SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Business Value, Governance and Risk (BG)

EXAMINATION DATE: 19 June 2018

Section 1
General comments
This examination consisted of a single case study with financial and industry data contained in appendices. 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 home-grown manufacturer of solar panels with a single manufacturing plant in China. The company plans to list on the Singapore Exchange (SGX) to fund its future expansion.

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

In Question 1, Candidates were tested on their understanding of the qualifying criteria for a Chief Financial Officer, the challenges facing a newly appointed Board Chairman and the priorities of an Audit Committee in a newly listed company. Question 2 focused on risk management where Candidates were required to identify key risks facing the Company, the relevant key risk indicators (KRIs) to monitor the respective risks, as well as relevant control procedures to manage these risks.

Overall, Candidates fared better in Question 2 but many Candidates failed to identify KRIs and control procedures that are relevant to the key risks. Marks were lost because of this. In Question 1, many Candidates failed to answer Question 1(b) and 1(c) which will be further elaborated below. Candidates should also be mindful that their answers should be specific to the case study and not taken from textbooks and references or generic in nature.

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

Question 3 tested Candidates on identifying reasons for locating the enterprise in Singapore, and performing partial valuation of a pre-IPO convertible bond issued to a private equity firm. The question was poorly answered by most of the Candidates.

Question 4 asked for valuation of the solar panels manufacturer using an Adjusted Present Value model. This question was poorly answered as Candidates did not display adequate understanding on capital expenditure and bond or debt vs equity. Candidates tend to spend too much time on Question 4 (a) and a large number of Candidates left Question 4 (c) and 4 (d) unanswered as Candidates appeared to have run out of time.

Overall, Candidates performed better for the Governance & Risk Component than they did for Business Valuation.

Future BG Candidates are reminded to always apply professional judgment and scepticism to the raw data given in the case and to make appropriate adjustments. Even if a Candidate feels that no adjustments are required, they would be wise to include this opinion as part of their answer. However, experience has shown that it is most unlikely that no adjustments at all would be required. Remember, the markers are looking for answers that have considered the veracity of the numbers provided in the case.

Section 2
Analysis of individual questions

Question 1

Overall, the answers to this question were weak with many Candidates providing very brief answers. It was noted that there was poor justifications or analysis made with regard to each of the main points made in respect of Question 1(b) & 1(c).

Part (a) was well attempted by most Candidates, with most of the Candidates being able to identify the reasons why Sally was not ready to take on role of the CFO. Most Candidates were able to cite the lack of accounting knowledge and risk management experience as the main reasons. However, some Candidates did not link the reasons with justifications in the case study which resulted in loss of marks.

Part (b) required Candidates to identify the challenges facing a newly appointed Board Chairman and how he can overcome them. Candidates did moderately well for **part (b) (i).** Most were only able to identify the lack of industry or business experience on the part of John as the incoming Board Chairman. As John holds a full-time job, some Candidates cited the lack of commitment and time but this matter is not conclusive from the case study. **Part (b) (ii)** was poorly attempted, partly due to a lack of understanding of the question and not answering to the context. Instead of focusing on the key areas on how John can be an effective Board Chairman, many Candidates gave generic recommendations such as taking up courses or attending training to improve accounting and industry knowledge. The question could be better attempted if Candidates can provide more in depth analysis with regard to the selection of board members, managing board agenda and setting matters that are to be reserved for the board decision, etc.

Part (c) was poorly answered, with many Candidates failing to reach passing marks. Most Candidates gave recommendations such as conducting stock counts and addressing the labour turnover in China, the latter primarily an executive function. The question could be better answered if Candidates put themselves in the role of a member of the Audit Committee and answer to the context.

Question 2

Many Candidates did not read the question carefully. This question requires Candidates to identify key risk events in **part (a) (i)**. Using these risk events, **part 2 (a) (ii)** and **part 2 (a) (iii)** require Candidates to identify the relevant key risk indicators (KRIs) and internal control procedures, respectively. Many Candidates

lost marks because their answers to **part 2(a) (ii)** and **part 2(a) (iii)** were not related to **part 2(a) (i)**.

In **part (a) (i)**, many Candidates seemed to not understand what a risk event is and instead offered internal control lapses in the day-to-day operational procedures such as input errors and transcription errors.

For **part (a) (ii)**, a fairly large number of Candidates were unable to identify KRIs. Some provided indicators which are non-measurable and therefore do not qualify as Key Risk Indicators while others did not answer this part of Question 2.

Part 2(a) (iii) tested Candidates on their ability to identify relevant internal control procedures to address the risks identified in **part (a) (i)**. Most Candidates were able to cite internal control procedures but not all were relevant to the risks that they had identified earlier in **part (a) (i)**.

Question 3
Part (a) required analysis of the effect of being located in Singapore on the company value. **Part (b)** required valuation of the straight portion of a convertible bond issued pre-IPO to a private equity firm.

Part (a) was not adequately answered. Some Candidates could suggest reasonable advantages of the Singapore location, such as taxes, government incentives as advantages. However, very few Candidates were able to identify and higher administrative costs as a disadvantage.

Part (b) was poorly answered. The question required computing the issuer's cost of debt using a synthetic credit rating based on two ratios—Return On Asset (ROA) and interest cover. Many Candidates could compute only ROA correctly. The question also required interpolating between the given points on risk-free rate curve. However, most Candidates were unable to perform the interpolation of the risk free rates and apply the spread correctly based on their synthetic credit rating.

Question 4
Question 4 required valuing the company using an adjusted present value approach.

Question 4 was poorly answered. Most Candidates could not complete the question possibly due to poor time management.

Part (a) required computing the free cash flow to the firm. Most Candidates could correctly compute the main operating revenue and expense items and apply the correct exchange rates where needed to express them in Singapore dollars. Many Candidates failed to properly reflect the capital allowances in computing the free cash flow to the firm. A number of Candidates misinterpreted the projected level of working capital to be the change in working capital. Most Candidates did not consider how to reflect capital expenditure in the last year of projections, which forms the basis for the terminal value.

Part (b) required computing the unlevered cost of equity for each year using the capital asset pricing model (CAPM). Most Candidates correctly reflected the mean or median guideline company unlevered beta. Most Candidates failed to reflect the risk-free rate as an annually compounded rate before including it in the CAPM equation.

Part (c) required computing the adjusted present value and using it to value a share. Most Candidates could not complete this part. For those who did, the application of the model was reasonably correct.

Part (d) required comparing the estimated share price to the conversion price of the convertible bond. Most Candidates either could not complete this part or provided inadequate answers, probably due to poor time management.