Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 13 December 2018

Section 1
General comments

Overall, there was a considerable variance in the quality of answers across Candidates. Candidates underperformed in Question 1 (associate with foreign currency translation) and Question 2 (operating segments).

Candidates are reminded to be well-prepared across the range of financial reporting standards and not leave any financial reporting standards uncovered in their revision. Candidates are also encouraged to be well-versed in various financial reporting standards, so as to be able to grasp and answer in situations where the application of two or more standards is tested in one single question. In addition, Candidates should be focused and relevant in their answers of the theoretical components in the paper. Verbatim extraction from standards and other sources will receive little or no marks.

Section 2
Analysis of individual questions

Question 1

Part (a) required Candidates to prepare consolidation adjustments for a group of companies. **Part (b)** required Candidates to perform translation of financial statements, prepare equity accounting entries, and perform analytical check (proof of balance) of the investment in associate.

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

In addition, Candidates need to demonstrate their understanding and application of Singapore Financial Reporting Standard (International) SFRS (I) 1-28 *Investments in Associates and Joint Ventures* and SFRS (I) 1-21 *The Effects of Changes in Foreign Exchange Rates*.

Candidates performed relatively well in **part (a)** of the question. Most Candidates were able to do the consolidation entries correctly.

Common errors included the following:

- Candidates did not calculate the impairment loss based on the amounts at the group level. Instead, Candidates used the amounts at entity level in their computation

- Candidates did not provide proper classification (investment property) for the adjustment of profit on sale of electrical system.

- Almost all Candidates missed out on the adjustment of fair value change of the investment property.

Candidates should take note of the basic principle of consolidation which is to evaluate the amounts that should be reported at the group level instead of the entity level to perform the necessary elimination and adjustment entries.

Candidates did not perform as well for **part (b)**, as compared to **part (a)**. In **part (b)(i)**, Candidates were asked to perform translation of financial statements.

For the Statement of Profit and Loss and Other Comprehensive Income, most Candidates were able to use the correct translation rate for sales, cost of sales, operating expense, and OCI – FV adjustment. The common errors noted were the use of the wrong translation rates for retrenchment expense and tax expense.

Candidates are encouraged to read the question carefully, and look for and apply the appropriate specific exchange rates as stated in the question, to minimise such errors.

For the Statement of Changes in Equity, most Candidates were able to apply the correct exchange rate for dividends declared. However, quite a significant number of Candidates did not compute the opening retained earnings correctly, as some Candidates did not know that the opening retained earnings is a derived figure (from workings), which should not be translated at a particular exchange rate.

As for the Statement of Financial Position, most Candidates applied the correct exchange rate to translate the net assets and share capital. However, some Candidates used the wrong rate to translate the OCI – FV adjustments. On the other hand, some but not all Candidates knew that there was the component – Foreign Currency Translation Reserve (FCTR), which is a balancing figure.

In **part (b)(ii)**, Candidates were required to prepare equity accounting entries.

Generally, Candidates did not do well in this question. Most Candidates were able to compute the share of change in post-acquisition retained earnings, and reclassified dividends correctly.

This question part was poorly attempted for the following reasons:

- Candidates left out the share of post-acquisition opening OCI and share of current OCI.

- The adjustment for past cost of sales on under-valued inventory was incorrect due to the use of the wrong foreign exchange rate.

- An incorrect share of current profit after tax (due to an incorrect computation of cost of sales of under-valued inventory), was allocated to non-controlling interests. This is because Candidates used the wrong percentage of under-valued inventory and/ or wrong foreign exchange rate.

Most Candidates were weak in the computation of share of FCTR due to the use of the wrong foreign exchange rates in the computation of FCTR on inventory and FCTR on goodwill.

Candidates are encouraged to understand thoroughly the concept of FCTR and the application of the appropriate rates in the translation of foreign operations.

In **part (b)(iii)**, Candidates were asked to perform analytical check (proof of balance) of the investment in associate.

Similar to the proof of NCI, the proof of investment in associate is an important concept and tool to check the equity accounting entries, and to validate the balance in the investment in associate.

Candidates did poorly for this question partly due to poor understanding in this area.

Most Candidates correctly identified the share of book value of equity, but they were unable to calculate correctly the share of the remaining under-valued inventory, mostly due to the use of wrong foreign exchange rates.

Quite a number of Candidates could identify the goodwill as a component, but a considerable number of Candidates either used the wrong foreign exchange rate or omitted the foreign exchange rate.

On average, although Candidates were able to obtain a pass for Question 1, most were generally weak in **part (b)** which relates to equity accounting and translation. Candidates are encouraged to understand the FCTR and translation concepts thoroughly, to be able to apply the correct foreign exchange rates. In addition, Candidates should be encouraged to learn how to perform proof of balance of the investment in associate correctly, to reinforce their understanding of equity accounting entries, and to minimise errors in these entries.

Question 2

Part I

This question required Candidates to calculate and prepare a journal entry to record the remuneration expense in accordance with SFRS(I) 2 *Share-based Payment* and to explain whether the given arrangement should be accounted for as "equity-settled" or "cash-settled" and which financial statement items would be impacted for the Parent, Subsidiary and the Group.

1. Some Candidates misinterpreted the term "during the vesting period" to be "during the remaining vesting period". The phrase "during the vesting period" appears elsewhere in the question and it is clear from the context that it is meant to be the absolute vesting period and not the remaining period.

2. A significant number of Candidates also did not know how to calculate the cumulative remuneration expense. In particular, many Candidates were confused over when to use the actual as opposed to the expected number of employees who resigned.

3. **Part 1 (a)** specifically asked the Candidates to provide workings. This means that the Candidates need to show how they derived their answers including the formula used. However, some Candidates gave a list of variables without showing how the answers were derived.

4. **Part 1 (b**) was generally well answered.

5. In **Part 1 (c)**, Candidates need to read the question carefully. The question asked the Candidates to indicate whether the transaction is considered equity or cash settled for each of the three entities which implied that the treatment may not be similar for all three entities. However, some Candidates gave an overall answer without specifying whether it was applied to all three entities.

6. Candidates need to also answer the question directly and in a more focused manner. It is irrelevant to discuss, for example, the situation under which the transaction would be cash settled when the candidate already decided that it is equity settled.

Part II

This question required Candidates to identify the reportable segments of a company in accordance with the minimum quantitative thresholds of SFRS (I) 8 *Operating Segments* and to present the quantitative footnote disclosure on segment revenues in accordance with the requirements of SFRS (I) 8.

Candidates did very poorly for question parts (a) and (b). Furthermore, there were a significant number of Candidates who did not attempt these question parts.

Part (a)

Most Candidates were able to identify the:

- Sales test in accordance with SFRS (I) 8 paragraph 13 (a).
- Assets test in accordance with SFRS (I) 8 paragraph 13 (c).
- Electrical, Furniture and Interior Design as reportable segments.

However, many Candidates did not determine the sufficiency of aggregate external sales test of SFRS (I) 8 paragraph 15. The paragraph states *If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments shall be identified as reportable segments (even if they do not meet the criteria in paragraph 13) until at least 75 per cent of the entity's revenue is included in reportable segments*.

- For this question, the percentage of reported aggregated external sales over the entity's sales is 74%. Thus additional reportable segment with the next largest external sales, i.e. painting segment, should be identified as a reportable segment.

- Candidates did not include additional segments to achieve the aggregate external sales criterion. Very few Candidates were able to identify "Painting segment" as an additional segment.

- When assessing the profitability of segments, many Candidates used the combined net profit as the denominator when there are offsetting net profit and net loss items.
  The threshold is prescribed by SFRS (I) 8 paragraph 13(b):
  Greater in absolute amount of (i) the combined reported profit of all reporting segments that did not report a loss and; (ii) the combined reported loss of all operating segments that reported a loss.

- Some Candidates missed out on concluding which segments are the reportable segments.

- Several Candidates answered qualitatively instead of calculating the sales, profit and loss and asset test in accordance with SFRS(I) 8.

Part (b)

- Many Candidates missed out on the elimination of internal sales in disclosures and hence showed combined sales that included internal sales.
- Some Candidates also did not include "**Other**" segments in their disclosures.
- Some Candidates presented disclosures for net profit and total assets which are not required in the question.

Question 3

Part I (a)
This question required Candidates to prepare journal entries for a company's bond investment and record the interest income, fair value changes and recognition of impairment loss in accordance with SFRS (I) 9 *Financial Instruments*. Candidates had answered this question reasonably well. However, calculation of final impairment loss was incorrect in a number of cases.

In generally, Candidates did well in presenting the basic journal entries for bond investment and interest income recognition. However, some Candidates were unable to pass entries for bond fair value changes and impairment loss. Some Candidates did not specify that the account "Other Comprehensive Income" (OCI) is to be used for fair value changes and impairment loss.

In addition, some Candidates only presented journal entries for transactions for year 20x1 but did not present any or a complete set of journal entries required for year 20x2. A few Candidates did not include narrative for journal entries passed.
A few Candidates also made an error in the direction of journal entries passed for interest income recognition.

Part I (b)
This question required Candidates to recognise that bonds are credit impaired when there is a default event. Candidates were required to explain the difference in accounting treatment under SFRS (I) 9 *Financial Instruments* for situations when there is a default event (Stage 3 impairment loss) and situations where there is an increase in credit risk without a default event (Stage 2 impairment loss).

Most Candidates did not do well for this part of the question. Some Candidates were able to identify that the bonds are credit impaired when there is a default event, and this requires interest income to be calculated on a **net** carrying amount (after deduction of loss allowance).

Most Candidates omitted to contrast this with the situation where there is an increase in credit risk and the accounting treatment required for interest income i.e. still calculated on **gross** carrying amount (before deduction of loss allowance).

Explanation of the difference between the default scenario (Stage 3) and the existing scenario (Stage 2) lacked depth. Some Candidates did not attempt this question.

Part II (a)
This question required Candidates to prepare journal entries in Singapore dollars (S$). Candidates are required to record the transactions and events relating to a foreign currency equity investment (which the entity opted under the irrevocable election permitted by SFRS (I) 9 *Financial Instruments* to measure the equity investment at fair value through other comprehensive income and a forward contract (which meets the hedge effectiveness test stipulated by the entity's risk management policies).

Candidates did not do well for this question. The following are the common errors noted:

- Errors were noted in the direction of the journal entries.
- A fair number of Candidates did not include narration/title of the journal entries.
- Some Candidates were disorganised in their presentation of journal entries and the dates of the journal entries were not provided.
- Some Candidates only presented the table showing the calculations without giving the required journal entries. Thus, Candidates are advised to not spend too much time and effort in preparing and "beautifying" the table showing the calculations at the expense of answering the question directly. Candidates should spend their time in preparing the journal entries instead.
- Candidates should be clearer in indicating whether the gain/loss was charged to P/L or OCI.
- Candidates had used the incorrect direction for the journal entries in relation to revaluation.

Part II (b)

This question required Candidates to provide any one plausible and significant reason to explain the entity's decision to measure the equity investments at fair value through other comprehensive income (FVOCI).

- Most Candidates have identified plausible reasons, however only some Candidates have provided depth in their explanations.

Question 4

SFRS (I) 16 *Leases* is effective for financial periods beginning on or after 1 January 2019, replacing the existing SFRS (I) 1-17 Leases. Hence, this question is set to test the Candidates on their knowledge on the differences between the new standard and the old standard on leases, the economic impact of adopting the new standard, and its application to real life business scenario.

- The majority of Candidates appeared to understand the main differences between the old standard and the new standard. Candidates generally performed quite well in accounting under SFRS (I) 1-17 *Leases*.
- For SFRS (I) 16 *Leases*, most Candidates answered correctly on the treatment of the Van (more straight-forward scenario), and were able to list the exemption criteria from capitalisation as leased assets.

- However, for the photocopiers, printers and computer equipment, a lot of Candidates failed to recognise that, as CO TW typically renews the leases to the maximum useful life of each item, they fail the exemption criteria of being a short-term lease (even though the lease term is one year with option to renew).

- Most Candidates did not mention that SFRS (I) 16 *Leases* does not specify an absolute threshold for "low value assets" in the exemption criteria. Nevertheless, most Candidates included discussion of "low value assets" in their answers.

- On the explanation of the significant economic impact of the new standard, most Candidates were able to explain the main impact on the financial statements, and the various financial ratios affected. In addition, some Candidates were able to identify the main impact being the concern with existing long-term loan and stringent debt covenants. Although the new standard has no direct cash flow effects, there are significant indirect cash flow effects that may have serious implications on the lessee's borrowing costs and capacity. A matured answer would reflect this observation.

- The weakest part of their answers lie in the last part to provide advice on any one significant action. Most Candidates lacked the business understanding and were unable to provide salient solutions, but merely mentioned some actions which will likely not be a viable business alternative.

Overall, this question was poorly answered. Candidates seemed to understand the basics of SFRS (I) 16 *Leases*, but they lacked depth in the application of the standard when more complex scenarios arise. In addition, Candidates are encouraged to think from a practical business angle, especially when answering questions related to identifying economic impact and identifying actions to mitigate the impact.