THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Business Finance Decisions	**SESSION** Certified Finance and Accounting Professional (CFAP) Examination - Summer 2018

General:

The overall performance was much better in this session as passing ratio increased to 41.37% as compared to 16% in the previous attempt. However, the vast improvement was mainly due to rather extraordinary performance in question 3 containing 15 marks where 84% candidates secured passing marks. Otherwise, the performance in questions 1, 2 and 5 were quite below average.

Question-wise comments:

Question 1

The overall performance in this question was below average as 30.9% of the candidates were able to secure passing marks. The requirement was to evaluate whether the proposed acquisition in the given scenario was beneficial for existing shareholders of the two companies or not. This required comparison of pre and post-acquisition share values vs. post-acquisition share value of both the companies' shareholders. Most of the students were not able to understand the complete concept and made a number of mistakes.

The common mistakes were as follows:

- Instead of calculating equity beta of the combined entity for calculating the post-acquisition cost of equity, many students used the asset beta to calculate the same.
- Many students used the book value of equity (instead of market value) to calculate the debt equity ratio, beta and the WACC. This resulted in incorrect calculation of the asset beta of both companies and consequently the asset and equity betas of the combined entity. Some students even used book values of equity for calculating the asset beta of individual companies but used the market values for calculating the same for the combined entity.
- Most of the students ignored the tax impact of savings in administrative cost, gain on disposal of textile manufacturing division and redundancy payments.
- The entire carried forward tax losses were taken as the benefit, instead of only 30% tax impact.
- A number of students used cost of equity as the discounting factor instead of the weighted average cost of capital.
- Annual administration cost savings were not taken to perpetuity.
- Acquisition gain to BTL's shareholders was incorrectly calculated by taking the number of shares in BTL instead of number of shares they were getting in TTL.

Question 2

The overall performance in this question was below average as 30.7% of the candidates were able to secure passing marks. According to the scenario given in the question a company intended to make strategic investment in any one of the three given companies with the objective of securing a seat on the board of directors.

The performance is further discussed below:

Question 2(a)

The requirement in this part was to recommend one of the three companies for investment. From the available data, the above evaluation was to be based on risk and return ratio of the three companies. Most of the students ended their answers at the reward side of the equation i.e. they just calculated the CAPM based return and compared it to the expected return given in the question and made recommendations based on that comparison. Some students went on to recommend investment in all the companies since all the companies had an expected return more than the CAPM based return.

Question 2(b)

In this part the candidates were required to determine the revised systematic risk and expected return of the company's equity investment after the investment as recommended on the basis of part (a) of this question and to discuss the impact of such revision. The calculation part was generally attempted well but the discussion was of low quality. In fact, many of the students ignored the discussion altogether. Most of them only highlighted the decrease in return and risk profile. Very few could deliberate further as to how the change would be seen by the management.

Question 3

The performance in this question was exceptionally good as 84% of the candidates secured passing marks. Moreover about 9% of the candidates secured full marks whereas about 52% of the candidates secured 80% or more marks.

Almost all the students scored well in the hedge using the money market. Most of the errors occurred in the part relating to hedge using the currency futures and are discussed below:

- Many students could not calculate the future closing rate of August installment correctly by apportioning the increase over a period of three months (July to September) to the two months i.e. July to August.
- Many students did not incorporate the borrowing cost of the margin in determining the net outcome. Many others calculated it incorrectly by taking the incorrect borrowing rate or incorrect borrowing period (3 months instead of 2 months) in case of August installment.
- A number of students arrived at the final conclusion on a combined basis instead of evaluating the hedging of August and December installments separately.

Question 4

Average performance was witnessed in this question and 39.6% of the candidates were able to secure passing marks.

The question required decision making on the basis of Modified Internal Rate of Return (MIRR) but a significant number of candidates had no idea of the concept. Many such students tried their luck by concluding on the basis of NPV.

Other common errors were as follows:

- Incorrect formula of MIRR was used. There are two alternate methods of calculating MIRR i.e. it can be calculated on the basis of future values of the return phase or on the basis of present values of the return phase. However, many students used formula based on future values when they had calculated present values of the return phase and vice versa.
- Some of the student showed their complete lack of understanding by only taking revenues as the return phase cash flows and the entire costs plus initial investment and the salvage value at the end of the project as the investment phase numbers.
- While calculating MIRR for Eds-Adv, many students took the entire net cash outflows of year 1 as the investment phase outflows. They were supposed to only consider the additional research cost in year 1 as the investment phase outflow, whereas the net business cash inflows of year 1 should have been part of the return phase cash flows.
- While calculating the cash flows for Eds-Adv, the fact that there was only 80% probability of success was ignored.
- In evaluating Eds-Adv, net cash flows were considered from year 1, ignoring the fact that in year 1 the research was to be carried out and (subject to successful research) Eds-Adv was to be introduced from year 2.

Question 5

This question required computation of sales variances and brief comments for the board on the variances and their impact on the profitability of the company. The performance remained below average as only 29% of the candidates were able to secure passing marks.

Most of the students were able to correctly calculate the sales price and sales mix variance. However, the market size variance and market share variances were incorrectly calculated. Many students attempted to calculate the market size and market share variances on an individual product basis. However, such a calculation was not possible since product wise market size was not given in the question. Many students were even not able to calculate the product wise standard contribution margin per unit. The most common error was that the sales commission was not correctly calculated or not calculated at all.

The performance in the report writing part was even worse. Even some of those students who scored full marks in part (a) of the question were unable to score passing marks in this part of the question. Comments were very brief and mostly focused on sales price variance. As regards the mix variance, many students only stated that the mix of products has changed. The main reason behind adverse mix variance i.e. the shift of sales from the higher margin product 1 to the lower margin product 2, was rarely mentioned. Analysis of other variances and their interconnecting implications were mostly ignored. Further, almost no one stated that the market size variance was outside the control of the company. Furthermore, the fact that though the market size has shrinked, market share has increased from 12% to 15% due to the expenditure on selling cost, was identified by few students only.

(THE END)