

## SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

**MODULE:** Business Value, Governance and Risk (BG)

**EXAMINATION DATE:** 8 December 2021

### General comments

The December 2021 BG examination consists of a single case study with financial and industry data covering four questions across the BG syllabus, with each question covering particular syllabus areas, consistent with prior examinations.

The scenario company is a leader in the sales and manufacturing of industrial and domestic air conditioning units that is listed. Its main market is Singapore and its main manufacturing site is in Indonesia. The company is ready to launch a more environmentally friendly domestic air conditioning unit.

Financing and business valuation learning outcomes were covered by Questions 1 and 2. Question 1 requires the valuation of new debt and the evaluation of the weighted average cost of capital before and after new debenture financing. Question 2 requires net present value investment appraisal and sensitivity analysis.

Risk and Governance learning outcomes were covered by Questions 3 and 4. Question 3 is on operating risk, information technology risk and sustainability risk assessment requiring Candidates to recommend how internal audit could assist the company in these areas. Question 4 required Candidates to complete a corporate governance analysis with commentary on the role of non-executive directors and improvements to governance required to ensure effective risk management practices.

As with prior BG examinations, it was noted that overall Candidate performance was superior on the numerical elements of the examination than the discussion requirements, particularly where a specific impact on the company in the scenario was required. Further analysis and advice for future Candidates are given below.

### **Question 1**

**Part (a)** required Candidates to recommend a suitable issue price for the new S\$10 million corporate debenture by determining its initial market value. Most Candidates were able to determine the correct credit spread and apply this to the correct cash flows to determine a suitable issue price. A small number of Candidates missed the redemption premium of 5%. Despite being asked to recommend a suitable issue price, many Candidates provided a calculation only.

**Part (b)** required Candidates to estimate the current weighted average cost of capital (WACC) and the revised WACC following the issue of the new S\$10 million corporate debenture and comment on the result. Most Candidates were able to correctly

calculate the current WACC. For the revised calculation, many Candidates were unable to ungear and regear the beta to correctly recalculate the revised CAPM. Another common error was not correctly incorporating existing and new debt into the calculation. The explanations for the change in WACC were of mixed quality.

**Part (c)** required Candidates to explain four reasons why the actual revised WACC may be different in reality from the WACC calculated in part (b). Most Candidates were able to relate how each component of the WACC formula might fluctuate in reality based on market values which change. However, many Candidates failed to provide four separate points.

**Part (d)** required Candidates to calculate the gearing level before and after the issue of the new corporate debenture and explain if the new corporate debenture will be acceptable to the company's shareholders. Most Candidates were able to correctly calculate gearing before and after the new issue of debt. Most Candidates were also able to comment on the increase in gearing and compare it to the 30% cap as required by one of the shareholders. However, few Candidates were able to connect increased debt to higher interest payments which reduced profits leaving less room for dividends, meaning that shareholders might not approve the new corporate debenture.

## Question 2

**Part (a)** required Candidates to estimate the net present value (NPV) which may arise if the Directors decide to launch the EcoAir50. Most Candidates were able to score at least 10 out of 14 marks for this part.

Common mistakes were noted in the following areas:

- **Sales Revenue:** Some Candidates applied 2% annual inflation from Year 1 instead of Year 2.
- **Lost contribution on lower sales of BC100:** Some Candidates prepared a separate NPV analysis for BC100 instead of incorporating the loss into the EcoAir50 NPV analysis to present a holistic picture or omitted this item altogether.
- **Investment in new machinery:** Some Candidates missed out the S\$200,000 salvage value at the end of the project.
- **Tax saved on capital allowance:** Many Candidates did not know how to treat the disposal proceeds of S\$200,000 in Year 5.
- **Working Capital:** The majority of Candidates were not able to compute Working Capital correctly and included a percentage of revenue, rather than working out the year-on-year change.

**Part (b)** required Candidates to discuss five factors, in addition to the NPV, which the Board of BeCool should consider before they decide whether to launch the EcoAir50. About half of the Candidates were able to score full marks for this question part, except for a few Candidates who either ran out of ideas or ran out of time.

**Part (c)** required Candidates to advise the Directors on two practical actions the Board should undertake before it proceeds with the launch of the EcoAir50. Likewise, most Candidates scored well by delivering insightful answers.

**Part (d)** required Candidates to calculate the sensitivity analysis of EcoAir50's Net Present Value (NPV) calculated in part (a) to forecast sales price and the weighted average cost of capital (WACC). Most Candidates were able to compute the sensitivity analysis on the forecast sales price. As for the comment on the result, almost all Candidates provided a one-line explanation of the calculation without linking the calculation to the business, product, pricing, impact on profit or investment risk. Whilst many Candidates were able to compute the sensitivity analysis on WACC, most explanations did not link sensitivity to an increase in the cost of debt finance.

### Question 3

**Part (a)** required Candidates to explain five environmental sustainability risks which will arise from manufacturing the EcoAir50 air conditioning unit and for each risk, explain how BeCool can mitigate the risk. Generally, most Candidates performed well as they were able to pinpoint and explain the risks pertaining to short product lifespans, product energy consumption, product and component recycling, and excessive use of air-conditioning by customers and appropriately apply these factors to the fact pattern provided in the case. Candidates were also able to suggest ways to minimise the impact of the identified risks. The area where Candidates faltered was in providing general textbook answers on businesses' responsibility to protect the environment, to conserve natural resources, to reduce the carbon footprint and to minimise the impact on ecosystems without connecting or linking these points to the scenario.

**Part (b)** required Candidates to explain four significant risks that affect the company's computerised operations and recommend a control action to mitigate each risk. Given the pervasive use of computers and information technology (IT) in both business and personal settings in today's hyperconnected world, and the well-publicised topics of IT security in the media, Candidates also performed well in this part. Many Candidates were able to identify and address the risks as provided in the descriptions of processes, the nature, history, and development of the IT infrastructure of the company and suggest appropriate procedures to eliminate or mitigate such risks. Candidates who failed to gain full marks lacked precision in their answers. For example, they suggested back-ups but did not suggest that they must be held offsite and performed frequently throughout the day.

**Part (c)** required Candidates to explain how each of the four internal audit projects suggested by the BeCool's Head of Internal Audit can help to manage risk at BeCool. Candidates generally did not provide focused answers and instead provided the usual functions and activities of an internal audit department rather than explain how an internal audit could add value at BeCool in the areas included in the scenario. A small number of Candidates did not respond to the entire question, several others left parts of the question blank, and some Candidates provided fewer answers than

the number required. Future Candidates are advised to ensure that they provide responses that are focused on and connected to the scenario rather than to provide standard generic answers.

#### Question 4

**Part (a)** required Candidates to comment on the Operation Director's assertion that the Non-Executive Directors (NEDs) are solely responsible for the culture of governance, effective internal control and risk management at BeCool. This requirement required a fundamental understanding of the role of Executive and NEDs. Generally, Candidate performance was fair, and some Candidates did not gain marks as they provided a general explanation without specifically linking to Principle 9 of the 2018 Singapore Code of Corporate Governance or not providing a detailed explanation on the difference between Executive and NED's roles and responsibilities.

**Part (b)** required Candidates to discuss five practical challenges or barriers faced by NEDs which may limit their effectiveness when performing their role as a member of the main Board of Directors. The majority of Candidates performed well and were able to explain the practical challenges or barriers in detail. However, some of the Candidates only provided vague or irrelevant explanations which resulted in a loss of marks.

**Part (c)** required Candidates to explain five recommendations to improve the governance of risk management at BeCool. In general, most Candidates performed satisfactorily, however, there were many instances of duplicate or irrelevant points that failed to specifically address the improvement on the governance of risk management. Some Candidates misinterpreted this question and ignored risk management, instead simply repeated the code of corporate governance requirements which should already be in place at the company. Overall, future Candidates are advised to be precise and detailed when providing the explanations and recommendations to fully access the marks available.