ACCA Think Ahead

Foundations in Financial Management (FFM) December 2024 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

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, but it was noticed that as in previous sittings, not all questions were attempted by some candidates. This immediately limits a candidate's ability to gain a pass score so candidates must ensure they attempt every question to help secure a pass.

An increasing number of candidates used the technology provided for the CBE efficiently and effectively, which is pleasing to see. However, a small number of candidates are still typing their final numerical answer into the spreadsheet cell, rather than the formula. This approach is time consuming, but also risky as marks can then only be awarded if the answer is 100% correct. **Failing to show workings is likely to lead to minimal marks** as the marking team cannot assume a correct methodology without workings.

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.

This section should take candidates no longer than 36 minutes to answer the 15 multiple choice questions. On average, candidates completed their answers 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. 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 and 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!

Let us now look at four example section A questions which had very low pass rates.

Example 1

Dalmation Co is preparing its cash budget for the next year and has forecast the sales revenue to be $75m. Dalmation Co uses a markup of 125% when pricing its products.

What is Dalmation Co's budgeted profit for the year?

A. $18.8m
B. $15.0m
C. $60.0m
D. $41.7m (correct answer)

Key to answering this is knowing the difference between "markup" and "margin" and also that the % quoted is the profit element only. Dalmation Co uses a 125% "markup" so the profit element on top of the cost is 125% (cost=100% with markup). That means that the sales revenue must be 225% of the cost figure, ie

Sales revenue = cost + profit =100% + 125% = 225%

You are told the revenue is $75m so if this is 225% you can work out what 125% (the profit) is by doing the following:

$75m x 125/225 = $41.7m (answer D)

The most common, but incorrect answer was $15m (B). This is obtained if the markup has been incorrectly applied by not adding the 125% to the cost of 100% and taking the sales revenue figure as just 125% of cost rather than 225%.

Example 2

A company has a short-term cash surplus which will be needed to pay its tax bill in three months' time.

Which factor should be LEAST important when deciding where to invest the surplus?

A. Return (correct answer)
B. Liquidity
C. Maturity
D. Risk

The key information in the scenario is "short-term surplus" and "needed to pay its tax bill". This suggests that the company cannot invest the money for a long period but also, it needs the cash to pay an obligation so it cannot afford to invest it in a risky investment. Important considerations here therefore are maturity (C) and risk (D) so these are eliminated. Answer C was the most common incorrect answer chosen.

That leaves just answer options A (return) and B (liquidity). Given that we need to be able to pay our tax bill in three months' time, we need to be able to convert the investment into cash quickly as we do not want to be paying our tax late. That means the liquidity of the investment is more important than the return.

That gives return (answer A) as the least important factor in this scenario.

Example 3

A company's capital structure is as follows:

	$m
Issued $0.50 Ordinary shares	100
Reserves	120
5% Long-term loan note	200

The company does not pay tax and its earning per share (EPS) is $0.80.

The company is considering changing its capital structure by issuing 20 million new shares at $10 each and using the proceeds to repay the long-term loan note.

What would the EPS be if the company changed its capital structure (to the nearest $0.01)?

A. $0.67
B. $0.68
C. $0.73
D. $0.77 (correct answer)

Here there is quite a tricky little calculation involving EPS when the level of debt is changing.

The share capital is currently $100m total value but the shares are $0.50 each so the number of shares at present must be $100m/$0.5 = 200m. That gives total current earnings of:

$0.80 x 200m = $160m

Now you have the total earnings but this change when the debt level changes as interest will be saved on the debt that is paid off. 20m shares are to be issued at $10 each so that will raise a total of $200m. This $200m will then be used to pay off the debt in full, saving $10m per year interest ($200m x 5%).

That means the new total earnings per year will be $160m + $10m = $170m. The most common error here was to deduct the $10m instead of adding. The $10m is a saving, earnings will increase after paying off the debt so this $10m must be added, not subtracted.

Now we just need the number of shares – remember that 20m new shares have been issued so the number in total is not 200m anymore but 220m. That then gives the new EPS of $170m/220m = $0.77

Example 4

Which of the following statements about convertible loan notes is/are true?

1. The issuing company has the right to convert the loan notes into equity at a predetermined rate and time.
2. The holder has the right to buy new shares in the company for cash at a predetermined price and time.
3. The interest rate offered on convertible loan notes is normally lower than straight loan notes.

A. 1 and 3
B. 2 and 3
C. 2 only
D. 3 only (correct answer)

With questions like these, you need to read each statement carefully, decide if it is correct or not and then see how that affects the answer options.

Statement 1- The issuing company has the right to convert the loan notes into equity at a predetermined rate and time.

This statement is FALSE but the vast majority of candidates thought this statement was true. The reason is that the right to convert rests with loan note **holder**, ie the person buying the loan notes as an investment, not the company that issues the loan notes.

This means that if statement 1 is false, answer option A is incorrect (this was the most common answer chosen!)

Statement 2 - The holder has the right to buy new shares in the company for cash at a predetermined price and time.

This statement is also FALSE as although the right to convert does indeed rest with the holder, if converted, the debt is turned into shares – there is no cash involved. Consequently, the holder is not buying shares for cash. This statement is actually explaining a share option, not convertible loan notes.

Given statement 2 is false, that means that answer options B and C must also be incorrect.

By process of elimination, that must mean answer option D is correct and that statement 3 only is true, but let us just check.

Statement 3 - The interest rate offered on convertible loan notes is normally lower than straight loan notes.

This is indeed TRUE. The conversion terms within a convertible loan note allow the holder to make possible gain in excess of the basic interest coupon payments which does not happen with straight loan notes where there is no conversion option. This means the issuing

company can set a lower coupon interest rate compared with straight loan notes while still offering sufficient return for the holder due to the possible conversion gain.

Only statement 3 is true, answer option D.

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 sittings, 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 longer form questions (20 and 15 mark questions) all had calculation requirements on subjects including cash budgeting, cleared funds forecast, investment appraisal, economic order quantity, and financial ratios.

These subjects 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.

Most questions 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 following question involves the preparation of a cash budget.

Cinnamon Co manufactures and sells outdoor furniture. The accountant is preparing the cash budget for the first six months of 20X2 and the following information is available:

Sales and receipts

Sales for 20X2 are forecast to be $50,000 for the year.

75% of the sales in 20X2 will occur equally in May, June and July with the remaining sales distributed equally throughout the rest of the year.

30% of all sales are for cash. Credit sales are payable the month after sale and 2% of credit sales become irrecoverable debt.

At 1 January 20X2 the receivables balance (net of irrecoverable debt) will be $900.

Production and payments

Production wages are currently $800 a month. A 4% pay increase will apply and be paid from the start of April 20X2.

Materials will be purchased in bulk in April 20X2 and October 20X2 and will cost $6,000 and $6,500, respectively. Suppliers are paid two months after purchase.

Cash overheads will be $450 a month and are paid when incurred.

Other information

In early June 20X2 a new machine will be installed. The new machine will cost $10,000 and will be paid for 50% in February 20X2 and 50% on installation. The new machine is a replacement for an existing machine. The cost of the new machine is four times the written down value of the existing machine at 1 January 20X2. The existing machine is depreciated at $100 a month. It will be sold for cash on 1 June 20X2 and achieve a $150 profit on disposal.

Cinnamon Co is expected to have an overdraft of $800 on 1 January 20X2.

The bank charges interest of 1.5% per month on overdrawn balances. The interest is calculated on the closing bank balance each month and is payable the following month. Cinnamon Co receives no interest for positive cash balances.

Prepare a cash budget for EACH of the months January to June inclusive.

(15 marks)

Approach:

A good starting point would be to think about a basic layout for the cash budget as follows with a column for each of the six months for January to June:

Cash receipts

Cash payments

Net cash flow

Balance brought forward (b/fwd)

Balance carried forward (c/fwd)

An important element of a monthly cash budget is showing the c/fwd balance at the end of each month – this was often ignored by a significant number of candidates with only the monthly net cash flow shown. There was 1 mark for showing a c/fwd each month.

Now let's look at the detail of these headings starting with cash receipts.

Monthly sales receipts:

This proved to be probably the most difficult area for most candidates as there was a combination of tricky calculations involving seasonal sales and sales split between cash and credit sales.

Starting with the underlying sales figures, you are told the following:

"Sales for 20X2 are forecast to be $50,000 for the year."

Many candidates assumed $50,000 per month instead of per year. You must read the question detail carefully as the $50,000 is for the whole year, ie 12 months. Some candidates then divided the $50,000 by 12 to get $4,167 per month but this was also incorrect.

"75% of the sales in 20X2 will occur equally in May, June and July with the remaining sales distributed equally throughout the rest of the year."

That means $37,500 of sales ($50,000 x 75%) occurs in May, June and July so for those months that is $12,500 per month ($37,500 / 3) for each of those months. You now need the sales for the other 9 months of the year which is the balance, evenly spread which is a total of $12,500 ($50,000 x 25%) spread over 9 months to give $1,389 ($12,500 / 9) per month for the other months of the year. The budget you are preparing is for the months of January to June only so you now have the following total sales figures:

	Jan	Feb	Mar	Apr	May	Jun
	$	$	$	$	$	$
Sales revenue	1,389	1,389	1,389	1,389	12,500	12,500

These are the revenue figures however, not cash flow. You now need to split these revenue figures into the individual cash and credit sales figures. The cash sales are easiest so do those first.

You are told that cash sales are 30% of the total sales and this amount will be received straight away, in the same month of sale, so that will give:

	Jan	Feb	Mar	Apr	May	Jun
	$	$	$	$	$	$
Sales revenue	1,389	1,389	1,389	1,389	12,500	12,500
	x 30%	x 30%	x 30%	x 30%	x 30%	x 30%
Cash sales	**417**	**417**	**417**	**417**	**3,750**	**3,750**

Now for the trickier credit sales. You are told the following information:

"30% of all sales are for cash. Credit sales are payable the month after sale and 2% of credit sales become irrecoverable debt."

If 30% of sales are for cash, that must mean the credit sales are the other 70% but 2% of the credit sales will never be received (irrecoverable debt). The credit sales are also "lagged"

one month, so January's credit sales will be received in February etc. That means credit sales receipts will be as follows:

	Jan	Feb	Mar	Apr	May	Jun
	$	$	$	$	$	$
Sales revenue	1,389	1,389	1,389	1,389	12,500	12,500
	x 70%	x 70%	x 70%	x 70%	x 70%	x 70%
Credit sales	972	972	972	972	8,750	8,750
	x 98%	x 98%	x 98%	x 98%	x 98%	x 98%
After 2% irrecoverable debt	953	953	953	953	8,575	8,575
Lagged one month		**953**	**953**	**953**	**953**	**8,575**

Notice how by lagging the credit sales one month, there is no credit sales receipt in the January column now. Is that correct? Of course, the answer is no as they will receive December's credit sales in January. You are told in the question that the opening trade receivables figure, after the 2% irrecoverable element, is $900 so this is the amount received in January.

That will give total sales receipts as follows:

	Jan	Feb	Mar	Apr	May	Jun
	$	$	$	$	$	$
Cash sales	417	417	417	417	3,750	3,750
Credit sales	900	953	953	953	953	8,575
Total sales receipts	**1,317**	**1,370**	**1,370**	**1,370**	**4,703**	**12,325**

There were 4 marks for getting to these figures for sales receipts.

Old machine disposal

The only other cash receipt was for the sale of the old machine which was worth another 2 marks. You are told the following:

"The new machine is a replacement for an existing machine. The cost of the new machine is four times the written down value of the existing machine at 1 January 20X2. The existing machine is depreciated at $100 a month. It will be sold for cash on 1 June 20X2 and achieve a $150 profit on disposal."

To get the sale proceeds you need to work backwards from the profit figure. If you add the profit figure to the written down value (WDV) at the time of disposal, you will get the proceeds. That means you need the WDV on 1st June which will be the WDV on 1st January less five months' depreciation (not six!).

The new machine costs $10,000 so if that is four times the WDV of the old machine, the old machine WDV must be $2,500 ($10,000 / 4) on 1st January. Now deduct five months' depreciation to give a WDV of $2,000 ($2,500 – 5 x $100) on the 1st June.

If the WDV on 1st June is $2,000 and a profit of $150 was made on disposal, the proceeds must have been $2,150 ($2,000 + $150).

You now have all the cash receipts:

	Jan	Feb	Mar	Apr	May	Jun
	$	$	$	$	$	$
Cash sales	417	417	417	417	3,750	3,750
Credit sales	900	953	953	953	953	8,575
Old machine proceeds						2,150
Total cash receipts	**1,317**	**1,370**	**1,370**	**1,370**	**4,703**	**14,475**

Cash payments

Most of the cash payments section just required figures straight from the question to be put into the correct column of the budget statement.

Wages (2 marks): $800 per month paid in the same month but there was a one-off increase in April of 4%. That makes wages $800 per month for January to March but $832 per month ($800 x 1.04) for April to June. A common error was to keep increasing the wages by 4% every month after April.

Overheads (1 mark): $450 per month paid in the same month.

Materials (1 mark): Two purchases were made being $6,000 in April and $6,500 in October but the payment is made two months' later. That means $6,000 purchased in April is not paid until June and the October purchase of $6,500 is not paid until December. The October purchase is after the budget period so will not appear in the budget to June at all.

New machine (1 mark): Total cost of $10,000 but paid 50% ($5,000) in February and the other 50% on installation which we are told is in June.

The above figures can now be placed into the budget as follows:

	Jan	Feb	Mar	Apr	May	Jun
	$	$	$	$	$	$
Wages	800	800	800	832	832	832
Overheads	450	450	450	450	450	450
Materials						6,000
New machine		5,000				5,000
Total payments	**1,250**	**6,250**	**1,250**	**1,282**	**1,282**	**12,282**

There is still the overdraft interest to calculate but this cannot be done until we have the b/fwd cash balance each month so now is a good time to pull everything together to calculate the cash balances:

	Jan	Feb	Mar	Apr	May	Jun
RECEIPTS	**$**	**$**	**$**	**$**	**$**	**$**
Cash sales	417	417	417	417	3,750	3,750
Credit sales	900	953	953	953	953	8,575
Old machine proceeds						2,150
Total cash receipts	**1,317**	**1,370**	**1,370**	**1,370**	**4,703**	**14,475**
PAYMENTS						
Wages	800	800	800	832	832	832
Overheads	450	450	450	450	450	450
Materials						6,000
New machine		5,000				5,000
Overdraft interest						
Total payments	**1,250**	**6,250**	**1,250**	**1,282**	**1,282**	**12,282**
Net Cash flow	67	- 4,880	120	88	3,421	2,193
Cash b/fwd	- 800					
Cash c/fwd						

The opening overdraft balance of $800 was given in the question and has been shown as the cash b/fwd in January but as it is overdrawn, it needs to be shown as a negative figure (1 mark).

Now for the overdraft interest which was worth 2 marks. You are told the following:

"The bank charges interest of 1.5% per month on overdrawn balances. The interest is calculated on the closing bank balance each month and is payable the following month. Cinnamon Co receives no interest for positive cash balances."

Key things here is that 1.5% is only applied to overdrawn balances (so no interest received if we have a positive cash balance) but also, the interest is based on the opening balance for the month (the b/fwd), not the closing balance.

In doing this on a spreadsheet a simple formula can be put in to just work out 1.5% on the b/fwd balance each month. Any positive figures for interest can then just be deleted.

Looking at January, the b/fwd is $800 overdrawn so January's interest payment is $12 ($800 x 1.5%). Putting this into the budget gives a c/fwd at the end of January of $745 overdrawn as follows:

6	New machine		5,000				5,000
7	Overdraft interest	12					
8	**Total payments**	**1,262**	**6,250**	**1,250**	**1,282**	**1,282**	**12,282**
9							
0	Net Cash flow	55	- 4,880	120	88	3,421	2,193
1	Cash b/fwd	- 800	- 745				
2	**Cash c/fwd**	**- 745**					
3							

Notice the $12 interest payment within the payments section now and how the net cash flow for January has reduced by $12 to only $55 now. Also, the c/fwd for January becomes the b/fwd for February. Now you can do February's interest calculation ($745 x 1.5% = $11) and so on to complete the budget as follows:

		Jan	Feb	Mar	Apr	May	Jun
5							
6	**RECEIPTS**	**$**	**$**	**$**	**$**	**$**	**$**
7	Cash sales	417	417	417	417	3,750	3,750
8	Credit sales	900	953	953	953	953	8,575
9	Old machine proceeds						2,150
0	**Total cash receipts**	**1,317**	**1,370**	**1,370**	**1,370**	**4,703**	**14,475**
1							
2	**PAYMENTS**						
3	Wages	800	800	800	832	832	832
4	Overheads	450	450	450	450	450	450
5	Materials						6,000
6	New machine		5,000				5,000
7	Overdraft interest	12	11	85	84	84	34
8	**Total payments**	**1,262**	**6,261**	**1,335**	**1,366**	**1,366**	**12,316**
9							
0	Net Cash flow	55	- 4,892	35	4	3,337	2,159
1	Cash b/fwd	- 800	- 745	- 5,637	- 5,602	- 5,598	- 2,262
2	**Cash c/fwd**	**- 745**	**- 5,637**	**- 5,602**	**- 5,598**	**- 2,262**	**- 102**
3							

Interest calculations as follows (overdrawn every month):

Jan = $800 x 1.5% = $12
Feb = $745 x 1.5% = $11
Mar = $5,637 x 1.5% = $85
Apr = $5,602 x 1.5% = $84
May = $5,598 x 1.5% = $84
June = $2,262 x 1.5% = $34

The budget is now complete.

The short-form questions

The four short-form (five-mark questions) are all written, knowledge-based questions. The most common errors in candidate answers to the written questions included:

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

Not answering the question set appears to be a usual problem with some of the written requirements on this exam. There is no credit given for “knowledge dumping” if your answer is not specifically addressing the question set.

A good broad knowledge of the syllabus is essential for the short-form questions, as these will often test some of the more knowledge-based areas of the syllabus.

Conclusion

The FFM exam has a broad syllabus so it is key that candidates study and prepare well for all learning outcomes in the syllabus, 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 in order to ensure 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.