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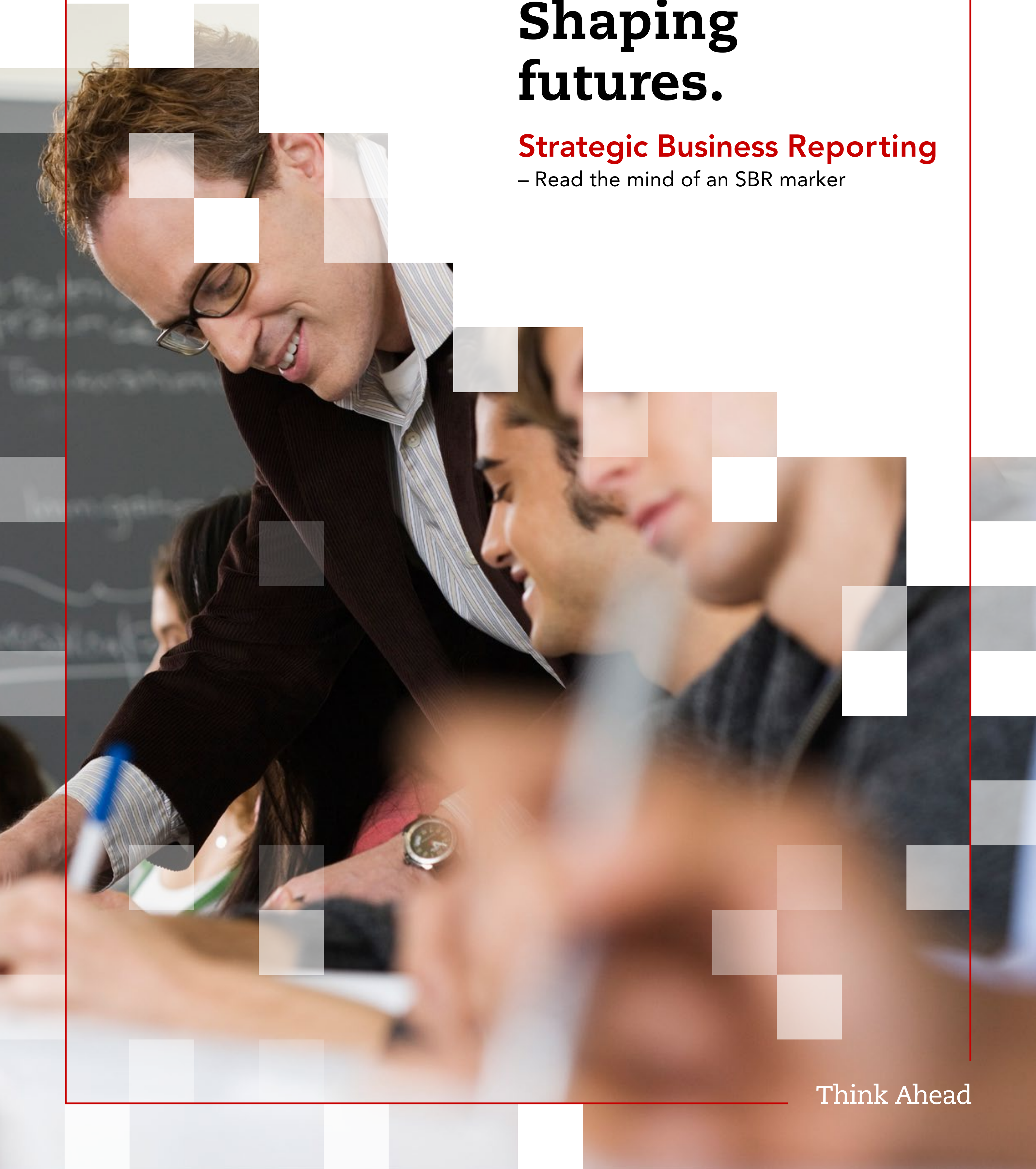
Strategic Business Reporting

– Read the mind of an SBR marker



Think Ahead

Think Ahead ACCA

Contents

Introduction

I am a member of the team who will mark Strategic Business Reporting. This article is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Strategic Business Reporting script.

By giving you an insight into a marker's thinking, explaining what we are trained to look for, what we award marks for, and to give you the reasons why marks may not be awarded, you will be better prepared to take the exam. It will help you fulfil your potential by being better able to translate your knowledge, experience and judgement into accumulating the necessary marks to pass.

> Translate your knowledge, experience and judgement into accumulating the necessary marks to pass.

At the time of writing there have been no live exam sittings of Strategic Business Reporting. For the purpose of this article, therefore, two sets of student-style answers were written to requirements from the specimen exam, under timed conditions for me to mark.

To support your reading of this article, follow this link to view the Strategic Business Reporting specimen exam **click the link here**.

Question 1 – first requirement

The first requirements selected from the specimen exam come from Q1, on the topic of group accounts. Traditionally this topic was examined at Q1 in P2 Corporate Reporting as a number cruncher, but going forward under Strategic Business Reporting it is expected that you will not be required to prepare a whole consolidated financial statement from scratch. Rather, with Strategic Business Reporting, the expectation is that you will be required to only perform some specific computations relating to the consolidation process (or extracts from the group accounts) and, crucially, to provide supporting explanations of the calculations. Q1 (a) parts (i) and (ii) of the Strategic Business Reporting specimen exam reflects this.

Let's look at the first requirement of Q1.

Required: (a) (i) Explain to the directors of Kutchen, with suitable workings, how goodwill should have been calculated on the acquisition of House and Mach showing the adjustments which need to be made to the consolidated financial statements to correct any errors by the finance director.
(10 marks)

Observations on the requirement

This part of the question requires both an explanation to the directors as to how goodwill should have been calculated, as well as the calculation of goodwill and the adjustments to correct any errors. The marking guide splits the marks 6/4 in favour of the explanation over the calculations. This means that there is only one mark for the calculation of each subsidiary's goodwill and one mark for the corrections required relating to each subsidiary. There are three marks available for the explanation as to how goodwill for each of the two subsidiaries should have been calculated.

Follow this link to see candidate one's answer to Q1 (a) (i).

View it here

Notes on candidate one's answer Q1 (a) (i)

The following notes explain the mark allocations on the candidate's answer.

Note 1
No mark is awarded. This is an abstract definition that is not applied to the scenario and as such it does not explain to the directors of Kutchen how the goodwill of House or Mach should have been calculated. No half marks can be awarded.

Note 2
One mark is awarded for each of:

- The explanation of the contingent consideration.
- The explanation of the NCI.

Note 3
No mark is awarded as this statement is too vague. It is not applied. Whilst it is appropriate to refer to basic principles, for a mark to be awarded here it needed to have been tied into the actual scenario of the question. Thus an answer that stated 'The directors of Kutchen are incorrect in omitting the NCI and excluding the contingent shares from the consideration' would have been awarded a mark.

Note 4
One mark is awarded for the correct calculation of the goodwill of House. As no half marks are awarded and there are several calculations necessary to correctly determine this goodwill figure, it would have been possible to award a mark even if the actual goodwill calculation had been incorrect if there had been a demonstration of understanding the basic issue.

The marking guide splits the marks 6/4 in favour of the explanation over the calculations.

Note 5
For the journal entry trying to show the correction necessary relating to House, no mark is awarded as it shows no understanding of the effect of the correction. The production of a journal entry is a suitable working to express the necessary adjustments, but note that journal entries were not specifically asked for in the question. The mark would be awarded for adopting an increase/decrease approach.

For example:

Increase	Goodwill	10.38
Decrease	Profits (Retained Earnings)	8
Increase	NCI	16.38
Increase	Other Components of Equity	2

The production of a journal entry is a suitable working to express the necessary adjustments.

Note 6
No mark is awarded. This is just repetition.

Note 7
One mark is awarded for each detail of the accounting treatment. Both details are supported by relevant points.

Note 8
One mark is awarded for the correct calculation of the goodwill of Mach.

Note 9
The journal entry attempts to show the correction required but shows no understanding and no mark is awarded.

The mark for candidate one for Q1 (a) (i) is 6/10.

TOTAL:

6/10

Notes on candidate two's answer Q1 (a) (i)

Follow this link to see candidate two's answer to Q1.

View it here

Note 1
No mark is awarded for the attempted calculation of the goodwill relating to House. There are two errors of principle included in this calculation, in that NCI is calculated using the wrong method and the parent's investment does not correctly measure the fair value of the contingent shares issued. No half marks are available for markers to award.

Note 2
The mark is awarded for the attempt at the correcting adjustment. In principle it is right to recognise NCI (though the number is incorrect it would be wrong to penalise a candidate twice) and there is a credit to retained earnings. It is possible to be awarded a mark for a numerical answer where the answer is not 100% correct.

Note 3
One mark is awarded, out of three possible marks, for this explanation. Let us remind ourselves of the question – explain to the directors of Kutchen how goodwill should have been calculated on the acquisition of House – and I hope you can see that this answer is neither applied or detailed enough to merit more than one mark out of three.

This answer is neither applied or detailed enough to merit more than one mark out of three.

Note 4
The mark for the goodwill of Mach is awarded as, although incomplete, it does demonstrate understanding of the key issue of the land element of the consideration being included at fair value.

Note 5
One mark is awarded, out of three possible marks, for this explanation of the calculation of goodwill relating to Mach. The key points around the measurement of the non-controlling interest are not mentioned.

Note 6
No marks are awarded. The requirement was to show the adjustments and this has not been addressed.

The mark for candidate two Q1 (a) (i) is 4/10.

TOTAL:

4/10

Question 1 – second requirement

Observations on the requirement

Required: (a) (ii) Explain, with suitable calculations, how the gain or loss on the sale of Niche should have been recorded in the group financial statements.
(5 marks)

Again this part of the question requires both explanation as well as a numerical calculation. A review of the marking guide shows a 3/2 split, again placing a greater weight of marks to the written explanation over the formulaic number crunching.

Notes on candidate one's answer Q1 (a) (ii)

Follow this link to see candidate one's answer to Q1.

View it here

Note 1
No marks are awarded as although what is written makes sense it is not specifically answering the requirement of the question.

Note 2
One mark is awarded for this simple description. This is the only mark awarded, out of a potential three, for explaining how the gain or loss to the group should have been recorded. A missed opportunity.

Note 3
Out of the two marks available for the calculations, one was awarded for the correct calculation of goodwill. As the calculation of the disposal to the group was both incomplete and contained an error, no further mark was awarded.

The mark for candidate one Q1 (a) (ii) is 2/5.

TOTAL:

2/5

Notes on candidate two's answer Q1 (a) (ii)

Follow this link to see candidate two's answer to Q1.

View it here

Note 1
The requirement of the question is to calculate the gain to the group on the disposal. The calculation given is the gain to the parent company and as such is not relevant to the requirement. Marks are never deducted for wrong answers but the candidate has wasted precious time, probably because they did not read the requirement of the question properly.

Note 2
No mark is awarded. To include the impairment loss for goodwill in the calculation of the gain to the group on the disposal of a subsidiary shows a lack of understanding that it is the asset of the unimpaired goodwill that is being derecognised as a result of the disposal.

Note 3
Whilst the calculation of the gain/loss of zero is incorrect, a mark has been awarded as the comment, based on the numbers calculated, is reasonable. This is what markers are trained to do, following through the logic of the answer, to ensure that the candidate is only penalised once for the incorrect calculation. It is following a similar principle to the own figure rule that markers use when following through an incorrectly calculated figure in a long numerical requirement.

The mark for candidate two Q1 (a) (ii) is 1/5.

TOTAL:

1/5

Question 2

The second question selected from the specimen exam is Q2, a 20 mark question which combines a discussion of a variety of accounting treatments integrated with a discussion of their ethical implications. Going forward the discussion of the ethical implications of accounting treatments will have a higher profile in Strategic Business Reporting than in the predecessor equivalent exam, P2 Corporate Reporting. The Strategic Business Reporting specimen exam reflects this.

> The discussion of the ethical implications of accounting treatments will have a higher profile in Strategic Business Reporting.

Required: Discuss the ethical and accounting implications of the above situations from the perspective of the reporting accountant.

(18 marks)

Professional marks will be awarded in question 2 for the application of ethical principles.

(2 marks)

TOTAL:

20

Observations on the requirement

The marking guide allocates 10 marks for discussing the accounting issues, with one mark allocated per valid point. There are five accounting issues raised in the scenario, related party transactions, segmental reporting, impairment of financial assets, fair value adjustments on acquisition and impairment reviews of goodwill. A good and balanced approach to the answer would therefore be to make two valid points for each accounting issue. The split of marks is not shown in the question paper, in which case the best assumption to make is to assume that the marks would be split roughly equally between the two aspects of the requirement, in this case **ethical** and **accounting** implications. This approach would have led to an estimate of 9 marks for the accounting issues, which again would lead to the same approach of aiming for two points for each issue.

In terms of ethics the marking guide allocates 8 marks for valid points and 2 professional marks for the application of ethical principles. However marks are not awarded for the reiteration of the five pillars in the ethical code i.e. it is not the case that the 8 marks are for pure knowledge and 2 are 'applying'. Application is required throughout.

> Application is required throughout.

For the professional marks, the answer is considered as a whole in the light of the following:

- Has the candidate thought a bit more deeply about the ethical issues; for example, what needs to be done to resolve the situation?
- They would also get marks for demonstrating that they can think widely about the issue considering other resources/implications where it is sensible to do so.
- Ethical issues are never clearcut, therefore candidates need to show that they understand the ethical dilemmas that accountants face. It requires a discussion which demonstrates an understanding of the reality of a problem.

> **Candidates need to show that they understand the ethical dilemmas that accountants face.**

Traditionally ethics was examined in P2 Corporate Reporting for only a few marks. Here we see in the Strategic Business Reporting specimen exam 10 marks being devoted to ethics in a financial reporting setting. This illustrates the increased emphasis on applied ethics as outlined previously.

Notes on candidate one's answer Q2

Follow this link to see candidate one's answer to Q2.

View it here

The answer has clear headings. The approach of addressing each accounting issue immediately followed by the ethical implications arising is logical. The use of blank lines really helps the presentation. All this assists the marker.

Note 1
No mark is awarded for this introduction, comforting though it is to read. It does nothing beyond describing the requirement.

Note 2
One mark for the clear statement of the principle underpinning related party transaction disclosures.

Note 3
One mark for the application, correctly identifying the related parties in the scenario.

Note 4
No additional mark is awarded for this point, which is really an extension of the first point made.

Note 5
One mark for applying the ethical principle of professional competence to related party transactions. The ethical implications of these related party transactions could have been developed. Another missed opportunity.

Note 6
One mark only for discussing the accounting issue of segmental reporting. What is written is correct but a little more detail and application is required to be awarded the second mark.

Note 7
One mark awarded for identifying the ethical implications.

Note 8
One mark awarded for the identification and application of expected credit losses.

Note 9
Raising the issue of objectivity demonstrates an ethical awareness and is awarded one mark. The fact that this point has been made under the 'Accounting' heading does not prevent the mark being awarded.

Note 10
Another mark for developing the ethical dilemma into a discussion on integrity and the need for action.

Note 11
One mark for identifying the correct accounting principle relating to fair values. To gain a further mark here, the candidate would have needed to add more detail on either the underlying accounting rules, or the effects on the financial statements.

Note 12
A considered evaluation of the ethical dilemma that the accountant faces is awarded a mark. A further mark is awarded for suggesting appropriate courses of action. This part of the answer demonstrates the level of practical application that is demanded in respect of ethical issues.

Note 13
No mark awarded for this comment as it is not fully explained. A further missed opportunity.

Note 14
Professional marks. One mark out of two available. There is clearly an attempt to apply the ethical principles to the scenario, and some of the points made show an understanding of the dilemma for the accountant and possible courses of action but other points were superficial, such as those points where the only action suggested was to 'disagree' or 'question'.

The mark for candidate one Q2 is 12/20.

TOTAL:

12/20

Notes on candidate two's answer Q2

Follow this link to see candidate two's answer to Q2.

View it here

The general layout of the answer at first glance seems neat and reasonable, However when we remember that the marks are evenly split between discussing the accounting issues and the ethical implications there is clear imbalance between a whole page of writing about accounting and just a paragraph about ethics. I prefer the approach taken by candidate one who after addressing each accounting issue then considers the ethical implications.

Note 1
No mark. This is a regurgitation and looks as if something learnt from a text book has been written out with no application. The copying out of chunks of definitions, without any context or any attempt to relate the material to the scenario, is sadly seen all too often.

Note 2
One mark is awarded as there is an attempt to apply the technical knowledge to the transaction in the scenario.

Note 3
One mark awarded for the comment on expected losses.

Note 4
The statement that 'the finance director is wrong and the accountant should make the adjustment' is too generic and simplistic to merit a mark.

Note 5
One mark is awarded for the discussion on the arbitrary nature of applying fair values.

Note 6
This rote learnt repetition of definitions is neither a discussion or applied to the scenario and so does not get awarded a mark.

Note 7
No mark is awarded as the comment is too simplistic.

Note 8
One mark is awarded for identifying the salary increase offer as being unethical. Had this been better developed, more marks would have been awarded.

Note 9
No mark is awarded. This is just another example of abstract facts being presented. In this exam, there will be no marks given for simply listing out the principles of professional ethics.

Note 10
One mark is given here for identifying objectivity as a relevant issue and the principle that the accountant in this scenario must follow.

Note 11
Professional marks. No marks have been awarded here. Overall the answer lacked practical application, and showed no understanding of the dilemmas the accountant was facing. What little advice or suggested actions that are given are too simplistic.

The mark for candidate two Q2 is 5/20.

TOTAL:

5/20

Specimen exam worked answers

Question 1 (a) (i) candidate one

Marks

Notes

Acquisition of House

Principles

Goodwill should be calculated as the difference between the acquisition date fair value of consideration, plus the non-controlling interest, and the fair value of the net assets acquired.

0 ← Note 1

Details of accounting treatment

(Note references are to the calculations below)

The consideration for this acquisition should include all of the following:

- shares issued (1)
- the contingent shares, using the acquisition date fair value, adjusted by a percentage to reflect probability (2)
- non controlling interest (NCI) standards allow two methods for measuring NCI. As the policy here is to use fair value, this has been done using the NCI of 30% of the fair value of House's share capital (3)

1

1 ← Note 2

The net assets acquired are valued at $48m (4) giving a goodwill value of $10.38 million.

Correction required

The contingent shares should be recognised as well as the non-controlling interest.

0 ← Note 3

Goodwill calculation: House

Notes	Consideration	$m
(1)	Issue of shares (20m x $2)	40
(2)	Contingent consid shares (5m x $2 x 20%)	2
(3)	NCI (13m x $4.20 x 30%)	16.38
		58.38
(4)	FV of identifiable net assets	(48)
		10.38

1 ← Note 4

Correction

Dr Goodwill	10.38	
Cr Share capital		10.38

0 ← Note 5

Relevant notes

Marks

Notes

Acquisition of Mach

Principles:

Goodwill measurement principles as above for House.

0 ← Note 6

Details of accounting treatment

(See calculations below)

Consideration should include all consideration, here the land. At its fair value of $5m. (1)

1

Again NCI should be included. A measurement based on earning multiples is acceptable. (2)

1 ← Note 7

Goodwill calculation: Mach

Consid	$m
Cash	52
(1) Land	5
	57
(2) NCI (20% x $3.6 x 19)	13.38
	70.68
(3) FV of net assets	(55)
	15.68

1 ← Note 8

Correction

Dr Goodwill	15.68	
Cr Share capital		15.68

0 ← Note 9

TOTAL Q1 (a) (i):

6/10

Relevant notes

Question 1 (a) (i) candidate two

Marks

Notes

House

Goodwill	$m
Shares (25m x 2)	50
NCI (W1)	14.4
	64.4
FV of NA	(48)
	16.4

0 ← Note 1

Workings	$m
1) NCI	
(30% x 48) =	14.4

To correct the error that was made:

Goodwill	16.4
Bargain purchase	8
	24.4

Debit goodwill	24.4	
Cr NCI		14.4
Cr Retained earnings		10

1 ← Note 2

Non-controlling interests should be included in goodwill because of accounting standards. Fair values are used to reflect the purchase as an arms length transaction. All of the shares issued, including the deferred consideration, should be included.

1 ← Note 3

Relevant notes

Marks

Notes

Mach

Goodwill	$m
Cash	52
Transfer of land	5
	57
NCI	?
FV of net assets	

1

← Note 4

All consideration must be included in the goodwill calculation. And must be included at fair value. The fair value of land would be based on IFRS 15 and revaluation credited to a revaluation surplus in the consolidation statement of financial position.

1

← Note 5

The correction would be to:

1. Revalue the land
2. Non-controlling interest.

← Note 6

TOTAL Q1 (a) (i): 4/10

Relevant notes

Marks

Notes

Question 1 (a) (ii) candidate one

Niche

The sale of the investment in Niche is a full disposal. Therefore a gain or loss should be recognised in the SOPLOC of the group.

As the disposal occurred at the end of the year, a full year's results of Niche would be included and a full year's NCI (20%) in those results. This would probably be a discontinued activity if separate line of business.

0 ← *Note 1*

The calculation should be the proceeds received less the group's ownership in the net assets of Niche at disposal date (including goodwill).

1 ← *Note 2*

Calculation of Gain/Loss		$m
Proceeds of disposal		50
Less: cons carry value at		
31 Dec 20 x 6 Net assets	60	
Goodwill (W1)	2.8	
		62.8
Group share (80% x 62.8)		

1 ← *Note 3*

Workings	$m
(1) Consideration	40
NCI (20% x 44)	8.8
Identifiable net assets	(44)
	4.8
Less: impairment	(2)
	2.8

TOTAL Q1 (a) (i):
2/5

Relevant notes

Question 1 (a) (ii) candidate two

Marks

Notes

Niche

Gain in House individual FS	$m
Proceed	50
Cost of inv	(40)
Gain	10

0 ← Note 1

Gain in House group FS	$m
Proceeds	50
Share of net assets sold (80% x 60)	(48)
Goodwill impairment	(2)
No gain or loss	–

0 ← Note 2

Niche is a discontinued activity. It is not in the consolidated statement of financial position after the sale. As sale was at the year end, results would be consolidated for full year.

As there is no gain or loss, no group gain/loss to disclose.

1 ← Note 3

TOTAL Q1 (a) (ii):
1/5

Relevant notes

Question 2 candidate one

	Marks	Notes
A number of issues involving judgement exist in the scenario relating to Abby. Each will be discussed in terms of its accounting and ethical implications.	0	Note 1
Arwight: Related Party Transactions		
Accounting Implications		
The principle of IAS 24 is that related party transactions must be disclosed so that users have a full understanding of how the position and the performance may have been affected.	1	Note 2
In this case the finance director (key management) and his wife (close family) are related parties of Abby. And so Arwight, the company controlled by them is also a related party of Abby.	1	Note 3
There is no exemption that permits non-disclosure of 'arms length' transactions.	0	Note 4
Ethical Implications		
The accountant must use professional competence and due care. This includes applying relevant standards so the accountant should question the proposed treatment.	1	Note 5
Segment Disclosure: Accounting		
The standard on segments requires that a range of figures, including revenue, and profit or loss, are disclosed for segments reviewed by the CODM. The disclosure of assets and liabilities only does not meet the requirement.	1	Note 6
Ethical Implications		
As above, the accountant must comply with standards and should disagree with the finance director's proposal.	1	Note 7
Unpaid invoice: Accounting		
The information indicates that the overdue invoice is unlikely to be paid. IFRS 9 uses an expected loss basis so an allowance should be made against this.	1	Note 8
The strange request from the finance director to say nothing raises the question of whether the finance director is being objective or is showing bias in relation to Arwight, the company he controls with his wife.	1	Note 9

Relevant notes

Marks

Notes

Ethical Implications

If the accountant believes that the finance director is being dishonest in the F.S. of Abby, to assist Arwight, where he has control, professional ethics requires that the accountant should protect his own reputation and integrity by bringing this to the attention of other directors in Abby.

1 ← Note 10

Fair value adjustments:

Again the finance director's proposal goes against standards. On acquisition, a sub's net assets should be measured at fair value. External valuations should be used.

1 ← Note 11

Ethical Implications

It seems that the finance director is trying to intimidate the accountant (the reference to 'current position') into doing as he wants. The right ethical response is to maintain integrity and resist the pressure. The accountant may want to take advice from ACCA but is likely to be advised to 'blow the whistle' or to resign.

1

1 ← Note 12

Impairments:

Again the suggestion of salary raise – trying to pressure accountant, but accountant again must maintain integrity and not agree to.

0 ← Note 13

PS1 ← Note 14 Professional Skills

TOTAL Q2:

12/20

Relevant notes

Think Ahead ACCA

Question 2 candidate two

Marks

Notes

Related parties

Transactions between related parties are a normal feature of business. IAS 24 requires disclosure of RPTs because they may distort the position of a company.

A person is related to an entity if they:

- have control or joint control
- significant influence
- key management.

An entity is related to an entity if:

0 ← Note 1

- members of the same group
- associate
- joint venture
- controlled by a person who is related
- provides management services.

The transaction should have been disclosed with amounts, and balances and whether or not a price was charged.

1 ← Note 2

Overdue invoice

IFRS 9 Financial Instruments requires an allowance to be made for expected losses. The finance director is wrong and the accountant should make the adjustment.

1 ← Note 3

0 ← Note 4

Fair value

Fair value adjustments must always be made on acquisition of a subsidiary. The calculation of goodwill may be arbitrary but it is an asset and so must be measured including non-controlling interest.

1 ← Note 5

IFRS 13 gives a hierarchy of valuations for fair value

- Level 1 = quoted prices
- Level 2 = observable inputs for similar assets
- Level 3 = reasonable information.

0 ← Note 6

The finance director is wrong and the fair value adjustment of $50 should be made.

0 ← Note 7

Relevant notes

Marks

Notes

Impairment

Goodwill must be tested for impairment annually. The director is telling the accountant to be flexible and putting pressure on the accountant through salary increase offer is unethical.

1

← Note 8

Ethical issues

The accountant must follow these principles:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour.

0

← Note 9

The accountant must maintain objectivity and do what is right despite offer of salary increase.

1

← Note 10

PS0

← Note 11 Professional Skills

TOTAL Q2:

5/20

Relevant notes

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