# Examiner's report

## Diploma in International Financial Reporting
## December 2016

ACCA

### General Comments

The examination consisted of four compulsory questions. Question 1 was primarily computational in nature and questions 2, 3 and 4 contained a mix of computation and explanation.

Candidates generally performed well on questions 1, 2(c) and 4. Performance was variable on questions 2(a), 2 (b) and 3 (all parts). The detailed question analysis later on in this report provides further detail for this overall assessment.

Question 1 is always a consolidation question and unsurprisingly the majority of candidates seemed to have studied this topic thoroughly and generally scored very good marks. However, candidates must be reminded that they should balance their study across the syllabus in order to ensure that they can answer all sections of the paper.

Following comments made in previous examiner reports, it is worth re-iterating that where the requirements include the verb 'explain' then marks will be given for explanations and candidates who only provide financial statement extracts will not gain full marks. This was much improved compared with recent sittings and it is pleasing to see that tutors and candidates are taking comments made in previous examiners reports on board. The 'explain' requirement is not normally included in question 1. Whilst it is clearly important that the marker can see where figures in question 1 come from, detailed explanations are not necessary and therefore providing such explanations wastes time in the examination. It is very important to read the requirements to see whether or not detailed explanations are required.

A recurring theme of the general comments in examiner's report is that a minority of candidates present themselves for this examination having apparently done little or no preparation for it. It is important to realise that this examination is a demanding one that requires a thorough programme of study in order to achieve success. The specific comments that are made in the next section of the report do not refer to such candidates, who not surprisingly tended to perform poorly throughout the paper. The comments in the next section are derived from the performance of candidates who appeared to have made a reasonable effort to study the syllabus appropriately based on the scripts they submitted.

### Specific Comments

#### Question 1

The scenario for the question was based around a parent entity, Alpha, with two subsidiaries, Beta and Gamma. Candidates were required to prepare a consolidated statement of financial position for the Alpha group as at 30 September 2016. The question incorporated a number of standard consolidation procedures but also required candidates to compute and process the following events:

- The impairment of goodwill on acquisition of Beta, where the non-controlling interest was measured using the proportion of net assets method.
- The inclusion of a contingent element in the purchase consideration for the acquisition of Gamma. The contingent element was still outstanding at the reporting date and its fair value had increased since the date of acquisition.
- The treatment at the date of acquisition of a contingent liability of Gamma that was unrecognised by Gamma in its individual financial statements. The contingent liability no longer existed at the reporting date.

As well as consolidation procedures, candidates also had to account for the expected cost of restoring the site on which a non-current asset had been constructed and brought into use on the first day of the accounting period.

On the whole, this question was answered satisfactorily. Candidates know that question 1 will always be a consolidation question and so understandably study the topic thoroughly. Many candidates obtained extremely high marks here. More particularly, most candidates performed well in the following areas:

- General consolidation procedures – aggregation, elimination of pre-acquisition profits and the computation of non-controlling interests.
- The calculation of the fair value adjustments required due to the acquisitions of Beta and Gamma.
- The calculation of goodwill and (in the case of Beta) related impairment. It was pleasing to note that a majority of candidates realised that the goodwill of Beta had to be grossed up in the impairment review calculation since the non-controlling interest in Beta was initially measured using the proportion of net assets method.
- The elimination of intra-group balances and the treatment of reconciling items. Having said this, a significant minority of candidates incorrectly 'eliminated' the cash in transit by deducting it from consolidated trade payables rather than adding to cash and cash equivalents.

Areas that candidates should work to improve on include:

- A number of candidates misread the information relating to the acquisition of Beta and assumed that the share exchange to effect the acquisition had not been accounted for by Alpha.
- A majority of candidates did not realise that the change in the fair value of contingent consideration since the date of acquisition should lead to an adjustment to consolidated retained earnings.
- Many candidates treated the contingent liability of the subsidiary at the date of acquisition, failing to recognise that this liability should be recognised at its fair value in the consolidated financial statements.
- Whilst most candidates were able to make a reasonable attempt to compute the restoration provision that was initially necessary at the start of the year, many candidates were not able to correctly account for the subsequent impact on property, plant and equipment (in terms of capitalisation and additional depreciation) and on the closing provision (in terms of the unwinding of the discount).

## Question 2

This 20-mark question required candidates to explain and show the accounting treatment of 3 separate issues in the financial statements of Delta:

a) An asset leased by Delta as a lessor under a finance lease
b) The sale of a product to an overseas customer where the customer had a right to return the product within a specified period.
c) A cash settled share-based payment arrangement

In part (a), the majority of candidates realised that the lease was a finance lease. However many candidates did not seem to realise that this involved the lessor recognising a financial asset rather than an investment property (or property, plant and equipment). A large number of candidates incorrectly stated that Delta would depreciate the asset and recognise rental income in profit or loss. This is of course the treatment that would have been appropriate had the lease been an operating lease. A significant minority of candidates answered this question as if Delta were the lessee, rather than the lessor.

In part (b) most candidates were able to correctly quote relevant sections from IFRS 15 – *Revenue* regarding the recognition of revenue. However a significant number of candidates were unable to correctly compute the refund liability that should have been provided for. Common errors here included applying IAS 37 - *Provisions, Contingent Assets and Contingent Liabilities* rather than IFRS 15. This often led to the incorrect conclusion that the refund liability was contingent and should be disclosed, rather than recognised. Even where the need to compute a refund liability was recognised, many candidates incorrectly used 22% rather than 8%, on the (incorrect) basis that the estimate made on 15th October 2016 was a non-adjusting event after the reporting date. It was pleasing to note, though, that most candidates were able to gain some marks in this part by correctly applying the requirements of IAS 21 – *Foreign Currency Transactions* – to this scenario.

Part (c) was generally answered quite well – almost all candidates had the basic idea that the cost should be taken to profit or loss over the vesting period based on the expected number of options vesting. However a minority of candidates appeared unclear of the differences between cash and equity settled share based payments. Common errors included using the fair value at the grant date throughout (that would have been appropriate had this been an equity settled scheme) and presenting the credit entry in equity rather than liabilities (again, this would have been correct had the scheme been equity, rather than cash settled.

Question 3

This 20-mark question required candidates to:

a) Explain the way in which IFRS 9 – *Financial Instruments* – requires financial assets to be classified and measured.
b) Apply the classification and measurement rules for financial assets to three specific transactions relating to Kappa.

Answers to part (a) were mixed. Most candidates were able to identify that there were three different measurement bases for financial assets dependent on the nature of the cash flows and the business model. However only a minority of candidates were able to correctly describe when each measurement basis would be appropriate. A minority of candidates mistakenly thought they were being asked to describe the requirements of IFRS 13 – *Fair Value*. This was not asked for and did not attract marks. Other candidates wasted time by referring to the measurement of financial liabilities and equity instruments – the question was clearly focused on financial assets. Still other candidates made out of date references to the classifications used in IAS 39 – the predecessor standard. A popular reference in this regard was to 'Available for Sale' assets.

Most candidates realised that the loan to the employee (part b(i)) was a financial asset that should be measured at amortised cost. However only about half the candidates realised that the initial carrying amount of the asset (on which the subsequent amortised cost measurement was based) would be the fair value of the loan at its inception (involving discounting).

Answers to part b(ii) were generally rather disappointing. Few candidates appreciated that the three year loan to company X failed the 'contractual cash flow test', meaning that the loan asset would be classified as fair value through profit or loss. A minority of candidates attempted to compute a 'split presentation' of the financial instrument along the lines of a convertible loan treated as part liability and part equity. All in all, answers to this part were unsatisfactory.

Answers to part b(iii) were generally satisfactory. Almost all candidates appreciated that equity investments had to be measured at fair value. However only some candidates mentioned the need to make an election should Kappa wish to measure the asset at fair value through other comprehensive income.

## Question 4

This 20-mark question required candidates, in their capacity as financial controller of Omega, to answer questions from a managing director relating to

a) Disclosure of related party transactions
b) The measurement of tangible non-current assets
c) The accounting treatment of research and development expenditure
d) The difference between listed and unlisted entities reporting under full International Financial Reporting Standards

In part (a) most candidates realised that entity X was a related party to Omega. However only few fully explained exactly why this was so, and that related party transactions are material by their nature rather than on the basis of their size. A few candidates made the erroneous statement that entity X was a subsidiary of Omega and should be consolidated by Omega.

Parts (b) and (c) were generally answered satisfactorily, with a pleasing level of knowledge being displayed by the majority of candidates. Answers to part (d) were more variable. Whilst some candidates scored good marks here, others wasted time by referring to the IFRS for SMEs – the question made it clear that entity X reported under full IFRS. Other candidates referred specifically to the reporting requirements of IFRS 8 – *Operating Segments*, and IAS 33 – *Earnings per Share*. Even where such references were accurate, no marks could be awarded since this was not what the question was asking.