Chartered Accountant
SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 4 December 2019

Section 1
General comments

Generally, Candidates displayed good understanding in the preparation of basic consolidation entries and translation of financial statements required for Question 1. However, Candidates need to improve in their ability to eliminate more complex intra-group transactions and to be more proficient in analytical checks (proof of balance) of the non-controlling interests and investment in associate balances.

Candidates performed poorly for Question 2, especially with respect to **Case A (a)**. Many Candidates tended to reproduce parts of the standards (SFRS (I) 1- 40 *Investment Property* and SFRS (I) 16 *Leases*) and did not provide adequate analysis in answering the question. In addition, Candidates demonstrated a poor understanding of deferred tax principles and their application in **Question 2 Case B (b) and (c)**.

Question 3 tested Candidates on their understanding of accounting for transactions relating to financial instruments as well as the effects of these transactions on the cash flow statement. Most Candidates did well for **Question 3 (a)** and were able to prepare the majority of the journal entries for the various financial instruments' transactions.

Many Candidates, however, seemed to be either confused or unfamiliar with the concepts involved in the preparation of the cash flow statements required for **Question 3 (c)**. For example, transactions affecting OCI should not have any impact on the cash flow statements. Yet many Candidates adjusted those transactions as non-cash items when preparing the cash flow statement.

Section 2
Analysis of individual questions

Question 1
Question 1 is an integration of various topics relating to group reporting - business combinations, consolidation, intra-group transactions, translation and equity accounting of a foreign associate - the concepts of which were generally well-grasped by Candidates.

Part (a) required Candidates to prepare consolidation adjustments relating to a Singapore incorporated company's interest in its subsidiary. The majority of Candidates did well in this part and were able to prepare the basic consolidation adjustments pertaining to the elimination of investment in subsidiary, allocation of postacquisition retained earnings and current year profit to non-controlling interests (NCI) and elimination of dividends declared by subsidiary.

However, **part (a)** also saw some Candidates making common mistakes relating to:

- Measurement of past impairment loss on the intangible assets of the subsidiary recognised during the business combination. Some Candidates calculated the amount of impairment loss wrongly or did not allocate the loss to NCI. Others omitted the adjustment of the tax effects.

- Adjustment for unrealized profit in inventory arising from the previous year's upstream intra-group sale of inventories. Some Candidates had directional errors in their adjustment entries to account for the inventory damaged by flood in the current year.

- Allocation of current year profit to NCI. While most Candidates were able to furnish the correct consolidation entry, many Candidates were unable to work out the correct amount. They either did not adjust or wrongly adjusted the subsidiary's current year profit for the realisation of the profit from the intra-group sale of inventories.

- Elimination of intra-group contract revenue, contract expense, contract asset and adjustment of fixed asset in progress. While majority of Candidates correctly eliminated the contract revenue and contract expense, some Candidates wrongly adjusted the contract asset or fixed asset in progress. Some Candidates also totally omitted this consolidation adjustment and/or the adjustment of the tax effects.

Part (b) required Candidates to perform an analytical check (proof of balance) of NCI as at the end of the year. This question was generally well answered by most Candidates, although some Candidates fumbled in the following adjustments to the book value of net assets:

- after-tax carrying amount of intangible asset
- after-tax unrealised profit in inventory

Part (c) required Candidates to translate the financial statements of an associate from its functional currency (US$) to the investor's reporting currency (S$). This question was generally well answered as most Candidates could provide the translated income statement and statement of financial position.

The common mistakes made by Candidates were:

1. Wrong rates used for items in the income statement

   A number of Candidates used historical rates for inventory purchases rather than rate at which inventories were sold when translating cost of sales. Some

Candidates also used the average rate for the year to translate impairment loss; rather than the year end rate even though the question stated that the impairment arose at the end of the year. In addition, tax expense should be translated at the rate(s) consistent with the rate(s) used to translate the related income item and not the average rate for the year.

2. Wrong rates used for items in the statement of financial position

   The question stated that revaluation surplus arose on two separate dates in 20x4 and 20x6. However, the associate was only acquired on 1 January 20x5. Therefore, the exchange rate to translate the revaluation surplus that arose in 20x4 should be the exchange rate on the date when the associate was acquired i.e. 1 January 20x5. Many Candidates used the wrong exchange rate (20x4 exchange rate) for the translation.

3. Beginning retained earnings as at 1 January 20x6

   A fair number of Candidates failed to derive the beginning retained earnings in S$ by reconstructing the statement of financial position as at 31 December 20x5 using the information given on share capital, revaluation reserve and foreign currency translation reserve. They merely translated the opening retained earnings in US$ using the exchange rate at the beginning of the year. As a result, the balance calculated for ending retained earnings and foreign currency translation reserve were wrong.

Candidates did not perform as well in **part (d)**, which required them to prepare an analytical check (proof of balance) of the investment in associate as 31 December 20x6. They fumbled in the following areas:

- Failure to use the closing exchange rate to translate year end share of book value of associate.
- Wrong calculation of implicit goodwill in associate due to errors, such as using the wrong exchange rate to translate goodwill and/or wrongly adjusting for the under-valued inventory that existed on date of investment purchase.

Question 2

Case A

Overall, question **part (a)** was poorly answered with few Candidates achieving a pass mark of 5 or more, which is an indication that Candidates were not fully conversant with the salient features of the relevant standards and their application. Many Candidates tended to reproduce parts of the standards (SFRS (I) 1- 40 *Investment Property* and SFRS (I) 16 *Leases*) and did not provide their own commentary and application of the key principles to the case. Many Candidates also repeated facts in the case without analysing how the facts affected the critical classification question.

Few Candidates commented on the nature of income, level of involvement and significance of fees. None of the Candidates discussed benchmarks such as the usual rental fees charged by other owners in a similar market. Some Candidates, but not many, mentioned independent cash flows while a few talked about the performance standards and its implications.

More Candidates were able to discuss about the lease arrangements, whether it was finance or operating lease, but not all went on to explain the implication of the lease classification on the classification of the property as an investment property.

Part (b) (i) required computation on the initial amounts of right-of-use (ROU) asset and lease liability. Many Candidates were unsure of the components that should be included in the computations. The lease liability includes the present value of the fixed lease payments. The variable lease payments are dependent on the annual net profit before tax (not an index or a rate); hence they should be excluded from the lease liability calculation. The amount of leased asset should include the amount from the lease liability and the present value of the reinstatement costs at the end of 10 years. Common mistakes included adding the variable component, not differentiating the lease liability and ROU asset (hence both amounts are the same) and not including the present value of the reinstatement costs in the calculation of the ROU asset.

Part (b) (ii) required Candidates to calculate specific expenses incurred from the lease contract. Interest expense should be calculated based on the initial lease liability less the first lease payment which was made at the beginning of the year. A number of Candidates did not deduct the initial payment when computing the interest. Depreciation expense should be calculated based on the initial leased asset amount. Many Candidates failed to account for the variable lease expense which was based on the year’s actual net profit and expensed off. Some Candidates accounted for it as an expense but based the calculation on the forecasted profit.

Case B

For **part (a),** a vast majority of the Candidates got the depreciation component correct. But many Candidates did not eliminate (close off) the accumulated depreciation prior to revaluation. A number of Candidates did not get the revaluation amount correct. For the 20x6 revaluation, many Candidates did not charge the excess portion of the revaluation loss to Profit or Loss and went to debit revaluation reserve instead. Many Candidates did not write the narration or title for their entries and lost marks for that as well.

For **part (b),** performance was generally poor. Only a handful were able to work out the carrying amount, tax base, temporary differences and deferred tax liability. Some Candidates did not attempt this question. It is clear that most Candidates have a poor understanding of deferred tax.

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Similar to **part (b),** a majority of the Candidates did poorly for **part (c)**. Quite a number of Candidates did not attempt this question. For those who did, almost no one credited revaluation reserve in the deferred tax entry.

Question 3

Part (a) required Candidates to prepare journal entries to record transactions relating to the bond investments for the year ended 31 December 20x6 in accordance with SFRS (I) 9 *Financial Instruments*.

This question part was very well answered. Most Candidates were able to correctly identify the interest income, fair value adjustment and the value of bonds disposed. Some Candidates, however, missed out the need to reclassify the realised loss from Other Comprehensive Income (OCI) to Profit or Loss (P/L).

Part (b) required Candidates to prepare journal entries to record the transactions relating to the equity investments and the put options for the year ended 31 December 20x6 in accordance with SFRS (I) 9 *Financial Instruments*.

Most Candidates were able to account for the purchase of the equity securities and put options as well as the dividend income. Some Candidates had difficulty computing the fair value adjustment to the equity security as a result of a decrease in the fair value per share as well as the increase in the intrinsic value of the put options and the decline in fair value of the time value of the put options.

Almost none of the Candidates accounted for the re-classification of the amortization of time value of put option to income statement as required under paragraph 6.5.15(c) of SFRS (I) 9 *Financial Instruments*.

Part (c) required Candidates to show the effect of the transactions relating to the bond and equity security investments as well as the put options on the Statement of Cash Flows for the year ended 31 December 20x6.

This is the most poorly answered part of the question. One possible reason could be due to the shortage of time as some Candidates did not even attempt this question part. Candidates are, therefore, advised to better plan and manage their time between questions.

Another possible reason is that some Candidates were not familiar with the concept of the Statement of Cash Flows. For the indirect method of preparing the Statement of Cash Flows, the preparation of the cash flow from operating activities typically starts with net profit. Hence, any movement in OCI would not have any impact on the Statement of Cash Flows. However, some Candidates put through OCI as non-cash adjustments. While all the transactions related to investing activities, some Candidates classified some of the transactions as financing activities.

