Chartered Accountant
SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 18 June 2024

Section 1
General comments

The Singapore CA Qualification examination continues to be a restricted open-book assessment, administered through the Cirrus e-exam platform. The examination assesses Candidates' understanding of financial management concepts in various business scenarios that mimic real-world situations. The exam maintains a consistent difficulty level compared to previous exam sittings, integrating both quantitative and qualitative elements of the module.

Overall, the pass rates and quality of the Candidates' performance have been stable across the recent cohorts. Candidates who did well exhibited a strong grasp of the module's core concepts. To do well in this module, Candidates should read widely to have a strong foundation. It is also advisable for them to do more practice questions using the recommended textbook and to attempt past FMF examination papers. Candidates should also make an effort to present the calculations for each step clearly to gain marks for the appropriate workings shown.

Section 2
Analysis of individual questions

Question 1

This question focused on the financial analysis for Shoeglue Ltd (SGL), specifically requiring Candidates to calculate:

- The cost and total market value of equity using the dividend valuation model.
- The post-tax cost and total market value of debt (ex-interest).
- The weighted average cost of capital (WACC) using market values.

Candidates were expected to apply financial principles and models to derive these financial metrics accurately. Candidates generally performed satisfactorily but there were notable areas for improvement, especially in part (c).

Part (a)(i): Cost and Market Value of Equity

Performance on this part varied, reflecting different levels of understanding and application of the financial concepts. Common errors included not doubling the growth rate and incorrectly deducting the dividend again from the share price.

Part (a)(ii): Cost and Market Value of Debt

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Results were mixed. Common errors included failing to deduct the interest coupon from the debentures' market price and stopping at the computation of the book value of debt rather than proceeding to calculate the market value.

Part (a)(iii): Weighted Average Cost of Capital (WACC)

Candidates generally performed well and were able to use the WACC formula and inputs derived from previous parts of the question.

Part (b): Equity Beta

Most Candidates performed the computations accurately, though some used incorrect inputs. Many Candidates did not provide the required interpretation, possibly due to negligence or poor time management.

Part (c): Assumptions of the CAPM Model

Candidates generally demonstrated accurate computation skills but often omitted the evaluation, likely due to negligence or time constraints.

Question 2

Question 2 was the best-performing question for the paper. It tested on the financial appraisal of a new product by Solar Cotton Ltd (SCL) that incorporates nano-sized solar panels into clothing fabric. The product will be manufactured in Singapore and sold in the US.

Part (a) tested the Candidates' understanding of exchange rates estimation, cash flow analysis, and Net Present Value calculations for the proposed investment, considering international business operations and tax implications. Performance was generally good for this question.

Part (a)(i): Forward Exchange Rate Calculation

Part (a)(i) required Candidates to determine the forward exchange rate of USD against SGD for 3 years using interest rate parity. Almost all Candidates were able to calculate the forward exchange rates correctly. Although the current exchange rate was given as SGD per USD, Candidates who correctly calculated the forward exchange rate as USD per SGD were awarded full credit.

Among those who did not perform well, a common mistake was that the interest rates used in the interest rate parity formula were switched.

Parts (a)(ii) & (iii): Nominal Cash Flows Calculation

Parts (a)(ii) & (iii) required the calculation of the amount and timing of nominal cash flows in SGD for a new product.

Common mistakes were as follows:

- Incorrect calculation of inflation factor for sales.
- Incorrect conversion of sales from USD to SGD. Since the forward exchange rate is expressed as SGD per USD, the conversion would involve multiplying the USD cost by the exchange rate (as opposed to dividing).
- Wrongly identifying the timing of investment cost at Year 1 when it should be at Year 0.
- Failed to include the contribution margin in determining taxable operating income.
- Incorrect calculation of change in working capital.

Part (b): Risks Associated with the Investment

For **Part (b),** Candidates were required to explain the transaction, translation, and economic risks associated with the proposed investment, and provide an example of each type of risk from this project. In addition, Candidates must give an example of each from this project. Most Candidates were able to explain the risks, but a number failed to relate examples from the project and lost marks.

Part (c): Monte Carlo Simulation

Part (c) was poorly attempted which tested Candidates on the concept of Monte Carlo simulation. Candidates were asked to evaluate one advantage and one disadvantage of using a Monte Carlo simulation for the project's decision-making.

Candidates were generally unfamiliar with the Monte Carlo simulation even though this has been included in the exam preparation guidance. Most Candidates gave unsatisfactory answers which did not directly address the Monte Carlo method. Additionally, a few Candidates did not attempt this question.

Question 3

Question 3 evaluated the Candidates' ability in financial analysis and strategic decision-making related to inventory management and HR review. The focus is on calculating changes in key financial metrics and evaluating a proposed early settlement discount strategy. Candidates are required to calculate how the transition from maintaining physical inventory to a virtual warehousing model will affect the balances of receivables, payables, and inventory. Performance for the question was mixed with notable strength in part (c).

Both parts (a) and (b) were badly attempted. Less than half of the Candidates passed the question parts.

Part (a): Impact on Financial Metrics

Part (a) required Candidates to calculate the impact of virtual warehousing on receivables, payables, inventory balances, and funding needs. It was observed that the Candidates were weak in the topic of funding requirements as only a handful of the Candidates managed to pass part (a). This showed that they were not familiar with the topic or did not know how to approach the question at all. Successful Candidates clearly showed their workings and understood the financial implications of the changes proposed.

Part (b): Net annual benefit/cost of the proposition

For **Part (b)**, the net benefit/cost calculation of the early settlement discount proposition revealed a need for more practice in applying financial formulas and interpreting results. Many Candidates failed to make a recommendation after computing the net cost/benefit.

On the other hand, Candidates who connected the financial impact to the overall business strategy scored well.

Part (c): Economy, Efficiency, and Effectiveness in HR Review

For **Part (c)**, Candidates are required to explain the concept of economy, efficiency, and effectiveness in the context of an HR review. This was the best-attempted part of the question based on the quality of the answers, as Candidates provided relevant examples. Some responses lacked clarity and failed to link concepts directly to the HR context.

Question 4

Question 4 tested topics on valuation, acquisition considerations, and practical financial management. This was the worst-performing question of the paper as most of the Candidates failed all three question parts. It was also observed that many Candidates did not attempt all the question parts which could be due to lack of time.

Part (a): Valuation for Acquisition

Part (a) required Candidates to arrive at a maximum amount to pay for the acquisition of an unlisted property management company by a listed business owning commercial properties. This question required a comprehensive understanding of valuation techniques and synergy benefits. Candidates who did well demonstrated meticulous calculations and logical reasoning.

Common mistakes Candidates made were:

- Failed to recognise that expected annual synergies should be taxed.
- Failed to recognise that the sale proceeds of the DeskNest property would be received at Year 0 (and not Year 1).
- Failed to calculate and include the terminal value in the valuation.

Part (b): Reasons for Overvaluation

For **Part (b)**, Candidates are required to explain four reasons why target companies are overvalued, with reference to DeskNest acquisition. Most of the Candidates provided general or repetitive answers and failed to link their answers back to the company in question.

Additionally, a few Candidates did not attempt this question.

Part (c): Practical Considerations in Reducing Dividends

Performance for **Part (c)** was poor. Candidates were required to explain 3 practical considerations relating to reducing dividends to finance the acquisition. Responses varied in depth and specificity, indicating room for improvement in connecting theory to practice. Most Candidates did not discuss the ramifications of financing the acquisition via other means such as debt financing and why it could be a viable alternative. In addition, none of the Candidates discussed why equity finance using dividends might be suitable as it matched the term of the finance with the term of the investment.

Additionally, some Candidates did not attempt this question.