SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Financial Management (FMF)

EXAMINATION DATE: 19 June 2023

Section 1
General comments

The Singapore CA Qualification examinations continued to be a restricted open-book examination and is administered on Cirrus, an e-exam platform. The exam tested Candidates' understanding of financial management concepts in various business scenarios found in the real world. The level of difficulty of this examination remains comparable with the previous examinations with both quantitative and qualitative aspects of the module being tested.

The pass rate and quality of the Candidates' answers remained consistent from the previous few cohorts.

Candidates who performed well demonstrated that they have a strong foundation in the module. For those who want to perform well, they should practice more questions as well as make a conscious effort to demonstrate the calculations involved in each step.

Section 2
Analysis of individual questions

Question 1

Question 1 tested Candidates on the concepts of Weighted Average Cost of Capital (WACC) as well as the assumptions when appraising a new project.

Part (a)(i) required Candidates to calculate the cost and market value of equity.

Common mistakes made by candidates were as follows:

(i) Erroneously used retained earnings as profit after tax in the calculation of dividend payout ratio.
(ii) Used the cum-dividend share price instead of the ex-dividend share price to calculate the market value of equity.
(iii) Used total capital instead of total equity as the denominator in the ROE calculation.

Part (a)(ii) required Candidates to calculate the cost and market value of debt.

Common mistakes made by candidates were as follows:

(i) Took the initial price of the debt as 100 instead of 97.

(ii) Took the final price of debt as 107 instead of 100.
(iii) Used before-tax instead of after-tax interest on debt in determining the cost of debt.
(iv) Failed to calculate the value of shares at redemption if the debt were converted into shares and hence missing out on the choice between conversion and non-conversion at maturity.
(v) Calculated the redemption value of debenture at Year 4 instead of Year 5.

For **Part (a)(iii)**, Candidates generally performed well and were able to calculate WACC which was required in this question.

Part (b) required Candidates to list 3 assumptions when using the current WACC to evaluate a new project. About half of the Candidates were unable to answer this question part although this was a relatively straightforward question. There were a handful of Candidates who did not attempt this question.

It was also observed that there were some irrelevant answers presented, such as:

(i) Problems associated with weights for debt and equity.
(ii) Assumptions made regarding market efficiency and transaction costs.

Question 2

Question 2 tested the concept of foreign exchange risks and its implication in the case of remittance restrictions. Candidates were also required to understand the concept and computation of Net Present Value.

Part (a) required Candidates to estimate the exchange rates for each of the 4 years of the project using purchasing power parity**.** Most of the Candidates were able to answer the question although some Candidates used the wrong inflation rate in the question.

For **Part (b),** Candidates were required to calculate the amount and timing of nominal cashflows in Z$. Most Candidates were able to score some marks as long as they presented the workings even if the final answers were wrong. The common error noted was that Candidates incorrectly accounted for the investment at T1 instead of T0. Another common mistake was that Candidates failed to account for inflation for the first year of income.

For **Part (c),** Candidates were required to calculate the NPV in A$ assuming the current policy on remittance restrictions continues. Common mistakes observed from candidates were as follows:

- Failed to account for the delay in remittance for years 1 and 2 to year 3.
- Candidates delayed the investment cash outflow of Z$22m for T0 to T3.

Part (d) required Candidates to calculate and interpret the impact on NPV in A$ if the policy on remittance restrictions is lifted from day 1 of the project. The answers for this question part were mixed. It was observed that some Candidates failed to calculate the difference in the NPV calculated in **part (d)** to the answer in **part (c)** and provided more explanation for their answer.

Question 3

Question 3 tested Candidates on the Modigliani & Miller theory and the traditional views of dividend policy. It also tested Candidates on the decision of offering an early settlement discount vs a reduction in the dividend policy.

For **Part (a),** using Modigliani & Miller's (M&M) theory vs the traditional view of dividend policy, Candidates were required to evaluate the effect of a dividend reduction on the value of the business. Candidates generally did poorly in this question. The expectation from Candidates was to determine whether changing dividend policy would affect the firm's value, using M&M's viewpoint compared to the traditional view. Candidates were to identify the presence or absence of information content or signalling content as well as shareholder preference for capital gains vs dividends for tax reasons using each theory.

Many Candidates attempted this question using the effect on Weighted Average Cost of Capital without discussing the effect of dividend policy directly from the perspectives of M&M as against the traditional view. Valid points were awarded marks.

Some Candidates did not distinguish between Modigliani & Miller theory and the traditional view while others discussed the effect of changes in the Weighted Average Cost of Capital on firm value.

Part (b) tested Candidates on how an early settlement discount would reduce the receivables balance and whether there would be an annual net cost or benefit as a result.

Common mistakes by Candidates in the calculation of the reduction in the receivables balance included the following:

(i) Failed to calculate the higher sales resulting from the discount.
(ii) Failed to calculate receivables before discount. This value is needed to calculate the change in receivables due to the discount.
(iii) Not knowing how to calculate receivables after discount.
(iv) Failed to recognise that receivables after discount have 2 components: those who take advantage of the discount and pay on day 60, and those who did not take advantage of the discount and pay on day 30.

On the calculation of the net benefit or cost of the discount, many Candidates failed to consider all the components required to calculate this. The net benefits or cost should comprise the higher profits due to the discount, the overdraft costs saved and the cost of the discount. Most Candidates failed to consider the higher profits that would arise due to the discount being offered. Candidates also failed to correctly calculate the cost of the discount.

For **Part (c)**, Candidates generally identified the correct course of action given the results of their calculations in the previous question. However, many failed to give appropriate justification for that course of action.

Part (d) required Candidates to give an explanation and illustration of the '3e's' of the Value for Money Framework in the context of the Human Resources Department.

Most Candidates only defined the 3e's without giving examples of how these would apply to the HR Department. A handful of Candidates did not attempt this question part. Some Candidates failed to apply the 3e's to the HR Department but gave general examples which were not applicable to the HR Department.

Question 4

Question 4 tested the concepts of different valuation models such as the Dividend Valuation Model, Assets based, Price-Earnings based and Discounted Cashflow basis. Candidates were required to discuss using the concepts of the above and apply them to the case provided. This was a relatively straightforward question.

Part (a) was generally well answered. A common error was the failure to adjust the dividend paid per share for the bonus share issue. Some Candidates also did not multiply the value per share with the total number of shares to obtain the value of FFTW.

For **Part (b)**, most Candidates managed to identify that the asset-based valuation method is not suitable for the business, considering that it is a service business. They also managed to identify forecasting-related issues for the discounted cash flow method.

For **Part (c)**, half of the Candidates managed to provide an appropriate range of values, although some Candidates did not provide a good rationale for the range.

Part (d) was well answered. Most Candidates managed to identify issues such as i) integration-related costs and problems, ii) the retirement of the current owner and iii) the risk of losing the company's personnel, given that the company's value is linked significantly to them.