

FINANCIAL REPORTING 4

APRIL TEST EXAMINERS COMMENTS

QUESTION 1

Part 1

- This question was difficult, as the required was quite open ended and required students to actually think about and identify the main issues, before discussing them.
- Many students approached all these contracts in a similar manner, discussing the 5-step revenue recognition process, including the performance obligations and whether revenue is accounted for at a point in time or over time. The required specifically indicated that this wasn't required. It was necessary to identify the actual issue for each of the contracts.

Contract A:

- The main issue with contract A was the identification and discussion of the material right for the free units to be allocated to the Department. Unfortunately, very few students identified this despite being very little else to discuss with this contract.
- Furthermore, many students that did identify that there was a material right contradicted themselves in their conclusion by not allocating any of the transaction price to this separate performance obligation and indicating that R20m of revenue should be recognised in 2019.
- Many students wasted time with too much discussion on performance obligations in general and whether revenue should be recognised over time or at a point in time.
- Many students incorrectly made the argument that the additional goods for no charge represents variable consideration, which was not applicable and the consideration was set at R50 million and therefore cannot be variable.
- Overall, students struggled to score marks in their discussion as they did not identify the material right and as a result their discussion was limited to general performance obligation discussion as well as when to recognise the revenue.

Contract B:

- Most students identified that the issue with this contract was the timing of the revenue recognition and discussed the no alternative use as well as enforcement right provision, which was the correct issue to be discussed.
- However, many students' discussion on the measure of progress and how to account for this contract was limited.
- In most cases, students concluded on an output measure, which was not in line with the scenario given. This indicated that they didn't take into consideration the clause the department will pay regardless of whether the units were transferred or the contract cancelled.
- Nonetheless, most students did better in this part of the question than in Contract A.

Contract C:

- Most students could identify what the issue here was but did not articulate themselves well.
- Many of the students just included the provisions of the standard with limited application to the actual scenario and thus could not get all their marks.
- For the financing component some students end up concluding that the practical expedient was applicable and did not account for time value of money.

- Some students still discussed the performance obligations here which was not relevant, thus indicating a blanket approach to all contracts.
- Students who identified and variable consideration and applied it to the issues at Nepsa actually did well in this part of the question.

Part 2

- Most students' discussion of this part of the question was a lot better than part 1.
- Most students could identify that this was an intangible asset transaction and applied IAS 38.45. However, the issues which were pervasive here was that students actually did not apply the provisions of paragraph 45 of IAS 38 well to the scenario.
- The issue of commercial substance was not discussed or was poorly discussed.
- The issue with the fair value measurement was touched upon, however, some students completely ignored the application of this even though they had mentioned it.
- Students reached the conclusion that the fair value of the asset being obtained could not be determined and as a result they measured the asset using the CV of the asset given up instead of the FV.
- There was a good understanding on the retained marketing rights and the application of this was well done to the information included in the question.
- Some students spent too much time on discussing the definition of an asset, which was not necessary in this question and in most instances concluded that there was no asset.
- Some issues identified here were also the fact that IFRS 16, IFRS 15 and IFRS 13 were discussed. This was an indication that a student would've missed that the assets being exchanged were intangible assets.
- Very few students actually calculated the correct amount to be recognised in the financial statements.

Part 3

- This part was well attempted with most students passing this part.
- The issues which were passive here was that application of IAS 19 on termination benefits was poorly done.
- Limited discussion was made on the actual restructuring which in most instances impacted on their overall mark for the question.
- There were a lot of students who also focused their discussion on the definition of a liability as well as the recognition criteria.

Overall:

- Overall the question was well attempted.
- Some students lost marks because of their application or limited application of the information in the question.
- Exam technique is something that the students should work on for discussion questions as this played a role in their final mark for the question.
- Time management also played a huge factor here as some students may have started with Q2 and did this question last.

QUESTION 2

Overall, this question was straight forward with very few complications or unusual issues to be dealt with. Students who understood their calculation principles should have performed very well in this question, and some did.

Part 1

- This question was fairly well answered, with most students getting the principles correct but not executing those principles effectively to achieve all the marks.
- The majority of students did not recognise the machinery at its original cost when the machinery ceased to be held for sale but rather recognised it at the carrying amount on the 1st of October 2018 (date machine ceased to be held for sale). Note that the machine needs to be recognised at its original cost with any related accumulated depreciation at that date being recognised.
- Some students wrote-down the machine to its recoverable amount when the machine was classified as held-for-sale. This is incorrect as a non-current asset held-for-sale is initially recognised at the lower of its carrying amount and **fair value less cost to sell**.
- Some students recognised an additional impairment of the non-current asset held-for-sale to the new fair value less cost to sell on the date it ceased to be held for sale. This is incorrect as the non-current asset held-for-sale is ceased as held-for-sale at that date and there is no need to process a subsequent write-down to fair value less costs to sell as indicated in IFRS 5:20.
- The majority of students omitted the depreciation expense that would have been processed for the period 01/04/2018 – 31/09/2018 if the machine had not been held-for-sale.
- For the deferred tax calculation, many students used a recovery rate of 22.4% for the opening balance of the deferred tax relating to the machine. This is incorrect because even if the asset was held-for-sale, the carrying amount for the machine at the 31/03/2018 was not greater than the original cost, thus the temporary difference recognised would be recovered at 28% (due to the recoupment of any previous tax allowances being taxed at 28%).
- Some students recognised the deferred tax balance amount at the end of the year for the deferred tax journal entry. Please note that the **deferred tax movement** is the amount that needs to be used when processing the deferred tax journal entry for the year.

Part 2

- Students who did not run out of time generally performed well in this question. There were many principle errors (which are outlined below) but students were still awarded method marks and their errors were worked with.
- It was worrying to see that many students presented their statement headings as *Statement of Financial Position for the year ended* and *Statement of profit and loss as at*. This is not expected at a Financial Reporting 4 level.
- Many students changed the measurement of the lease liability on the 1 April 2018 to reflect the new incremental borrowing rate. At that date neither a change in the lease term nor a change in the assessment of an option to purchase the underlying asset occurred (as per IFRS 16: 40) and thus the new incremental borrowing rate should not have been used.
- In many cases students used the correct inputs in the calculation of the PV of their lease liability, yet presented the incorrect answer. It is clear that students are struggling to use their financial calculators. If you are struggling with using the financial calculator please refer to the videos “Using a Financial Calculator: Time Value of Money (TVM) – Part 1” and “Using

a Financial Calculator – Part 2” under the **Financial Skills** section on <http://learnaccounting.uct.ac.za/>

- The reassessment of the likelihood of exercising the option to purchase the machine occurred on 31 March 2019. Some students adjusted the lease liability and right-of-use asset on the 1 April 2018 and calculated depreciation and interest based on these new balances. Note that it is incorrect to adjust the opening balance of the lease liability and right of use asset as the change in assessment occurred at the end of the year and should be applied from that date onwards.
- Many students depreciated the right-of-use asset over the lease term, which is incorrect in this case as the lease transfers ownership of the underlying asset to the lessee by the end of the lease term and as per IFRS 16:32 the right-of-use asset should therefore be depreciated over the **useful life of the underlying asset** (i.e. 6 years).
- The majority of students omitted the current tax consequences of the lease payment of R55 000 in their statement of profit and loss.
- It was pleasing to see many students realising that the tax base of both the right-of-use asset and lease liability would be zero.
- Many students picked up that the right-of-use asset would be limited to zero after adjusting for the reassessment of exercising the option to buy and recognising the excess amount in profit and loss.