SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 23 December 2020

Section 1
General comments

Generally, Candidates displayed good understanding in the preparation of basic consolidation entries required for Question 1. However, Candidates generally did not perform well in **part (d),** in comparison to **part (a) to (c)**, in terms of evaluating and assessing whether P Co has control over S Co.

The performance for Question 2 Case A is below expectation. Most Candidates were able to compute or state the carrying amounts but not the tax base of the assets and liabilities with the consequence that the related temporary differences were incorrect as well. Candidates were unable to get the tax base of research expenditures and interest receivable and their temporary differences right.

Question 3 tests Candidates' understanding of SFRS(I) 15 *Revenue from Contracts with Customers*. In particular, the Candidates are required to correctly identify the various performance obligations, determine when revenue should be recognised, allocate the contract consideration to the respective performance obligations and detail the appropriate journal entries in relation to the various transactions.

Most Candidates were able to answer a significant portion of this question although there was some common misunderstanding of concepts (see below).

Section 2
Analysis of individual questions

Question 1

Part (a) required Candidates to prepare consolidation adjustments relating to a company's interest (P Co) in its subsidiary (S Co). **Part (b)** required Candidates to perform an analytical check (proof of balance) of non-controlling interests, while **part (c)** required Candidates to account for a change in ownership interests without the gain of control. Finally, **part (d)** required Candidates to evaluate whether P Co has control over S Co, under various fact patterns.

In this question, Candidates were required to demonstrate their understanding and application of Singapore Financial Reporting Standard (International), SFRS (I) 3 *Business Combinations* in accounting for fair values of unrecognized intangible assets in a business combination and SFRS (I) 10 *Consolidated Financial Statements* in the application of consolidation principles.

Most Candidates performed quite well in Question 1, especially on the consolidation adjustments pertaining to the elimination of the investment in subsidiary, allocation of post-acquisition retained earnings and revaluation reserves to non-controlling interests (NCI), and elimination of dividends declared by subsidiary.

Most Candidates also performed quite well in the analytical check of non-controlling interests. However, a small number of Candidates listed down the adjustment entries for non-controlling interests instead of providing the analytical check. 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 non-controlling interests.

Most Candidates performed quite well in the accounting for change in ownership interests without change of control, understanding that it is an equity transaction.

However, Candidates generally did not perform well in **part (d),** in comparison with **part (a) to (c)**, in terms of evaluating and assessing whether P Co has control over S Co.

Common errors included the following:

- Many Candidates missed the entry or provided a wrong entry on elimination of transfer of intangible asset from P Co to S Co.

- On the adjustment for excess amortization on transferred intangible asset, some Candidates wrongly adjusted the excess amortization as "under amortization". In addition, they wrongly allocated the amount to NCI in-spite of the transaction being a downstream transaction.

- On the adjustment for unrealized profit from transfer of inventories from S Co to P Co, many Candidates missed out the credit entry to research expense for the percentage of inventory used by P Co for research purposes. Instead, they expensed it as research giving rise to an incorrect cost of sales adjustment amount.

- On the allocation of share of current income to non-controlling interests – most Candidates were able to furnish the correct consolidation entry but many were unable to work out the correct final amount. Some Candidates did not adjust or wrongly adjusted the subsidiary's current year profit for the unrealized profit arising from the intra-group sale of inventories and/or current depreciation of subsidiary's fixed assets

- Some Candidates treated S Co as an associate instead of a subsidiary, and hence all subsequent entries were incorrect. Candidates are advised to be careful in reading and interpreting the question.

- When proofing the balance of non-controlling interests, some Candidates wrongly included the downstream transaction, instead of adjusting for under-valued fixed assets.

  Most Candidates were able to identify correctly that a change in ownership interests without a change of control is an equity transaction. However, some Candidates provided all entries, while the question only required the consolidation adjustment to show the effect of the change in ownership interest. Candidates are encouraged to read the question carefully, and not provide unnecessary entries, to maximize time in the exam.

Candidates generally seem to be weaker in **part (d)**, and missed out the following points, including the following:

- Some Candidates failed to recognise that P Co has the highest relative voting rights or *de facto* control, when 60% non-controlling interests comprise 20 shareholders with approximately equal ownership each.

- Some Candidates failed to recognise that the lawyer of P Co, while not being a related party, is likely to represent P Co's interests and strengthen P Co's power of S Co.

- Some Candidates did not refer to their answers in **part (i)** when answering **part (ii)**, in fact, some answers in part (ii) can be inferred from answers in **part (i)**. For example, the lawyer of P Co, while not being a related party, is likely to represent P Co's interests and strengthen P Co's power of S Co, and one of the assumptions is that P Co's lawyer is acting in the interests of P Co, due to their relationship.

Question 2

Q2 Case A (a)

This part of the question required determining three items, namely, carrying amount, tax base and the corresponding temporary difference of several balance sheet items.

Most Candidates were able to compute or show the correct carrying amounts but not the tax base of the assets and liabilities with the consequence that the related temporary differences were incorrect as well. Some Candidates were unable to correctly show the carrying amounts even though these were given in the fact pattern or could have been quite easily computed based on Candidates' accounting knowledge. Some Candidates got the direction wrong, i.e. unable to differentiate whether it's a taxable or deductible difference.

The two items that Candidates had most issues with were the tax base of research expenditures and interest receivable and their temporary differences.

Q2 Case A (b)

This part of the question was a simple follow-through from Case A (a) and was generally well answered. Most Candidates were able to use the temporary differences computed in **part (a)** and multiply by the correct tax rate

Q2 Case A (c)

The final part was on the computation of tax expense.

Most Candidates were able to provide the following: (i) correct tax rate; (ii) profit before tax, disallowed items and tax – exempt items; and (iii) the tax on profit after disallowed and tax-exempt items.

Most Candidates were also able to correctly compute the current tax portion but a vast majority were unable to arrive at the deferred tax expense.

Candidates should ensure that they are thoroughly familiar with the concept of carrying amount of assets/liabilities, and importantly, should have a clear understanding on the concepts of tax base and temporary differences and the practical consequence of a change in tax rate between periods.

Q2 Case B (a)(i)

Most Candidates were able to get the journal entry to record the issue of the bonds correct although some miscalculated the quantum of the equity options.

Q2 Case B (a)(ii)

The most common error is the miscalculation of the interest expense and amortization of the bond discount as the wrong period was used.

Q2 Case B (a)(iii)

Overall, Candidates were able to score the minimum mark on the credit entry on cash of $7,000,000. Many Candidates did not recompute the new cash offer for equity options and used the initial equity option value. Hence, while a number of Candidates knew the correct entries, the amounts were wrong.

Q2 Case B (b)(i)

Quite a number of Candidates were able to get this part right. However, some Candidates forgot to apply the Present Value and some did not account for the 60% probability of the payment.

Q2 Case B (b)(ii)

Some Candidates debited the Profit or Loss account instead of investment when recording the initial entry for the contingent consideration. Quite a number of Candidates did not compute the revised contingent consideration correctly and did not debit the Profit or Loss for the increase in contingent consideration. Candidates should have a better understanding on the concept of contingent consideration on initial recognition and subsequent measurement.

Question 3

Part (a) required the Candidates to identify the various performance obligations associated with the contract. Most Candidates were able to correctly identify the performance obligations although many Candidates identified additional and unnecessary performance obligations. This is probably due to a lack of proper understanding of what constitutes a performance obligation.

According to the definition of performance obligation in SFRS(I) 15 *Revenue from Contracts with Customers*, it is "a promise in a contract with a customer to transfer to the customer either (a) a good or service (or a bundle of goods or services) that is distinct or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer." The key in this definition as far as this part of the question is concern is "distinct". Hence, the certificate of entitlement (COE) and normal assurance-type warranty should not be identified as performance obligations as they are not distinct goods or services within the context of the contract to be transferred to the customer (see SFRS(I) 15.27). Some Candidates also failed to identify the three car servicing and the reward points as separate performance obligations.

Part (b) required the Candidates to indicate the timing of recognition of the revenue for each of the performance obligations identified in Part (a) above.

Candidates who correctly identified the performance obligations in **part (a)** typically were also able to correctly indicate the timing of revenue recognition in respect of those performance obligations.

However, while Candidates were able to correctly point out that revenue in relation to the extended warranty should be recognised when utilised, many Candidates failed to identify the way the revenue should be apportioned between the fourth and the fifth year (i.e. that it should be apportioned based on the expected warranty claims in the two years). There were also Candidates who incorrectly identified the date of the sale as the date for recognising revenue for the motor vehicle instead of the date of delivery.

Part (c) required the Candidates to allocate the contract consideration to the separate performance obligations identified.

Most Candidates were not able to correctly identify the standalone value of some of the identified performance obligations. In particular many Candidates incorrectly identified the standalone value of the motor vehicle (inclusive of the COE) as $98,000 instead of $100,000. Candidates probably misread the question which stated that the actual COE price for the vehicle sold was $38,000 and took that to be the standalone value of the COE. However, the question stated that the agreed price for the COE is $40,000 and any difference is absorbed by the dealer. Hence, the stand-alone price for the COE should be $40,000 and not $38,000. Another common error was to take the discounted fee for the extended warranty of $3,000 the standalone fair value for the extended warranty of $4,000. This is a mistake that should not have been made since the question was clear in indicating the fair value. Candidates would do well to read the question carefully.

Part (d) required the Candidates to calculate the amount of each instalment payment to be paid by the Customer under the extended credit plan offered.

Most Candidates did not have any problem to correctly compute the payment amount for each instalment. However, there were candidates who carelessly mistook the interest rate of 2.5% to be the annual interest rate instead of the stated semi-annual rate. As a result, they were unable to obtain full marks for this part of the question. Candidates are advised to provide workings as this will allow the markers to provide marks for workings even if the final numerical solution is incorrect.

Part (e) required the Candidates to prepare the journal entries for the dealer to record all transactions for the year ended 31 December 20x6 as regards the sale of the motor vehicle.

This is the most poorly answered portion of this question. Some candidates left this blank due to the lack of time. Many missed out transactions such as the cost of sale, the collection of the non-refundable deposit of $5,000 and interest income at the end of the year. Candidates were also unclear about the concepts of contract assets and contract liabilities and had either used the wrong term or recorded the wrong amounts. Another common mistake was in respect of the performance obligation relating to extended warranty vis-à-vis warranty provision. The former is required under SFRS(I) 15 as an allocation of the contract consideration while the latter is a requirement under SFRS(I) 1-37 *Provisions, Contingent Liabilities and Contingent Assets* to make a provision for the cost of providing the warranty. While the two concepts are related, they are different much akin to revenue and cost of sale. Yet, a few Candidates lumped the two together by proposing journals to debit provision for warranty and credit sale of extended warranty.

The question specifically required the Candidates to indicate the specific dates for each journal entry and to show workings clearly. However, some candidates still did not indicate the dates leading to marks being deducted unnecessarily. Again, by not showing workings, the Candidates lost the opportunity to be given marks for correct workings.