

## SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

**MODULE:** Financial Management (FMF)

**EXAMINATION DATE:** 6 December 2021

### Section 1

#### General comments

The December 2021 Financial Management exam is a well-structured and comprehensive paper. The level of difficulty was similar to the previous examinations and there was a good combination of both quantitative and qualitative questions. The paper required Candidates to appreciate different financial concepts and apply them to both computational and theoretical questions.

The overall performance of the examination was satisfactory and comparable to the previous examination session. The Candidates were observed to be generally weaker in the quantitative questions. Examination time management skill is still an area of improvement as it was observed that most Candidates did not manage to complete all parts of the questions.

Candidates are required to have a good understanding of the concepts in Financial Management in order to perform well for the subject. They are encouraged to practice more questions using the recommended textbook and past FMF examination papers to understand how to present the steps in the calculations. They should also read the case facts of the questions carefully when attempting the paper.

### Section 2

#### Analysis of individual questions

##### Question 1

Question 1 tested the Candidates on the Weighted Average Cost of Capital, Cost of Equity, Share price and gearing and the impact of a rights issue. This was a relatively straightforward computation question, however the overall performance was poor for this question.

For **part (a)**, one common issue noted was the incorrect computation of the market value of equity capital. This was mainly due to poor understanding of the concept of **g** (future anticipated annual growth rate in dividends per share) and **r** (the return on invested earnings). Most Candidates have no issues computing the Weighted Average Cost of Capital, taking into account the overdraft.

For **Part (b)**, the quality of the answers were mixed. Most Candidates did not understand how to compute the gearing ratio (pre and post the rights issue).

**Part (c)** was the worst performing question part. Some Candidates were able to explain the effect on the cost of equity due to the increase in gearing as well as the

increased exposure to the financial risk. However, the majority of the Candidates did not explain the effect of the tax deductibility of interest.

## Question 2

Question 2 tested the concept of Interest rate parity, relevant cash flows and the net present value of a product.

**Part (a)** required Candidates to calculate the forward exchange rates of USD per SGD dollars. Many Candidates were able to compute the figures correctly.

Common mistakes made by Candidates are as follows:

- (i) Included inflation rate in the calculation when the question explicitly stated: "Using Interest Rate Parity."
- (ii) Mixed up the interest rates applicable in the interest rate parity equation.
- (iii) Confusing USD per SGD and SGD per USD. A handful of the Candidates calculated SGD per USD and called it USD per SGD which was incorrect. If they had calculated SGD per USD and called it SGD per USD, full marks would have been awarded.

**Part (b)** required Candidates to compute the SGD equivalent values of US revenues. This required calculating probability-weighted volumes and prices adjusted for inflation.

Common mistakes made by Candidates included the following:

- (i) Failure to use probabilities in calculating volumes.
- (ii) Used the wrong inflation adjustment or not adjusting for inflation when calculating the price.
- (iii) Incorrect conversion from USD to SGD. If forward exchange rates are expressed as USD per SGD, then conversion to SGD would mean dividing US revenues by the USD per SGD exchange rate. Some Candidates did the reverse.

**Part (c)** required Candidates to calculate the NPV of a proposed new project and conclude if the investment should proceed. This was the worst performing question part for question 2. Several Candidates did not attempt or complete **part (c)** which commanded the most marks.

Candidates lost marks in the following areas:

- (i) Failed to consider the terminal value of the project. Many Candidates focused on the first 4 years of the project and failed to recognise that the forecast revenues would be at a constant level thereafter.
- (ii) Incorrectly calculating material costs. As material costs were given at the beginning of the year and were expected to escalate at a rate of 10% per

year, the 10% escalation should be applied from the first year onwards as all cash flows reflect the end of year figures.

- (iii) Incorrectly calculating “other variable costs”. Many Candidates ignored the years following the first 4 years. This same mistake was made for material costs as well.
- (iv) Some Candidates were not familiar with the Fisher equation and calculated the discount rate incorrectly, while others simply applied the real cost of capital. The correct discount rate was the nominal cost of capital.
- (v) The working capital calculation should reflect the change year-on-year but some Candidates used the actual working capital figures for each year.
- (vi) Few of the Candidates calculated the terminal discount factor correctly, which was simply the discount factor used to calculate the PV of a perpetuity (since the constant cash flows are continuing indefinitely) discounted back to the present.

### Question 3

Question 3 tested the concept of using a debt factor, managing credit risk and the Baumol model. The majority of the Candidates performed well for this question.

**Part (a)(i)** required Candidates to calculate the reduction in receivables and the finance cost that this reduction in receivables will create.

The following mistakes were observed:

- (i) Candidates erroneously used 40 days for the calculation of the amount of the old receivables, instead of the USD 2.229 million that was provided in the question.
- (ii) Candidates multiplied the new receivables days with the USD 2.229 million receivables amount instead of the sales amount.
- (iii) Used the difference of 7% and 5% to obtain the finance cost savings instead of just using the short-term finance cost of 5%.

For **part (a)(ii)**, most Candidates managed to obtain marks for including administrative cost savings and computing the annual fees payable to the factor. However, some Candidates had issues with the computation of bad debt savings and the finance cost of the factor advance. While most Candidates obtained a net cost/benefit figure successfully, there were some Candidates who did not include a recommendation after obtaining their figure.

For **part (b)**, the general observation is a lack of elaboration of the methods identified.

For **part (c)**, although most Candidates managed to apply the correct formula, they used the wrong annual interest rates. Some Candidates did not compute the number of transfers required per year, and thus lost marks.

Like **part (b)**, most Candidates identified the correct issues with the model for **part (d)** but failed to provide sufficient elaboration on the issues.

#### Question 4

Question 4 tested the equivalent annual cost method, non-financial considerations before making a final decision and calculating the profit maximising investment plan.

For **Part (a)**, the following observations were noted:

- Most Candidates did not apply the correct rates from the Present Value table provided. Candidates should try to indicate Year 0 in their workings in order to avoid using the wrong rates.
- Most Candidates were unable to derive the net cash flow.

**Part (b)** was the worst performing question part for this question. The majority of the Candidates failed to discuss 3 non-financial considerations and provided financial related considerations instead. There were also some Candidates who used the PESTEL model to explain. It is recommended that Candidates should be more precise in answering this sort of qualitative questions by answering in relation to the case facts.

**Part (c)** was a relatively simple question on a profit maximising investment plan. However, it was observed that many Candidates stopped at the 25% computation and did not go further to compute the Net Present Value of project D. About half of the Candidates managed to derive the actual percentage required for each project.