SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Advanced Financial Reporting (AFF)

EXAMINATION DATE: 8 June 2021

Section 1
General comments

The Candidates have performed better in this examination. Overall, Candidates performed better in the quantitative components than in the qualitative parts in the June 2021 examinations. Most of the Candidates underperformed for Question 2 (share-based payments) and Question 3 (allocation of impairment loss to assets in cash-generating units). Further analysis and common errors made by the Candidates are detailed in Section 2.

Candidates are reminded to be well-prepared across the range of Singapore Financial Reporting Standards (International) (SFRS(I)) and not leave any SFRS(I) uncovered in their revision. Candidates should also be focused and relevant in their answers to the theoretical components in the paper. Copying and pasting the contents of the relevant paragraphs from the SFRS(I) 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)**, provide independent proof for the retained earnings of the group in **part (b)** as well as compute the fair value of consideration for a business combination in **part (c)**. This question required the application of SFRS(I) 3 *Business Combinations*, SFRS(I) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures*.

Part (a) was quite well attempted by Candidates. However, many Candidates misread the question, which stated that inter-company sales were at a certain gross profit margin instead of mark-up. Consequently, they made errors in calculating the unrealised profit on unsold inventories of the group by the mark-up instead of the gross profit margin. Another common mistake Candidates made is the calculation of non-controlling interest (NCI) share of profit for the year and post-acquisition retained earnings.

However, some Candidates did poorly in their consolidation journal entries, even in the elimination of investment entry for the subsidiary.

Chartered Accountant SINGAPORE

As for equity accounting for associates, most Candidates have done well (like past exam sessions).

Generally, the Candidates did well for **part (b)** as they were able to identify the % interest, as well as the relevant ending and beginning retained earnings to compute the share of post-acquisition retained earnings for both the subsidiary and associate; though not many Candidates scored full marks due to various errors in the consolidation adjustments. However, some Candidates did not attempt this question part, and some Candidates did not understand what the question was asking for and hence did not know how to approach this question part.

Part (c) appeared to be the most challenging part of the question, and almost 20% of the Candidates did not attempt at all. In addition, more than half of the Candidates who attempted this part could not understand how to discount future payments to present value by using the respective borrowing rate and cost of capital of the entity.

Candidates should work towards high competency in consolidation, which is a question with significant weightage for the paper. In addition, more attention should be given to the understanding of the processes in consolidation and equity accounting.

Question 2

Part (a) was about the preparation of journal entries for the share appreciation rights (SARs) over the vesting period in accordance with SFRS(I) 2 *Share-based Payment.*

Most Candidates were able to calculate the total remuneration expense during the vesting period. However, some of the Candidates could not allocate the expense over the respective years but expensed it off in the first year instead. Others could not calculate the remuneration expense correctly, either due to using the incorrect number of SARs expected to vest or by applying the incorrect fair value of the SARs.

Most Candidates were able to account for the cash payment as part of exercising the SARs. However, only very few Candidates were able to compute the amounts for all the accounting entries of the respective financial years correctly.

Candidates are again reminded to provide clear and relevant workings. For example, if Candidates presented incorrect amounts/accounts in their journal entries, the absence of such workings results in loss of working marks.

Part (b) required the Candidates to explain the accounting treatment of a new share-based plan based on certain information given in the question.

Candidates generally did not do well for this question. As limited information has been provided, Candidates are **not** expected to provide quantitative answers but an analysis of the initial recognition of the debt and equity component of the compound instrument, subsequent remeasurement of the debt component and recognition of the equity component, and the settlement process based on the choice of cash settlement and issue of share options and the accounting for both sides.

Most of the Candidates focused on calculating a value without sufficient inputs, and some made wrong assumptions regarding their calculations. Candidates who scored better were able to identify the debt and equity component of the compound instrument and discussed both the initial recognition and subsequent accounting treatments. However, very few Candidates were able to follow through to the point of settlement and the accounting process for both choices.

Question 3

Part (a) tested the Candidates on the application of the requirements of SFRS(I) 1-36 *Impairment of Assets* which stipulates that an entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. The facts of the case in this question identified several aspects that suggested that the reporting entity's business operations had been hit either by a fall in demand for their services or by restrictions imposed by the Government due to Covid-19 pandemic. As a result of these factors, there was a likelihood that a triggering event had occurred which warranted testing of impairment of assets. Few Candidates directly associated the facts of the case and identified indicators of impairment of the asset (as stipulated by SFRS (I) 1-36) in their answers.

When a triggering event has occurred, management of the reporting entity needs to determine the recoverable amount of an asset or cash-generating unit (CGU), which usually requires management to forecast future cash flows. To forecast future cash flows, significant assumptions (such as forecast sales, prices, gross margins, discount rates) will need to be reassessed and updated as appropriate due to the significant changes in economic and market conditions due to the pandemic outbreak. The discount rate used to discount the forecast cash flows may be significantly affected by Covid-19 due to the increase in uncertainty and risks. SFRS(I) 1-36 requires that the discount rate reflect the impact of changes in interest rates and the risk environment at the reporting date. Hence these will be the impacts of the Covid-19 pandemic outbreak on impairment assessment. Very few Candidates identified these estimation uncertainties as an impact of the pandemic outbreak on the impairment assessment for the financial year ended 30 June 20X0.

Part (b) was a continuation to **Part (a)** addressing the requirements of SFRS(I) 1-36 *Impairment of Assets* to perform a test to ascertain whether there are any indicators of impairment to determine the impairment loss that is to be allocated on a reasonable basis to the impaired assets. This question warranted an arithmetical calculation that involved ascertaining the adjusted carrying amounts after an appropriate allocation of the assets to the CGUs identified in the question, comparing the recoverable amounts given in the question with the carrying amounts to identify any impairment loss and to eventually allocate the impairment to the assets.

A CGU serves two primary roles in the impairment review. First, it facilitates the testing of assets for which the recoverable amount cannot be determined individually. It also facilitates testing of goodwill impairment (as goodwill by definition do not generate cash inflows on their own and, therefore, must be allocated to a CGU). SFRS (I) 1-36 *Impairment of Assets* stipulates that the goodwill must be allocated to individual CGUs for impairment testing. Several Candidates did not consider the goodwill identified in the question as a part of the CGU. A few Candidates performed the impairment testing at the Country level - combining the assets of the Restaurant and Food delivery business for Country X and Country Y, respectively. This approach disregarded the CGUs identified in the question and was contrary to the requirements of SFRS(I) 1-36.

The carrying amounts of kitchen premises identified in the question were considered an asset that contributes to the cash flows of the respective CGUs. Hence, it must be appropriately allocated to the respective CGUs based on the annual sales, as annual sales are stated to be a reasonable indication of the proportion of the kitchen operations devoted to each business in Country X and Country Y. A few Candidates made errors in allocating the carrying amounts of kitchen premises to the Restaurant and Food delivery business of the respective countries.

As a result of these errors mentioned above, impairment losses determined by several Candidates were wrong.

Upon recognising the impairment loss that must be recognised for a CGU, it shall be allocated to reduce the carrying amount of the assets within a CGU in the order mandated by SFRS(I) 1-36. First, an impairment loss shall be allocated to reduce the carrying amount of any goodwill allocated to the CGU. Many Candidates did not allocate the impairment loss to goodwill as the first step of the allocation. Instead, the impairment loss was allocated to all the assets in the CGU pro-rata to their respective carrying amounts.

The impairment loss that remains after allocation to the goodwill is to be allocated to the other assets of the CGU pro-rata based on the carrying amount of each asset in the CGU. However, many Candidates left the remaining impairment loss unallocated to the other assets of the CGUs.

Performance of further impairment testing is required by comparing the recoverable amount of the investment with net carrying amounts of the CGUs (after considering the impairment loss) in Country X and Country Y, as well as the carrying amount of the corporate asset which could not be allocated to the respective CGUs. Some of the Candidates had left their answers incomplete without performing additional impairment tests for the investment in the entity.

It is critical for Candidates to thoroughly comprehend the requirements of SFRS(I) 1-36 *Impairment of Assets* and to apply the requirements while demonstrating their understanding of concepts relating to impairment testing and allocation of impairment losses appropriately.

Chartered Accountant SINGAPORE

Question 4

Part (a) involved an application of requirements of SFRS(I) 9 *Financial instruments* and preparing the journal entries to identify the fair value changes in the hedging instrument and hedged item identified in the question.

Candidates generally performed well in answering this question and had prepared the journal entries with most of the accounts/amounts stated correctly. However, the portion of the gain or loss on the hedging instrument shall be recognised in profit or loss instead of other comprehensive income (OCI). A few Candidates recognised the portion of the gain or loss on the hedging instrument in OCI instead of recognising profit or loss.

Many Candidates erroneously interpreted the portion of the gain on the hedging instrument given in the question as a loss and vice-versa. The aforementioned erroneous interpretation of gain or loss on hedging led to the incorrect recording of related journal entries.

This question involved a sale of the crude oil and referenced the adoption of a perpetual inventory system and hence the requirement to present the journal entry to recognise the cost of sales upon sale of the crude oil. Unfortunately, many Candidates determined the amount of cost of sales incorrectly as they ignored the effect of fair value changes to the hedged item, and several Candidates ignored the journal entry for the recognition of the cost of sales corresponding to the sale of crude oil on 31 May 20X0.

Part (b) involved the identification of one fundamental principle which is being threatened based on the facts of the question. Most of the Candidates performed well by identifying the appropriate fundamental principle which is being threatened.

Part (c) involved the identification of one threat that could be compromised or perceived to compromise based on the facts of the question. Most of the Candidates performed well by identifying one threat that could be compromised or perceived to compromise.

For **part (b) and (c)**, Candidates should provide relevant answers to address the fundamental principle which is being threatened and the threat which could be compromised or perceived to compromise. Copying and pasting of contents of relevant paragraphs from the question will receive little or no marks. Marks can only be awarded for the correct application of the fundamental principles to the facts of the case and correct identification of the threat that could be compromised or perceived to compromise.

Part (d) involved the identification of two appropriate measures that could be taken to eliminate or reduce the threat to the fundamental principles. Most of the Candidates performed well by identifying two appropriate measure which could be adopted to eliminate or reduce the threat to fundamental principles.

