
Examination Panelist's Report

Paper I
PBE Financial Accounting
(December 2019 Session)

(The main purpose of the following report is to summarise candidates' common weaknesses and make recommendations to help future candidates improve their performance in the examination.)

General Comments

The overall performance in the December 2019 session was extreme. Some candidates demonstrated sufficient preparation, while some did not prepare well for the examination. Candidates should equip themselves with technical knowledge relating to financial reporting in order to get satisfactory results in this examination.

Specific Comments

Section A – Compulsory Question

Question 1 – 40 marks

Parts (a) and (b) required candidates to apply the concepts of HKFRS 16 *Leases* from both the perspectives of a lessee and a lessor. Candidates were weak in this area despite the fact that the lease in this case was very straightforward. A number of candidates were unaware of the new lease accounting requirements in recognising both the right-of-use asset and lease liability, especially on the calculation of the lease liability by discounting the future lease payments. Although the lessor accounting in HKFRS 16 should not be new to candidates, the performance was poor and many candidates ignored the justification of how to classify the lease in the lessor's financial statements. Candidates should equip themselves with the latest development in the accounting standards.

Part (c) required candidates to outline the accounting treatments for intra-group transactions in the consolidated financial statements. This part is straightforward and a number of candidates were able to state the basic requirements.

Part (d) was a continuation of the above parts requiring candidates to prepare consolidated financial statements. In this part, candidates were required to deal with one fair value differential adjustment, calculation of goodwill and non-controlling interest using the "full goodwill approach", downstream intra-group sale of vehicles, an intra-group leasing transaction and dividends declared by the subsidiary. Candidates' performance varied. It was encouraging to note that a number of candidates could arrive at the correct amount of goodwill, and some candidates started demonstrating sufficient knowledge on the impacts to retained earnings for a consolidation relating to an acquisition occurred several years ago. Further, more candidates attempted, though not perfect, to reconcile the consolidated retained earnings and the non-controlling interest at the end of the reporting year instead of leaving blank.

The following mistakes were, however, still commonly observed in this part of the examination:

- (i) A number of candidates ignored the dividends declared by the subsidiary. Those who were aware of the declaration of dividends by the subsidiary could not eliminate the transaction properly.

- (ii) Candidates understood that the intra-group sale of vehicle generated unrealised profits and a number of them could eliminate it successfully. Yet, they could not demonstrate sufficient understanding towards the realisation of such unrealised profit which would lead to a reversal of depreciation expense.
- (iii) Many candidates failed to apply the results in parts (a), (b) and (c) in eliminating the intra-group leasing transaction.

Candidates are encouraged to grasp a better understanding of the mechanics of consolidation through consolidation adjustment journal entries.

Section B – Optional Questions

Question 2 – 20 marks

This question required candidates to apply the basic concepts of HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and HKAS 16 *Property, Plant and Equipment* in two scenarios.

The first scenario deals with the accounting treatments of a disposal group classified as held for sale. Part (a) required candidates to explain what a disposal group was and state the conditions for classifying it as held for sale. The performance varied. Many candidates were able to state the basic elements of disposal group. Some outstanding candidates could even state all the conditions for classifying it as held for sale. Yet, other candidates either did not demonstrate awareness on such conditions or mixed up with the definition of cash-generating unit.

Part (b) further required candidates to explain the initial measurement for classifying a disposal group as held for sale. Candidates demonstrated weaknesses in this area. They could not state the terminologies (for example, fair value less costs to sell) and basic measurement requirements (that is, measuring it at the lower of carrying amount and fair value less costs to sell) in their explanation. Candidates were not able to state whether the items in a disposal group were within or outside the measurement scope of HKFRS 5.

The second scenario deals with the recognition criteria of an item of property, plant and equipment. Candidates failed to state the fundamental keywords (such as probable, future economic benefits) in their answers and the performance was fair.

Question 3 – 20 marks

This question required candidates to apply the concepts in HKFRS 9 (2014) *Financial Instruments* to a number of financial assets.

Part (a) assessed candidates' ability to explain the conditions for measuring a financial asset at amortised cost and apply to an investment in debt instruments. Again, the performance varied. Outstanding candidates were able to detail such conditions and apply correctly to the scenario. Other candidates simply provided the journal entries without explaining the treatments.

Part (b) assessed candidates' ability to explain the accounting treatments for an investment in equity instruments. Performance in this part was not satisfactory. Candidates were not able to logically explain in particular why such financial asset should be measured at fair value and the accounting treatment for the transaction costs.

Part (c) required candidates to apply the definition of significant influence to a short scenario. Some candidates could state the threshold of the ownership percentage for having significant influence and make the correct conclusion.

Part (d) required candidates to state the basic requirements of the new impairment model in HKFRS 9 (2014). Yet, candidates demonstrated very limited awareness towards the expected credit loss approach in HKFRS 9 (2014). Some candidates applied the requirements in HKAS 36 *Impairment of Assets* which was incorrect in this context.

Question 4 – 20 marks

This question required candidates to apply the concepts in HKAS 21 *The Effects of Changes in Foreign Exchange Rates* and HKFRS 15 *Revenue from Contracts with Customers* in a case context.

Part (a) assessed candidates' basic understanding towards the factors in determining the functional currency of an entity. Performance in this part varied. Some were able to provide very good answers while some candidates did not even know the basic factors for such determination.

Part (b) required candidates to apply the concepts in HKAS 21 to purchase of two properties. It was delighted to see that candidates were able to classify the two properties correctly based on their purposes. However, as highlighted in previous Examination Panelist's Report, candidates still demonstrated weaknesses in the basic terminologies in HKAS 21 such as non-monetary items, monetary items, spot rate and closing rate. Candidates therefore could not explain logically the accounting treatments in this part.

Part (c) required candidates to determine the timing of revenue recognition in HKFRS 15 which is one of the steps in the five-step revenue recognition model. Although most of the candidates were able to arrive at the correct amount of revenue recognised during the year, most of them could not apply the terminologies used in HKFRS 15 correctly (such as contract liability, performance obligation, at a point in time and over time).

Question 5 – 20 marks

This question required candidates to deal with a short case on employee remuneration package, mainly applying the concepts in HKFRS 2 *Share-based Payments*. This is the least popular question in Section B.

Part (a) required candidates to explain briefly why share options can enhance corporate governance. Many candidates simply ignored this part.

Parts (b) and (c) assessed candidates' ability to deal with equity-settled share-based payment transactions. While a number of candidates could grasp the basic computation

requirements, some candidates mixed them up with cash-settled share-based payment transactions. Further, many candidates were not aware of the accounting requirements of an equity-settled share-based payment transaction with performance conditions.

Part (d) required candidates to demonstrate awareness of the fundamental accounting treatments of short-term employee benefits in accordance with HKAS 19 (2011) *Employee Benefits* and the various types of employee benefits in HKAS 19 (2011). Candidates demonstrated very limited awareness of such and provided irrelevant answers by simply listing out examples of employee benefits such as housing and medical allowances etc.

Conclusion and Recommendation

I was delighted to see that the performance in this examination improved over the previous session. However, candidates must remember that PBE Paper I is a technical examination. Candidates are required to apply terminologies and concepts in the financial reporting standards to scenarios in order to arrive at the correct conclusion. There is no short-cut in preparing for this examination.

* * * END OF EXAMINATION PANELIST'S REPORT * * *