Examiner's report

DipIFR Diploma in International Financial Reporting
December 2014

General Comments

The examination consisted of four compulsory questions. Section A contained one question for 40 marks. Section B contained three further questions of 20 marks each.

The vast 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.

A majority of candidates answered the questions in the order in which they appeared on the paper. However there appeared to be two other relatively common strategies adopted by candidates:

- Leaving question 1 to the end, possibly on the basis that there was more potential for time over-run on this question.
- Answering the questions in the order that reflected (usually accurately) candidate perceptions of how well they could answer them.

Generally speaking candidates performed well in questions 1a, 2 (all parts), 3a(ii), 3(b) and 4c. Candidates performed satisfactorily in questions 1b and 4b. On the whole candidates found questions 3a(i) and 4a somewhat challenging. This appeared to be due to candidates not having a sufficiently up to date knowledge of recent changes in International Financial Reporting Standards. Question 3 a(i) tested the definition of control in the context of a parent-subsidiary relationship. Question 4a tested the requirement for certain entities to produce segment reports. The standard requirements for both of these topics have been subject to relatively recent change (IFRS 10 and IFRS 8 respectively).

A number of common issues arose in candidate's answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few if any marks.
- Poor time management between questions, some candidates wrote far too much for some questions and this put them under time pressure to finish the remaining questions.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes, especially in relation to the amount of preparation needed for this paper.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One

This 40 mark question tested the preparation of consolidated financial statements . The group consisted of a parent entity, Alpha, and two partly owned subsidiaries, Beta and Gamma. Gamma was acquired part way through the accounting period. In part (a), for 32 marks candidates were required to prepare the consolidated statement of comprehensive income. In part (b), for 8 marks, candidates were required to prepare the summarised consolidated statement of changes in equity.

Many of the consolidation procedures that were required in order to answer part (a) of this question - the need to reflect the impact of intra-group transactions such as intra-group trading and intra-group dividend payments, the treatment of fair value adjustments, the identification of non-controlling interests, and the treatment of a

subsidiary acquired part-way through the accounting period would have been expected by candidates and in the main were dealt with satisfactorily. However a reasonable minority of candidates made one or more of the following 'basic' consolidation errors when answering this part:

- Using proportional consolidation for both subsidiaries.
- Failing to time –apportion the profits of Gamma or time-apportioning the profits for the wrong number of months.
- Failing to appreciate that Gamma's other comprehensive income all arose post-acquisition but that Gamma's dividend was paid prior to the date of acquisition.
- Deducting unrealised profits on intra-group sales from consolidated revenues.
- Reflecting the unrealised profit on intra-group sales when computing the non-controlling interest in Beta and Gamma when the sales were made by Alpha, the parent.

A further required consolidation procedure in this part was for candidates to implement the impact of an impairment review of the goodwill on acquisition of Beta. Beta had four cash-generating units. This procedure was one that would have perhaps been less expected but it is very pleasing to note that the vast majority of candidates were able to perform it to a satisfactory standard.

This part included a number of 'single entity' financial reporting issues that affected the financial statements of Alpha (the parent) and so affected the consolidated financial statements in the same way. These issues were:

- Accounting for the impact of a defined benefit retirement benefit plan.
- Identifying the appropriate amounts to include in a re-organisation provision.
- Accounting for a bond issued by Alpha with an option for the holders to convert into equity shares.
- Accounting for the impact of a perfectly effective cash flow hedge of the foreign currency risk of a firm future commitment.

The majority of candidates coped quite reasonably with all four issues. However, only a minority of candidates were able to identify that the equity component of the bond issued during the period would need to be included in the consolidated statement of changes in equity (see below).

On the whole, candidates were less able to prepare the consolidated statement of changes in equity. As stated above, few candidates appreciated the impact of the issue of the convertible bond on this statement. Similarly, only a minority of candidates realised that the non-controlling interest column of this statement would be affected by the acquisition of Gamma part-way through the year. It would seem that candidates need to give this statement more attention when preparing for the Dip IFR examination.

Question Two

This 20 mark question required candidates to explain and show the financial reporting treatment of three issues:

a) The sale of a machine including post-sale maintenance.
b) The construction of a factory on a leased piece of land.
c) The post year-end settlement of a legal case in which the relevant entity (Delta) was the defendant.

Overall, the performance of candidates on this question was very pleasing. However, a number of specific issues arose in each part that future candidates for this paper may wish to note:

- In part (a) a number of candidates allocated the sale price between the two components of the transaction but then failed to develop their answers by explaining the differing pattern of revenue recognition that should have been applied to each component in the year ended 30 September 2014..
- In part (b) a number of candidates wasted time by discussing the distinction between operating leases and finance leases when the question quite clearly stated that the lease of the land was an operating

lease. A smaller number wasted further time by reflecting on how the 'lease of the factory' should have been treated. This was not necessary given that the factory was constructed, not leased.

- In part (c), whilst the vast majority of candidates realised a provision was required for the damages payable to Chi (the plaintiff), a number of candidates incorrectly stated that the payment of damages was a non-adjusting event. A significant number of candidates, whilst correctly stating that a liability existed, referred to this liability as a 'contingent liability', indicating a lack of understanding of the meaning of the term 'contingent liability'.

Question Three

This 20 mark question required candidates to:
Define 'control' in the context of consolidated financial statements – part a(i).
Explain how goodwill and gains on bargain purchases are computed and accounted for – part a(ii).
Compute goodwill for a given business combination – Epsilon acquiring Kappa (part b).

Answers to part a(i) were of a variable standard. The majority of candidates were aware of the fact that control can be achieved in a number of ways and is considered in accordance with its commercial substance, rather than simply in relation to share ownership. However, only a minority of candidates were aware of the way in which control is defined and interpreted in IFRS10 – *Consolidated Financial Statements*. IFRS10 has become examinable only relatively recently but candidates need to ensure they are aware of all standards as soon as they become examinable.

Answers to parts a (ii) and part (b) were generally of a satisfactory standard. Having said this, a number of candidates struggled to correctly measure the three- part cost of Epsilon's investment in Kappa.

- The share exchange should be measured at the market value of the shares issued by Epsilon.
- The deferred cash consideration should be measured at the present value of the future payment.
- The contingent consideration should be measured at its fair value at the **acquisition date**.

Question Four

This 20 mark question required candidates to answer questions concerning:

a) The reporting of financial information by segment.
b) Equity-settled share-based payments.
c) Non-current assets held for sale.

Candidates did not answer part (a) very well. A significant number of candidates were unaware of any of the requirements of the international financial reporting standard on segment reporting – IFRS 8. Many such candidates made reference to IAS 14 – the predecessor standard to IFRS 8. It has already been stated in this report that candidates need to keep their knowledge up to date and it appears that further attention is required to new standards. Another factor in part (a) was that many candidates did not address the requirements of the question specifically enough. The question asked why the segment reports of two apparently similar entities could be so different. A number of candidates did not really attempt to address this issue, but simply defined the meaning of an operating segment and (in some cases at least) the relevant requirements of IFRS 8.

Answers to part (b) were generally of a satisfactory standard but a significant minority of candidates wasted time by making references to cash settled share based payments. These were not part of the requirement so, whilst

the comments were in many cases correct, they did not score marks. Once again the message here is that candidates must focus carefully on the exact requirements of each question.

Answers to part (c) were generally satisfactory.