F3 Financial Strategy

Questions and answers from past ‘ask a tutor’ events – archived by syllabus area

[Please note that the responses given are the tutors’ own. They are not definitive nor do they necessarily reflect the views of CIMA.]

Syllabus area A – Formulation of Financial Strategy

Question: (Borrowing Debt and equity)
Why do firms borrow capital that has to be repaid rather than finance a firm with 100% equity?

Response from tutor:

The question that you have asked initially appears straightforward to answer, though in reality it is a deceptively cost of capital (WACC), to generate returns for the shareholders of the business. If the managers of the business failed to provide at least some debt financing of the organisation in its capital structure, they would be wasting the complicated issue to try to tackle on an Internet discussion forum. Indeed, around 15% of your syllabus addresses the issues of long-term financing and capital structure. However, I shall try to give you some pointers.

Basically, because an organisation owns some non-current assets, it is possible to secure debt financing against these assets. This debt finance can then be invested in projects that yield IRR’s greater than the company's weighted average opportunity to use the non-current assets in this way.

Allowing some debt in the organisation's capital structure helps to bring down the WACC by allowing use of the 'tax shield', therefore the interest payments on the debt finance are a deductible expense for the organisation, so reducing their corporation tax payments. Furthermore, using debt finance rather than equity finance helps to preserve the ownership structure of the organisation, eliminating the need to dilute the current owners' shareholding by issuing more equity financing.

Syllabus Area B – Financing Decisions

Question: (Asset Beta Calculation)
What is the meaning of “Asset Beta”? How it is practically calculated? What is the relation of asset beta with the equity beta of the company? Kindly explain & illustrate.

Response from tutor:

An asset beta is the measure of market risk associated with that asset - in other words, the extent to which macroeconomic changes are likely to cause the market price of the asset to change. The higher the value of beta, the more volatile the price of the asset.

How is it practically calculated?

We take observations of actual market price changes of that asset class over time, and plot them onto a graph. We then take the line of best fit for the line of the graph to estimate beta, the gradient of that line. You won't be asked to do this in your exam - you will be given an estimate of any beta
values that have been calculated already for you.

*What is the relation of asset beta with the equity beta of the company? Kindly explain & illustrate.*

We would estimate the relative level of market risk associated with a particular company vis à vis the rest of the industry sector of that company. If more risky than the industry average, we would take the beta of the organisation to be slightly higher than that of the industry, and if less risky than the industry average, we would take the beta of the organisation to be slightly higher than that of the industry. If asked to do this in the exam, you should perform this estimation (remembering that this can never be a precise science), and justify your estimate based on the information given in the scenario. You would then use the beta you have estimated as normal in your capital-asset pricing model calculations that follow.

**Question: (Systematic and Unsystematic risk)**

What is the difference between Unsystematic risk and “business risk ” of Systematic Risk?

**Response from tutor:**

Business risk is the risk associated with the particular activities undertaken by the organisation. Systematic risk is the risk associated with the macroeconomic environment in which all entities of that industry are operating. It is assumed that unsystematic risk (therefore the business risk of all of the entities of the industry) can be diversified away by an investor investing in a balanced portfolio including investments in many different asset types or industries.

**Question: (Floatation)**

When and why ‘introduction’ is used as a method of obtaining floatation?

**Response from tutor:**

Introduction is a particularly good floatation method when no new shares are issued for the business, and no new finance is being sought. Usually this occurs when the owners are trying to move the listing of the business from one stock exchange to another, or if ownership of shares in the business is widespread and the owners would like a publically-available quotation for the shares to be achieved. Good luck in your exam.

**Question: (Asset beta and equity beta)**

Please explain the terms asset beta and equity beta, the difference between the two and how they are related. Is there any standard formula to calculate re-gearing and de-gearing betas? Though the formula is given in the formula sheet of the exam paper, in the suggested answers given by the examiner, other formulas are used to calculate the above.

**Response from tutor:**

Beta is the measure of systematic (or ‘market’) risk used by the CAPM model. An asset beta-value is a measure of the systematic risk of any asset, whether that be a share, a bond, a portfolio of shares (perhaps in a unit trust or other similar vehicle), or a project. An equity beta is the beta-value for a particular share. Equity betas are examples of asset betas.
As you say, the formulae to use are all specified in the formula sheet. I suggest that the model answers you are looking at involve the examiner having algebraically-rearranged the formulae found on this sheet.

**Question:** *(Graphical representation systematic and unsystematic risk)*

In the examiners 'Questions and Answers' for May 2010, question four (a) required a diagram illustration for systematic and unsystematic risks. I have not attempted such a question in the CIMA Exam Practice Kit, which made me quite anxious. Besides this diagram and the diagram for working capital policy, what other diagrams should I learn? I understand that Modigliani and Miller (MM) theory is an important part of the F3 syllabus, but I have difficulty in understanding it. Can you explain the theory in simple terms, including the limitations of the theory?

**Response from tutor:**

The diagram you refer to is a very basic graph showing the way in which diversification of a portfolio can help to reduce total risk, by progressively eliminating specific ('unsystematic') risk, and so total risk tends towards market ('systematic') risk. You really should understand this relationship in order to make any sense of the CAPM model, and this is a fundamentally important topic for F3. The graph I refer to is on page 192 of the CIMA F3 Study System, and I urge you to study it carefully - this is a topic that will come up time and again in this exam. I cannot hope to list all of the possible diagrams that the examiner might ask you to draw - all I will say is that the examiner will never ask you to draw a diagram that is not based on a common, typically examinable topic (such as CAPM).

M&M theory is indeed an important part of the syllabus, and you will find a proper discussion of it on pages 178 to 182 of the CIMA F3 Study System - this is not the forum for me to be teaching you complex theories such as this one.

In simple terms, M&M '58 suggest that the weighted average cost of capital of an entity (WACC) remains constant as gearing levels increase, since the lower cost of debt capital is offset by the higher return expected by equity holders to compensate them for the higher risk incurred by holding equity in a more highly geared company. M&M '63 updates this theory to recognise the tax-beneficial effect of loan financing having interest charges taken from pre-tax profits, thereby giving a 'tax shield' effect, and reducing the WACC as gearing increases.

Limitations of the theory include:
in the real world, cost of equity and cost of debt do not increase in a linear fashion with changing gearing; companies give their shareholders limited liability for their debts, therefore giving less risk to investors from increasing gearing than M&M allow for; if gearing gets too high, the company is likely to collapse.

**Question:** *(cost of equity and cost of capital)*

Can you please explain to me the difference between cost of equity and cost of capital? For a geared entity, how would raising equity finance impact on the cost of equity? I understand that equity finance would not affect the cost of equity of a non-geared entity, since the financial risk will not be changed.

**Response from tutor:**

Cost of equity means the return expected by shareholders from their investment in the business (return on equity finance). Cost of capital is a weighted average of the returns expected by all
providers of capital to the organisation; in other words, a weighted average of the cost of equity and the cost of debt.

According to Modigliani and Miller (M&M), the relationship between cost of capital and cost of equity changes in a predictable way as gearing levels increase or fall. If the entity increases its level of equity finance whilst keeping debt levels constant, then gearing will fall. See pages 178 to 182 of the CIMA F3 Study System for a discussion of how theoretical models (such as M&M) allow the effect of changes in gearing to affect the cost of capital of the entity.

**Question: (WACC Gearing and Ungearing)**

How do you work around questions involving WACC and what does it mean to gear and regear?

**Response from tutor:**

Weighted average cost of capital (WACC) is a function of the organisation's cost of equity and cost of debt. Cost of equity means the return expected by shareholders from their investment in the business (return on equity finance). Cost of debt means the average return expected from holders of debt (i.e. average interest charges suffered for borrowing). Cost of capital is a weighted average of the returns expected by all providers of capital to the organisation, in other words, a weighted average of the cost of equity and the cost of debt.

The point of ungearing and regearing the beta values of companies is as follows:

An asset beta-value is a measure of the systematic risk of any asset, whether that be a share, a bond, a portfolio of shares (perhaps in a unit trust or other similar vehicle), or a project. An equity beta is the beta-value for a particular share.

If you need to calculate a discount rate to use to evaluate (using an NPV calculation) a project or investment that has a significantly different risk profile (i.e. beta) than existing business, this is how you do it:

(i) estimate the systematic risk of the project's operating cash flows by comparing it with published betas of companies operating within that industry;

(ii) adjust these beta values to allow for the company's level of gearing:

- ungear the published beta
- regear the ungeared beta using the company's own gearing ratio

This gives you a project-specific geared beta

**Question: (Interpretation of Beta)**

If Beta(eq) measures financial & business risk, what does Beta(debt) measure and if debt is risk-free is Beta (debt) = 0 ?

**Response from tutor:**

Beta is the measure of systematic (or 'market') risk used by the CAPM model. An asset beta-value is a measure of the systematic risk of any asset, whether that be a share, a bond, a portfolio of shares (perhaps in a unit trust or other similar vehicle), or a project. An equity beta is the beta-value for a particular share. Equity betas are examples of asset betas. Debt betas are also asset betas, used to compare the systematic risk of a particular debt instrument with a market debt benchmark (such as a treasury bond). Debt betas work in broadly similar ways to equity betas.
Question: (WACC with Tax without Tax)

WACC three propositions always confuse me both in the Tax and the No tax together with the calculation. So please can you explain it in simple words?

Response from tutor:

Weighted average cost of capital (WACC) is a function of the organisation's cost of equity and cost of debt. Cost of equity means the return expected by shareholders from their investment in the business (return on equity finance). Cost of debt means the average return expected from holders of debt (i.e. average interest charges suffered for borrowing). Cost of capital is a weighted average of the returns expected by all providers of capital to the organisation, in other words, a weighted average of the cost of equity and the cost of debt.

I believe the 'three propositions' you are referring to are those of Modigliani and Miller (M&M). M&M theory is indeed an important part of the syllabus, and you will find a proper discussion of it on pp178-82 of the CIMA F3 learning system - this is not the forum for me to be teaching you complex theories such as this one. In simple terms:

Proposition 1 - Ignoring tax, the market value of an organisation is independent of gearing levels as cheaper debt financing pushes up the return expected by equity shareholders

Proposition 2 - the level of gearing of specific companies when compared to other companies in their class, and the formula given helps us to understand this:

\[ \text{keg} = \text{keu} + (D/E)(\text{keu} - \text{kd}) \]

Proposition 3: Calculating the WACC gives us the hurdle rate of return which any project considered by the organisation must satisfy.

These three propositions are summed up in M&M's theory, initially published in 1958 but then updated in 1963 to consider the effect of taxation.

- M&M '58 suggest that the weighted average cost of capital of an entity (WACC) remains constant as gearing levels increase, since the lower cost of debt capital is offset by the higher return expected by equity holders to compensate them for the higher risk incurred by holding equity in a more highly geared company

- M&M '63 updates this theory to recognise the tax-beneficial effect of loan financing having interest charges taken from pre-tax profits, thereby giving a 'tax shield' effect, and reducing the WACC as gearing increases
- limitations of the theory include:
- in the real world, cost of equity and cost of debt do not increase in a linear fashion with changing gearing
- companies give their shareholders limited liability for their debts, therefore giving less risk to investors from increasing gearing than M&M allow for
- if gearing gets too high, the company is likely to collapse

Question:

You can find the question in below link as question No. Four
My question is:
In the solution, PV (4.1) of rentals is considered for 5 years, but the PV (7.024) of maintenance is being considered for 10 years …Why?

**Response from tutor:**

If the company chooses to go ahead with method 1 (long-term lease), then the company will need to pay 10 years’ worth of maintenance costs (hence the 10 year PV for maintenance). However, only five years' rentals are paid (hence the 5 year PV for rentals), after which a 'nominal rent' would be paid. As such, the nominal rent can be ignored.

**Question:**

Could you please explain when the marginal cost of capital versus adjusted cost of capital should be used.

**Response from tutor:**

The marginal cost of capital should be used if both the investment project is large relative to the current size of the entity (therefore accepting the project will cause a discernable change to the capital structure of the entity), and also if the funds raised by the entity to finance the project can be separately identified and 'ringfenced' from funds used for other purposes. If these two conditions cannot be met, adjusted cost of capital should be used instead. See pp219-220 of the CIMA Official Study Text for further details.

**Question:**

Can you please explain the term EVA economic value added?

**Response from tutor:**

Economic value added (EVA) is also sometimes known as 'economic profit', and is a concept trademarked by Stern Stewart. It attempts to measure the 'value added' by the activities of the entity, in excess of the required returns to providers of finance (i.e. shareholders and debtholders). If value added is positive, then the activities of the entity are worthwhile in economic terms as managers are adding value through their efforts. The approach is analogous to residual income (RI), though supporters of EVA hold that EVA is superior as RI can more easily be distorted through accounting adjustments ('window dressing').

It is defined as:

\[
EVA = \text{net operating profit after tax} - \text{capital charges}
\]

...where

\[
\text{capital charges} = \text{capital invested} \times \text{WACC}
\]

There is a brief discussion of the concept on p105 of the CIMA Official Study Text.

**Question: (liquidation)**

Can you please explain what is liquidation and how it affects the different stakeholders, how does a company manages a good liquidating position.
Response from tutor:

'Liquidation' is the process by which a company's existance is brought to an end. This can be either voluntary (via extraordinary resolution of the shareholders at a company meeting, usually referred to as a 'winding up' of the company), or involuntary (usually as a result of the insolvency of the company).

The Insolvency Act 1986 determines the exact order of priority in paying off the stakeholders of the business in the event of liquidation. It is beyond the scope of the F3 syllabus to discuss this in precise terms (and will have already been covered by you in detail in your previous CIMA studies). However, in broad terms, creditors get repaid before shareholders. Often in the event of involuntary liquidation, there is no value left after creditor debts have been addressed.

I'm not entirely sure what you mean by 'how does a company manages a good liquidating position'. In the UK, it is possible for a company in difficulty to carry out a liquidation of the original company, quickly followed by the creation of a 'phoenix' company with the same premises, staff, customers etc. This can help the company become profitable again after leaving onerous debts and leases etc. behind.

A full discussion of liquidity management, issues and measurement is given in chapter 5 of the CIMA Official Study Text.

Syllabus Area C - Investment Decisions and Project Control

Question: (Boots Strapping and YTM)
What is bootstrapping of earnings and how it has the impact i.e. on what aspects of business? What are tax depreciation allowances or depreciation or tax relief? Are these terms the same? Why and how they are calculated? What's the formula for calculating YTM i.e. yield to maturity?

Response from tutor:

1. Bootstrapping
Take a look at this example:
Big plc is considering buying out Small plc by offering two Big shares for each Small:
Big plc shares = 3,800,000
Small plc shares = 200,000
Annual earnings Big = $1,140,000
Annual earnings Small = $100,000
EPS Big = 30c per share
EPS Small = 50c per share
Assuming there is no synergistic effect from the acquisition, and no earnings growth occurs, look what happens post acquisition:
New co shares = (3,800,000 + (2x100,000)) = 4,000,000
New co earnings = ($1,140,000 + $100,000) = $1,240,000
New co EPS = ($1,240,000 / 4,000,000) = 31c per share
Big has attempted to improve its market standing by boosting its EPS, but rather than doing this in the 'right' way (i.e. increasing earnings by investing in projects with positive NPVs), it has 'bootstrapped' itself through the acquisition of a target with higher EPS than its own.
2. **Tax depreciation allowances**

Tax depreciation allowances are used by governments to take the place of income statement provisions for tax relief in a DCF calculation. The effect of these is to reduce taxable profits, therefore representing a cash saving (or cash inflow) in a DCF calculation.

Taxation authorities require a single set of rules for depreciating non-current assets to be used by all companies within that jurisdiction, so as to allow comparability between entities and reduce scope for tax evasion through profit manipulation by organisations. There is a full discussion of this topic on pages 338-9 of the 2010 CIMA F3 learning system.

You calculate these according to the instructions given to you by the examiner. Due to the international nature of the CIMA qualification; you will never be asked questions about a particular company's tax regime. Usually these are on a reducing balance basis. Perform a side working for your tax savings using a typical reducing-balance calculation, and put the savings into your DCF calculation as cash inflows.

3. **Formula for calculating YTM**

YTM is effectively an internal rate of return calculation.

Assume a bond, with a coupon rate of 8%, repays its face value of $100 in 15 years. If the bond is currently valued by the market at $78.40, then its current YTM can be calculated as:

Assume two discount rates, DRlow 10% and DRhigh 14%. Look up the 15 year annuity factors for the two rates, namely 7.606 and 6.142 respectively, and also the 15 year discount factors for the two rates, namely 0.239 and 0.140 respectively, to price the bond:

at 10%; ($8 \times 7.606) + ($100 \times 0.239) = $84.75

at 14%; ($8 \times 6.142) + ($100 \times 0.140) = $63.14

And then interpolate:

\[
YTM = 10\% + \left[ \frac{($84.75 - $78.40) / ($84.75 - $63.14)}{4\%} \right] 
\]

\[
YTM = 10\% + 1.175\% 
\]

\[
YTM = 11.175\% \text{ (or approximately 11\%)} 
\]

**Question: (Discount rates for IRR)**

How do I know which two discount rates to use when using the IRR (trial & error) method to find effective yield (YTM) for a redeemable bond? In September 2010 CIMA FM Magazine, the tutor was able to use two rates that gave the correct YTM (same when calculated using financial calculator). In the exam how should I guesstimate which two rates to use? I have tried using two different discount rates onto the IRR formula which gave me a different answer.

**Response from tutor:**

The IRR method involves interpolation using the NPV calculated at two selected discount rates. Try to get two discount rates where one gives a positive result and the other a negative result. As you increase the discount rate, the NPV will reduce. The IRR calculated by this method is only ever an estimate; estimate it in this way for the marks. Because it is an estimate, you will get a slightly different answer to somebody else’s estimate - this is not the point - the examiner is testing to see if you understand the principle involved.

Let me invent some numbers to demonstrate. Say you try DRs of 5% and 10%. 5% gives an NPV of +$100,000 and 10% gives an NPV of -$10,000. You can see now that the IRR will be slightly higher than 10%. Try a third DR, say of 12%, which gives an NPV of -$8,000. Now plug in the 10% and 12% figures to the formula, to find an estimate of the IRR.
**Question: (Treatment for residual Value)**

Just want to find out if we have to exclude the residual value when calculating depreciation. I see sometimes when using a reducing balance method there is always an amount left after the residual value. I also did not see the tax calculation for recoupment or scrapping allowance.

**Response from tutor:**

With the reducing balance method, by definition, there will always be a residual value calculated from the method. This is inevitable, and it gets taken account of when calculating the profit or loss on disposal of the non-current asset. If you are talking about rounding errors here, don’t worry about these - NPV (however depreciation is calculated) is always only ever an estimation of the true economic value of the asset. As for calculating the effect of taxation and capital allowances when performing investment appraisal, this is covered in the examples given of investment appraisal techniques on pages 330 to 334 of the CIMA F3 study system.

**Question: (PE ratios in Mergers & Acquisitions)**

Under Mergers and Acquisitions, when two different PE ratios are given for the acquirer company and for the target company, and if the question asks to value the target company, but the question does not mention which PE ratio to use, do we have to select PE ratio of the acquirer based on the ‘bootstrapping’ effect or the PE ratio of the target company? How should I know what PE ratio to use in both cases of valuing the Acquirer and Target Company?

**Response from tutor:**

If there are two ratios given in the question, you will be told where these ratios have come from, and the examiner will expect you to use both of them in coming up with possible values for the target, before then discussing and justifying which value you think should be used. Valuing a target company is an art, not a science. See pages 265 to 281 of the CIMA F3 Learning System for a full discussion and worked examples of this.

**Question: (Effects of Taxation arrears and advance/ Cash flows)**

With particular reference to May 2008 Question 2, can you clarify when the liability to tax normally arises? The question reads in part ----“The entity is liable to tax at a marginal rate of 25%, payable 12 months after the end of the year in which the liability arises (that is, a time lag of 1 year). This rate is not expected to change.” If the tax depreciation is correctly allocated to year 2 onwards, the tax relief on maintenance should be allocated to year 3 onwards, because the maintenance is incurred from year 1 onwards but this is not the method adopted in the suggested solution. Similar wording is used in the May 2007 Question 2.

**Response from tutor:**

I think you have some confusion as to when cash flows are assumed to occur. 't1' means 'at the end of the first year', therefore both the tax depreciation and the maintenance tax relief should be
allocated to year 2 (as in the solution to the exam questions you cite), not to year 3 as you mistakenly suggest. See pages 330 to 334 of the CIMA F3 Learning System for further examples of how to correctly calculate tax relief.

**Question:** *(Working capital and DCF)*

Why is the working capital added back in DCF? Can you please help in demonstrating the logic behind this?

**Response from tutor:**

Working capital is simply another incremental cash flow that needs to be invested, in order to finance a project. If the average level of working capital of the organisation increases to allow an organisation to carry out a project, this increase is a relevant cost that needs to be added into our DCF calculation. At the end of the project, working capital reduces back to the level required for ongoing business activities - this is a relevant benefit used to reduce the incremental cash outflows at the end of the project.

**Question:** *(Foreign Currency)*

Please explain the terms appreciation, depreciation, strengthening & weakening of foreign currency with a simple example & necessary assumptions.

**Response from tutor:**

These terms are relative to another currency that you are examining. Say we are examining the relationship between the Euro and the US Dollar. I might quote a rate of EUR1:$1.4400 USD, for example.

'Appreciation' and 'strengthening' in this context would refer to the US Dollar, relative to the Euro. If the US Dollar was said to 'strengthen', or 'appreciate' (same thing), versus the Euro over the next month, this would mean one would get fewer US Dollars per Euro in one month's time from now. Perhaps the spot currency rate might be EUR1:$1.4100, for example. The purchasing power of the Dollar is increasing versus the purchasing power of the Euro, therefore our Euro purchases fewer items priced in dollars, yet the dollar purchases more items priced in Euros. By contrast, if the US Dollar was said to 'depreciate', or 'weaken' (same thing), versus the Euro over the next month, this would mean one would get more US Dollars per Euro in one month's time from now. Perhaps the spot currency rate might be EUR1:$1.4700, for example. The purchasing power of the Dollar is reducing versus the purchasing power of the Euro, therefore our Euro purchases more items priced in dollars, yet the dollar purchases fewer items priced in Euros.

You need to be able to discuss these terms in the context of the company in the exam question you are analysing. In the discussion below, I refer to 'USA' as short for, 'USA and also any of the many countries around the world whose national currency is pegged to the USD'. If the business is an exporter to the USA, or if it owns subsidiaries in the USA, then the weak USD is bad news, since it makes the profits earned (in USD) from American operations worth less when translated into home currency (e.g. GBP). If the business is an importer from the USA, then the weak USD is a good thing since it makes buying in American goods more profitable. If the business is a subsidiary of an American company, then it means that the American parent company enjoys income from abroad that is worth more when translated into USD.
Of course, the weakening USD will also have profound balance of trade impacts, both for the USA and also for countries trading with the USA, and the consequent inflationary and other macroeconomic consequences this will bring. The main impact of foreign currency in the operations of a business is to do with foreign currency risk. This risk needs to be managed via hedging of one sort or another.

**Question: (Valuation of a Company)**

When calculating the value of a company, what is the number of year cash flow to be taken for discounting purpose?

**Response from tutor:**

Depends upon the type of company, the planning horizon of the company, and the type of financing used to acquire the company. Equity financing is a form of perpetuity, and so it might be appropriate to use 5-8 years if such a planning horizon can be stated with any degree of confidence. Remember to discount the final year's cash-flow to infinity to estimate cash flows beyond this point. If using debt financing, look ahead as far as possible, but at least as far as the duration of the debt finance itself.

**Question: (Decision Tree)**

The decision tree is dependent on events and outcomes; I get confused in deciding between the two what are the main distinctive elements of an event is?

**Response from tutor:**

An 'event' is a point on a decision tree where two or more possible alternative courses of action can be taken. The probability of each course of action is estimated and placed onto the tree. An outcome is the end result of each possible sequence of events.

By multiplying the probability of each event in the branch leading up to an outcome together, the joint probability of that event can be estimated. These joint probabilities then be used to calculate the expected value of each outcome by multiplying the joint probability by the payoff from that event. This is an aid to forecasting and budgeting.

This topic is covered in more depth on pp 369-71 of the CIMA Official Study Text. Decision trees are not new for the F3 exam. The topic is covered in detail via the P1 syllabus, so you ought to have come across decision trees before.

**General Questions**

**Question:**

This query is for Management Accounting - Financial Strategy, but your reply may suitably apply to the other two papers of Strategic level. I want to understand the requirement of the examiner with regards to the length of discussion for questions that call for elaborations after numerical calculations. For example, we are asked to select the most appropriate means of finance for an entity and we are also supposed to discuss Venture Capital as one of the means available for the same. So, can we write a short note on this or we are supposed to write a detailed report?
Response from tutor:

There's no hard-and-fast rule as to the length of answer that you should create for any particular written question, whether or not the examiner has asked you to prepare calculations in advance. The best way to get used to the length of answer that you should produce is to practice lots of past exam questions for which you have the examiner's post-exam guide (PEG) (freely available at cimaglobal.com for all past exams). After you have attempted the question, look carefully at the PEG, to see whether all of the points that the examiner considers important are appearing in your answer.

Other general pointers to look for are these:
- Practice exam questions against the clock - 1.8 minutes per mark. Exam questions are designed to be attempted within this time limit. If you are consistently under- or over-shooting your time allocation, then you are either writing too little or too much.
- A good benchmark for written questions is to try to allow one paragraph, of 3-4 sentences in length, for each two marks of the question. Therefore a 10-mark written question would typically be around 5 paragraphs long.
- Another good benchmark to aim for is to try to cover one side of the answer booklet for each 5-6 marks of the question. Therefore a 10-mark written question would be around 2 sides of the answer booklet long.

Bear in mind these pointers should be adapted for your own personal handwriting size, writing style and the particular question you are attempting.

Question:
What questions and from which topics should candidates sitting for F3 paper expect?

Response from tutor:

It isn't possible for me to say which questions and which topics will come up for the May 2010 F3 paper. The only person that knows which questions will be on the exam paper is the examiner.

The best thing that you can do is study the whole of the F3 syllabus carefully, and practice plenty of past exam questions for this paper, both from the previous syllabus P9 exam and also questions from a good quality revision kit. Make sure you thoroughly analyse and rework the model answers after you have attempted each question yourself.

I can, however, give you some general exam technique pointers to help you with your question practice:

- plan your written answers before you start writing them;
- aim for one paragraph for every two marks;
- justify the points you make;
- use all the information in the scenario - it is there because the examiner expects you to use it;
- don't get 'bogged down' in the numerical questions, do what you can in the time for the question (1.8 minutes per mark) then move on;
- state the formulae you are using before using it;
- tabulate your numbers
- practice exam questions against the clock - 1.8 minutes per mark.
Exam questions are designed to be attempted within this time limit. If you are consistently under or over-shooting your time allocation, then you are either writing too little or too much;

- a good benchmark for written questions is to try to allow one paragraph, of 3-4 sentences in length, for each two marks of the question. Therefore a 10-mark written question would typically be around 5 paragraphs long;
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Bear in mind these pointers should be adapted for your own personal handwriting size, writing style and the particular question you are attempting.

**Question:**

General question about strategies, specifically for F3. Why are some of the questions - notably calculations - not answerable within the time limit given?

On the pilot paper was a table of fixed and variable interest rates, and I attempted to work backwards to find the individual amounts. However, from the answer, it was not meant to be analysed numerically, so that is not very fair to those who attempt to do so.

**Response from tutor:**

You asked two questions.

1. Why are some of the questions - notably calculations - not answerable within the time limit given?
   I'm not sure that this is the case. All exam questions for all papers go through a comprehensive moderation process whereby CIMA checks that the questions are fair, and are possible to be attempted within the time available for the exam.
   If you are having problems answering questions within the time available, I would suggest that this is for one of two reasons:
   
   (a) You are reading too much into the question, and attempting to make your answer more complex than needs be.
   (b) You have poor time management skills.

   Either way, the solution to these issues is to practice lots of past questions for this paper, both from the previous syllabus P9 exam and also questions from a good quality revision kit. Make sure you thoroughly analyse and rework the model answers after you have attempted each question yourself. Also practice exam questions against the clock - 1.8 minutes per mark. Exam questions are designed to be attempted within this time limit. If you are consistently under or over-shooting your time allocation, then you are either writing too little or too much.

2. On the pilot paper was a table of fixed and variable interest rates, and I attempted to work
backwards to find the individual amounts - however, from the answer, it was not meant to be analysed numerically, so that is not very fair to those who attempt to do so.

Again, I’m not sure that this is the case. As mentioned above, exam questions for all papers go through a comprehensive moderation process whereby CIMA checks that the questions are fair, and are possible to be attempted within the time available for the exam. Part of the reason tutors like me suggests that you do lots of past questions for this paper is so that you can analyse carefully the model answers given. Now that you have tried the question you mention in the incorrect manner, and analysed the model answer carefully, you won’t make the same mistake if a similar question comes up in the future.

Good luck for your exam.

Additional response from the P3 Tutor.
With the strategic papers there is always going to be more information available than time allows you to use. What you need to be able to do is make decisions on prioritising what you want to include in your exam answers. This mirrors what happens at this level in the real world and will also be the case on the T4 examination. It is advisable to practice as many past questions as possible under timed conditions to help build up speed and force you to make these decisions more regularly so that you become more comfortable in the examination.

**Question:**
Is it acceptable that answer plans are written in English? I intend to use mind maps / Spider diagrams to plan my answers for the Financial Strategy paper in May.

**Response from tutor:**
Yes, your answer plans should be written in English. You can use whatever method you like to construct answer plans:
• Bullet pointed list;
• Mind map;
• Spider diagram, etc.
What really matters is the answer you then construct using the answer plan.

**Question:**
For paper F3 November 2010 exam, will the exchange rates format be A1-B5 with the base currency being A1 and B5 being the quoted currency according to international format as explained in the financial management magazine in June 2010, or format for exchange rate for exams being B5-A1 with B5 as quoted currency and A1 as base currency?

**Response from tutor:**
I have no better idea than you as to what will be in the F3 November 2010 exam. I am not the examiner, and even if I were, I still would not be able to tell you what is going to be in the exam. I will offer the following advice:

(i) Articles in FM magazine are written deliberately to give you help and guidance in preparing for your exams. I would read the article you cite carefully and ensure you understand it.
(ii) You should be able to deal with foreign currency questions using any format of quotation given to you. This is not supposed to be an easy exam!
Question:
I do a lot of practice on past papers and feel confident going into the exam, but my nerves get the better of me when I get in the exams and end up with very disappointing marks. I do a home study using CIMA and other materials. Please can you tell me how I can improve on my marks in May.

Response from tutor:

The best thing that you can do is study the whole of the F3 syllabus carefully, and practice plenty of past exam questions for this paper, both from the previous syllabus P9 exam and also questions from a good quality revision kit. Make sure you thoroughly analyse and rework the model answers after you have attempted each question yourself.

I can, however, give you some general exam technique pointers to help you with your question practice:

- plan your written answers before you start writing them
- aim for one paragraph for every two marks
- justify the points you make
- use all the information in the scenario - it is there because the examiner expects you to use it
- don't get 'bogged down' in the numerical questions, do what you can in the time for the question (1.8 mins per mark) then move on
- state the formulae you are using before using it
- tabulate your numbers
- practice exam questions against the clock - 1.8 minutes per mark. Exam questions are designed to be attempted within this time limit. If you are consistently under- or over-shooting your time allocation, then you are either writing too little or too much.

A good benchmark for written questions is to try to allow one paragraph, of 3-4 sentences in length, for each two marks of the question. Therefore a 10-mark written question would typically be around 5 paragraphs long.

Another good benchmark to aim for is to try to cover one side of the answer booklet for each 5-6 marks of the question. Therefore a 10-mark written question would be around 2 sides of the answer booklet long.

Bear in mind these pointers should be adapted for your own personal handwriting size, writing style and the particular question you are attempting.

Question:
I want to know the key strategy how to pass strategic level exams or what's the effectiveness of reading and understanding of past papers.

Response from tutor:

The best way to pass the strategic level exams is to be as prepared as it is possible to be before going into the exam room. You should be confident in both your exam technique, and in your syllabus knowledge. The solution to both these issues is to practice lots of past questions for this paper, both from the current syllabus and from the previous syllabus P9 exam, and also questions from a good quality revision kit.
Make sure you thoroughly analyse and rework the model answers after you have attempted each question yourself. Also practice exam questions against the clock - 1.8 minutes per mark. Exam questions are designed to be attempted within this time limit. If you are consistently under- or over-shooting your time allocation, then you are either writing too little or too much.