

## Singapore CA Qualification Examination

6 December 2023

### Business Value, Governance & Risk

#### INSTRUCTIONS TO CANDIDATES:

1. The time allowed for this examination paper is **3 hours 15 minutes**.
2. This examination paper has **FOUR (4)** questions and comprises **TWENTY-TWO (22)** pages (including this instruction sheet). Each question may have **MULTIPLE** parts and **ALL** questions are examinable.
3. This is an open book examination. During the examination, you are allowed to use your laptop and any calculators that comply with the ACRA's regulations. Please note that smart watches, mobile phones, tablets, and all other electronic devices **MUST NOT** be used during the examination.
4. During the examination, videos of you and your computer screen will be recorded for the purpose of ensuring examination integrity and you have consented to these recordings.
5. This examination is the property of the Accounting and Corporate Regulatory Authority.

#### MODULE-SPECIFIC INSTRUCTIONS:

6. This case is hypothetical and has been written exclusively for the purpose of this examination. Names, characters, places and incidents used are imaginary or fictional. Any resemblance to actual events or locales or persons, living or dead, is entirely coincidental. This case is not to be cited without the permission of the Accounting and Corporate Regulatory Authority.

**IMPORTANT NOTICE:**

**If you are not feeling well, please do not press “Start Assessment”. If you have started and leave during the exam, you would be deemed to have attempted the paper.**

**\*\*VERY IMPORTANT NOTICE\*\***

1. Your question paper is attached under the "**Resources**" tab found at the bottom right of **EACH** question.
2. You may also download the question paper that allows annotation throughout your exam in Question 1 of the e-Exam portal.
3. Please download the relevant required Appendices in Question 1 of the e-Exam portal.

**Other important information:**

4. You will be allowed to access your reference materials but **will not be allowed** to communicate with anyone either physically or through any electronic means.
5. You are **NOT ALLOWED** to access any websites during the exam.
6. You are **NOT ALLOWED** to print the question paper.
7. **Please take note that your screen will be monitored throughout the examination. If you are found to have accessed any websites, or if you cheat or attempt to cheat, you will be liable to severe disciplinary action.**

Should you encounter any issues during the exam, please call the following numbers:  
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8. **You do not need fill in an answer for this question.**

**Note to Candidates:** It is 15 December 2023.

### **Company Information**

Major Stays is a large private hotel chain which provides a luxury short break holiday destination for city dwellers in Singapore, Malaysia and foreign travellers. Major Stays is a premium hotel chain favoured by hotel guests with high levels of disposable income and has an excellent reputation with its guests.

The company was founded by Marie Chung, a visionary entrepreneur who wanted to demonstrate that luxury and sustainability are not mutually exclusive. Marie opened her first hotel in Singapore's Ocean Road in 2010. Each Major Stays' hotel offers a first-class experience with a relaxing spa, state of the art gym and a fine dining restaurant.

What differentiates Major Stays from other luxury hotels' experiences is the concept of being in harmony with nature. The design of the hotel is intended to integrate nature into the design of its hotel rooms, restaurants, and public areas, aiming to bring the outdoors, inside.

Major Stays also offers local tours to its guests, which have proven to be extremely successful in attracting more customers and are now a key feature of all Major Stays hotels. For example, knowledgeable guides lead tours daily for guests to experience the local area and learn about the local history, architecture, natural spaces and indigenous wildlife. Each Major Stays' hotel now features exhibition areas around the premises where guests can learn more.

There are now eight hotels in Major Stays' portfolio, situated in Singapore and Malaysia.

All current Major Stays' Executive Directors have been on the Board of Major Stays (the Board) for over six years. Marie Chung remains as the CEO and Chairperson of Major Stays. The other Executive Directors have been promoted to the Board from previous positions as Hotel or Operations Managers within Major Stays. As a private company, Major Stays is not required to appoint independent Non-Executive Directors.

## **Major Stays' Strategy for Expansion**

The hotel's strategy for growth aims to focus on improving its sustainability performance by focusing on environmental, social and governance impacts at Major Stays with the aim of attracting environmentally conscious customers.

In order to fund future expansion of the Major Stays hotel chain in Southeast Asia, the Board of Directors have been considering how to raise finance for investment.

Firstly, the Board is relying on funds generated from its current operations over the next three years, with an objective to generate S\$100 million in cash by 31 December 2026 to provide funds for its "Expansion for Growth" strategy and provide liquidity for its ongoing operations.

## **Existing Bank Loan**

Major Stays has a fixed 4% loan of S\$200 million, which has an outstanding term of four years, repayable at S\$50 million per annum with the next repayment due on 31 December 2024.

The bank loan agreement includes three restrictive covenants as follows:

1. Major Stays' gearing ratio will not exceed the industry average of 35% where gearing ratio is determined by the book value of interest-bearing debt divided by the combined book values of debt and equity.
2. The fixed assets to loan ratio computed by the book value of non-current assets/outstanding loan value remains higher than 300%.
3. Profit after tax margin is at least 20%.

Major Stays is required to report to the bank on the following:

1. Actual restrictive covenants' results at each year end. If Major Stays does not meet the minimum requirement, then this can be considered by the bank as a contractual breach of the loan agreement and the bank can call in the outstanding loan balance; and
2. Forecast restrictive covenants' results for the following three years.

The next restrictive covenant report to the bank will be based on Major Stay's 31 December 2023 financial results.

The bank has been supportive of Major Stays' businesses and strategic plans. Historically, the relationship with the bank has been good as it has been sympathetic of minor restrictive covenant breaches in the past.

### Major Stays' Financial Information

The Directors have provided a summary of Major Stays' financial information, as follows:

<b>Statement of Profit and Loss for the year ending 31 December 2023</b>	<b>S\$m (expected)</b>
Revenue	195.2
Raw materials and other consumables	(51.3)
Personnel costs	(17.5)
Depreciation	(50.2)
Energy, hotel maintenance and repairs	(17.2)
Other operating expenses	(8.7)
Finance costs	<u>(8.0)</u>
<b>Profit before tax</b>	<b>42.3</b>
Tax at 17%	<u>(7.2)</u>
<b>Profit for the year</b>	<b>35.1</b>
Dividends	<u>(3.1)</u>
<b>Retained profit</b>	<b><u>32.0</u></b>
<b>Statement of Financial Position for year ending 31 December 2023</b>	<b>S\$m</b>
Property, fixtures and fittings and equipment	<u>501.8</u>
<b>Non-current assets</b>	<b><u>501.8</u></b>
Inventories	5.3
Trade and other receivables	15.9
Cash and cash equivalents	<u>38.7</u>
<b>Current assets</b>	<b>59.9</b>
<b>Total assets</b>	<b><u>561.7</u></b>

<b>Equity</b>	
Share capital	1.0
Retained earning	<u>310.4</u>
<b>Total Equity</b>	<b>311.4</b>
<b>Liabilities</b>	
Trade and other payables	50.3
Loans and borrowings	<u>50.0</u>
<b>Current liabilities</b>	<b>100.3</b>
Non-current loans and borrowings	<u>150.0</u>
<b>Total liabilities</b>	<b>250.3</b>
<b>Total Liabilities &amp; Equity</b>	<b><u>561.7</u></b>

Major Stays' Board of Directors has requested a profit and cashflow forecast. In response, the Finance Director has provided the following information of a three-year profit and cash-flow forecast starting from 1 January 2024.

#### **Board's Profit and Cash-Flow Forecast Assumptions**

- Revenue is expected to increase by 10% in 2024, and then increase by 5% in 2025 and by 5% in 2026.
- Raw materials and other consumables and other operating expenses are expected to grow at 5% per annum each year for the next three years.
- In order to save costs and improve the profit margin, staffing levels will be reduced to keep the personnel costs unchanged till 31 December 2024 then grow at 6% per annum each year for the following two years.
- Energy, hotel maintenance and repair costs are expected to rise by 10% for the year ended 31 December 2024 and then rise at 5% per annum each year for the following two years.
- Annual capital expenditure at the start of the year will be budgeted at S\$50 million per annum for the year ending 31 December 2024 and then S\$25 million per annum each year for the following two years. Depreciation on non-current assets is 10% per annum and is computed on a reducing balance basis. Full year depreciation is computed for capital expenditure incurred during the year.
- Receivable and payable balances are expected to increase by 10% in 2024, and then increase by 5% in 2025 and by 5% in 2026.

- From 1 January 2024, the annual dividend will remain at 10% of profit after tax.
- There is no difference between accounting depreciation and tax depreciation (capital allowances) for the calculation of corporation tax at 17%. Therefore, a capital allowance forecast is unnecessary.

### **Additional Finance Options**

Additionally, the Board is considering finance options to raise an additional S\$100 million so it can accelerate its “Expansion for Growth” strategy should a suitable hotel site become unexpectedly available, which will provide an excellent fit with Major Stays current hotel portfolio.

The following two finance options have been added to the agenda for the next Major Stays’ Board meeting, for discussion by the Directors:

#### **(1) Refinance by increasing the loan with the bank currently used by Major Stays**

Refinance the existing bank loan of S\$200 million with Major Stays’ current bank and increasing the loan value by S\$100 million using part of Major Stays’ unpledged non-current assets as collateral.

#### **(2) Refinance by issuing a convertible loan note**

As a large private company, Major Stays could issue convertible corporate debenture (loan note) through the capital markets to raise S\$300 million. S\$200 million would be used to repay the existing loan. The offer of a convertible loan note is expected to incentivise investors, while offering them a potential stake in Major Stays in the future.

The Directors have not yet investigated the cost of debt of either option, or the conversion terms for the loan note which the market would require.



**e-Exam  
Question  
Number**

**Question 1 required:**

- 2**            **(a)** Calculate loan covenants required by the bank loan agreement between the bank and Major Stays and conclude on the results.  
**(2 marks)**
- 3**            **(b)** Discuss the impact to Major Stays should the loan covenants calculations fall below the threshold required in the loan agreement and advise how Major Stays should respond.  
**(2 marks)**
- 4**            **(c)** Prepare an annual cashflow forecast for the next three years from 1 January 2024 to 31 December 2026 using the assumptions provided by Major Stays' Board of Directors.  
**(11 marks)**

**e-Exam  
Question  
Number**

**Question 1 required:**

**5**

**(d)** Using the annual cashflow forecast prepared in **part (c)**:

**(i)** Determine if Major Stays is forecast to reach its cash target for investment at 31 December 2026 from the cashflow forecast and advise how Major Stays could implement changes to improve its forecast net cashflow.

**(2 marks)**

**(ii)** Analyse forecast compliance with the three bank loan covenants for each of the years ending 31 December 2024, 2025, and 2026.

**(3 marks)**

**6**

**(e)** Discuss the two finance options suggested to finance future expansion plans and conclude on the suitability of each option to the Board. The finance options are:

**(i)** Refinance by increasing the loan with the bank currently used by Major Stays.

**(3 marks)**

**(ii)** Refinance by issuing a convertible loan note.

**(4 marks)**

**(Total: 27 marks)**

## **Potential Initial Public Offering (IPO) on the Singapore Exchange (SGX)**

The Board of Major Stays is considering a possibility in the future to list the shares of Major Stays on the Singapore Exchange (SGX) to raise a substantial amount of new equity capital which would enable the company to accelerate its growth and expand the number of hotels, either by building new hotels, buying existing hotels from competitors or through acquisition of a small hotel company.

The Board intends to plan ahead and consider the possibility of listing in the next three years. It would like to put together a range of preliminary valuations in order to determine the new equity value of capital which could be raised by an initial public offering (IPO).

The Board has requested the following equity valuations for Major Stays by applying the additional information below:

1. Net assets valuation at book value and also at realisable value;
2. Dividend valuation;
3. Market approach using 31 December 2023 EBITDA and an average market multiple; and
4. Free cash flow valuation.

### **Additional information**

For the realisable net asset value, the Directors have estimated the realisable value of each class of asset as follows:

<b><u>Class of Asset</u></b>	<b><u>Realisable value as % of book value</u></b>
Property, Fixtures and Fittings, Equipment	75%
Inventories	90%
Trade and other receivables	80%

- The Directors have determined that the dividend valuation should be based on the dividend at 31 December 2023 and expected dividend growth into perpetuity of 5% per annum.
- An external brand consultant engaged by the Board has estimated that the open market value of the “Major Stays” brand is in the region of S\$50 million.
- The Finance Director has researched the top four SGX listed companies in the hotel and hospitality industry. The currently quoted market EBITDA multiples are 11.2, 15.3, 9.9 and 13.6. The Directors also believe a downward adjustment of 25% is suitable as Major Stays is relatively small compared to other major listed hotel chains.
- The free cash flow valuation to be based on the estimated free cash flow (before interest and after tax) of S\$40 million at 31 December 2023 which is then expected to grow at 10% per annum for the next three years, and 5% per annum for each year thereafter.
- Major Stays’ weighted average cost of capital (WACC) is estimated to be 11% and the cost of equity ( $K_e$ ) is estimated to be 15%.
- The cash and cash equivalent balance 31 December 2023 is entirely required to fund continuing operations and ongoing working capital requirements and therefore surplus cash is considered to be zero for valuation purposes.

### **Singapore Exchange (SGX) Listing Rules**

Additionally, the Major Stays’ Board would like to understand the rationale for the following six SGX Main Board Listing Rule which are listed below. The Board would also like to understand if Major Stays is currently compliant with each of these six rules:

1. **Profitability:** The company must have been profitable in the latest financial year (pre-tax profit of at least S\$30 million based on the latest full year consolidated audited accounts), has an operating track record of at least three years.
2. **Prospectus:** A listing on the SGX must be supported by a prospectus which contains the proposed share issue, the business activities of the company, financial information about the company.

3. **Forecast:** The prospectus must contain a cashflow forecast for at least twelve months from the date of the publication and must have a market capitalisation of not less than S\$150 million based on the issue price.
4. **Public ownership:** At least 25% of the share capital in the newly listed company must be in more than 500 public hands (for companies with less than S\$300 million market capitalisation).
5. **Management experience:** The Directors and Executive Officers should have appropriate experience and expertise to manage the group's business.
6. **Non-Executive Directors:** Independent Directors must comprise at least one-third of the issuer's Board and the issuer's Board must have at least two Non-Executive Directors who are independent and free of any material business or financial connection with the issuer.

**e-Exam  
Question  
Number**

**Question 2 required:**

- 7            **(a)** Calculate the range of equity values for Major Stays required by the Board. **(13 marks)**
- 8            **(b)** When valuing the equity of Major Stays using a market approach:
- (i)** Explain **TWO** reasons why EBITDA may be preferable to Profit after Tax as an earning base for a market multiple. **(2 marks)**
- (ii)** Explain **TWO** problems for applying a market multiple of similar listed companies. **(2 marks)**
- 9            **(c)** Explain **FOUR** specific adjustments to the free cash flow valuation in **part (a)** which could increase the value of Major Stays. **(4 marks)**
- 10           **(d)** Explain the rationale behind the **SIX** SGX Listing Rules to the Board of Major Stays and advise if Major Stays is currently compliant with each listing rule. **(6 marks)**

**(Total: 27 marks)**

## **Risk evaluation**

The Finance Director is looking to renew Major Stays' insurance policy. The insurance policy should protect Major Stays in the event that a hotel employee or hotel guest has a serious accident at one of the hotels which results in a significant claim against the company.

The information has been provided by Major Stays' Operations Director:

<b>Category</b>	<b>Probability</b>	<b>Expected cost to Major Stays</b>
No accident	80%	Zero
Minor accident	15%	S\$0.25 million
Serious accident	4%	S\$1 million
Fatality	1%	S\$10 million

From past accident history, there has been an average of one accident every three years.

## **New sustainability objectives**

Despite its marketing image, currently, Major Stays has no specific environmental performance policies or targets.

During a recent Board meeting, the Operations Director said this was not good enough, as its hotel guests are increasingly requesting information on the hotels' environmental record. It is now time the Board took concrete actions to improve its performance and transparency in the area of sustainability.

The Operations Director also discussed the following areas where improvements could be made:

- The company's Procurement Team has budgetary targets and is rewarded for achieving additional discounts with current suppliers and achieving further cost savings.
- Currently, safety inspections are carried out by the Hotel Manager at each respective hotel.

- Training for employees is arranged by the respective Head of Department at each hotel. For example, the Head Chef will organise training for new kitchen employees.
- Each Hotel Manager will respond to enquiries from local communities.
- Major Stays has had a long-standing problem of attracting and retaining female employees as a flexible working hours policy for Major Stays' employees is not currently in place.

The Board of Major Stays agreed with the Operations Director and as a result, it has decided to enhance its sustainability record and has implemented eight new environmental, social and governance (ESG) objectives which it will require its Managers to implement, monitor and provide regular updates in the new quarterly internal sustainability report for the Board.

The eight new Major Stays' sustainability objectives are categorised as follows:

### **Major Stays' Environmental Objectives**

1. **Climate-Change Related Emissions:** Ensure compliance with relevant laws and regulations that have a significant impact on the issuer, relating to air and greenhouse gas emissions and water pollutants. (Note: Air emissions include carbon dioxide, methane, nitrous oxide, and other pollutants regulated under Singaporean laws and regulations.)
2. **Consumption:** Ensure Major Stays' operations make efficient use of resources, including energy, water, and other raw materials.
3. **Natural Resources:** Ensure that actions are taken to identify and manage significant impacts of Major Stays' activities on the environment and natural resources.

### **Major Stays' Social Objectives**

4. **Employment:** Ensure compliance with relevant laws and regulations that have a significant impact on the issuer, relating to compensation and dismissal, recruitment, and promotion, working hours, rest periods, equal opportunity, diversity, anti-discrimination, and other benefits and welfare.



5. **Guest and Employee Safety:** Ensure compliance with relevant laws and regulations that have a significant impact on the issuer, relating to providing a safe working environment for employees and protecting hotel guests from hazards.
6. **Training and Development:** Policies on improving employees' knowledge and skills for discharging hotel duties and supporting personal development for employees.

### **Major Stays' Governance Objectives**

7. **Supply Chain:** Improve procurement policies and processes to develop more sustainability in its supply chain.
8. **Local Community:** Improve community engagement to understand the needs of the communities where its hotels operate, and to ensure its activities take into consideration the communities' interests.

### **Enterprise Risk Management**

Major Stays' Risk Committee is a small group consisting of representatives from each main hotel employment category. The Risk Committee is responsible for all analysis required to produce the quarterly risk report which is submitted to the Board for review each quarter.

One of the members of the Risk Committee has been researching COSO's Enterprise Risk Management framework (ERM) and has been inspired by the overall aims of ERM, as follows:

“Enterprise Risk Management (ERM) emphasises the integration and management of strategic risks at the same time as managing other business and operational risks and considers an organisation's culture, its capabilities and its operations alongside strategy setting with the purpose in creating, preserving and realising long-term sustainable shareholder value.”

The Risk Committee would now like to understand the aims of ERM further and how an organisation which implements its philosophy and approach to risk management can benefit. It is specifically considering how each of the following specific benefits of ERM could be beneficial to Major Stays, if ERM was adopted by the Risk Committee.

## **Benefits of ERM**

1. Widens strategic thinking
2. Entity-wide approach to risk management
3. Increases positive outcomes while reducing negative surprises
4. Reduces performance variability
5. Improves resource deployment
6. Enhances enterprise resilience

The Risk Committee is looking to submit a proposal to the Board containing four of the above benefits only, as this is considered to be sufficient to present a case to the Board for discussion at the next Board meeting to adopt ERM.

**e-Exam  
Question  
Number**

**Question 3 required:**

- 11** (a) Quantify the financial exposure to Major Stays from a hotel employee or hotel guest accident for one year and advise on the required level of annual accident insurance cover which Major Stays should obtain. **(4 marks)**
- 12** (b) For each of the **EIGHT** new Major Stays' sustainability objectives, recommend **ONE** suitable key performance indicator which will improve its management and disclosure of ESG related risks. **(4 marks)**
- 13** (c) For each key performance indicator recommended in **part (b)**, advise how Major Stays could take specific actions at its hotels which will help the hotel company meet its ESG objectives. **(8 marks)**
- 14** (d) Discuss **FOUR** benefits of implementing an integrated risk management information system at Major Stays for inclusion in the Risk Committee's proposal to Board to adopt ERM. **(4 marks)**
- 15** (e) Discuss **FOUR** additional cost areas which would be incurred if Major Stays' Risk Management Committee proceeded to implement an integrated risk management information system to improve its risk management practices. **(4 marks)**

**(Total: 24 marks)**

## **Major Stays' Board Governance**

Marie Chung, Major Stays' CEO, currently performs the roles of Chairperson of Board and CEO. Marie believes she has been best placed up until recently to take on both roles as she understands the needs of the Board and company.

Major Stays does not currently employ any Non-Executive Directors as the other Board members seldom voice any disagreement with Marie's judgement or her decisions at Board meetings. Marie believes this has served the Major Stays well, as it has grown from a small company with a single hotel.

Board meetings at Major Stays are scheduled every other month; so occur six times per year. Marie has acknowledged that as operational matters are taking up most of her time and her professional capacity is stretched, she has less time for strategic matters, such as hotel expansion, then scheduled Board meetings are not as valuable and effective as they should be. For example, scheduled Board meetings can be cancelled due to conflicting commitments or postponed until relevant information and analysis to support Marie's agenda items are available for an effective discussion and decision making.

In the last Board meeting minutes, it was recorded that the company secretary held the following opinions:

- (i)** Information to support Board meeting agenda items, is not always available prior to the meeting and is only distributed to Directors during the meeting.
- (ii)** The Board does not monitor well enough the performance of its operations and hotel management teams, and explanations from management to the Board about performance at each Major Stays' hotel are accepted without much questioning from any Board member.
- (iii)** Hotel Managers are making too many strategic and policies related decisions without referring the matters in the first instance to a Director of the Board to avoid delay in response as Board meetings are often postponed at short notice.

## **Customer Complaints**

It has also come to the Board's attention that the number of written complaints from customers has increased. The Hotel Managers have reported that there are other priorities for their teams to address unless the complaint is deemed to be serious by the relevant hotel's operations and administration teams.

The CEO has recently received a message from a customer, on a well-known social media platform asking if it is Major Stays' policy to ignore its customers.

This negative exposure, which has spread widely on the social media, has alerted Major Stays' Board which has agreed that action is now required.

**e-Exam  
Question  
Number**

**Question 4 required:**

- 16**                    **(a)** Briefly explain the respective roles of a CEO and a Chairperson of the board (Chair) and explain **THREE** benefits for separating the role of the CEO from that of the Chair to any large or listed companies.
- (5 marks)**
- 17**                    **(b)** Explain **FIVE** weaknesses which are evident in Major Stays' current boardroom practice and boardroom behaviour.
- (5 marks)**
- 18**                    **(c)** For each weakness identified in **part (b)**, recommend improvements that might create a more effective Board at Major Stays.
- (5 marks)**
- 19**                    **(d)** Advise the Board on **FOUR** consequences if the management of customer complaints at Major Stays is not improved.
- (4 marks)**
- 20**                    **(e)** Recommend and justify **THREE** governance or internal control measures that aim to ensure customers' complaints are appropriately dealt with at Major Stays.
- (3 marks)**
- (Total: 22 marks)**

**END OF PAPER**