

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 11 June 2019

Section 1

General comments

Generally, Candidates were able to show basic understanding of equity accounting and consolidation required for Question 1. However, Candidates were less competent in dealing with the more complex aspects of Question 1.

Candidates' performance for Question 2 was of moderate standard. Candidates were able to answer the quantitative components of the question.

The overall performance of Candidates for Question 3 was poor, especially with respect to Case B. For Question 3 Case B (c), most Candidates did not correctly identify the sale to Co D as a bill and hold arrangement. Instead, Candidates simply presented or attempted to apply the five steps in SFRS (I) 15 *Revenue from Contracts with Customers* without answering the question.

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

Candidates have to demonstrate their understanding and application of Singapore Financial Reporting Standard (International), SFRS (I) 1-28 *Investments in Associates and Joint Ventures*.

In addition, Candidates need to demonstrate their understanding and application of 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.

Candidates performed relatively well for **part (a)** as well as **part (b)** of the question.

Majority of the Candidates were able to prepare the equity accounting entries to account for the share of revaluation reserves and post-acquisition retained earnings of the associated company and reclassify dividend as a reduction of investment.

Candidates were also able to prepare the entry to recognize the holding company's share of current year profit but many Candidates were unable to calculate the correct amount.

Candidates who did not perform well for these parts were unable to prepare the correct accounting entries to recognize the share of the past amortization of intangible asset and adjust for the unrealized profit on the transfer of fixed assets. Some Candidates totally omitted these journal entries.

Most Candidates performed better for **part (b)**. Many of them were able to perform an analytical check on the investment in the associated company. The common mistakes made by Candidates were wrong calculation of the goodwill, unrealized profit of fixed assets and unamortized balance of intangible assets.

Candidates are encouraged to have a better understanding on the basic principles in accounting for downstream and upstream transaction of associated companies.

Generally, Candidates did not perform as well in **part (c)** as compared to **part (a) and (b)**. In **part (c)**, Candidates generally performed well on basic consolidation adjustments such as the elimination of investment, elimination of dividends, elimination of intercompany balances and allocation of revaluation reserves to non-controlling interests. However, Candidates generally struggled with more advanced concepts such as the accounting for upstream and downstream transactions and accounting for remeasurement gain on previously held investment in associate.

This question part was poorly attempted due to the following reasons:

- Many Candidates omitted the consolidation entry to recognise the remeasurement gain on previously held investment in associate.
- Candidates failed to compute the correct adjustment for amortisation and impairment of intangible assets.
- Candidates omitted the entries to adjust the unrealised interest capitalised in fixed assets and also failed to capitalise the external interest.
- Many Candidates did not adjust the unrealised profit in upstream transfer of inventory correctly.
- Many Candidates omitted the adjustment to reverse the claim expense already recognised by Amber Co.

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.

Question 2

Question 2 tested Candidates on their understanding of financial instruments and the computation of earnings per share. Most Candidates are able to do at least part of the question, especially in relation to the computational portions.

Part (a) required Candidates to identify whether the two stated financial instruments are equity, debt or hybrid financial instruments to J Ltd. in accordance with the criteria provided in SFRS (I) 1-32 *Financial Instruments: Presentation*.

In this part of the question, Candidates have to demonstrate their understanding of the criteria listed in SFRS (I) 1-32 *Financial Instruments: Presentation* by categorising the financial instruments correctly. In particular, Candidates should evaluate each instrument against the definition of equity and financial liability in the standard.

Candidates were generally able to correctly identify mandatorily redeemable preference shares as a debt instrument. However, many Candidates appeared to have difficulty with the various characteristics of financial instruments such as convertibility and redeemability. The existence of a contractual obligation to redeem a preference share is relevant in the analysis (refer paragraph AG25 of the standard). Some Candidates incorrectly identified the cumulative convertible preference shares as a hybrid financial instrument instead of an equity financial instrument. Paragraph AG26 of SFRS (I) 1-32 *Financial Instruments: Presentation* specifically states that “When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments.” In this case, J Ltd. has the discretion to determine when to distribute the dividends and so it would be considered an equity instrument.

Part (b) required Candidates to prepare the journal entries to account for the transactions relating to the convertible bonds for the year ended 31 December 20x6.

This part of the question was generally well-answered. Many Candidates were able to work through the computations and correctly provided the journal entries for the issue of the bonds on 1 July 20x6, interest expense incurred during 20x6; and conversion of the bonds on 31 December 20x6.

As a convertible bond is a compound financial instrument, there is a need to separately identify the debt and equity components of the financial instrument. Further, as the bond was issued at a discount, it is good practice to separately account for the unamortised discount on the bond. Some Candidates had separately identified the discount in the journal entries while others have netted it against the bond payable. Either approach is acceptable for this paper although the better method is to separate the bond payable from the unamortized discount.

Although the question did not specifically request for workings to be provided, Candidates are advised to include their workings as much as possible for all calculations as marks would be awarded for right concepts and workings even though the final answers may not be correct.

Parts (c), (d) and (e) dealt with topic on Earnings Per Share (EPS).

Part (c) required Candidates to calculate the Basic EPS for J Ltd for the year ended 31 December 20x6. In computing the Basic EPS, there is a need to account for the preference dividends declared on the preference shares. Most Candidates remembered to deduct preference share dividends from net profit after tax to arrive at net profit attributable to ordinary shareholders. However, some Candidates did not take into account the conversion of 2,000,000 preference shares to ordinary shares on 1 July 20x6, thereby reducing the amount of preference shares that were entitled to preference dividends as at 31 December 20x6. Other Candidates forgot to account for the preference shares that had yet to be converted and were entitled to preference dividends as at 30 June 20x6 that were not paid.

In computing the weighted average shares, either the cumulative balance method or the incremental method could be used. Most Candidates adopted the former method.

Part (d) required the Candidates to compute Earnings per Incremental Share (EPIS) for each of the dilutive securities of J Ltd. for the year ended 31 December 20x6 and to rank the dilutive securities from the most dilutive to the least dilutive.

Candidates are encouraged to read the question carefully before attempting the question as there were Candidates who did not rank the dilutive securities after computing the various EPIS.

A significant number of Candidates computed the EPIS for the mandatorily redeemable preference shares despite the fact that such instrument would not be dilutive since they could not be converted to ordinary shares. This implied that some Candidates were not familiar with the characteristics of the various financial instruments as tested in **part (a)**.

Part (e) required the Candidates to calculate the Diluted EPS for J Ltd. for the year ended 31 December 20x6. SFRS (I) 1-33 *Earnings per Share* required the financial instrument that is most dilutive to be considered first. Most Candidates were able to follow the correct sequence based on their ranking of the dilutive securities in **Part (d)**.

Question 3

Case A

This question required Candidates to compute the impairment loss for the cash-generating unit (CGU) and allocate it to the assets in Division ABC.

Most Candidates were able to compute the value in use (VIU) and the discounted value of the sales proceeds on divestment but could not derive the recoverable amount (RA), which is a summation of VIU and sales proceeds on divestment. Some Candidates mistook sales proceeds on divestment to be the fair value less cost of disposal amount. Some Candidates failed to compute the present value of the future cash flows, which resulted in computing the wrong RA and arriving at the wrong conclusion.

After deriving at the RA and impairment loss amount, some Candidates stopped at this stage and did not allocate the impairment loss to the respective assets. For those Candidates who did, not all of them allocated it to goodwill first.

Case B

Part (a) required Candidates to record transactions and translate them to the functional currency of the company. In addition, Candidates had to demonstrate their application of SFRS (I) 1-21 *The Effects of Changes in Foreign Exchange Rates* and SFRS (I) 9 *Financial Instruments* on the accounting for an investment in fair value through other comprehensive income (FVOCI) debt security including recording the effective interest and fair value gain/loss and foreign exchange gain/loss.

Many Candidates did not do well for **part (a)** because they mistook the gain/loss on disposal of property, plant and equipment (PPE) as foreign exchange gain/loss. Candidates showed lack of understanding that PPE and inventory are non-monetary assets which are not subject to foreign exchange translation at year end. Many Candidates also used the wrong foreign exchange rates to compute the translation difference and could not distinguish between foreign exchange and fair value gain/loss.

For the debt security investment, some Candidates mistook it for a financial liability and got the entries reversed. Many Candidates also failed to calculate the interest income correctly and they were unable to distinguish foreign exchange gain from fair value gain at year end.

For the inventory purchase and sale, some Candidates erroneously computed foreign exchange gain/loss and was unable to record journal entry on the sale of inventory.

Part (b) involves four different parties which Co A had transactions with and Candidates had to determine whether they are related parties of Co A in accordance with SFRS (I) 1-24 *Related Party Disclosures*. Most Candidates did not get all the answers correct showing their lack of familiarity with the principles in the above standard.

Part (c) was the most challenging for most Candidates. The question required Candidates to determine whether revenue should be recognised as at year end for a bill and hold arrangement. Some Candidates did not attempt the question probably due to a lack of time. The question required Candidates to explain *how* they would

evaluate the appropriateness of the arrangement as revenue under SFRS (I) 15 *Revenue from Contracts with Customers* and to identify relevant and practical evidence needed to support the evaluation. Most Candidates did not directly answer the question. Instead, they made reference to and discussed the five steps of revenue recognition in SFRS (I) 15 *Revenue from Contracts with Customers*. Only a handful of Candidates correctly identified and discussed the issues relevant to a bill and hold arrangement. Even for those who did, they did not apply the principles in the standard to evaluate when it is appropriate to recognize revenue from a bill and hold arrangement. They also did not identify the evidence that is required to support the evaluation.