SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 8 December 2022

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) 1-*28 Investments in Associates and Joint Ventures.* Most Candidates displayed a good understanding of the preparation of basic consolidation journal entries. However, Candidates did not perform well in **Parts (d)** and **(e),** as compared to **Parts (a) to (c)**, in determining the balance of the investment in Associate and calculating the profit or loss on sale and remeasurement gain (loss).

The overall performance for Question 2 was mixed. Candidates did well for **Case A** on SFRS(I) 8 *Operating Segments* and **Case B (a)** as compared to **Case B parts (b) to (c)**. However, it was noted that many Candidates lacked a good knowledge of SFRS(I) 1-33 *Earnings per Share*, with respect to the calculation and explanation of Diluted Earnings per Share.

Question 3 comprised three cases. **Case A** tested Candidates' ability to correctly classify preference shares as either equity or liability and their ability to account for the preference shares. **Case B** tested the Candidates' understanding of how to account for the issuance of convertible bonds, and **Case C** dealt with hedge accounting.

Most Candidates handled **Case A (a)** & **Case B** reasonably well. However, many Candidates had difficulty with **Case C**.

Candidates still left the whole of Question 3 unanswered or parts of it unanswered, presumably due to a lack of time or knowledge of the topics tested. Candidates are again advised to pay attention to their time management as they may lose unnecessary marks if they spend too much time on parts of earlier questions that they had difficulty with, resulting in the lack of time to take on some of the more straightforward questions.

Furthermore, Candidates are also 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.

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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) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures*.

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

Most Candidates performed well for this part of Question 1. They 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, but made the common errors identified below.

Common errors included the following:

- Past and current adjustments on undervalued intangible assets –
  While many Candidates could furnish the correct consolidation entries, some of the Candidates could not calculate the correct amount either for the past amortisation and impairment loss or the current year's amortisation. Some Candidates omitted the adjustment for the current year's amortisation.

- The elimination of intra-group profit in the downstream transfer of investment property and the subsequent adjustment for the change in fair value –
  Some Candidates were unable to work out the correct profit to be eliminated, while others adjusted in a reverse way. There were also some Candidates who omitted or wrongly calculated the adjustment on the fair value change of the investment property.

- The allocation of current year profit to NCI –
  While most Candidates could furnish the correct consolidation adjustment in terms of account and direction, many Candidates could not work out the correct amount. They either did not adjust for the after-tax amortisation of undervalued intangible assets or the unrealised loss from the upstream sale of inventory. Some Candidates made the adjustments in a reverse way.

- Some Candidates omitted the consolidation adjustment relating to the upstream sale of inventory from S Co to P Co.

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, intangible assets among others

Part (b) required Candidates to perform an analytical check (proof of balance) of the non-controlling interests of S Co.

While some Candidates demonstrated that they understood and correctly applied the concept of performing an analytical check (proof of balance) of non-controlling interests (NCI) of S Co, other Candidates need to have a better understanding of how to perform an analytical check of non-controlling interests, especially the adjustment for undervalued intangible assets, and the adjustment for unrealised loss in inventory.

Some Candidates simply listed the consolidation adjustments pertaining to NCI or listed the book value of So Co's net assets as of the acquisition date.

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 consolidated key numbers. Candidates are encouraged to understand the logic behind the analytical check of non-controlling interests.

Part (c) required Candidates to prepare equity accounting adjustments relating to an investment in A Co prior to the loss of significant influence on 31 December 20x6.

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 for unrealised profit in opening inventories –
  Some Candidates calculated the wrong amount due to the wrong percentage used for the unrealised profit. Moreover, many Candidates wrongly computed the reversal of the share of unrealised profit on inventory, which was realised in the current year.

- The adjustment for expense on provision for claims in the prior year and current year –
  From P Co's group perspective, since P Co had implicitly recognised the provision for claims in the investment of Associate at initial recognition, the actual claims expense incurred by the Associate in the prior year and current year should be reversed from the share of prior years' profit of Associate (through opening retained earnings) and the share of the current year's profit of Associate respectively.

- Certain Candidates prepared consolidation adjustments, instead of equity accounting adjustments, for the investment in Associate. Candidates are reminded to carefully note the difference between a subsidiary and an associate and when to consolidate, and when to equity account for an investee.

Part (d) required Candidates to perform an analytical check (proof of balance) of the investment in Associate prior to the loss of significant influence on 31 December 20x6.

This appeared to be one of the challenging parts of this question as many Candidates did not attempt this part at all. Those who did answered this part unfortunately did not perform well. Many Candidates showed that they were unfamiliar with how to perform the analytical check, and quite a few Candidates compiled the balance by just listing/ adding the equity accounting entries instead.

The analytical check is a way of determining the investment in associate balance independently of the process of passing equity accounting entries. 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.

Common errors included the following:

- Many Candidates wrongly computed the implicit goodwill in the investment in Associate by using the cost of investment after the partial divestment during the year instead of re-grossing to the original cost of investment as at the date of initial investment.

- Many Candidates were unable to calculate the correct amount of the parent's share of the identifiable net asset of the Associate at the end of the year. As a result, most Candidates either missed out or wrongly calculated the unrealised profit remaining unsold in the closing inventories; and the provision of claims which has been fully reversed out as of year-end.

Part (e) required Candidates to calculate the profit (loss) on the sale and remeasurement gain (loss) for P Co's group, arising from the loss of significant influence over the Associate.

The performance of **part (e)** was the worst performing part in Question 1, and only a handful of Candidates managed to pass. Many Candidates left it blank and did not attempt or answered wrongly.

There was a loss of significant influence in the Associate through sale during the year. The profit on the sale of Associate should be measured by comparing the sales proceeds with the proportionate share of investment in Associate calculated in **part (d)**. The remaining share of the investment in Associate should be re-measured to fair value at the date of loss of significant influence, and remeasurement gain on previously held interests should be recognised.

Many Candidates did not recognise the parent's share of the post-acquisition retained earnings up to the date when significant influence was lost. As a result of the omission, the remeasurement gain was incorrect as the Candidates calculated the gain as the difference between fair value and the remaining investment at cost and not the balance of the investment in Associate under the equity method.

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Question 2

Question 2 Case A

Question 2 Case A required Candidates to identify the reportable segments according to SFRS(I) 8 *Operating Segments* and present the quantitative footnote disclosure on segment revenues for the company.

This question part was well attempted by the Candidates. Most of the Candidates were able to apply the quantitative thresholds (i.e., sales, net profit and assets) step-by-step and conclude what the reportable segments are.

However, there were some common errors noted as follows:

1. According to SFRS(I) 8 paragraph 15, if the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments shall be identified as reportable segments (even if they do not meet the criteria in paragraph 13) until at least 75 per cent of the entity's revenue is included in reportable segments. However, some Candidates failed to do this step.

2. Many Candidates lost marks for failing to identify the reportable segments based on each quantitative threshold (i.e., sales, net profit and assets). Though they can compute the percentage of sales, net profit and assets for each segment, they do not clearly indicate which segments meet each quantitative threshold before arriving at an overall conclusion on the reportable segments.

3. For the profit test, SFRS(I) 8 paragraph 13(b) states that the threshold is met based on the 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss. Some Candidates failed to interpret and apply this requirement correctly.

4. In the footnote disclosure requirement, some Candidates failed to insert a column for the elimination of internal sales, as the total for internal sales should be zero at the company level.

5. Some Candidates described the footnote disclosure qualitatively instead of presenting the quantitative footnote disclosure. Also, some of the Candidates included segment profit and loss and segment assets, which were not required in this question.

Question 2 Case B

The performance for **Question 2 Case B** was mixed. It was noted that many Candidates were not familiar with SFRS(I) 1-33 *Earnings Per Share*. Earnings Per Share (EPS) is only applicable to listed companies.

It is important for Candidates to be familiar with SFRS(I) 1-33 beyond the basic principles, such as in this question – **Case B (a)** tested on the basic EPS calculation while the subsequent two question parts (**Case B (b)** and **(c)**) tested on the more complicated aspects of SFRS(I) 1-33.

Question 2 Case B (a)

This was the best-performing part in Question 2 Case B. It tested on the basic EPS calculation, and many Candidates scored near to or full marks for this question part.

Common errors were noted:

- Candidates did not compute the weightage of the 30% of preference shares converted correctly.
- Some Candidates overlooked the conversion factor (2:1) and simply assumed 1:1.
- A few of the Candidates erroneously adjusted NPAT for ordinary dividends declared.

Question 2 Case B (b)

This question part required Candidates to calculate the Diluted Earnings per Share (DEPS) of C Ltd. As DEPS computation is more complicated, Candidates fared less well here. Many Candidates struggled with the treatment of the 700,000 unconverted preference shares. Other Candidates failed to add back the preference dividends that were deducted out of NPAT in the previous question.

Only a handful of Candidates who were well prepared managed to score full marks for both parts (a) and (b).

Question 2 Case B (c)

This question was poorly attempted. It was noted that many Candidates did not attempt this question part or answered the question wrongly. Few Candidates were aware that SFRS(I) 1– 37 *Provisions, Contingent Liabilities and Contingent Assets* is applicable and therefore the majority of the Candidates could not competently answer the narration part of the question. Some Candidates answered that no adjustments were required.

It appears that if the question does not mention a specific SFRS (I), Candidates will not consider whether another SFRS (I) is applicable.

The computational aspect was relatively straightforward as other than the retrenchment expense of $1.5m, all the other figures came from the answers to the earlier questions.

Most Candidates were also not aware of the need to ascertain whether the computed diluted EPS is anti-dilutive, and therefore they did not state the reported EPS correctly.

Question 3

Case A (a) required Candidates to first identify whether the Mandatorily Redeemable Preference Shares (MRPS) were a liability or an issued equity instrument and to justify their answers. This part was well attempted by the Candidates, and the majority of the Candidates scored near to or full marks for this question part.

Most Candidates correctly identified the MRPS as a debt instrument (i.e. liability). Most of the Candidates were also able to correctly identify that as the issuer had a contractual obligation to deliver cash at a future date to the investor, this satisfied the requirement of SFRS(I)1-32 paragraph 11 definition of financial liability. However, a number of Candidates did not mention the distinguishing factor between liability and equity as stated in SFRS(I) 1-32 paragraph 16 (a).

Case A (b) tested the preparation of journal entries for all transactions relating to the MRPS for the year ended 31 December 20x6 in Singapore dollars (S$). Most Candidates were able to correctly prepare the journal entries for the issuance of the debt instrument on 1 January 20x6. However, some Candidates overlooked the fact that the MRPS was issued in United States Dollars (US$) and so had not accounted for the foreign exchange gain/loss when accounting for the interest expense at the end of the year. They also did not translate the debt liability at the closing rate as at 31 December 20x6.

Case B was the best-performing question part among Question 3. Most Candidates did well and passed this question part.

This question required the Candidates to first set up a bond amortisation table from 1 January 20x6 to 31 December 20x7 (prior to conversion) for the 3-year convertible bond that was issued on 1 January 20x6. Candidates were then required to prepare the journal entries for (i) the issue of the bond on 1 January 20x6, (ii) interest expense for the year ended 31 December 20x6, and (iii) conversion of the bond on 31 December 20x7.

Most Candidates were able to construct the bond amortisation table. Some careless mistakes, however, were observed:

- For example, some Candidates misread the question and treated the present value of $4,793,828 as the carrying amount as at 31 December 20x6 when the question specifically mentioned that it was on 1 January 20x6.

- Some Candidates computed the interest expense for the period after deducting the cash interest instead of computing the interest expense based on the carrying value brought forward from the preceding period.

Candidates were generally able to provide the journal entries required for the issuance of the bond, interest expense at the end of the year and conversion of the bond. Candidates who were not able to work out the journal entries generally were those who were unable to construct the bond amortisation table in the first place.

Case C dealt with hedge accounting and required the Candidates to (i) explain the type of hedging relationship in respect of the swap transaction undertaken by K Co with L Co; (ii) complete the swap valuation table of K Co; and (iii) complete the "Extracts of the Financial Statements of K Co for the half-year ended 30 June 20x6".

Most Candidates were able to correctly identify the swap as a cash flow hedge, although a small number of Candidates had incorrectly identified it as a fair value hedge. Most Candidates were also able to provide the correct justification for their conclusion that it was a cash flow hedge.

In terms of completing the swap valuation table of K Co, most Candidates were able to complete the "Receiving floating" and "Net receipt (payment)" columns. Some Candidates, however, were unable to correctly complete the "Swap asset (liability)" column.

As regards to the Financial Statements of K Co, many Candidates had difficulty completing all the required information. Some Candidates filled in interest income instead of an expense. Since K Co had a loan payable of $10 million, it should be interest expense and not income that should be recorded in the income statement. Some Candidates forgot that the interest was payable every quarter and so only accounted for interest expense of $50,000 instead of $100,000.

As no further information was given regarding "cash" and "retained earnings", the amounts to be included should be the same as the interest expense. Finally, since hedge accounting was adopted, the change in the swap value should be taken to other comprehensive income instead of the profit or loss account.

