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SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 2 December 2024

Section 1 General comments

The December 2024 exam paper provided a comprehensive assessment of key corporate financial management topics, including project appraisal, capital structure, risk management, and working capital decisions. Overall, the paper was well-received, though performance varied considerably across questions. Students demonstrated a good understanding of the theoretical aspects, but there were notable weaknesses in the application of concepts to more practical, real-world scenarios.

As in previous sittings, students who performed well typically adopted a structured approach, thoroughly addressing all parts of each question with clear workings and explanations. However, many candidates lost marks by not showing their calculations or omitting steps. Time management remains a concern, as some students gave overly detailed responses to the early questions but became vague or rushed towards the end of the paper.

Section 2 Analysis of individual questions

Question 1

This question required candidates to calculate the cost and market value of BBO's debentures, bank loans, and equity, along with valuing a potential acquisition and recommending appropriate financing options for the expansion. BBO, a listed company that manufactures gentlemen's clothing accessories, plans to acquire a metalworking business, and candidates were expected to provide a thorough valuation of the new business and offer financing recommendations—whether to use debt or equity for the acquisition.

Part (a): Calculating the Cost and Market Value of Debentures, Bank Loans, and Equity

• (i) Cost and Market Value of Debentures

Candidates generally performed well in calculating the market value of debentures using bond valuation formulas. However, common errors included neglecting to adjust for the redemption premium and misinterpreting the conversion option into shares, which led to miscalculations. Some students also failed to account for after-tax interest when determining the cost of debentures. Additionally, a few candidates successfully used Excel to calculate the Internal Rate of Return (IRR) for



redeemable debentures, which provided precise results, although some lost minor marks for not showing their Excel workings.

• (ii) Cost and Value of the Bank Loan

This part of the question was relatively straightforward. Most candidates correctly identified the cost of the bank loan as the interest rate provided. However, a small number misunderstood the repayment terms, which led to incorrect conclusions. Overall, this was one of the more successfully answered sections, with minimal calculation errors.

• (iii) Cost and Market Value of Equity

Candidates generally demonstrated a solid understanding of equity valuation, particularly when using the WACC equation to solve for the cost of equity. Although some students attempted to apply the Gordon Growth Model, they struggled due to insufficient variables in the question. Most students who used the WACC approach were successful, though some failed to round their answers as required. Common mistakes included misapplying growth rates or misunderstanding the relationship between share price growth and dividend growth.

Part (b): Valuation of the Buckle Business

Performance was varied on this part. Strong candidates used the discounted cash flow (DCF) technique effectively, while others struggled, particularly with calculating the present value of cash flows in perpetuity. Some weaker responses also applied incorrect discount rates, which significantly impacted their valuations of the Buckle business. A notable number of candidates failed to attempt this question at all, possibly due to a lack of familiarity with perpetuity-based valuations.

Part (c): Financing Recommendation for BBO's Expansion

While many students made reasonable financing recommendations based on their earlier calculations, a significant number provided generic answers that lacked a direct link to BBO's specific circumstances. For instance, many failed to calculate BBO's current gearing ratio, which would have supported a more tailored recommendation. Students are reminded that financing recommendations should always be supported by clear, quantitative analysis rather than generic or theoretical responses. Additionally, structured and reasoned justifications are essential for scoring well in this section.

Some common errors include:

- Failing to adjust for the debenture redemption premium.
- Misapplying the growth rate when calculating the cost of equity.
- Providing generic recommendations in part (c) without linking them to quantitative findings

Question 2

This question focused on project appraisal, including machine choice, exchange rate forecasting, and NPV calculations. Candidates were asked to evaluate whether to redeploy an existing machine or purchase a new one, estimate exchange rates over a five-year period, and conduct a cash flow analysis to provide NPV-based recommendations.

Part (a): Machine Choice – New Machine vs. Existing Machine

Candidates were expected to provide a comparison between purchasing a new machine and redeploying the existing one. Strong candidates demonstrated clear and logical comparisons, accurately identifying the relevant cash flows for both options. However, many candidates failed to recognize that the value of the existing machine should be the higher of its value in use or its resale value. A number of students also neglected to include critical cash flows, such as scrap value or tax effects, which led to incorrect conclusions. Additionally, a common oversight was the failure to account for the opportunity cost of redeploying the existing machine. Most candidates missed the key point that the machine with the lower cost in NPV terms should be selected.

Part (b): Exchange Rate Forecasting

This was one of the best performing questions. Candidates were required to calculate the forward exchange rate of SGD against USD for 5 years if the SGD is expected to weaken against the USD by 5% p.a. The small minority who correctly calculated the forward exchange rate as USD per SGD (instead of SGD per USD as given in the question for the current exchange rate) were given full credit.

Part (c): NPV Calculation and Recommendation

Candidates were required to identify the relevant cash flows, calculate the NPV, and make a recommendation based on their findings. Students who approached this part in a step-by-step manner generally performed well. However, several common errors emerged:

- Wrongly locating the timing of the initial machine cost at Year 1 instead of Year 0
- Failing to include machine cost in net cash flow
- Failing to include rent in determining the taxable income
- Failing to calculate rent correctly

Question 3

This question required candidates to produce a cash flow forecast for All Year Headgear (AYH) for the three months ending 31 March 20x5, based on sales forecasts, inventory policies, and payment terms. AYH sells high-tech helmets with



air filtration and temperature control. Candidates were expected to create a cash flow forecast and to make commentaries on the forecast.

The question also tested candidates' ability to apply the TARA risk management framework to address risks like order cancellation, warehouse fire, and helmet theft. Finally, they were asked to suggest ways to embed risk management in AYH's operations.

Part (a): Cash Flow Forecast

Performance in this section was mixed. While most candidates demonstrated an understanding of cash flow forecasting, common errors included confusing cash flow statements with income statements and including non-cash items like depreciation. Many candidates provided cash flow tables, but often included unnecessary details, such as the cash flow for the entire period rather than the specified months. Strong candidates showed clear steps and workings, aiding in the understanding of their answers. To improve, candidates should focus on separating relevant parts of the question and checking calculations for accuracy.

Part (b): Risk Management – TARA Framework

Candidates generally understood the question but struggled with applying the TARA framework correctly. Many did not adequately consider the probability and impact of risks and often recommended all possible actions instead of selecting and justifying the most appropriate course. Strong responses identified risks, assessed their likelihood and impact, and recommended one well-justified action. To improve, candidates need a deeper understanding of the TARA framework and how to apply it effectively to specific risks.

Part (c): Embedding Risk Management

This section was the best answered overall, with many candidates successfully explaining how to integrate risk management into an organisation's culture and operations. However, some answers lacked sufficient elaboration. Strong responses provided detailed, practical methods for embedding risk management, demonstrating a clear understanding of the concept. Future candidates should focus on providing more comprehensive elaborations to ensure full marks.

Across all parts, candidates demonstrated several common errors, including miscalculations, failure to justify answers, and lack of elaboration. Specific issues were:

- **Part (a)**: Incorrect handling of extended credit terms in the cash flow forecast and confusing cash flow with income statements. Some candidates included non-cash items like depreciation.
- **Part (b)**: Inconsistent application of the TARA framework, particularly in assessing the probability and impact of risks like non-payment. Some candidates recommended all actions instead of selecting and justifying one.

• **Part (c)**: Providing generic risk management examples without relating them to the scenario.

To improve, candidates should focus on understanding the requirements, structuring their answers clearly, and justifying their responses.

Question 4

This question assessed students on capital budgeting, credit risk, dividend policy, and working capital management.

• (a) Equivalent Annual Cost (EAC):

Part (a) on the Equivalent Annual Cost (EAC) was mixed in performance. While some students were able to correctly apply the EAC formula, many struggled to annualize costs properly, resulting in incorrect conclusions. Maintenance costs were often not accounted for correctly, which led to incomplete or inaccurate answers. Candidates who managed to correctly apply the formula showed a strong understanding of the concept, but a significant number made computational errors. To improve, students should focus on properly incorporating all relevant costs, including maintenance, when calculating the EAC.

• (b) Additional Factors for Line Selection:

Part (b), which required candidates to discuss additional factors for production line selection, also saw a mixed performance. Several students provided relevant and accurate answers, discussing factors such as demand forecasts and technological obsolescence. However, some candidates focused on broader financial aspects or operational issues, without elaborating on how these factors specifically influenced the decision between two production lines. This lack of detail led to incomplete answers. For future improvement, students should ensure they focus on the specific factors that affect the choice between production lines and provide a more detailed analysis of how these factors can impact the decision-making process.

• (c) Credit Risk Management:

Part (c) on credit risk management was generally well answered. Most students demonstrated a strong understanding of the key methods for managing credit risk, such as credit insurance and tighter credit control policies. However, some answers lacked depth, as students did not fully elaborate on how these strategies could be applied in the context of European expansion. To improve, students should aim to provide more detailed and specific examples of how credit risk management tools can be tailored to particular scenarios and challenges, such as those faced when expanding into new markets.

(d) Impact of Withholding a Dividend: Part (d), which focused on the impact of withholding dividends, was more mixed. Several students struggled with identifying the Modigliani and Miller

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theory and failed to assess its assumptions appropriately. As a result, their answers lacked the critical depth required to fully evaluate the implications of withholding dividends. A few candidates were able to correctly apply the Modigliani and Miller theory but did not tie their explanation to practical considerations, such as the effects on shareholder confidence or company valuation. To improve, students should strengthen their understanding of the Modigliani and Miller theory and ensure they apply it critically to realworld business scenarios, considering both theoretical and practical implications.

• (e) Working Capital Ratios:

Part (e), which dealt with working capital ratios, also saw a mixed performance. Many candidates provided correct answers and discussed the impact of working capital changes on business operations, but others struggled to identify the relevant ratios or failed to discuss their practical implications. Some candidates did not understand that the question required not only an explanation of the ratios but also an analysis of the potential ramifications for the business from proposed changes in working capital. To improve, students should focus on reading the question carefully, understanding the relationship between working capital and liquidity, as well as the broader business implications of working capital management decisions.

Some common errors include:

- Misapplying the EAC formula by not accounting for maintenance costs correctly.
- Overly theoretical discussions of dividend policy without considering practical impacts.
- Failing to link changes in working capital management to the broader financial position.

Conclusion

Overall, the performance of the cohort was satisfactory, with students demonstrating a general understanding of the core concepts, though there were clear areas for improvement. The most common mistakes included misapplication of formulas, lack of depth in analysis, and failure to connect theoretical concepts to practical business situations. To improve performance, students should work on providing more detailed and specific answers, practicing real-world applications of financial theories, and ensuring that they understand the broader implications of their analyses. Additionally, improving time management during the exam is essential for maximizing marks across all parts.