Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Advanced Financial Reporting (AFF)

EXAMINATION DATE: 11 December 2018

Section 1
General comments

For this examination, unless specified otherwise, Candidates were to assume that all reporting entities (including any subsidiaries and associates) adopted, for all the relevant years, the Singapore Financial Reporting Standards (International) (SFRS(I)) that were issued by the Accounting Standards Council as at 1 January 2018.

December 2018 exam session was the first time Candidates used e-Exam software, with each of them recording their answers using their personal laptop (in full lockdown mode – no internet/network connectivity or hard drive access) instead of traditional pen and paper. Notwithstanding the use of laptops, all SCAQ Foundation Module examinations continue to be a restricted open-book format with Candidates being able to bring in a double-sided A4 page of personal notes for reference.

Overall, the Candidates in this examination were able to apply the basic concepts contained in the SFRS(I). However, many Candidates fell short when applying the SFRS(I) to complex transactions. While the Candidates' performance for Questions 1 and 2 was satisfactory, a number of Candidates did not score well for Questions 3 and 4. Further analysis and common errors made by the Candidates are detailed in Section 2 of this report.

It was noted that most of the Candidates attempted all the questions with at least some solutions provided, indicating that Candidates were generally able to manage their time during the examination.

Candidates are reminded to put in enough time and effort in their preparation for every examination. As the AFF module builds upon the knowledge acquired from the Principles of Financial Reporting (PFF) module, Candidates are expected to revise the PFF topics as part of their preparation for the AFF examination. The level of proficiency required for AFF is also substantially higher than what is required to complete the PFF module successfully, so the level and intensity of preparation and practice should be commensurate to the higher level of proficiency required. Candidates must exhibit more than just basic knowledge of the SFRS(I). 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

Question 1 was on Consolidated Financial Statements. The case involved a simple group where the parent acquired control of a subsidiary and significant influence in an associate.

This question involved the usual accounting for non-controlling interests and goodwill (SFRS(I) 3 *Business Combinations*), inter-company transactions and the equity method of accounting for associates (SFRS(I) 1-28 *Investments in Associates and Joint Ventures*). The question required the preparation of consolidation journal entries and preparation of the consolidated Statement of Comprehensive Income.

Most of the Candidates did well in the basic investment elimination entries (inter-company interest expense and dividends) and equity accounting entries. Also, most Candidates were able to prepare the consolidated Statement of Comprehensive Income showing the understanding that only the subsidiary's (and not the associate's) income needed to be consolidated. However, many Candidates were not able to deal with the complex transactions presented in this question.

The common errors made by the Candidates were as follows:

(a) Undervalued freehold land of the subsidiary at acquisition date, which was subsequently sold at a profit by the subsidiary in the current year.

From the group's perspective, the freehold land should first be adjusted to reflect the fair value at the group level and thereafter eliminated against the profit on disposal of freehold land in the books of the subsidiary. Most of the Candidates were not able to identify the correct entry (or correct amount) for the reversal of the undervaluation of freehold land disposed.

(b) The subsidiary sold a piece of equipment to its parent at a <u>loss</u> (not a profit) in the prior financial year. The equipment was still held and being used by the parent at the end of the current financial year.

From the group's perspective, the unrealised loss arising from the intra-group sale of the equipment should first be eliminated against beginning retained earnings (and <u>not</u> current year's profit) and the realisation of the unrealised loss (through depreciation expense) for the prior year and current year should be adjusted through beginning retained earnings and operating expense respectively. Also, the group's share of the subsidiary's beginning retained earnings and net profit after tax for the year should be adjusted for the non-controlling interest's share in this up-stream transaction.

Most of the Candidates failed to identify the correct entry relating to this intra-group sale of equipment, and as a result, the non-controlling interest of the subsidiary for the prior year and current year were not determined correctly.

(c) The parent advanced an interest-bearing short-term loan to its subsidiary. The entire loan amount and interest owing remained unpaid as at the financial year-end. While most Candidates were able to identify the inter-company loan balances elimination entry, many of them failed to include the interest expense owing for the current year even though this amount was clearly stated in the question.

For the consolidated Statement of Comprehensive Income, a lot of Candidates failed to show their workings for the Profit attributable to Equity Holder and Non-Controlling Interests. This same omission was noted in previous AFF examinations. The absence of clear and relevant workings resulted in loss of marks for a Candidate where incorrect amounts/balances were presented in the consolidated Statement of Comprehensive Income.

Candidates are reminded that relevant workings are those that show clearly the items that make up the amounts/balances in the consolidated financial statements. As such, consolidation journal entries generally do not constitute workings, especially if a Candidate does not show clearly how the amounts in the journal entries attribute to the amounts/balances in the consolidated financial statements.

Question 2

Part I of this question required the Candidates to identify the related parties of the reporting entity and to disclose the relevant transactions and balances with these related parties together with other information as required by SFRS(I) 1-24 *Related Party Disclosures*.

Part II of the question required the Candidates to translate the financial statements of a foreign operation into the group's presentation currency under SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates*.

Candidates performed well for the related party disclosures in **Part I**. Generally, they could identify most of the related parties. For the items and relationships to be disclosed in the financial statements, some Candidates listed the related party transaction disclosures requirements under SFRS(I) 1-24 without specific application to the facts in the case. Although the Candidates were able to identify most of the items or transactions that required disclosure in the financial statements, many of them omitted items such as the outstanding balances pertaining to the transactions with fellow subsidiaries.

In respect of the short-term loan to a related party, Candidates also omitted items like the "terms and conditions of the loan" and "any allowance for impairment related to the loan amount and the impairment expense recognised during the current year". It was also noted that some Candidates used the concept of "control" very loosely to include all related parties, regardless of whether the parties were subsidiaries, associates or key management personnel, which indicates that these Candidates do not have a clear understanding of the requirements under SFRS(I) 1-24.

In **Part II**, Candidates generally performed well for the translation of foreign currency financial statements. Most of them could apply the correct exchange rates for the income statement items, assets and liabilities. However, errors were made when translating the equity items, especially the share capital, the fair value reserve and the currency translation reserve.

Common errors made for translation of share capital were mainly due to using the wrong exchange rates (it was stated in the question that additional shares were issued by the foreign operation after the date of acquisition).

For the translation of the fair value reserve, many Candidates did not apply the relevant exchange rate to each movement in the reserve. In the question, there was movement in the fair value reserve during the prior year and the current year. The question stated that the fair value reserve arose from the revaluation of a long-term equity investment which was designated to be classified as fair value through Other Comprehensive Income. The question also stated that the investment was revalued as at each year-end.

One of the most common mistakes made by the Candidates was the translation of the cumulative balance of the fair value reserve at the end of the current year using the closing exchange rate, instead of translating the prior year's fair value reserve balance and current year's fair value reserve movement at the exchange rate applicable at the respective year-end.

As a result of the above errors, most Candidates could not derive the currency translation gain for the current year nor the currency translation reserve as at the balance date correctly.

Question 3

Question 3 also comprised two parts.

Part I tested the Candidates on identification of potential threat/s to ethical behaviour and the application of professional ethics in the context of financial reporting and the working environment. Candidates were to use the information in the case and their understanding of Ethics Pronouncement (EP) 100 (the *ISCA Code of Professional Conduct and Ethics*) to evaluate whether the threat/s was/were significant and thus identify what appropriate safeguards (if any) could be applied.

Most of the Candidates were able to identify the fundamental principles and threats in the scenario given. However, not many Candidates were able to name and identify the appropriate safeguard/s that could eliminate (or reduce to an acceptable level) the threat to the fundamental principle that they had identified.

Part II focused on the application of the concept of cash-generating units (CGUs), impairment testing of CGUs and the allocation of impairment losses to specific CGUs and corporate assets, including those loss amounts which could not be allocated to an individual CGU.

Generally, most Candidates did poorly for **Part II** of this question. Although most of them were able to explain the concept of a CGU, many Candidates were unable to apply the concept to the case scenario appropriately. They were also not able to compute the impairment required by comparing the adjusted carrying amount of the individual CGUs to the recoverable amounts, and so drew the incorrect conclusion for the impairment test of the respective CGUs. Further, many Candidates did not know how to allocate the impairment amount between goodwill and the net identifiable assets of the respective CGUs.

The vast majority of Candidates also did not know how to allocate the impairment loss based on the adjusted carrying value of the CGUs and the corporate asset (which was the central office). As a result, the net carrying amount of the impaired CGUs and the corporate asset after impairment testing were incorrectly derived, thus adversely affecting the computation of the total impairment loss of the entire business.

Question 4

Question 4 required the Candidates to prepare accounting entries for cash flow hedges under SFRS(I) 9 *Financial Instruments* and explain the purpose of hedging and hedge accounting if elected.

For **Part (a)**, most of the Candidates were able to correctly identify the double entries for the transactions, even though only a few of them were able to compute the amounts for all the accounting entries correctly.

Some Candidates did not have a good grasp of the concept of hedging and how the instrument works, resulting in very illogical accounting entries being provided and computations done. While some Candidates computed the amounts correctly, the direction of their journal entries were wrong. Candidates need to be clear about the increase/decrease in the fair value of the instrument and how this affects Other Comprehensive Income.

For **Part (b)**, most of the Candidates were able to explain the purpose of hedging. However, only a few Candidates were able to explain correctly the purpose of hedge accounting.

