INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Advanced Accounting and Financial Reporting	**SESSION** Certified Finance & Accounting Professional (CFAP) Examination - Winter 2016

General:

The overall performance in this paper was much below expectations. In fact, it was the poorest performance in the last six attempts. The students generally displayed inadequate knowledge of important concepts and the accounting standards. They also showed poor planning in solving the questions which was most probably due to lack of practice on their part. Several students resorted to lengthy workings where much shorter alternatives were available. The worst performance was in Question 3 which was quite surprising as it was a short question with no complexities and any one with reasonable knowledge of IFRS-15 could have solved it easily.

Question wise comments are given below:

Question 1

According to this question, a company (AL) had entered into an arrangement with another company (BL) to establish two separate vehicles (SV-1) and (SV-2) to manufacture and distribute their products. Extracts from the draft financial statements of AL and the two separate vehicles were provided along with certain other information. The requirement was to prepare separate financial statements of AL after incorporating the relevant information pertaining to the separate vehicles.

The overall performance was quite poor. Approximately 12 percent of the students did not attempt this question which carried 21 marks, and even those students who did attempt, made a number of crucial errors. From most of the answer scripts it appeared as if the students did not appreciate the difference between the treatment of joint operations and joint ventures and did not know how these are to be accounted for. The common mistakes were as follows:

- In the case of SV-1 which was a joint operation, AL had 80% share and accordingly 80% of the assets, liabilities, revenue and expenses of SV-1 should have been included in assets, liabilities, revenue and expenses of AL respectively. However, most of the students consolidated 100% of the amounts. Some of them disregarded the fact that AL held 80% share with effect from July 1, 2015 (beginning of the year) and added only 50% of the amounts.
- SV-2 was a joint venture but instead of applying the equity method for joint venture, several students also accounted for assets, liabilities, revenues and expenses of SV-2 as per IFRS 11.

- Most of the students did not take into account the goodwill on further acquisition of BL's ownership in SV-1. Many students who did compute the goodwill, did not deduct net income of current year from the closing balance of accumulated profit, for determining net assets at the beginning of the year.
- Majority of the students did not adjust AL's interest in the receivables/payables from/to SV-1 in arriving at AL's current assets and liabilities.
- Following common errors were observed in recording of intra group transactions:
  - In case of AL's transactions with joint operation, many students did not book adjustments for the unrealized profit in calculating stocks in hand and cost of sales;
  - In case of AL's sales to joint venture, many students did not adjust AL's share in unrealized profit while arriving at the amount of investment. .
  - In case of sales of SV-2 to AL, most of the students were unable to make adjustment in respect of AL's share in unrealized profit while computing AL's share of profit in SV-2 .

- Many students did not charge-off the acquisition related cost incurred on further investment in SV-1 and included it in the cost of investment.
- In order to calculate closing accumulated profit to be recorded in AL's financial statements as on 31 December 2016, AL's net profit for the year after taking into account of its share in revenue and expenses of SV-1 and its share in net profit of SV-2 should have been added to the opening accumulated profit. However majority of the students were unable to compute it correctly.

Question 2

Approximately 20 percent of the students did not attempt this question pertaining to IAS 36 on 'Impairment of Assets'. Common mistakes were as follows:

- In order to compute impairment of all CGUs, most of the students failed to allocate corporate assets, including goodwill among all CGUs. Those who did allocate the assets amongst the CGUs considered only fair value of assets as a basis of allocation and did not take cognizance of weightage of expected remaining useful life of CGUs.
- According to IFRS 13 criterion of 'fair value measurement', the value of buses should have been determined by taking highest selling price, less estimated transaction cost for disposal. However, several students computed fair value of buses by relating prices of three showrooms with three CGUs i.e. prices quoted by Showroom 1, 2 and 3 for Green, Yellow and Orange respectively.
- The most common mistake was that either students failed to allocate the impairment amount altogether or allocated the impairment amount among the different assets incorrectly because while allocating the impairment, they were unable to follow the sequence specified in paragraphs 104 and 105 of IAS 36.
- Recoverable amount is equal to fair value less cost to sell or value in use, whichever is higher. Some students considered fair value less cost to sell as recoverable amount and ignored the value in use altogether.
- Some students computed impairment of buses separately which is not the correct treatment. Since buses do not generate independent cash flows, impairment should not be determined on an individual asset rather it should be computed on the entire cash generating unit.

Question 3

The question was based on a transaction whereby the owner (TL) of a property had sold it but continued to occupy it by paying rent and under a contract, was also responsible for its maintenance and also had the option to repurchase it after two years at a specified price. The requirement was to prepare accounting entries and offer explanation of the treatment with reference to the appropriate IFRS.

This was the worst attempted question. Approximately 19% students did not attempt it altogether whereas 53% did attempt but could not secure any mark. The performance was indeed, disappointing which is indicative of the selective studies by considerable number of students. A large number of students were not cognizant of the concept that the transaction should not be recorded as a sale because the right to use and repurchase the asset was retained by the seller. Rather, it should be treated as a financing arrangement as the present value of cash outflows was more than original selling price of the asset. Even the few students who recognized that the said transaction is a financing arrangement made the following errors:

- explanation of the accounting treatment as required in part (a) of the question was not offered
- deferred tax on related temporary differences was not accounted for.

Question 4(a)

In this question the students were required to describe the accounting treatment of share-based transactions. According to the scenario, two different sets of conditions were offered to marketing managers and back office managers. Performance in this question was also below average. Major errors noted in the answers were as follows:

- In the explanation of accounting treatment of share options offered to marketing managers:
  - Instead of taking intrinsic value (fair value less exercise price) of share option, some of the students took fair market value of shares to account for the expense;
  - In the event of non-fulfillment of the condition associated with the offer, the expense was required to be reversed. Some students did not offer any comment in this regard whereas many students transferred it to retained earnings.

- While explaining accounting treatment of share option offered to back office managers:

  - Several students failed to clarify that any subsequent change in the probability of meeting the condition would not have effect on expense recognition because the probability of meeting the market based condition was taken into account in determining the fair value of share option at the grant date..
  - While recording the modification in the last year of the vesting period, the entire impact of increase in fair value of the option was to be recognized in 2016, however, some students recognized its impact proportionately for six months.
  - Many students booked the expense of 2016 by assuming estimated number of managers and ignored that 2016 was the last year of vesting period so actual number of managers should be taken to account for the expense.

Question 4(b)

This part of the question was based on a scenario where an investment had been made in five-year bonds with the intention of holding them till maturity. However, the issuer had restructured the payment plan in consultation with the bond holders. The requirement was to describe the accounting treatment in the books of the investor. The performance in this part was below average and only about 20% of the candidates were able to secure passing marks. Very few of the students completed the entire question correctly. The performance of the remaining students may be categorized as under:

- Majority of the candidates had little or no understanding of the accounting treatment and the related issues such as initial and subsequent amount of such investment, basis for recognizing interest revenue and the amount to be reported in statements of comprehensive income and financial position.
- A large number of candidates were not aware that the transaction costs need to be capitalized and ignored it completely. Some of them deducted it from the amount of investment.
- Many students who were able to calculate the effect of change in estimated value of the bond correctly, were unable to describe the accounting treatment of this change.

Question 5

This was a question which required students to compute the amounts to be shown in consolidated cash flow statement under different heads of accounts. This was the best attempted question and about 74% of the students scored passing marks.

The following discrepancies were, however, observed in the answers:

- While determining dividend received from associates and dividend paid to non-controlling interest (NCI), some students did not consider the impact of change in opening and closing balances of investment in associates and NCI respectively.
- In computing changes in working capital, some students did not recognize the impact of change in other current assets.
- While computing net cash flow on acquisition of the subsidiary, bank overdraft of the subsidiary was ignored.

Question 6

This question required preparation of a note on 'Investment by type' for inclusion in the financial statements of a Bank. This question was also reasonably well attempted and about 48% students were able to obtain passing marks. The commonly observed errors were as follows:

- Separate column for securities given as collateral was not prepared.
- In the disclosure of 'Available for sale' investments ordinary shares of unlisted companies were not included.

(THE END)