SINGAPORE CA QUALIFICATION EXAMINER’S REPORT

MODULE: Financial Reporting (FR)

EXAMINATION DATE: 14 December 2017

Section 1
General comments

Overall, Candidates were better able to apply the basic concepts contained in the Singapore Financial Reporting Standards (SFRS) in the December 2017 examination compared to previous examination sessions.

Future Candidates are reminded that questions in the FR examination are often integrated questions requiring the application of several SFRS to the facts of the case. As such, to be well-prepared, Candidates must exhibit more than just basic knowledge of the SFRS, but also demonstrate competencies in analysing the facts presented and applying the appropriate standard or standards to complex transactions.

Section 2
Analysis of individual questions

Question 1

This question required Candidates to prepare consolidation and equity accounting adjustments. It also required Candidates to analytically determine (carry out a proof of balance) of the investment in an associate.

In this question, Candidates had to also demonstrate their understanding and application of SFRS 103 Business Combinations and SFRS 110 Consolidated Financial Statements in accounting for changes of ownership interests with gain in control.

Although Candidates did well in the basic elimination entries, they were less able to deal with the complex transactions in that question. Many Candidates were also not able to analytically determine the investment in the associate balance.

The following segment highlights specific common errors in Question 1, with amplification of the more complex scenarios.

(a) Scenario: Under-valued inventory of the subsidiary at acquisition date was subsequently used for the construction of own building in the current year.

Principle: From the group’s perspective, the building should be adjusted to reflect the fair value (not book value) of the materials used. The under-valued inventory had effectively been transformed into a building in progress. As the building was still under construction, there should be no depreciation or tax effects or unwinding of the deferred tax liability at this point.
Errors noted:

- Instead of adjusting the building in construction, many Candidates made the adjustment to the income statement as if the inventory was sold.

- Many Candidates passed unnecessary tax entries in relation to the above when there were no tax effects as one asset is simply transformed into another asset.

(b) Scenario: The parent company leased a warehouse to its subsidiary. The warehouse was classified as an investment property by the parent. The lease was recognised as an operating lease by the subsidiary who used the warehouse for production purposes.

Principle: From the group’s perspective, the warehouse was used for production of goods and services and should be classified as a fixed asset and not as an investment property. The accounting for warehouse on the consolidated statement of financial position should be in accordance with SFRS 16, Property, Plant, and Equipment and not SFRS 40 Investment Property.

Errors noted:

- Many Candidates did not reclassify the asset from investment property to fixed assets.

- Subsequent adjustments relating to removing the fair valuation of the investment property and recognising depreciation were missed out.

- A number of Candidates eliminated rental income and rental expense relating to the prior year. The elimination was unnecessary as there was a naturally offsetting effect in opening retained earnings of both entities.

(c) Scenario: The associate company became a subsidiary on 2 January 20x7.

Principle: The investment in associate under the equity method should be re-measured to fair value at the date of gain of control and a re-measurement gain on previously held interests should be recognised.

Errors noted:

- Many Candidates did not re-enact the recognition of the investor’s share of post-acquisition retained earnings up to the date when control was obtained.

- As a result of the above omission, the re-measurement gain was incorrect as Candidates calculated the gain as the difference between fair value and
initial investment at cost and not the balance of the investment in associate under the equity method.

(d) Analytical determination (proof of balance) of investment in associate.

- Many answers showed lack of familiarity with this proof and a number of Candidates compiled the balance from the equity accounting entries instead. As this proof is practically important to establish the reasonableness of the final balance, Candidates should learn and be conversant with this proof and other proofs (e.g. non-controlling interests and consolidated retained earnings balances).

(e) Many Candidates also eliminated balances with associates. This was unnecessary and incorrect as associates are not entities within the group.

Question 2

This question related to lease accounting, cash flow statements, and the impact of the forthcoming accounting standard SFRS 116 Leases on the lessee.

The performance for this question was of reasonable standard although common errors and omissions were noted, which included the following:

(a) Several Candidates misclassified the finance and operating lease classification for Plan A and Plan B. Although the current standard SFRS 17 Leases will be replaced in 2019 by SFRS 116, the concept of finance and operating lease is important with respect to lessor accounting and the application of operating lease to recognition exemptions permitted by SFRS 116.

(b) Many Candidates incorrectly included the guarantee fee paid to the parent in the calculation of minimum lease payments.

(c) Several answers also showed incorrect processes for the calculation of depreciation, with many Candidates neglecting to deduct the residual value from the calculation of depreciation.

(d) Candidates did poorly on the cash flow question or did not attempt this part of the question. Many Candidates did not prepare the operating cash flow segment in full or in accordance with the question’s instructions. Several answers showed lack of understanding of the difference between investing and financing cash flows as defined by SFRS 7 Statement of Cash Flows.

(e) The question also required Candidates to comment on the impact of the forthcoming standard SFRS 116 on the financial statements and its consequential impact on the case company:
Many Candidates simply re-produced extracts from SFRS 116 or other sources without any specific application to the case. Candidates are reminded that no marks are awarded for extractions of such a nature;

Only a handful of Candidates highlighted the application of recognition exemptions permitted by SFRS 116 to the case;

Most Candidates missed out the difference in treatment of guaranteed residual values under the two standards; and

Very few Candidates explained the consequential impact of on-balance sheet recognition of leases on the performance metrics, risk analysis, debt covenants, and other critical attributes of the case company.

Question 3

This question examined Candidates’ ability to translate foreign-currency denominated issued bonds and to properly apply hedge accounting through two hedging instruments.

The following observations were made of Candidates’ answers:

(a) Several Candidates did not calculate interest expense in accordance with the effective interest method and calculated instead the cash interest expense;

(b) In almost all cases, the exchange loss on loan payable was incorrectly calculated as Candidates missed out the unamortised premium in their calculations;

(c) While correctly recognising the receipt of cash on settlement of the forward contract, many Candidates incorrectly missed the entry to recognise the gain on settlement;

(d) Directional errors were noted in calculating the swap net receipt (payment) although the amounts calculated were correct;

(e) Candidates were also not able to identify the correct date of a swap payment or receipt; and

(f) Many Candidates incorrectly recognised the change in fair value of the swap in other comprehensive income (OCI) when the swap was a fair value hedge. Describing the account as ‘hedging reserve’ or ‘fair value adjustment reserve’ was also incorrect as these describe accounts that are outside of the income statement.
Question 4

This question tested Candidates ability to account for the recognition, initial and subsequent measurement, and presentation of research and development expenditure and goodwill over two alternative pathways.

Generally, Candidates did better in their answers to Pathway 1 (organic growth) than they did for Pathway 2 (acquisition of a start-up company).

(a) Candidates were able to differentiate research from development and did reasonably well in explaining the accounting treatment of expenditure in Phase 1 (Survey) and Phase 2 (Experimental Modelling).

(b) However, Candidates were less able to deal with the ambiguity in Phase 3 (Testing). Candidates needed to be bold to address the lack of evidence at this point and explain how they would proceed with an accounting decision.

(c) Most Candidates were able to respond adequately to the accounting treatment of Phase 4 expenditures (Commercialisation). However, many Candidates reproduced extracts from SFRS 38 Intangible Assets without any effort to apply the requirements to the case. Candidates are reminded that such extractions do not earn any marks.

(d) Of greater concern, many Candidates missed the application of acquisition accounting under SFRS 103 Business Combinations. Although Candidates showed proficiency in recognising goodwill and fair value adjustments in Question 1 of this paper, they appeared to be less proficient in applying the same principles to this case scenario.