which of the following are potential consequences of increasing the proportion of short-term finance used to fund a company?**

- A The need for regular renegotiation of financing arrangements will be reduced
- B Paying lower interest rates than if long-term finance had been used
- C An increase in the company's capital gearing ratio
- D An increase in the company's current ratio

The correct answer is **option B** This is because short -term finance carries less risk to the lender than long-term finance. Longer- term finance carries more risk because the factors that can prevent it being repaid as agreed are less visible as the future becomes less certain the further away it is. If there is higher risk, there will be an associated increase in interest rate.

Taking each of the distractors in turn:

**Distractor A** If short-term finance is used there is likely to be an increase in the need for regular renegotiation of financing arrangements. For example, a one year loan will need to be renegotiated/ rearranged five times compared to once for a five year loan.

**Distractor C** The capital gearing ratio is an expression of the proportion of long- term debt to equity. As the financing change proposed is from long-term to short term, the amount of long-term debt and therefore, the gearing ratio will reduce.

**Distractor D** An increase in the company's current ratio would require either an increase in its current assets or a decrease in its current liabilities. As the increase in the proportion of short term financing would involve an increase in the current liabilities this distractor cannot be true.

## Question 3

The third least well answered MCQ was as presented as follows:

Ess Co sells goods on credit to Dee Co. Both companies use overdrafts to finance working capital and neither is close to their overdraft limit. Ess Co offers an early settlement discount to Dee Co which has an annual value of 8.5%. Ess Co's overdraft costs 10% per year whilst Dee Co's overdraft costs 7% per year.

**Which of the following is/are true?**

1. It is financially worthwhile for Ess Co to offer the settlement discount.
2. It is financially worthwhile for Dee Co to pay early and take the discount.

- A 1 only
- B 2 only
- C Neither 1 nor 2
- D Both 1 and 2

For this type of question, it is best to take each of the statements in turn in order to establish whether they are true or false. As the interest/ discount rates are all expressed in annual terms, this is a simple comparison of cost versus benefit.

Statement 1. Ess Co is the supplier of goods on credit and it is offering a discount that will cost it 8.5% in order to save 10%. Therefore, the discount will save Ess Co more than it will cost and statement 1 is true.

Statement 2. If Dee Co takes the discount it will benefit by 8.5%. Dee co will have to pay for this benefit by using an overdraft that costs it 7%. As the benefit of the discount is higher than the cost statement 2 is also true.

Therefore, the correct answer is D

## **Section B**

As mentioned above, section B consisted of seven questions. The requirements were a combination of numeric and written questions, both knowledge and application based, allowing candidates the opportunity to demonstrate their abilities across a range of syllabus topics. As in previous diets, under the old syllabus as well as the December 2019 and September 2020 new-syllabus sittings, it was clear that candidates prefer answering the numerical questions compared to the written ones as these sections tend to be fuller with more time spent on them.

### **The longer-form questions**

The calculations required for these questions included: a project evaluation, the benefit of a factoring arrangement, a working capital cycle and the value of a bulk purchase discount. These subjects, together with cash budgets, are regularly examined and it is expected that candidates have a thorough understanding of them. All these calculations were completed well by the majority of candidates indicating that candidates were well prepared.

Each question contained a written element that tested the underlying understanding of the calculations. Answers to these written parts were also well answered by most candidates. Many answers contained reference to the scenario background of the questions and used these to illustrate and explain the point being made. This was very pleasing to see. Future candidates should be aware that the scenarios in the long-form questions often contain facts that are intended as prompts and guides for candidates.

### **The shorter-form questions**

The four shorter-form five-mark questions were all written, knowledge-based questions. Common errors in candidate answers include:

**Not answering the question set.** One question asked for an explanation of the benefits of cash budgeting. Many answers described what a cash budget is in detail but failed to include any benefits. Other answers explained the benefits of budgeting generally but did not explain with any reference to cash budgets. This second type of

answer was given some credit, but this was limited as it did not answer the question specifically enough.

**Not including the correct number of points required.** Most of the short form questions asked for a specific number of points. For example, THREE reasons or TWO benefits. There were answer templates with the correct number of points labelled to help candidates, but many candidates ignored these and either provided too many or too few points. The answers that contained too few points limited the number of marks that could be awarded while the answers with too many points only had the required number marked. Future candidates should be aware that answers with too many points usually sacrifice depth for quantity and therefore these answers score less well.

**No knowledge of the subject.** This examination required an explanation of TWO benefits of a post-completion audit of a capital investment project. Few candidates appeared to know what a post completion audit is and therefore scored minimal marks. Many confused a post completion audit with a statutory audit or believed it was another label for NPV or payback. Neither misunderstanding could be awarded any credit. Post completion audit is clearly included in syllabus area E2a and candidates that do not study the whole syllabus will be disadvantaged.

## **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. Finally, candidates should practice as many pilot and past papers as possible, especially the ones in CBE format on the ACCA website.