Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 7 December 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* and SFRS(I) 10 *Consolidated Financial Statements.* Most Candidates displayed a good understanding of the preparation of basic consolidation journal entries. However, Candidates did not perform well in **Part (b)** to **Part (e)**, as compared to **Part (a)**.

Question 2 comprised two case studies, which tested Candidates' understanding and application of the requirements of SFRS(I) *15 Revenue from Contracts with Customers.* **Case A** required Candidates to identify the performance obligations and timing of revenue recognition, to allocate and account for the revenue, related to the sale of handsets (mobile phones) bundled with mobile plan subscriptions in a contract with its customer. **Case B** required Candidates to determine whether Telco Ltd was a principal or an agent in a contract with its supplier. **Case B** also required Candidates to apply SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates*, for Telco Ltd, with foreign currency transactions.

Question 2 was fairly well-attempted. Most Candidates were able to answer **Case A Part (a)** to **Part (c)**. However, some Candidates were unable to provide the correct journal entries for the recognition of revenue in **Case A Part (d)**. For **Case B**, it was noted that many Candidates used the wrong exchange rates in their calculations.

Question 3 tested Candidates on their understanding of SFRS(I) 9 *Financial Instruments.* The majority of Candidates did well for **Part (a)** and **Part (b)**. However, most Candidates did not fare well in **Part (c)** and **Part (d)** on the preparation of journal entries on partial conversion of bonds and repurchase of bonds.

Overall, Candidates are advised to read the questions carefully before attempting, to avoid losing marks unnecessarily. In addition, Candidates are encouraged to show workings, as marks may be awarded for correct workings, even though the final answer may be 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* and SFRS(I) 10 *Consolidated Financial Statements*.

Part (a) required Candidates to prepare consolidation adjustments relating to a company's (P Co's) interest in its subsidiary, S Co.

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

However, we noted common errors which included the following:

- The elimination of investment in subsidiary – some Candidates did not work out the correct cost of investment. As a result, they also were not able to determine the correct amount of goodwill.

- The adjustment for current depreciation of undervalued fixed assets of S Co – some Candidates were unable to calculate the revised depreciation for the current year in view of the change in remaining useful life, while others adjusted for the depreciation in the reverse way.

- The adjustment for the unrealised profit on the upstream sale of inventory – many Candidates were unable to calculate the correct amount to be adjusted for the following accounts:
    - opening retained earnings - due to goods yet unsold to third parties in the previous year
    - cost of sales – due to goods re-sold to third parties in the current year
    - sales/ returns – due to goods returned in the current year
    - inventory – due to unsold goods at the end of the year

  While some Candidates missed out on adjusting for one or more of the above accounts, others adjusted the movements in the reverse way.

- The elimination of contract revenue, contract expense and unrealised profit in building – many Candidates were unable to provide the correct accounts to be adjusted. Most Candidates were only able to provide the correct accounts for contract revenue and contract expense, but not contract asset and building in progress.

- The allocation of current year profit to NCI – 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 after-tax depreciation of undervalued fixed assets or the after-tax realised profit from sales and returns. There were also some Candidates who made the adjustments in the reverse direction.

- Some Candidates omitted the following consolidation adjustments:

- Elimination of contract revenue, contract expense and unrealised profit in building
- Adjustment for the unrealised profit on upstream sale of inventory
- Adjustment of current depreciation of undervalued fixed assets

Overall, 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 (b) required Candidates to prepare the consolidation adjustment to record the effects of the last transaction in 20x6 which relates to the divestment of ownership interests of P Co to NCI. This question part was poorly attempted. While some Candidates were able to eliminate the correct amount of investment in S Co and profit on sale, most Candidates were unable to derive the correct amount of NCI to be adjusted due to wrong adjustment for the undervalued fixed assets, unrealised profit in inventory or goodwill. As a result, they also did not derive the correct amount of equity to be adjusted.

Part (c) required Candidates to perform an analytical check (proof of balance) of NCI of S Co. This question part was also not well-attempted. While some Candidates demonstrated that they understood and correctly applied the concept of performing an analytical check (proof of balance) of NCI of S Co, other Candidates need to have a better understanding of how to perform an analytical check of NCI, especially the adjustment for undervalued fixed assets and unrealised profit in inventory. Many Candidates included goodwill in the analytical check of NCI, but the amounts were wrong.

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 NCI.

Part (d) required Candidates to prepare equity accounting adjustments in relation to P Co and its associate A Co. Many Candidates provided the correct basic equity accounting adjustments and correctly recognised the share of post-acquisition retained earnings and reclassified dividend income as a reduction of investment.

Common errors included the following:

- The adjustment of capitalised interest
- The adjustment of depreciation on capitalised interest
- The adjustment of expense on provision for claims

Part (e) required Candidates to perform an analytical check (proof of balance) of the investment in associate of A Co. While some Candidates demonstrated that they understood and correctly applied the concept of performing an analytical check (proof of balance) of investment in associate of A Co, other Candidates need to have a better understanding of how to perform an analytical check of this key figure.

Common errors included the following:

- The calculation of the fair value of net assets of A Co at acquisition in the computation of implicit goodwill in investment in A Co

- The omission of the interest differential on fixed assets in the calculation of P Co's share of A Co's identifiable net assets

The analytical check is a way of determining the investment in associate balance independently of the process of passing equity accounting adjustments. It serves as a method of analytically validating this key figure. Candidates are encouraged to understand the logic behind the analytical check of investment in associate balance.

Question 2

Question 2 comprised two case studies, which tested Candidates' understanding and application of the requirements of SFRS(I) *15 Revenue from Contracts with Customers*, and SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates.*

<u>Question 2 Case A</u>

Part (a) required Candidates to identify the performance obligations where handsets (mobile phones) were sold bundled with a subscription to a 24-month mobile plan. Candidates were able to correctly identify the sale of the handset and the provision of mobile services as the two performance obligations that arose from the contract. However, it was noted that some Candidates incorrectly identified the activation and set-up and the provision of warranty, as separate performance obligations.

The activation and set-up was not a separate performance obligation as the benefits of activation and set-up could not be enjoyed on its own.

The case scenario was a normal warranty and was not distinct from the sale of the handset.

Part (b) required Candidates to identify the timing of revenue recognition for Telco Ltd for the following activities:

(i) Sale of the handset;
(ii) Provision of mobile services; and
(iii) Activation and set-up.

Most Candidates were able to identify the correct timing of revenue recognition for the sale of the handset and the provision of mobile services. However, a significant number of Candidates incorrectly stated that the activation and set-up should be recognised when the activation and set-up was done. The activation and set-up was linked with mobile services. It was not a separate performance obligation and was effectively an advance payment for the provision of mobile services. Hence, it should be recognised over the same period as the provision of mobile services. Customers obtained continuous control over time through consumption of the services.

Part (c) required Candidates to allocate the total revenue from the contract to each performance obligation. The majority of Candidates were able to answer this question part correctly.

Common errors included the following:

- A number of Candidates forgot to multiply the monthly subscription amount by 24 months, to get the total revenue for the 24-month mobile subscription.

- Some Candidates used the $100 promotional fee instead of the normal $150 activation and set-up fee, as the standalone price, in their calculation.

Part (d) required Candidates to prepare journal entries to recognise the revenue for the first year from 1 January 20x6 to 31 December 20x6 (the first year of mobile plan subscription). This question part was not well-answered. A significant number of Candidates incorrectly recognised revenue immediately when the activation and set-up was done, resulting in incorrect journal entries.

<u>Question 2 Case B</u>

Part (a) required Candidates to determine if Telco Ltd was a principal or an agent in the contract with the supplier. Candidates generally did well for this question part as they were able to correctly apply the principles in SFRS(I) 15 Appendix B:B34 to B38, to determine if Telco Ltd was an agent. However, a few Candidates only stated the indicators from SFRS(I) 15, without applying them to the case and explaining their conclusion.

Part (b) required Candidates to determine the lower of cost and net realisable value (NRV) of a phone in Singapore dollars (S$) on 31 December 20x6. This question part was not well-answered by Candidates, and they were not able to apply the correct exchange rates to translate the US$ amounts to S$ amounts.

Part (c) required Candidates to prepare an extract of the Income Statement in S$ for the year ended 31 December 20x6 for Telco Ltd under the following assumptions - (i) Telco Ltd was a principal in its contract with the supplier, (ii) Telco Ltd was an agent in its contract with the supplier. This question part was also not well-answered by most Candidates.

Common errors included the following:

- Using the wrong exchange rate to translate the cost of sales (as a principal). This should be translated at the exchange rate at the date of the receipt of the inventory, which was 1 July 20x6.
- Omitting to include inventory impairment loss to write down the ending inventory to the lower of cost and NRV (as a principal).
- Incorrectly presenting gross revenue and cost of sales when preparing extract of the Income Statement (as an agent). As an agent, net revenue should be presented instead.

- Failing to account for exchange gain between the time when taking delivery of the phones (1 July 20x6) and settlement of the payable (15 September 20x6)

It was also noted that some Candidates prepared journal entries instead of preparing an extract of the Income Statement as required by the question.

Question 3

This question tested Candidates on their understanding and application of SFRS(I) 9 *Financial Instruments.*

Part (a) required Candidates to prepare the bond amortisation table from inception to maturity before the conversion and repurchase of bonds.

This question part was generally well-answered by Candidates. However, some Candidates indicated the wrong amount for opening carrying amount, resulting in the wrong amount for effective interest expense.

Part (b) required Candidates to prepare the journal entry on the issue of the convertible bonds.

This question part was generally well-answered by Candidates. However, some Candidates calculated wrong amounts for debt and equity options in the journal entry.

Part (c) required Candidates to prepare the journal entry on partial conversion of bonds. Some Candidates were not able to calculate the correct amounts for debt and equity options in the journal entry.

Part (d) required Candidates to prepare the journal entry on repurchase of bonds. This question part was not well-answered by Candidates. Many Candidates were unable to derive the correct amounts for bond redemption expense and equity options in the journal entry.