

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 5 December 2019

Section 1

General comments

The December 2019 paper covered both comprehensive quantitative and qualitative questions which required Candidates to be capable of applying the concepts in the questions. Candidates who have prepared thoroughly in the coursework should meet the basic expectations required in the examination.

Section 2

Analysis of individual questions

Question 1

Question 1 tested the fundamental concept of Net Present Value (NPV). The question tested Candidate's knowledge on computation of nominal sales revenue as well as the respective cost of the projects as well as the computation involved to derive the NPV of the project.

Part (a) required Candidates to calculate the Sales Revenue and the respective cleaning and labour costs for each of the year. Most Candidates managed to answer the question well. Some Candidates may have made some errors in computation or failed to account for inflation for every year.

Part (b) required Candidates to come out with the computation of the Net Present Value of the project. Candidates performed well for this question part and a few Candidates managed to get full marks for this question. Candidates who scored very well for this question demonstrated strong conceptual knowledge in deriving the NPV of the Project.

Common mistakes that Candidates made were:

- included working capital changes as part of profit before tax (working capital is a non-taxable item)
- calculated balancing charge for the asset at Year 4
- included the full 10% of sales as working capital in cash flow movement, instead of just the change in working capital during the year and
- not accounting for the working capital change in the year prior to it (i.e., first working capital build-up should occur in Year 0).

In addition, some Candidates failed to account for the wage cost for the four employees as they only calculated for one. The above mistakes resulted in loss of marks.

Question 2

Question 2 was a mixture of quantitative and qualitative questions which required Candidates to compute Net Present Value of cash flows as well as discussion of advantages and disadvantages of Organic Growth vs Acquisition.

Part (a): Candidates demonstrated the ability to compute the NPV of cash flow and were able to apply a discount rate by the appropriate discount factors. Most Candidates managed to get the correct answer. Only a handful of Candidates did not manage to get the Year 4 net cash flow figure correct, as they may have been confused with the cash flow of Year 4 as well as the terminal value involved.

Part (b): Most of the Candidates were able to choose the correct options by comparing option 1 and option 2. However, they did not manage to give concrete additional factors and hence the performance for the question was moderate. Most Candidates provided justifications that did not address the question directly and the explanations often showed lack of reasonableness as well as elaboration. There were some Candidates who provided repetitive answers and hence were not awarded points.

Part (c): This question tested the Candidates on the advantages and disadvantages of organic growth vs growth by acquisition. Most Candidates displayed appreciation and understanding of the topic in question and have provided adequate and sound justifications. For advantages, most Candidates were able to identify culture and familiarity of the business as a factor. For disadvantages, most Candidates cited expertise and time to expand business as the reason. However, the Candidates were not able to elaborate mainly due to time constraints under exam conditions. The Candidates would have been awarded more points if elaboration to their justifications was provided or avoided providing generic or repetitive justifications.

Question 3

Question 3 is a question which tested the concept as well as the computation of Weighted Average Cost Of Capital (WACC).

Part (a): Most of the Candidates demonstrated strong concepts of WACC (equity, bank loan and preference share) were able to derive the correct computation. It was noted that some Candidates did not use the NPV method to compute the cost of capital for preference shares. The concept of IRR was also weak, some Candidates attempted to find IRR when both NPV points are positive.

Common mistakes by the Candidates included using the wrong share price in the computation as they should have deducted the dividend of \$0.50 in the computation. In addition, the cost of preference shares was computed wrongly by most Candidates as they either took the wrong present value or did not even include the present value or discount factor into consideration when computing the cost of preference shares.

Part (b): This question required Candidates to compute the revised WACC which most Candidates managed to perform well and were able to compute the cost of financing for each component of the equation. However, some Candidates made the mistake of not separating the new loan and the old loan.

The presentation of the answers could be improved as the workings and figures presented were scattered. Candidates should adopt a more structured presentation format. The PV tables were given; however, some Candidates used financial calculators and did not show workings.

Part (c): Most Candidates were able to identify that the WACC had reduced due to a lower cost of debt as compared to lower cost of equity. However, there were not many Candidates who were able to infer that the revised cost of capital was reduced partly due to a worsening credit rating which increased the cost of individual sources of finance.

Question 4

Question 4 mainly tested the concept of financial ratios as well as to evaluate between a conservative versus an aggressive financing policy.

Part (a): This was the best answered question, with many Candidates scoring full marks. Of those who did not, common mistakes made were:

- Calculated the cost of sales as (gross margin * sales) instead of $(1 - \text{gross margin}) * \text{sales}$.
- Calculated the length of working capital cycle as “receivables days plus inventory days plus payables days” (instead of “receivables days plus inventory days minus payables days”)

Part (b): This question required Candidates to discuss the implementation mechanics of the new operating policies and any concerns they may have with the new policies.

Some Candidates did not answer this question. Among those who did, there was generally inadequate exploration of the issues relating to each of the components of the working capital cycle, receivables days, inventory days and payables days.

Part (c): Candidates were required to calculate and compare the short-term vs long-term loans needed under each financing policy, assuming the current operating policies remain in place.

A key mistake made by Candidates was failing to note the condition “assuming current operating policies remain in place”. Some Candidates used the new operating policies to calculate the short and long-term loans under the new financing policy.

Part (d): This question required Candidates to discuss two risks and two benefits of an aggressive financing policy.

The most common mistake was failing to discuss the financing aspects of the new aggressive financing policy with regard to a shift from long-term finance to a mix comprising of 75% short-term and only 25% long-term finance.

Several Candidates discussed working capital cycle without reference to financing issues and wrote out of point.