

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 6 December 2023

Section 1

General comments

The Singapore CA Qualification examination continues to be a restricted open-book assessment, administered through the Cirrus e-exam platform. These examinations assess Candidates' comprehension of financial management concepts in diverse business scenarios mirroring real-world situations. The examination's difficulty level remains comparable to the previous examinations, encompassing both quantitative and qualitative aspects of the module.

In general, the pass rates and the quality of Candidates' responses have been consistent across the recent few cohorts.

Candidates who excelled demonstrated a strong foundation in the module. Aspiring high performers are advised to engage in extensive question practice and conscientiously exhibit the calculations involved in each step of their workings.

Section 2

Analysis of individual questions

Question 1

Question 1 tested Candidates on the concepts relating to the evaluation of the cost and market value of equity and debt, as well as the weighted average cost of capital (WACC), for a company considering issuing shares to finance a new project. It also tested Candidates on the theories of capital markets efficiency and behavioural finance that demonstrate investors' irrationality and the implications this has for share price.

Part (a)(i) required Candidates to calculate the cost and market value of equity. The quality of the answers was mixed. Common errors included failing to take into account the stock split and scrip issue in their calculation of the dividends. However, many Candidates managed to score some marks for the calculations of the annual growth rate and the cost of equity. Many Candidates also managed to calculate the market value of equity correctly.

Part (a)(ii) required Candidates to calculate the cost and market value of debt. Many Candidates failed to score full marks for the question part. Common errors included (i) using the wrong cash outflow at the start (which should be market price excluding interest) and (ii) using the wrong number of periods (i.e., T1-10 instead of T1-5).

For **Part (a)(iii)**, Candidates generally performed well and were able to calculate the WACC.

Part (b) required Candidates to explain the theories of capital markets efficiency. It was observed that some Candidates did not address the following issues:

- i. Whether the lack of a share price reaction to the formal announcement of the new product launch is consistent with the theories; and
- ii. Whether the price of shares under these theories reflected the true value of the share. Some Candidates did not understand that the share price under a strong-form efficient market would reflect the best available value of a share, given that it would incorporate all available information, including private information. As such, share prices under the other two forms of markets would not reflect the true value of a share.

For **Part (c)**, although the Candidates were able to provide correct examples of behavioural finance, they were unable to explain the implications for share price based on the examples provided.

Question 2

Question 2 was the second best-performing question for the paper. It tested the concept of foreign exchange risk, calculating the nominal cash flows in Singapore dollars, determining the Net Present Value of the project in Singapore dollars, and computing the impact on the Net Present Value of the project if the case company chose to lease the excavators instead of purchasing them. The question aimed to evaluate the financial viability of the project and the potential impact of the different financing options on its overall value.

Part (a) required Candidates to estimate the US dollar to Singapore dollar exchange rates for the end of each year for the 5 years of the project using purchasing power parity. Many Candidates did well in this question part. A common mistake observed was that the inflation rates used in the purchasing power parity formula were switched.

Although the current exchange rate given was USD per SGD, Candidates who gave the forward exchange rate as SGD per USD were awarded full marks if answers were correctly calculated.

For **Part (b)**, Candidates were required to calculate the amount and timing of nominal cash flows in SGD. Most of the Candidates scored well for this question part.

Common mistakes observed were as follows:

- i. Incorrect calculation of spare parts cost in USD.
- ii. Failed to convert spare parts cost to SGD.

- iii. Incorrect conversion of spare parts cost from USD to SGD. The forward exchange rate is expressed as USD per SGD, hence, the conversion would involve dividing the USD cost by the exchange rate (as opposed to multiplying).
- iv. Incorrect adjustment of inflation factor for operating costs.
- v. Wrongly locating the timing of investment cost at Year 1 when it should be at Year 0.
- vi. Failed to include scrap value in Year 5, or incorrect calculation of scrap value.
- vii. Failed to include tax when calculating the value of writing down allowances.
- viii. Incorrect calculation of balancing charge on disposal.

Part (c) required Candidates to calculate the NPV of the project in SGD. Some Candidates forgot about tax and did not calculate the after-tax cash flows and used the before-tax cash flows to determine the project's NPV. A handful of the Candidates did not attempt this question part.

Part (d) required Candidates to calculate the impact on the NPV if the company chose to lease rather than buy the equipment. This is the worst-performing question part for Question 2 and most of the Candidates failed to include all the relevant cash flows.

Common mistakes observed were:

- i. Indicated wrong timing of payment for lease (i.e., Start at Year 1 instead of Year 0). It should start at Year 0 as the question stated it was to be paid *in advance*.
- ii. Used the wrong discount rate to discount the cash flows.
- iii. Failed to recognise that spare parts cost was saved when leasing instead of buying.
- iv. Used pre-tax cost of leasing instead of post-tax.
- v. Erroneously included the cost of the machine which was not incurred since it was now leased.

About half of the Candidates did not attempt this question part or did not know how to answer the question.

Question 3

Question 3 tested on the concept of business valuation techniques, investment appraisal and mergers and acquisitions. Candidates did not perform very well for the question.

Part (a) was the worst performing question part for Question 3. Candidates were required to calculate a suitable valuation using the P/E ratio and data provided. The majority of Candidates did not provide complete answers and did not obtain full marks. It was observed that most of the Candidates did not deduct 20% of the prior year's profits due to the loss of the major customer. However, many Candidates

correctly calculated the adjusted P/E of the company for its unlisted status and correctly calculated the value of the company based on this adjusted P/E and their calculated earnings. Candidates were awarded marks for this calculation even if their calculated earnings were incorrect.

Part (b) was a straightforward question and required Candidates to calculate the profitability index of the 5 projects and rank them in a situation of limited funds. Many Candidates scored well for this question part.

Those who did badly or did not score full marks failed to calculate the profitability index (PI) and did not rank the projects based on the PI. A small number of Candidates failed to calculate the total NPV created, as the question had required “total value created” to be determined.

Part (c) was a qualitative question and required a description of two advantages and two disadvantages of growing by acquisition rather than organically. Most Candidates did well for this question part. It was observed that some Candidates described the advantages and disadvantages of growing organically instead, but marks were still awarded for the relevant points.

Question 4

Question 4 was the best-performing question for the paper. It tested the concept of receivables days, payables days, inventory days, the length of the working capital cycle, reducing the length of the working capital cycle, the Baumol model and why the case company needed to maintain working capital for successful business operations, in response to a comment made by the Operations Director during a board meeting.

Part (a) required Candidates to compute the receivable days, payable days, inventory days and the length of the working capital cycle.

Some of the errors included:

- i. Used total sales instead of just credit sales for the computation of receivables days.
- ii. Used credit sales instead of total sales to calculate cost of sales.
- iii. Failed to deduct payables days when computing the working capital cycle.

For **Part (b)**, most Candidates managed to answer well, with many Candidates providing correct measures that would be able to improve the working capital cycle.

For **Part (c)**, the most common error observed was Candidates used the wrong interest rate. Some Candidates failed to calculate the frequency of the investments that should be sold.

Part (d) was a qualitative question. It required Candidates to explain three reasons why the case company needed to have working capital in order to operate successfully as a business. Only half of the Candidates managed to pass this

question part. It is crucial to note that the focus should be on presenting reasons for having working capital, rather than addressing how to enhance working capital management, as that aspect would be covered in part (b). Candidates are advised to read the questions thoroughly and comprehend the specific demands of each question before answering them to avoid losing precious marks.