Examiner's report

Diploma in International Financial Reporting DipIFR
December 2017

General Comments

The examination consisted of four compulsory questions. Section A contained question 1 for 40 marks. Section B contained questions 2, 3 and 4 for 20 marks each.

Candidates generally performed very well on question 1 (the consolidation question). There were a number of instances where candidates scored well over half marks on question 1 but performed very poorly on the other questions and so failed overall. It is clearly important to study consolidations thoroughly but candidates should be aware that a good consolidation technique alone is not enough to secure a pass on this paper. Candidates must also give attention to other topics to ensure success.

Most candidates performed reasonably on questions 2 and 4 but performance on question 3 was disappointing overall. Question 3 tested various aspects of IFRS 16 – the new leasing standard. Whilst some candidates produced pleasing answers to question 3 it was evident that many candidates were not aware of the new standard at all. It is essential to keep up to date to ensure success in this examination.

In previous examination reports I have stated that *'a number of candidates lost marks in section B (questions 2, 3 and 4) by failing to provide explanations to support the financial statement extracts they were asked for. Where the requirements include the verb 'explain' then marks will be given for explanations and candidates who only provide extracts will not gain full marks even if the figures in the extracts are 100% correct. Other candidates provided unnecessary written explanations to support the figures they were computing 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.'* This statement continues to be relevant for the current sitting. It is perhaps of particular relevance in the current examination sitting for question 2. This issue will be elaborated upon further in this report.

A related issue to the one discussed in the previous paragraph was the tendency for candidates to write explanations that were correct in principle but which did not address the specific requirement of the relevant question. For example, one of the explanations required in question 4 of this paper (query 3) was the implications of a newly acquired subsidiary having a year-end that was different from the year-end of the parent. When attempting this explanation a number of candidates referred to the need for a fair value exercise and to consolidate the results of the subsidiary from the date of acquisition only. These references were all correct in principle but attracted no marks since the question did not ask for them. It is really important to read all questions carefully before answering them.

A recurring theme of the general comments in my examiners 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 One

The scenario for the question was based around a parent entity, Alpha, with two subsidiaries, Beta and Gamma. Both had been subsidiaries for the whole of the accounting period. As well as the standard consolidation procedures the question required candidates to consider three accounting issues that primarily related to the financial statements of the parent entity – Alpha. These comprised the accounting treatment of:

- A portfolio of investments that were classified as 'fair value through profit or loss'.
- An equity settled share-based payment arrangement.
- A long-term loan issued on the first day of the accounting period that carried an option to convert into equity shares.

On the whole, this question was answered satisfactorily. Consolidation techniques were generally sound and the treatment of the 'non-consolidation' issues mentioned above was satisfactory.

As far as the consolidation issues were concerned, errors that recurred in a significant minority of cases included:

- Providing for only one year's additional post-acquisition depreciation and amortisation on the fair value adjustments relating to the non-current assets of Beta at the date of its acquisition.
- Treating the fair value adjustment to the inventory of Gamma at the date of acquisition as an adjustment to the carrying value of consolidated inventory at the reporting date. The question clearly stated that the inventory of Gamma at the date of its acquisition by Alpha had all been sold prior to the reporting date.
- Adjusting the cash in transit from Gamma to Beta at the reporting date by (correctly) reducing consolidated trade receivables but (incorrectly) reducing trade payables rather than increasing cash.

Errors noted in the 'non-consolidation' issues included:

- Showing the adjustment to the carrying value of Alpha investments classified as 'fair value through profit or loss' as a credit to 'other components of equity' rather than retained earnings.
- Incorrectly computing the cumulative share-based payment adjustment by failing to use the fair value of the share options at the grant date and/or failing to account for the adjustment proportionally over the vesting period.
- Computing the cumulative share-based adjustment (either correctly or incorrectly) but then failing to appreciate that only the current period adjustment needed to be provided for since (as stated in the question) the prior-year accounting was correct.
- Incorrectly computing the 'loan element' of the convertible loan. Common errors here included computing the loan element as the present value of the principal repayment

only or computing the loan element as the present value of the principal repayment plus only the first year's interest payment.

Question Two

This 20-mark question required candidates to explain and show the accounting treatment of 2 separate issues in the financial statements of Delta:

a) A retirement benefit obligation relating to a defined benefit plan of current and former employees.
b) The construction of a power generating facility with a potential decommissioning obligation at the end of its useful life.

As already stated, where explanations are required, marks will be specifically awarded for such explanations and full marks will not be obtained if the explanations are not provided, even where the accounting treatment provided is correct. This was particularly an issue in part (a) of question 2. A significant minority of candidates simply computed the re-measurement loss arising on the actuarial valuation of the plan without any explanations whatsoever of the accounting treatment of the constituent elements of the reconciliation. The computation of the re-measurement loss was often correct but such candidates only scored around half marks by not displaying the knowledge they apparently possessed in the form of supporting explanations.

The issue of failure to back up computational work with supporting explanations was less evident in part (b) of question 2. That said, a number of candidates lost marks by failing to *explain why* Delta had a constructive obligation to decommission the power generating facility at the end of its useful life. Similarly, not all candidates *explained why* depreciation of the facility was required from 1st April 2017 rather than 1st July 2017. Other errors made in part (b) by a significant minority of candidates were:

- Showing the corresponding debit entry to the credit for the provision as a cost in the statement of profit or loss rather than including it as part of the cost of the power generating facility in non-current assets.
- Depreciating the facility from 1st July 2017 (when it was brought into use), rather than 1st April 2017 (when it was available for use – as required by IAS 16 – *Property, Plant and Equipment*.

Question Three

This 20-mark question required candidates to:

(a(i)) Explain the reason why IAS 17 – *Leases* – was replaced by IFRS 16 – *Leases*.

(a(ii)) Explain the usual IFRS 16 requirements for the treatment of leases in the financial statements of lessees.

(a(iii)) Identify any exceptions to the normal IFRS 16 requirements in part (a{ii}).

(b) Apply the provisions of IFRS 16 to a property being leased by Kappa.

On the whole, answers to this question were not as good as they might have been. It was obvious that many candidates were not aware of the new leasing standard or that it was examinable in December 2017. This clearly meant that such candidates scored very few marks in part (a) of this question.

Candidates fared slightly better in part (b) of the question. This was because even candidates who apparently failed to appreciate the impact of the changes introduced by IFRS 16 were able to compute the present value of the minimum lease payments and identify these as creating an asset and a liability for Kappa. Such candidates were often able to gain further marks by computing a depreciation charge and a finance cost. Thus certain marks were gained in part (b) even though underlying appreciation of the impact of IFRS 16 was not always apparent.

There is a clear message here that candidates for this examination should ensure that they are up to date with the topics that are examinable in each sitting and focus their study appropriately. Candidates and tutors are advised to bear this in mind when preparing for future examination sittings.

Question Four

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

1. The contrasting accounting treatment of two equity investments that do not give control over the invested entities.
2. The accounting treatment of the revaluation of a property portfolio with a particular reference to the tax implications.
3. The consolidation of a newly acquired subsidiary whose year-end differed from the year-end of the parent.
4. The requirement to disclose apparently insignificant transactions with a related party

Answers to the first part of the question were generally satisfactory. The majority of candidates were able to explain the contrasting accounting treatment in terms of the differing reasons for making the two equity investments. However the discussion of the implications of gains or losses being reported in profit or loss or other comprehensive income was generally below the standard that might be expected. A minority of candidates did state that amounts included in profit or loss affect earnings per share whilst amounts included in other comprehensive income do not. However very few candidates mentioned that as a listed entity the disclosure of earnings per share was mandatory for Omega.

Answers to the second part of the question were also satisfactory. The majority of candidates were able to appreciate that the revaluation of properties attracts a deferred tax liability under IAS 12 – *Income Taxes* - regardless of the intention (or otherwise) to dispose of properties in the future.

Most were then able to go on to compute the liability. However not all such candidates went on to explain that the deferred tax liability created by the revaluation reduces the credit to other comprehensive income that would otherwise have equalled the debit to property, plant and equipment. A minority of candidates wasted time by talking about the general treatment of the revaluation of property, plant and equipment rather than focussing on the tax aspects.

Answers to the third part of the question could have been better if they had been kept relevant. The question clearly asked about the implications of a subsidiary having an accounting date that was different from that of the parent. Many candidates wasted time by discussing general issues concerning acquisition accounting and the need to consolidate post-acquisition profits only. Even where such discussions are factually correct they will not attract marks unless they relate to the question actually asked.

Answers to the final part of the question were generally of a very pleasing standard. Almost all candidates identified this as a related party issue, with the consequential need to disclose details of transactions. One factor that did discriminate between candidates was the extent of comment on the fact that related party transactions are material by their nature, rather than by their size.