

REPORT ON CANDIDATES' PERFORMANCE

May 2001 Exam

Management Accounting - Case Study (FLCS)

CIMA publishes a Question and Answer booklet for each paper of the May 2001 exam which is essential reading for students and tutors. The published answers are written by the Case Study Facilitator and should be read together with this report.

Report on Candidates' Performance: Case Study (Proton Quest)

This was the first examination under the new syllabus, and inevitably quite different from previous examinations, testing a wide range of skills in a new way.

General issues:

There were some fairly general problems seen in many scripts which can be ascribed to mistaken expectations of potential requirements. A key issue was the undue emphasis on presentation rather than content.

Guidance is given in the published answers on the formatting of the report. There was no need to use separate pages for:

- "Report".
- Report title.
- Report "To" and "From".
- Terms of reference (ie – the question).
- Executive Summary (usually repeating conclusions).
- Table of contents.
- Report.
- Conclusions.) often identical
- Recommendations.)

The key tests for presentation of an answer, to meet the requirements of the assessment matrix, are fairly limited:

- a recognisable format;
- ease of navigation; that the reader can follow the report and find the various parts without undue problems, and find them clearly identified and explained. The key words in the matrix show that a report earning a marginal fail on format is "difficult to navigate."

The format expected in an examination is naturally simpler than that expected in large organisations – this recognises the constraints of time. Apart from the normal headings, the key requirement is that there should be a clear and logical table of contents, and that each part of the report should be clearly headed and identified.

The other general problem was that many candidates had prepared for the examination, assuming that it would be very largely based on the pre-seen material. They had not considered or anticipated sufficiently that the problem posed would change the overall balance of the situation, so that candidates had to answer a question on a situation assessed on the day. To a large extent, answers prepared in advance could meet with little prospect of success.

The most obvious example of this problem was the presentation of SWOT analyses (Strengths, Weaknesses, Opportunities, Threats) which had clearly been prepared in advance, and which were not updated for quite basic new data such as the cash problem.

There were also problems with candidates who had clearly worked on the pre-seen and forecast unseen, and possible questions on these, and whose answers clearly referred to a hypothetical unseen, not the one provided in the examination.

The pre-seen material provides some general background material to enable candidates to undertake general research into the industry and the type of firm and its potential problems. Identifying a firm which may have been used as a partial model for the development of the case has its limitations, as significant changes will occur via the unseen material. The examination is dealing with the firm in the scenario. Research should have identified the problems of extremely high and possibly unrealistic initial expectations and forecasts, and the problems of cash burn and difficult refinancing. It could also have identified the problems of valuing firms without significant tangible assets and without an established record of earnings.

Other possible issues could also have been identified, including some which were not taken up in the unseen and the requirement.

Part (a):

For part (a) there were effectively two sub-requirements:

- assess the issues facing the group;
- evaluate five strategic options that Proton Quest has itself identified.

A report was required, including recommendations.

A well structured answer would discuss the issues prior to evaluating the options, rather than attempting to combine the sub-requirements.

It was noticeable that some, weaker, candidates assessed issues primarily on the basis of the pre-seen data, and failed to recognise the cash flow ("cash burn") problems.

The strategic options have to be discussed, and placed in some sort of order of preference and feasibility. Recommendations are sought, and at this level it is necessary for recommendations to be supported by clear reasons. Also, recommendations should be consistent with the analysis of the issues and problems.

The Assessment Matrix

For ease of reference, the Case Study facilitator has indicated expectations of performance against the assessment matrix in two separate listings.

Only one assessment matrix applies for this examination; this is published on the CIMA website.

The Assessment Matrix sought for part (a):

Prioritisation:

- issues in order of relative importance;
- recommendations re the strategic options.

Knowledge:

- understanding the nature of the strategic options;
- understanding the relevant new financial data.

Numerical skills:

- analysis of the financial data, especially the new data.

Structure:

- the link between the analysis and the recommendations.

Business communication:

- as in the published Matrix.

Format:

- as in the Matrix. Limited marks were available, as the structure was clearly defined by the requirement.

Business awareness:

- understanding the business environment of small young high technology companies.

Breadth:

- commentary on the issues, including those arising from the analysis of the new financial data.

Depth:

- discussion of the strategic options.

Part (b):

For part (b), a second report was required; again including effectively two sub-requirements:

- a report on the potential implications of the sale of the Techno Insights division (potentially the most wide ranging part of the overall requirement);
- a valuation of the division (by implication utilising the information provided).

Recommendations, and justifications, were again required.

The discussion of the potential implications of the sale of Techno Insights could be quite wide ranging, but the essential component was an assessment of whether the remainder of Proton Quest could survive without Techno Insights.

The valuation requirement invited the use of the free cash flows provided and a discounted cash flow evaluation including a perpetuity, and the calculation of the appropriate cost of capital. It also invited, but did not always obtain, some sensible comment on whether the price indicated by the calculations was in any way feasible.

The Assessment Matrix sought for part (b):

Prioritisation:

- of the potential implications, and recommendations on whether to sell the division, related to the recommendations made in part (a), and to an acceptable price.

Knowledge:

- of the principles of valuation.

Numerical skills:

- in applying these principles to the available data, and producing a valuation.

Structure:

- linking the analysis in parts (a) and (b) to the recommendations, which should obviously be related to the recommendations already made in part (a).

Business Communication:

- as in the published Matrix.

Format:

- as in the Matrix. Limited marks were again available, as the requirement was clearly defined.

Business awareness:

- recognition of the complexities of the possible separation of Techno Insights from the remainder of Proton Quest.

Breadth:

- the range of issues discussed in the implications of the possible sale.

Depth:

- the discussion of the possible price obtainable for Techno Insights, and the assumptions made in the valuation.

Problems common to many unsuccessful candidates:

Scripts from unsuccessful candidates showed:

- over-emphasis on presentation, rather than content;
- poor time management;
- poor attention to the basic rule for all examinations – “read the requirement”.

Paper consumption was, in many instances, significant and unnecessary. Candidates should write on both sides of a page, unless starting a new part of the question or an Appendix.

Time management was often poor. It was quite obvious that many candidates had not taken basic guides such as allowing 50% of the net time available (after careful reading of the unseen) for each part of the question. Some candidates wrote little for part (b).

Traditional examination skills, such as reading the question and ensuring that the answer deals with the exact requirements, were forgotten by some candidates. Parts were often omitted, notably:

- The first sub-requirement in part (a) – “assess the issues”, where a separate report section was clearly needed;
- One or more of the five options to be evaluated. This may have been because certain candidates did not appear to know what was meant by a demerger; Others, having failed to analyse the new financial information, had little to say concerning the “Do Nothing” case;
- The valuation in part (b) – but this may have been due to time pressure, or the lack of sufficient technical knowledge to make a valuation using the available information;
- Commentary on the valuation; figures alone are of little use without some discussion of their credibility;
- Any attempt to discuss the wider implications of a possible sale.

Preparing a corporate appraisal (a SWOT analysis) based on the pre-seen material devised in relation to the anticipated requirement, and then producing this in the examination, was not useful. Such analyses had not been modified to allow for the significant further information in the unseen.

Some candidates provided what were clearly rote-learned listings of industry characteristics and of potential issues in financial strategy, information strategy and business strategy.

The preparation of hypothetical unseen and questions for candidates initially sounded a good idea, but produced some unfortunate consequences. Attempting to identify the company had its limitations.

The most noticeable feature of many scripts was the degree of naivety, and the lack of awareness of the current problems of many small quoted technology companies. The case scenario had become very topical since it was first drafted, and companies with similar problems featured frequently in the financial pages. Business awareness was clearly important for this case, in terms of providing pragmatic business solutions. Reading good financial reporting (Financial Times, Investors Chronicle, Economist, and related websites) would have helped significantly.

Candidates should have been aware of the problems of new high technology companies, which can be broadly similar whether the company is in biotechnology, telecommunications, or software, and which include:

- raising equity finance to fund development;
- raising additional funds to continue development;
- considerable fluctuations in share prices for individual companies and for market sectors;
- issues of cash burn.

The requirements in both parts of the question included recommendations. It goes without saying that these are recommendations with reasons. In any case study, the information provided is limited, and possibly ambiguous. Nonetheless, recommendations are required. Stating the need for more information, and further investigation, does not amount to providing, and justifying, recommendations based on the available information.

Perhaps the most common failing amongst unsuccessful candidates was that they appeared overwhelmed by the new data, and the need to adjust their view of the situation of Proton Quest. They only made very limited attempts to answer the very precise questions in parts (a) and (b) in reasonable detail. Markers saw variable content, and a lack of firm, well-argued recommendations.