



Think Ahead

Foundations in Financial Management (FFM) December 2022 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.

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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.

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.

Future candidates should be aware that the majority of marks for the calculative elements of section B are for method. **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 calculative elements were answered better than the discursive elements, but there was a noticeable difference in quality of answer between the two. Although there were some good written answers, there were a high number of answers where the calculations had been attempted but **NOT** the discursive part. Candidates **MUST** attempt all parts of a question otherwise the achievement of a pass mark is more difficult.

This sitting, as in previous sittings, there were a large number of candidates who appeared to answer a different discursive question to the one set. While these answers demonstrated some knowledge, it is difficult to award marks as they do not answer the specific question set. For example, one question asked for reasons why small and medium sized entities (SME) encounter problems when raising finance. Answers needed to focus on **WHY** they have problems and not (as some candidates

did) explain what an SME is or explaining typical SME financing solutions, such as venture capital. Neither approach was answering the specific question set.

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

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 can be achieved by not only possessing good knowledge and understanding, but also from good exam technique. Good examination technique in 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 as well as an attention to detail.

When reading an 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. 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.

The three options that are not the correct answer are called distracters; they are designed to be plausible and are based on errors candidates may be expected to make. For this reason, candidates should always double check their answers. Just because your answer is one of the answer options does not mean it is correct!

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

Example 1

Zilla Co is a listed company and needs to raise new equity finance for a project.

Which of the following methods would be suitable for Zilla Co to raise the equity finance it needs?

- (1) Rights issue
- (2) Private placing
- (3) Initial public offering
- (4) Bonus issue

- A. 1 only
- B. 1 and 2 only
- C. 3 and 4 only
- D. All of them

Correct answer: B

The key to answering this question correctly was to read the scenario carefully (attention to detail). The company is already listed, therefore it has already undertaken an IPO – it will not undertake another one. Also, it needs to raise finance (cash) which means a bonus issue is of no help as a bonus issue does not raise any cash at all. This removes (3) and (4) from the list of acceptable methods, and means answers C and D are both incorrect.

That leaves a rights issue (1) and a private placing (2), both of which are acceptable methods, hence answer B.

Distracters:

A: this was the most popular answer but unfortunately missed out the private placing which was also correct. This may highlight some knowledge gap with candidates not understanding what a placing is.

C: incorrect as explained above.

D: this was the 2nd most popular answer but incorrect as explained above.

Example 2

Which of the following is/are true?

- (1) Bankruptcy occurs when either an individual or a company is unable to pay their debts.
 - (2) Insolvency only occurs with companies that are unable to pay their debts.
- A. Both 1 and 2
 - B. 1 only
 - C. 2 only
 - D. Neither 1 nor 2

Correct answer: C

This was a question about technical terminology with regards to insolvency and bankruptcy. Basically, companies become insolvent but individuals go bankrupt. This means only statement 2 was correct as statement 1 is using the word bankruptcy but includes companies in the statement.

Distracters:

- A: this was the second most popular answer but incorrect as statement 1 is incorrect.
- B: this was the most popular answer but again, incorrect as statement 1 is incorrect.
- D: statement 2 is correct

Example 3

A company is considering investing in the following project:

Initial outlay	\$100,000
Residual value	\$0
Project life	10 years
Annual project cash flow	\$14,500

What is the accounting rate of return (ARR) for the project using the average investment?

- A. 4.5%
- B. 9%
- C. 14.5%
- D. 29%

Correct answer: B

ARR is calculated as average annual profit/average investment x 100%. ARR can be calculated using initial investment but the question specifically states “average investment”. Candidates must check the definition of the ratio being used.

To calculate the average annual profit, depreciation must be deducted from the annual cash flow of \$14,500. The investment of \$100,000 has no residual value and a ten- year life so depreciation = $\$100,000/10 = \$10,000$ per year.

Subtracting this from the annual cash flow gives average annual profit of \$4,500 ($\$14,500 - \$10,000$).

The average investment is $(\$100,000 + \$0)/2 = \$50,000$.

This gives an ARR of $4,500/50,000 \times 100\% = 9\%$

Distracters:

A: this fails to use the average investment as asked for and instead is based on just the initial investment. Candidates selecting this answer had failed to read the question carefully!

C: this was the most popular answer but incorrect as firstly it ignores depreciation (ARR uses profit so depreciation cannot be ignored) and secondly it uses initial investment, not average investment.

D: this answer ignores depreciation.

Example 4

Drogo Co has an operating profit of \$10m per year. Its long-term funding is as follows:

Long-term bank loan (6%)	\$40m
Share capital (50c nominal value per share)	\$25m

Drogo Co is now raising an additional \$30m of long-term debt at an annual cost of 7%. Drogo Co pays tax at 20%.

What will be Drogo Co's earnings per share (EPS) after raising the new debt finance?

- A. \$0.088
- B. \$0.122
- C. \$0.126
- D. \$0.176

Correct answer: A

EPS has been examined many times before as an MCQ and the key is to read and understand the detail.

The basic EPS calculation is:

EPS = profit after tax and preference dividends / average number of shares

The question asks for EPS **after** raising the new debt, not before. As debt is being raised, the number of shares will remain the same. Share capital is \$25m in total but each share is only \$0.50 so the number of shares = \$25m/\$0.5 = 50m

Profit **AFTER** tax (and interest) is then needed. We have the operating profit figure but this is BEFORE tax and interest so these need deducting to get the profit after tax figure. Care is needed however as the company taking on some new debt so interest will increase.

Total new interest = $6\% \times \$40\text{m}$ (existing debt) + $7\% \times \$30\text{m}$ (new debt) = \$4.5m

This gives profit after tax = $(\$10\text{m} - \$4.5\text{m}) \times (1 - 0.2) = \4.4m

EPS = $\$4.4\text{m} / 50\text{m} = \0.088

Distracters:

B: this is the current EPS, ignoring the new debt (question asks for the new EPS after the new debt).

C: this only includes the new debt in the interest charge. The existing debt is not repaid so cannot be ignored.

D: this ignores the \$0.50 nominal value per share and assumes \$1 per share to give 25m shares. This was the most common incorrect answer chosen which suggests a lack of attention to detail.

Section B

Section B consisted of seven questions and the requirements were a combination of calculation and discussion with both knowledge and application being tested. As in previous diets, it was clear that candidates preferred answering the numerical aspects of questions compared to the written ones as the numerical answers tended to be fuller with more time having been spent on them.

The long-form questions

The calculations required for these questions included a cleared funds forecast, project appraisal and working capital. These subjects, together with factoring arrangements, are regularly examined and it is expected that candidates have a thorough understanding of them. Completion of all these calculations was very mixed, indicating that candidates were perhaps, not as well prepared as expected.

Each question contained a written element that tested either the underlying understanding of the calculations or other aspects of the syllabus area. Answers to these written parts were also very mixed.

Example long-form question

The 20-mark question on the exam was a cleared funds statement, and was the worst answered of the long-form questions. Less than a quarter of candidates managed to achieve a pass on this question. This was surprising because preparation of cash budgets/forecasts, cleared funds forecasts etc is a key syllabus area and is regularly examined. Well prepared candidates should have practised this type of question as part of their exam preparation.

The question was as follows:

Lim owns a business called Saturn Furnishing (SF) which sells furniture. Today is Monday and Lim needs to prepare a cleared funds forecast for this week and has the following information:

1.	Takings over the weekend (Saturday and Sunday) were \$10,000 in total with 75% received in cash and 25% by cheques.
2.	During the week (Monday to Friday) daily sales are expected to be \$4,000 per day with the same cash/cheque split as the weekend.
3.	Lim banks all cash and cheques held after close of business on Monday and Friday.
4.	All weekend takings are banked on the Monday together with Monday's takings.
5.	Once banked, cash clears on the same day.
6.	Cheques banked on Monday clear two days later.
7.	Cheques banked on Friday clear on the following Monday.
8.	Lim must pay his main furniture supplier \$30,000 today. Payment will be by cheque and the cheque will clear four days later.
9.	The opening cleared funds balance today is \$21,000.

(a) Prepare a DAILY cleared funds forecast for SF for this week (Monday to Friday) including the uncleared and total (book balance) funds.

(14 marks)

As well as banking on Mondays and Fridays, Lim is now considering banking on Wednesdays also.

(b) Using your answer to part (a) but WITHOUT further calculation, explain how each of the following balances would be affected if Lim also banks on Wednesday:

- Friday's cleared funds
- Friday's uncleared funds
- Friday's total (book balance) funds

(6 marks)

(20 marks)

Looking at part (a) a DAILY statement needs to be prepared showing three things: the cleared funds, the uncleared funds and the book balance. Many candidates only showed the cleared funds and failed to show the uncleared funds and book balance.

This immediately capped their mark at 7 out of 14 and made it difficult to obtain a pass for the whole question if their answer to part (b) was poor.

A good starting point would have been a proforma, something like below:

		Mon	Tues	Wed	Thurs	Fri
						
Cleared funds:						
Weekend	Cash					
	Cheques					
Weekday	Cash					
	Cheques					
Prior week	cheques					
Supplier						
Net						
Cleared b/fwd						
Cleared c/fwd						
Uncleared funds:						
Weekend	Cheques					
Weekday	Cash					
	Cheques					
Supplier						
Total uncleared:						
Book balance (cleared + uncleared)						

Then deal with the easy marks first which would be splitting the weekend and weekday amounts into cash and cheques (2 marks):

Weekend: cash = \$10,000 x 75% = \$7,500 cheques = \$10,000 x 25% = \$2,500

Weekday: cash = \$4,000 x 75% = \$3,000 cheques = \$4,000 x 25% = \$1,000

Most candidates were able to do this although a significant minority did not split the \$4,000 weekday into its separate amounts, despite being told in the scenario that the percentages split was the same as the weekend.

The weekend's takings were to be banked on Monday, along with Monday's takings. Takings for the rest of the week would not be banked until Friday. Cash when banked would clear straight away whereas cheques take 2 days to clear. This means the amounts banked would clear as follows:

- Weekend's cash (\$7,500) – banked Monday, clears Monday
- Weekend's cheques (\$2,500) – banked Monday, clears Wednesday (Mon+2)
- Monday's cash (\$3,000) – banked Monday, clears Monday
- Monday's cheques (\$1,000) – banked Monday, clears Wednesday
- Tuesday to Friday cash (4 x \$3,000 = \$12,000) – Banked Friday, clears Friday
- Tuesday to Friday cheques (4 x \$1,000 = \$4,000) – Banked Friday, clears following Monday

The latter item also meant that there would be cheques banked the previous Friday which will be clearing this Monday.

The only other cleared item to include is the supplier payment which although paid on Monday, takes 4 days to clear which would be Friday (Mon+4).

Along with the given opening cleared funds balance, the cleared funds part of the proforma can now be filled in:

		Mon	Tues	Wed	Thurs	Fri
Cleared funds:						
Weekend	Cash	7500				
	Cheques			2500		
Weekday	Cash	3000				12000
	Cheques			1000		
Prior week	cheques	4000				
Supplier						-30000
Net		14500	0	3500	0	-18000
Cleared b/fwd		21000	35500	35500	39000	39000
Cleared c/fwd		35500	35500	39000	39000	21000

If all of this had been done correctly, 7 marks would have been achieved. A large number of candidates achieved around 5 to 6 marks for this part which was good.

The common errors were as follows:

- Not showing the \$12,000 cleared cash on Friday but instead, showing \$3,000 in each day's column
- \$1,000 cleared cheques in both the Thursday and Friday columns, presumably representing Tuesday and Wednesday cheques
- Not showing the \$4,000 cheques clearing on Monday from the previous week which would have been banked the previous Friday

- Basic timing errors such as the cleared supplier payment in Thursday column instead of Friday.

The uncleared section was worth another 6 marks. However, this section was not as well done as the cleared section. In fact, many candidates did not even do the uncleared section, immediately losing out on 6 marks. The key elements here are as follows:

Cash: Tuesday to Thursday cash will accumulate (\$3,000 per day) as uncleared until taken to the bank on Friday. This results in figures of \$3,000 at the end of Tuesday, \$6,000 at the end of Wednesday and \$9,000 at the end of Thursday. This all clears on Friday when taken to the bank.

Weekend and Monday's cheques: These will be uncleared until Wednesday so this will give \$2,500 and \$1,000 uncleared in both Monday and Tuesday.

Tuesday to Friday cheques: Not taken to the bank until Friday so will accumulate at a \$1,000 per day to give \$4,000 by the end of Friday (but still uncleared).

The only other uncleared item is the supplier payment. The cheque is written on Monday but not clearing until Friday so will show as an uncleared item from Monday to Thursday.

Including these uncleared items gives the following:

		Mon	Tues	Wed	Thurs	Fri
Cleared funds:						
Weekend	Cash	7500				
	Cheques			2500		
Weekday	Cash	3000				12000
	Cheques			1000		
Prior week	cheques	4000				
Supplier						-30000
Net		14500	0	3500	0	-18000
Cleared b/fwd		21000	35500	35500	39000	39000
Cleared c/fwd		35500	35500	39000	39000	21000
Uncleared funds:						
Weekend	Cheques	2500	2500			
Weekday	Cash		3000	6000	9000	
	Mon cheques	1000	1000			
	Tues-Fri cheques		1000	2000	3000	4000
Supplier		-30000	-30000	-30000	-30000	
Total uncleared:		-26500	-22500	-22000	-18000	4000
Book balance (cleared + uncleared)		9000	13000	17000	21000	25000

A common error in the uncleared section was incorrect signage such as the supplier payment shown as a positive figure instead of negative.

Some candidates decided to show the uncleared amounts as a cumulative, uncleared float balance rather than a daily figure to add/subtract to the cleared balance as shown above. A float approach was acceptable and equal credit was given providing the correct figures and timings were shown. Such an approach would have made the bottom section look as follows:

Uncleared funds:						
Weekend	Cheques	2500		-2500		
Weekday	Cash		3000	3000	3000	-9000
	Mon cheques	1000		-1000		
	Tues-Fri cheques		1000	1000	1000	1000
Supplier		-30000				30000
Total uncleared:		-26500	4000	500	4000	22000
Uncleared b/fwd:		0	-26500	-22500	-22000	-18000
Uncleared c/fwd:		-26500	-22500	-22000	-18000	4000
Book balance (cleared + uncleared)		9000	13000	17000	21000	25000

Candidates who adopted this approach tended to either forget to reverse out any cheques on Wednesday when they cleared, or incorrect timings/reversals generally.

There was a final, easy mark for showing the book balance which was just the cleared + uncleared. A large number of candidates did not show this resulting in an easy mark lost!

No candidate managed to achieve full marks for requirement (a) but a small minority did achieve high marks, having perhaps made only a couple of small errors. What was disappointing was the minority of candidates who made no attempt. This is a key syllabus area and candidates must be able to prepare some form of cash forecast. This highlights a significant weakness in some candidates' knowledge and exam preparation.

Part (b) required candidates to explain how the three key balances (cleared, uncleared and book) would change if Lim now also banked on a Wednesday. This requirement was essentially testing candidates underlying knowledge of how the three link together.

The key to answering this requirement was to realise that banking on a Wednesday would get cash and cheques to the bank sooner (earlier clearing) but would not change the total amounts received and banked.

Key points:

- Banking on Wednesday would mean that the cheques received on Tuesday and Wednesday would now be banked on Wednesday rather than Friday.
- These cheques totalling \$2,000 would now clear on Friday, rather than the following week.
- Thus, Friday's cleared funds would **increase** by \$2,000

- Friday's uncleared funds would **decrease** by \$2,000 due to the quicker clearing of the above
- Book balance (cleared + uncleared) **would not change** as the two effects just cancel each other out.

Disappointingly, responses to this requirement were extremely poor. There was a high incidence of candidates providing no response at all to the requirement which immediately meant candidates missing out on 6 marks which should have been easily obtainable. There were also a large number of answers which were technically incorrect. One of the most common technical errors was stating that banking on Wednesday would increase the book balance. The book balance is affected by when amounts are received from customers, not by banking dates. Tuesday and Wednesday's cash and cheque receipts are recorded when received – whether they are banked on Wednesday or Friday makes no difference to the recording of the receipt and consequently no difference to the book balance.

There were however, a very small number of candidates who answered this section correctly and achieved full marks which was pleasing to see.

A large number of candidates did not appear to understand exactly what was being asked for in this requirement and rather than explain the impact of banking on a Wednesday chose instead to:

- explain what the cleared, uncleared and book balance mean
- discussing/repeating their figures from part (a)
- discussing whether having cleared/uncleared balances was a good thing

None of these types of response were answering the question set and therefore achieved no marks. Candidates are reminded that they **MUST** answer the question set to achieve good marks. Far too many candidates were awarded zero for part (b) due to not answering the question set.

The short-form questions

The four short-form five-mark questions included three all written, knowledge-based questions and one calculative question involving a factoring arrangement. Common errors in candidate answers to the written questions included:

- Not answering the question set
- No knowledge of the subject.

The factoring calculation was well attempted by most candidates with many getting full marks.

Conclusion

The FFM exam 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 do as much question practice as possible, including attempting the specimen exam available on the [ACCA website](#).