Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (PROFESSIONAL) EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 22 June 2023

Section 1
General comments

The paper tested Candidates on their understanding and application of Singapore Financial Reporting Standards (International) (SFRS(I)).

In Question 1, Candidates were required to demonstrate their understanding and application of SFRS(I) 3 *Business Combinations,* SFRS(I) 10 *Consolidated Financial Statements,* and SFRS(I) 9 *Financial Instruments.* Most Candidates displayed a good understanding of the preparation of basic consolidation journal entries. However, Candidates did not perform well in **Parts (a)** and **(c),** as compared to **Part (b)**, in determining the balance of non-controlling interests.

The overall performance for Question 2 was mixed. Candidates did well for **Case A (a)** on SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates* and **Case B** on SFRS(I) 16 *Leases* as compared to **Case A Part (b)** and **Part (c)**. However, it was noted that many Candidates lacked a good knowledge of preparing equity entries on SFRS(I) 1-28 *Investments in Associates and Joint Ventures* and SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates* and determining the balance of investment.

Question 3 comprised two case studies. **Case A** tested Candidates' understanding of the definition of a financial instrument as outlined in SFRS(I) 1-32 *Financial Instruments: Presentation* and apply the criteria to determine if bitcoin, a cryptocurrency, qualify as a financial asset. **Case B** required Candidates to display their proficiency in the accounting of equity instruments, derivatives (i.e., put option) as well as hedge accounting. In addition to having the Candidates prepare journal entries to record the stated transactions in **Part (a)**, **Part (b)** required the Candidates to explain whether impairment loss needs to be recognised in the stated scenario.

This question was generally poorly attempted. About half of the Candidates who attempted **Case A** incorrectly identified Bitcoin as a financial asset. While most Candidates who attempted **Case B Part (a)** were able to correctly provide the more straightforward journal entries for the transactions mentioned in the case, many Candidates were not able to account for the exercising and settlement of the put option. The majority of the Candidates failed to score any marks for **Case B Part (b)** either because they did not attempt the question or wrongly identified that impairment loss is required.

Furthermore, Candidates are advised to read the questions carefully before attempting each question to avoid unnecessarily losing marks.

In addition, Candidates are reminded to show workings, as marks may be awarded for correct workings, even though the final answer is incorrect.

Section 2
Analysis of individual questions

Question 1

In this question, Candidates were required to demonstrate their understanding and application of SFRS(I) 3 *Business Combinations*, SFRS (I) 9 *Financial Instruments*, and SFRS(I) 10 *Consolidated Financial Statements*.

Part (a) required Candidates to enact the journal entries in the books of a parent company (P Co) in relation to the market fee for providing a guarantee on a 10-year loan for its subsidiary (X Co).

This Part was not well-attempted by most Candidates. Only a small percentage of Candidates were able to provide the correct journal entries on the recognition of contract liability/deferred or unearned revenue and the amortisation of fee income/guarantee fee income for the current year 20x6. Many Candidates wrongly recorded the full fee of $10,000 as fee income for 20x6 and omitted the amortisation of fee income.

Part (b) required Candidates to prepare consolidation adjustments relating to a company's (P Co's) interest in its subsidiaries, X Co and Y Co.

Most Candidates performed well for this part and were able to correctly furnish the consolidation adjustments pertaining to the elimination of investment in X Co and Y Co, allocation of post-acquisition retained earnings to non-controlling interests (NCI), elimination of intra-group balances and elimination of dividends declared by X Co, except for the common errors identified below.

Common errors included the following:

- The elimination of investment in subsidiaries – some Candidates adjusted the fair value differential of inventory (X Co) or fixed assets (Y Co) wrongly, while others used the wrong balance for retained earnings or OCI or NCI for Y Co. As a result, they also did not derive the correct amount of goodwill.

- The adjustment for the cost of sale of undervalued inventory (X Co) – some Candidates adjusted for the full value of the inventory instead of the differential in fair value at the acquisition date, while others adjusted the cost to the current year's profit instead of opening retained earnings. Candidates are reminded to carefully note the year in which the event happened and the difference between adjusting to the current year's profit versus adjusting to opening retained earnings, and their respective scenarios.

- The adjustment of unrealised loss on transfer of fixed assets from X Co to P Co and reclassification of loss on sale to impairment loss – some Candidates calculated the loss on sale of fixed assets wrongly, while others did not reclassify the correct amount of the loss on sale to an impairment loss. Candidates are reminded to note the parent's point of view versus that of the subsidiary's point of view, to be able to identify the correct consolidation adjustment.

- The adjustment for depreciation of undervalued fixed assets (Y Co) – some Candidates did not adjust for the current year's and/or prior year's depreciation correctly.

- The adjustment to profit on sale of undervalued fixed assets to P Co – some Candidates were unable to work out the correct amount of profit to be adjusted. There were also some Candidates who omitted this adjustment entirely.

- The allocation of the current year profit of X Co to NCI of X Co – While most Candidates were able to furnish the correct consolidation adjustment, many were unable to work out the correct amount. They either did not adjust for the dividend received from Y Co, or the unrealised loss on the sale of fixed assets from X Co to P Co. There were also some Candidates who made the adjustments in the reverse way.

- The allocation of the current year profit of Y Co to NCI of Y Co – While most Candidates were able to furnish the correct consolidation adjustment, many were unable to work out the correct amount. They either did not adjust for the depreciation of undervalued fixed assets, or the profit on sale of undervalued fixed assets, while some made the adjustments in the reverse way. There were some Candidates who used the wrong NCI percentage.

- Elimination of dividends declared by Y Co – while most Candidates could work out the correct entry, many calculated the wrong amounts to be adjusted.

- Many Candidates omitted the following consolidation adjustments:
  - Elimination of fee income and fee expense on guarantee; and
  - Elimination of contract liability and prepayment arising from guarantee.

Overall, for this question part, Candidates are reminded to understand the common consolidation adjustments required, including but not limited to, intra-group sale of assets, past and current adjustments related to undervalued fixed assets, etc.

Part (c) required Candidates to perform an analytical check (proof of balance) of non-controlling interests (NCI) of X Co and Y Co.

While some Candidates demonstrated that they understood and correctly applied the concept of performing an analytical check (proof of balance) of NCI of X Co and Y Co, other Candidates need to have a better understanding of how to perform an analytical check of NCI, especially the adjustment for unrealised loss on fixed assets.

Some Candidates omitted to less out the investment in Y Co while performing the analytical check of NCI of X Co.

Most Candidates correctly included goodwill in the analytical check of NCI, but the amounts were wrong.

There were also some Candidates who simply listed the consolidation adjustments pertaining to NCI.

The analytical check is a way of determining the consolidated balances of key figures independently of the process of passing elimination and adjusting entries. It serves as a method of analytically validating key consolidated numbers. Candidates are encouraged to understand the logic behind the analytical check of non-controlling interests.

Question 2

<u>Question 2 Case A</u>

Question 2 Case A (a) required Candidates to translate the United States dollars (US$) financial statements to Singapore dollars (S$) in accordance with the requirements of SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates.*

This question part was well attempted by the Candidates. Generally, Candidates have a good understanding of the concepts on Foreign Currency Translation Reserve (FCTR), i.e., using the different exchange rates for balance sheet, P&L items, and reserves. The common error made by the Candidates was to derive the retained earnings figure as at 31 Dec 20x5, Candidates will need to consider the net profit and the dividends declared for 20x5.

Candidates are reminded to write clear workings for their answers as the markers will not be able to award the marks correctly if they could not find the answers as it was not organised.

Overall, both **Question 2 Case A (b) and Question 2 Case A (c)** were poorly attempted by the Candidates.

Case A (b) required Candidates to prepare equity accounting entries in accordance with the requirements of SFRS(I) 1-28 *Investments in Associates and Joint Ventures* and SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates.*

The following common errors by Candidates were noted:

- Share of profit in associate for 20x6 – Candidates did not factor in amortisation of intangible assets.
- Share of post-acquisition FCTR – Candidates did not compute goodwill correctly nor the FCTR on goodwill, and/or did not compute the FCTR on

intangible assets correctly. Some Candidates did not even consider the FCTR double entry in their answers.

- A number of Candidates missed out on the entry on the past amortisation of intangible assets.

- Quite a number of Candidates applied the FX wrongly, hence not being able to come up with the correct answers, but marks were still awarded if appropriate workings were in place.

Case A (c) required Candidates to perform an analytical check (proof of balance) of the balance of Investment in A Co. Many Candidates either did not attempt or did not manage to pass this question part. Some Candidates were unsure of how proofing should be done. Candidates are reminded to have more practice or revisions on accounting and translation of foreign entities and associate proofing concepts.

<u>Question 2 Case B</u>

This part required Candidates to determine the amount of leased asset and lease liability at the inception of the lease and prepare the necessary journal entries and lease amortisation table from the lessee perspective according to SFRS(I) 16 *Leases*.

Candidates generally did well. Most of the Candidates can prepare the journal entry to record the leased asset and lease liability on the inception of the lease and lease amortisation table. However, there were some common errors noted as follows:

1. In determining the amount of lease liability, the expected loss on the guarantee of $5,000 was omitted from the present value calculation. Also, some Candidates mixed up the timing of the payment since, in this case, the annual lease payment is payable and paid in advance on 1 January (which is the beginning of the payment interval); hence the interest computation was affected.

2. As for the provision for restoration ($10,000), this was part of the cost of the leased asset but not lease liability. Please refer to SFRS(I) 16, paragraphs 24 and 27 for a breakdown of the leased asset and lease liability, respectively.

3. For **part (c)** on the lease amortisation table, some Candidates failed to indicate clearly that the annual lease payments of $86,791 were made on 1 January. The first lease payment on 1 January 20x4 (lease inception) should not include interest. Hence, the interest expense for 20x4 should be calculated based on the lease liability amount at inception, less the first lease payment of $86,791.

4. Most Candidates omitted the last payment of $5,000 (which was the expected loss on the guarantee) on 31 December 20x6 in the lease amortisation table.

5. For **part (d)** on journal entries in 20x6, many Candidates omitted the lease payment journal entry on 1 January 20x6.

6. For journal entries on 31 December 20x6, many Candidates missed out on the journal entry to record the interest expense for that year. Some Candidates also failed to record the depreciation of the leased asset.

7. In this case, the variable lease payment was based on a % of annual sales; hence this was not part of the lease liability. Instead, the amount should be recorded as an expense in the year of occurrence.

8. The additional restoration cost should be recorded as an expense in 20x6 with the provision reversed out.

9. Since the actual residual value of the truck turned out higher than the initial expected amount, the expected loss on the guarantee of $5,000 is unwarranted; it should be written back and recognised as a P/L gain in 20x6.

Question 3

Case A required Candidates to specify whether bitcoin held by an investor qualifies as a financial asset in accordance with SFRS(I) 1-32 *Financial Instruments: Presentation*.

Most of the Candidates incorrectly identified it as a financial asset. Those Candidates who correctly identified the bitcoin held as not a financial asset could elaborate on 2 to 3 criteria out of the four criteria stipulated in paragraph 11 of SFRS(I) 1-32. They could also identify that bitcoin is not cash, and some were able to highlight that it is not an entity instrument of another entity. For those who correctly identified that bitcoin is not a contractual right to exchange financial assets or liabilities with another entity, they failed to highlight the need for the exchange to be under conditions that are potentially favourable to the entity.

Case B part (a) required the Candidates to document the journal entries for the (i) purchase of shares of A Co and classifying it as fair value through other comprehensive income (FVOCI), (ii) purchase of put options to hedge the investment in A Co, (iii) receipt of dividend from A Co, (iv) sale of A Co shares, and (vi) exercise the put option at maturity based on net settlement.

Most Candidates were generally able to articulate the journal entries for the purchases of A Co shares and put options as well as the dividend declared. While most Candidates were able to correctly journalise the receipt of cash arising from the sale of A Co shares, many Candidates ignored or forgot about the need to account for the difference in the purchase and sale price as an adjustment directly to equity (i.e. through Other Comprehensive Income (OCI)). Many Candidates also did not follow through on the put option and so had not accounted for the gain in fair value of the put option.

Case B part (b) was not well attempted by the Candidates. Many Candidates incorrectly identified that an impairment loss had to be recognised for the significant deterioration in the credit risk of A Co. Candidates either forgot or did not realise that no impairment loss assessment is required for financial assets carried at fair value.