Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Advanced Financial Reporting (AFF)

EXAMINATION DATE: 5 December 2023

Section 1

General comments

The overall performance of the Advanced Financial Reporting (AFF) December 2023 examination falls short of expectations. Most of the Candidates underperformed in Question 2 (Impairment of Assets) and Question 3 (Financial Instruments). Further analysis and common errors made by the Candidates are detailed in Section 2.

Candidates are reminded that the AFF module builds upon the knowledge and skills studied in the Principles of Financial Reporting module, and therefore they need to put in enough time and effort in their preparation for the examination. Candidates are expected to demonstrate sound knowledge of and apply the Conceptual Framework and the Singapore Financial Reporting Standards (International) (SFRS(I)) to produce a complete set of financial statements for single entities and simple groups, including basic notes to the financial statements. Candidates are also expected to be able to explain and advise on the application of the SFRS(I), including the appropriate treatment and disclosure requirements, demonstrating appropriate professional judgment.

Candidates have to be well-prepared across the range of SFRS(I) and not leave any SFRS(I) uncovered in their revision. In addition, Candidates should also be focused and relevant in their answers to the theoretical components of the paper. Quoting the text from the standards and other sources will receive little or no marks for the question.

Marks can only be awarded for the application of the requirements to the facts of the case.

Section 2
Analysis of individual questions

Question 1

This question was on consolidated financial statements involving a Group comprising a subsidiary and an associate. It required Candidates to prepare consolidation and equity accounting journal entries in **part (a)**, and provide independent proof of the net profit after tax; other comprehensive income, and total comprehensive income attributable to owners in **part (b)**. This question required the application of SFRS(I) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures*.

Part (a) was generally well attempted by the Candidates. However, it was noted that a number of Candidates who attempted the question could not provide the correct basic investment elimination entries including the computation of goodwill.

The common errors made by the Candidates were as follows:

(a) Under-valued factory building of the subsidiary at the acquisition date, which was subsequently sold at net book value by the subsidiary to an external party in the prior year.

From the group's perspective, the factory building should first be adjusted to reflect the fair value at the group level and thereafter to recognise the loss on disposal of the factory building in the prior year at the group level. Most Candidates were not able to identify the correct journal entries (or the correct amount) for the reversal of the under-valuation of the factory building, subsequent depreciation of the under-valued factory building and the recognition of the loss on disposal of this asset at group level. As a result, the non-controlling interest's share in the beginning retained earnings of the subsidiary were not determined correctly.

(b) Inter-company sales during the current year and the inter-company balances at the end of the current year.

A number of Candidates did not eliminate inter-company balances and/or computed the wrong amounts for inter-company sales and balances at the year-end.

As for equity accounting for associates, most Candidates have done well. Common errors arose mainly from the reversal of unrealised profit in ending inventories arising from upstream sale from the associate to the parent. Many Candidates could not compute the amount of unrealised profit correctly.

Part (b) continued to be the most challenging part for Question 1 as many Candidates did not attempt this part at all. For those Candidates who attempted, they did not perform well. Instead of preparing the independent proof of the net profit after tax; other comprehensive income and total comprehensive income attributable to owners (as required by the question), they showed the workings of Consolidated Statement of Comprehensive income that presented the Net profit after tax and Other Comprehensive income of the group instead. Some Candidates also prepared the independent proof of the consolidated retained earnings instead of the total comprehensive income.

Analytical checks are critical review function that allows the accountant to derive a balance independently of the journal entries. Candidates should be familiar with analytical procedures that underscore a deeper understanding of the processes in consolidation.

Candidates should work towards high competency in consolidation. More attention should be given to complex transactions that involve inter-company elimination.

Question 2

Question 2 comprised of two parts and the first part of the question was not well attempted by the Candidates.

Question 2 Part I

This part examined the Candidates on the application of both SFRS(I) 1-16 *Property, plant and equipment* and SFRS(I) 1-36 *Impairment of Assets.* It required Candidates to calculate and record the relevant journal entries in respect of the production equipment; i.e., to compute the impairment loss for the asset and the subsequent depreciation expenses and reversal of impairment loss for the respective years.

Most Candidates were able to identify and record the impairment loss expense for the first year correctly. However, most Candidates made errors in computing the depreciation expenses in the subsequent years. The carrying amount of the production equipment (after impairment) should be depreciated over the remaining useful life, rather than the expected useful life of the asset.

SFRS(I) 1-36 paragraph 117 stated that the increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss has been recognised for the asset in prior years. Majority of the Candidates did not compute the amount of write-back of impairment loss correctly and hence could not provide the correct journal entry in respect of the write-back of impairment loss.

A number of Candidates did not provide the workings of the respective carrying amounts of the production equipment with impairment loss and without impairment loss. Candidates are reminded to provide clear and relevant workings. If Candidates presented incorrect amounts/balances in their journal entries, the absence of workings will result in the loss of marks.

Overall, Candidates could have scored better if they read carefully the facts of the case and addressed the requirements of the question.

Question 2 Part II

This question required Candidates to apply SFRS(I) 5 *Non-current Assets Held for Sale and Discontinued Operations* and state if the respective assets in the question should be classified as “held for sale” and to determine their respective carrying amount including any impairment loss.

Most Candidates scored well for this part. They were able to identify the asset that was classified as "held for sale" correctly and were able to compute both the carrying amounts and the impairment loss of the relevant assets.

Question 3

Question 3 comprised of two parts and both parts were badly done by the Candidates.

Compared to prior examinations, Candidates in this session did not do well in this topic. Both question parts tested Candidates on the new updates to the Financial Instruments standards, and it appears that most Candidates were not competent in the technical aspects of the standards and also on the updates to the standards relating to Expected Credit Loss and its interaction with the Fair Value through Other Comprehensive Income financial instruments. Candidates should look at para 5.5.1 of SFRS(I) 9 onwards, particularly para 5.5.8 for the correct accounting treatment.

Question 3 Part I involved an application of requirements of SFRS(I) 1-32 *Financial instruments: Presentation* and to discuss whether perpetual bonds and preferred shares should be classified as equity. This is a straightforward question on the classification of financial instruments between liability and equity.

SFRS(I) 1-32 paragraph 16 stated that a financial instrument is an equity instrument from the issuer's perspective if, and only if, both the following conditions are met:

(a) The instrument includes no contractual obligation to deliver cash or another financial asset to another entity; or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer; and

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the issuer.

Most Candidates were able to derive the correct answers by applying the tests given in the standards. However, it was noted that majority of the Candidates ended up concluding the wrong answers instead.

Question 3 Part II required the Candidates to apply SFRS(I) 9 *Financial Instruments* and to prepare the journal entries for the purchase of bond and for the fair value changes, interest income received, impairment loss and eventual sale of the bond identified in the question.

Paragraph 5.5.8 of SFRS(I) 9 states that an entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this standards.

Most Candidates were unable to score well in this question part. The following were the common errors made by the Candidates:

- Classification of the financial asset as fair value through other comprehensive income (FVTOCI) should be included in the account name in the journal entries to avoid ambiguity. This requirement was clearly stated in the question.

- Effective Interest Rates (EIR) were not relevant in answering this question but many Candidates used the EIR method to determine the fair value of the debt instrument with insufficient information.

- The difference in the accounting treatments between financial instruments recognised as fair value through profit or loss (FVTPL) and FVTOCI was poorly understood by many Candidates.

- The Expected Credit Loss model was poorly understood and rarely applied to this question.

While the Expected Credit Loss model is relatively new, the Candidates should be familiar with the standards and apply them correctly. As stated in the examination guide, Candidates are expected to be familiar with all the SFRS(I) that were issued by the Accounting Standards Council as at 1 January 2023.

Question 4

Question 4 comprised of two parts and this question was relatively well-attempted by the Candidates.

Question 4 Part I (a) and (b) required the Candidates to identify the related parties of the reporting entity and to disclose the relevant information and relationship as required by SFRS(I) 1-24 *Related Party Disclosures* in the financial statements.

The Candidates generally performed well in identifying the related parties and many Candidates scored full marks for this question part.

Errors noted:

- A handful of Candidates wrongly identified Company F as a related party even though Mr D, the key management personnel of the parent does not have control over the entity;

- Some Candidates did not justify the related party relationships correctly. They merely mentioned the respective parties are related parties to the reporting entity; without indicating Company A or Mr D. The correct application of SFRS(I) 1-24 was to identify the relationship specified in the questions such as key management personnel of the parent, entities with significant influence or joint control.

For information and relationships to be disclosed in the financial statements, Candidates generally were able to identify most of the items or transactions that required disclosure under SFRS(I) 1-24. However, some of them omitted items such as the amount outstanding between the related parties and the reporting entity; including the allowance for impairment and the impairment expense recognised during the period in respect of the amount outstanding, if any.

Question 4 Part II required the Candidates to apply SFRS(I) 15 *Revenue from Contracts with Customers* to prepare journal entries to record contract costs incurred, progress billings made, as well as contract revenue and contract cost for the current year in **part (a)** and to compute the balance of the contract asset or liability as at the end of the current financial year in **part (b)**.

Part (a) was a straightforward question on revenue recognition via input method based on the percentage of completion. The performance of the Candidates was fair as most Candidates were able to compute the correct contract revenue and contract costs for the year.

Common errors noted were:

- Some Candidates did not manage to calculate the percentage of completion correctly as they interpreted the contract cost incurred for the current year wrongly as the cumulative contract cost incurred to date;

- Wrong computation for the cumulative contract costs; as some Candidates did not include the contract costs incurred in prior years; and

- Candidates were still using terminology under the old FRS 11 *Construction Contracts* which had been superseded by SFRS(I) 15 on 1 January 2018. Candidates should be familiar with the accounting treatments under SFRS(I) 15 and should use the correct account name i.e., Contract assets and liabilities rather than the old names like Construction work-in-progress and progress billing.

As emphasised in past years, Candidates need to show workings to support the percentage of completion, contract revenue and contract costs. If Candidates presented incorrect amount/answers, the absence of such workings resulted in the loss of working marks.

For **part (b)**, many Candidates did not attempt or complete poorly for this last question part. Candidates were advised to manage their time better to ensure sufficient time is allocated to all the questions in the examination. This is especially important since additional marks could be scored for their attempt at each question.

Most Candidates lost their marks due to the wrong interpretation of the question. The question required an answer relating to the balance of Contract liability as at the end of the year. Some Candidates provided the answer for the total costs incurred on the contract, while others provided the actual profit & loss for the current year instead.

Candidates are advised to read the questions carefully before attempting the question.