Chartered Accountant SINGAPORE

# SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

**MODULE:** Advanced Financial Reporting (AFF)

**EXAMINATION DATE:** 7 December 2021

## Section 1
## General comments

The overall performance of the Advanced Financial Reporting (AFF) December 2021 examination falls short of expectation. Generally, the Candidates underperformed in Question 1 (Consolidation) and Question 3 (Financial Instruments). Further analysis and common errors made by the Candidates are detailed in Section 2.

Candidates are reminded that the AFF module builds upon the knowledge and skills studied in the Principles of Financial Reporting (PFF) module. Candidates are expected to demonstrate a sound knowledge of and apply the Conceptual Framework and the Singapore Financial Reporting Standards (International) (SFRS(I)) to produce a complete set of financial statements for single entities and simple groups, including basic notes to the financial statements.

Candidates are also expected to be able to explain and advise on the application of the SFRS(I), including the appropriate treatment and disclosure requirements, demonstrating appropriate professional judgement.

Candidates have to be well-prepared across the range of SFRS(I) and not leave any SFRS(I) uncovered in their revision. In addition, Candidates should be focused and relevant in their answers to the theoretical components of the paper. Quoting the text from the standards and other sources will receive little or no marks. Marks can only be awarded for the application of the requirements to the facts of the case.

## Section 2
## Analysis of individual questions

### Question 1

This question was on consolidated financial statements involving a Group comprising a subsidiary and an associate. It required Candidates to prepare consolidation and equity accounting journal entries in **Part (a)**, provide independent proof of the total comprehensive income attributable to owners in **Part (b)**. This question required the application of SFRS(I) 3 *Business Combinations*, SFRS(I) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures*.

Performance for **Part (a)** was fair. Many Candidates who attempted the question could provide the basic investment elimination entries, including the computation of goodwill. In addition, most of the Candidates did well for the equity accounting entries, including the share of fair value reserves of the associates. However, some

Candidates made mistakes with the direction of the entries, as there was fair value loss in the current year and negative fair value reserve as at year-end, rather than fair value gain.

The common errors made by the Candidates were as follows:

(a) Over-valued specialised equipment of the subsidiary at the acquisition date, which was subsequently sold at a loss by the subsidiary in the current year.

From the group's perspective, the specialised equipment should first be adjusted to reflect the fair value at the group level and thereafter eliminated against the loss on disposal of specialised equipment in the books of the subsidiary. Most of the Candidates were not able to identify the correct journal entries (or the correct amount) for the reversal of the over-valuation of the specialised equipment, adjustment of subsequent depreciation of the over-valued specialised equipment and the reversal of the loss on disposal of this specialised equipment at group level. As a result, the non-controlling interest of the subsidiary for the current year and the share of post-acquisition reserve of the subsidiary at the year-end were not determined correctly.

(b) The associate sold equipment to its parents at a loss (not profit) in the current year. The equipment was still held at being used by the group at the end of the current year.

From the group's perspective, the unrealised loss arising from the sale of the equipment should first be reversed and recognised as share of current year's profit of associate and the realisation of the unrealised loss (through depreciation) for the current year should be adjusted through a share of profit of associate respectively.

Most of the errors made by the Candidates arose from the computation of the reversal of the share of unrealised loss of the associate, and many Candidates omitted to account for the realisation of the loss through depreciation in the current year.

**Part (b)** appeared to be the most challenging part of the question as almost 50% of the Candidates did not attempt this part. For those Candidates who did, they did not perform well. Instead of preparing the independent proof of the total comprehensive income (as required by the question), they showed the workings of Consolidated Statement of Comprehensive income that presented the Net profit after tax and Other Comprehensive income of the group instead. Some Candidates also prepared the independent proof of the consolidated retained earnings instead of the total comprehensive income.

Analytical checks are critical review function that allows the accountant to derive a balance independently of the journal entries. Candidates should be familiar with analytical procedures that underscore a deeper understanding of the processes in consolidation.

Candidates should work towards high competency in consolidation. More attention should be given to complex transactions that involve inter-company elimination.

**Question 2**

Question 2 comprised of two parts and this question was well-attempted by the Candidates.

**Question 2 Part I (a)**

This question involved the identification of one fundamental principle that is being threatened based on the facts of the question, with reference to Ethics Pronouncement (EP) 100, the *ISCA Code of Professional Conduct and Ethics*.

Most of the Candidates performed well for this question by identifying the right principle, but many failed to obtain full marks because they did not explicitly state the reason as to how the fundamental principle that was threatened for the Finance Director i.e., changing the accounting treatment despite knowing that there is no justification to do so.

**Question 2 Part I (b)**

This question involved the identification of one threat that could compromise or be perceived to compromise based on the facts of the question.

This question was generally well answered by the Candidates, however, quite a handful failed to describe appropriately the direct outcome of the threat identified.

As such, marks will only be awarded if the Candidates identified the correct threat and described the outcomes with relevance.

**Question 2 Part I (c)**

This question involved the identification of one appropriate action to eliminate or reduce the threat to the fundamental principle identified.

This question was well answered with most of the Candidates identifying the right parties to consult/highlight. However, it was noted that a number of Candidates did not further discuss how or what these parties can do to eliminate or reduce the threat.

**Question 2 Part I (d)**

This question involved the identification of one relevant stakeholder that could be affected by the action of the Finance Director based on the facts of the question.

The question was well answered, with most of the Candidates identifying the stakeholders correctly (both external and internal). Marks were awarded for any plausible explanations for which the stakeholder was identified correctly and an explanation on how the stakeholder could be affected.

**Question 2 Part II (a) and (b)** required the Candidates to identify the related parties of the reporting entity and to disclose the relevant information and relationship as required by SFRS(I) 1-24 *Related Party Disclosures* in the financial statements.

The Candidates generally performed well for the identification of the related parties. However, it was note that most of the Candidates were unable to score full marks for this question part due to a lack of understanding and wrong application of the SFRS(I) 1-24*.*

Common errors noted were:

(a) Quite a number of Candidates incorrectly identified Braddell Co. as the subsidiary of Anderson when it is clearly stated in the question that Anderson is an individual (Finance Director), not an entity.
(b) Candidates failed to identify Commonwealth Pte Ltd as a related party even though Anderson (who has control over Braddell Co.) has a significant influence on Commonwealth Pte Ltd via his 30% shareholding.
(c) Some of the Candidates also failed to identify Esplanade Pte Ltd as a related party when the close family member of the controlling shareholder of Braddell Co. (Anderson's wife) is a key management personnel of Esplanade Pte Ltd.
(d) The majority of the Candidates also did not identify Faber Corp as a related party even though it provides key management personnel services to Braddell Co.

For information and relationship to be disclosed in the financial statements, Candidates generally were able to identify most of the items or transactions that required disclosure under SFRS(I) 1-24. However, some of the Candidates omitted items such as the purchase of old equipment and sale of inventories. Also, quite a number of them failed to identify that the fact that key management personnel services provided by Faber Corp is a disclosure requirement itself.

**Question 3**

Question 3 comprised of two parts and most candidates performed poorly for Part (a).

**Part (a)** examined the Candidates on the application of the requirements of SFRS(I) 9 *Financial Instruments* which stipulates the criteria which are to be wholly adhered in order to evaluate whether a hedging relationship qualifies for hedge accounting. The facts of the case in this question clearly identified the existence of a formal designation and documentation of the hedging relationship, the entity's risk management objective and strategy for undertaking the hedge. The facts of the question also demonstrated that the given case meets all the hedge effectiveness requirements as listed in SFRS(I) 9.

The performance of this question part was badly done by the Candidates. Only a few Candidates appropriately applied the hedge effectiveness requirements to the facts of the given case.

Many Candidates did not identify the hedge effectiveness requirements as listed in SFRS(I) 9 and therefore they were unable to associate the facts of the case to evaluate whether all the three mandatory requirements on hedge effectiveness are fulfilled to explain whether the proposal by the accountant could meet the criteria for hedge accounting.

When the question specifically required the application of SFRS(I) 9, a few Candidates identified the hedge effectiveness requirements which were stipulated in the former financial reporting standards FRS 39 *Financial Instruments: Recognition and Measurement*, which has been superseded. FRS 39 has included the condition where the hedge effectiveness is assessed on an on-going basis with the actual result of the hedge which was required to be within a range of 80–125 per cent in order to evaluate whether the hedge was effective. The conditions in FRS 39 for hedge effectiveness was not replicated in SFRS(I) 9. Hence, it is very important for Candidates to clearly comprehend the requirements of the question and then answer specifically to the requirements identified in the question.

It is important for the Candidates to note that repeating the facts of the question without addressing the requirements of the question will receive little or no marks.

A few of the Candidates did not attempt this question at all, which reiterates the requirement for the Candidates to manage their time on the day of the examination. Candidates must plan their time accordingly to the requirements of each question so as to avoid a situation of being constrained to leave a question unanswered.

**Part (b)** involved an application of requirements of SFRS(I) 9 and preparation of the accounting journal entries to record the fair value changes of the put option due to intrinsic value and time value separately for the respective financial years.

The overall performance for this question part was borderline. Some of the Candidates were able to demonstrate their knowledge on hedge accounting by presenting appropriate accounting entries to record the change in fair value of hedging instrument/put option and fair value of hedged item/FVOCI equity instrument.

The question specifically mandated the Candidates to distinctly identify whether the fair value changes in the hedging instrument and hedged item are to be recognised as a profit or loss or an other comprehensive income item. Although many Candidates identified the correct accounting entries and the correct amount of changes in fair value of hedging instrument and hedged item in their answers, they did not identify whether the effect of changes in fair value are to be recognised in profit or loss, or other comprehensive income. It is very important for Candidates to clearly comprehend the requirements of the question and then answer specifically to the requirements identified in the question.

 

It was also noted that there are some Candidates who did not provide narrations in their answers when preparing accounting entries.

On disposal of the FVOCI equity investment, SFRS(I) 9 permits the changes in the fair value of investments in equity instruments designated as FVOCI to be transferred directly from the equity account (in which other comprehensive income is accumulated) to other equity accounts, such as retained earnings. In the given question, as the FVOCI equity investment was sold during the financial year, the appropriate accounting entry for the accumulated balances in OCI is to be transferred to retained earnings. Most of the Candidates did not identify this accounting entry in their answers for the reclassification of accumulated (OCI) gains within equity.

**Question 4**

Question 4 comprised of two parts, and generally, some Candidates did poorly for this question.

**Part (a)** of this question is on revenue recognition, and more specifically on the percentage-of-completion method of revenue recognition most commonly used for construction contracts. This question part required the Candidates to compute the relevant contact costs for the respective financial years by applying SFRS(I) 15 *Revenue from Contracts with Customers.* The Candidates were also required to state which items of the expenditure are to be excluded from the contract costs and the reasons.

Most of the Candidates did not read the question correctly and assumed that it involved revenue recognition under the percentage-of-completion (POC) method and directly went into the computation of the POC method of revenue recognition. However, if they were able to identify the items of expenditure to be excluded and gave a valid explanation why they were excluded, marks were awarded accordingly.

There were many Candidates who were unable to correctly identify which items of expenditure, with some excluding direct labour and direct material costs from the computation of relevant contract costs. Despite the above, most Candidates were able to score most of the marks for this question, as they were able to identify most of the relevant contract costs and items of expenditure to be excluded, even if they are unable to justify their answers in a logical manner.

**For Part (b)**, Candidates generally did not do well for this question. The question required the Candidates to prepare the journal entries to record the contract costs and revenue, as well as the billings made and the cash collected for the construction contract for the financial year ended 31 December 20x2. Most Candidates did not get the correct answer due to errors carried forward from the earlier question, but marks were still awarded for the correct journal entries. It was noted that some Candidates prepared journal entries for the three years, which were not necessary.

 

Chartered Accountant SINGAPORE

Although the percentage of completion was incorrectly calculated in several answers, Candidates showed understanding of the process of determining revenue to be recognised for a contract whose performance obligation is satisfied over time.

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 penalty and administrative costs from the total expenditures. Some Candidates excluded only one of the two costs from the total expenditures mentioned earlier. In addition, most of the Candidates failed to identify that the cost of the construction equipment needs to be allocated over the life of the contract by calculating proportionate depreciation for the respective years.

Many Candidates applied the right process to determine the contract revenue for the two years. However, some Candidates only calculated the cumulative revenue and not the current year revenue/profit.

Only a handful of the Candidates were able to derive the contract costs from **Part (a)** correctly and therefore prepared the correct journal entries for the revenue recognition amount for financial year 20x1. Most of the Candidates were only able to prepare the correct journal entries for cash collection and progress billings.