Examiner's report
Dip IFR
December 2013

General Comments

The examination consisted of four compulsory questions. Section A contained one question for 40 marks. This question involved the preparation of a consolidated statement of financial position.
Section B comprised three further questions of 20 marks each. These three questions all required candidates to discuss the financial reporting treatment of a number of different issues:

- Question 2 required analysis of the treatment of a financial asset, the treatment of a business segment that was held for sale, and the treatment of a sale and leaseback.
- Question 3 was a single-topic scenario question that focussed on various aspects of deferred tax.
- Question 4 required the computation of the cost and depreciation of a complex non-current asset, and an analysis of the treatment of an equity settled share based payment arrangement.

The majority of candidates attempted all four questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

As in previous sessions, candidates generally performed well in question one, where consolidation skills were tested. Questions two, three and four, being more written in nature, caused more problems for candidates. This is typical of financial reporting examinations, where on the whole candidates are far more comfortable performing computational tasks than analysing and explaining underlying principles. Discussion of the financial reporting treatments was generally not thorough enough in section B. Having said this, in general, the performance in question four was relatively satisfactory whilst questions two and three seemed to cause more problems for candidates. This is outlined in more detail in the specific comments that are made below.

Specific comments

Question One
The standard of the consolidation answers has gradually improved from previous sittings with most candidates understanding the basic principles of control and the difference between a subsidiary and an associate. The principles of calculating goodwill (including the calculation of consideration), investment in associate and group retained earnings were answered well on the whole. Most candidates seemed to know that only intra-group balances for receivables and payables, rather than balances with associates, were adjusted on the consolidated statement of financial position. However there were a number of common mistakes made as listed below:

- The derivative financial asset was often not included in the consolidated statement of financial position although many wrote notes about how it should be dealt with.
- In the deferred tax computation candidates correctly calculated the subsidiary amount on acquisition and the balance at the year-end but then took the incorrect figure to the consolidated statement of financial position.
- Most candidates did not correctly adjust for the 'own goodwill' in the net asset working.
- Many did not understand that the revaluation of non-current assets in the subsidiary needed to be removed. Those that did were not normally able to correctly to compute the impact on pre and post acquisition reserves.
- For the intangible assets most wrote long explanations demonstrating an understanding of the principles of IAS38. However, the application was poor. Many confused the correct amount of intangible to be capitalised with the research element to be adjusted in the consolidated statement of financial position and so deducted $20,000 instead of $35,000.

- Deferred consideration was correctly calculated for the goodwill consideration but many forgot the other side of the double entry and did not unwind and add the interest. Those who did often simply added one year's interest and did not identify the 15 month period.
- The convertible loan workings were often hard to follow. There were a number of mistakes – largely from not understanding how the liability element was calculated. These ranged from applying discount factors to $60 million nominal value instead of the redemption value of $75.6 million to adding up all the interest payments at 8% (despite the question stating that there are none) and discounting these to present value. Then many deducted this from the repayment value instead of $60 million to arrive at the equity figure. The final error seemed to be on calculation of the interest payment where most applied 8% and not 10%.
- For the investment in Gamma many did not deduct the $2 million fair value adjustment (some added it) although it should not have been valued to fair value in the consolidated statement of financial position.
- Many wasted time calculating goodwill for Gamma and then either did not use the figure (the majority) or added it to the associate value.

Question Two
On the whole many candidates failed to score well on this question. Many left out part a, which was the least well answered. As discussed above in the general comments there was too much emphasis on the numbers and very little discussion.

Part a – the financial asset
- Very few discussed the fact that this was valued at amortised cost and even fewer explained why. Some suggested this was a liability not an asset.
- Most identified the initial carrying value of $36 million but applied the effective rate to $40 million and did not apportion for 6 months. Most applied the rules for amortised cost valuation but deducted the 4% receivable to arrive at the carrying value even though this had not been received. This meant that the point about it being a current asset was missed.
- Far too many thought the financial difficulty of Epsilon was an adjusting event according to IAS 10. Therefore much time was wasted calculating impairment values and discussing the rules regarding impairment generally. There were no marks for this.

Part b – the held for sale business unit
Of all the parts to question 2 this was answered the best. Many understood the impairment issue as well as how to allocate the impairment across the assets in the Cash Generating Unit. The main point missed was the discussion of the held for sale rules and why they applied here.

Part c – the sale and leaseback
The majority who answered this correctly identified that it was an operating lease. Some then spoiled this conclusion by stating that the asset would not be de-recognised due to the fact that the transaction was not carried out at fair value. Few candidates addressed the issue of the apparent loss on sale being deferred over the lease term due to below market value lease rentals. Many candidates failed to spot that the transaction took place half-way through the accounting period.

Question Three – deferred tax question

Part a – discussion of tax base and the IAS 12 recognition and disclosure requirements
Far too many candidates simply copied the information from the question and this, of course, gained no marks. Many gave very lengthy examples of where deferred tax may apply and again this did not answer the question. The better answers discussed the asset being deductible but did not go on to talk about the economic benefits and that if benefits are not taxable the tax base is the same as the carrying value. For the liability the explanations were very vague.
It seemed that many simply regurgitated the notes from the exam text and did not try and answer the question set.

Part b – application to three specific scenarios - revaluation of an investment, unrealised profit on an intra-group sale, revenue received in advance taxed on a receipts basis
Generally candidates focussed on the deferred tax issues and did not discuss the current tax ones. This lost about 1/3 of the marks for each section. Other candidates wasted time by lengthy discussions of the non-tax financial reporting implications of each transaction rather than focussing on the taxation aspects as required by the question.

Question Four
This question was generally answered better than the others in section B although very few explanations were given despite being specifically asked for – most candidates simply gave a numerical answer.

Part a – computation of the carrying value of a complex non-current asset
The most common mistakes were:

- Incorrectly taking the land legal fees to the statement of profit or loss.
- Incorrectly deducting the income from the car park from the cost of the asset
- Calculating the interest capitalised for 7 months not 8 and then pro- rating the $100,000 income over the period that the interest is capitalised instead of deducting the full amount.
- Some created a provision for the demolition as $9,200,000 instead of $920,000 because they took 46% and not 4.6%. Others gave detailed calculations and explained how this would be provided for but did not mention the debit entry to the asset. In addition many wasted time discussing the unwinding of the discount to profit or loss – which was not required in the computation of the carrying amount of the asset.
- Failure to apply component depreciation to the asset – some candidates stated that the cost of replacing the roof in 20 year's time would be charged as an expense at that time.

Part b – analysis of an equity settled share based payment
Many candidates wasted time by discussing the difference between cash and equity settled. This was not required. A number of candidates failed to give any explanation for the figures they had used, despite this being a specific requirement of the question. Other common errors included

- Crediting the carrying value in the statement of financial position to liabilities rather than equity
- Updating the fair value of the share price when the value of the option at the grant date would not change.
- Forgetting to pro-rate the charge over the 3 year vesting period.