Examiner's report

P2 Corporate Reporting
March 2016

General Comments

The examination consisted of two sections. Section A contained one question for 50 marks and Section B contained three questions of 25 marks each, from which candidates had to answer two questions. The Corporate Reporting examination requires a deep understanding and knowledge of the Conceptual Framework, IFRSs and Code of Ethics. Questions at professional level will challenge the candidate to show this knowledge and then to apply it to a particular scenario, and this requires extensive preparation. Candidates' learning is expected to extend beyond reliance on a single textbook or revision course; the required knowledge and understanding does not come through rote learning but through a deeper understanding of the subject matter. A well-prepared candidate would have reviewed relevant websites including those of the standard setters (IASB), the profession, and ACCA to maintain their knowledge and keep up to date with topical issues. Practice of past exam questions and exam-standard questions under timed conditions will better prepare candidates for allocating their time in the exam. Candidates with good exam technique (allocating time appropriate to available marks, preparing a plan, and reading the scenario and requirements carefully before answering) are more likely to succeed.

This examination required candidates to display more than just knowledge of accounting standards. A professional accountant *advises* clients, and the Corporate Reporting examination tests the candidate's ability to apply knowledge to a scenario. The examination tests a candidate's ability to explain the correct accounting treatment, the principles that underpin the treatment, and the implications of this, in complex scenarios. Whilst the examination contains technical material, a significant part is based around the application of the fundamental principles within IFRS, based upon the Conceptual Framework.

In the optional questions, the key requirement is to *discuss* the accounting issue. A well-prepared candidate would approach this requirement by first outlining their knowledge of the issue, referring to the Conceptual Framework and the appropriate reporting standard(s), and secondly applying this knowledge to the given situation. Less-prepared candidates tended to omit one of these two aspects, limiting their response to a listing of reporting requirements, or jumping directly to the application element (the accounting treatment) without a clear explanation of why the method is appropriate. Professional accountants would be expected by their clients to provide advice which outlines both the correct accounting treatment and also the reasons for this treatment.

Specific Comment

Question One

This question required the candidates to prepare a consolidated statement of financial position. In this question candidates were required to deal with two subsidiaries, one of which was a step acquisition from associate to subsidiary in the year, involving an indirect holding via the other subsidiary.

As in previous exams, more than half of the marks in question 1 were allocated to the group accounting part of the question. Candidates must therefore be prepared to complete appropriate workings for goodwill (full or partial methods), retained earnings, other components of equity (OCE) and non-controlling interest (NCI). Other syllabus areas tested within the consolidation requirement included an inventory write-down and related onerous contract, the conversion of part of a building to an investment property and an impairment of a subsidiary's goodwill (with NCI valued at their share of fair value of net assets). Candidates fared well in calculating the inventory write-down and onerous contract, but the investment property and impairment were less well-answered.

Question 1b required candidates to discuss the principles-based approach of IFRS 9 *Financial Instruments* to the classification and measurement of financial assets. The question was split into two requirements: to explain the meaning of the entity's business model and contractual cash flow characteristics, and to describe the alternative accounting treatments under IAS 27 *Separate Financial Statements* and any possible impact on the consolidated financial statements. The first requirement was, generally, well-answered. The second was not; with a significant number of candidates not even attempting it. Even if candidates were not familiar with the alternatives of IAS 27 (and the amendment to IAS 27), they should be aware that alternative treatments would be eliminated upon consolidation.

Question 1c required a discussion of the accounting, ethical and professional issues relating to the treatment of a 30% equity share investment, where the remaining shares were held by another company. This part of the question was well answered, with better answers applying the scenario to IAS 28 *Investments in Associates* .Candidates who read the requirements would have also discussed the ethical issues, where a range of points were possible, and candidates were given due credit for relevant opinion on the subject matter of the question.

Question Two

This question required candidates to discuss the way in which an entity should fair value assets with reference to the principles of IFRS 13 *Fair Value Measurement*.

The first asset was farmland which had an alternative use. The question provided details from which fair value could be calculated under both uses. Candidates answered this aspect well. Detail on the fair value of the farm's brand name was also provided. This aspect was poorly answered – or ignored. Candidates at this level should be aware that fair value is ascertained from the perspective of a market participant, and not the entity.

Answers to the second issue on the fair value of farm produce were quite mixed. The question provided information from three markets for the produce, including sales volume, price and costs. Candidates who had practiced Q2(a) from June 2015 would have been familiar with the requirements of IFRS 13: the relevance of the principal market and most advantageous market, and what costs are included within a fair value calculation. Weaker candidates spent considerable time listing out workings for each market with no accompanying explanation. The question required a discussion, and answers without discussion or justification of calculations gained few marks.

The third issue related to a non-controlling equity interest in a private company which the entity wished to fair value. During the year, the private company issued preferred shares with similar voting rights to the ordinary shares, but with more favourable dividend entitlement and ranking. A well-prepared candidate should be aware of the issues outlined by IFRS 13 of measuring fair value of individual unquoted equity instruments, using a market-based approach. The question provided the price of an equity instrument, similar but not identical to the unquoted equity instrument, which could then be adjusted to reflect the advantages of the preferred shares. A significant minority of candidates were distracted by the information on the preferred shares, and focused on the treatment of this, rather than the equity interest held by the entity.

Question Three
Question 3 was a case study question which required the application of the fundamental principles of several accounting standards.

In part (a), candidates were required to discuss the accounting treatment of two portfolios of trade receivables. This was generally well-answered. The first portfolio was assigned to a factor, and advice was being sought as to whether the portfolio should be de-recognised. A significant minority of candidates jumped to a conclusion without explaining why. Candidates should always try to break their answer to a discussion question into two elements. They should first explain the applicable knowledge or theory; and second, they should apply the knowledge to the scenario. The second portfolio involved measuring expected credit losses. It included a table of expected defaults according to age of debt and an analysis of gross amounts due under each age category. Most candidates worked out the expected credit loss allowance, although a few disregarded the required increase from the previous to current provision. Explanations of the acceptability of a provision matrix under IFRS 9 *Financial Instruments* tended to be a little too brief.

Part (b) examined candidates' knowledge of IAS 16 *Property, Plant and Equipment*, IAS 36 *Impairment of Assets*, and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. A new store was acquired in the year with the business incurring renovation and other costs. Candidates fared well in identifying those costs that could be capitalised, and those that could not. Candidates at this level should have recognised some facts in the scenario as indications of impairment, however many answers overlooked this issue, jumping directly to the issue of whether the store can be classed as a discontinued operation. Weaker answers made the decision without considering the requirements, or merely listed the requirements under IFRS 5 without applying them to the scenario. Better answers began with the requirements, and then applied this knowledge to the scenario. In doing so, candidates identified that the entity had failed to fix a sales price for the store, and a liquidation sale of the inventory was required before the store was available for sale. Despite management being described as having "a commitment" to the sale, there was insufficient evidence of this commitment (for example, management had only "started to look for a buyer"). A significant number of candidates overlooked this.

In part (c), candidates were required to discuss the accounting treatment of payments relating to long lease agreements for three stores. The question describes one of the leases as a finance lease and the other two as operating leases. The payments for the operating leases related to a premium to obtain the site ahead of a competitor, and a refundable interest free deposit. Answers to this part were varied. A significant number of candidates were distracted by the opportunity to describe the differences between finance and operating leases (marks were not available for such basic knowledge). Some candidates incorrectly reconsidered the treatment of the leases (despite the question deeming them operating or finance leases). Better-prepared candidates read the question carefully (the final sentence states the requirement) and considered how to treat each payment in turn.

Question Four
This question is normally the current issues question. Part (a) had two sections. In section one, candidates were required to discuss the key practical considerations and financial statement implications to consider when implementing a move to a new IFRS. Most candidates who attempted this question managed to identify many of the key considerations, including the need for communication with stakeholders, the practical resource implications, and impacts on covenants,

distributions, and performance-related pay. This section was generally well-answered.

In section two, candidates were asked to discuss why regulators may focus on the impairment of non-financial assets and deferred tax assets in a period of slow economic growth, and to set out the key areas entities should focus on when accounting for these elements. This also yielded some very good answers. Many candidates identified key concerns over the preparation of valid cashflow projections and, in the case of deferred tax assets, evidence of future profitability.

Part (b) required candidates to discuss the acceptability of two changes to accounting practice proposed by an entity. In the first case the entity wished to change the useful life of an intangible asset (a portfolio of customers acquired from a competitor) to ‘indefinite’, because of an inability to predict the asset’s life. This was not well-answered in general. Although some candidates did argue that a customer’s relationship will change over time, very few made reference to the need for maintenance costs in order for cash inflows to continue for an unlimited period of time, under IAS 38 *Intangible Assets.* The second proposed change in accounting practice was to alter a cash-generating unit (CGU) to the product line level rather than individual retail branch level. This was answered better, with many candidates first explaining the requirements for a CGU, and then applying this to the situation to reach the correct conclusion.