INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Advanced Accounting and Financial Reporting	Final Examination - Summer 2008

Overall Feedback

Overall performance indicates that students resorted to selective study. Their performance lacked consistency. Many of them secured excellent marks in one or two questions but failed to secure marks in the other questions. The candidates also lacked sufficient practice in solving the questions.

Question-wise Comments

Q.1 The question was poorly attempted although the topic of consolidation is tested in almost every attempt and the question contained relatively simple adjustments only. The following errors were commonly observed:

1. As FL acquired the shares of SL at par, on the date of its incorporation, the question of goodwill did not arise. Many candidates failed to realize this fact and wasted their time in the calculation of goodwill.

2. Some candidates wasted their time in the computation of income taxes and corresponding figures although it was specifically mentioned in the question that taxes are to be ignored.

3. Surprisingly, some candidates reported the investment in the subsidiaries on the consolidated balance sheet which clearly indicated their ignorance as regards the very basic concept of consolidation.

4. While eliminating the gain on sale of plant and machinery, most students reduced the cost of plant and machinery by the full amount, whereas they were required to adjust the cost as well as the accumulated depreciation.

5. While accounting for inter-company transfer of fixed assets, the depreciation expenses were overstated. Most of the students failed to incorporate appropriate adjustment in the consolidated financial statements.

6. While eliminating the inter-company mark up from closing stocks, majority of the candidates did not consider the fact that stock was already written down by Rs. 100 million, in the books of Faisal Limited.

7. Significant weaknesses were seen in the students understanding as regards the treatment/calculation of minority interest. Some students made the following types of errors which are not expected at this level:

   - The figure that is to be reported in the Balance Sheet was reported in Profit and Loss Account and vice versa.

   - The amount in balance sheet was calculated on share capital and opening balance of retained earnings instead of the closing balance i.e. minority's share of current years profit was not taken into account.

8. Some of the candidates adjusted the dividend declared by the parent company with the dividend income of the parent company.

Q.2 According to the question a company had contracted to import plant and machinery from USA. The candidates were required to prepare accounting entries under two different options i.e. if all the payments were treated as (i) advance payment or (ii) progressive payments. IAS 21 "The Effect of Changes in Foreign Currency Exchange Rate" suggests different treatment in each case.

Under Option 1

The asset is capitalized by applying the exchange rate prevailing on the date on which the risk and rewards of ownership are transferred, on the price of assets in foreign currency. The difference between actual payments and the amount capitalized is debited/credited to exchange gain/loss account.

Under Option 2

The asset is capitalized at an amount which is determined by adding up the payments actually made (in local currency) upto the date on which risk and rewards of ownership are transferred plus the amount payable thereafter. The amount payable after the transfer of ownership is converted into local currency at the rate of exchange prevalent on the date of transfer of ownership.

Many of the students did not appear to have studied the topic and were unable to differentiate between the two options and relied on guess work.

The other common mistakes were as under:

1. Many candidates seemed confused and interchanged the above treatments.

2. Inappropriate head of accounts such as Financial Asset Account, Progressive Payment Account, Earned Income Account, etc. were used which was not expected from professional level students.

3. It was clearly mentioned in the question that risk and rewards of ownership are transferred on shipment but surprisingly many candidates debited plant and machinery at the time of first payment. On the other hand, many candidates debited plant and machinery on September 30, 2007 instead of debiting plant and machinery in transit account or the capital work in progress account.

4. Under the first option the asset should have been capitalized at Rs. 6.1 million ($ 100,000 @ 61.00) i.e. by applying the rate of exchange prevailing on the date on which risk and rewards of ownership were transferred which was September 30, 2007, on the amount payable in foreign currency.

   Whereas, under the second option, the plant and machinery should have been capitalized at Rs. 6.09 million (20,000 x 60.5 + 50,000 x 61.0 + 30,000 x 61.0) i.e. the amounts actually paid upto the date on which risks and rewards of ownership were transferred plus the amount payable thereafter, computed at the rate of exchange prevailing on the date of capitalization.

   Most of the candidates failed to compute the two amounts correctly.

5. Very few candidates recorded exchange gain or loss on December 31, 2007.

Q.3 It was a straight forward question based on para 48 and 49 of IAS-31 "Interests in Joint Ventures" and many students were able to secure full marks. The candidates who didn't perform well, usually made the following types of mistakes:

1. In the first transaction, many candidates reversed the loss attributable to CNC Limited for the purpose of consolidation. In fact, no adjustment was required as according to paragraph 48 of IAS-31 the venturer shall recognize the full amount of any loss when the sale provides evidence of an impairment loss.

2. In the second transaction, instead of reversing the CNC Limited's share of profit, some candidates incorrectly reversed the other venturer's share of profit.

3. Very few of the candidates were able to explain the rationale for the gain or loss recorded in the accounting entries. Most of them wasted lot of time as they produced whole paragraphs from IAS-31 while explaining the rationale instead of mentioning the relevant portions only. It also indicates that the students do not have proper grip over the topic.

Q.4 This was an easy question on earnings per share and was well attempted by many candidates. A similar type of illustration (example 9) is given at the end of IAS-33 "Earnings per share".

Some of the mistakes which were commonly observed are as follows:

- Many candidates did not deduct preference dividend from profit after tax, while calculating basic earnings per share for ordinary shareholders.

- Few candidates incorrectly provided the tax shield of 30% on dividend related to preference shares.

- In part (b) many students did not know that they were required to test whether the options available with the preference shareholders and debentureholders had a dilutive or an anti-dilutive effect on the earnings per share related to ordinary shareholders. Very few of the students disclosed the fact that the convertible debentures had an anti-dilutive effect.

Q.5 It was an easy question from IAS-26 "Accounting and Reporting by Retirement Benefits Plan" but probably on account of selective study, very poor performance was observed in most of the answer scripts.

Common mistakes committed by the students were as follows:

- They were unable to differentiate between "Statement of Net Assets Available for Benefits" and "Statement of Changes in Net Assets Available for Benefits".

- Many students could not prepare the note on investment. Some of those who did try to prepare it, did not disclose the movements during the year.

- Most of the candidates did not split the investments between "Held to Maturity" and "Available for Sale".

Q.6 This was an easy question according to which a company has incurred various types of expenses on the development of its websites. The students were required to comment on the accounting treatment of each expense in accordance with the requirements of IAS-38 "Intangible Assets" and SIC-32 "Intangible Assets – Web Site Costs". Many candidates restricted their answers to recommending accounting treatment only. It has been mentioned time and again that a large proportion of the marks are allocated for assigning reasons in support of the recommended treatment but this problem seems to persist although it has reduced significantly. Other significant aspects of the student's performance are discussed below:

- Many candidates recommended that the cost of undertaking a feasibility study should be capitalized as intangible asset. In fact, such costs are incurred in the planning stage and all costs incurred at the planning stage should be expensed out.

- Many candidates were of the view that cost incurred on development of internal web-site should be capitalized as an intangible asset. They failed to read the question carefully where it was mentioned that the management is not in a position to estimate the amount of economic inflows that this website may generate and in such a situation, the expenditure incurred should be expensed out.

- Most candidates were able to figure out that the cost of linking external website to credit card should be capitalized as an intangible asset. However, the reasons given in most of the answers were not very convincing.

- According to IAS 16 "Property, Plant and Equipment", the servers as well as their **operating software** are tangible assets. Several students recommended that they should be capitalized as intangible assets.

- Accounting treatment of website maintenance, personnel training and advertising costs was rather too easy at this stage and almost all candidates declared correctly that such costs should be expensed out.

(THE END)