Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 5 December 2024

Section 1
General comments

The paper tested Candidates on their understanding and application of Singapore Financial Reporting Standards (International) (SFRS(I)).

In **Question 1**, Candidates were required to demonstrate their understanding and application of SFRS(I) 3 *Business Combinations*, SFRS(I) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures*. Most Candidates displayed a good understanding of the preparation of basic consolidation journal entries. However, Candidates did not perform well in **Part (a)(ii)** and **Part (e)**, as compared to **Part (b)**.

In **Question 2 Case A**, Candidates were required to demonstrate their understanding and application of SFRS(I) 16 *Leases.* Most Candidates were able to answer **Case A Part (a)** and **(b)** quite well. However, the majority of Candidates failed to score any marks for **Case A Part (c)** either because they did not attempt the question or did not correctly identify any profit or loss impact.

In **Question 2 Case B**, Candidates were required to demonstrate their understanding and application of SFRS (I) 1-40 *Investment Property* and SFRS (I) 1-16 *Property, Plant and Equipment*. The majority of Candidates did not perform particularly well for this case. The majority of Candidates failed to score any marks for **Case B Part (a)** because they were unable to correctly apply the principles of SFRS (I) 1-40 *Investment Property*.

In **Question 3**, Candidates were required to demonstrate their understanding of the definition of “equity” and “liability” in SFRS(I) 1-32 *Financial Instruments: Presentation,* and their understanding and application of SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates*. The majority of Candidates who attempted this question did not perform well.

Overall, Candidates are advised to read the questions carefully before attempting, to avoid losing marks unnecessarily. In addition, Candidates are encouraged to show workings clearly, as marks may be awarded for correct workings, even though the final answer may be incorrect.

Section 2
Analysis of individual questions

Question 1

In this question, Candidates were required to demonstrate their understanding and application of SFRS(I), mainly SFRS(I) 3 *Business Combinations*, SFRS(I) 10 *Consolidated Financial Statements* and SFRS(I) 1-28 *Investments in Associates and Joint Ventures.*

Part (a) (i) required Candidates to enact the journal entry or entries in the books of a parent company (P Co), to record the fair value of consideration transferred to acquire S Co, on 1 January 20x3.

The performance for this part was fair. Most Candidates were able to correctly record the amount of cash and land transferred. But some Candidates wrongly computed the contingent consideration payable, and hence did not derive the correct amount for the investment in S Co. In addition, many Candidates did not provide the journal entry for the remeasurement of land.

Part (a)(ii) required Candidates to enact the journal entry in P Co's books, to record the transaction relating to the contingent consideration payable on 1 January 20x5.

This part was not well-attempted by most Candidates. Most Candidates were unable to provide the required journal entry correctly. They either recorded the fair value change/loss on settlement wrongly to the investment in S Co account or did not consider the amortisation of discount and adjusted the wrong amount for contingent consideration payable.

Part (b) required Candidates to prepare consolidation journal entries relating to P Co's interest, in its subsidiary, S Co.

Most Candidates performed well for this part. Most Candidates were able to correctly furnish the consolidation journal entries pertaining to the elimination of investment in S Co, allocation of post-acquisition retained earnings to non-controlling interests (NCI), elimination of intra-group balances and elimination of dividends declared by S Co, except for the common errors identified below.

Common errors included the following:

- The elimination of investment in S Co – some Candidates did not include the fair value adjustment for intangible asset. As a result, they did not derive the correct amount of goodwill.

- The adjustment for past and current amortisation of intangible asset – some Candidates used an incorrect useful life to calculate the amortisation.

- The adjustment of unrealised profit on upstream transfer – many Candidates were unable to calculate the correct amount to be adjusted for the following accounts:

- opening retained earnings & NCI - due to goods re-sold to third parties in the previous year
  - cost of sales – due to goods re-sold to third parties in the current year
  - inventory – due to unsold goods at the end of the year

- The elimination of contract revenue, expense and unrealised profit for the robotic equipment that P Co built for S Co – some Candidates did not adjust for prior year's profit while others adjusted the wrong amount for current year contract revenue and expense. Some Candidates also wrongly accounted for NCI share although it is a downstream transaction.

- The allocation of current year profit to NCI – While most Candidates were able to furnish the correct consolidation adjustment, many were unable to work out the correct amount. They either did not adjust or adjusted the wrong amount, for after-tax amortisation of intangible asset, after-tax profit on sale of intangible asset and after-tax realisation of profit from transferred inventory.

- Some Candidates omitted the following consolidation adjustments:
  - Adjustment for past and current amortisation of intangible asset
  - Disposal of intangible asset
  - Adjustment of depreciation on robotic equipment

Overall, for this question part, Candidates are reminded to understand the common consolidation adjustments required, including but not limited to, intra-group sale of assets, past and current adjustments related to undervalued fixed assets, etc.

Part (c) required Candidates to perform an analytical check (proof of balance) of NCI of S Co.

The performance for this part was fair. While some Candidates demonstrated that they understood and correctly applied the concept of performing an analytical check (proof of balance) of NCI of S Co, other Candidates need to have a better understanding of how to perform an analytical check of NCI, especially the adjustment for after-tax unrealised profit in inventory.

Some Candidates correctly included goodwill in the analytical check of NCI, but the amounts were wrong.

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 NCI.

Part (d) required Candidates to prepare equity accounting journal entries in relation to P Co's associate A Co.

This part was relatively well-attempted by Candidates. Many Candidates provided the correct basic equity accounting adjustments and were able to correctly recognise the share of post-acquisition retained earnings and correctly reclassify dividend income as a reduction of investment.

However, some Candidates adjusted wrongly for the adjustment of expense on provision for litigation loss, and/or adjustment for unrealised loss in inventory. Only a minority of Candidates were able to derive the correct amount of share of current year profit after tax, due to wrong adjustment for after-tax litigation loss expense, and/or after-tax realised cost of sales.

Part (e) required Candidates to perform an analytical check (proof of balance) of the investment in associate A Co.

This part was not well-attempted by Candidates. Some Candidates did not adjust or adjusted the wrong amount or in the reverse way for the after-tax unrealised loss in inventory. Some Candidates correctly included goodwill in their workings, but the amounts were wrong, while others omitted the implicit goodwill.

The analytical check is a way of determining the investment in associate balance independently of the process of passing equity accounting journal entries. It serves as a method of analytically validating this key figure. Candidates are encouraged to understand the logic behind the analytical check of investment in associate balance.

Question 2

Question 2 comprised two case studies, which tested Candidates' understanding and application of the requirements of SFRS(I) 16 *Leases*, SFRS(I) 1-40 *Investment Property* and SFRS (I) 1-16 *Property Plant and Equipment*. The overall performance for this question was mixed.

<u>Question 2 Case A</u>

Part (a) required Candidates to calculate the lease liability as at 1 January 20x1 for Co X, and to prepare the lease amortisation table to show the lease liability balances as at 1 January 20x1, 1 January 20x2 and 1 January 20x3.

In general, most Candidates performed well for this part. However, only some Candidates were able to determine the correct lease term to calculate the lease liability.

Common errors included the following:

- Some Candidates incorrectly used 4 years (instead of 6 years) as the lease term, failing to add the additional 2 years for the option to renew the lease at the end of the non-cancellable lease term. As the option price is significantly below the estimated residual value at the exercise date, it is reasonably certain the option will be exercised, and the lease will be extended.

- Many Candidates did not include the purchase option price in the lease liability calculation at the lease commencement date.

- Some Candidates incorrectly included residual value in the lease liability calculation.

Part (b) required Candidates to prepare the journal entries for Co X, the lessee, to record the transactions on 1 January 20x1, 31 December 20x1, 1 January 20x2 and 31 December 20x2.

In general, most Candidates performed well for this part, except for the common errors identified below.

Common errors included the following:

- Some Candidates incorrectly recorded the interest expense entry at the beginning of the year instead of at year-end.

- Many Candidates used an incorrect useful life to calculate the depreciation of the right-of-use asset. As it is reasonably certain that the purchase option will be exercised in view of the favourable terms, the economic useful life of the asset (10 years) should be applied in the calculation of depreciation.

Part (c) required Candidates to prepare the journal entry to record the forfeiture of the purchase option.

Many Candidates did not attempt this question. Among those who did, common errors included the following:

- Some Candidates recorded no profit or loss impact, or incorrectly recorded as a balance sheet impact.

<u>Question 2 Case B</u>

Part (a) required Candidates to determine whether Hotel X should be classified as a fixed asset or investment property of Co X, by applying the principles and requirements of SFRS(I) 1-40 *Investment Property*.

Most Candidates did not perform well for this part. And many Candidates did not make a conclusion.

The main principle: If the hotel is owner-managed (i.e. owner-occupied) by Co X, it is a fixed asset of Co X; if the hotel is not managed by the owner, it is an investment property of Co X.

Candidates are encouraged to review the principles in SFRS(I) 1-40 *Investment Property*.

Part (b) required Candidates to determine: (i) the carrying amount of the hotel as at 31 December 20x1, (ii) the depreciation of the hotel for the year ended 31 December 20x2 and (iii) the impairment loss or reversal of impairment loss in 20x2, assuming that Hotel X is classified as a fixed asset of Co X and is measured using the cost model of SFRS(I) 1-16 *Property, Plant and Equipment*.

One of the common errors was related to the "reversal of impairment loss". Candidates are encouraged to review the principles particularly relating to the "reversal of impairment loss".

Part (c) required Candidates to determine the fair value gain or loss of Hotel X in 20x1 and 20x2, assuming that Hotel X is classified as an investment property of Co X and is measured using the fair value model of SFRS(I) 1-40 *Investment Property* on the date of initial recognition.

Most Candidates performed quite well for this part.

Question 3

In this question, Candidates were required to demonstrate their understanding of the definition of "equity" and "liability" in SFRS(I) 1-32 *Financial Instruments: Presentation,* and their understanding and application of SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates*.

Many Candidates did not attempt this question. For those who did, this question was poorly answered.

Part (a) required Candidates to calculate the ratios (return on equity, return on assets, debt/equity) for the 2 financing options – mandatorily redeemable preference shares (MRPS), and convertible preference shares (CPS), where the formulae for calculating the ratios were given.

Candidates were generally able to correctly identify MRPS as "liability", and CPS as "equity". However, many Candidates applied the wrong amounts when computing the ratios.

Part (b) required Candidates to consider the ratio analysis in part (a) and other factors and evaluate the benefits and disadvantages of MRPS and CPS.

Candidates who attempted this question performed well. Candidates were generally able to identify the different impacts on equity, solvency, net profit after tax and cash flows, under each financing option - MRPS and CPS.

Part (c) required Candidates to explain if and how the ratios calculated in part (a) will change for each financing option - MRPS and CPS, if the functional currency of Co Z is the Singapore dollar (SGD) and the MRPS and CPS were issued in United States dollars (USD) and the USD is appreciating relative to the SGD.

This part was poorly answered by Candidates. Most Candidates were able to correctly identify that liabilities would increase, and net profit after tax and equity would decrease for MRPS. However, a significant number of Candidates failed to comprehend that the appreciation of USD would have no impact on equity, and no foreign exchange gain/loss would arise, for CPS.