PP

Chartered Accountant SINGAPORE

Singapore CA Qualification Examination

10 June 2019

Assurance

INSTRUCTIONS TO CANDIDATES:

1. The time allowed for this examination paper is **3 hours 15 minutes**.
2. This examination paper has **FOUR (4)** questions and comprises **EIGHTEEN (18)** pages (including this instruction sheet). Each question may have **MULTIPLE** parts and **ALL** questions are examinable.
3. This is an open book examination. During the examination, you are allowed to use your laptop and any calculators that comply with the SAC's regulations. Please note that watches, mobile phones, tablets, and all other electronic devices **MUST NOT** be used during the examination.
4. This examination paper is the property of the Singapore Accountancy Commission.

MODULE-SPECIFIC INSTRUCTIONS:

5. Assume that all dollar amounts are in Singapore dollar (S$) unless otherwise stated.
6. Unless specified otherwise, assume that all the reporting entities in all the questions adopt, 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 2019.

ISCA INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS

SINGAPORE ACCOUNTANCY COMMISSION

Question 1 – (a), (b), (c) and (d)

Express Medical (EM) Pte Ltd was incorporated on 1 April 2018. EM is a Traditional Chinese Medicine (TCM) clinic. Its financial year end is 31 March. Besides providing medical consultation, EM also:

- Sells herbal medicine in the form of tablets that are procured from an overseas manufacturer - Herbe; and
- Sells medical equipment such as knee guards and ankle guards.

The terms of sale of medical tablets state that customers have no right of return. All sales are made on a cash basis.

Sales return

The terms of sale of medical equipment comes with 10-days return policy so long as customers can produce the sales invoices and return the equipment in their original packaging.

The accounting for sales return consists of two stages, namely, recording the actual returns during the year and recognising a provision for returns at year end.

During the year, customers returning goods during the allowable period will be refunded cash for sales returns after signing a sequentially numbered sales return voucher (SRV). The SRV is used by the accounting department to record the following details in the general ledger:

Dr Sales return $xx
   Cr Cash $xx

The products returned will be put back into store and the following entries are recorded:

Dr Inventory $xx
  Cr Cost of sale $xx

At financial year end on 31 March 2019, the accountant produced a list of goods returned between 1 April 2019 and 10 April 2019 using the details in the SRV from 1 April to 10 April 2019. The total sales return in this goods returned list will form the basis for following entries:

Dr Sales return $xx
   Cr Provision for sales return $xx

There is no quantification of the cost of inventories associated with the provision for sales return.

Examplify Question Number	**Question 1 required:**
1	**(a)** Discuss the risk of material misstatements in relation to the above accounting for sales return. Your discussion should include which accounts are likely to be overstated and/or understated, where applicable. You should consider whether accounting for sales return complies with the requirements in Singapore Financial Reporting Standard (International) (SFRS (I)) 15 *Revenue from Contracts with Customers*. **(6 marks)**
2	**(b)** Describe the audit procedures to be performed to confirm:
	(i) The completeness of accounting for sales return; and **(2 marks)**
	(ii) The cost of the inventories is relation to the sales return. **(1 mark)**

EM also conducts TCM courses for public with the objective of improving public awareness of TCM. The courses are not meant for TCM practitioners.

The TCM courses last 26 weeks and customers are required to make the following payment:

- *Registration fee of $100* – the fee is non-refundable; both EM and the customer have unilateral right not to proceed with the course without paying compensation to the other party.

EM has recorded the registration fee as follows:

Dr Cash $xx
  Cr Revenue – registration fee $xx

- *Enrolment fee* – amounting to 10% of the course fee and payable at enrolment of the course. From EM's perspective, enrolment fee is considered as partial payment of the course fee. Enrolment commences when the course is confirmed and the course start date has been scheduled, which is usually one month before course commencement.

EM has recorded the enrolment fee as follows:

Dr Cash $xx
  Cr Revenue – enrolment fee $xx

- *Course fee* – the entire course fee has to be paid in cash at the commencement date. The enrolment fee paid is used to offset the course fee. The customers sign a course contract that states that any course fee paid by customers is non-refundable except on medical grounds, in which case, the pro-rated course fee for the portion of the course not yet conducted will be refunded.

EM has recorded the course fee as follows:

<u>Upon collection of course fee</u>

Dr Cash $xx

  Cr Deferred revenue $xx

<u>Upon completion of course</u>

Dr Deferred revenue $xx

  Cr Revenue – course fee $xx

Examplify Question Number	**Question 1 required:**
3	**(c)** Discuss the risk of material misstatement in the recognition and/or disclosure of: **(i)** Registration fee revenue; **(3 marks)** **(ii)** Enrolment fee revenue; and **(3 marks)** **(iii)** Course fee revenue. **(3 marks)** Your discussion should focus on the appropriateness of recognising each of the above revenue streams and the accounts that are likely to be overstated and/or understated because of the accounting treatment.

On 18 March 2019, Singapore's Health Sciences Authority (HSA) issued a directive to recall a "ZZZ" brand of medical tablets because it contains higher than acceptable amounts of nitrosamine impurity, which can potentially cause cancer. According to the Food and Drug Administration of the United States, Herbe has been recalling certain batches of these medicines since February 2019.

EM imported only one batch of ZZZ products from Herbe in February 2019. None of the ZZZ products were sold by EM yet. At 31 March 2019, the cost of ZZZ included in the inventory balance amounted to $480,000. EM filed a legal claim against Herbe to recover the amount paid to Herbe. The legal action was necessary because Herbe refused to refund EM and rejected any return of ZZZ products. The amount claimed has been recognised as other receivable in the statement of financial position as at 31 March 2019. Herbe has replied through its lawyer that it intends to defend the legal claim rigorously.

Examplify Question Number	**Question 1 required:**
4	**(d)** In relation to the other receivable arising from the legal claim: **(i)** Explain the risk of material misstatement in the recognition of the other receivable and the accounts that are likely to be overstated and/or understated; **(2 marks)** **(ii)** Describe two audit procedures to be performed; and **(2 marks)** **(iii)** Describe the audit procedures to be performed in relation to the ZZZ inventories. **(3 marks)** **(Total: 25 marks)**

Question 2 – (a), (b), (c) and (d)

Hightension Pte Ltd (HPL) is involved in the construction of infrastructure such as roads and bridges. Its financial year ends on 30 June 2019. Dunn & Old is the audit firm that audited the financial statements of HPL for the year ended 30 June 2018. The audit opinion was a qualified opinion on inadequate disclosure of cash flow problems that created significant uncertainty affecting the going concern status of HPL.

During the audit planning meeting with the Finance Director (FD) of HPL, the following information was provided by the FD:

- The going concern uncertainty has been resolved by cash injection through a bond issue.

- A white knight investor, PT Sulaiman (PTS), injected $200 million in the form of subscription to a five-year bond issued by HPL. The bond carried a nominal interest rate of 8% per annum payable annually at the end of the year. HPL would have to repay the principal amount of $200 million on redemption date, with a $40 million premium. The bond payable was recorded in HPL's book as a financial liability at a cost of $200 million. HPL recorded the finance cost based on the interest rate of 8%. The Bond Subscription Agreement (BSA) was signed on and became effective from 28 December 2018 and the fund was transferred to HPL on the same date.

- With the fund injection, HPL called off the planned job redundancy and the proposed sale of its cement manufacturing plant. HPL has issued written instruction to the agent to stop all activities relating to the search for potential buyers for the cement manufacturing plant. For the year ended 30 June 2018, the provision for redundancy amounted to $10 million and the cement manufacturing plant together with the equipment were presented as disposal group of assets held for sale in the statement of financial position. The FD did not intend to make any adjustment to the provision for redundancy and disposal group held for sale in the financial statements for year ending 30 June 2019.

Examplify Question Number	**Question 2 required:**
	(a) For the bond issue:
5	**(i)** Explain the risk of material misstatements in the accounting of the bond issued and the accounts that are likely to be overstated and/or understated. **(4 marks)**
6	**(ii)** List FOUR source documents expected to be provided by HPL to be used as audit evidence in relation to the bond issue. For each of the source documents, explain how each source document will be used by the auditor, i.e. the objective of obtaining the source documents. **(8 marks)**
7	**(b)** For the provision for redundancy brought forward from prior year:
	(i) Explain the risk of material misstatement and the accounts that are likely to be overstated and/or understated; and **(3 marks)**
	(ii) Describe the audit procedures to be performed. **(2 marks)**

Examplify Question Number	
8	**(c)** For the disposal held for sale brought forward from prior year: **(i)** Explain the risk of material misstatement and be specific by stating the exposures and accounts affected; and **(3 marks)** **(ii)** Describe the audit procedures to be performed. **(2 marks)**
9	**(d)** Discuss how the prior year's modified opinion will affect the audit report for the current year's financial statements. **(3 marks)** **(Total: 25 marks)**

Question 3 – (a), (b) and (c)

James Kong, an audit partner of XO LLP (XO) left the partnership and joined YO LLP (YO) as an audit partner. After James joined YO, some of the audit clients of James at XO appointed YO as the auditor.

Amongst these clients was a large listed company Followu Ltd (FL). James has completed seven years as an audit engagement partner of FL when James was in XO. James preferred to remain as the audit engagement partner for FL when FL officially appointed YO as the statutory auditor. If not, James would prefer to stay in connection with FL by acting as the client service partner (CSP). The role of CSP is to act as a single point of contact for FL to discuss any requirements and needs with a senior person in the audit firm, for example, coordinating other services such as consulting services provided to audit clients.

Examplify Question Number	Question 3 required:
10	**(a)** Discuss the ethical issues involved in relation to James' request and suggest how James' request is to be handled. **(5 marks)**

Another of James' audit client, Pailing Pte Ltd (PPL), enquired whether YO could provide PPL with an Internal Audit (IA) service. PPL's reason for having an IA function is in preparation of a proposed listing on the Singapore Exchange (SGX) in four years' time. As PPL does not have any in-house experience or expertise in relation to IA, PPL requires the firm that provides the IA to be fully in charge of the IA, including setting IA's plan, deciding areas for audit by IA, and timing of IA's work.

Examplify Question Number	**Question 3 required:**
11	**(b)** Discuss the ethical issues involved in providing IA services to PPL and recommend an appropriate response to PPL's request. **(5 marks)**

James has approached the firm's Ethics Partner to discuss an unusual request from an audit client, Laundry Monster & Co (LM). The Finance Director of LM called James on the phone to inform him of a mistake. LM had made a duplicate payment for an invoice on audit fee in relation to the audit that had just been completed. This duplicate payment was made from LM's overseas office. The Finance Director has requested YO to refund the duplicate payment in cash to a person known as Felix. Upon further enquiry, James was told that Felix is a Purchasing Director of a company that is a customer of LM. LM just secured a large contract from this customer. The Ethics Partner's preliminary thought is that this scenario has the look of a suspicious transaction in relation to money laundering. YO might be used as a channel for one of the 3 stages of money laundering, i.e. placement, layering and integration.

Examplify Question Number	Question 3 required:
12	**(c)** In relation to the Ethics Partner's suspicion:

(i) Identify the potential proceeds of crime in the case. **(3 marks)**

(ii) Explain at which stage of money laundering the firm might be in if it agreed to LM's request. **(3 marks)**

(iii) Describe the TWO <u>immediate steps</u> YO LLP should take if there is reasonable ground to suspect LM's request is a money laundering transaction. **(4 marks)**

(iv) Discuss the appropriateness of YO LLP <u>communicating</u> the suspicious transaction to those charged with governance of LM, considering the requirements in Singapore Standard on Auditing (SSA) 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*; SSA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*; SSA 260 *Communication with Those Charged with Governance* and Ethics Pronouncement (EP) 200 *Anti-Money Laundering and Countering the Financing of Terrorism – Requirements and Guidelines for Professional Accountants in Singapore*. **(5 marks)**

(Total: 25 marks)

Question 4 – (a) and (b)

Pineapple Pte Ltd (Pineapple) is a new audit client. Its main business activities comprise trading of electronic products. Its financial year end is 31 May 2019. On 1 December 2018, Pineapple acquired 90% of the share capital of Strawberry Pte Ltd (Strawberry), a local competitor, for $3,500,000 in cash. The Pineapple Group would then consist of Pineapple and Strawberry.

The auditor held a planning meeting with the client in March 2019 and the client has presented the pro forma consolidated schedule and consolidation adjusting entries prepared by the accountant during the meeting.

	Statement of Financial Position As at 1 December 2018	
Strawberry Pte Ltd	**Book Value $**	**Fair value (if it is different from book value) $**
Equity		
Share capital	2,000,000	
Retained earnings	1,500,000	
Total equity	**3,500,000**	
Liabilities		
Current trade payable	500,000	
Contingent liability	-	100,000
Current liabilities	**500,000**	
Total equity and liabilities	**4,000,000**	
Assets		
Property, plant and equipment	1,500,000	1,300,000
Inventory	800,000	
Current trade receivable	1,000,000	
Cash at bank	700,000	
Total assets	**4,000,000**	

The contingent liability related to a legal claim by an ex-management personnel for unfair dismissal and discrimination.

The downward fair value adjustment of property, plant and equipment related to a warehouse owned by Strawberry.

Pineapple and Strawberry do not trade with each other.

The following is an extract of the pro forma consolidation schedule prepared by the accountant of Pineapple. As this is the first time the company has a subsidiary, this is also the first time this accountant has prepared a consolidation schedule.

Extract of Pro forma consolidation schedule

31 May 2019	**P**	**S**	**CJE**	**Consolidation Adjustments**		**Consolidated Balance**
				Dr	**Cr**	
	$'000	**$'000**	**No**	**$'000**	**$'000**	**'000**
Share capital	10,000	2,000	1	2,000		10,000
Retained profit	20,000	3,000	1	1,500		21,500
Equity	**30,000**	**5,000**				**31,500**
Non-current loan	5,000	0				5,000
Current trade payable	3,000	600				3,600
Intra-group payable	0	400	2	400		0
Total liabilities	**8,000**	**1,000**				**8,600**
Equity and liabilities	**38,000**	**6,000**				**40,100**
Investment in subsidiary	3,500	0	1		3,500	0
Property, plant & equipment	20,000	2,000				22,000
Inventory	7,000	1,000				8,000
Current trade receivables	4,000	1,800				5,800
Intra-group receivable	400	0			400	0
Cash at bank	3,100	1,200				4,300
Total assets	**38,000**	**6,000**		**3,900**	**3,900**	**40,100**

Pro forma Consolidation Adjusting Entries (CJE)

1			**$'000**	**$'000**
	Dr	Share capital (S)	2,000	
	Dr	Pre-acquisition retained earnings (S)	1,500	
	Cr	Investment in subsidiary		3,500
Being elimination of investment in subsidiary.				

2			**$'000**	**$'000**
	Dr	Intra-group payable	400	
	Cr	Intra-group receivable		400
Being elimination of intra-group receivable and payable. This arose from the sale of a property by Pineapple to Strawberry.				

In relation to the sale of a property by Pineapple to Strawberry. The following entries are recorded in Pineapple's book:

Dr	Intra-group receivable	$400,000	
Cr	Property, plant and equipment (PPE)		$200,000
Cr	Profit on disposal of PPE		$200,000

Additional depreciation arising from transfer of the property is $50,000, i.e. Strawberry depreciated the property $50,000 more than if the property is depreciated in Pineapple's book.

Examplify Question Number	Question 4 required:
	(a) With regard to the acquisition of Strawberry by Pineapple:
13	**(i)** Explain SIX audit procedures to be performed in relation to the business combination. **(12 marks)**
14	**(ii)** Identify the SIX misstatements in relation to the accounting for investment in subsidiary and consolidation adjustments prepared by the client. **(6 marks)**
	(b) Given the misstatements identified in **(a)(ii)** above, the accountant is very discouraged and is considering not preparing consolidated financial statements for the current year:
15	**(i)** If Pineapple met the exemption criteria in Singapore Financial Reporting Standards (International) (SFRS(I)) 10 *Consolidated Financial Statements* and thus did not need to prepare consolidated financial statements, and the reason for non-preparation of consolidated financial statements is **<u>NOT</u>** adequately disclosed in the note to the financial statements, explain the implication on the audit report, including the audit opinion. **(4 marks)**

Examplify Question Number

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(ii) If Pineapple did not meet the exemption criteria in SFRS(I) 10 *Consolidated Financial Statements* for not preparing consolidated financial statements, explain the implication on the audit opinion. **(3 marks)**

(Total: 25 marks)

END OF PAPER