Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 9 June 2021

Section 1
General comments

The June 2021 Financial Management exam is a well-balanced paper in terms of the level of difficulty and it tests Candidates on the fundamental knowledge of Financial Management. The level of difficulty and amount of knowledge required from the Candidates are similar to past examination sessions in terms of expectation. The paper required Candidates to apply relevant concepts in attempting the computational as well as theoretical questions.

The overall performance of paper was weaker compared to the previous examination session. The Candidates were observed to performed poorer for both quantitative and qualitative questions. Poor time management skills and weak understanding of the required financial management concepts were assessed to be the attributing reasons. It was also noted that many Candidates left some questions blank which contributed to the loss of marks.

Candidates should prepare themselves to clearly understand the requirement of the questions, demonstrate clear calculations and their implications. This can be done by having a strong concept in Financial Management theories in the syllabus and be exposed to more practice questions using the recommended textbooks or past FMF examinations.

On time management, Candidates should use the 15 minutes reading time to plan their responses to each question. Given each question is worth 25 marks, Candidates should apportion the examination duration to each question equally.

Section 2
Analysis of individual questions

Question 1

Question 1 tested the Candidates to compute the cost of debentures, as well as to derive the net present value of purchasing vs leasing an asset. This was a relatively straightforward question and most Candidates managed to pass this question. There were a few Candidates who demonstrated weak understanding of the questions and hence performed poorly in both the computation and qualitative aspects.

For **part (a),** most Candidates were able to score well for this question. A few Candidates wrongly computed the interest to be net of tax which affected their overall answer.

For **part (b), t**he following observations were noted:

- In **(b)(i)**, most Candidates did not take into consideration the tax savings on the annual maintenance which affected their final computation of Net Present Value.
- Most Candidates took the wrong discount factor as they did not consider the post-tax cost of borrowing.
- Many Candidates were able to calculate the writing down allowance at the end of the 1st and 2nd year, however they failed to realise tax is paid in arrears, therefore the tax savings will start only in T2. This may be due to unfamiliarity with the topic.

For part (c), many Candidates have shown good appreciation of this question and were able to state assumptions such as expected values for the maintenance cost and discount rate used in their computation. There were several instances where Candidates left the answers blank maybe due to lack of time management in the examination.

Question 2

Question 2 tested on the methodology of valuation of a share using Discounted Cash Flow, Future Maintenance Earnings and Revised Net Assets. Candidates need to discuss the applicability of each method of valuation according to the scenario provided in the question. Most Candidates performed badly for this question. Candidates seem to be unfamiliar with the various valuation methods and did not manage to apply the appropriate formulae to the case study. There were several Candidates who did not attempt the question. This could be due to poor time management or the lack of knowledge on the question's requirements.

Part (a) required Candidates to calculate a suitable discount rate for evaluating the purchase of SSL and most Candidates who attempted the question were able to apply the CAPM to derive the discount rate and hence scored passing marks for this portion.

Part (b) is a quantitative question and require Candidates to consider all three methods of valuing SSL shares.

The following observations were noted:

- For Discounted Cash Flow, Candidates failed to compute the cashflow and did not add back the unusual write off of $1.2 million receivable. Also, the number of shares and share value were not computed even though it was required by the question.
- For Future Maintainable Earnings, most Candidates did not account for the lack of marketability when deriving the adjusted P/E. Some Candidates missed out computing the share value as well.
- Most Candidates were able to correctly obtain value using the Revised Net Assets method. It was noted there were a few Candidates who have

mistakenly applied the non-current assets value instead of the book value of equity into the formula.

Part (c) required Candidates to discuss the methods in the scenario given and only a handful of the Candidates were able to explain the three methods. Most of them failed to explain the justification of the range of value either due to poor time management or not knowing how to answer this question.

Question 3

Question 3 tested the concept of cost of equity and debt as well as Weighted Average Cost of Capital. In general, Candidates did not do well for question 3. Many Candidates did not attempt all the question parts. For Candidates who attempted the question parts, the quality of the answers was mixed. While there were certain parts that were relatively well answered, there were also certain areas of weaknesses.

Part (a) required Candidates to compute the beta factor of TEL. While some Candidates managed to score full marks for the question, many did not seem to be aware that they had to calculate the weighted average beta for the individual divisions.

Part (b) required Candidates to compute the percentage cost of equity and preference shares. Some Candidates inaccurately used the market risk premium as the equity return instead when calculating the cost of equity. Some Candidates did not use the ex-dividend price of the preference shares when computing the cost of the preference shares.

Part (c) tested on the weighted average cost of capital. The common errors noted was that some Candidates did not include the overdraft in the computation. Also, Candidates did not calculate the ex-dividend preference shares. Other mistakes pertain to the incorrect computation of the market value of the individual components.

For **part (d)**, while Candidates were able to identify that beta will increase, insufficient explanation was provided which resulted in the loss of marks.

Question 4

Question 4 was largely qualitative and tested on a wide range of topics which required Candidates to explain and apply the concepts of financial strategy, dividend payment and risk management in a case study scenario. The quality of the answers was mixed.

For **part (a)**, the following observation was noted:

- For **(a)(i)** and **(a)(ii)**, Candidates generally identified the right decisions, but insufficient elaboration was provided in some cases. Most failed to point out how the financial decisions interrelated to each other.
- For Part **(a)(iii)**, many Candidates failed to understand that the question was asking about how to fit in a dividend payment and did not managed to answer the question correctly. Some Candidates did not include the recommendation or the justification for the recommendation.

Part (b) was generally well addressed, although some Candidates did not manage to answer the question correctly.

Part (c) and **(d)** were well addressed. For **part (c)**, some Candidates did not evaluate the IT Director's comments. However, the recommendations on embedding risk management were generally addressed satisfactorily. For **part (d)**, Candidates did not provide sufficient elaboration on the impact of debt on WACC and credit rating which resulted in a loss of marks.