Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 18 June 2018

Section 1
General comments

Overall, Candidates performed better in the quantitative components in the December 2018 than in the qualitative components. There was also a considerable variance in the quality of answers across Candidates. Candidates underperformed in Question 2 (joint arrangements) and Question 4 (qualitative analysis of accounting challenges posed by e-commerce in revenue recognition).

Candidates are reminded to be well-prepared across the range of standards and not leave any standards uncovered in their revision. Candidates should also 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

This question requires Candidates to prepare consolidation adjustments for a multi-level group of companies. It also requires Candidates to analytically determine (carry out a proof of balance) of total non-controlling interests in an intermediate parent and its subsidiary.

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 unrecognized intangible assets and liabilities in a business combination and SFRS (I) 10 *Consolidated Financial Statements* in the application of consolidation principles.

Candidates performed relatively better in the consolidation process of passing elimination and adjusting entries (albeit with errors and lapses explained below) than they did for the analytical check of non-controlling interests. 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.

Common errors included the following:

- In calculating the allocation of income to non-controlling interests of the intermediate parent, a number of Candidates failed to remove the intra-group dividend income included in the net profit after tax of the intermediate parent.

Many Candidates simply allocated income to non-controlling income on the basis of unadjusted net profit after tax.

- Many Candidates missed the adjustment for the write-back of impairment loss of the intangible asset acquired in the business combination.

- The adjustments and follow through of the realization of transferred inventory were also incorrect in many answers.

- Some Candidates used the wrong percentage (direct and indirect non-controlling interests) to eliminate dividend.

- In the analytical check of non-controlling interests, several Candidates adjusted acquisition date balances against the shareholders' equity at year-end. For example, the unrecognized provision for claim at acquisition date was deducted from the shareholders' equity balance at current year-end. The logic is incorrect and reflects confusion in the understanding of the check.

- Adjustments were also made to the wrong entity balances. For example, unrealized profit on an upstream sale of inventory by Venus to P Co was adjusted against Saturn's shareholder's equity.

- In analytically determining the non-controlling interests of the intermediate parent, many Candidates failed to deduct the intermediate parent's investment in its subsidiary (Venus) from its shareholders' net assets as at year-end.

- Further, in the analytical proof of non-controlling interests, many Candidates did not include the unrecognized intangible asset in the subsidiary's net assets at year end.

The calculation of goodwill was incorrect in many answers because of the omission of the intermediate parent's share of its subsidiary's fair value of identifiable net assets as at acquisition date.

Question 2

This question relates to the accounting effects of a joint operation and a joint venture and the impact of the effects on financial analysis. This question tests Candidate's understanding of the differences between a joint operation and a joint venture in accordance with the definition and requirements of SFRS (I) 11 *Joint Arrangements.*

Although this question is quite straight-forward, we noted significant gaps in Candidate's knowledge of SFRS (I) 11. It also surprised us to note that a sizeable number of Candidates could not compute the ratios as required.

Specific observations are as follows:

1. Candidates appeared to be more familiar with the accounting of joint ventures than joint operations. While joint operations are less common in practice than

joint ventures, they are an important alternative risk-sharing and asset-sharing arrangement that prevails in a number of industries.

2. Some Candidates misread the question and showed the incremental effect of accounting for the joint arrangement rather than the combined numbers that would be reported by the investor or joint operator.

3. Many Candidates could not determine the correct investment amount under each option. In accounting for the arrangement as a joint operation, several Candidates did not eliminate the initial investment, leading to the double counting of net assets of the joint operation. In addition, many Candidates did not correctly determine the investment in the joint venture under the equity method.

4. Total assets under the joint operation option was mainly incorrect because of the double-counting of net assets of the joint operation (refer point 3).

5. Total equity was incorrect in several answers because Candidates did not include the share of net profit of the joint arrangement.

6. Ratio analysis was poorly done. Other than the last ratio (where the formula was given in the question), many Candidates applied the wrong formula to working out the net profit margin, return on assets and assets turnover ratio. Some Candidates worked out return on assets as revenue divided by total assets. The majority of Candidates appeared to be unfamiliar with the assets turnover ratio. As these metrics are important to the decision-making processes of both internal and external stakeholders of a reporting entity, Candidates should be familiar with these fundamental tools of analysis.

In the concluding part, Candidates are required to explain which option they will choose. While most Candidates were able to identify their choice of the joint arrangement, the justification of their opinions was poor. Only a few Candidates can logically explain their conclusions.

Question 3

<u>Part 1</u>

The majority of Candidates performed reasonably well for this question. The question required Candidates to account for a construction project under SFRS (I) 15 *Revenue from Contracts with Customers*. Although the percentage of completion was incorrectly calculated in several answers, Candidates showed understanding of the process of determining the revenue to be recognized for a contract whose performance obligation is satisfied over time.

1. Candidates were asked to calculate the percentage of completion to measure the progress of the construction project. Many Candidates were unable to correctly calculate the percentage of completion because they failed to exclude the general and administrative costs and wastage of material costs

from the total expenditure. They excluded only one of the two costs mentioned or wrongly excluded other costs.

2. Most Candidates applied the right process to determine the current year revenue and construction profit for the years ended 31 December 20x4 and 20x5. However, some Candidates only calculated the cumulative revenue and/or profit but not the current year revenue and/or profit.

3. Candidates were generally able to determine the tax expense for year 20x4. However, not many were able to correctly calculate the tax expense for year 20x5 as they failed to account for the increase in tax rate from 20% to 22%.

4. The question also required the Candidates to make retrospective adjustment in 20x6 for the errors made in 20x4 and 20x5. Many Candidates made the mistake of passing the normal journal accounting entries to account for the construction project in years 20x4 and 20x5, without showing the retrospective adjustment as required by SFRS (I) 1-8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

<u>Part II</u>

This question relates to the issue and conversion of foreign currency convertible bonds. Candidates have to recognize and measure the bonds and translate them to Singapore dollars, which is the issuer's functional currency.

1. Most Candidates were able to present the appropriate journal entry to record the issue of the convertible bonds. However, there were a number of careless mistakes made when Candidates divided rather than multiplied the US$ denominated bond to arrive at the S$ amounts. However, while credit is given for the correct process in this exam, we would like to remind Candidates that an accountant's work should always reflect careful attention to fundamental details.

2. The question indicates that accrued interest is paid to bondholders on conversion. Candidates did not make use of this information in their answers. Even if Candidates missed reflecting the payment in the interest expense entry, the conversion entry of the bond should reflect the extinguishment of accrued interest due to bondholders who converted the bonds.

3. The answers on the conversion of the bonds were very poorly done. Candidates either did not attempt this part of the question or did it incorrectly. As convertible bonds are compound financial instruments, conversion is a typical event in the tenure of the instruments and Candidates must be conversant with the accounting for the conversion from bonds to equity.

Question 4

This question requires Candidates to identify any three significant accounting challenges in e-commerce with respect to revenue recognition or measurement issues and explain whether and how the requirements of SFRS (I) 15 *Revenue from Contracts with Customers* are able to deal effectively with the challenges. Candidates are also required to provide an example for each of the challenges identified.

This question was generally poorly done for the following reasons:

1. Many Candidates did not explain *why* their identified arrangement in e-commerce posed significant accounting challenge(s). Presenting the technological or business arrangement is not sufficient. The issues or impact on accounting must be explicitly explained.

2. Some of the challenges were generally described without focusing on the e-commerce context. These challenges could have applied to any context outside of e-commerce.

3. Many Candidates did not provide a real-life example to reflect the accounting challenge, let alone an example from the e-commerce space.

4. Some of the issues identified overlapped and were sub-issues of a more significant issue. As a result, Candidates lost the opportunity to make a greater impact by failing to focus on fundamental issues that had greater accounting significance.

5. The question requires explanation of *whether* and *how* SFRS (I) 15 deals with these challenges. The question requires a critical review of *whether* SFRS (I) 15 is effective in this respect. However, most Candidates did not give their views on this question.

6. There was lack of depth in answers. In answering the question on *how* SFRS (I) 15 deals with the challenges, Candidates did not explore the application of the 5-step framework to the particular challenge.

7. Many Candidates extracted the text from SFRS (I) 15 *verbatim* without any attempt to explain the application of the text to the question on hand. *Verbatim* extractions do not contribute to the answers and do not earn any credit for the Candidate.