

PP

Singapore CA Qualification Examination

21 June 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 **NINETEEN (19)** 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.**

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8. **You do not need fill in an answer for this question.**

Note to Candidates: It is 15 June 2023.

Company Information

Singing Sauces Limited (“Singing Sauces”) is a listed company on the Singapore Exchange (SGX) that manufactures a range of highly popular sauces branded as “Singing Sauces” which are very popular in Singapore households and are commonly used by many restaurants and street food establishments in Singapore.

Singing Sauces was established over forty years ago by its founder Lawrence Sim. The company was listed on the SGX over fifteen years ago as it expanded to become one of Singapore’s best-known food products. During this time, Singing Sauces has diversified into the manufacture of other processed food products. However, its Singing Sauces range remains its most well-known and successful product range.

Chen Yew is the Chief Executive Officer (CEO). Chen joined Singing Sauces three years ago. Immediately prior to that, Chen headed a major, successful private food processing company for over ten years where she had a reputation for “straight-talking” and achieving results. The Board of Singing Sauces (“the Board”) has ten Board members: six Executive Directors and four Non-Executive Directors.

The Singing Sauces range is currently manufactured from one main production facility located at the Defu Industrial estate in the east of Singapore. This production facility supplies products for Singing Sauces entire domestic and commercial customers. It also supplies its small international customers of expatriate Singaporeans who “cannot live” without Singing Sauces with their meals.

The recipes and production methods for the Singing Sauces range are a closely guarded secret which protects the company from imitation products. Although many competitors have tried, Singing Sauces consistency comes top in consumer taste tests.

Singing Sauces aims to minimise waste throughout its production processes. It also employs a small research and development team which develops new recipes and products, tests product quality and ensures compliance with food safety regulations.

Singing Sauces has operated various social media accounts over the past five years and has gained a considerable number of followers in Singapore. The marketing department updates Singing Sauces' social media accounts approximately once a month with product news and promotions.

Growth by acquisition and product innovation

Singing Sauces Limited is ready to expand and grow beyond its current markets in Singapore and expand its range of branded food products. Singing Sauces has a small product research and development team that focuses on product innovation and has recently completed a recipe for a new Chipotle sauce to be added to the Singing Sauce range.

Additionally, the Board is considering expanding its range of processed food products through a potential acquisition of Food Express Sdn Bhd ("Food Express"), a major food manufacturing company based in Malaysia and listed on the Malaysia Stock Exchange. Food Express is located near the Lumat port which is a major shipping terminal in Malaysia in the Perak region.

Food Express specialises in processed instant foods and meals, such as flavoured rice, but it is best known for its range of instant noodle meals which are supplied in many flavours. Many Malaysians add further flavour to their noodles using spicy sauces made by other manufacturers.

Currently, Food Express products are not widely available in Singapore. The Directors of Singing Sauces wish to exploit the complimentary opportunity between Malaysian noodles products and the Singing Sauces range of products which a customer focus group was highly approved of in recent taste tests.

An initial discussion has been held between the CEO of Singing Sauces and the CEO of Food Express who has confirmed that the Food Express Board of Directors will fully cooperate with Singing Sauces and answer commercial queries about Food Express operations and provide relevant financial and production information under a mutual non-disclosure agreement should Singing Sauces make an offer for Food Express.

The Directors of Singing Sauces held an emergency Board meeting last week to discuss the Board's response should a formal offer for the shares of Food Express be made.

As the next step, the Directors have decided that Singing Sauces' Chief Financial Officer should determine a preliminary valuation of Food Express based on assumptions made by the Board.

This valuation can be used to compare with the current quoted market value of Food Express.

Food Express Financial Information

The most recent management accounts for Food Express have been provided by the Directors of Food Express and reproduced below. The management accounts for the year have been provided. These are actual until May 2023 and estimated for the month of June 2023.

Whilst Food Express operates in Malaysian Ringgit, to help the valuation process, the management accounts have been restated in Singapore dollars by Singing Sauces Finance Director using the average Singapore Dollar to Malaysian Ringgit exchange rate.

Food Express Statement of Profit and Loss for year ending 30 June 2023

	S\$m
Revenue	6,941.1
Expenditure	
Staff costs	(1,406.5)
Production materials	(2,071.8)
Depreciation of property, plant and equipment	(485.0)
Other manufacturing costs	(394.3)
Distribution expenses	(960.4)
Marketing and administration expenses	(242.6)

Research and development costs	(144.9)
Other operating expenses	(427.7)
Total expenditure	(6,133.2)
Operating Profit	807.9
Finance charges	(62.5)
Profit before taxation	745.4
Taxation at 25%	(186.4)
Profit after taxation	559.1

Initial assumptions regarding the acquisition of Food Express made by the Board of Directors of Singing Sauces

In order to assist with the valuation, the Directors of Singing Sauces have provided the following notes regarding Food Express together with estimates and assumptions for its future growth. All relevant amounts have been restated in Singapore dollars by applying the average S\$:RM exchange rate.

Notes:

(1) Annual growth for the years 30 June 2024 to 2027 are expected to be as follows:

	Annual Growth
	(% per annum)
Revenue	5.0%
Expenditure	
Staff costs	2.5%
Production materials	3.5%
Depreciation of property, plant and equipment	See Note (4) below
Other manufacturing costs	4.0%
Distribution expenses	5.0%
Marketing and administration expenses	2.0%
Research and development costs	2.0%
Other operating expenses	2.5%

- (2) For the year to 30 June 2028, assume growth in profit after tax is 2% per annum from forecast 2027 levels, and assume growth continues at 2% per annum for all years thereafter.
- (3) Annual capital expenditure on food processing manufacturing equipment is expected to be S\$200 million in the year to 30 June 2024 and subsequent capital expenditure is expected to rise by 2% per annum each year thereafter.
- (4) The net book value of relevant non-current assets at 30 June 2023 is S\$2,500 million. Depreciation is charged on all non-current assets at an average of 20% per annum on a reducing balance basis. Also, assume full year of depreciation is charged on all capital expenditure additions at 20% per annum on a reducing balance basis.
- (5) For the purpose of this valuation, assume forecast accounting depreciation is a reasonable forecast for available capital allowances on non-current assets.
- (6) Annual corporation tax in Malaysia is expected to remain at 25% per annum.
- (7) Food processing requires significant working capital due to significant inventory and payments to suppliers. For the years 30 June 2024 to 2027, additional working capital, equivalent to 15% of the increase in revenue for that year, will be required. For simplicity, assume that the additional working capital cash flows occur at the end of the year in which the increase in revenue arises.
- (8) Food Express has finance charges on its existing borrowings. For the years 30 June 2024 to 2027, assume the annual finance charge increases by 2% per annum from the 2023 finance charge.
- (9) For the year to 30 June 2028 and each year thereafter, assume all cashflows increase by 2% per annum from 2027 forecast cashflows.

The Directors of Singing Sauces have advised that the valuation should be based on Singing Sauces weighted average cost of capital based on recently available market values for its existing debt and equity, and adjusted for the additional risk of expanding internationally and operating a food processing company in Malaysia.

The beta of a similar Singapore-listed food processing company to Singing Sauces which has trading subsidiaries in other countries such as Malaysia, is 2.28. This company is 1:2 geared (measured as debt:equity). The Directors of Singing Sauces believe this company provides an appropriate equity beta which can be used to determine a risk-adjusted weighted average cost of capital to value its potential acquisition of Food Express.

Market Information at 31 May 2023

Singing Sauces is listed on the SGX with 20,000 million shares trading at S\$3.50 per share.

Also, Singing Sauces currently has S\$20,000 million of outstanding debt in issue in the form of corporate bonds which are trading at par. The average maturity of Singing Sauces corporate bonds is 15 years. Singing Sauces currently has an 'A' credit rating which is average in the food processing industry.

Quoted credit spread for corporates in the food processing sector are as follows:

Rating	1 year	2 years	3 years	5 years	7 years	10 years	20 years
AAA	24	30	34	39	49	63	85
AA	34	43	49	61	69	81	109
A	59	77	83	97	102	109	143
BBB	73	119	139	159	167	175	213
BB	249	284	296	319	326	343	390
B	468	485	516	543	568	585	643
CCC+	594	630	652	691	721	742	764

Note: The table of yields above is quoted in basis points where 1% = 100 basis points.

Food Express is listed on the Malaysian Stock Exchange and its 5,000 million shares are quoted at S\$2.25 per share.

Food Express currently has S\$1,500 million of long-term loans which will remain following acquisition. The share price and debt value of Food Express have been restated in Singapore dollars after applying the average S\$:RM exchange rate.

The current yield on 10-year Singapore government bonds is 2.00% which the Directors estimate approximates to the risk-free rate of investment in Singapore.

The current market return on the Singapore equity market portfolio is 6.25% and the corporate tax rate in Singapore is expected to remain at 17% in the future.

**e-Exam
Question
Number**

Question 1 required:

2 **(a)** Calculate a suitable risk-adjusted discount rate for Singing Sauces for the purpose of valuing Food Express.
(9 marks)

3 **(b)** Calculate an estimated valuation for Food Express using the free cash flow to the firm valuation method. Your valuation should be for 100% of Food Express shares.
(15 marks)

Note: Candidates are required to ignore ALL potential synergy which may arise on acquisition. Apply year end discount factors throughout and show cash flow clearly by year.

4 **(c)** Calculate the change in valuation of Food Express calculated in **part (b)** if the following changes to the assumptions made by the Directors of Singing Sauces **occur simultaneously** and explain your result.

Change in assumptions:

- The proxy beta used to determine the WACC in **part (a)** rises by 20% due to increased risk expectations.
- Singing Sauces credit rating falls from A to BBB due to market credit risk concerns of the expanded company.
- The risk free rate rises by 1%.
- Revenue annual growth rates decrease from 5% to 4% in the years from 30 June 2024 to 2027.

(7 marks)

(Total: 31 marks)

Singing Sauces Risk Committee

The Legal and Compliance Director of Singing Sauces, Philip Chan, has emailed the Board with a request for help from all Singing Sauces Executive and Non-Executive Directors to provide their views on the company's principal risks.

The purpose of this consultation is to update the risk register as this is required to be disclosed in a prospectus should the Board decide to proceed and make an offer for all shares in Food Express.

The email from Philip to the Board is reproduced below:

To: The Board of Directors of Singing Sauces

From: Philip Chan, Legal and Compliance Director

Subject: Principal risks of Singing Sauces

Dear fellow directors,

As you know, we have only a very small risk and compliance committee here at Singing Sauces. Below is a list of our principal risks which the committee compiled at last week's monthly meeting. The committee would like all Directors to help by providing their perspective on each risk in greater detail, to consider the potential impact of each risk and also, provide views that will feed into the risk response and risk mitigation strategy.

The eight principal risks determined by the risk committee are as follows.

1. **Non-Compliance with food safety regulations:** If Food Express is acquired by Singing Sauces then there is a risk of non-compliance with Malaysian food safety regulations where these are different to regulations in Singapore.
2. **Supply chain disruption:** A single event or simultaneous multiple events which result in an unforeseen disruption or delay to the supply chain which impacts Singing Sauces production operations.

3. **Availability of suppliers:** Singing Sauces may be unable to source sufficient manufacturing supplies in the long-term due to many potential factors which may impact on food suppliers in the future.
4. **Supplier non-compliance:** Suppliers of Singing Sauces may not be fully compliant with our code of ethics or other environmental legislation or regulations.
5. **Competition and changing consumer preferences:** Competitors may be quicker to meet changes in consumer tastes than we are at Singing Sauces.
6. **Production quality issues:** News of a serious food contamination issue is received from a customer and is reported in the media or other food production quality issues.
7. **Product packaging:** Singing Sauces product packaging fails to meet environmental expectations or does not include all relevant information for food products.
8. **Global cost inflation:** Costs of Singing Sauces are rising quickly as food producers compete for ingredients and other necessary resources.

The risks listed above are not intended to be a complete list as further risks have been identified. However, these are the eight risks which the risk committee seeks your advice.

The risk committee will compile all responses from each Director and circulate them early next week in preparation for discussion at next week's full Board meeting.

Many thanks in advance,

Philip

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Number**

Question 2 required:

- 5** **(a)** For each of the **EIGHT** risks identified in Philip Chan’s email to the Board, describe each risk further for the purpose of inclusion in Singing Sauces’ risk register.
(8 marks)
- 6** **(b)** Discuss the potential consequences of each risk described in **part (a)** which will aid the evaluation of risk at the next Board meeting.
(8 marks)
- 7** **(c)** Determine a suitable risk mitigation strategy which will address the potential consequences of each risk discussed in **part (b)**.
(8 marks)
- (Total: 24 marks)**

Internal Audit Department review of governance procedures

The internal audit department has recently concluded a review of policies and procedures which provide governance over strategy setting and decision making, ethics and sustainability practices and risk management and internal controls at Singing Sauces.

The main findings from this report have made for difficult reading for Audit Committee and Singing Sauces Board of Directors. Particularly, the following issues:

1. Non-Executive Directors

There is an observed lack of spoken contributions from the Non-Executive Directors at Singing Sauces Board meetings. Also, it is common for one or more Non-Executive Directors to be not in attendance. The October 2022 Board meeting was not attended by any Non-Executive Directors, other than the Chair.

2. Strategic Decision Making

Chen Yew, CEO and an Executive Director at Singing Sauces, has been regularly observed to interrupt or talk over other Directors during Board meetings and speak harshly to some of the other Directors. On one occasion, a Board member temporarily left the meeting as they were visibly upset due to being shouted at by Chen.

Also, Chen would often announce that she has made her decision, without all Directors having had the opportunity to present their opinions during Board meetings.

3. Singing Sauces Code of Ethical Conduct

There is a general unawareness of Singing Sauces Code of Ethical Conduct amongst its employees. Also, there is a lack of formal monitoring of compliance with the Singing Sauces Code of Ethical Conduct or enforcement. Singing Sauces human resources department said the Code of Ethical Conduct is referred to only if an employee is reported as doing “something bad”.

The procurement team that manages Singing Sauces supplier relationships confirmed they had no awareness of the existence of Singing Sauces Code of Ethical Conduct.

4. Singing Sauces Sustainability Report

The publication of Singing Sauces sustainability report is delayed and will not be published with the Singing Sauces 2023 Annual Report. The Chief Finance Officer, Zaw Chua, explained this is because the Board and finance team have been focused on identifying potential acquisition targets and spending time analysing and considering a potential merger with Food Express. Progress of completing the sustainability report and its target publication date is not known.

Whilst there are no specific compliance concerns regarding the contents of the report, the Audit Committee has yet to review a draft of the report.

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Question 3 required:

8 **(a)** Explain why each of the **FOUR** issues included in the internal audit report may impact on the effectiveness of Singing Sauces strategic or sustainability performance.

(8 marks)

9 **(b)** For each issue explained in **part (a)**, recommend **TWO** actions that will help to improve or resolve the issue.

(8 marks)

10 **(c)** Identify **ONE** example of each form of capital at Singing Sauces listed below.

- Natural capital
- Human capital
- Intellectual capital
- Social capital
- Manufactured capital
- Financial capital

For each example, explain how Singing Sauces can apply corporate governance mechanisms to ensure its continual and sustainable supply.

(12 marks)

(Total: 28 marks)

Financing the potential acquisition of Food Express

Due to the size of the potential acquisition of Food Express, the Board will need to consider an acquisition funded by a share-for-share exchange.

The Chief Finance Officer, Zaw Chua, is of the opinion that the company does not have sufficient debt capacity to increase its borrowings in the short term. In order to avoid raising new debt finance, the Board of Directors of Singing Sauces are considering a formal offer for all of the issued share capital of Food Express in the form of a share-for-share exchange.

Singing Sauces is considering offering **THREE** new Singing Sauces shares for every **FOUR** existing Food Express shares, assuming the offer is accepted by 30 June 2023.

Revenue synergy identified by the Board

As a result of the merger, Singing Sauces expects to create synergy which will increase the equity value of the newly created group. The Directors have identified a number of possible sources of revenue, cost and risk reduction synergies.

For one potential source, the revenue synergy is the opportunity of exporting its existing range of Singing Sauces products from its Singapore food production site and selling these to new customers in Malaysia by distributing these alongside Food Express products.

The Directors of Singing Sauces have estimated that Singing Sauces revenue in year 2023 could increase by 5% in 2024, with cost of sales and other operating costs increasing by 4% in 2024. This will increase its Singapore profits from sales exports. This revenue synergy is expected to recur annually thereafter with growth of operating profit before tax of 2% per annum.

Singing Sauces revenue for the year to 30 June 2023 was S\$22,500 million and its cost of sales and all other operating costs before tax are approximately 85% of its revenue.

Exchange controls

One of the Non-Executive Directors, Lee Ho, has raised a concern that the Malaysia Government could implement exchange controls in the future which may impose a maximum on the amount of Malaysian Ringgit profits which can be exchanged into other currencies for repatriation to a foreign parent company. Lee is uncertain of the impact on the new group should this occur.

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Question 4 required:

- 11 (a) Explain **TWO** impacts of foreign exchange risk which Singing Sauces will be exposed to as a result of acquiring Food Express. (2 marks)
- 12 (b) Explain the impact following the implementation of exchange controls by the Malaysian Government and recommend **ONE** measure which the Board of Singing Sauces could implement to counter the impact. (2 marks)
- 13 (c) Explain **FOUR** ways how the regulatory framework for mergers and acquisitions for listed companies in Singapore aims to protect the shareholders of Singing Sauces and the shareholders of Food Express. (4 marks)

**e-Exam
Question
Number**

Question 4 required:

- 14** **(d)** Under this share-for-share exchange offer proposed by Singing Sauces to acquire Food Express, calculate the number of new Singing Sauces shares which will be awarded in exchange for existing Food Express shares and determine the percentage holding in the new group by Singing Sauces shareholders and by Food Express shareholders, respectively. **(2 marks)**
- 15** **(e)** Using discounting techniques and the assumptions made by the Directors of Singing Sauces, calculate the estimated value synergy arising from the acquisition of Food Express and explain your result. **(5 marks)**
- 16** **(f)** Discuss other potential sources for further synergy which have not currently been identified by the Directors, which could be realised if Singing Sauces proceeds with the acquisition of Food Express, as follows:
- i. ONE** source of potential revenue synergy. **(1 mark)**
- ii. ONE** source of potential cost synergy. **(1 mark)**
- (Total: 17 marks)**

END OF PAPER