MARKER'S COMMENTS ON MARKED SCRIPTS

DEPARTMENT: Management Accounting

Module name	Application of financial management techniques
Module code	MAC3702

1. General comments - Examination

Topics covered in the study guide are of equal importance and students are advised to study in detail all the sections as highlighted in the study guide as well as in additional information resources supplied during the course of the semester. Previous question paper should not be solely used as guidance of how the marks would be allocated in the next examination – majority of students who pass this module generally demonstrate a good level of understanding in every topic of the syllabus. Financial management is broad and students are encouraged to dedicate enough study time to cover each topic. Students tend not to apply general business knowledge when answering questions especially on theory questions. In this module, we aim to integrate discussion/theory into the question – students are therefore advised to spend enough time in studying the theory behind every topic. Students continue to struggle to articulate themselves in theory questions – although, presentation, grammar and layout are still important, students should try to shorten their sentences and where necessary give bullet points using key words. This will save you a lot of time and it is still easy to mark.

Below is a high level analysis of students' performance in the October 2014 MAC3702 examination. The question paper consisted of 5 questions:

Question 1 – Ratio analysis (out of 22 marks)
Question 2 – Working capital management (out of 13 marks)
Question 3 – Capital budgeting (out of 20 marks)
Question 4 – Weighted average cost of capital (out of 30 marks)
Question 5 – Foreign exchange and interest rate (out of 15 marks)
TOTAL – 100 marks

About 40 marks required students to explain, interpret, discuss or to advise – this had nothing to do with calculations.

Students also lose easy marks on presentation – if a question says round to the nearest 2 decimals, you must do exactly that. If you are required to draft a memo/letter, have the appropriate structure (to/from/date/heading, etc.).

Question 1: Ratio analysis

The question had the highest pass rate of all the questions. Students managed to get a number of ratio computations correctly, although generally students demonstrated lack of knowledge especially of basic ratios. Students were not able to calculate basic "growth ratios" which are extensively covered at 2nd year level – e.g. students could not calculate *change in turnover (sales)*.

Students rarely seem to understand what the purpose of each ratio is – and they take little time to look at the final answer to determine whether a ratio makes sense or not. For example, students would have say 383 days as *debtors' collection period*. This should get students asking: does it make sense that it takes more than a year to collect money from debtors? Is it possible that the formula used is incorrect? Did I multiply by the number of days in a year?

Generally where you get the ratio calculation wrong, most of the time the interpretation will also be incorrect. This is because you have used incorrect variables (numerator and denominator). Ratio interpretation is about looking at the drivers/variables of the ratio and commenting on those. For example, a company having a smaller closing debtors' balance compared to previous year will likely have a shorter *debtors' collection period* (assume all things equal). This is because the numerator of the formula has reduced – this information is given to you. You just have to establish why debtors' balance would decrease. Is it because more clients are settling their accounts on time and/or less credit is now given? Did we give clients incentives to pay early? Could it have been debtors in a different currency now translation rates have moved? **You should be applying information given in the scenario and the knowledge of how that specific industry operates and not make assumptions**

based on prior questions.

Students tend to do badly in interpreting the ratios. Students write long paragraph stating that a ratio **improved** or **worsened** – at 3rd year level, no marks are given for just stating that a ratio *increased* or *decreased* but only when an appropriate commentary that accompanies the statement is given. To save time, you can just say "improved" or "deteriorated" and then move on to provide the required explanation. Try to keep sentences short (bullet points) – straight to the point. Do not provide just one reason/recommendation – give as many points as you can, but without contradicting yourself.

You should take time to understand exactly what the question asks and then give an appropriate answer – students usually explain what a ratio does instead of answering the question. Question normally requires an explanation of:

1. *Why* has the ratio improved/worsened? (answer could be e.g. the return on asset has decreased because of idling assets)
2. *What impact* will this ratio have? (assets might be rusty or this might lead to impairment of assets as they are generating less returns)
3. What remedial *action* may be required to manage the ratio? (company may consider disposing of assets not being fully utilised, stricter control around production hours)

Question 2: Working capital management

Students had the lowest average mark on this question, meaning that even those who managed to pass the question did not score a lot of marks. Most students struggled with part (a) of the question (working capital requirements) where they had to establish effect of increase in sales on working capital. Students were not even able to identify what makes up working capital. The answer should have been arranged such that they demonstrate how each class of working capital would be affected (viz. Debtors; Creditors, Inventory and Cash).

A similar question for part (a) was also in the textbook – which means students might not have gone through the working examples in the textbook. Students struggle to establish a relationship between increase in sales and increase in debtors. For example, if credit sales increase by 10% (all things equal), debtors at the end of the year are likely to also increase by the same 10%. The textbook and study guide have got a number of examples that should equip you in answering any working capital question that can be asked. As much as working capital management is an important aspect of the financial management syllabus, because the question carried only 15% of the entire exam paper, it was not a "deciding factor" of student passing or failing the exam.

Question 3: Capital budgeting

This question had the second highest pass rate (after Ratio question). Calculations made up 50% (10 marks) of the question, with many students being able to perform basic NPV computations (about 5 marks). Some students were not able to calculate NPV – one of the reasons might have been students who did not take in their financial calculators or did not know the formulas. Students had been told beforehand that no NPV tables were going to be provided in the exam.

Students were not able to perform other calculations beyond basic NPV (e.g. 2nd part of the question required students to use NPVI). They also did not demonstrate good understanding of the theory that comes with capital budgeting. For students to know which method to apply in investment appraisal, they need to know the theory well (e.g. different lives, different initial investment amounts, capital rationing and independent, mutually exclusive or divisible projects and indivisible projects).

As part of assessing the project, the decision is normally not based on costing/quantitative factors only but other factors must be taken into account (e.g. environmental, political, social legal, etc.). Identifying these factors can be subjective and answers may differ from one student to another. Some of the reasons students lose marks in this section include:

1. Instead of identifying the factors, students give a solution to the factor (e.g. if you have to list environmental factors to consider in a project – you should say: *management to consider water & air pollution* and NOT: *management must try and minimise water & air pollution*).
2. Incorrect classification of factors (e.g. political factors are asked but students give environmental factors).
3. Few points are given – if question is out of 4 marks, students limit their answers to only 4 bullet points. Always give more than allocated marks – no negative marking applies.
4. Not reaching a conclusion – e.g. accept or reject the project and which project do you choose

Question 4: Weighted average cost of capital

This question carried a lot of marks – 22% of the exam paper related to the calculation of WACC (calculation of cost of capital and calculation of market values). Another 8 marks of the paper focused on the theory of capital structure and calculation of shares (understanding how the capital structure works – debt and equity). This question had the worst pass rate of the entire paper and because of the weight it carried (30% of the paper), most students who passed this question were also able to pass the exam.

Some marks on the WACC calculation do not required a lot of technical knowledge – just presenting the WACC table (with the cost of capital, proportion and WACC) gives students a few marks (layout). In most WACC questions, a lot of marks are allocated to the calculation of market values and especially calculation of values using a financial calculator. Students are also expected to know how equity is determined in a company and should be able to rewrite formulas to arrive at any missing variable. Students in this topic are required to be able to work back and apply their mathematics knowledge. This requirement also applied to the sub-question that the calculation of no of shares to be issued. Many students, like in other sections of the paper, do not study the theory behind each topic – understanding the theory helps to know which methods of calculation and how these methods should be applied.
Students also failed to understand what market rate of return (cost of capital) is and when to use after tax cost.

Students should also ensure that they understand what forms part of the WACC calculation and what types of funding should be excluded.

SHOW ALL YOUR CALCULATIONS EVEN IF YOU ARE USING A CALCULATOR.

Question 5: Interest & FOREX rates and calculation of no of shares

This question was a variety of small topics – and similar questions were covered in the study guide as well as in the textbook. For students who had practiced the questions on these topics would not have had any problems with this section. However, the question seems to have caught a lot of students off guard. This shows dangers of "spot-checking" – it is for this reason that students are encouraged to cover and give all topics equal importance to prepare effectively for the exam.

Analysis of financial and non-financial statements – 7th edition of FO Skae textbook (chapter 8)

- You are expected to study **ALL** ratios covered in this chapter, except financial market/investor, cash flow-related and performance-related ratios.
- You must also study all the ratios covered in the study guide (MO001) and elsewhere in the textbook (where the ratio formulas are different between the textbook and the study guide, study guide formulas **MUST** be used).
- You will be given ratios to calculate – so it is important to understand the formula/how the ratios are calculated.
- You do not have to classify commentary in terms of difficulty level (e.g. Fundamental, Intermediate and Advanced).
- For capital structure & solvency and return on invested capital ratios, use **book** values (and not market values).
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