General Comments
This paper consisted of twenty 2 mark (40 marks in total) multiple choice questions (MCQs) in Section A which are electronically marked and a 60 mark Section B with two 15 mark and one 30 mark question which are professionally marked. Candidates’ performance on both sections was closely correlated and the overall performance has maintained the satisfactory performance of recent diets.

The paper was regarded by most commentators as a fair test of familiar topics which a well-prepared candidate should have comfortably passed.

Section A
As may be expected, the scores on individual MCQs varied considerably and the following comments relate to two questions that were not very well answered.

Question 3
Although most items in financial statements are shown at their historical cost, increasingly the IASB is requiring or allowing current cost to be used in many areas of financial reporting.

Drexler acquired an item of plant on 1 October 2012 at a cost of $500,000. It has an expected life of five years (straight-line depreciation) and an estimated residual value of 10% of its historical cost or current cost as appropriate.

As at 30 September 2014, the manufacturer of the plant still makes the same item of plant and its current price is $600,000.

What is the correct carrying amount to be shown in the statement of financial position of Drexler as at 30 September 2014 under historical cost and current cost?

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<th>historical cost</th>
<th>current cost</th>
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<tr>
<td>A</td>
<td>320,000</td>
<td>600,000</td>
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<tr>
<td>B</td>
<td>320,000</td>
<td>384,000</td>
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<td>C</td>
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<td>600,000</td>
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<tr>
<td>D</td>
<td>300,000</td>
<td>384,000</td>
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Less than a third of candidates got this answer correct.

The correct answer B is worked out as:

Historical cost
Annual depreciation = $90,000 ($500,000 x 90%)/5 years.
After two years carrying amount would be $320,000 ($500,000 - (2 x 90,000))

Current cost
Annual depreciation = $108,000 ($600,000 x 90%)/5 years.
After two years carrying amount would be $384,000 ($600,000 - (2 x 108,000))

Most candidates chose A or C meaning that they did not appreciate that the manufacturer's current list price (of $600,000) was for a NEW item of plant as at 30 September 2014, whereas, at this date, the item of plant
owned by Drexler is two years and the list price needs to be depreciated for two years to give an appropriate current value.

D was the least popular wrong answer and choosing it would imply that a candidate had not taken account of the estimated residual value (of 10%) when calculating the historical cost, but had when calculating the current.

**Question 19**
During the year ended 30 September 2014 Hyper entered into two lease transactions:
On 1 October 2013, a payment $90,000 being the first of five equal annual payments of a finance lease for an item of plant. The lease has an implicit interest rate of 10% and the fair value (cost to purchase) of the leased equipment on 1 October 2013 was $340,000.

On 1 January 2014, a payment of $18,000 for a one-year lease of an item of excavation equipment.

What amount in total would be charged to Hyper’s statement of profit or loss for the year ended 30 September 2014 in respect of the above transactions?

A  $108,000  
B  $111,000  
C  $106,500  
D  $115,500

This question involves a finance lease and an operating lease which require different treatments. The requirement is for the amount of the charge to the profit or loss account for both leases. Observing the dates given, the finance lease charge is based on a full year and comprises of depreciation of the fair value of the plant plus a finance cost; whereas the operating lease charge is an apportionment of the annual rental as it covers only nine months of the current year.

The correct answer is C:

- $68,000  
- $25,000  
- $93,000  
- $13,500  
- $106,000

The most common error was answer A which simply treated both lease payments as the annual charge ($90,000 + $18,000 = $108,000). This wrong on two counts; treating the finance lease as an operating lease and not time apportioning the actual operating lease.

Selecting the incorrect answer of B meant a candidate had treated the finance and operating lease correctly in principle, but forgot to time apportion the operating lease (which would give $93,000 + $18,000 = $111,000).

The last incorrect answer of D meant the candidate, again understood the principles of finance and operating leases, but had treated the finance lease payment as occurring at the end of the year (in arrears) rather at the
beginning of the lease (in advance). Thus the finance charge would have been calculated as $34,000 ($340,000 \times 10\%) instead of $25,000 ((340,000 - 90,000) \times 10\%) giving answer $9,000 more than the correct answer.

Although the answers B and D meant that the candidate got most of the question correct, neither gain any marks which is a feature of multiple choice questions in general.

Section B

The questions in section B covered the areas which in past papers were usually regarded as 'core' topics and as such were generally well answered, particularly Q3 on consolidation.

A welcoming feature of this diet, perhaps due to the new structure, is that most candidates attempted all the required questions in section B, although question 1 was the most often omitted when not all questions were attempted.

Despite the above, there were still some areas of poor examination technique, in particular, not reading (or thinking about) the question requirements carefully enough. This was particularly true of Q1 (ratio calculation and interpretation) where a number of candidates calculated and discussed ratios that were not required and provided a revised statement of financial position. This wasted considerable time and, no matter how accurate the calculations may be and how good their interpretation, this gained no marks.

Other familiar poor examination technique issues were: a lack of understandable workings for figures and poor handwriting that many markers struggled to read.

Report on individual questions

Question One

The scenario of this question was that an acquisitive company was seeking to acquire an investment in another company as part of an expansion programme. The target company’s results had been favourably influenced by it being one of several family owned businesses. It had received a favourable price on its purchases, a lower charge for directors’ remuneration (based on commercial rates of remuneration) and effectively received interest free directors’ loans.

Four ratios for the company (based on the presented results) and the sector averages were provided in the question.

Requirement (a) asked candidates to recalculate the given ratios after making appropriate adjustments for the favourable treatments.

Many candidates made a good attempt at the adjustments, the most problematic was an inability to correctly gross up the actual cost of sales by the 10% discount given by another family company. Many calculated it at $4.5 million (10% of the $45 million cost of sales) apparently not realising that the cost of sales represented 90% of the ‘full’ cost and thus the discount was $5 million ($45 million/90% - $45 million). A number of candidates reduced the cost of sales to $40.5 million and others even reduced revenue by 10%. A substantial number of candidates added the new amount directors’ remuneration to the old amount, whereas the new amount replaced the previous remuneration.
Other common errors were when calculating return on equity (ROE) many candidates instead calculated return on capital employed (ROCE), which is a very different ratio, and using equity (rather than capital employed) for net asset turnover. Despite this, most candidates scored quite well with some gaining full marks.

Part (b) required candidates to comment on the performance of the target company (based on the given and their adjusted ratios) in comparison to the sector average. Some did quite well; the main issue, relating to most of the ratios, was that the performance based on the reported results showed the company to be performing much better than the sector average, but when the favourable effects of being part of a family group were removed, the company's performance was much closer, but still slightly better, than the sector average. Less well-prepared candidates simply reiterated the ratios without any real attempt at interpretation, often saying nothing more than the ratios were higher/lower than the sector averages.

Question Two
This question was a shortened form of a traditional preparation of a single company's financial statements requiring a schedule of adjustments to retained earnings figure (part (a)) and the preparation of a statement of financial position (part (b)) from a summarised trial balance (i.e. after a draft statement of profit or loss had been prepared). Adjustments were required for: the issue of a loan note with an effective interest rate different to the nominal rate (due to issue costs and a redemption premium); a revaluation of land and buildings; depreciation and income and deferred tax calculations. This question was generally well answered with most candidates showing a sound knowledge of preparing financial statements. Most of the errors by candidates were made within the adjustments:

- The loan note issue costs were sometimes added to (rather than deducted from) the issue proceeds (with consequential effects on the calculation of interest charges and the loan carrying value in the statement of financial position). In this case only the initial error caused marks to be lost provided the correct method of calculation had been used.

- Most did well with the revaluation, but some forgot to include the revalued amount of the land (in the carrying value of the assets) and some incorrectly depreciated the land. Some candidates that had calculated the carrying amount of the land and buildings (and the plant) did not adjust the retained earnings for the related depreciation in part (a); others incorrectly included the revaluation surplus as part of their calculation of retained earnings.

- The deferred tax seem to cause the most problems; many correctly calculated the movement on deferred tax for the year at $1.9 million, but they then debited the whole of this to profit or loss (via the schedule of adjustments to retained earnings). However deferred tax of $2.4 million related to the revaluation of the land and buildings and should have been debited to the revaluation reserve leaving a credit of $500,000 ($2.4 million - $1.9 million) as the correct adjustment to retained earnings.

A significant minority of candidates did not prepare a schedule of adjustments to retained earnings (as required by part (a)) even where the relevant figures had been calculated as part of the preparation of the statement of financial position. This left markers trying to allocate some credit for these items in the workings. This was especially true of the depreciation and income tax charges. This is an example of poor examination technique on the part of those candidates.

Generally the answers to the statement of financial position were quite good and most errors related to previously mentioned issues.
Question Three
In part (a), this question required candidates to prepare the consolidated statement of profit or loss and other comprehensive income and the consolidated statement of financial position for 27 marks, with a short three-mark written part (b) on the recognition of intangible assets at acquisition. Part (a) tested fair value adjustments, intra-group trading with unrealised profits (URP) and cash in transit, an intra-group loan and a goodwill impairment.

Part (a) was generally done very well and was the best answered of the section B questions. The majority of candidates have a good understanding of the principles of consolidation. Nearly all candidates did time apportion (pre- and post-acquisition) profit or loss items and there were very few examples of (incorrect) proportional consolidation. There were however some recurring errors of principle in relation to pre- and post-acquisition adjustments; several candidates treated the post acquisition additional depreciation on the fair value of the plant (and sometimes the URP on inventory) as part of the goodwill calculation at the date of acquisition. Another common error was the incorrect determination of the subsidiary's pre-acquisition profit. Several candidates took the subsidiary's retained earnings at the year-end and added to this the post acquisition share of the subsidiary's profit for the year. The correct calculations were either to deduct the post-acquisition element (9 months) of the subsidiary's profit for the year from the retained earnings at the year end, in effect, working back to the pre-acquisition profit or to calculate the subsidiary's retained earnings at the start of the year and add the pre-acquisition element (3 months) of the subsidiary's profit for the year, in effect working forwards.

The main errors on the consolidated statement of profit or loss and other comprehensive income related to:

- a deduction of 12 months ($300,000 x12) intra-group sales from revenue (and cost of sales); it should only be the post-acquisition sales of 9 months ($300,000 x 9)
- URP in inventory was calculated as 25% x $600,000 (i.e. as a gross profit margin) rather than 20% (25/125) x $600,000 (a mark-up on cost) and sometimes even the whole of the inventory was treated as the URP amount
- additional depreciation of the fair value of plant was sometimes ignored or even time apportioned, although the question stated this charge specifically referred to the post-acquisition period
- the goodwill impairment was sometimes deducted from administrative expenses, in effect treating it as income and this was sometimes time apportioned
- very few candidates got the finance costs amount entirely correct. This was mainly due to the unwinding of the deferred consideration; some completely ignored it, some based it on $1.98 million rather than the discounted (at 10%) $1.8 million and many included a full year's cost ($180,000) rather than only the post-acquisition amount of nine months ($180,000 x 9/12).
- Many candidates also included a full year's interest on the intra-group loan ($100,000) although as this was accepted on the year-end date there would be no interest charge for the year (even if there was it would have to cancel with the issuer's interest income)
- the correct reporting of the property revaluation (of the subsidiary) within other comprehensive income was very mixed; some candidates incorrectly took in the pre-acquisition fair value increase of the subsidiary's property ($4 million) and some (also incorrectly) time apportioned the post-acquisition increase of $600,000
- several candidates did not attempt to calculate a non-controlling interest in the profit for the year, and even fewer in the total comprehensive income.

Comments on the consolidated statement of financial position:
Many errors in the statement of financial position were ‘knock on’ errors from calculations made when preparing the statement of profit or loss and other comprehensive income and, as such, were not marked as being...
incorrect. This particularly applied to the revaluation and additional depreciation of plant, URP in inventory, revaluation surplus, non-controlling interest and deferred consideration (although this item was often completely omitted).

The calculation of goodwill generally scored well, but errors were made in the calculation of the consideration mainly due to using incorrect share prices, and the previously mentioned determination of the pre-acquisition retained earnings.

There was some confusion over the cancellation of intra-group trading and cash in transit (CIT); the elimination of the payables/receivables was often reversed and the CIT added to inventory or receivables, also the bank balances were sometimes incorrectly netted off (which is not allowed as the parent and subsidiary are separate legal entities). A significant number of candidates adjusted the subsidiary's bank balance for the CIT although the question stated that all cash timing differences should have been adjusted in the parent's financial statements (thus reducing the parent's reported bank overdraft).

Several candidates did not account correctly (or at all) for the share exchange increasing share capital and share premium. The non-controlling interest in the statement of financial position was often confused with the non-controlling interest in total comprehensive income.

Many candidates missed marks on retained earnings by not deducting URP on inventory and/or the finance cost on the deferred consideration.

Part (b) asked candidates to consider if a subsidiary's in-process research costs and a list of customers were intangible assets that should be recognised separately (to goodwill) on consolidation. The short answer to this is they both should be, however most candidates thought the first shouldn't be. In-process research is an example of where its treatment in the entity financial statements (it should be expensed) differs to that on consolidation, where it should be recognised if its fair value can be reliably measured.

**Conclusion**

Overall this was an encouraging performance with many candidates displaying good knowledge and technique. Many of the above comments on the individual questions focus on where candidates made errors. This is intended to guide candidates' future studies and to highlight poor techniques with a view to improving future performance. This may appear to give an overly pessimistic view of candidates' performance. This is not the intention, nor is it necessarily the case. There were many excellent scripts that were rewarded appropriately.