



ADVANCED FINANCIAL MANAGEMENT (AFM)

**Read the mind
of an AFM marker
SPECIMEN EXAM Q2**

Think Ahead

Contents

INTRODUCTION	3
QUESTION 2	4
Observations on the requirement	4
Specimen exam marked answers	5
Question 2 candidate one	5
Notes on candidate one's answer to Q2	8
Question 2 candidate two	9
Notes on candidate two's answer to Q2	12
Question 2 candidate three	13
Notes on candidate three's answer to Q2	15





Introduction

I am a member of the team who marks Advanced Financial Management. This article is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Advanced Financial Management script.

Insight into a marker's thinking – appreciating what we are trained to look for, what we award marks for, the reasons why marks may not be awarded – will help you fulfil your potential and gain the necessary marks to pass. It will help you appreciate the points that will attract marks so that you can better assess your answers when practicing questions.

This article uses three candidates' answers to Question 2 from the AFM specimen exam. To support your reading of this article, you should refer to the specimen exam on the **ACCA Practice Platform**.

You may also find it interesting to refer to the published answers for the specimen exam, noting the differences and comparing the length and style to the candidates' answers seen in this article. It's important to remember that you don't need to replicate the published answer to achieve a pass. You can access the answers on the **ACCA Practice Platform**.

Question 2

Observations on the requirement

Question 2 has requirements that feature regularly in this exam, namely to apply a technique to an investment decision and then discuss some specific issue relevant to the decision. Here the technique is adjusted present value and the issue is how the investment should be financed.

In another question the technique could be the modified duration method or net present value model.

The screenshot displays the AFM Specimen interface for the exam starting from September 2022. The interface includes a top toolbar with icons for Symbol, Highlight, Strikethrough, Calculator, and Scratch Pad. On the left, there are three main sections: Exhibits (1. Colvin Co, 2. Project information, 3. Discount rate), Requirements (Requirements (25 marks)), and Response Options (Word Processor, Spreadsheet). The main content area shows the Requirements section for Question 2, which is titled 'Requirements (25 marks)'. It contains two parts: (a) Evaluate the suitability of the investment proposal in Canvia, including the impact of the country risk premium on the net present value of the project. (14 marks) and (b) Discuss the validity of the chief executive's reasons for adjusting the discount rate used in appraising the project in Canvia. (6 marks). Below these, a note states: Professional marks will be awarded for the demonstration of skill in analysis and evaluation, scepticism and commercial acumen in your answer. (5 marks). The bottom of the interface features a Help/Formulas Sheet button and navigation controls (Previous, Navigator, Next).

The 20 technical marks were split between two requirements:

Part (a) for 14 marks required a calculation of adjusted present value and a conclusion on whether or not the project should be accepted.

Part (b) for 6 marks required a discussion of the reasons given for adjusting the discount rate for this project.

For the calculation in part (a), each part of the calculation will generally be awarded 1 or 2 marks, depending on complexity. A well-justified conclusion and discussion of the results is likely to be worth 2 marks.

For the discussion elements, each relevant point will generally be awarded 1 mark, although a well-discussed point can be worth 2 marks.

A good answer to part (a) would take a methodical approach with clear and easy to follow workings.

A good answer to part (b) would look at both reasons why the chief executive's proposal might be valid and also why it may not be valid.

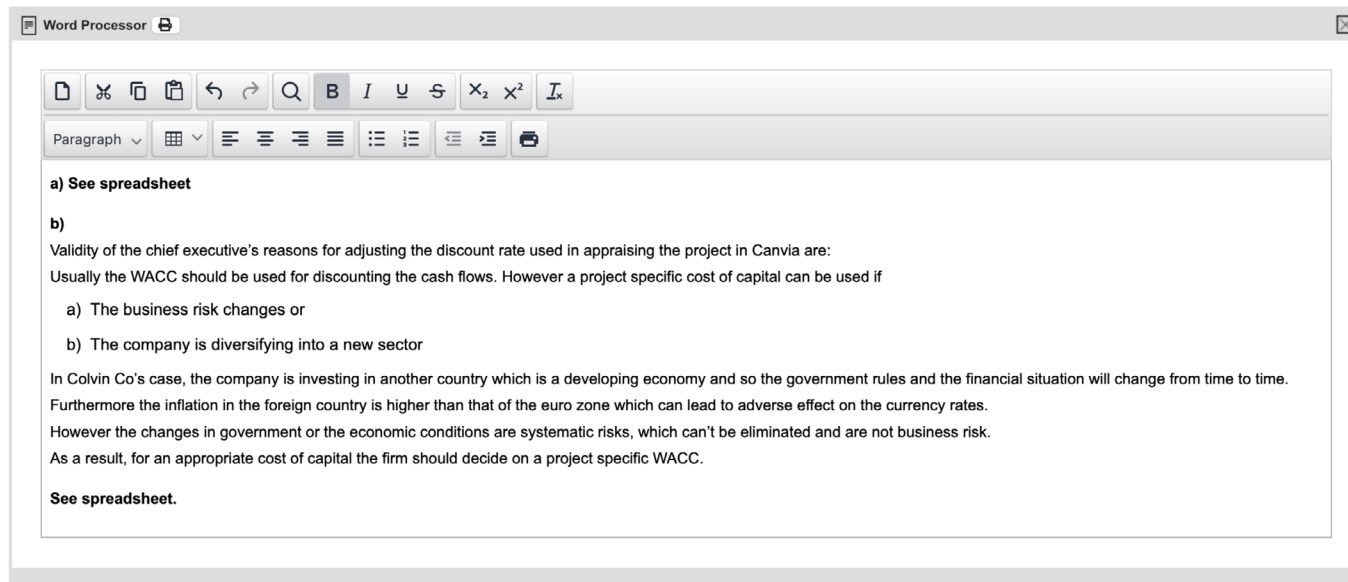
Professional marks would be obtained from producing answers which fully address the requirements.

Specimen exam marked answers

Marks awarded and comments:

Question 2 candidate one

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:



Word Processor

Paragraph

a) See spreadsheet

b)

Validity of the chief executive's reasons for adjusting the discount rate used in appraising the project in Canvia are:
Usually the WACC should be used for discounting the cash flows. However a project specific cost of capital can be used if

- a) The business risk changes or
- b) The company is diversifying into a new sector

In Colvin Co's case, the company is investing in another country which is a developing economy and so the government rules and the financial situation will change from time to time.
Furthermore the inflation in the foreign country is higher than that of the euro zone which can lead to adverse effect on the currency rates.
However the changes in government or the economic conditions are systematic risks, which can't be eliminated and are not business risk.
As a result, for an appropriate cost of capital the firm should decide on a project specific WACC.

See spreadsheet.

Specimen exam marked answers

Marks awarded and comments:

Question 2 candidate one

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

The screenshot shows a spreadsheet application window titled 'Spreadsheet'. The interface includes a menu bar with 'Edit' and 'Format', a toolbar with various icons, and a zoom level of 100%. The spreadsheet grid displays data for four working capital calculations. Working 1 TAD shows a cost of 700 and depreciation of 175. Working 2 Land value shows a cost of 70 and a value of 118.3. Working 3 working capital shows a change of 25. Working 4 FX shows a contribution per unit of 9. The spreadsheet is currently on Sheet1.

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
1															
2	Working 1 TAD														
3		cost	Depreciation												
4		1	700	175											
5		2	525	175											
6		3	350	175											
7		4	0	350											
8															
9	Working 2 Land value														
10		cost													
11		1	70												
12		2	91												
13		3	118.3												
14		4	153.79												
15															
16	Working 3 working capital														
17															
18		0	1	2	3	4									
19	Working capital change	25	2.5	2.8	3	-33.3									
20															
21	Working 4 FX														
22		0	1	2	3	4									
23	CL per \$	9.91	10.48	11.09	11.96	12.89									
24															
25	Transfer price		10.4	10.82	11.03	11.25									
26	Manufacturing cost		2.08	2.16	2.21	2.25									
27	Contribution per unit \$		8.32	8.65	8.83	9									
28															

1/2

Specimen exam marked answers

Question 2 candidate one

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
29	Calculation of NPV														
30		Amount in m	Amount in m	Amount in m	Amount in m	Amount in m									
31		0	1	2	3	4									
32	Sales units		109,725	121,795	148,590	197,624									
33	Contribution		460	609	997	1,900									
34	Fixed cost		270	292	315	340									
35	TAD		175	175	175	350									
36															
37	PBT		15	142	507	1,210									
38	Tax		-4	-36	-127	-303									
39	PAT		11	107	380	908									
40	TAD		175	175	175	350									
41	Working capital	-25	-3	-3	-3	33									
42	Initial investment														
43	Land	-75				84									
44	Plant	-700													
45															
46	Total cash flow in CL	-800	184	279	552	1,375									
47															
48	FX	9.91	10.48	11.09	11.96	12.89									
49															
50	Amounts in \$m	-80.73	17.53	25.14	46.19	106.63									
51															
52	Contribution earned		9.13	10.54	13.11	17.79									
53	Tax on contribution		-1.83	-2.11	-2.62	-3.56									
54															
55	Total cashflow	-80.73	24.83	33.57	56.68	120.86									
56															
57	NPV at 16%	68.69													
58	Based on a positive NPV the project can be undertaken														

Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

2/2

Notes on **candidate one's** answer to Q2

Summary of marks:

TECHNICAL:	
Part (a)	9
Part (b)	4
TOTAL technical marks	13
PROFESSIONAL:	
Analysis and evaluation	3
Scepticism	0
Commercial acumen	0
TOTAL professional marks	3
OVERALL TOTAL	16/25

How could this answer have been improved?

Professional skills summary

For analysis and evaluation there has been good use of the data to determine suitable calculations, and good use of the data to draw appropriate conclusions, although not much support for the discussion. In this instance this answer would obtain 3 marks for analysis and evaluation.

For scepticism and commercial acumen, there is no real focus on either of these skills in this answer and so there are no marks awarded for either of these skills. Marks for these skills could have been awarded if the answer had used scenario information to make commercial points relevant to Colvin Co or if the view of senior management had been challenged regarding the discount rate.

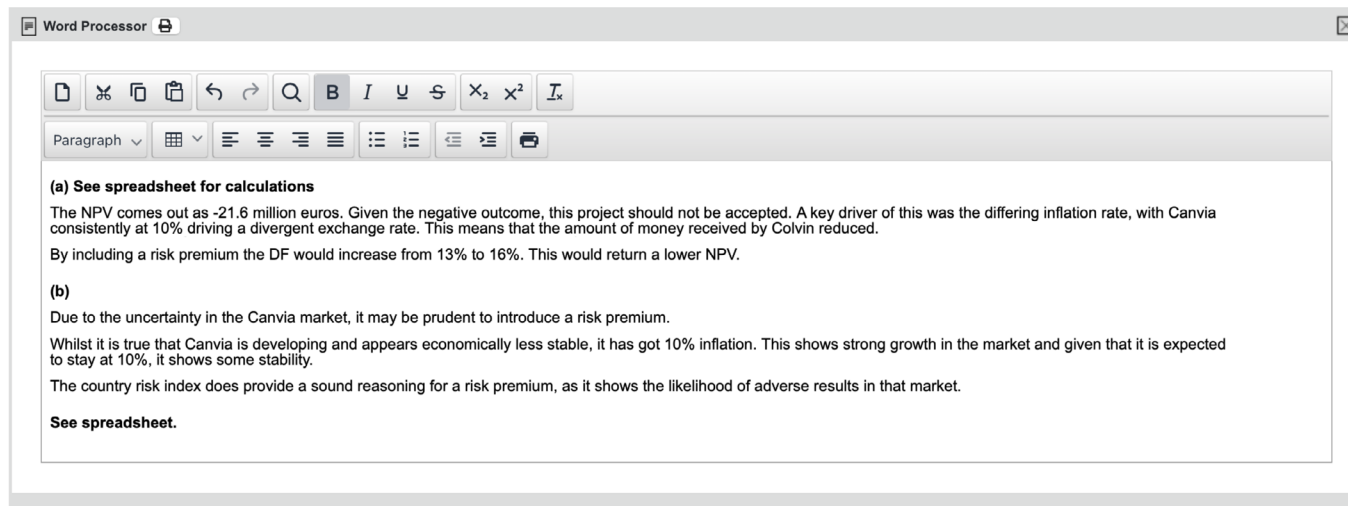
This gives a total of 3 marks out of 5 for the professional skills.

Specimen exam marked answers

Marks awarded and comments:

Question 2 candidate two

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:



The screenshot shows a Word Processor window with a toolbar and a document area. The document contains two numbered notes, (a) and (b), which are highlighted in yellow. Note (a) discusses NPV calculations and the effect of a risk premium. Note (b) discusses the uncertainty in the Canvia market and the country risk index. The document also includes a reference to a spreadsheet.

(a) See spreadsheet for calculations

The NPV comes out as -21.6 million euros. Given the negative outcome, this project should not be accepted. A key driver of this was the differing inflation rate, with Canvia consistently at 10% driving a divergent exchange rate. This means that the amount of money received by Colvin reduced.

By including a risk premium the DF would increase from 13% to 16%. This would return a lower NPV.

(b)

Due to the uncertainty in the Canvia market, it may be prudent to introduce a risk premium.

Whilst it is true that Canvia is developing and appears economically less stable, it has got 10% inflation. This shows strong growth in the market and given that it is expected to stay at 10%, it shows some stability.

The country risk index does provide a sound reasoning for a risk premium, as it shows the likelihood of adverse results in that market.

See spreadsheet.

Specimen exam marked answers

Question 2 candidate two

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet																
Edit Format																
100%																
11 B I U A 00 % 1/2																
	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
1																
2		T0	T1	T2	T3	T4										
3	Contribution (W4)		422.1	502.2	671	956.3										
4	Fixed costs		-270	-291.6	-314.9	-340.1										
5	Tax allowable dep'n (W1)		-175	-131.2	-98.4	295.3										
6	Taxable Profit		-22.9	79.4	257.7	911.5										
7	Tax (W2)		0	-14.1	-64.4	-227.9										
8	Land and buildings (w3)	-75				214.2										
9	Investment in plant	-700														
10	FCF	-775	-22.9	65.3	193.3	897.8										
11	DF (13%)	1	0.855	0.783	0.693	0.613										
12	PV	-775	-19.6	51.2	133.9	550.4										
13	Exchange Rate 1Euro: xCI (W5)	9.91	10.48	11.09	11.96	12.89										
14	PV (Euros M)	-78.2	-1.9	4.6	11.2	42.7										
15	NPV	-21.6														
16	As the NPV is 0, I would not accept this project. One of the main drivers for this is the exchange rate, as Canvia has got a much higher rate of inflation than the eurozone.															
17																
18																
19	NPV at stable exchange rate.	-78.2	-1.98	5.16	13.51	55.54										
20																
21	W1 - Tax allowable dep'n															
22		CLm														
23	Opening (T1)	700														
24	TAD	-175														
25	CF (T2)	525														
26	TAD	-131.25														
27	CF (T3)	393.75														
28	TAD	-98.43														
29	CF (T4)	295.3125														
30	Written off	0														
31	Balancing figure	-295.313														

Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

Specimen exam marked answers

Marks awarded and comments:

Question 2 candidate two

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

The screenshot shows a spreadsheet with the following data:

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
32	W2 - Tax															
33	Year 1 loss 22.9m carried forward.															
34	Year 2 taxed on 79.4-22.9 = 56.5m															
35																
36	W3 - Land															
37	Year	Value	Additional value to previous year													
38		0	75													
39		1	97.5	22.5												
40		2	126.8	29.3												
41		3	164.8	38												
42		4	214.2	49.4												
43																
44	W4 - Contribution															
45	Of the contribution 10 euro relates to component manufactured in Eurozone.															
46			1	2	3	4										
47	Sales volume		109725	121795	148590	197624										
48	Pre tax contribution (m)		419.4	500.2	671.3	961.2										
49	Remove component (10euros = 99.1Ct)		408.5	488.1	656.6	941.6										
50	Revised cost of component		13.6	14.1	14.4	14.7										
51	Add back component		422.1	502.2	671	956.3										
52																
53	W5 - Exchange Rates															
54	Using purchasing power parity															
55	Year	Exchange Rate														
56		0	9.91													
57		1	10.48													
58		2	11.09													
59		3	11.96													
60		4	12.89													
61																

2/2

Notes on **candidate two's** answer to Q2

Summary of marks:

TECHNICAL:	
Part (a)	8
Part (b)	1
TOTAL technical marks	9
PROFESSIONAL:	
Analysis and evaluation	4
Scepticism	0
Commercial acumen	1
TOTAL professional marks	5
OVERALL TOTAL	14/25

How could this answer have been improved?

Professional skills summary

For analysis and evaluation there has been good use of the data to determine suitable calculations, and good use of the data to draw an appropriate conclusion, and also to support the discussion. As a result this answer would obtain 4 marks for analysis and evaluation.

For scepticism, there is no real focus on scepticism in this answer and no challenge of the view of senior management, so there are no marks awarded for this skill.

In terms of commercial acumen, there are examples of using the scenario information to make commercial points. All together this shows some demonstration of the skill and would be worth 1 mark for commercial acumen.

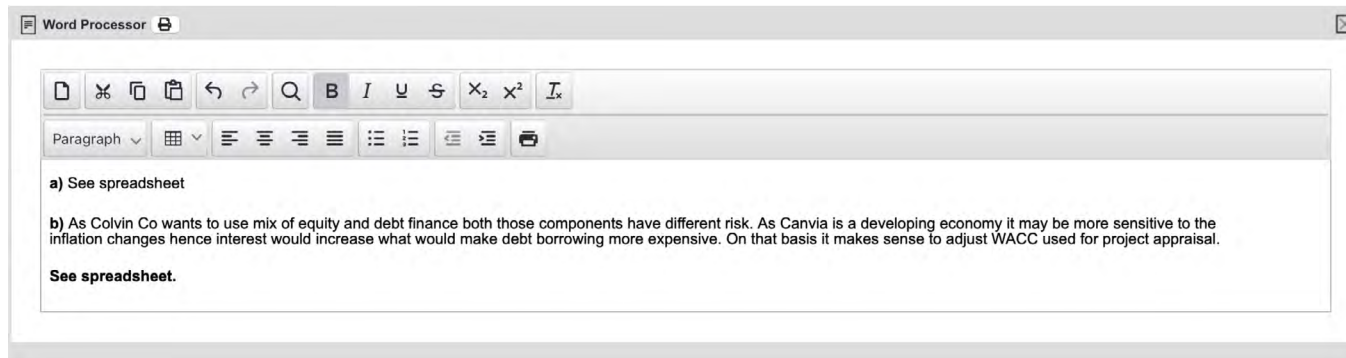
This gives a total of 5 marks out of 5 for the professional skills.

Specimen exam marked answers

Marks awarded and comments:

Question 2 candidate three

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:



Specimen exam marked answers

Question 2 candidate three

Roll your cursor over each of the highlighted cells in the spreadsheet to view the formulas that were used.

Roll your cursor over each numbered note for the marks awarded and marker's comments to appear in the right side panel:

Spreadsheet

EditFormat

</

Marks awarded and comments:

OFR = own figure rule. This is when credit is awarded where a previous error has been carried forward correctly in subsequent calculations.

Notes on **candidate three's** answer to Q2

Summary of marks:

TECHNICAL:	
Part (a)	5
Part (b)	1
TOTAL technical marks	6
PROFESSIONAL:	
Analysis and evaluation	2
Scepticism	0
Commercial acumen	0
TOTAL professional marks	2
OVERALL TOTAL	8/25

How could this answer have been improved?

Professional skills summary

For analysis and evaluation there has been good use of the data to determine suitable calculations, although no use of the data to draw an appropriate conclusion, and a lack of support for the discussion. In this instance this answer would obtain 2 marks for analysis and evaluation.

For scepticism and commercial acumen, there is no real focus on either of these skills in this answer and so there are no marks awarded for either of these skills.

This gives a total of 2 marks out of 5 for the professional skills.

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