Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 9 December 2021

Section 1
General comments

Generally, Candidates displayed a good understanding of the preparation of basic consolidation entries required for Question 1. However, Candidates did not perform as well in **Parts (b) and (c)**, in comparison to **Parts (a) and (d)**, in performing an analytical check of non-controlling interest of Y Co and preparing equity accounting adjustments relating to P Co's interest in JV Co.

The overall performance for Question 2 is below expectations. Candidates lacked good knowledge of Singapore Financial Reporting Standards (International) (SFRS(I)), in particular, SFRS(I) 16 *Leases*, SFRS(I) 2 *Share-based Payment* and SFRS(I) 1-33 *Earnings per Share*. For Question 2 **Case A**, many Candidates failed to identify the additional entries needed in light of the additional information provided, that is, the entries required due to the revision of the estimated residual value of the leased asset at the end of the lease for **Case A Part (c)**. They were not able to determine if the lease is a finance or operating lease in **Case A Part (d)**.

Question 3 tests Candidates' understanding and ability to apply SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates* in the translation of financial statements of an overseas subsidiary that is denominated in the subsidiary's functional currency to the parent's presentation currency. The final part of the question also tests the Candidates' knowledge of SFRS(I) 1-7 *Statement of Cash Flows* and SFRS(I) 10 *Consolidated Financial Statements*.

As with past years, many Candidates did not attempt the last parts of the paper. The missed parts could be either attributed to the lack of time or a lack of knowledge of the topics. If it is the former, Candidates are advised to plan their time management better to ensure that time is appropriately allocated to the different questions. This is especially important since precious marks could be obtained for some parts of the paper.

Furthermore, as parts of the questions are inter-related, Candidates should ensure consistency in their answers which will serve to either check or assist them in determining balancing items. For example, in **Part (a)**, in translating the statement of financial position of S Co, Candidates would have worked out the cash amount in Singapore dollars (S$) as at 31 December 20x6. The same information would flow through to the closing balance of the cash movement in **Part (b)** and the closing cash and cash equivalents in **Part (c)**. This would then allow Candidates to work out the foreign currency translation reserve (FCTR), which is a balancing amount.

As discussed below, some of the errors made were due to missing out on the information provided in the question. Candidates are, therefore, advised to read the questions carefully before attempting each question.

Section 2
Analysis of individual questions

Question 1

Question 1 was the best performing question among the three questions. Candidates were required to demonstrate their understanding and application of SFRS(I) 3 *Business Combinations,* SFRS(I) 10 *Consolidated Financial Statements*, SFRS(I) 1-28 *Investments in Associates and Joint Ventures*, and SFRS(I) 1-23 *Borrowing Costs*.

Part (a) required Candidates to prepare consolidation adjustments relating to a company's (P Co's) interest in its subsidiary (Y Co) and intra-group transactions, including the intra-group sale of investment property.

Most Candidates performed well for this part and were able to furnish the correct consolidation adjustments pertaining to the elimination of investment in the subsidiary, allocation of post-acquisition retained earnings to non-controlling interests (NCI), elimination of intra-group balances and elimination of dividends declared by the subsidiary.

Common errors included the following:

- The adjustment of past impairment loss and reversal of impairment loss in the current year for the subsidiary's intangible asset that was not carried at fair value at the date of acquisition. While some Candidates only adjusted for the past impairment loss and omitted the reversal of impairment loss in the current year, others wrongly adjusted the reversal of impairment loss above the intangible asset's original recorded amount. There were some Candidates who totally omitted the consolidated journal entries (CJEs) pertaining to the adjustment of impairment loss for the subsidiary's intangible asset.

- The elimination of profit on the sale of intra-group sale of subsidiary's investment property to the parent company – some candidates were unable to work out the correct profit to be eliminated while others calculated the wrong amount to be adjusted for the current year depreciation. Some also adjusted the depreciation in the opposite direction. There were some Candidates who totally omitted the CJEs pertaining to the intra-group sale of the subsidiary's investment property to the parent company.

- The allocation of current year's profit to NCI – while most Candidates were able to furnish the correct consolidation entry, many were unable to work out the correct amount. They either did not account for the after-tax reversal of impairment loss or elimination of intra-group sale of investment property or adjustment for depreciation.

Part (b) of the question required Candidates to perform an analytical check (proof of balance) of non-controlling interests of Y Co.

While some Candidates demonstrated that they understood and correctly applied the concept of performing an analytical check (proof of balance) of non-controlling interests of Y Co, a number of Candidates need to have a better understanding of how to perform an analytical check of non-controlling interests, especially with respect to the adjustment for the intangible asset (fair value differentials), and the adjustment for unrealised profit in fixed assets.

The analytical check is a way of determining the consolidated balances of key figures independently from 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.

Part (c) required Candidates to prepare equity accounting adjustments relating to P Co's interest in JV Co.

Only a handful of Candidates performed well in the adjustments relating to recognising the share of post-acquisition retained earnings of JV Co and reclassifying dividend income as a reduction of investment.

Common errors included the following:

- Most Candidates missed out/miscalculated the adjustment for interest differential in the capitalisation of borrowing costs. When construction is completed, interest will no longer be capitalised, hence, interest differential has no effect in equity accounting after construction has been completed. Candidates are encouraged to refresh their concepts on capitalisation of borrowing costs under SFRS(I) 1-23 *Borrowing Costs*.

- Regarding the recognition of P Co's share of current profit after tax of JV Co, most Candidates missed out the effect of the decrease in additional depreciation and related tax, arising from the interest differential in the capitalisation of borrowing costs related to the construction of a factory.

Part (d) required Candidates to determine the goodwill arising from the acquisition of X Co and Z Co.

Most Candidates demonstrated a good understanding and were able to do this part of the question correctly.

Question 2

Overall, the Candidates' performance for Question 2 was the worst among the three questions. The probable reason for this could be due to Candidates' lack of familiarity with the finer details of SFRS(I) 16 *Leases*.

Question 2 Case A (a)

This question part tested Candidates on the calculation of lease liability and preparation of lease amortisation table and balances. The performance for this part was borderline.

Common mistakes noted include:

- Using the guarantee on the residual value given by the lessee ($500,000) as part of the computation of lease liability

- Discounting cash flows at the end of the period instead of at the beginning.

Question 2 Case A (b)

Candidates did relatively better for this question part on preparation of journal entries for the lessee. Common errors noted include:

- Expensing off the legal cost
- Depreciating the asset over 10 years instead of 5 years
- Recognising interest expense on 1 January instead of 31 December

For those who used the alternative approach of journalising accrued interest, there were errors involving accrued interest versus interest expense accounts. Some Candidates did not read the question carefully and ended up not providing journal entries for 31 December 20x1 as required. Like past examinations, many Candidates still lost marks unnecessarily, by failing to provide narration and/or dates for their journal entries.

Question 2 Case A (c)

While the first two parts tested on the basic application of lease accounting (calculation of lease liability and preparation of lease amortisation table and balances and on the preparation of entries for the lessee), **Case A parts (c)** and **(d)** involved a deeper knowledge of lease accounting, and Candidates fared badly.

This question part was the worst-answered part and only a handful of Candidates managed to pass. A sizeable proportion of Candidates did not attempt this part. It was noted that some Candidates used undiscounted numbers. For those Candidates who provided workings to compute the present value, common errors included the use of incorrect interest rate (6%), and the wrong treatment of the decline in the estimated residual value of the leased asset at the end of the lease in which many Candidates used the full value ($450,000) instead of the differential ($50,000).

For the journal entries for the lessee, many Candidates were at a loss; wrong accounting entries for impairment, residual value, depreciation, interest, loss, among others, were noted in the answers.

Question 2 Case A (d)

Most Candidates did not calculate the present value (PV) correctly but instead relied on the computation done in **Case A Part (a)**. Candidates failed to realise that **Case A Part (a)** was to be answered from the lessee's perspective, while **Case A Part (d)** required an evaluation from the lessor's perspective. Many Candidates were able to get the 5 out of 10 years lease term correctly but computed the PV wrongly and ended up with a wrong conclusion.

Question 2 Case B (a)

This question part required Candidates to prepare the journal entries to record the effects of the share-based compensation plan for Company X for the years ended 31 December 20x1 and 31 December 20x2 in accordance with SFRS(I) 2 *Share-based Payment*. Overall, it was poorly attempted. It was noted that some Candidates who provided incorrect answers did not show the workings involved. As such, marks could not be awarded to those answers without any workings. Candidates are reminded to show the necessary workings on how they derived their answers, to avoid losing marks for the process.

Common mistakes made by Candidates include:

- Failure to note the distinction between share capital versus share option reserve, and incorrectly crediting share capital instead of share option reserve in their journal entries

- Failure to record the expenses relating to the share-based compensation plan as compensation/remuneration/staff costs

Question 2 Case B (b)

A number of Candidates lost marks because they did not understand the concept of the weighted average ordinary shares during the year. Common errors included:

- Failure to prorate the 120,000 shares (new shares issued via the exercise of options on 1 July 20x7) for only six months to derive the correct weighted average ordinary shares during the year

- Failure to include the impact of the exercise of options during the year, in the calculation of the weighted average ordinary shares during the year

Question 2 Case B (c)

Candidates were tested on the calculation of diluted earnings per share (EPS) in this question part. The overall performance was poor as many Candidates did not attempt this question part. Among Candidates who attempted the question part, many of them were not able to compute the conversion of dilutive options (if exercised and converted to shares) to derive the correct diluted EPS. Most Candidates were unable to derive the additional shares issued without consideration. They either included the amount 300,000 (number of option units vested and not exercised as at 1 January 20x7) or the amount 180,000 (number of option units vested and not exercised as at 1 July 20x7) as the options outstanding, and did not consider the weighted average number of options during the period effects.

Question 3

Part (a) required Candidates to translate the S Co income statement for the year ended 31 December 20x6 and the statement of financial position as at that date from United States dollars (US$) to Singapore dollars (S$).

This part was well-answered by the Candidates, and a significant percentage of the Candidates passed this question part.

The main errors made were in the translation of the tax expense and the retained earnings as at 1 January 20x6.

In the case of tax expense, a number of Candidates wrongly used the average exchange rate for the year (i.e. 1.28) to translate the tax expense from US$ to S$ when the question specifically mentioned the sale of the fixed assets arose at the end of the year. Hence, the Candidates should apply the closing exchange rate to translate the tax on the gain on the sale of the fixed assets instead of the average exchange rate. Alternatively, total tax expense can be calculated as 20% of translated profit before tax, where 20% is the given tax rate.

Regarding the translation of the retained earnings as at 1 January 20x6, the common mistake is to assume a share capital of US$1,120,000 when the question states that an additional share capital contribution of US$120,000 was injected by both P Co and the NCI on 18 December 20x6. This implied that the share capital as at 1 January 20x6 should only be US$1,000,000 and not US$1,120,000.

Based on the information provided, when translating the amount of share capital from US$ to S$ for the statement of financial position, Candidates should account for the initial capital of US$1,000,000 and the additional capital of US$120,000 separately. Many Candidates overlooked this and translated the whole amount using the rate on incorporation (i.e., 1.29).

Part (b) required Candidates to translate the cash movement of S Co for the year ended 31 December 20x6.

Similarly, most Candidates were able to apply the correct exchange rate to translate the various transactions. However, many Candidates forgot about the foreign currency translation reserve (FCTR), which can be computed as a balancing item had they put in the correct translated closing cash balance. Perhaps due to time constraints, Candidates simply summed up the translated amounts for the various transactions during the year and treated the computed amount as the closing balance without checking against the statement of financial position.

Likewise, for the payment of tax expense, since the question mentioned that tax expense was settled immediately in cash on its recognition, the translated amount should be the same as that for the income statement. Yet a number of Candidates incorrectly derived different amounts in their answers.

Part (c) required the Candidates to complete the consolidated cash flow statement of P Co and its group. This part was generally the most badly answered portion of the question compared to the earlier two parts. Apart from carelessness, such as inserting a line for tax expense when the given template starts with “profit after tax”, some Candidates demonstrated a lack of understanding on how to prepare a cash flow statement. For example, proceeds from the sale of fixed assets should be classified as cash flow from investing activities.

In filling up the cash flows for S Co, many Candidates overlooked the share capital contribution from NCI. Many Candidates also did not tally the closing cash and cash equivalents to the S$ amount worked out in **Part (a)** for the statement of financial position, resulting in not identifying the change in FCTR.

Many Candidates also were not able to compute the changes in working capital for S Co. The changes should be calculated by taking the difference between the opening and closing balances and multiplying them by the average exchange rate. Candidates are advised to read the question carefully; for example, information about the timing of various cashflows was mentioned in the Additional Information relating to P Co and So Co.

For the consolidation adjusting entries, many Candidates did not eliminate the dividend income received from S Co. Some Candidates treated that as an adjusting item or adjusted it in cash flow from investing activities. However, the question specifically mentioned that the dividends were declared and paid in cash on 16 July 20x6. Furthermore, the question also stated that P Co recognised dividend income as an operating cash flow. This meant that it should be adjusted against the profit after tax line item of the consolidated cash flow statement.