Examiner’s report

P2 Corporate Reporting
June 2011

General Comments

The examination consisted of four questions (Question 1 for 50 marks and three further questions of 25 marks each of which candidates had to chose two to answer) The performance of candidates was quite pleasing with good marks being achieved in all aspects of the paper. The approach to the examination is good with little evidence of time pressure although some candidates are still failing to produce answers of sufficient length and appear to be spending too much time on a single question. Candidates do not use the information in the scenario in order to develop their answers.

Question 1 is designed to test candidates’ computational skills and brief explanations are often useful to the marker but detailed discussion of the relevant standard is not normally required. Candidates often wasted time discussing a standard in detail when an application of the standard was required. It is important also to make sure that the answer is relevant to the question. In this exam there was evidence of students discussing standards at length that were not relevant to the question

Specific Comments

Question One
This question required candidates to discuss and apply the principles set out in IAS 21 *The Effects of Changes in Foreign Exchange Rates* in order to determine the functional currency of an entity. It then required candidates to prepare a consolidated statement of financial position of the group at 30 April 2011 showing the exchange difference arising on the translation of the entity’s net assets. Candidates had to show how to deal with an acquisition of a further interest from the non-controlling interest for a cash consideration and the revaluation of an overseas property Further a long-term bonus scheme for employees and a change in the residual value of property had to be dealt with by candidates.

The determination of the functional currency was well dealt with by candidates. The question set out all of the relevant detail for this determination but some candidates did not use this information and did not accrue marks as a result. The consolidation of the financial statements was again well carried out by candidates. There are alternative ways to arrive at the correct solution to this type of question and this was taken into account in the marking of the answers. Candidates seemed to generally understand the method used to translate the financial statements of an overseas subsidiary. Some candidates used incorrect exchange rates to translate the statement of financial position of the subsidiary but most candidates managed to compute goodwill correctly using the full goodwill method. The cumulative bonus payable on the long term bonus scheme was often incorrectly calculated with the main problem being the present value calculation.

Part b saw the company considering the acquisition of a service company which had contract-based customer relationships with well-known domestic and international companies. Candidates had to discuss the validity of the accounting treatment proposed by the entity and whether such proposed treatment raised any ethical issues. The main issue with the answers to this question was that candidates focussed on the accounting treatment at the expense of the ethical considerations. The contract-based customer relationships were identifiable in accordance with IAS 38 and would probably have value. In order to be recognised separately, the identifiable assets, liabilities and contingent liabilities have to satisfy the probability and reliable measurement criteria of IFRS 3. For intangible assets acquired in business combinations the probability recognition criterion is always considered to be satisfied. Many candidates failed to reach this conclusion.

Question Two
This question dealt with an entity that had recently made the transition to International Financial Reporting Standards (IFRS). In part a candidates had to discuss the principles behind the use of deemed cost and whether estimates were a reliable form of evidence on which to base the fair value calculation of tangible assets to be then adopted as deemed cost. Part b required candidates to deal with the treatment of fishing rights acquired in a business combination that were included as part of goodwill and to discuss group accounting on transition to IFRS.

Part c required candidates to consider whether a database had an indefinite useful life when reconsidered annually for impairment and to discuss the reasons supporting the assessment of an indefinite useful life. The final part required candidates to review two restructuring projects and whether the entity should recognise a provision in respect of the projects.

IFRS 1 is still very current in many parts of the world as countries move to the standards not only for large corporations but also for local government accounting. Hence it is a very relevant exam topic. The treatment of deemed cost was not well answered by candidates. Assets carried at cost (e.g. property, plant and equipment) may be measured at their fair value at the date of the opening IFRS statement of financial position. Fair value becomes the 'deemed cost' going forward under the IFRS cost model. Deemed cost is an amount used as a surrogate for cost or depreciated cost at a given date. These points were not well understood.

In part b candidates recognised that if an entity during the transition process to IFRS, decides to retrospectively apply IFRS3 to a certain business combination then it must apply that decision consistently to all business combinations. However the key point often missed was that the decision to apply IFRS 3 cannot be made selectively.

Candidates answered part c very well with the main omission being the fact that under IAS 1 *Presentation of* Financial Statements an entity should disclose accounting policies relevant to an understanding of its financial statements.

Part d was also answered well. Candidates were well versed in the principles behind how a constructive obligation to restructure arises under. IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*,

Question Three
This question dealt with a series of practical situations that had arisen in corporate reports. Part a dealt with an entity that had defaulted on an interest payment on an issued bond loan repayable in 2015. The bondholders had issued a waiver postponing the interest payment until after the year end. Candidates had to discuss the treatment of this loan. The loan should have been classified as short-term debt but many candidates came to a different conclusion. If candidates gave a rationale for their conclusions then due credit was given. Only a few candidates mentioned that according to IAS 1, Presentation of financial statements, a liability should be classified as current if it is due to be settled within 12 months after the date of the statement of financial position.

Part b dealt with the recognition of revenue (and the related costs) on a straight-line basis over a contract term, and the treatment of accounting estimates. Candidates understood well the nature of IAS 18 but few treated the change in accounting treatment as a correction of an error in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors. The previous policy applied was not in accordance with IAS 18, *Revenue*, which requires revenue arising from transactions involving the rendering of services to be recognised with reference to the stage of completion at the date of the statement of financial position.

Part c dealt with a two-tier board structure consisting of a management and a supervisory board and the provision of related party information in the annual accounts in an ambiguous way to prevent users of the financial statements from tracing remuneration information back to specific individuals. Many candidates realised that the exclusion of the remuneration of the non-executive directors from key management personnel disclosures did not comply with the requirements of IAS 24 and most scored well on this part of the question

Part d required candidates to determine the nature of a pension plan which was accounted for as a defined benefit plan. The question detailed all the necessary criteria for the decision to be made. Candidates should realise that generally all of the information in the question is relevant in some way and should therefore use it accordingly. The pension arrangement did not meet the criteria as outlined in IAS 19 Employee Benefits for defined contribution accounting on the grounds that the risks, although potentially limited, remained with the entity. This conclusion was reached by a good proportion of candidates.

Question 4ai required a discussion of the approach taken by IFRS 9 in measuring and classifying financial assets and the main effect that IFRS 9 will have on accounting for financial assets. This question was well answered by those candidates who answered in accordance with IFRS 9.However many chose to answer using IAS 39 which was not relevant in this context. The question produced some excellent scores.

Part aii required a discussion of how a financial asset should be accounted for in the financial statements of an entity where there is restatement of financial information. This part of the question was again answered very well. Part bi required candidates to discuss briefly the issues related to considering the effects of expected losses in dealing with impairment of financial assets and in bii to calculate the impact on the financial statements if the entity anticipated the expected losses on the loan portfolio in a particular year. Part bi was quite well answered as candidates set out the principle that the expected loss model is more subjective in nature compared to the incurred loss model, since it relies significantly on the cash flow estimates prepared by the reporting entity which are inherently subjective. Part bii was poorly answered as candidates could not apply the principles set out in part bi.