

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 5 December 2022

Section 1

General comments

The examination is conducted online via an e-Exam platform (Cirrus), and the examination format remained unchanged, a restricted open-book format with an Appendix containing the formulae and present value tables. The level of difficulty for the examination remains comparable with the previous examinations, with both quantitative and qualitative aspects of the module being tested.

Generally, the passing rates and quality of the answers have remained comparable to the previous cohort. It was observed that Candidates generally performed better in the qualitative questions for this paper.

To do well in this module, Candidates should read widely to have a strong foundation and do more practice questions using the recommended textbook and past FMF examination papers. They should also make an effort to present the calculations involved in each step so that they can gain marks for the appropriate workings shown.

Section 2

Analysis of individual questions

Question 1

Question 1 tested Candidates on the concepts of net present value (NPV), relevant cashflows and the payback period of a new product. They were required to compute and compare the suitability of the approaches.

Part (a) was generally well answered by the Candidates. It was observed that some Candidates did not know the formula even though it was provided in the appendix.

Part (b) was well answered by the Candidates. Most Candidates managed to score a pass mark for the question part. There were a handful of Candidates who managed to get full marks for the question part.

Common mistakes made by Candidates were as follows:

Sales and Operating Costs

- Failed to include the inflation rate in the sales or operating costs computation.
- Used the wrong inflation rate for operating costs (i.e. used the same inflation rate as used for sales).

- Failed to differentiate between income items (such as sales and operating costs) and non-income items (capital investments and working capital).

Working Capital

- Failed to take into account that the working capital **change** for the current year was the cash flow to be included.

For **Part (c)**, most Candidates were able to perform well.

For **Part (d)**, the main error that Candidates made was to use the wrong monthly cash flow to calculate the payback period for the last year. The monthly cash flow should only include operating cash flows (i.e. sales less operating costs), as other cash flow items such as working capital, taxes, and investment scrap value will only occur at the end of the year.

Part (e) required Candidates to recommend and justify which approach was more suitable. Although the Candidates were able to pass the question, the quality of their answers was poor. They do not seem to understand the difference between the NPV and payback methods. Candidates should also understand that NPV measures the impact of the projects on shareholders' wealth, and projects with negative NPV should not be pursued.

For **Part (f)**, about half of the Candidates were able to compute the sensitivity of the NPV to the estimate of the initial investment. However, the elaboration on the percentage sensitivity and the potential impact on decision-making could have been better.

Question 2

Question 2 tested the concept of foreign exchange risks, spot rate, forward contract, money market hedge, futures contracts and options. This was the worst-performing question for the paper.

Part (a) required Candidates to explain the three types of foreign exchange risks pertaining to LGY. Generally, Candidates were able to list the three types of foreign exchange risk; only a handful of Candidates related the risk to LGY.

Parts (b) and (c) required Candidates to calculate the Singapore equivalent of the US\$45m receipt using the current spot rate and forward contract. It was observed that Candidates demonstrated a lack of understanding of foreign exchange concepts and, as a result, used the wrong rates in the computation.

For **Part (d)**, Candidates were required to calculate the Singapore equivalent value of the US\$45m receipt in 6 months' time using a money market hedge. A common mistake noted was that Candidates used the interest rate in the question without pro-rating it to the 6-month period.

Parts (e) and (f) required Candidates to discuss the advantages and disadvantages of the various financial instruments. Generally, Candidates were able to cite the key points but did not provide sufficient explanation to support their answers.

Question 3

Question 3 tested Candidates on the concept of working capital management – to produce a profit and loss statement and cash flow forecast for a given scenario. This was the second-best performing question for the paper.

For **Part (a)**, most of the Candidates were able to produce the monthly profit and loss statement, albeit with some careless mistakes.

Part (b) required Candidates to produce a monthly cash flow forecast, and it was observed that there were careless mistakes which were carried forward from part (a). However, marks were still awarded for the correct understanding and appropriate workings.

Part (c) required Candidates to explain and compare the trends in parts (a) and (b). Most Candidates were able to explain the differences between profits vs cash flows but failed to compare the trends.

For **Part (d)**, most of the Candidates were able to provide practical solutions.

Part (e) required Candidates to calculate the net benefit or cost of each party of entering into a swap to change the characteristics of their loan interest compared to approaching their own bank directly. This was the worst-performing question part of the paper. Many Candidates did not attempt this question part, and those who attempted the question did not present their answers in percentage terms even though it was indicated in the question. Candidates are advised to read the question carefully to avoid getting penalized unnecessarily.

Question 4

Question 4 tested the concepts of the Dividend Growth Model, Capital Asset Pricing Model and Weighted Average Cost of Capital. Candidates were required to prepare computations using the concepts above and apply them to the case provided. This was a relatively straightforward computation question, and the overall performance was satisfactory.

Part (a) was generally well answered by most of the Candidates.

Common mistakes made by Candidates were as follows:

- (i) Failed to account for the impact of the stock split when using the historical dividends.
- (ii) Using the wrong number of years.

Part (b) was also well answered by the Candidates. Common mistakes include failing to deduct the risk-free rate from the market return. Other mistakes include computation errors and using the wrong figures.

Part (c) required Candidates to discuss two reasons why there may be a difference between the answers to parts (a) and (b) in the case. Most of the Candidates did not manage to provide reasons for the difference between the two methods or were unable to link their reasons to the situation in the question.

Parts (d) and **(e)** were commonly tested topics and the Candidates' performance was satisfactory.

For **Part (d)**, common mistakes made by Candidates were as follows:

- (i) Used the cum-interest price of the debenture for year 0.
- (ii) Failed to use after-tax interest.
- (iii) Failed to consider the redemption proceeds.

For **Part (e)**, many Candidates lost marks as their computation of the market value of equity or debt was wrong.