

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS – FINAL EXAMINATIONS

SUBJECT	SESSION
Advanced Accounting and Financial Reporting	Summer 2007

Overall Feedback

For the first time, open book policy was introduced and the candidates were permitted to bring in the officially published book of IASs / IFRs. The purpose of this open book policy is to allow the candidates more time to understand the concepts and practice the questions by relieving them of tension of memorizing and retaining the standards.

The performance was quiet discouraging. The main cause of poor performance was the candidates' selective study. It was evident that many candidates performed very well in one or two questions but their performance in other questions was very poor. A significant number of students did not attempt question 7 pertaining to financial statements of banking companies. We once again suggest that selective studies should be avoided in professional examinations. Candidates should go through the syllabus and cover each and every aspect in order to achieve a positive result. Moreover, it seemed that some of the candidates had not studied the standards at all and were perhaps of the view that they will be able to grasp them from the book on the day of the examination. This approach should be avoided.

Question-wise comments

Q.1 This was a very straight forward question from IAS-37 "Provisions, Contingent Liabilities and Contingent Assets" and many candidates performed quite well.

- Few candidates correctly mentioned the conditions which need to be met for recording a provision but either they failed to conclude that a provision is to be made or incorrectly concluded that a provision should not be made.
- Majority of the candidates were able to quote the three conditions discussed in IAS-37 and correctly concluded that since all the conditions have been met a provision will have to be made. There were some candidates who mentioned the three conditions but did not give any conclusion. Many candidates incorrectly concluded that the provision should not be made as the case was filed on January 18, 2007 and therefore it was a future event and should be disclosed only as contingent liability in the financial statements. They failed to realize that obligation was created when the employee contacted the management of the company on December 28, 2006 and asked for compensation. The filing of suit, its outcome and the opinion of the lawyer are subsequent events which confirm that the obligation had been created.

- Most of the candidates were not able to draft a suitable note for the financial statements. The main reason for such response was the poor drafting abilities of the candidates. There were many others who did not know what information has to be disclosed.

Q.2 The candidates were required to pass Journal Entries for 'Right Issue' under three different options. Although only simple calculations were involved yet the performance of the candidates was very poor. Some common mistakes are given hereunder:

- Most of the candidates did not know about the accounting treatment of a derivative and resultantly lost marks.
- Few candidates misconstrued the question and created entries in the company's books as if the company has announced a right issue for its shareholders.
- Many candidates were of the view that there should be no accounting of right letter. They were of the view that it should be recognized when the company exercised its right to purchase the shares. According to IAS-39, a derivative is classified as held for trading and is initially recognized at fair value through profit or loss. Moreover, initial recognition should be made when the entity becomes a party to the contract i.e. on the date of book closure. Since right letter meets the requirements of a derivative, it should have been recognized accordingly.
- Most of the candidates didn't know whether the investment in Hunza Foods Limited is to be treated as held for sale or held for trading. They tried to deceive the examiner by not specifying any thing. But such treatment could not gain any favour from the examiners.

Q.3 This question revolved around IAS-27 and IFRS-5. No workings were required. The candidates were simply required to give their opinion based on the above standards.

Our comments on each situation are given as under:

- (a) Most of the students were able to conclude correctly that Balakot Limited will be treated as a subsidiary and a line by line consolidation will be required. They could easily identify that Skardu Limited are in a position to control Balakot Limited on account of the following:
- 43% shareholding
 - Agreement with Mr. Saleem who holds 30% shares
 - Influence as a major creditor

- (b) This part proved difficult for the students mainly because they lacked in depth knowledge of the Standards. Since Mangora Textile (Pvt) Ltd. was acquired exclusively with a view to its subsequent disposal **within a year**, it was not required to be consolidated. It should have been classified as held for sale at the lower of its carrying amount and fair value less costs to sell. Many candidates believed otherwise. Few candidates were able to correctly explain that investments in Mangora Textile should be reported as held for sale but failed to mention the treatment thereof in the financial statements i.e. in the following manner:
- On the balance sheet date, Skardu Limited will have to remeasure the investments in Mangora at the lower of its cost and Rs. 37 million being the fair value less cost to sell.
 - The assets (Rs. 52 million) and liabilities (Rs. 15 millions) will have to be presented separately in the consolidated financial statements from any other assets and liabilities.
- (c) Skardu Limited was in a position to control the operating policies of Mansehra Limited although they only had four out of ten directors on the board. Therefore according to IASs it was required to be consolidated. Most of the students were unable to realize this and concluded incorrectly that it need not be consolidated.

Q.4 Many candidates performed extremely well in this question and secured full marks. On the other hand, many were totally ignorant and could not secure any mark. The mistakes generally committed by some of the average students were as follows:

- In the first option where none of the TFC's were converted into ordinary shares, the students calculated the weighted average number of shares (5,500,000 shares) quite easily. However, in the second option, while converting TFCs into shares, for the purpose of calculating weighted average number of shares, many students did not consider the fact that the conversion took place in the middle of the year i.e. on July 1, 2006.
- Many candidates ignored the effect of tax shield on profit TFCs, which resulted in incorrect amount of diluted earnings.

Q.5 The performance of the candidates was average in this question. Following types of mistakes were common in most examination scripts:

- Many candidates while working out the deferred tax liability for the year 2005, ignored the tax credit available against turnover tax. There were many others who calculated deferred tax for 2006 only.
- Some candidates calculated the impact of addback on account of more than three years old liabilities, in respect of the year 2006 only and failed to

consider the impact of such disallowances on deferred tax liability of the year 2005.

- Surprisingly, a large number of candidates did not know that prior and current year taxes are required to be disclosed separately.
- In many scripts tax on dividend was erroneously omitted.
- In computing the taxable income for the year 2006, some candidates added back the accounting written down value instead of accounting depreciation.

Q.6 This was a very poorly attempted question and most of the candidates failed to comprehend the situation and lost marks. Common mistakes noted by the examiners were as follows:

- Most of the candidates worked out the consideration for acquisition by applying the PE ratio on estimated profit before tax instead of estimated profit after tax.
- Many candidates did not work out the accumulated profit at the beginning of the year and did not complete the profit and loss account beyond the figure of "Profit for the year" .
- Many candidates worked out the dividend of Ayubia Limited by applying the dividend percentage on profit instead of share capital.
- Even at this level some of the candidates did not know how dividend is to be accounted for and booked it net of tax.
- Most of the calculations involved working back various figures. It was evident that most students lacked practice and in a large number of cases conceptual understanding was also lacking. Many of the adjustments were totally ignored whereas in many cases the amounts which were required to be deducted were added back and vice versa.

Q.7 Here again, poor performance was witnessed due to selective studies. A large number of candidates did not attempt this question mainly because they had not bothered to study the relevant disclosure requirements and the published accounts of the bank.

Among those who did manage to attempt the question, the following mistakes were generally witnessed:

- Overall presentation of the answer was very poor and even those who secured some marks were not able to present it in accordance with the legal requirements.

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- Many candidates did not work out the corresponding figures for the year 2005.
- Many candidates did not classify the domestic and overseas advances separately.
- The special provision made on the advice of State Bank was mostly ignored.
- Since the specific provision required and specific provision made was the same, many students did not show them separately.
- Schedule of movement in the provision was missing in most cases.

(THE END)