Examiner's report

DipIFR
December 2012

General Comments

The format for the December 2012 examination was unaltered from that of June 2012. The 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 the practical consideration of a number of other financial reporting issues.

The first of the three 20 mark questions (question two on the paper) was scenario based. The second of the 20 mark questions (question three on the paper) dealt with revenue recognition. The third of the 20 mark questions (question four on the paper) was scenario based.

The pass rate for this sitting was lower than in recent examination sittings. The performance of candidates was very polarised, with very few marginal scripts encountered. Candidates often failed to complete all of the requirements. Some candidates wasted time with headings like 'facts' where they copied out large amounts of the question and then tried to apply them. The problem was that this left them little time to make sensible comments. Obviously there are no marks for simply copying out the question.

A key message going forward is the need for candidates to present themselves for examination having acquired a satisfactory level of knowledge by disciplined study and being able to explain clearly the steps they are taking when answering examination questions. The level of knowledge displayed by many candidates was somewhat disappointing.

Specific Comments

Question 1

This question required the preparation of a consolidated statement of comprehensive income for a group that contained one subsidiary and one joint venture. There was trading between the parent and both the subsidiary and the joint venture. Information about the recoverable amount of the subsidiary and the investment in the joint venture at the year-end was provided and it was necessary to test the goodwill on acquisition of the subsidiary and the investment in the joint venture for impairment.

In addition to the consolidation tasks candidates were required to adjust the statement of comprehensive income of the parent for a number of transactions that had not been properly accounted for by the parent. These included an equity settled share-based payment, a derivative that had been used to manage the financial risk associated with a sale where the proceeds were receivable in a foreign currency, and the re-measurement of a financial instrument that had been designated as fair value through other comprehensive income.

On the whole this question was answered reasonably well although the standard of the workings varied considerably. It is very important that candidates show clear workings to support the figures that are being produced in a question like this.

Areas showing good knowledge:

- Most candidates correctly consolidated the parent and subsidiary (Beta) with only a small number attempting to proportionally consolidate Beta.
- Most candidates used good standard formats although some did not split the total comprehensive income between the group and the non-controlling interest (NCI). It was also pleasing to see that most made an attempt to calculate the profit relating to the NCI.
- Calculations for goodwill were often correct
- Most candidates were able to correctly account for the unrealised profits on inter-company trading, although a reasonable number did not adjust for only the group share of the unrealised profit with the joint venture (Gamma).

Areas where mistakes were common:

- Many candidates used proportionate consolidation to deal with Gamma – not the equity method
- For the deferred tax charge for the year many either ignored the movement going to profit or loss or added the closing balance.
- The share based payment was often incorrect. Many thought this was the second year of the scheme so deducted a charge for last year. In addition it was placed in some strange sections of the statement, e.g. other comprehensive income (OCI) instead of cost of sales or administrative expenses.
- Some added the adjustments for investment income and finance cost instead of deducting them
- The impairment for Gamma was often not calculated correctly (ignoring the dividend and taking the wrong proportion for the period). Also because candidates had used the wrong method to account for it they did not know where to put the impairment and often included it in cost of sales.
- Calculations of the gain on investment at FVTOCI and the reclassification of the cash flow hedge were rarely done correctly. The figure most commonly added to OCI for the former was $100,000 (rather than $50,000). Few candidates were aware that the gain on re-measurement of the hedging derivative was taken initially to OCI and then reclassified to profit or loss.

Question Two

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

a. A financial loan asset that had suffered impairment in the current accounting period
b. A complex non-current asset that had not been depreciated in the previous period in error.
c. A legal claim that was expected to be covered by insurance

Part (a)

Areas showing good knowledge:

- Most candidates were aware that, whilst the financial asset had a zero coupon rate, the repayment premium meant that there was a finance cost associated with it due to the redemption premium.
- Most candidates were able to compute the finance cost using the effective rate of interest.

Areas where mistakes were common:

- Many candidates were not able to correctly deal with the issue costs of the loan asset. Some incorrectly stated that the costs should be recognised as an immediate expense, whilst others deducted the amount from the initial carrying value, rather than adding it on.
- Few candidates appreciated that the asset had suffered impairment in the current financial period. Where candidates did realise that this had occurred, some incorrectly stated that the loss would be recognised over the remaining term by reducing the effective rate of interest.

Part (b)

Areas showing good knowledge:

- Most candidates were aware that depreciation of this complex asset needed to be carried out in two parts.
- Basic depreciation calculations were generally of a satisfactory standard where candidates appreciated the 'complex asset' issue discussed above.

Areas where mistakes were common:

- A number of candidates who realised that the asset was complex added the $4m overhaul cost to the $20m total cost rather than treating it as a part of the $20m overall cost.

- A number of candidates failed to appreciate that failure to depreciate an asset in a previous period is an accounting error that needs to be adjusted for retrospectively.

Part (c)

Areas showing good knowledge:

a. Most candidates appreciated that the potential legal claim needed to be provided for as a liability.
b. Most candidates realised that the potential re-imbursement was a contingent asset.

Areas where mistakes were common:

- A significant minority of candidates used expected values to compute the provision rather than the most likely outcome.
- A significant minority of candidates stated that the insurance claim should be recognised as an asset.
- A smaller minority of candidates stated that the legal claim should not be provided for, but disclosed.

Question Three

This question required candidates to:

a. Explain the criteria that needed to be satisfied before revenue from the sale of goods and services can be recognised and the basis on which revenue should be measured.
b. Apply the principles in (a) to two small scenarios, one involving the sale of cars on a consignment basis and the provision of consultancy services.

Part (a)

Areas showing good knowledge:

- The majority of the candidates were able to identify the criteria that needed to be satisfied before revenue from goods and services could be recognised.

Areas where mistakes were common:

- Most candidates were not able to identify the fair value basis for measuring revenue, merely repeating the recognition criteria.

Part (b)

Areas showing good knowledge:

- Most candidates made a reasonable attempt to discuss the risks and rewards associated with the consignment arrangement, albeit often coming to the incorrect conclusion (see below).
- Most candidates appreciated that consultancy revenue can be recognised on a time apportionment basis.

Areas where mistakes were common:

- Most candidates concluded that the revenue on the consignment arrangement could not be recognised, despite clear evidence that the risks and rewards of ownership had passed to the dealer.
- Most candidates did not use discounting when measuring the consultancy revenue.

Question Four

This question required candidates to explain and illustrate the accounting treatment of:

a. A division classified as held for sale.
b. The construction of a factory on a leased site

Part (a)

Areas showing good knowledge:

- Most candidates realised that the division should be classified as held for sale and the net assets shown separately in the statement of financial position.

Areas where mistakes were common:

- Few candidates correctly computed the impairment loss on reclassification and allocated it to goodwill.
- Very few candidates appreciated that the partial reversal of the impairment loss between the date of classification as held for sale and the year-end could not be recognised as it related to goodwill.
- Many candidates did not make the link to treatment as a discontinued operation in the statement of comprehensive income.

Part (b)

Areas showing good knowledge:

- Most candidates were able to identify the basic costs that should be capitalised as part of the cost of construction.

Areas where mistakes were common:

- Some candidates wasted time discussing the lease classification when it was given in the question
- Many candidates computed the capitalised finance costs incorrectly.
- Few candidates appreciated that the factory should be depreciated over 29½ years rather than 30 years.