

## FEEDBACK ON SPECIFIC QUERIES RAISED FOR NOVEMBER 2012 SESSION

### **P1, Performance Operations**

#### **Question 3**

##### Students/Tutor query:

Almost all students do not understand the residual (re-sale) value of new digital equipment. They think it is too immaterial/low as expressed in thousands (20,000) and it is incomparable with the RV of existing equipment (in millions) and cost of investment. Also economy from existing equipment is in thousands and also incomparable. As a result they receive inevitably negative NPV. They discuss that they have never come across similar question in the books and other resources and it is a typo. Unfortunately tutors share same approach and tell them it is an error and expect official response from CIMA. Some students presented 2 scenarios for calculations and hope it will be positively marked or skipped this question as they thought it is a clear typo.

##### CIMA response:

Irrespective of what figure is given, they should have used the figure that was supplied in the question. In reality, just as in this question, the resale value would be a guess at what the market would be prepared to pay in the future. The new digital machine is new technology and this no doubt will be improved on as soon as you have signed the purchase order (a comparable real-life example would be the mobile phone industry - what version of the i-phone are we now on in just a short time-period?). Consequently it is doubtful that there would be much demand for out-dated digital x-ray equipment (as a comparative real-life example, try selling a 5 year old digital camera!). Also the chips used in digital technology have a limited life. For example, the chips in digital cameras have a fixed guaranteed life (a stated number of exposures). Therefore the number of x-rays taken and the availability of new technology will impact on the resale of the machine. The accountant for the hospital will have taken those factors into account when estimating the resale value.

The machine savings should be over \$1,250,000 each year with at least 40,000 patients @1.2 x-rays @\$25 and the figure increasing each year in addition to the salary savings. If candidates are getting savings in thousands it suggests that they have failed to include the cost of the film used in the old machine that is not used in the new machine, but the question clearly states that the new machine requires no film so it is clearly a saving. They should get a negative NPV - this doesn't mean the answer is incorrect but means that the hospital shouldn't buy the new machine.

It is very perplexing, and a serious concern, that candidates have not seen a negative NPV. Are all projects in Russia feasible? The decision rule when performing project appraisals using NPV (which is the theoretically superior method) is that from a financial perspective only projects that have a positive NPV should be undertaken. If negative NPV's did not exist the rule would be meaningless!

Tutors should consider a range of business situations when teaching NPV.

## P2, Performance Management

### Question 1

[Students query:](#) Did not understand the question requirements.

#### **CIMA Response:**

Part (a) was a straight-forward budgeted profit question. Part (b) called for basic maths/management accounting skills. The question required candidates to calculate the revised profit arising from bundling (packaging) of A and B together, and then consider the revised breakeven point for the company. Packaging of A and B, as AB, would improve the overall contribution/sales ratio, lower the breakeven revenue and increase profit. Part b(ii) required the candidate to consider the sensitivity of the selling price of AB. Bundling A and B as AB offered a saving of \$40 to the customer, but would it be attractive to those customers who originally only wished to buy product A? There could be an adverse reaction from such customers. Candidates needed to discuss this. The question is straightforward and deals with relatively easy concepts.

### Question 4

[Student query:](#) Suggestion that this covers P1 syllabus content.

#### **CIMA Response:**

Question 4 is intended to cover aspect of syllabus section C, Lead area 2, component C. Please also note that subsumed knowledge from the lower levels of the syllabus is assessable at the higher level.

### Question 7

[Student query:](#) Did not understand question requirements.

#### **CIMA response:**

Parts (a) and (b) are straightforward in their requirements. Part (c)(ii) requires the candidate to show the impact of the age of the assets and the depreciation policy by adjusting the financial statements of Y to be comparable to Z". Candidates needed to read the extracts from the Financial Statements of the two companies carefully. Note (2) of the Financial Statements states that "both companies use the group depreciation policy of 20% per annum on a reducing balance basis for their non-current assets and that neither company made any additions or disposals of non-current assets during the year. Further direction was given in the question itself: "show the impact of the age of the assets and the depreciation policy...".

Candidates needed to calculate ROCE ('with transfer' for Y and Z, and 'without transfer' for Y; there is nothing to imply that Z could have obtained goods from elsewhere.). Based on the original figures Y is generating significantly higher ROCE than Z. It is doing this by a higher profit margin and a higher asset turnover, as the secondary ratios show. If the internal transfers are eliminated from the results

of Y it can be seen that the ROCE of Y is still better than that for Z. Although the profit margin has fallen the asset turnover is still much higher than it is for Z.

Z has a 6% long term loan and consequently must bear the interest charges. It has an interest cover of 2.8 times.

The profiles of non-current assets are different for the two companies. The net book value of the assets in Y are only 26.21% of their original value whereas for Z they are 64%. This shows that the assets have been depreciated by only 2 years in Z but by 6 years in Y. This would boost the ROCE for Y.

Recalculating the depreciation for Z to match that of Y (i.e. to the second year) will impact on the depreciation charged in the income statement and on the asset value. The resulting revised performance ratios for Y indicate that the ROCE and profit margin for Y are lower than those of Z.