Examiner's report

Diploma in International Financial Reporting (DipIFR)
June 2016

General Comments

The examination consisted of four questions, one question for 40 marks and three questions for 20 marks each, all of which were compulsory.

The majority of candidates attempted all four questions, and the exam seemed to be manageable within the allocated time. As in previous sessions, almost all the candidates focused on Question 1. It is important to demonstrate good time management between questions. There was evidence that some candidates were well trained to differentiate between easier and more challenging questions and this gave them additional time to concentrate on the questions that they were able to score well in. Candidates need to ensure that answers to narrative questions, such as Question 4, are focused on the question asked and do not non-relevant answers.

Future DipIFR candidates are reminded that:

- It is very important to read the question requirement clearly and avoid providing answers that are inconsistent with the question.
- It is important to allow time to ensure that answers are clearly laid out especially in narratives. Q1 in this paper was split into three parts but many candidates did not place their answers under appropriate headings.
- Answers should be focused on the question asked and should not be overly extensive. Candidates should not waste time by providing more than the required number of points. Issues noted in this examiner's report are common issues that are repeated frequently in exams. Candidates should try to learn lessons from earlier examiner's reports in order to avoid making the same mistakes, especially in relation to consolidation process and to the options.

In general, performance in this examination was less satisfactory than in December 2015.

Questions 3 and 4 comprised computational and explanation elements. It was surprising to find that the explanation elements were more strongly answered than the computational elements.

Candidates performed particularly well on questions 1b, 2b, 4b and 4c. The questions candidates found most challenging were questions 1a, 2a, 3b and 4a. This is mainly due to candidates finding the core syllabus areas of IFRS 2 – *Share-based Payments* and IFRS 12 – *Income Taxes*, challenging. Question 4a tested theoretical and practical knowledge of newly amended IFRS 9 – *financial instruments.* This seemed to be surprising for the part of candidates who tried to apply the concept laid out in other IFRS (IAS 36). As a new topic area these concepts should have been prioritised by candidates.

Specific Comments

Question One

This question was split into three parts with 8 marks allocated to the computation of goodwill on acquisition of Beta and Gamma (Q1a) and 7 marks for the consolidated statement of changes in equity.

Q1a. Calculation of goodwill and its impairment was the most challenging component of Q1.

Most of the candidates correctly computed goodwill of Beta. There were candidates who added cost of investment to net assets or subtracted this cost from NA figure. The goodwill calculations are fairly typical calculations that should be practised in advance of the exam.

Goodwill of Gamma was more challenging. Some candidates calculated separate components, but, in fact, forgot to calculate the overall goodwill figure. Not all the candidates succeeded in calculating share exchange figure and non-controlling interest at the date of acquisition which looks strange being rather typical exercise. A number of candidates were not comfortable in correctly calculating the net assets of Gamma on acquisition date.

A small number of candidates incorrectly used the proportionate method in calculating goodwill.

Q1b. The 25-mark question required preparation of the consolidated statement of profit or loss and other comprehensive income of a group consisted of the parent company and two subsidiaries. Investment in the subsidiary one was made before the start of the accounting period and Investment in the subsidiary two – during the accounting year. There were other investments in financial assets measured at fair value through other comprehensive income, intra-group trading, dividend payment and a convertible bond issue during the year.

Most candidates correctly dealt with revenues, cost of sales and inter companies trading, correctly added extra depreciation arriving at fair value adjustment figure. In general, well trained candidates managed to score full marks for this.

Many experienced no difficulties in calculating unrealised profit in inventory though there were some candidates who used mark-up instead of profit margin.

Candidates are reminded to adjust investment income by dividends from subsidiaries, in this case Beta and Gamma. Impairment of Beta goodwill was correctly dealt with by many candidates who understood the need for grossing up. Candidates mostly calculated impairment without making corrections (multiplying by 100/80) and without writing off the 80% of the calculated amount to cost of sales.

Tutors and future candidates must take into consideration the concept of gross impairment. Candidates should be aware about the above mentioned aspects as they are subject to regular examination.

The adjustments to revenue were correctly done by many of candidates. Many candidates are to be commended for correctly calculating deferred service revenue which was rather challenging exercise. Surprisingly, many candidates succeeded in calculating actual price of ‘package’ (A), the sum of fair values of individual components (B) thus calculating the proportion (A/B) used for service revenue calculation and recognizing only 1/8 of the revenue figure. It is important to pay attention to dates to ensure that pro-rating and time periods are applied correctly.

Around half of the candidates correctly calculated losses on finance assets designated at fair value through other comprehensive income and gains on derivatives classified as effective fair value hedges. Candidates must read the exam question carefully to note that the investment is accounted for at fair value through OCI.
A small number of candidates showed the adjustment for contingent consideration in OCI instead of P/L.

Candidates should note that they should calculate non-controlling interest in profits. Some candidates did not note that Alpha measured the NCI in Beta using the proportion of net assets method and subtracted goodwill from NCI. The majority of candidates showed owners' share in net profits but only some of them showed this share and NCI in total comprehensive income for the year.
Calculations of the liability element of convertible loan were generally done satisfactory but candidates must also charge it to the consolidated statement of changes in equity. A common error was discounting the amount upon issue instead of the amount on redemption.
Q1c - Consolidated statement of changes in equity.
Not all candidates attempted this question. Those who knew the topic scored well in this question. Other candidates calculated only dividends and comprehensive income for the year.

The basic preparation of the consolidated statements was satisfactory. On average the candidates scored a good portion of the available marks for Q1b and correctly accounted for the two subsidiaries. Many scored marks for the principle of consolidation despite of some calculation errors. It is important for candidates to understand what they are doing rather than relying heavily on following a set process for working through consolidation.

Candidates should also ensure that they are comfortable with the presentation of the financial statements.

Question Two
This 20-mark question required to explain and show how the three events would be reported in the financial statements of Delta. The question covered the topics of fair value of an option, contingent assets and liabilities, and related parties.

Q2a – **The fair value of an option**
This question for 9 marks based on IFRS 2 – *Share-based Payments* - was generally satisfactory answered.
Many candidates wrote that equity settled share based payment arrangement should be measured using the fair value of an option on the grant date based on the number of options expected to vest according to estimates at the reporting date and earned two marks. Many forgot to mention that the cost should be spread over the vesting period (three years), to correctly calculate the charge to P/L for the year and mention that the credit entry should be to other components of equity (option reserve).
Still it was not a problem for well-prepared candidates to score at least two thirds of marks.
Candidates found it difficult to deal with the re-pricing on 30 September 2015. Candidates sometimes charged the incremental increase in fair value over the remaining vesting period on the same basis as the original charge. This means that the additional credit to equity in respect of the

re-pricing of one option will be based on the increase in its fair value ($1·05 – $0·90) and the number of months in the reporting period related to the remaining period of 18 months (6/18). This ratio was correctly calculated only a few candidates.
Some candidates used the term “option reserve” without stating that this is equity and failed to score any mark because “reserve” may well refer to liability.
As for the employment expense not all the candidates wrote that these should be charged to P/L under operating costs. Mentioning “other comprehensive income” is not correct because there are P/L and OCI at the same time. Mentioning provision or reserve cost is not correct either.

Q2b - Supply of faulty products
Candidates were required to consider the potential liability to pay damages on the claim from customer and the contingent assets to be recognised as assets (potential amount receivable) in the statement of financial position. This was a popular question and many candidates correctly classified a claim to S as contingent asset stating that estimated financial effect is disclosed where the future receipt of economic benefits is probable. But not all of them noted that it was to be included into the disclosure to the Financial Statements.
Many candidates correctly identified the adjusting event but some incorrectly stated the amount recognized as the best estimate of the amount required to settle the obligation. This should be the estimate made just before the financial statements are authorised for issue.
The knowledge of IFRS(IAS) 37 - *Provisions, Contingent Liabilities and Contingent Assets,* and IFRS (IAS) 10 - *Events after the Balance Sheet Date* – was a prerequisite in answering this part of the question. There were many candidates who mixed up contingent liabilities with provisions.
Most part of the candidates mentioned “provision” without any clarification that this is a liability as opposed to part of equity.
Those who simply mentioned that “provision should be created” lost valuable marks for relevant explanation.

Q2c Related parties
The acquisition by the spouse of Delta’s director of the controlling share in X makes Delta and X related parties. It was necessary for candidates not only to mention related parties but also name them and explain why they should be treated as related parties (because he/she is a
close family member of one of the key management personnel of Delta). Not all candidates referred to Delta and X as related parties, some believed that the spouse and X are related parties basing on the control shareholding. Some candidates stated that Delta becomes the parent company for X and should consolidate its financial statements.
Candidates were expected to note that related parties’ data should be disclosed, including the amounts of revenues (after the purchase of controlling share) and outstanding balances were to be disclosed.

Question Three
This 20-mark question was based on IFRS (IAS) 12 – Income Taxes. Despite that this topic is frequently tested during the exams, candidates found it challenging.
Q3a(i) required to define the tax base of an asset as outlined in IAS 12 and use this definition to compute
the tax base of the assets. Not all candidates correctly reproduced the definition and stated that if economic benefits would not be taxable, the tax base of the asset was equal to its carrying

amount. Consequently, the tax base for the machine was correctly calculated by the minority. Many decreased the carrying amount by depreciation charge and a tax deduction.
The tax base on current asset was correctly stated as zero by many candidates though without any relevant explanations.
Q3a(ii) required to define the tax base of a liability as outlined in IAS 12 and use this definition to compute the tax base of the liabilities. As in previous part a(i) the definition was correctly stated only by well-prepared minority. Relatively few candidates mentioned that in the case of revenue received in advance, the tax base of the resulting liability was its carrying amount, less any amount of the revenue which would not be taxable in future periods.
The tax base of a trade payable is equal to its carrying amount because the tax deduction has already been made. The tax base of an accrual is zero because the liability (40) has already been accounted for and its settlement is expected in the future. That means that tax deduction is expected to be 40.
Both hints were given in the text and candidates are reminded to read the question carefully.
Both questions a(i) and a(ii), 4 marks each, were challenging for candidates without in-depth knowledge of the core issues of deferred taxes. It is important to read the requirements of the question carefully to avoid producing non-relevant definitions of the temporary differences, taxable and tax deductible, and deferred tax assets/liabilities.

Q3b (12 marks) required to compute the deferred tax liability of the company and the charge or credit to both profit or loss and other comprehensive income relating to deferred tax.
All three cases dealt with deferred tax liabilities (carrying amount exceeded their tax base). Nevertheless, vast majority of candidates attempted this question focused on explaining why there is DTL as opposed to DTA, and omitting whether a charge or credit is made related to deferred tax. Again, it is important to read and understand the requirements before starting an answer. Many candidates made the mistake of calculating deferred tax without using the balance sheet method. Many candidates calculated revaluation surplus and multiplied it by tax rate. This does not comply with IFRS (IAS) 12 requirements even if correct figures were produced.
Few candidates correctly calculated opening deferred tax balance for investment property and mentioned that it should be charged to P/L. Head office property –many candidates produced correct answers. May be this was due to the hint in the text where carrying value and tax base figure were given. It is important that candidates can calculate carrying amount and tax base after tax deduction, depreciation and revaluation. Only a few candidates scored marks on computing the increase in the deferred tax liability and debiting this increase to other comprehensive income.

Question Four
This 20-mark question required to provide answers to the three queries raised by the managing director who is not an accountant.
Query one for 8 marks required to explain how an impairment review is carried out for Type A financial assets (those measured at amortized cost).
It means that candidates should depict the model of expected credit losses as was stated in newly amended IFRS 9 – *Financial Instruments*. This topic is tested for the first time since it had been included into DipIFR programme (December 2015). That is why there were reasonable expectations for this topic to appear in the exam paper.
Unfortunately, not all candidates were aware of this model. Many candidates simply described three stages of impairment though in the standard there is no such structuring. In doing this they

were demonstrating neither deep understanding, nor knowledge of accurate terminology. In general this was focused on two assumptions:

- in case where credit risk is not significant, the loss allowance is recognized basing on expected credit loss during the next 12 months;
- in case where credit risk increased significantly the loss allowance is based on the credit losses which are expected through lifetime.

Some candidates scored an easy mark mentioning that where financial assets are measured at fair value through profit and loss, any impairment of the asset is automatically reflected in the measurement basis, so no further action is required.

Only few candidates gave the definition of credit loss mentioning discounted cash flows which are expected under current circumstances.

Some candidates described impairment with reference to IFRS (IAS) 39 (old) comparing amortised cost and future cash flows expected from the instrument using initial effective rate and recognizing the impairment loss, which is not in keeping with IFRS 9.

It should be noted once again that answers that do not address the requirements of the question will not be awarded marks. In this particular case there was no need to waste time for definitions of financial instruments, classification of financial assets including criteria, business models for managing FAs, etc. It was no need to describe requirements of IFRS (IAS) 36 – Impairment of Assets - and to compare carrying value with recoverable amount to arrive at the impairment loss. Those candidates who recognized that they were not aware of the impairment of FAs and that IFRS (IAS) 36 is not relevant at least save valuable time missing this question.

Query two for 5 marks required to briefly explain how biological assets are recognized and measured in the financial statements.

This question was very popular and generally quite well answered.

Most candidates know that the initial measurement of biological assets should be at its fair value less costs to sell and that further gains or losses should be recognized in profit or loss.

Some candidates wrote much about biological transformation and changes in fair value but forgot to mention that those changes less costs to sell are to be recognized in profit or loss.

Only a few candidates mentioned that it was necessary to disclose changes in fair value related to the qualitative changes and to changes in market prices.

Query three for 7 marks required to demonstrate knowledge of IFRS (IAS) 8 – *Accounting Policies, Changes in Accounting Estimates and Errors.*

In general, many candidates scored well in this question.

Many candidates scored marks for the correct definition of an accounting policy and providing examples.

Majority of the candidates correctly stated that changes in accounting policy were applied retrospectively, whereas changes in accounting estimates were made prospectively. At the same time there were some candidates who did not provide for the correct description of the meaning of the term “retrospective”. They limited their answers to mentioning that this means the accounting policy applies as if it was used always in the past. The advanced candidates scored marks for mentioning that comparative figures were based on the new policy (rather than last year’s actual figures) and that the opening balance of retained earnings was restated in the statement of changes in equity.