

## SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

**MODULE:** Financial Management (FMF)

**EXAMINATION DATE:** 8 December 2020

### **Section 1**

#### **General comments**

The December 2020 Financial Management exam is a well-structured and comprehensive paper. This paper tests the fundamental knowledge of Financial Management and comprises a good combination of both quantitative and qualitative questions. This paper required Candidates to apply the concepts in attempting the computational as well as theoretical questions.

The overall performance of the December 2020 paper was satisfactory and comparable to the previous examination session. Candidates were able to answer the basic Financial Management computations, however very few did exceptionally well. It was observed that Candidates were unfamiliar with some topics in the paper, such as the Baumol model of cash management and Risk management.

Candidates could improve on their application of knowledge in the qualitative aspect of the paper by reading the requirements of the questions carefully and elaborate on their arguments with specific recommendations. Candidates could also improve on their time management skills in the examination and be more systematic in presenting their answers. This can be done by having a strong concept in Financial Management theories in the syllabus and be exposed to more practice questions.

### **Section 2**

#### **Analysis of individual questions**

##### **Question 1**

Question 1 tested the Candidates on the different types of foreign exchange risks, cash flows computation as well as hedging methods towards foreign exchange exposure. Most Candidates managed to pass this question.

For **part (a)**, most Candidates have shown a good understanding of the various types of forex risk. However, Candidates were not able to score for this question due to a lack of application to the project in the question. A few Candidates have failed to answer the requirements of the question.

Approximately half of the Candidates did not score well for **part (b)** of the question.

The following observations were noted:

- Price increase and cost inflation (both variable and fixed costs) for revenue and costs are compounded from Year 1 instead of starting from Year 2.

- Variable costs being taken as 30% of revenue instead of 70%.
- Some Candidates factored in an additional general country inflation to the sales and costs calculated, therefore overstating the amounts.
- Lack of understanding of concept of interest rate parity.
- Many Candidates were used a single exchange rate for INR: SGD conversion for all years.
- A few Candidates compounded the scrap value at Year 4.
- Many Candidates failed to provide comments on the project, which is part of the question requirements.

**For part (c),** most Candidates have shown good appreciation of this question but failed to provide the required recommendation, hence many did not manage to score full marks. A few Candidates provided suggestions that were not forex risk-related, such as interest rate risk. These Candidates were not awarded marks.

## Question 2

Question 2 tested on the concept of weighted average cost of capital and the 3 theories of capital structure - Modigliani and Miller Theorem (with and without tax), and the Traditional view (trade-off theory). Candidates performed reasonably for this question.

**Part (a)** required Candidates to calculate WACC for a company.

The following observations were noted:

- Candidates failed to adjust for the share consolidation and hence, failed to correctly calculate the growth rate of dividends.
- For those who correctly calculated the growth rate of dividends, calculated the cost of equity incorrectly. Many Candidates forgot that the dividends were expressed in cents and failed to adjust the stock price accordingly to cents.
- A handful of Candidates failed to show working for IRR which resulted in reduction of marks. For those who used the IRR estimation method, many forgot to take the after-tax cost of interest and used the before-tax cost of debt in the cash flows instead.
- Most Candidates were able to correctly obtain the market values of equity and the convertible debentures.
- Majority of the Candidates correctly applied the formula to calculate WACC.

**Part (b)** required Candidates to consider all 3 theories of capital structure to determine the effect that financing with debt will have on the company's WACC. This is a qualitative question and many Candidates seemed to have regurgitated the course material. Answers tend to be very straight jacketed. Very few Candidates succinctly addressed the question in their own words to apply it to the case company. Candidates did reasonably for this question part.

The following observations were noted:

- Candidates failed to discuss the 3 theories and not distinguishing among the 3 theories.
- Candidates failed to apply the theories to the case company.
- Majority failed to calculate the gearing level of the case company and apply it to the theories discussed.

### Question 3

Question 3 tested the concept of cashflows and the Baumol model. It was a mixture of quantitative and qualitative questions.

For **part (a)**, many Candidates managed to get the right cash inflow from sales. However, the section on payment for purchases was weakly addressed. Many Candidates erroneously used a proportion of sales instead of cost of sales to compute the inventory levels. Several Candidates failed to show adequate workings on how they obtained their purchases. The Candidates generally answered the parts on overheads, dividends and new equipment purchases well. Some Candidates failed to show the opening cash balance and closing cash balances of the respective months or named their cash balances erroneously as net cash flows.

In general, it would be better if Candidates showed their workings clearly and separated into different sections, such as having one overall cash flow statement, and separate sections for purchases computations etc.

For **part (b)**, several Candidates did not use dividend or equipment purchase delays, which are the most relevant and direct answers in addressing the cashflows shortfall.

Candidates have a mixed record in addressing **part (c)** of this question. Several Candidates were not familiar with the Baumol model and left the question blank or answered it incorrectly. However, for those Candidates who know the Baumol model generally did well for this question part.

For **part (d)**, a handful of the Candidates left the question blank or answered it wrongly. Those who attempted this question part only listed the assumptions but failed to provide an assessment of the assumptions.

### Question 4

Question 4 tested the Candidates ability to assess certain fact patterns of the case and to apply his/her learning of various concepts, ideas, and principles of risk management to the instance of an entity that provides satellite relay communication services by placing equipment on the moon for such purposes. This was the worst performing question of the paper. There were several Candidates who did not manage to attempt parts of the question due to poor time management.

Overall, the answers to all four parts of this question were weak, with most Candidates being unable to correctly respond to the impressions of the various actors in the case with regards to risk management concepts and principles. No parts of the question were particularly well answered.

**Part (a)** required an explanation of the distinction between risk and uncertainty and a response to the HR director's comment. A fair number of Candidates were able to correctly point out the difference between the two concepts, while some could only explain one of the two concepts with little clarity. Most Candidates did not provide a response to the HR director's point about risk and uncertainty.

For **Part (b)**, the following observations were noted:

- No Candidates mentioned that investing means moving funds from a low risk to a high-risk position. However, many Candidates were able to connect risk to the reward aspect and why investors would demand a high return for taking on high risk.
- A substantial number of Candidates were able to provide one or two explanations for why controls could not be entirely effective while only a few could provide three on point reasons as required by the question. Many Candidates did not address the question and merely repeated the point quoted in the question that robust controls cannot eliminate risk.
- Many Candidates were able to articulate the difference between risk appetite and risk capacity. Some could only define one of these concepts while others confused both.
- While many Candidates could provide the general position of the risk reward trade-off, only a few could point out that the subject company was in a high-risk industry and therefore would naturally have a high-risk threshold.

For **part (c)**, the first part of the question was mostly off-point or not addressed at all. Only a few Candidates could explain the reasons why risk management should be embedded within the business. The responses for the second part was mixed. Some Candidates could provide explanations for how this could be done. Many Candidates provided general boilerplate answers about the risk management process and risk management setup in an organisation.

For **part (d)**, the question for the development process risk was not very well answered with many Candidates not being able to provide the risk assessment and leaving out the appropriate course of action to address this risk altogether. The answer to the risk assessment for rocket fuel price increase was mixed but the risk response was very well answered with a large majority Candidates citing hedging as an appropriate risk strategy to mitigate the risk of fuel price increases.