Section 1
General comments

Overall, the performance for the December 2017 sitting was satisfactory. This was the third centralised examination for the Financial Management module and there was a slight improvement in the passing rate compared to the previous examination session.

Generally, Candidates were adequately prepared and were able to handle basic financial management questions. However, none of the Candidates did exceptionally well.

A majority of Candidates did fairly well for Question 1, which required them to calculate free cash flows, Net Present Value (NPV), and payback period. Questions 2 and 3 covering, amongst other topics, Weighted Average Cost of Capital (WACC), working capital, and risk management were below satisfactory level. The Candidates’ performance was satisfactory for Question 4, which covered equity valuation, ethics, and efficient market hypothesis topics.

The higher average mark for Question 1 indicates that many Candidates did not apportion their time appropriately, spending more time than they should have to complete Question 1, which left them with insufficient time to complete the remainder of the questions to a satisfactory level. Future Candidates should take heed that relying on passing one question extremely well is unlikely to achieve a passing grade for the examination overall.

To do well for this module, Candidates needed to have concise answers and show all detailed workings clearly. A handful of Candidates used a financial calculator, which improved the speed and accuracy of certain computations.

Section 2
Analysis of individual questions

Question 1

This question required Candidates to calculate free cash flows for a potential investment in a foreign jurisdiction, NPV, and payback period, as well as identify one foreign exchange risk and describe an appropriate hedging strategy for the company.

For Part (a), most Candidates were able to compute the sales, variable costs, fixed costs, and tax correctly. However, some Candidates were unable to work out the capital allowance accurately, including the balancing charge in Year 5. A common
mistake made by a few Candidates was to include the initial investment in Year 1 instead of Year 0. While most Candidates were able to compute the NPV (either manually using the present value table or using a financial calculator), a handful of Candidates could not work out the payback period. Some Candidates used profit instead of cash flow for the latter. Candidate should have presented the cumulative cash flow figures clearly.

**Part (b)** required Candidates to identify one foreign exchange risk faced by the company and describe a suitable hedging strategy to mitigate the risk. While most Candidates were able to name a foreign exchange risk, they neglected to explain why the item they identified was a risk given the facts of the case. When describing a suitable hedging strategy, again most Candidates were able to name a suitable hedging strategy but some Candidates lost marks because they did not describe the main characteristics and features associated with their chosen hedging strategy.

An overwhelming majority of Candidates noted currency fluctuations between the Malaysian Ringgit and the Singapore Dollar as a transactional foreign exchange risk. While this answer was correct, the frequency of this answer suggests that Candidates’ knowledge of the types of foreign currency risks is limited. Very few Candidates chose to mention translation risk (e.g. financial reporting consequences) or economic risk (how currency movements affect the validity of NPV calculations over time).

Candidates are strongly advised to make good use of the verbs list provided in the appendix attached to each examination paper to ensure that their answer is in line with what the Examiner expects and this will help them to maximise their mark.

**Question 2**

This question required Candidates to calculate the WACC, state the assumptions for using the WACC, and tested concepts relating to crowdfunding, Sharia-compliant financing, and capital structure.

For **Part (a)**, the majority of Candidates were not able to compute the WACC correctly for several reasons. The most common mistake was failing to adjust the dividends per share in 20x4 for the stock split when computing growth rate. Some Candidates failed to use the ex-dividend share price when estimating cost of equity and market value of equity. On a positive note, most Candidates were able to obtain the cost of debt and value of debt correctly. However, a fair number of Candidates did not use the market value of preference shares to compute the WACC.

Candidates are reminded that there are three key decisions in a long-term financial strategy – the investment decision, the finance decision, and the dividend decision. The finance decision is therefore central to financial management, and calculating the cost of capital and discussing what influences it is therefore likely to be a recurring theme in future examination sessions.

Candidates performance was satisfactory for stating the assumptions for using the WACC in **Part (b)**.
### Question 3

This question focused on topics relating to the nature and purpose of financial management, working capital management, and risk management.

To maximise their mark for **Part (a)**, Candidates needed to provide a holistic description of the nature and purpose of financial management in relation to the case study company, which included both short-term and long-term factors. Most Candidates were able to articulate the short-term goals, but neglected to think about financial management in terms of long-term goals and so lost marks.

When answering **Part (b)**, most Candidates were not able to calculate the working capital correctly because their approach was flawed. Candidates needed to determine the level of accounts receivable, inventory, and accounts payable based on the assumptions given. Instead, some Candidates computed the average accounts receivable, inventory, and accounts payable days which were not required. The part which required Candidates to propose ways of reducing accounts receivable was generally well answered.

**Part (c)** required Candidates to apply the TARA (transfer, avoid, reduce, or accept) framework to review four common risks in relation to the case study company. Most Candidates were able to achieve a pass for this question part, but a few Candidates made recommendations that were clearly impractical, such as ‘avoid the risk’ by moving the catering plant to another location (too costly and the operations would be interrupted during the relocation process) rather than recommending ‘transfer the risk’ by buying appropriate insurance coverage. Another common oversight was to correctly match the risk strategy to the risk, but fail to explain why this strategy was appropriate.

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**Part (c)** looked at the advantages and disadvantages of two non-traditional sources of financing, which are available in Singapore: i) crowdfunding, and ii) Sharia-compliant loan finance. Candidates were more able to explain crowdfunding than they were Sharia-compliant loan finance. Candidates who did well for this question part were able to clearly describe and articulate one advantage and one disadvantage of each source. In relation to sharia-compliant loan financing, one common mistake was to assume that because no interest is charged that the loan is provided free of charge.

**Part (d)** required Candidates to analyse the WACC that they had computed in **Part (a)** and recommend whether the major new investment should be financed by debt or equity. Overall, this question part was poorly completed, with many Candidates not able to justify their recommendation. The majority of Candidates also did not refer to ‘theory’ (Modigliani and Miller versus the traditional view) to help strengthen their answer.

As a point to note, if a Candidate had incorrectly calculated the gearing level in **Part (a)**, and therefore recommended equity funding rather than debt financing, but went onto appropriately justify their recommendation, they were awarded marks accordingly, with a few Candidates achieving full marks for **Part (d)**.
For **Part (c)** there were multiple acceptable answers for each risk, making this an easy question to achieve full marks, but quite a number of Candidates underperformed because they failed to justify their recommendations.

**Question 4**

**Part I** covered equity valuation and ethical issues.

The majority of Candidates were able to calculate the value per share using the net asset, dividend discount, and price-earnings (P/E) model correctly. However, for the P/E model, no Candidate applied a discount for lack of marketability.

Most Candidates were able to outline a limitation of the above mentioned valuation methods. However, some Candidates were not able to identify one ethical issue based on the facts of the case. It is worth noting that the agency problem is not an ethical issue. Some Candidates left this part blank, possibly suggesting poor time management or a lack of understanding of the importance of ethical conduct and values to professional accountants.

**Part II** covered the Singapore *Code of Take-overs and Mergers* and the efficient market hypothesis.

Although most Candidates had sufficient time to attempt **Part II** of Question 4, overall, it was generally poorly attempted. For **Part (a)**, Candidates were required to explain how the directors of the Acquiring Company AND the Target Company should behave under the Singapore *Code of Take-overs and Mergers*. Acting fairly towards all parties and making as much information as possible available was a great place to start. Candidates also needed to ensure that they commented on how the Board of Directors of each company (the Acquiring Company AND the Target Company) should behave **based on the facts given in the case**. A common error was to state actions that were not relevant to the facts given. Another common error was only commenting on the appropriate action to be taken by the Acquiring Company but neglecting to comment on the appropriate actions to be taken by the Board of Directors of the Target Company.

**Part (b)** was quite poorly attempted, with many Candidates just providing a scant definition for each market type, which was not required, with few Candidates stating that, generally, the market in Singapore is ‘semi-strong’.