

**Subject CA2 —
Model Documentation, Analysis and Reporting**

EXAMINERS' REPORT

Project SB01

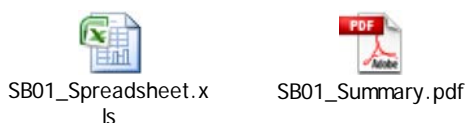
Introduction

The attached subject report has been written by the Principal Examiner with the aim of helping candidates. The specimen solutions are based on one possible approach to modelling the project set but the examiners gave credit for any alternative approach or interpretation which they considered to be reasonable.

R D Muckart
Chairman of the Board of Examiners

June 2010

A possible model with audit trail is included in the Excel file and a possible summary is included in the PDF file. These are not intended to be model solutions. In practice a wide number of solutions was acceptable.



Technical Approach

Candidates were required to model the (highly simplified) cashflows of a mobile phone provider over a 10 year period.

Candidates had to choose whether to model the cashflows on a monthly or on an annual basis. Either approach was acceptable although a monthly approach would have been easier to implement, particularly in looking at the different alternative scenarios that had to be modelled. If an annual approach was adopted, then a key assumption required was on the timing of the cashflows in a calendar year. Many candidates did not discuss this assumption in either their audit trail or summary; this is a material assumption since the use of a 10% discount rate gives very different answers depending on when cashflows are assumed to occur and some commentary is appropriate.

The data was given as at 30 June 2009 with the requirement to discount the future cashflows from 1 January 2010 (the proposed acquisition date). Many candidates failed to allow properly for a roll forward of the data to 1 January 2010, even when some used the simplistic assumption that contracts could only be cancelled at the beginning or end of a calendar year. The data was given as at 30 June in the expectation that those candidates who chose to project on an annual basis would project the number of contracts as at the middle of the following calendar years.

Other important assumptions to make were on the level of tax to be paid and the assumed rate of inflation. Better scripts justified these assumptions by reference to the material in the question.

Most candidates managed to model the base case cashflows to obtain the base price requested and the impact of implementing a new administration system. In documenting their approach in either the audit trail or in the summary, a number of candidates did not discuss how the number of phone contracts in force was projected. This is an important part of the model and an explanation was expected in each document.

The modelling of the proposal to close the cheaper phone tariffs and to switch customers to the more expensive packages was not well handled. A high proportion of candidates failed to model this appropriately and the explanations in both audit trail and summary were mostly very poor.

A number of candidates omitted the payment of the base price in calculating the internal rates of return, often getting results for the internal rate of return that were completely unreasonable compared to the net present values already calculated. Even if the internal rate of return was calculated correctly, very few candidates made any meaningful comments on

whether the results reconciled with the initial discount rate given and the movements in the net present value using the initial discount rate.

The additional information required candidates to model the impact of a loan being used to provide part of the purchase price. Not all candidates managed to do this, or complete it, and some did not realise that the receipt of the loan would affect the purchaser's initial outlay and the resulting internal rate of return. Few candidates commented that taking out a loan at an interest rate lower than the discount rate used to value the initial cashflows would increase the internal rate of return due to the gearing effect. As part of the next steps, many candidates suggested that cheaper financing should be sought from other banks, apparently forgetting that the assignment background stated that they were employees of the bank offering the finance.

Having completed the base scenario many candidates copied the original formulae before modifying some cells for the new scenarios. This is a poor practice since any changes needed to the original formulae would need to be made to subsequent work as well. A better (and quicker) approach was to refer to the results of the original calculations as much as possible. This was particularly relevant in the loan scenarios.

This assignment gave a lot of scope for suggested next steps. However, many candidates made suggestions that were not related to the model itself or to the calculation of a possible purchase price. Discussion of personnel problems on integrating the two companies, competition issues and the like were irrelevant to the modelling exercise set and did not score any marks.

END OF EXAMINERS' REPORT