Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 21 June 2024

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 demonstrated good understanding of the preparation of basic consolidation journal entries. However, Candidates did not perform well in **Part (b)**, in which Candidates were required to perform an analytical check (proof of balance) of non-controlling interests (NCI).

Question 2 comprised of two case studies. Case A tested Candidates' understanding and application of *SFRS(I) 1-28 Investments in Associates and Joint Ventures* as well as *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates*. Candidates were required to translate the financial statements of an associate from United States dollars (US$) to Singapore dollars (S$), and to prepare equity accounting entries to recognise A Co's investment in the associate, Z Co. Case B (a) required Candidates to prepare journal entries relating to convertible bonds. The remaining parts of Case B required Candidates to calculate and evaluate the impact on the basic earnings per share (BEPS), and the diluted earnings per share (DEPS) in accordance with *SFRS(I) 1-33 Earnings per Share*.

Question 2 Case A was generally well answered. Candidates displayed good knowledge on how to translate the financial statements from a different functional currency to the required reporting currency. Most Candidates were able to provide the correct journal entries for most of the transactions relating to the associate.

For Question 2 Case B, most Candidates were able to answer well on the part of the question relating to the accounting of convertible bonds, and the calculation of the BEPS. However, a significant number of Candidates showed a lack of good understanding of how to calculate the DEPS, resulting in incorrect calculation.

Question 3 tested Candidates' knowledge and application of *SFRS(I) 9 Financial Instruments* and *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates.* Candidates were required to prepare journal entries in US$ (in **Part I**), and in S$ (in **Part II**), to record transactions relating to the forward contract and the sale of platinum. This question part was overall poorly answered. Candidates performed relatively well in **Part I**, as compared to **Part II**. Majority of Candidates did not attempt **Part II**, and those who did performed poorly on this part.

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.

Another good practice is to have good time management, to allow adequate time to answer all questions.

Section 2
Analysis of individual questions

Question 1

In this question, Candidates were required to demonstrate their understanding and application of SFRS (I), mainly *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 subsidiaries, X Co and Y Co.

Most Candidates performed quite well in this question part. Most Candidates 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 NCI, elimination of intra-group balances and elimination of dividends declared by its subsidiaries, except for the common errors identified below.

Common errors included the following:

- The elimination of investment in subsidiaries – some Candidates did not include the fair value adjustment for equipment (for X Co) and/or inventory (for Y Co). As a result, they also did not derive the correct amount of deferred tax liability and goodwill.

- The adjustment for past and current depreciation and impairment of undervalued equipment of X Co – some Candidates were unable to derive the correct depreciation amount while others calculated the wrong impairment amount.

- The adjustment for upstream unrealised profit on X Co's construction of warehouse for P Co – some Candidates made wrong adjustments to current year construction revenue and expense, instead of opening retained earnings, while others did not take into account the NCI share.

- The adjustment for cost of sale of undervalued inventory of Y Co – many Candidates were unable to calculate the correct amount to be adjusted for the following accounts:
    - Opening retained earnings and NCI – due to goods re-sold to third parties in the previous year
    - Cost of sales – due to goods re-sold to third parties in the current year

- Inventory – due to unsold goods at the end of the year

Some Candidates used the wrong NCI percentage to adjust for opening retained earnings and NCI for goods re-sold to third parties in the previous year, while others adjusted in the reverse way.

- The adjustment for interest differential and elimination of interest income and interest expense – many Candidates did not correctly eliminate the intercompany interest income of $90,000 and interest expense of $60,000 but only eliminated interest income of $30,000 (interest differential) instead.

- The allocation of current year profit to NCI of X Co and 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 or adjusted the wrong amount for dividend received from Y Co, after-tax depreciation and impairment of undervalued equipment, after-tax realisation of profit through depreciation of warehouse, and after-tax cost of sales of undervalued inventory of Y Co. There were also some Candidates who used the wrong NCI percentage of Y Co.

- Some Candidates omitted the following consolidation adjustments for:
  - Past and current depreciation and impairment of undervalued equipment of X Co
  - Upstream unrealised profit on X Co's construction of warehouse for P Co
  - Realisation of upstream profit through depreciation of warehouse
  - Interest differential and elimination of interest income and interest expense

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

Part (b) required Candidates to perform an analytical check (proof of balance) of NCI of X Co and Y Co.

This question part was poorly answered by most Candidates. 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 after-tax unamortised fair value difference for equipment, and after-tax unrealised profit and current year realisation of profit from construction of warehouse, and after-tax fair value difference of unsold inventory.

Some Candidates correctly included goodwill in the analytical check of NCI, but the amounts were wrong. It was also noted that some Candidates used the wrong NCI percentage for Y Co.

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.

Question 2

In this question, Candidates were required to demonstrate their understanding and application of SFRS(I), mainly *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates* and *SFRS(I) 28 Investments in Associates and Joint Ventures* (for Case A); and mainly *SFRS(I) 1-33 Earnings per Share* (for Case B).

<u>Case A</u>

Part (a) required Candidates to translate the financial statements of an associate from US$ to S$, in accordance with *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates,* using the template provided. Candidates were generally able to apply the correct exchange rates in the translation.

Part (b) required Candidates to prepare equity accounting entries in S$, to account for A Co's investment in an associate, Z Co, in accordance with *SFRS(I) 28 Investments in Associates and Joint Ventures* and *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates.* Most Candidates were able to correctly furnish the equity accounting entries pertaining to share of post-acquisition opening retained earnings, share of revaluation reserve, equity accounting profit and dividend reclassification, except for the common errors identified below.

Common errors included the following:

- The share of post-acquisition FCTR. While most Candidates were able to identify the correct equity accounting adjustment, some were unable to compute the correct amount for FCTR, due to incorrect foreign exchange rates, incorrect goodwill amount, and neglecting the after-tax provision for claims.

- Some Candidates omitted the following equity accounting adjustment:
    - Adjustment for past settlement of provision of claims

<u>Case B</u>

Part (a) required Candidates to prepare journal entries in relation to the issue of convertible bonds: interest expense of bonds and the conversion of bonds. This question part was generally well answered by Candidates. Most Candidates were able to correctly furnish the required journal entries, except for the common error identified below.

Common error included the following:

- The interest expense for the period from 1 January 20x7 to 30 June 20x7 – many Candidates wrongly credited Cash instead of Interest Payable for the interest expense accrued for remaining bondholders. It should be noted that coupon interest is paid to bondholders annually on 31 December, while bondholders who convert their bonds are paid accrued interest on the conversion of bonds.

Part (b) required Candidates to calculate the BEPS for B Ltd, in accordance with *SFRS(I) 1-33 Earnings per Share*. Most Candidates performed relatively well for this part of the question.

Part (c) required Candidates to calculate the DEPS for B Ltd, in accordance with *SFRS(I) 1-33 Earnings per Share*. Candidates generally did not perform this part well, as compared to **Part (b)**. Most Candidates who attempted this part of the question were able to correctly compute the effects of assumed conversion of convertible bonds, on the weighted average number of shares, except for the common error identified below.

Common error included the following:

- Incorrect computation of amount of avoidance of interest on convertible bonds, from the assumed conversion of convertible bonds. This is partly due to using the coupon rate instead of the effective interest rate, in the calculations.

Part (d) required Candidates to assume that 40% of bondholders converted their bonds to ordinary shares on 1 January 20x7 instead of 30 June 20x7, and to assess the impact this would have on the BEPS and the DEPS. This part of the question was the worst performing part, as compared to the other parts of this question. Some Candidates did not attempt this part of the question, totally or partially.

Common errors included the following:

- Impact on the DEPS – Some Candidates recomputed the DEPS, without understanding that the DEPS would not be affected by the actual date of conversion of the 40% of bonds. because the DEPS is computed based on the assumption that all the bonds had been converted to shares at the beginning of the financial period, i.e., 1 January 20x7.

- Calculation of new BEPS – many Candidates neglected the 6 months' after-tax interest saving on the assumed 40% conversion of the bonds at the beginning of the year; some Candidates used the wrong interest rate (i.e. coupon rate) to compute the interest saving.

Question 3

In this question, Candidates were required to demonstrate their understanding and application of *SFRS(I) 9 Financial Instruments* and *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates.*

Candidates were required to prepare journal entries in US$ (in **Part I**), and in S$ (in **Part II**), to record transactions relating to the forward contract and the sale of platinum.

This question was overall poorly performed. Many Candidates did not attempt the question at all, especially **Part II (a) & (b)**. Candidates performed relatively better in **Part I**, as compared to **Part II**.

Part I (a)
Candidates were required to prepare journal entries in US$ to record transactions relating to the forward contract and the sale of platinum in accordance with the requirements of *SFRS(I) 9 Financial Instruments.*

Candidates performed relatively well in this part of the question, as compared to **Part II**, except for the common error identified below.

Common error included the following:

- Loss on forward contract – many Candidates erroneously used the spot price per ounce of platinum of US$940 on 31 December 20X6 to compute the unrealised loss on the forward contract, instead of the forward price per ounce of platinum (for contracts maturing 31 January 20x7) of US$930 on 31 December 20x6.

Part II (a)
Candidates were required to prepare journal entries in S$, to record transactions relating to the forward contract and the sale of platinum, in accordance with the requirements of *SFRS(I) 9 Financial Instruments* and *SFRS(I) 1-21 The Effects of Changes in Foreign Exchange Rates.*

This question part was poorly answered. Many Candidates did not attempt this question. Among those who did, most were unable to provide all the required journal entries.

Common errors included the following:

- Loss on forward contract – many Candidates prepared the journal entries in the reverse direction. It should be noted that the forward contract entered, is to sell platinum, at the contracted forward price.

- Foreign exchange loss – many Candidates omitted this journal entry. The forward contract is a monetary item as it is settled net in cash on maturity. The foreign exchange loss arises because the forward contract (net payable) is a monetary item and the increase in foreign exchange rate increases the net payable.

Part II (b) was a qualitative question requiring Candidates to explain whether C Co should buy or sell the US$9,100,000 in the forward contract, and why, given the assumption that C Co decided to also hedge the foreign exchange risk by entering a forward contract with a notional amount of US$9,100,000.

Several Candidates did not attempt this part of the question. Among those who did, more answered “buy” US$ (incorrect) instead of “sell” US$ (correct). Also, many justified their answers using the exchange rates on 31 December 20X6 and 31 January 20X7 provided in the question. This was inappropriate as these Candidates had used “hindsight” to justify their conclusion.

Candidates are encouraged to answer systematically based on the chronological dates of the transactions, which may minimise the chances of missing necessary information and/or entries.

Overall, this question was the worst performing question of the exam. The weak performance could be partly due to poor time management, as this was the last question in the exam.

