Examiner's report
DipIFR
June 2011

ACCA

General Comments

The format for the June examination was altered from that of previous sittings. A significant departure from the previous format was the removal of any choice from the paper. The June paper consisted of one 40 mark question and three 20 mark questions. The 40 mark question required the preparation of a consolidated statement of comprehensive income and a consolidated statement of changes in equity. Two of the three 20 mark questions were scenario based and required candidates to evaluate the financial reporting treatments of each scenario. The third 20 mark question also contained a scenario element, albeit one focussed on a specific international financial reporting standard – IAS 38 in this sitting.

The pass rate for this sitting was somewhat below that of recent sittings. A key reason for this was the change in format of the paper already discussed. In the previous version of the paper candidates had as an optional question the preparation of a set of published financial statements for a single entity. Average marks on this question tended to be high. The new format, rightly in my view, focuses more on knowledge and application of International Financial Reporting Standards (IFRS) than on financial statement preparation. A key message going forward is the need for candidates to present themselves for examination having acquired this knowledge by disciplined study and being able to explain clearly the steps they are taking when answering examination questions.

Specific Comments

Question One

This question required the preparation of a consolidated statement of comprehensive income and statement of changes in equity for a group that contained one subsidiary and one associate. Information about the recoverable amount of the subsidiary at the year-end was provided and it was necessary to test the goodwill on acquisition of the subsidiary for impairment.

In addition to the consolidation tasks candidates were required to adjust the financial statements of the parent for a number of transactions that had not been properly accounted for by the parent. These included a complex financial instrument that contained both a debt and an equity component, the sale and the re-measurement of two financial instruments that had been designated as fair value through other comprehensive income, and a number of potential environmental clean-up liabilities.

On the whole the basic preparation of the consolidated statement of comprehensive income was satisfactory. However a significant minority of candidates consolidated both the subsidiary and the associate whilst others used proportional consolidation for both the subsidiary and the associate. The calculation of impairment of goodwill produced a wide range of answers, ranging from the excellent to the very poor. Many candidates were able to correctly compute the goodwill figure using the full goodwill approach which was very encouraging. However other candidates struggled with the computation of the cost of investment, particularly the contingent consideration element. Not all candidates were aware of the need to remove the acquisition costs from the cost of investment given that they had been incorrectly included there in the draft financial statements. The calculation of the net assets of the subsidiary at the year-end for impairment purposes was not well done uniformly, the majority of candidates failing to correctly deal with the continuing impact of the fair value adjustments.

The performance of candidates on the calculation of the environmental provision and the split of the complex financial instrument was generally encouraging but candidates were less sure of the treatment of financial instruments measured at fair value through other comprehensive income, possibly because this aspect of financial reporting has changed given the issue of IFRS 9 – examinable for the first time in June 2011.

As noted in previous reports many candidates were considerably less able to cope with preparation of the consolidated statement of changes in equity than was the case for the consolidated statement of comprehensive income. I will continue to examine the preparation of this statement in future examination sittings. A particularly common mistake was failing to include the equity component of the complex financial instrument within this statement as a new component of equity in the current period.

Question Two
This question required candidates to explain and illustrate the financial reporting treatment of:

1. The cash flow hedge of a future firm commitment.
2. The operating lease of a property from the perspective of the lessee. The lease terms contained a lease incentive together with an obligation to restore the property to its original state following alterations carried out to the property during the period of the scenario.

Performance on this question was mixed. On the whole candidates struggled with the financial reporting of the cash flow hedge. Many failed to appreciate that the future firm commitment was an executory contract that should not yet be recognised in the financial statements. A number of candidates appeared to have little or no knowledge of how to account for a year-end cash flow hedge, beyond that there was a financial liability of $20,000 at the year-end. The knowledge requirement for this question is typical of what I might expect in future examination sittings.

Candidates tended to perform better on the treatment of the operating lease, with a number of very good answers being produced. However many candidates spent far too long speculating on whether the lease was operating or finance and doing very little else. A minority of candidates incorrectly stated that because the lease was operating all the costs relating to the lease should be taken to the income statement. This is of course true in the case of the lease rental but not in the case of the cost of the improvements and the future restoration costs, both of which should have been treated as property, plant and equipment.

Question Three
This question required candidates to explain and apply the basic principles underpinning the recognition and measurement of intangible assets. Answers to this question were in general extremely satisfactory with a number of excellent marks being recorded. Three relatively common mistakes were:

- Incorrectly concluding that employees could be recognised as an intangible asset.
- Incorrectly computing the recoverable amount of an intangible asset at the lower (rather than higher) of value-in-use and fair value less costs to sell.
- A failure to reflect on whether the revaluation model can be applied when measuring intangible assets

Question Four
This question required candidates to explain and illustrate the financial reporting treatment of:

1. Equity settled share based payments.
2. An error in the computation of depreciation of a complex asset.
3. Recognition of revenue from a sale and service transaction.

Knowledge and application of the share-based payments rules was generally disappointing. This topic seems to have caused difficulty for candidates whenever it has been examined. A particularly disappointing error was to state that equity settled share based payment arrangements created a liability for the grantor, rather than an equity instrument. Many candidates failed to appreciate the basic principles that the transaction should be measured using the fair value of the option at **grant** date, and that the number of options expected to vest should be re-estimated at each reporting date

Performance on the depreciation calculation was mixed. Some candidates produced near perfect answers, whilst others added the overhaul cost onto the total cost, rather than treating it as a separate component of that cost. A number of candidates incorrectly concluded that there had been no error in the calculation. Only a minority were able to correctly conclude that the error in the computation of depreciation in the previous period should have been adjusted retrospectively in the current period.

On the whole candidates were able to correctly identify that there were 2 revenue streams in part 3. Many candidates made a creditable attempt to allocate the transaction price to the goods and services components. However the identification and treatment in the statement of financial position of the resulting deferred income was less well done. Where candidates treated the future servicing as a provision, rather than a separate revenue stream, they did receive some credit.