## SINGAPORE CA QUALIFICATION EXAMINER’S REPORT

**MODULE:** Business Value, Governance & Risk (BG)

**EXAMINATION DATE:** 12 December 2017

### Section 1

#### General comments

This examination consisted of a single case study with financial and industry data contained in appendices. Considering the specialist nature of the topics examined in this module, the question paper was divided into two distinct sections of equal weight.

The case study company was a home-grown manufacturer and supplier of medical devices with plans to list on the mainboard of the Singapore Exchange (SGX) to fund its future expansion.

**Governance & Risk component – Questions 1 and 2 (50 marks)**

In Question 1, Candidates were tested on their understanding of the composition of audit committees (AC), the roles and responsibilities, and requirements/qualifications of AC members, and on the independence criteria of directors. The second question tested the Candidates’ understanding of risk management, focusing on their ability to identify and describe risks, as well as advising the Board and management on choosing the appropriate risk response.

Overall, Candidates performed much better for Question 1. As this was an open book examination, the better result for Question 1 may be due to Candidates being able to refer more easily to specific information from documents such as the *Code of Corporate Governance*. However, Question 2 tested Candidates on risk identification and choices in risk responses where they needed to be more analytical, as well as having better industry knowledge and be able to apply professional judgment. As in the previous examination, it was noted that more than 10% of Candidates did not complete all the question parts in Question 2. As can be seen from the comments below, there are a fair number of Candidates who failed to read the questions carefully.

**Business Value component – Questions 3 and 4 – (50 marks)**

Question 3 focused on analysing the case study company’s financial prospects, provide a valuation for the company demonstrating the appropriate use of a guideline company, and derive a range of values for the Initial Public Offering (IPO) price.

The company intended to use part of the IPO proceeds to acquire an existing (non-related) company located in Malaysia, following which part of the current Singapore production would be moved there. The target company, which was the focus of Question 4, was part of a Multinational Corporation (MNC) and used the United States dollar (US$) as its functional and presentation currency.
Overall, Candidates performed substantially better for the Governance & Risk Component than they did for the valuation component. While Candidates demonstrated reasonable understanding of valuation concepts and principles, there were gaps in practical application and computational errors which meant that some Candidates failed to perform to the best of their ability in this section.

Future BG Candidates are reminded to always apply professional judgment and scepticism to the raw data given in the case and to make appropriate adjustments. Even if a Candidate feels that no adjustments are required, they would be wise to include this opinion as part of their answer. However, experience has shown that it is most unlikely that no adjustments at all would be required. Remember, the markers are looking for answers that have considered the veracity of the numbers provided in the case.

Section 2
Analysis of individual questions

Question 1

Question 1 was divided into four parts, (a), (b), (c) and (d) and focused on whether the new directors to be appointed qualified as ‘independent directors’ and on the diversity of experience of these new directors to discharge their responsibilities as AC members.

Part (a) required Candidates to review the proposed Board composition and advise the Chairman of three additional considerations that needed to be taken to comply with the Singapore Code of Corporate Governance. This question part was generally well answered by most Candidates.

Part (b) required Candidates to apply the principles in the Code of Corporate Governance to evaluate whether each of the proposed directors would be considered independent. Most Candidates assessed the independence of these nominees correctly. A number of Candidates also questioned in the case of Dr Gomez, though considered independent, whether his business commitments would permit him to attend to Board matters.

Assuming all of the proposed new directors qualified as independent, Part (c) required Candidates to identify the challenges these new directors may face as AC members given their respective backgrounds. Although Candidates could identify the challenges, most Candidates did not suggest what the Board should do to resolve the knowledge gaps.

Part (d) required Candidates to review the re-appointment of the external auditors given the fact of the case. This question part was generally well answered.

Question 2

Question 2 was divided into (a), (b), and (c), focusing on risk identification and risk responses. Generally, Question 2 was not as well answered as was Question 1. Most
Candidates seemed to struggle with identifying the appropriate risks and providing a description of the risks.

**Part (a)** required Candidates to identify risk responses and recommend an appropriate risk response to the Board. Although most Candidates could identify the risk responses, they were unable to define these risk responses correctly. For example, ‘accepting’ a risk was defined as introducing additional controls. A number of Candidates also neglected to provide a recommendation to the Board as required in the question part.

**Part (b)** required Candidates to identify risks and risk descriptions. Some Candidates were confused with risk description. For example, the description for ‘credit risk’ in fact relates to liquidity risk.

In **Part (c)**, many answers were irrelevant in respect of Ms McCabe’s supervision of the treasury activities. Candidates evaluated the suitability of her banking experience being a relationship manager and not a dealer, instead of her role as a Board member of the company.

**Question 3**

This question focused on the case study company (the acquirer) and was presented in three parts.

**Part (a)** required the preparation of two years of pro forma financial statements for the case study company and to derive a projected free cash flow from these statements. Most Candidates answered this question part adequately. To score well, the projections needed to be justified based on past history or other case facts, which most Candidates also did adequately.

**Part (b)** required finding the best choice as a guideline company based on selected ratios given in the case. Most Candidates could correctly compute the ratios and made a reasonable choice of guideline company based on these computations.

For **Part (c)**, Candidates were asked to propose a valuation based on the valuation ratios they had calculated in **Part (b)**. The valuation could show an adjustment for the synergy from the proposed post-IPO acquisition, which most Candidates did not reflect. Also, medians or trimmed means would have provided a more robust valuation rather than using the raw averages of the guideline company data, since these showed a wide variation. Many Candidates omitted to reflect any adjustment for this in their computations.

**Question 4**

This question focused on the company identified for acquisition and was also presented in three parts.

For **Part (a)**, Candidates were required to calculate free cash flow for the proposed acquisition target in a form that could be used in valuing it. Most Candidates answered
this question part poorly, neglecting to adjust the pro forma financial statements to reflect market conditions.

**Part (b)** required estimating the Weighted Average Cost of Capital (WACC). Many Candidates answered this question poorly, failing to correctly match the parameters to the currency used to measure cash flows.

For **Part (c)**, Candidates were required to estimate a valuation for the target company using a discounted cash flow approach. Most Candidates were able to answer this question part adequately, except for errors flowing from the previous parts (although these consequential errors were not penalised).