Examiner’s report

P2 Corporate Reporting
December 2011

General Comments
Candidates’ scripts were of varying quality and reflected the degree of understanding of the subject matter. There were elements of the paper where application of knowledge and understanding was of paramount importance and some candidates failed in this regard. Many candidates passed the examination because of strong performance on question 1 and the questions answered best by candidates were questions 1a, questions 3(a/c), and question 4(a)(i)

The general weakness amongst most candidates continues to be that they fail to make a reasonable attempt at all parts of the questions they choose. This can either be no response at all or answers that only briefly outline the subject area. There is a need for more comprehensive answers in order to justify a pass mark on the question.

In section B answers are often very general in nature with no relationship to the facts given in the scenario. This can involve just repeating information given in the question without explaining how it impacts on the financial statements or just quoting facts from standards without reference to the question. This can result in long answers that often don’t address the issues in a scenario and may leave candidates bemused as to why they have failed when they have written so much. Often these scripts bordered on illegibility, which makes marking difficult. It is often better to explain a few points well than trying to regurgitate all the knowledge that the candidate possesses. There were however many excellent scripts, particularly in answering the technical aspects of group accounting and the issues surrounding intangible assets.

Finally a small number of candidates answered all 4 questions. This occurrence seems to be increasing but it is unwise as candidates are penalising themselves by not spending sufficient time on each question.

Specific Comments

Question One
This question required candidates to prepare a consolidated statement of financial position for the Traveler Group. The question included the calculation of goodwill arising on the acquisition of subsidiaries using both the full and partial goodwill methods. Additionally, goodwill was impairment tested, thus candidates had to determine whether goodwill was impaired in situations where goodwill had been calculated using both methods set out in IFRS3 Business Combinations.

Traveler also held a ten-year loan, which was held at amortised cost, but Traveler now wished to value the loan at fair value. Traveler had agreed for the loan to be restructured. Thus candidates had to determine, if under IFRS 9 Financial Instruments, the loan could be fair valued and also had to impairment test the loan.

Candidates also had to use component accounting in relation to a non-current asset and had to account for the entity’s pension scheme, which showed a surplus. The pension scheme also wished to reduce its contributions, which were paid shortly after the year-end.

On the whole candidates demonstrated a good knowledge of the consolidation process together with calculation skills for the accounting adjustments needed to the parent’s financial statements. A range of different methods was used to perform the consolidation and candidates were not penalised for using a different method to the model answer. It is important however to lay out answers in a logical and understandable manner.
Candidates performed well in the calculation of full goodwill but many candidates did not complete the partial method of calculating goodwill successfully. This problem was exacerbated when candidates’ impairment tested goodwill. Full goodwill was impairment tested correctly in most cases but the unrecognised goodwill on the non-controlling interest, which represents the grossing up of goodwill for the purpose of impairment testing partial goodwill, was not included in many candidates’ answers.

The impairment loss on the financial asset was calculated by discounting the annual payments using the original effective interest rate. Most candidates recognised the need to discount the future cash flows but many used the incorrect discount rate. Candidates accounted for the defined benefit pension scheme very well but often did not recognise that there was a ceiling placed on the amount to be recognised as an asset. This element of the syllabus is quite difficult and therefore the mark allocation reflected this fact.

Traveler had a factory that required component accounting. The entity could not treat the roof and the building as a single asset and therefore should treat them separately. This procedure was not carried out successfully in many cases. The confusion seemed to arise over the relative length of lives of the two components and over the treatment of the residual value.

Candidates are generally performing well on the group accounting question in the paper but still seem to be spending a disproportionate amount of time on the question. Full goodwill is well calculated but the adjustments to the financial statements require candidates to deal with situations which may not be familiar to them. Thus candidates are required to use the principles which they have learned. Application of principles seems to be an issue for some candidates.

Common weaknesses of answers included:

- Ignoring the change in ownership interest
- Calculating impairment by simply comparing goodwill to recoverable amount without considering the net assets or fair value adjustment
- Not calculating a movement in equity for the non controlling interest change
- Including OCI changes in retained earnings rather than other components of equity

In part b of the question, Traveler had three distinct business segments and the management was unsure as to how they should allocate certain common costs and whether they can exercise judgment in the allocation process. Candidates were required to advise the management of Traveler on these points. This part of the question was not well answered by candidates and some candidates failed to answer it at all. This is a mistake as marks can readily be gained by applying simple accounting principles in questions such as this. It is the ability to apply principles, which is being tested just as much as the principles themselves. This reinforces the point made in question 1a. Many candidates wrote detailed answers about the requirements of IFRS 8 for identifying segments rather than the question set or candidates wrote generally about allocation rather than addressing the specific issues in the question.

Part c of the question required candidates to discuss how the ethics of corporate social responsibility disclosure are difficult to reconcile with shareholder expectations. The ethics of corporate social responsibility disclosure are difficult to reconcile with shareholder expectations as companies must remain profitable and there may be conflict. There is no ‘correct’ answer to such a question and therefore candidates can express their views within certain parameters and gain marks. Candidates cannot gain marks if they do not answer the question. Question 1b and c are critical to candidates. They often represent the difference between pass and failure especially if they are not answered

Question Two

This question required candidates to prepare the individual entity statements of financial position after a proposed restructuring plan, to set out the requirements of IAS 27 Consolidated and Separate Financial Statements as regards the reorganisation and payment of dividends between group companies, and to discuss the implications of the restructuring plan.

This question tested restructuring for the first time under the revised syllabus. The numerical part of the question was similar in format to a past question but differed in terms of the adjustments required. This question required candidates to apply a series of accounting adjustments, which were laid out in the question. It did not require detailed knowledge of IFRS but the ability to apply accounting techniques. There were several adjustments to be made which were quite simple and required a logical and systematic approach.

Candidates performed quite well on the numerical part of the question but often seemed to find it difficult to apply the requirements and often made basic mistakes due to not reading the question thoroughly. For example, the holding company sold an investment in a subsidiary to another subsidiary. Many candidates left the investment sold in the financial statements of the holding company.

Part aii of the question was poorly answered. The amended IAS 27 allows the cost of an investment in a subsidiary, in limited reorganisations, to be based on the previous carrying amount of the subsidiary rather than its fair value. This point is quite difficult and again the marks reflected this. However, it is important for candidates to understand that IAS 27 will require all dividends from a subsidiary, jointly controlled entity or associate to be recognised in profit or loss in its separate financial statements. The distinction between pre- and post-acquisition profits is no longer required and the payment of such dividends requires the entity to consider whether there is an indicator of impairment. This is a point fundamental to the preparation of group accounting and will be examined again.

Part b of the question required the key implications of the restructuring to be discussed. Candidates' answers were disappointing because many did not realise that the reconstruction only masked the problem facing the group. It did not solve or alter the business risk currently being faced by the group. As discussed above, application of principles was required here. Rote learning of IFRS would not have helped candidates in this question but understanding certainly would.

Question Three

This question required candidates to discuss the validity of certain accounting treatments proposed by an entity in its financial statements. The question required candidates to deal with internally generated intangibles. Candidates automatically assumed that the accounting treatments were incorrect but in this case the entity was correctly expensing maintenance costs, as these did not enhance the asset over and above original benefits. Similarly, the decision to keep intangibles at historical cost is a matter of choice and therefore the accounting policy outlined in the question was acceptable. Candidates answered the part of the question, dealing finite or indefinite life and impairment, very well. Similarly, candidates realised that the way in which the entity determined its value in use for impairment testing purposes did not comply with IAS 36 Impairment of Assets. However the fact that the cash flow projections should be based on reasonable and supportable assumptions, the most recent budgets and forecasts, and should be assessed for reasonableness, was not often included in answers.

In part b of the question, candidates realised that the calculation of the discount rate was not wholly in accordance with the requirements of IAS 36 but did not often set out that this was because the discount rate applied did not reflect the market assessment of the contributing factors and that if a market-determined asset-specific rate is not available, a surrogate must be used.

Further again candidates felt that the entity had not complied with the disclosure requirements of IAS 36, but were not sure why this was the case.

Part c dealt with the identification of intangible assets in a football club in the form of registration rights of players and agents fees. The definition of an intangible asset was well expressed by students and candidates realised in most cases that the players' registration rights met the definition of intangible assets. However very few candidates stated that the agents' fees represented professional fees incurred in bringing the asset into use and therefore could be included in intangibles.

The final element of the question dealt with the situation where an entity purchases the rights to a proportion of the revenue that a football club generates from ticket sales. This part of the question was answered well with discussion as to whether the entity has acquired a financial asset. Candidates realised that where the entity has no discretion over pricing or selling of the tickets and is only entitled to cash generated from ticket sales, this represents a contractual right to receive cash but if the entity had purchased the rights to sell the tickets for a football club, and was responsible for selling the tickets, then this would create an intangible asset. The correct answer in fact was that the entity had a financial asset. However where a candidate discussed the situation but came to the wrong conclusion, they still gained a significant proportion of the marks available.

Question Four

This question required a discussion of the main weaknesses in the current standard on revenue recognition together with the reasons why it might be relevant to take into account credit risk and the time value of money in assessing revenue recognition. Part b of the question required candidates to discuss how transactions would be treated in financial statements under IAS 18 Revenue and also whether there would be a difference in treatment if the collectability of the debt and the time value of money were taken into account.

This question was well answered. There are many issues with IAS 18 and candidates' general discussion was good. Similarly the discussions regarding credit risk and the time value of money often mentioned that in many cases the effect will not be material but that in some contracts, the effect could be material. Also candidates realised that the use of discount rates is always quite a subjective way of measuring transactions. However some candidates often wrote general comments about recognition criteria for revenue and again these answers did not relate to the requirements of the question. Those candidates that knew the issues surrounding revenue recognition raised valid issues. However, these were often not in sufficient detail to justify full marks and the length and depth of the answers were often too short given the mark allocation for this question. Candidates should be aware of the amount of marks for a question part and answer accordingly.

In the second part of the question candidates did not appear to realize that IAS 18 already deems it is necessary to discount the consideration to present value in order to arrive at fair value. Other than this, this part of the question was quite well answered