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Chartered Accountant SINGAPORE

Singapore CA Qualification Examination

13 December 2018

Financial Reporting

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 **NINETEEN (19)** 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 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 2018.

ISCA INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS
SINGAPORE ACCOUNTANCY COMMISSION

Question 1 – (a) and (b)

P Co has "control" of Y Co, a Singapore incorporated company and "significant influence" over Z Co, a United States incorporated company since its initial investment in these two companies. The functional and presentation currency of P Co is the Singapore dollar (S$). The functional currency of Y Co is S$ while the functional currency of Z Co is the United States dollar (US$).

The abridged financial statements of P Co, Y Co and Z Co in their respective functional currencies for the current year ended 31 December 20x6 are as follows:

Abridged Statement of Profit and Loss and Other Comprehensive Income for the year ended 31 December 20x6

	P Co	**Y Co**	**Z Co**
	S$	**S$**	**US$**
Sales	6,000,000	3,200,000	990,000
Cost of Sales	(3,300,000)	(2,480,000)	(702,000)
Gross profit	2,700,000	720,000	288,000
Operating expenses	(1,450,000)	(248,000)	(165,000)
Retrenchment expense	0	0	(50,000)
Profit before tax	1,250,000	472,000	73,000
Tax expense	(250,000)	(94,400)	(14,600)
Profit after tax	1,000,000	377,600	58,400
Other comprehensive income (OCI) –			
Fair value adjustments			20,000
Comprehensive income	1,000,000	377,600	78,400

Partial Statement of Changes in Equity for the year ended 31 December 20x6			
	P Co	**Y Co**	**Z Co**
	S$	**S$**	**US$**
Retained earnings, 1 January 20x6	3,590,000	760,000	270,000
Profit after tax	1,000,000	377,600	58,400
Dividends declared	(400,000)	(140,000)	(57,000)
Retained earnings, 31 December 20x6	4,190,000	997,600	271,400

Abridged Statement of Financial Position as at 31 December 20x6			
	P Co	**Y Co**	**Z Co**
	S$	**S$**	**US$**
Investment in Y Co	1,700,000		
Investment in Z Co	900,000		
Other net assets	4,190,000	1,797,600	775,400
Net assets	6,790,000	1,797,600	775,400
Share capital	2,600,000	800,000	500,000
Retained earnings	4,190,000	997,600	271,400
Other comprehensive income (OCI) -			
Fair value adjustments			4,000
Shareholders' equity	6,790,000	1,797,600	775,400

Additional information

1. Apply a tax rate of 20% on fair value differentials and other adjustments. Dividend income is tax-exempt.

2. Information on the ownership interests in Y Co is as follows:

Date of acquisition	1 Jan 20x3
Percentage acquired by P Co on date of acquisition	90%
Shareholders' equity of Y Co at date of acquisition	***S$***
Share capital	800,000
Retained earnings	380,000
	1,180,000
Fair value of non-controlling interests as at date of acquisition	170,000

Non-controlling interests are to be recognised at full fair value on acquisition date.

On 1 January 20x3, the net identifiable assets of Y Co were at fair value, except for certain equipment with carrying amount (book value) of S$175,000 but fair value of S$235,000. The estimated remaining useful life of the equipment at acquisition date was 5 years. On 31 December 20x6, an impairment review showed the following information for the equipment:

Value in use	S$30,000
Fair value less costs of disposal	S$20,000

3. On 30 June 20x6, Y Co sold new electrical parts to P Co. Details of the transfer are as follows:

Sales price invoiced by Y Co to P Co	S$1,000,000
Carrying amount of the electrical parts carried as inventory in Y Co's books before the transfer	S$600,000

By 30 September 20x6, P Co completed the installation of the electrical parts into its buildings, which P Co classified as investment property. P Co uses the fair value model to account for its investment property. Typically, the electrical parts have an economic useful life of 10 years. P Co and Y Co had settled intercompany balances by 31 December 20x6.

4. Information on the ownership interests in Z Co, an associate of P Co, is as follows:

Date of investment by P Co	1 Jan 20x5
Percentage of Z Co acquired by P Co	40%
Shareholders' equity of Z Co	***US$***
Share capital	500,000
Retained earnings	80,000
	580,000

P Co invested S$900,000 in Z Co on 1 January 20x5. On that date, Z Co had inventory that was under-valued by the amount of S$120,000. Subsequently, the inventory was:

Sold during 20x5	70%
Sold during 20x6	20%
Unsold as at 31 December 20x6	10%

5. Fair value adjustments in other comprehensive income arose on the following dates:

Transaction date	**US$**
Arose on 31 December 20x5	(16,000)
Arose on 31 December 20x6	20,000

6. Sales, cost of sales and operating expenses of Z Co occurred evenly throughout the year.

   Retrenchment expense was recognised following an announcement on 31 December 20x6 of a retrenchment exercise that would be carried out on 31 January 20x7. The company's stated policy is to make retrenchment payments to affected employees.

   Tax expense is recognised on the dates of the underlying income or expense transactions.

7. Exchange rates are as follows:

Date	**S$ to US$1**
1 January 20x5	1.47
Average rate for 20x5	1.48
31 December 20x5	1.45
Average rate for 20x6	1.40
16 July 20x6: Date of dividend declaration	1.33
31 December 20x6	1.37
31 January 20x7	1.34

8. The foreign currency translation reserve on the book value of equity of Z as an entity at 1 January 20x6 was a debit balance of S$12,000.

Examplify Question Number	**Question 1 required:**
1	**(a)** Apply Singapore Financial Reporting Standard (International) (SFRS (I)) 3 *Business Combinations* and SFRS (I) 10 *Consolidated Financial Statements.* Prepare the relevant consolidation entries for the year ended 31 December 20x6 with respect to Y Co. Analytical checks of the non-controlling interests' balance is not required. **(16 marks)**
	(b) Apply 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* and answer the following:
2	**(i)** Translate the abridged financial statements of Z Co for the year ended 31 December 20x6 into Singapore dollars (S$). **(9 marks)**
3	**(ii)** Prepare the relevant equity accounting entries in Singapore dollars (S$) for Z Co for the year ended 31 December 20x6. **(13 marks)**
4	**(iii)** Perform an analytical check (proof of balance) of the Investment in Z Co in Singapore dollars (S$) as at 31 December 20x6. Listing of the entries is not required. **(4 marks)** **(TOTAL: 42 marks)**

Question 2 – Part I and Part II

Part I

Start-up companies often use employee incentive schemes that link compensation with performance outcomes to motivate their employees to work hard during the growth period. However, start-up companies are often cash-strapped and the employee benefits are deferred or contingent on future outcomes. One such scheme is the share-based plan with performance conditions as shown below.

Grant date	1 Jan 20x4
Units granted per employee	100,000 options x (1 + average annual growth in sales during the vesting period)
Number of employees at grant date	50 employees
Vesting period	5 years
End date of vesting period	31 Dec 20x8
Exercise price (also the market price at grant date)	$46
Fair value of option at grant date	$10

The actual and estimated information of the above share-based plan is shown below:

	20x4	**20x5**	**20x6**
Number of employees			
Resigned during the year	0	4	3
Estimated leaving during vesting period	5	10	12
Actual annual growth in sales	5%	10%	12%
Estimated average annual growth in sales during the vesting period	8%	12%	14%

Examplify Question Number	**Question 2 Part I required:**
5	**(a)** Calculate the current remuneration expense for 20x4, 20x5 and 20x6, in accordance with the requirements of SFRS (I) 2 *Share-based Payment*. **(4 marks)**
6	**(b)** Prepare the journal entry, with brief header or narrative, to record the remuneration expense for 20x6. Entries for 20x4 and 20x5 are not required. Ignore taxes. **(1 mark)**
7	**(c)** In other cases, start-up entities that have listed parent companies benefit from arrangements whereby the parent companies issue share options of the parent companies directly to the employees of the subsidiaries, without need for payment by the subsidiaries. With respect to the requirements of SFRS (I) 2 *Share-based Payment*, explain whether the arrangement is accounted for as "equity-settled" or "cash-settled" <u>and</u> which financial statement items would be impacted for such a share-based arrangement for each of the following entities: **(i)** Parent; **(ii)** Subsidiary; and the **(iii)** Group. Discussion of tax effects is not required. **(6 marks)**

Question 2

Part II

Under One Roof (UOR) Limited, a publicly listed company, provides house owners with a comprehensive suite of products and services in one portal. It has six divisions. One of its divisions, Interior Design often buys the products from other units and re-sells to customers under bundled packages. However, divisions also make direct sales to end users. Details of the audited current sales, net profit and total assets for each of the six divisions are shown on page 11.

Divisions of UOR Limited							
	Electrical	Curtains	Plumbing	Furniture	Painting	Interior Design	Total
External sales	10,000	20,000	40,000	20,000	66,500	330,000	486,500
Internal sales	120,000			100,000			220,000
Combined sales (internal and external)	130,000	20,000	40,000	120,000	66,500	330,000	706,500
Net profit (loss)	(60,000)	5,000	15,000	55,000	10,000	260,000	285,000
Total assets	300,000	40,000	80,000	2,500,000	120,000	250,000	3,290,000

Examplify Question Number	Question 2 Part II required:
8	**(a)** SFRS (I) 8 *Operating Segments* sets out requirements for the identification of operating segments. Identify the reportable segments of Under One Roof Limited in accordance with the minimum quantitative thresholds of SFRS (I) 8. For completeness, calculate the percentages (up to one decimal point) for all thresholds. **(7 marks)**
9	**(b)** Present the quantitative footnote disclosure on segment revenues for Under One Roof Limited in accordance with the requirements of SFRS (I) 8. Disclosures on segment profit and loss and segment assets are not required. **(4 marks)**

(TOTAL: 22 marks)

Question 3 – Part I and Part II

Part I

Invest-B carries a portfolio of fixed income investments, which includes bonds issued by Co R. The contractual cash flows of Co R bonds are solely payments of principal and interest on principal. Invest-B manages the portfolio within a business model of collecting contractual flows and maximising capital gains from the sale of the bonds when the opportunity is right. Hence, Invest-B carries the bonds at fair value through other comprehensive income (FVOCI) as required under SFRS (I) 9 *Financial Instruments*. Details of Co R bonds held by Invest-B are as follows:

Date of purchase	1 January 20x1
Purchase price	$5,200,000
Principal amount	$5,000,000
Maturity date of bonds	31 December 20x5
Cash interest per annum, payable 31 December	4%
Effective interest rate per annum	3.1235%
Fair value of bonds held by Invest-B as at 31 December 20x1	$5,025,000

On 1 January 20x1, Invest-B estimates that Co R bonds are of high credit quality with 12-months expected credit loss of $10,000. However, during December 20x2, Invest-B receives news that Co R had lost 20% of its market share due to the unstable economic environment caused by trade tariff wars. In spite of the negative news, Co R is able to pay its interest on 31 December 20x2 and assured its investors that it has sufficient cash reserves to pay off its obligations. However, rating agencies downgraded Co R by two scales on 31 December 20x2. Invest-B's auditors deemed the downgrade to be evidence of a significant deterioration in credit quality. The following information was available to Invest-B with respect to its holdings of Co R bonds on 31 December 20x2:

Expected principal amount to be recovered on maturity date, 31 December 20x5	$4,414,000
Expected interest to be recovered in 20x3, 20x4 and 20x5	$200,000 per annum (no disruption to payment is expected)
Present value of future cash flows relating to Invest-B's holdings of Co R bonds as at 31 December 20x2	$4,589,322

Ignore tax effects.

Examplify Question Number	**Question 3 Part I required:**
10	**(a)** Prepare journal entries to record the transactions and events relating to Invest-B's holdings of Co R bonds for the year ended 31 December 20x1 and 31 December 20x2, in accordance with the requirements of SFRS (I) 9 *Financial Instruments.* **(10 marks)**
11	**(b)** If the situation had been such that Co R defaulted on its interest payments on 31 December 20x2, explain one difference in the accounting treatment to (a) above (besides the magnitude of the loss) that is necessary under SFRS (I) 9 *Financial Instruments*. No numerical calculations are required. **(2 marks)**

Question 3

Part II

On 1 January 20x6, Invest-B purchased 120,000 units of Co T shares at US$9 per share. The functional currency of Invest-B is the Singapore dollar (S$). At inception, Invest-B opted under the irrevocable election permitted by SFRS (I) 9 *Financial Instruments* to measure the equity investments in Co T at fair value through other comprehensive income (FVOCI).

On 1 January 20x6, Invest-B also entered into a forward contract to sell US$1,080,000 at the contracted forward rate of S$1.41 to hedge the foreign currency risks arising from the holding of Co T shares. The forward contract matures on 31 December 20x7, the expected date of sale of Co T shares. The forward contract meets the hedge effectiveness test stipulated by Invest-B's risk management policies.

Information on spot exchange rates, market forward rates and the share price of Co T shares is shown below:

Date	**Spot rate** S$ to US$1	**Market forward rate** S$ to US$1	**Co T's share price per unit**
1 January 20x6	S$1.45	S$1.41	US$9.00
Average for 20x6	S$1.40		
31 December 20x6	S$1.37	S$1.35	US$10.00
Average for 20x7	S$1.39		
31 December 20x7	S$1.42	S$1.42	US$9.50

Gain or loss in fair value is determined at the end of each year.
On 31 December 20x7, Invest-B sold its entire holdings in Co T.
Ignore tax effects.

Examplify Question Number	**Question 3 Part II required:**
12	**(a)** Prepare journal entries in Singapore dollars (S$) to record the transactions and events relating to Invest-B's holdings of Co T shares and the forward contract for the year ended 31 December 20x6 and 31 December 20x7, in accordance with the requirements of SFRS (I) 9 *Financial Instruments.* **(10 marks)**
13	**(b)** Provide any ONE plausible and significant reason to explain Invest-B's decision to measure the equity investments at fair value through other comprehensive income (FVOCI). **(2 marks)** **(TOTAL: 24 marks)**

Question 4 - (a), (b), (c) and (d)

The World Bank has ranked Singapore as Asia's top logistic hub for ten years in a row[1]. SFRS (I) 16 *Leases* is effective for financial periods beginning on or after 1 January 2019. It is important to consider the impact of the new SFRS (I) 16 on logistic firms that are highly dependent on leasing as a source of financing of their operational assets.

To evaluate the impact of SFRS (I) 16 in comparison with the existing standard SFRS (I) 1-17 *Leases*, the scenario of a fictitious medium-sized logistic firm, Co TW, is featured below. Co TW provides transportation and warehousing services to e-commerce firms.

The primary operational assets of Co TW and their source of financing are explained below:

<u>Vans</u>

- As Co TW's service standards require use of high-performing delivery vehicles, the vans leased are all new vans and are leased on a non-cancellable lease term of five years, commencing from the start of their Certificate of Entitlement (COE) period.

<u>Photocopiers, printers and computer equipment</u>

- These items are leased and not purchased.
- On average, each item is leased for a non-cancellable lease term of one year with an option to renew the lease at normal market rent.
- Typically, Co TW renews the leases to the maximum useful life of each item.

<u>Warehouse facility</u>

- The purchase of the facility is financed by a long-term bank loan with stringent debt covenants.

[1] https://www.edb.gov.sg/en/our-industries/logistics-and-supply-chain-management.html

Examplify Question Number	**Question 4 (a), (b), (c) and (d) required:**
14	**(a)** How are the following items likely to be accounted for by Co TW under SFRS (I) 1-17 *Leases*? **(i)** Vans; and **(ii)** Photocopiers, printers and computer equipment. **(2 marks)**
15	**(b)** How are the following items likely to be accounted for by Co TW under the new SFRS (I) 16 *Leases*? **(i)** Vans; and **(ii)** Photocopiers, printers and computer equipment. **(4 marks)**
16	**(c)** Explain the most significant economic impact that the new lease standard SFRS (I) 16 *Leases* may have on Co TW. **(4 marks)**
17	**(d)** Advise Co TW on any one significant action that it can take to mitigate the economic impact in (c). **(2 marks)** **(TOTAL: 12 marks)**

END OF PAPER