

Examiner's report

DiplFR

June 2012

The ACCA logo is a black square with the letters 'ACCA' in white, bold, sans-serif font.

General Comments

The June 2012 sitting was the second under the relatively new format that was introduced in June 2011. The June 2012 paper consisted of one 40 mark question and three 20 mark questions. The 40 mark question required the preparation of a consolidated statement of financial position and the practical consideration of a number of other financial reporting issues. Two of the three 20 mark questions were scenario based mixed issue questions. Question two required candidates to evaluate the financial reporting implications of the construction of a complex asset, a share based payment arrangement, a legal case and damage to inventory caused after the end of the reporting period. Question four required candidates to consider the financial reporting implications of the lease of a property and a hedging contract. Question three was a single-issue scenario question requiring candidates to consider various aspects of IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations*.

The pass rate for this sitting was lower than that of June and December 2011. As in previous sittings the performance of candidates was very polarised, with very few marginal scripts encountered. A key impact on the pass rate this time was that many candidates seemed to have a problem with time allocation. This was evidenced either by candidates spending a disproportionate amount of time on question one, when tackling it first, or insufficient time on question one when tackling it last. Time management is a key component of examination technique and one to which candidates should give more attention. I repeat the comment made in last time's report that candidates need 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.

Specific Comments

Question One

This question required the preparation of a consolidated statement of financial position 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 deferred consideration on acquisition of the subsidiary, a financial liability repayable in a foreign currency, and a defined benefit retirement benefit plan to which the parent contributed.

On the whole the standard of presentation of the statement of financial position was good and workings were clearly labelled and easy to follow – suggesting that most candidates are tackling the question in a methodical way.

Areas showing good knowledge:

- Most candidates correctly consolidated the parent and subsidiary but a significant minority of candidates proportionally consolidated the associate Gamma.
- Basic goodwill calculations for Beta – although only a minority of candidates correctly computed the deferred consideration at the date of acquisition. Most candidates correctly identified the fair value adjustments and calculated the correct amount of deferred tax on them at the date of acquisition.
- Most candidates correctly dealt with intercompany balances – although only many also deducted balances relating to trading with the associate
- Most candidates correctly deducted the unrealised profit relating to the subsidiary from inventories – although many included the associate's too, rather than deducting it from the investment in associate.

- On the whole, most candidates made a reasonable attempt at correctly accounting for the defined benefit retirement benefit arrangements. However a significant minority failed to realise that the retirement benefits actually paid would have no impact on the net pension liability.

Areas where mistakes were common:

- Incorrect calculation of the fair value adjustments relating to property, plant and equipment (PPE) at the reporting date. Many candidates were not aware how to do this when part of the PPE in existence at the date of acquisition had been disposed of by the reporting date.
- Impairment of goodwill - common mistake was not taking the goodwill into account for the carrying value so comparing \$70,000 with \$75,000 and saying there was no impairment. Also many candidates forgot to complete the double entry and take the debit to retained earnings and NCI.
- Candidates' performance in accounting for the loan measured at amortised cost but denominated in a foreign currency was disappointing. A significant minority tried to discount the future cash flows using an effective rate of interest and compute a liability and equity component, as if this were a compound financial instrument. This indicated a fundamental misunderstanding of the topic. It may or may not be relevant that question 1 from December 2011 did contain a compound financial instrument and perhaps candidates were influenced by the fact. As already stated, this indicates a basic lack of understanding of the topic. Additionally few candidates seemed able to correctly translate whatever they had computed for the year end liability in foreign currency.
- Few candidates were able to correctly account for the reversal of the post-acquisition revaluation of Beta's PPE to apply with group policy, particularly as regards its impact on other components of equity.

Question Two

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

- a. The construction of a complex asset that was used in the mineral extraction process.
- b. A share based payment.
- c. A legal claim against the reporting entity and a counter-claim by the reporting entity.
- d. Damage to inventory caused after the reporting date.

Part (a)

Areas showing good knowledge:

- Most candidates were aware that the basic costs of constructing the asset, including the provision for restoration at the end of its useful life, should be capitalised and depreciated.
- Most candidates were aware of the need to compute the provision at present value and unwind the discount.

Areas where mistakes were common:

- Many candidates were unable to distinguish between the provision for restoration, which should be capitalised, with the provision for damage already caused by the reporting date, which should be charged to profit or loss.

- Many candidates attempted to provide for all the expected damage, rather than just that damage actually caused by the reporting date.
- The standard of calculations of depreciation and unwinding of the discount was generally poor.

Part (b)

Areas showing good knowledge:

- Most candidates were aware of the principle that the cost of an equity settled share based payment should be recognised over the vesting period.
- Most candidates measured the cost using the fair value of the options at the grant date.

Areas where mistakes were common:

- A significant minority of candidates used the incorrect number of employees when computing the total expected cost of the share based payment.
- A significant minority of candidates stated that the credit entry for an equity settled share based payment was to liabilities, rather than equity.
- Even candidates whose computations were generally satisfactory did not always back up their computations with appropriate explanations, particularly of the difference in treatment of a market and non-market vesting condition.

Part (c)

Areas showing good knowledge:

- Most candidates were aware that the case against the company would result in the recording of a liability, although a number did then go on to state that this would be a contingent liability.
- Most candidates correctly stated that the counter-claim by the company would result in a contingent asset that could not be recognised.

Areas where mistakes were common:

- A significant minority of candidates stated the appropriate provision for a legal case in which \$1 million is claimed, with a 75% chance of success, would be \$750,000. This is unlikely to be correct in the case of a potential obligation with effectively only two outcomes.
- A minority of candidates stated that the appropriate provision would be \$200,000 (the \$1 million claim less the \$800,000 counter-claim).

Part (d)

Areas showing good knowledge:

- The majority of candidates were aware that the damage to the inventory occurred after the reporting date and that this was a significant issue in how it should be reported.

Areas where mistakes were common:

- A significant minority of candidates stated the damage to the inventory was an adjusting, rather than a non-adjusting, event.
- A minority of candidates completely failed to appreciate that the issue was an event after

the reporting date and concentrated on computing the net realisable value of the inventory, a calculation that basically wasn't needed.

Question Three

This concerned IFRS 5 – *Non Current Assets Held for Sale and Discontinued Operations*. Part (a) required candidates to explain the basic terms outlined in the standard, and also how both non-current assets held for sale and discontinued operations should be reported in the financial statements. Part (b) was essentially a practical scenario that illustrated the principles outlined in part (a).

Part (a)

Areas showing good knowledge:

- The majority of candidates were able to explain the meaning of 'held for sale' and the financial reporting implications of classifying an asset or disposal group in that manner.
- The majority of candidates were able to correctly explain that the results of discontinued operations were separately disclosed in the statement of comprehensive income.

Areas where mistakes were common:

- Most candidates' explanations of the meaning of discontinued operations were disappointing. A common cause of confusion was to cite the criteria for recognising a restructuring provision rather than those for reporting a discontinued operation.

Part (b)

Areas showing good knowledge:

- Most candidates were able to correctly compute the overall impairment loss and allocate it to goodwill in the first instance.
- A pleasing number of candidates were aware that impairment losses on goodwill can never be reversed.

Areas where mistakes were common:

- A large number of candidates did not explain how the balance of the impairment loss of \$12 million would be treated after allocating the first \$10 million to goodwill.
- A large number of candidates seemed unaware that there was the partial reversal of the original impairment loss by the year end. Even those that were aware of this were on the whole unaware of exactly how to treat it.
- Despite the requirements of part (a) few candidates seemed aware that there were issues surrounding a discontinued operation in this part as well

Question Four

This question required candidates to:

- Explain and illustrate the appropriate financial reporting treatment of the lease of a property where the lease rentals included a significant premium.
- Explain and illustrate the financial reporting treatment of the purchase of an asset under a contract denominated in a foreign currency where the associated currency risk was hedged by a derivative.

Part (a)

Areas showing good knowledge:

- Most candidates were aware that the lease needed assessing in two parts.
- Most candidates were able to conclude that the land lease was an operating lease but the buildings lease was a finance lease.

Areas where mistakes were common:

- Many candidates made arithmetical errors in allocating the lease payments to the two lease elements.
- Very few candidates realised that the lease premium would result in a pre-payment when applied to the operating lease of land.
- Very few candidates demonstrated an understanding that the amount capitalised on the finance lease was the lower of the present value of the minimum lease payments and the fair value of the asset.
- The standard of classification of the finance lease liability into its current and non-current components was poor.

Part (b)

Areas showing good knowledge:

- Most candidates were aware that in year one the contract to purchase the asset was an executory one that would not be recognised in that year.
- Most candidates were aware that the exchange rate used to recognise the asset in year two should be the spot rate at the date of delivery.

Areas where mistakes were common:

- Many candidates were clearly unaware of the basic principles of hedge accounting and wasted time performing meaningless calculations with the numbers and exchange rates they'd been given.
- A significant minority of candidates did not appreciate that the forward currency contract was a derivative which should be recognised at fair value in the statement of financial position.