

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

**MODULE:** Financial Management (FMF)

**EXAMINATION DATE:** 18 June 2018

### **Section 1**

#### **General comments**

Overall, this cohort did well. The FMF examination continues to be a restricted open book format with Candidates being able to bring in a double-sided A4 page of personal notes for reference.

While Candidates more readily attempted quantitative questions, not all Candidates scored well. Candidates who scored well on qualitative questions tended to do better overall and usually passed the examination.

Generally, it has been observed that Candidates who did not score well on qualitative questions, tended to earn marks for their quantitative answers but still struggled to pass the examination overall. On qualitative questions, weaker Candidates tended to waffle, instead of discussing the main content as required by the question. A small number of Candidates provided some good examples and were awarded higher marks.

Notably, there was another category of very poorly prepared Candidates who scored very low consistently across the paper. This is most likely a function of poor time management and inadequate preparation.

### **Section 2**

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

#### **Question 1**

The case focused on a Singapore company looking to expand overseas and tested Candidates on various issues relating to the acquisition of a foreign private company operating in a similar industry.

**Part (a)** had three sub-sections requiring Candidates to calculate the estimated Japanese Yen (¥) valuations for one ordinary share in the target company using the following methods:

- (i) Revised (revalued) net assets;
- (ii) Price/Earnings (P/E); and
- (iii) Dividend discount model.

For (i), most Candidates did well, scoring nearly full marks, with the majority passing this part.

In relation to the P/E valuation in (ii), many Candidates did not deduct the once-off profit of ¥40 million (the sale of a waterfront property) to obtain the underlying earnings. Another common mistake was not discounting for the unlisted status of the target entity, even though the case facts stated that a 30% discount was considered appropriate. A downward adjustment was required to allow for the fact that private company shares usually have a much lower value than comparable shares in quoted (listed) public companies. Candidates should ensure that they read the requirements carefully – the question required value per share, not value in total and so lost marks. Additionally, Candidates should ensure they show their workings, as these interim calculations can often be awarded some marks even if the final figure is incorrect.

For (iii), common mistakes in this sub-part were:

- Use of an incorrect discount rate; and
- Not using the following year's dividend as the input into the Gordon's Growth model.

Throughout **Part (a)**, most Candidates omitted to state simple assumptions, which cost them some marks, even though the question specifically asked for assumptions to be stated. For instance, in (a)(ii), an adjustment to profit was required due to a once-off transaction in 20x8. In this instance, the key assumption to state in your answer (or your advice to your client/employer) would be that you have assumed that this was the **only** transaction for the year that needed adjusting.

In **Part (b)**, Candidates tended to be brief and general in their answers. Many Candidates failed to discuss the full implications of taking up a specific hedge. Again, Candidates need to read the question carefully. Discussion of only one hedging method was asked for but several Candidates discussed more than one type of hedge. For two marks, a little more than just identifying a method by name was insufficient – an outline of how the hedge works, and its advantages and disadvantages in brief was required.

Overall, Candidates performed badly for **Part (c)**, indicating that they are unable to handle questions that introduce an element of complexity and/or ambiguity in relation to cash flows and valuations.

Candidates were unfamiliar with the two-stage dividend discount model examined in **Part (d)**. While many Candidates were able to calculate the terminal value, they incorrectly showed it as the share value without discounting, and completely ignored the first three years of dividends. Some Candidates did not recognise that the terminal value was the present value of the expected dividends in perpetuity.

## Question 2

This question was both qualitative and quantitative requiring Candidates to apply basic valuation methods to a start-up technology business in Singapore.

Adequately prepared Candidates generally did well for **Part (a)**, except some Candidates lost marks for careless calculation errors. Most Candidates could demonstrate that they knew how to apply the formula for the weighted average cost of capital (WACC).

**Part (b)** was a relatively simple requirement asking Candidates to comment on their calculation in Part (a). Only a few Candidates gave strong enough answers to pass this part. Most Candidates were unable to provide sufficient points, with most Candidates providing three to four points only. This outcome suggests that while most Candidates were able to compute the WACC correctly, they had limited or no understanding of the assumptions underpinning its usefulness or the limitations of its application.

Most Candidates were able to get the basics correct in **Part (c)**, but easy marks were lost for not incorporating capital allowances into their calculations. Also, most Candidates did not calculate the working capital requirements from the 2<sup>nd</sup> year onwards correctly. Most Candidates used the gross working capital requirements instead of the incremental working capital amount.

## Question 3

The case presented a common scenario where a young entrepreneur's business was growing rapidly and was profitable but there was insufficient cash available to keep the business running. Most Candidates generally answered Question 3 well.

Typically, Candidates were able to compute the cash conversion cycle correctly and provided relevant comments on the impact of changes of each component in **Part (a)**, but Candidates let themselves down with poor qualitative answers in Part (b).

In **Part (b)**, most Candidates could not provide a coherent explanation as to why the business was struggling for cash when it was profitable, but only outlined one or two factors in a general way. For instance, most Candidates suggested over-trading as one of the explanations but overlooked the fact that cash was used in investing activities and the payment of interest on the bank overdraft. Even fewer Candidates thought to use the cash flow statement method to demonstrate the change in the cash balance. While reconstructing the cash flows was not essential, Candidates could have used this computational method as an alternative way to illustrate the movements in cash.

There were adequate and reasonable responses for **Part (c)** and most Candidates were able to provide three possible ways the business could better manage its cash flows, so they did well for this question part.

#### Question 4

The focus of this question was risk management and the application of the *Singapore Code of Corporate Governance*. The case company was a family-run business with ambitious expansion plans, including listing on the Singapore Exchange (SGX). The quality of the answers for this question were mixed.

For **Part (a)**, most Candidates gave reasonable solutions but few Candidates scored the full four marks, even though this was a relatively simple question part. Some Candidates misunderstood what was required and proceeded to write solely about the COSO framework, which was only one aspect of how risk management should be implemented in a company listed on the SGX.

In **Part (b)** most Candidates did not give clear explanations of the meaning of low risk appetite and so they were unable to then describe the likely risk appetite of the case study company.

Generally, Candidates did not explain the difference between operational risk and strategic risk well, despite **Part (c)** being a definition type of question. Candidates were also not able to comment adequately on the Board's view that operational risks *'just need to be dealt with as problems arise'*.

In **Part (d)**, most Candidates could provide the basic actions required and scored at least a pass for this question part. However, for **Part (e)**, Candidates tended to just list out the attributes in terms of severity and impact but few Candidates were able to then relate their commentary back to the case facts. Nonetheless, most Candidates discussed the 'Transfer, Accept, Reduce, Avoid' (TARA) model at length and scored fairly well.