SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Advanced Financial Reporting (AFF)

EXAMINATION DATE: 6 December 2022

Section 1
General comments

Overall, the Candidates have performed well in the Advanced Financial Reporting (AFF) December 2022 examinations .Generally, the Candidates underperformed for Question 1 part (b) (independent proof for the Group's Consolidated Statement of Comprehensive Income) 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 that the AFF module builds upon the knowledge and skills studied in the Principles of Financial Reporting (PFF) module. Candidates are expected to demonstrate a sound knowledge of and ability to apply the Conceptual Framework and the Singapore Financial Reporting Standards (International) (SFRS(I)), to produce a complete set of financial statements for a single entity and simple Group. Candidates are also expected to be able to explain and advise on the application of the SFRS(I), including the appropriate treatment and disclosure requirements, demonstrating appropriate professional judgement.

Candidates are reminded to be well-prepared across the range of SFRS(I) and not leave any SFRS(I) uncovered in their revision. Candidates should also be focused and relevant in their answers of 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)**, and to provide independent proof for the Group's net profit, other comprehensive income, total comprehensive income and retained earnings in **part (b)**. This question required the application of SFRS(I) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures*.

The majority of the Candidates performed well for **Question 1 part (a)**. Many Candidates who attempted the question could provide the basic investment elimination entries, including the computation of goodwill; elimination of pre-acquisition retained earnings of the subsidiary; recording of non-controlling interests (NCI) of the subsidiary; as well as the inventory and intangible assets fair value adjustments and the subsequent amortisation adjustments of the intangible assets. Most Candidates also displayed a good understanding of the preparation of basic equity accounting journal entries and were able to compute the parent's share of change in post-acquisition retained earnings and reclassified dividend income correctly.

The common errors made by the Candidates were as follows:

- Wrong direction in the entries for the reversal of the over-valued inventories subsequently sold after the date of acquisition of the subsidiary;

- Wrong computation of the amounts of unrealised profit in closing inventories arising from the upstream sales from the subsidiary to the parent; and hence the resultant errors made in the consolidation journal entries in respect of NCI share for the current year profit and post-acquisition retained earnings in the subsidiary;

- Some Candidates computed the beginning retained earnings for both the parent and the subsidiary wrongly, as this amount was not given in the question. It required the Candidates to determine the amount by using the retained earnings at the end of the financial year in the Statement of Financial Position less total comprehensive income for the year stated in the Statement of Comprehensive Income but added back the dividend paid during the financial year;

- The parent's share of the current year's other comprehensive income in the associate was omitted;

- The adjustment for unrealised profit in closing inventories arising from upstream sales was wrongly computed by the Candidates; and

- The parent's share of the post-acquisition fair value reserve of the associate at the beginning of the year was computed wrongly. Instead of using the fair value reserve at the beginning of the year, it should be the movement of the fair value reserve from the date of acquisition to the beginning of the current year.

Part (b) appeared to be the most challenging part of the question, as a handful of Candidates did not attempt this part of the question. For those who attempted, most of the Candidates failed this part of the question.

Instead of preparing the independent proof of the **Group's** net profit, other and total comprehensive income, and retained earnings (as required by the question), they showed the workings of the Consolidated Statement of Comprehensive Income that presented the Net profit after tax and Other Comprehensive income of the Group instead. A handful of Candidates showed the entire Consolidated Statement of Comprehensive Income from Sales to Net profit after tax, which was also not required by the question.

Analytical checks are critical review function that allows the accountant to derive balances independently of the consolidation and equity accounting journal entries. Candidates should be familiar with analytical procedures that underscore a deeper understanding of the processes in consolidation and equity accounting.

As the two parts of the question were interrelated, Candidates should ensure consistency in their answers which will serve as a check and assist them in answering each part accordingly. Candidates are also advised to read the questions carefully before attempting the question.

Question 2

Question 2 comprised two parts, and overall, this question was generally well-attempted by the Candidates.

Question 2 – Part I

Question 2 Part I (a) and (b) required the Candidates to identify the related parties of the reporting entity and to disclose the relevant information and relationship as required by SFRS(I) 1-24 *Related Party Disclosures* in the financial statements.

The Candidates performed well in identifying the related parties and many Candidates scored full marks for **Part I (a)**.

Some errors were noted as follows:

- A handful of Candidates did not identify Company G Inc. as a related party even though it was the joint venture of Company F Pte Ltd, and Company F Pte Ltd had significant influence over the reporting entity;
- Some Candidates identified Mr C as a related party and stated that he was the major shareholder; when it was clearly stated in the question that he was the key management personnel of the parent; and
- Some Candidates did not justify the related party relationships correctly. They merely mentioned the respective parties are major shareholders in the reporting entity, but the correct application of SFRS(I) 1-24 was to identify the relationship specified in the questions, such as key management personnel of the parent, entities with significant influence or joint control.

Part I (b) required the Candidates to state the information and relationship to be disclosed in the financial statements. Candidates generally were able to identify most of the items or transactions that required disclosure under SFRS(I) 1-24. However, some of the Candidates omitted items such as the amount outstanding between the related parties and the reporting entity, including the allowance for impairment and the impairment expense recognised during the period in respect of the amount standing, if any. Also, a few Candidates failed to identify that the name of the parent is a disclosure requirement itself.

Question 2 Part II involved an application of the requirements of SFRS(I) 9 *Financial Instruments* and preparation of the journal entries to record the fair value changes of the futures contract for the respective financial years, including its settlement and sale of the inventory; by applying **cash flow hedge** accounting to the transactions.

Most Candidates demonstrated a good understanding of the SFRS(I) 9 and were able to do this part of the question correctly.

A cash flow hedge involves hedging future cash flows. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive income and accumulated in equity. The amount accumulated in equity is reclassified to profit or loss when the hedged expected future cash flow arises.

The majority of the Candidates were able to prepare the journal entries for hedge accounting for the respective financial years correctly. However, some Candidates ignored or forgot to indicate clearly if the fair value gain resulted in a 'profit or loss item' or an 'other comprehensive income item.' A few of the Candidates omitted to prepare the journal entries to record the cost of inventory sold and/or to transfer the cash flow hedge reserve from equity to profit upon settlement of the futures contract.

Candidates are also reminded to provide clear and relevant workings. If Candidates presented an incorrect amount of cash flow hedge reserve due to the wrong calculation of the fair value gain of the futures contract, the absence of such workings resulted in loss of marks.

Question 3

Question 3 examined the Candidates on the application of the standard SFRS(I) 1-36 *Impairment of Assets.* It required Candidates to explain what was a cash-generating unit (CGU) and, identify the relevant CGUs in the question in **Part (a),** and perform an impairment test for the entities in the Group, including the calculation and the allocation of any impairment loss and the total impairment loss recognised for the financial year in **Part (b)**.

Overall, the Candidates' performance for **Question 3** was the worst among the four questions. The question was poorly answered, and most Candidates failed this question. The possible reason for this could be that the Candidates still lack a good knowledge of the finer details of SFRS(I) 1-36, particularly in relation to CGUs and corporate assets.

A CGU is the smallest identifiable group of assets that generate cash inflows largely independent of the cash inflows from other assets or groups of assets. Corporate assets are a group or divisional assets such as a head office or a research centre. Essentially, corporate assets are assets that do not generate cash inflows independently from other assets. Hence their carrying amount cannot be fully attributed to a CGU under review.

In testing a CGU for impairment, an entity should identify all the corporate assets that relate to the CGU.

a) If a portion of the carrying amount of a corporate asset **can be allocated** to the CGU on a reasonable and consistent basis, the entity compares the carrying amount of the CGU (including the portion of the corporate asset) with its recoverable amount.

b) If a portion of the carrying amount of a corporate asset **cannot be allocated** to the CGU on a reasonable and consistent basis, the entity:
   i. compares the carrying amount of the CGU (excluding the corporate asset) with its recoverable amount and recognises any impairment loss;
   ii. identifies the smallest group of CGUs that includes the CGU to which the asset belongs and to which a portion of the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis; and
   iii. compares the carrying amount of that group of CGUs (including the portion of the corporate asset allocated to the group of units) with the recoverable amount of the group of units and recognises any impairment loss.

Where possible, it is normally most appropriate to allocate shared assets by reference to the extent to which they are used by each CGU.

An impairment loss should be recognised for a CGU (the smallest group of CGUs to which goodwill or a corporate asset has been allocated) if (and only if) the recoverable amount of the CGU (group of units) is less than the carrying amount of the CGU (group of units). The impairment loss should be allocated to reduce the carrying amount of the assets of the CGU (group of units) in the following order/priority:

a) First to the goodwill allocated to the CGU (group of units);

b) Then to all other assets in the CGU (group of units), on a **pro-rata basis**.

Most of the Candidates were able to answer the definition of CGU in **part (a)**. However, the majority of the Candidates were unable to apply the concept of the CGU and identify correctly there were only two CGUs in the question, i.e., Subsidiary B and Subsidiary C.

Most of the mistakes came from **part (b)**, relating to the wrong computation of the impairment loss. Therefore, the resultant impairment loss when allocating to the respective CGUs were not correctly determined.

Common errors included the followings:

- The Candidates did not allocate the carrying amount of the corporate assets in Subsidiary A to both Subsidiary B and Subsidiary C;
- Most of the Candidates correctly allocated the impairment loss determined by them first to goodwill. However, many of them allocated the balance of the impairment loss to all the assets in Subsidiary B; instead of allocating to the carrying amount of Machinery and other equipment, other assets within the scope of SFRS(I) 1-36 and Subsidiary A's corporate assets allocated to Subsidiary B, on a pro-rata basis; and
- As the corporate asset in the Head office cannot be allocated to the two CGUs on a reasonable and consistent basis, there would be a further impairment test to compare the carrying amount of the whole business with its recoverable amount. In this case, the revised carrying amount of the business would include the net carrying amounts of the two CGUs (i.e., Subsidiary B and Subsidiary C) after impairment combined with the carrying amount of the corporate asset in the Head Office. Most of the Candidates failed to compute the total impairment loss recognised for the year correctly.

Question 4

Question 4 required the Candidates to apply SFRS(I) 15 *Revenue from Contracts with Customers* to prepare journal entries to recognise contract revenue and contract cost for the current year in **part (a)** and to compute the foreseeable future loss from the contract for the current financial year in **part (b)**.

Part (a) was a straightforward question on revenue recognition via the percentage of completion method. Candidates did well, as most Candidates were able to compute the correct contract revenue and contract costs for the year.

Common errors noted were:

- Some Candidates did not manage to calculate the percentage of completion correctly as they wrongly interpreted the contract cost incurred for the current year as the cumulative contract cost incurred to date; and
- Wrong computation for the cumulative contract costs, as some Candidates did not include the contract costs incurred in prior years.

As emphasised in past years, Candidates need to show workings to support the percentage of completion, contract revenue and contract costs. If Candidates presented incorrect amounts/answers, the absence of such workings resulted in the loss of working marks.

For **part (b)**, some Candidates did not attempt or complete poorly for this last part of the paper. Candidates are advised to manage their time better to ensure sufficient time is allocated to all the questions in the examination. This is especially important since additional marks could be scored for their attempt at each question.

Most of the marks lost in this question related to the wrong interpretation of the question. The question required an answer relating to foreseeable future loss from the contract for the current year. Some Candidates provided the answer for the total loss incurred on the contract, while others provided the actual loss for the current year instead.

Candidates are advised to read the questions carefully before attempting the question.