ACCA

Strategic Professional – Options

Advanced Financial Management (AFM)

EXAM KIT

KAPLAN
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CONTENTS

Versions of some questions in this Exam Kit may also be available on the ACCA Practice Platform on the ACCA website. They are a very useful reference, in particular to attempt using ACCA's exam software. However, you should be aware that ACCA will decide when those questions will be amended for syllabus changes or replaced, so they may differ slightly from the versions in this Exam Kit

SECTION A-TYPE QUESTIONS

SPECIFIC AFM EXAM INFORMATION

THE EXAM

FORMAT OF THE EXAM

		Number of marks
Section A:	One compulsory question worth 50 marks	50
Section B:	Two compulsory questions worth 25 marks each	50
		100

Total time allowed: 3 hours and 15 minutes

AIM

To apply relevant knowledge, skills and exercise professional judgement as expected of a senior financial executive or advisor, in taking or recommending decisions relating to the financial management of an organisation.

OBJECTIVES

On successful completion of this exam, candidates should be able to:

- Explain and evaluate the role and responsibility of the senior financial executive or advisor in meeting conflicting needs of stakeholders and recognise the role of international financial institutions in the financial management of multinationals
- Evaluate potential investment decisions and assessing their financial and strategic consequences, both domestically and internationally
- Assess and plan acquisitions and mergers as an alternative growth strategy
- Evaluate and advise on alternative corporate re-organisation strategies
- Apply and evaluate alternative advanced treasury and risk management techniques
- Apply a range of professional skills in addressing requirements within the Advanced Financial Management exam, and in preparation for, or to support, current work experience
- Apply employability and technology skills

PASS MARK

The pass mark is 50%.

DETAILED SYLLABUS

The detailed syllabus and study guide written by the ACCA can be found at:

https://www.accaglobal.com/gb/en/student/exam-support-resources/professional-exams-study-resources/p4/syllabus-study-guide.html

Section 1

PRACTICE QUESTIONS – SECTION A

ADVANCED INVESTMENT APPRAISAL

1 CHMURA CO (DEC 13)

Since becoming independent just over 20 years ago, the country of Mehgam has adopted protectionist measures which have made it difficult for multinational companies to trade there. However, recently, after discussions with the World Trade Organisation (WTO), it seems likely that Mehgam will reduce its protectionist measures significantly.

Encouraged by these discussions, Chmura Co, a company producing packaged foods, is considering a project to set up a manufacturing base in Mehgam to sell its goods there and in other regional countries nearby. An initial investigation costing $500,000 established that Mehgam had appropriate manufacturing facilities, adequate transport links and a reasonably skilled but cheap work force. The investigation concluded that, if the protectionist measures were reduced, then the demand potential for Chmura Co's products looked promising. It is also felt that an early entry into Mehgam would give Chmura Co an advantage over its competitors for a period of five years, after which the current project will cease, due to the development of new advanced manufacturing processes.

Mehgam's currency, the Peso (MP), is currently trading at MP72 per $1. Setting up the manufacturing base in Mehgam will require an initial investment of MP2,500 million immediately, to cover the cost of land and buildings (MP1,250 million) and machinery (MP1,250 million). Tax allowable depreciation is available on the machinery at an annual rate of 10% on cost on a straight-line basis. A balancing adjustment will be required at the end of year five, when it is expected that the machinery will be sold for MP500 million (after inflation). The market value of the land and buildings in five years' time is estimated to be 80% of the current value. These amounts are inclusive of any tax impact.

Chmura Co will require MP200 million for working capital immediately. It is not expected that any further injections of working capital will be required for the five years. When the project ceases at the end of the fifth year, the working capital will be released back to Chmura Co.

Production of the packaged foods will take place in batches of product mixes. These batches will then be sold to supermarket chains, wholesalers and distributors in Mehgam and its neighbouring countries, who will repackage them to their individual requirements. All sales will be in MP. The estimated average number of batches produced and sold each year is given below:

Year	**1**	**2**	**3**	**4**	**5**
Batches produced and sold	10,000	15,000	30,000	26,000	15,000

The current selling price for each batch is estimated to be MP115,200. The costs related to producing and selling each batch are currently estimated to be MP46,500. In addition to these costs, a number of products will need a special packaging material which Chmura Co will send to Mehgam. Currently the cost of the special packaging material is $200 per batch. Training and development costs, related to the production of the batches, are estimated to be 80% of the production and selling costs (excluding the cost of the special packaging) in the first year, before falling to 20% of these costs (excluding the cost of the special packaging) in the second year, and then nil for the remaining years. It is expected that the costs relating to the production and sale of each batch will increase annually by 10% but the selling price and the special packaging costs will only increase by 5% every year.

The current annual corporation tax rate in Mehgam is 25% and Chmura Co pays annual corporation tax at a rate of 20% in the country where it is based. Both countries' taxes are payable in the year that the tax liability arises. A bi-lateral tax treaty exists between the two countries which permits offset of overseas tax against any tax liabilities Chmura Co incurs on overseas earnings.

The risk-adjusted cost of capital applicable to the project on $-based cash flows is 12%, which is considerably higher than the return on short-dated $ treasury bills of 4%. The current rate of inflation in Mehgam is 8%, and in the country where Chmura Co is based, it is 2%. It can be assumed that these inflation rates will not change for the foreseeable future. All net cash flows from the project will be remitted back to Chmura Co at the end of each year.

Chmura Co's finance director is of the opinion that there are many uncertainties surrounding the project and has assessed that the cash flows can vary by a standard deviation of as much as 35% because of these uncertainties.

Recently Bulud Co offered Chmura Co the option to sell the entire project to Bulud Co for $28 million at the start of year three. Chmura Co will make the decision of whether or not to sell the project at the end of year two.

Required:

(a) Discuss the role of the World Trade Organisation (WTO) and the possible benefits and drawbacks to Mehgam of reducing protectionist measures. (7 marks)

(b) Prepare an evaluative report for the Board of Directors of Chmura Co which addresses the following parts and recommends an appropriate course of action:

(i) An estimate of the value of the project before considering Bulud Co's offer. Show all relevant calculations (14 marks)

(ii) An estimate of the value of the project taking into account Bulud Co's offer. Show all relevant calculations (5 marks)

Note: in the Computer Based Exam (CBE), the "BSOP calculator" spreadsheet option will be provided to help you to answer this question.

(iii) A discussion of the assumptions made in parts (i) and (ii) above and the additional business risks which Chmura Co should consider before it makes the final decision whether or not to undertake the project. (14 marks)

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, scepticism and commercial acumen in your answer. (10 marks)

(Total: 50 marks)