Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Advanced Financial Reporting (AFF)

EXAMINATION DATE: 7 June 2022

Section 1
General comments

Overall, the Candidates who took the Advanced Financial Reporting (AFF) June 2022 examination were able to apply the basic concepts contained in the Singapore Financial Reporting Standards (International) (SFRS(I)). However, many Candidates fell short when applying the SFRS(I)s to complex transactions. While the Candidates' performance for Questions 1 and 2 was satisfactory, the number of Candidates did not score well for Questions 3 and 4. Further analysis and common errors made by the Candidates were detailed in Section 2.

Candidates are reminded to put in enough time and effort in their preparation for the examination. As the AFF module builds upon the knowledge acquired from the Principles of Financial Reporting (PFF) module, the level of proficiency required for AFF is also substantially higher than what is required to complete the PFF module. So, the level and intensity of preparation and practice should be commensurate to the higher level of proficiency. Candidates must exhibit more than just basic knowledge of the SFRS(I)s. They must be able to demonstrate competency in analysing the facts presented and apply the appropriate standard or standards to complex transactions.

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 provide independent proof of the net profit or loss attributable to owners 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*.

Performance for **part (a)** was relatively well. Many Candidates who attempted the question could provide the basic investment elimination entries, including the computation of goodwill.

The common errors made by the Candidates were as follows:

(a) Wrong computation of the amounts of unrealised loss arising from the intercompany sales of property, including subsequent years' depreciation; and hence the resultant errors made in the consolidation journal entries;

(b) Elimination of downstream sales of inventories from the parent to the subsidiary. Some Candidates misinterpreted it as upstream transactions. It is mentioned in the question that sales were made from the parent to the subsidiary; so, it should be clear that it was downstream transactions; and

(c) Some Candidates took the wrong figures from the Statement of Comprehensive Income to account for the non-controlling interest's share of current year's profit as well as post-acquisition retained earnings and revaluation reserves.

Most Candidates did well for the equity accounting entries for the associate, including the share of fair value reserves. However, some Candidates made mistakes with the direction of the entries. Errors in equity accounting entries arose mainly from the reversal of depreciation of the over-valued property in the associate.

Part (b) appeared to be challenging as a number of Candidates did not attempt this part. For Candidates who attempted this part, they did not perform well. Instead of preparing the independent proof of the net profit or loss attributable to the owners of parent (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 few Candidates also prepared the independent proof of the consolidated retained earnings. 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 a critical review function that allows the accountant to derive balance independently of the consolidation journal entries. Therefore, Candidates should be familiar with analytical procedures that underscore a deeper understanding of the processes in consolidation.

Question 2

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

Question 2 – Part I (a)

Part I (a) examined the Candidates on the application of the requirements of Ethics Pronouncement (EP) 100 the *ISCA Code of Professional Conduct and Ethics* and had tested the Candidate's analytical ability to comprehend the facts of the case given in this question and in identifying significant abnormalities associated with the practice of offsetting of accounts receivable and accounts payable balances.

Most Candidates were able to demonstrate their analytical skills and identified the significant impact of the abnormalities stated in the case. A few Candidates further attempted to associate the abnormalities with the underlying root cause, i.e., errors arising from the new accounting system.

A few Candidates answered the part by copying the content of the given case. However, 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.

Regarding the facts given in the case which highlighted the practice of offsetting the balances of Accounts Receivable and Accounts Payable, very few Candidates associated the direct correlation of this practice to the requirements mandated in SFRS(I) 1-32 *Financial Instruments: Presentation* on offsetting a financial asset and a financial liability and presenting a net amount on the Statement of Financial Position. The entity can do so when, and only when:

(a) It currently has a legally enforceable right to set off the recognised amounts; and

(b) It intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Question 2 – Part I (b) and (c)

Part I (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 I (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 **Parts I (b)** and **(c)**, Candidates addressed the requirements of the question, which includes identifying 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 stated and correct identification of the threat that could be compromised or perceived to compromise.

Question 2 – Part I (d)

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

Question 2 – Part II

Question 2 Part II (a) and (b) examined the Candidates on the application of the requirements stipulated by SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates* and required the Candidates to translate the financial statements as at the reporting date in **Part II (a)** and prove the balance of the translation reserve in **Part II (b)**.

Majority of the Candidates did well for **Part II (a)**. They used the correct currency exchange rate to translate the balances of monetary items as at the reporting date.

The gains and losses arising on a revaluation of property, plant and equipment measured in a foreign currency are measured in a foreign currency are to be translated using the rate at the revaluation date. A few Candidates attempted to apply this principle of translation. They applied the currency exchange rates (which were given during the respective revaluation dates) on the cumulative fair value of property, plant and equipment instead of calculating the revaluation gain or loss on each revaluation date.

As the transactions like share buyback and issuance of equity shares (e.g., rights issue) are non-monetary transactions, they should be measured and recorded using the exchange rate on the date of transactions. A few Candidates used incorrect exchange rates for translating the equity instruments.

For the purposes of translation of monetary items and non-monetary items, a few Candidates adopted incorrect currency exchange rates - which were inconsistent with the requirements of SFRS(I) 1-21.

A handful of Candidates ended up making careless arithmetical errors when determining the exchange differences arising from the settlement of monetary items or on translating monetary items forming part of the Statement of Financial Position as at the reporting date. The Candidates should exercise caution during the examination to avoid such arithmetical errors. We would like to remind Candidates that an accountant's work should always reflect careful attention to fundamental details.

Almost half of the Candidates demonstrated their understanding by reconciling foreign currency translation reserve in **Part II (b)**. Candidates tend to make common mistake, e.g., ignored the issuance of equity shares while attempting to prove the reconciliation of foreign currency translation reserve; and hence did not manage to get the right answer.

It is critical for Candidates to thoroughly comprehend the requirements of SFRS(I) 1-21 and to apply the requirements appropriately while demonstrating their understanding of the concepts relating to the translation of foreign currency balances.

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Question 3

Question 3 comprised of two parts and the performance of this question was below borderline.

Question 3 Part I

This question examined the Candidates on the application of the standard SFRS(I) 5 *Non-current Assets Held for Sale and Discontinued Operations.* It required Candidates to prepare journal entries immediately prior to the reclassification as a disposal group held for sale in **Part (a)** and to compute the adjusted carrying amount of the assets in the disposal group and allocation of the impairment loss to each of the asset in **Part (b)**.

A key provision under SFRS(I) 5 states that impairment must be considered both at the time of classification as held for sale and subsequently; immediately before the initial classification of a non-current asset (or a disposal group) as held for sale, the carrying amount of the asset (or of all the assets and liabilities in the disposal group) should be measured in accordance with the applicable SFRS(I)s. Additionally, SFRS(I) 5 requires the non-current assets to be subject to the impairment test. Any impairment loss should reduce the carrying amounts of the non-current assets in the group that are within the scope of the measurement requirement of SFRS(I) 5, in the order of allocation set out in SFRS(I) 1-36 *Impairment of Assets*.

Therefore, the impairment will be allocated first to goodwill. No impairment loss was allocated to inventories and trade receivables. SFRS(I) 1-36 also requires the impairment loss to be allocated to the assets in proportion to their respective carrying amounts, i.e., for owner-occupied property and plant and equipment.

Most of the Candidates performed well in **Part (a)** and provided the correct journal entries in relation to the revaluation of the property and write-off of the inventories and trade receivables.

Candidates did badly for **Part (b)**. Most of the mistakes made by Candidates were related to the wrong computation of the impairment loss. A number of Candidates did not consider the property at revalued amount and the impaired inventories and trade receivables when measuring the adjusted carrying amounts of the assets in the disposal group. Therefore, the resultant impairment loss when comparing the adjusted carrying amounts to the fair value less costs to sell of the disposal group was not correctly determined.

Most of the Candidates correctly allocated the impairment loss determined to goodwill. However, many of the Candidates allocated the balance of the impairment loss to all the assets in the disposal group instead of allocated to owner-occupied property and plant and equipment proportionately.

Overall, Candidates could have scored better if they read the facts of the case carefully and addressed the requirements of the question.

Question 3 Part II

Question 3 Part II involved an application of the requirements of SFRS(I) 9 *Financial Instruments* the preparation of the accounting journal entries to record the fair value changes of the put option due to intrinsic value and time value separately for the respective financial years, including its settlement.

This was a question that many Candidates struggled with despite the clear wording. Candidates may need to have a better understanding of the differences in accounting treatments for the various financial instruments and apply the correct accounting treatment following SFRS(I) 9.

Many Candidates tried to apply hedge accounting which was not relevant to the question. Other Candidates tried to split the intrinsic and time value of the put option without realising that the two combined would be the fair value adjustment of the put option.

Most Candidates ended up giving too many or too few journal entries due to their wrong interpretation/application of the required accounting treatment to the put option. Wrong answers included treating it as an option hedging the underlying share or treating it as a share purchase instead of a derivative purchase.

Candidates were also reminded to provide clear and relevant workings. If Candidates presented incorrect amounts/balances in their journal entries, the absence of such workings results in a loss of marks.

Question 4

Question 4 comprised of two parts, and generally, the majority of the Candidates did poorly for this question.

This question required Candidates to calculate and prepare journal entries to record the remuneration expense in accordance with SFRS(I) 2 *Share-based Payment* in **Part (a)** and discuss the accounting treatment for the share-based payment if the employee has chosen the settlement in equity instrument in **Part (b)**.

Overall, Candidates did not perform well in terms of both journal entries and theory question. We noted that there was a significant knowledge gap for share-based payment topic and the relevant SFRS(I). It was also noted that a large number of Candidates could not compute the debt and equity component of the share-based payment, which was in actual fact a compound financial instrument.

For share-based payment transactions in which the terms of the arrangement provide the employee with the choice of whether the entity settles the transaction in cash or by issuing equity instruments, SFRS(I) 2 states that the entity has, in fact, issued a compound financial instrument with a debt component (i.e., the employee's right to demand payment in cash) and an equity component (i.e., the employee's right to demand settlement in equity instrument).

SFRS(I) 1-32 *Financial Instruments: Presentation* requires "split accounting" for such compound financial instruments, and that the fair value of the debt component is to be determined first.

Consistent with the requirement of SFRS(I) 1-32, SFRS(I) 2 requires that:

- For transactions with employees, the entity should first measure the fair value of the debt component and then measure the fair value of the equity component; considering that the employee must forfeit the right to receive cash in order to receive the equity instrument.

On the settlement date, SFRS(I) 2 requires that:

- if the employee demands settlement in equity instrument, the entity should transfer the liability to equity, as the consideration for the equity instrument issued, and

- if the employee demands settlement in cash, the entity should treat that payment as full settlement of the liability, any equity component previously recognised should remain within equity.

The answers on the issuance and settlement of the share option in **Part (a)** were very poorly done. Candidates either did not attempt this part of the question or did it incorrectly. As share options which are compound financial instruments, is a common remuneration package for employees, Candidates must be conversant with the accounting of this type of share-based payment.

Most of the Candidates did not know how to calculate the cumulative remuneration expense for the respective financial years. Also, some Candidates gave journal entries but failed to provide workings. If Candidates presented incorrect amounts/balances in their journal entries, the absence of such workings results in loss of marks.

Candidates need to answer the theory question in **Part (b)** directly and in a more focused manner. It was irrelevant to discuss and extract the text from SFRS(I) 2 without any attempt to explain the application of SFRS(I) 2 to the question. It was noted that some Candidates did not attempt this question part at all.