Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 9 June 2022

Section 1
General comments

Most Candidates displayed a good understanding of the preparation of basic consolidation journal entries (CJEs) required for Question 1. However, Candidates did not perform well in **Part (b),** as compared to **Parts (a) and (c)**, mainly in the preparation of CJEs relating to the change in ownership interests.

The overall performance for Question 2 was fair. Candidates did better for **Parts (a) and (b)** as compared to **Parts (c) to (e)**. However, it was noted that many Candidates still lack a good knowledge of Singapore Financial Reporting Standards (International) (SFRS(I)), in particular, SFRS(I) 1-37 *Provisions, Contingent Liabilities and Contingent Assets.*

Candidates did not perform well for Question 3. **Case A** tests Candidates' understanding and ability to account for cash flow hedges based on SFRS(I) 9 *Financial Instruments* and the effects of changes in foreign exchange rates based on SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates*. **Case B** tests Candidates' understanding of the accounting of bonds based on amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL), also based on SFRS(I) 9 *Financial Instruments*. It appeared that a significant number of Candidates were not prepared for the first part of the question, particularly on the requirement to account for the effect of foreign exchange.

As in the 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 tested. If it is the former, Candidates are advised to manage their time better to ensure sufficient time is allocated to the different questions. This is especially important since additional marks could be obtained for their attempt at these question parts.

Furthermore, as parts of the questions are interrelated, Candidates should ensure consistency in their answers which will serve as a check and assist them in determining the balancing items. Candidates are also advised to read the questions carefully before attempting each question.

Section 2
Analysis of individual questions

Question 1

In this question, Candidates were required to demonstrate their understanding and application of SFRS(I) 3 *Business Combinations* and SFRS(I) 10 *Consolidated Financial Statements*.

Part (a) of the question required Candidates to prepare CJEs relating to a company's (P Co's) interest in its subsidiary (X Co) and X's subsidiary (Y Co).

The majority of the Candidates performed well for this part of Question 1 and were able to furnish the correct consolidation adjustments pertaining to the elimination of investment in Y Co, elimination of preacquisition retained earnings of both X and Y, recording of non-controlling interests (NCI) of X Co and Y Co, as well as the inventory and accounts receivable fair value adjustments and related deferred tax adjustments, except for the common errors identified below.

Common errors included the following:

- Most Candidates wrongly eliminated the investment in X Co of $4,000,000 (which was the remaining amount of investment after P Co's partial divestment on 31 December 20x5), instead of the original initial investment of $4,800,000 as at the date of acquisition.
- Some Candidates wrongly eliminated the revaluation reserves in Y Co (which were the revaluation reserves as at 1 October 20x2, before P Co's acquisition of X Co) instead of the revaluation reserves as at 1 January 20x4 (date of P Co's acquisition of X Co). Even though X Co acquired Y Co on 1 October 20x2, P Co only acquired X Co on 1 January 20x4.
- Some Candidates debited a generic account 'Asset', instead of a specific, appropriate account name for the fair value differential on inventory and accounts receivable, on the date of acquisition. Candidates are reminded that marks might not be awarded for account names that are too generic, e.g., Asset, Liability, etc.

Candidates are reminded to note the date of acquisition to calculate the correct amounts in the journal entry for the elimination of initial investment.

Part (b) required Candidates to prepare CJEs in Year 20x6 relating to the change in ownership interests as at 31 December 20x5.

This question part was poorly answered, and most Candidates failed this part. Although many Candidates could identify the accounts and debit/credit legs of the adjustment for investment, capital reserve and NCI, they did not manage to get the amounts correct.

Some Candidates were able to compute the 15% of initial investment in X Co ($800,000) and P Co’s share of post-acquisition RE of X Co ($630,000) correctly.

Common errors included the following:

- Most Candidates erroneously provided 'Profit on sale' in the debit leg of the entry, instead of the opening retained earnings (ORE), even though the amount was calculated correctly. Candidates are advised to read the question carefully, to note whether they are asked to prepare CJE in the year of divestment or after that. As the divestment happened in Year 20x5, and the requirement was to prepare CJE in the subsequent year (i.e., Year 20x6), the correct account for the debit leg of the entry was ORE.

- Most Candidates were not able to calculate the correct amount of P Co's share of the equity of the sub-group as at 31 December 20x5. Most Candidates missed out on the adjustments relating to P Co's share of past reversal of accounts receivable loss of X Co, past cost of sales of under-valued inventory of Y Co, unrealised profit of Y Co.

Part (c) required Candidates to prepare the remaining CJEs relating to P Co and its subsidiaries (X Co and Y Co) in the post-acquisition period to 31 December 20x6.

The performance of this question part was fair. Most Candidates were able to correctly furnish the CJEs pertaining to the elimination of intra-group balances, elimination of dividends declared by the two subsidiaries and allocation of post-acquisition retained earnings to NCI. However, many Candidates made mistakes in the NCI-related adjustments due to the change in P Co's ownership interest in X Co upon a partial divestment by P Co in X Co.

Common errors included the following:

- Allocation of current year profit to NCI –
  While most Candidates were able to furnish the correct accounts for the Debit and Credit legs of the consolidation entry, many Candidates were unable to compute the correct amounts. They either did not eliminate the dividend received from Y Co (for X Co); added the realised after-tax profit from the upstream sale of inventory (from Y Co to P Co) or deducted the additional after-tax cost of sales on written-off under-valued inventory (for Y Co). Many Candidates were also unable to calculate the correct NCI percentage for Y Co.

- Elimination of intra-group transfer on intellectual property –
  Some Candidates were not able to work out the correct amounts in profit and loss (‘Other income’ and ‘Research and Development expense’) to be eliminated or the correct adjustment to the capitalised intellectual property, while others calculated the wrong amount to be adjusted for the amortisation. Some Candidates also incorrectly adjusted the amortisation in the opposite direction.

- Adjustment for upstream sale of inventory from Y Co to P Co –
  Some Candidates were unable to compute the correct profit to be realised for sales made to the third parties in the current year, while other Candidates incorrectly adjusted for NCI.

- Recognition of the additional cost of sales on the under-valued inventory –
  Some Candidates adjusted the full amount to the current year's cost of sales, while others incorrectly adjusted for NCI.

- Reversal of impairment loss on accounts receivable –
  Some Candidates adjusted the wrong amount or in a reverse way, while others incorrectly accounted for the NCI.

There were also some Candidates who completely omitted the CJEs pertaining to the following adjustments:

- Intra-group transfer of intellectual property and related adjustment on amortisation
- Upstream sale of inventory from Y Co to P Co
- Recognition of the additional cost of sales on under-valued inventory
- Reversal of impairment loss on accounts receivable

Question 2

Part (a) of the question required Candidates to classify expenditures items into those relating directly to the contract, 'Non-contract expenses', or other specific accounts. It was generally well done. Most Candidates were able to identify architectural fees, cost of demolition, lease expense, depreciation of equipment used in the construction and salaries of foremen and construction works as costs directly related to the contract.

The common errors made by the Candidates included the incorrect classification of:

- 'Cement stocks purchased before construction' as part of the costs of the contract. It should be classified as 'Inventory'.

- 'Sub-contractor costs paid in advance' as part of the costs of the contract. It should be classified as 'Prepayment'.

- 'Salaries and wages of administrative and accounting staff deployed on construction-related activity', 'Liquidated damages', and 'Search costs to replace insolvent sub-contractors' as part of the costs of the contract. They should be classified as 'Non-contract expenses'.

Part (b)(i) and (ii) were the best performing question parts. Most Candidates did well and passed this part.

For (b)(i), most Candidates were able to compute the right Percentage of Completion (POC) for Year 20x5. However, many Candidates did not manage to calculate the correct percentage for Year 20x6 as they have taken either the incorrect numerator or denominator. Some Candidates even forgot to include the cumulative construction costs of Year 20x5 ($11,500,000) for the Year 20x6 computation.

Part (b)(ii) required the Candidates to calculate the current revenue and contract expenses. It was noted that most Candidates were able to calculate the correct amounts for Year 20x5. Other than the wrong application of percentage mentioned earlier for **Part (b)(i)** for Year 20x6, additional errors noted for Year 20x6 were:

- Wrong contract price for Year 20x6; due to the incorrect computation of the variation order request.
- Wrong cumulative costs for Year 20x6; most Candidates did not include the amount of $11,500,000.

As emphasised in past exams, Candidates need to show workings to support the POC percentage, revenue and expenses. No marks will be awarded when the final answer is wrong, even if the workings are partially correct.

Performance for **Parts (c) and (d)** was borderline. Most Candidates did not get the journal entries and the naming convention correct for **Part (c)**, e.g., the term 'Progress Billings' was used instead of 'Contract Asset' in the journal entry. Some Candidates omitted the journal descriptions for the journal entries, which was similarly noted in all the past examinations.

Part (d) required the Candidates to calculate the taxable temporary differences and Deferred tax liability (DTL). The process of calculation of the DTL was reasonably well done by Candidates, though many Candidates did not get the correct numbers which may be due to carelessness or the adding/subtracting of incorrect numbers. Furthermore, some Candidates wrongly deducted the Year 20x5 DTL amount to derive the 20x6 DTL balance even though the question was not asking for Year 20x6 deferred tax expense amount.

Part (e) was the worst-performing question part for Question 2. Most Candidates failed to identify the contract as an onerous contract; hence, they were unable to explain further with the given case facts. It was an onerous contract because the unavoidable costs of meeting the obligations under the contract exceeded the economic benefits to be received under it. The unavoidable costs were the least net cost of exiting the contract, which was the lower of the costs to fulfil the contract ($2.5 million), and the compensation costs for terminating the contract ($2 million). Hence, a provision of $2 million should be provided.

Many Candidates also wrongly determined that this was a case of contingent liability. Some Candidates simply stated that a provision should be recognised, without providing the amount. Candidates should apply the given case facts in their answers and not just quote directly from the SFRS(I).

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Question 3

Overall, the Candidates' performance for Question 3 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) 9 *Financial Instruments* and SFRS(I) 1-21 *The Effects of Changes in Foreign Exchange Rates*.

Part (a) required the Candidates to provide the journal entries to account for the cash flow hedge relating to the purchase of 10,000 metric tons of steel.

Most Candidates were able to work out the journal entries for hedge accounting. However, many Candidates ignored or forgot to account for the differences in exchange. As both the margin deposit as well as the futures contract are monetary items, they need to be revalued using the spot rate at each reporting date. Consequently, when accounting for the change in the value of the futures contract, there was a need to attribute part of this change in the value to changes arising from foreign exchange rate fluctuations.

Part (b) required the Candidates to first set up a bond amortisation table showing at least the following items, namely (i) cash interest amounts, (ii) effective interest amounts, (iii) gross carrying amounts (before loss allowances), (iv) loss allowances, and (v) amortised cost balances (net of loss allowances). Thereafter, the Candidates were required to show the financial effect(s) on the Statement of Profit or Loss and Other Comprehensive Income.

Most Candidates were able to construct the bond amortisation table for **Part (a)**. However, some Candidates did not include all the required items specified in the question. Candidates were advised to read the questions carefully to avoid losing marks unnecessarily.

For **Part (b)**, most Candidates were able to identify the interest income where the bonds were categorised as carried at amortised costs and FVOCI. However, many Candidates ignored or forgot that the question specified that Co L's accounting policy was to recognise interest on a cash basis in the case where the bond was classified as FVTPL. This being the case, the interest income should be based on the coupon rate and not the effective interest rate. Further, under SFRS(I) 9, impairment should only be considered for financial assets that were incorrectly classified as carried at amortised costs or FVOCI but not FVTPL. Hence, the fair value gain as at 31 December 20x1 when the bond was classified as carried at FVTPL should not factor in the impairment loss of $12,000. The same applied when computing the change in fair value as at 31 December 20x2.

In the case where the bond was classified as carried at FVOCI, some Candidates forgot to write back the FV gain recognised as at 31 December 20x1.