Chartered Accountant
SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Business Value, Governance & Risk (BG)

EXAMINATION DATE: 11 December 2018

Section 1
General comments

This examination consisted of a single case study with financial and industry data. Considering the nature of the topics examined in this module, the question paper was divided into two sections of equal weight.

The case study company was a medium sized designer of microchips, manufacturer and retailer of a low priced range of personal computers which targeted predominantly the Singapore market. The company planned to divest its manufacturing site to fund international expansion.

Governance & Risk component – Questions 1 and 2 (50 marks)

Question 1 covered corporate governance while Question 2 covered risk management. Generally, Candidates fared better in Question 1 as compared with Question 2 because Candidates could refer to the code of corporate governance to provide the appropriate answers. However, for both questions and similar to the past examinations, there were Candidates who did not read the questions carefully and therefore marks were lost. Some Candidates also provided very general/ generic answers to questions that were not relevant to what was being asked.

Business Value Component – Questions 3 and 4 (50 marks)

Question 3 tested Candidates on determining a risk adjusted rate of return to evaluate the value of its manufacturing subsidiary and recommend a range of valuations to the Board of Directors, value additional possible synergies and explain the merits and demerits of the methods of valuation specified by the scenario. Overall, the question was adequately answered with numerical works methodically completed, although it was observed that some Candidates struggled to get started. The higher skill of relating the valuation findings to the Board of Directors and linking to a negotiation strategy was less well done overall. The majority of Candidates could improve their consideration of the implications of their results to the company in the scenario and use judgements to determine a suitable starting point for negotiation.

Question 4 assumed that the company was now in a position to acquire a new start-up company which has technology which fits with the company's strategic aims. This question required three straight forward valuation methods to be computed which in many instances were poorly answered as it was clear Candidates were not well-prepared. For example, many Candidates were not able to value intangible assets using the premium method.

Overall, for this paper, Candidates performed better for the Business Valuation portion than they did for Governance and Risk portion.

Future BG Candidates are advised to understand and practice all valuation methods included in the BVGR Study Text as these skills are vital to the ability of appraising the value of an asset, project, subsidiary or company.

Section 2
Analysis of individual questions

Question 1

There were 3 parts to this question. Candidates were required to assess the independence of the candidates who were proposed by the non-independent Chairman to replace the current retiring independent directors (IDs); to comment on the current selection process for the IDs; and on board diversity.

Part (a): Most Candidates fared well on this question. Candidates were able to quote the relevant SGX rules on independence and to comment on whether the nominees were independent. However, some Candidates did not read the question carefully and commented instead on the independence of the current board.

Part (b): Candidates did reasonably well on this question and were at least able to mention that the Nominating Committee (NC) should carry out a process to select the candidates to replace retiring board members instead of accepting only those provided by the Executive Chairman. Most Candidates were also able to mention that the lead independent director should be a member of the NC.

Part (c): This question was well answered. Candidates had demonstrated their understanding of the requirements over board diversity such as age, industry experience and gender.

Question 2

This question is about risk management with a focus on managing risks during a crisis. There were 4 parts to this question, all of which focused specifically on the case scenario. Most Candidates did not do well in all 4 question parts, reflecting a weak understanding of risk management. Similar comments about Candidates' weakness in risk management knowledge were also made in past examiner's reports. This has consistently been the weakness area of Candidates over the past few exams.

In all 4 question parts, many Candidates did not provide answers relevant to the case scenario but provided generic answers.

Part (a): This question required Candidates to identify possible actions in relation to the crisis that management could take to alleviate the potential disruption. Candidates who were able to identify specific actions were awarded marks. Some Candidates discussed general enterprise risk management (ERM) or risk

management concepts instead of specific actions. No marks or poor marks were awarded for these answers.

Part (b): Candidates had to comment on the Chairman's statement on whether this crisis was unforeseen. Candidates who took a firm position, i.e. agree or do not agree, were given marks for their respective discussions. Some Candidates sat on the fence and would agree and then disagree. No marks or low marks were awarded for such answers.

Part (c)(i): Candidates had to identify the new or emerging risks arising from the collapse of the shipping company and briefly discuss why these risks were significant. A large number of Candidates described generic risks which was not directed at the specific event, and were not awarded marks.

Part (c)(ii): Candidates had to identify factors that have contributed to the crisis in the company, and the corresponding mitigating measures that management should take to become more resilient in a similar crisis in the future. Again, a number of Candidates failed to identify the appropriate factors or mitigating measures.

Question 3

Part (a) required the calculation of a risk adjusted return using a similar industry beta which was generally answered well by the Candidates.

Part (b) was a straight forward analysis of reservations when using CAPM theory in practice and was described very well by most Candidates.

Part (c) required a subsidiary valuation using the free cash flow method. This was well attempted, with many Candidates providing a correct or reasonable calculation. It was clear that those who failed this part of the question have not sufficiently practised this valuation technique to provide the precision and logic which this method requires.

Part (d) was the most difficult requirement in this question as it required Candidates to consider the acquisition from the buyer's perspective and understand why a company may be prepared to pay an acquisition premium due to risk, revenue and cost synergies. Many Candidates were unable to respond to this requirement in a meaningful way, or provided workings which lacked clarity or explanation.

Part (e) required Candidates to advise the directors of the merits and demerits of divesting the manufacturing subsidiary. This final requirement was generally well done, although too many Candidates provided generic rationale without fully considering the nature of the subsidiary or the impact on the product and retailing subsidiary.

Question 4

Part (a) required Candidates to value a potential acquisition of the start-up company using the net asset method, the multiple of earnings method and the free cash flow method. In doing the calculations, Candidates should have been thinking about the appropriateness of these methods to a new technology company which would not have many assets or a stable trading history. It was observed that many Candidates were unable to value the intangible assets by valuing an earnings premium as a perpetuity. The multiple of earnings methods was generally well answered although many Candidates failed to adjust a listed company price to earnings ratio when valuing a non-listed company. Overall, Candidate answers to the free cash flow valuation method were incorrect as the information provided in the scenario provided clear growth rates to apply to each revenue and cost stream but many Candidates took an average of these growth rates rather than apply them individually. Overall, Candidates did poorly for this question part.

Part (b) required Candidates to explain the result of the valuation and recommend a suitable price to commence negotiations. Only a few Candidates were able to respond to this requirement well by considering the nature of the company being valued. Instead, many Candidates provided generic statements about each of the methods of valuation.

Part (c) required Candidates to demonstrate their general understanding of the three methods of valuation required by part (a) and this part of the question was generally well answered.