# Examiner's report

## Diploma in International Financial Reporting
## June 2015

### 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 reasonably well on questions 1, 2b, 2c, 3a and 3b(ii). The questions candidates found most challenging were questions 2a, 3b(i) and the whole of question 4. In general, the reason candidates found specific question parts challenging was lack of relevant technical knowledge. In questions 2a and 3b(i) the issues were related to a specific aspect of the relevant topic (financial instruments and share based payments respectively). These matters are discussed in more detail in the specific question comments which appear later in this report. As far as question 4 was concerned many candidates seemed to have insufficient general knowledge of the topics examined (IAS 41 – *Agriculture* – and the IFRS for SMEs). These are both topics that would not be expected to appear in every paper and it appears that many candidates did not study the syllabus in sufficient depth.

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.

A recurring theme of the general comments in my 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.

### Specific Comments

### Question One

This 40 mark question required the preparation of a consolidated statement of financial position for a parent entity with two subsidiaries, one of which was acquired part way through the current accounting period. As well as the standard consolidation procedures the question required candidates to consider a number of accounting issues that primarily related to the financial statements of the parent entity – Alpha. These comprised:

- The restatement of financial assets that were measured at fair value through other comprehensive income.
- The amounts that can appropriately be recognised as part of a restructuring provision.
- The treatment of non-current assets that have been classified as held for sale at the year-end.

- The 'split accounting' treatment of convertible loan notes issued by Alpha at the end 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.

More particularly, most candidates performed well in the following areas:

- Calculating goodwill, especially the calculations of fair value adjustments and the deferred tax on them.
- Dealing with the intra-group balances (although a number of candidates adjusted the payables instead of the cash figure for the group cash in transit).
- Calculating the split of debt and equity for the convertible debt (although a number of candidates tried to compute an adjusted finance cost when the debt was issued on the last day of the accounting period).
- Understanding the method for calculating the non-controlling interests even if the numbers were often incorrect.
- Dealing with the provision for unrealised profit and calculating the related deferred tax.

Areas that were not done as well in some cases were as follows:

- Some candidates, having correctly computed the net assets at the date of acquisition for the purposes of computing goodwill, did not then separate the retained earnings and other components of equity of the subsidiaries into their pre and post acquisition components for the purposes of computing consolidated reserves.
- Some candidates pro-rated the statement of financial position figure for Gamma to 9/12 (since Gamma was acquired 9 months before the year-end).
- A minority of candidates proportionally consolidated the subsidiaries. This has arisen in a number of past examinations. Candidates and tutors should take note of this issue.
- In the retained earnings workings many deducted the provision amounts (that had already been provided for in the draft financial statements) rather than adding back those amounts that were provided incorrectly.
- Whilst most candidates correctly identified the assets as held for sale many did not correctly measure them, *on an asset by asset basis*, at the lower of current carrying value and fair value less costs to sell.
- Many candidates did not include the premium on the shares issued to acquire Gamma in consolidated 'other components of equity'

## Question Two

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

a) The purchase and subsequent exercise of a share option.
b) The sale and lease-back of a property under an operating lease. The sales proceeds and the subsequent lease rentals were at less than fair value.
c) The accounting treatment of an event after the reporting date.

I have already mentioned in this report that where explanations are asked for in the requirement marks will be specifically awarded for such explanations and full marks will not be obtained if the explanations are not given, even if the accounting treatment is correct.

On the whole, candidates found part (a) of this question challenging. A number of candidates did not identify that the share option was a derivative which needed to be measured at fair value through profit or loss. The majority of candidates realised that the shares that were purchased by the exercising of the option needed to be measured at fair value. However many candidates stated that the measurement basis should have been fair value through other comprehensive income, despite the question making it clear that these shares were part of a trading portfolio. This should have led candidates to conclude that the shares should be measured at fair value through profit or loss. As a result many candidates incorrectly stated that the transaction costs should be included in the initial carrying value of the equity investment, rather than being immediately taken to profit or loss.

Part (b) of this question was well answered by the majority of candidates attempting it. Almost all candidates realised that the lease-back was an operating lease and that the lease rentals should therefore be charged to profit or loss on a straight-line basis. However not all candidates stated that the loss caused by the sale and under-value should have been deferred and recognised over the lease term.

Part (c) of this question was also well answered on the whole, with a number of candidates scoring full marks. Some candidates lost marks by concluding that the event after the reporting date was an adjusting, rather than a non-adjusting, event after the reporting date. A minority of candidates misinterpreted this part and discussed the issue of revenue recognition, rather than inventory valuation.

### Question Three

This 20-mark question required candidates to:

a) Explain three specific aspects of the accounting treatment of share based payments under IFRS 2 – *Share based payment*.
b) Show the accounting treatment of both an equity settled (part (i)) and a cash settled (part(ii)) share based payment.

Part (a) was answered well by most candidates. A minority of candidates lost marks by not addressing the questions specifically enough and writing about share based payments too generally. Some candidates repeated information about IFRS 2 that was given in the question. This clearly attracted no marks.

Candidates found part b(i) challenging on the whole. A reasonable number were able to compute the cost based on the initial share award, by basing the cost on the fair value of the option at the grant date and the expected numbers vesting based on the best estimate at the reporting date. However very few candidates were able to deal with the modification to the award that was necessary because of the fall in Kappa's share price in the year ended 31 March 2014. It would appear that in general candidates had not studied this aspect of accounting for share based payments.

Answers to part b(ii) were on the whole satisfactory. Having said this, only a minority of candidates correctly identified the liability as non-current.

**Question Four**

This 20-mark question required candidates to explain the accounting requirements of:

a) IAS 41 – *Agriculture*.
b) The IFRS for SMEs.

This question was not answered well by the majority of candidates attempting it and indeed a reasonable number of candidates did not attempt it at all. As has already been noted in this report, this may be indicative of the fact that these subjects have been regarded as 'fringe' topics and not studied diligently by many candidates. It is very important for candidates to ensure that they have studied the whole of the syllabus.

Part (a) required candidates to explain the applicability of general international financial reporting standards (IFRS) to farming entities and also to outline the main recognition and measurement issues outlined in IAS 41. Candidates were specifically asked about the way government grants relating to agricultural activity need to be accounted for. A number of candidates incorrectly stated that other IFRS do not apply to farming entities. The majority of candidates incorrectly stated that government grants for agricultural activity are accounted for in the same way as other government grants. Most candidates did have some awareness of the concept of a biological asset, and the difficulty of applying the cost concept to the measurement of such an asset. However the general level of knowledge displayed in this part was rather disappointing.

Part (b) asked candidates to outline the main components of the IFRS for SMEs, and explain whether the IFRS for SMEs could be used by a small listed entity. Most candidates stated that the small entity in question could use the IFRS for SMEs, despite the fact that the IFRS for SMEs cannot be used by listed entities, whatever their size. A reasonable minority of candidates incorrectly stated that there was no such thing as the IFRS for SMEs and that all entities have to use full IFRS. A few candidates misinterpreted this part and reflected on the accounting requirements of IFRS 1 – *First time adoption of IFRS*. As in part (a), the level of knowledge displayed in part (b) was rather disappointing.