

<b>THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN</b>	
<b>EXAMINERS' COMMENTS</b>	
<b>SUBJECT</b> Business Finance Decisions	<b>SESSION</b> Certified Finance & Accounting Professional (CFAP) Examination - Winter 2016

**General:**

The overall performance of students was much below the performances seen in the previous few attempts. Very poor performance was witnessed in Question 5. Performances in all other questions were below average except Question # 3.

Question wise comments are as under:

**Question 1(a)**

This part of the question required the students to compute net amount and net interest rate receivable/payable under SWAP arrangement and to discuss the relative advantages and disadvantages of the swap transaction for the company. The overall performance in this part was average. The most common mistake was that the amount of bank fees could not be incorporated correctly in the answer. A large number of candidates ignored it altogether. Further, many students could give one or two advantages/disadvantages of swap transactions only. In many cases, the same points were repeated in different wordings.

**Question 1(b)**

In this part the candidates were required to demonstrate how interest rate futures can be used to hedge against any rise in interest rate and to determine the effective interest rate on loan, in the given situation and the hedge efficiency. The performance in this part was below average. The students generally failed to determine the future outcome (in this case future receipts) correctly as they failed to prorate gain on futures correctly. Most of them also failed to determine the hedge efficiency correctly. In fact many of them did not have any idea about the concept

**Question 2(a)**

This part was based on a detailed scenario whereby a company involved in import of household products was considering to establish a manufacturing plant. The candidates were required to determine the feasibility thereof by using NPV method. The question was quite straight forward yet the overall performance was much below the expectations. The most glaring mistake was that decision was taken on the basis of NPV of the manufacturing option only. NPV under the existing situation was totally ignored.

Other major observations are as follows:

**Option I: Continue with existing practice i.e. Imports**

- Sales tax was not adjusted while computing the net sales.
- Most of the students included sales tax and withholding tax in the computation of cost of sales.
- While computing income tax, large number of students failed to compute the amount of minimum tax correctly. Some of them ignored minimum tax and turnover tax altogether.

**Option II: Develop own manufacturing facilities**

- Large number of students ignored or failed to adjust the amount of sales tax correctly while computing sales and cost of sales.
- Sales and cost of sales was computed on the basis of plant manufacturing capacity instead of demand.
- Monthly fixed overheads were provided in the question. Many students did not convert them to annual figure.
- Carry forward of tax losses was ignored.
- Amount of turnover tax paid in excess of normal tax was not adjusted in future tax liability, although it was specifically mentioned in the question.

**Question 2(b)**

In this part the candidates were required to estimate the project's sensitivity with respect to direct material costs. Most of the candidates failed to realize that calculation of sensitivity with regard to cost of direct material would be irrelevant if their decision was to continue with the existing option. Only those students should have actually calculated the sensitivity whose calculations showed that manufacturing option was better. Further, while making the calculations, a significant number of candidates computed the sensitivity on the basis of total NPV instead of difference of NPVs of the two options.

**Question 3(a)**

This part required the determination of optimum investment mix with limited funds. Overall performance was good. The errors noted were as under:

- Some students did not scale up or scale down the projects.
- Many students wasted their time in developing numerous options without ranking them through the use of profitability index. Many candidates ranked the projects on the basis of NPV of the projects instead of profitability index.

**Question 3(b)**

This part required the determination of maximum interest rate that may be paid on the borrowed funds if the investor wanted to invest in all the remaining options i.e. all options available after exhausting the available funds of Rs. 500 million. The overall performance was average as the following shortcomings/errors were commonly noted:

- Instead of determining the maximum rate of interest on the basis of IRR of the remaining available options, large number of students computed it by dividing the total NPV by total investment.

- Some students ignored the best mix determined in part (a) of the question and calculated maximum interest on the basis of the entire portfolio.

#### **Question 4**

This was straight forward question on standard costing. Overall performance was below average. Although a number of candidates obtained full marks also, yet, a large number of candidates could not secure any mark. The common mistakes were as follows:

- Many students could not differentiate between planning and operational variances.
- Many students did not present the answer in the form of statement reconciling the budgeted contribution with actual contribution as was required in the question. Some of them computed the variances only and ignored the statement altogether.
- Many candidates computed the variances without showing the calculations. Consequently, they lost all marks if their figures did not tally.
- Sales volume variance was mostly computed incorrectly.

#### **Question 5(a)**

This part of the question was based on a scenario where a listed company was considering to acquire another listed company. The candidates were required to discuss the impact of proposed acquisition on the existing shareholders of both companies in two different situations i.e. where the market is weak form efficient and also if it was strong form efficient.

The performance in this question was quite poor. A vast majority of the students was totally baffled and did not seem to know anything. Among the rest, a significant number displayed lack of understanding, knowledge and application of key concepts. Most importantly the ability to present the ideas in a proper and logical manner was found lacking. Some of the common mistakes are discussed below:

- Many students did not seem to understand the difference between weak form efficient market and strong form efficient market and consequently decided to provide comments without making this distinction. Such students could hardly secure any mark.
- Many students lacked even the basic concepts and tried to use book values to determine the share price.
- Many students did not distinguish between annual savings and one-time savings.
- Many students only carried out the calculations. No analysis or comments were offered.

#### **Question 5(b)**

This part of the question required the candidates to discuss other factors i.e. other than future profitability and share price, which may influence the above decision. The important areas that should have been mentioned include impact on share ownership (control), gearing, dividend policy, possibility of achieving future plans and the possible risks, other valuation techniques, etc. Most of the students discussed one or two of these only and included totally generalized and irrelevant points such as going concern, general economic conditions, reaction of the competitors, etc. Many of them repeated the points related to part (a) i.e. profitability and share price.

**(THE END)**