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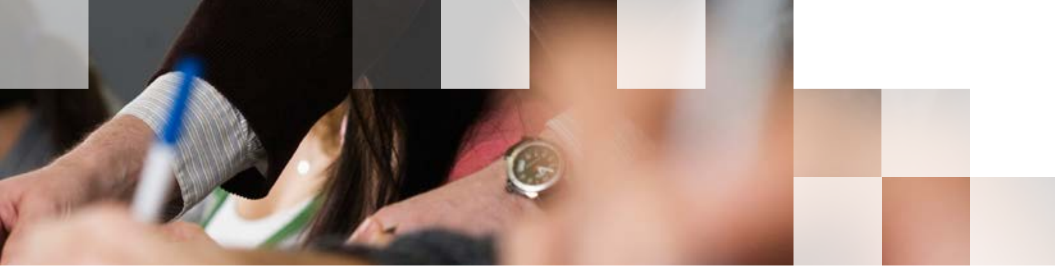
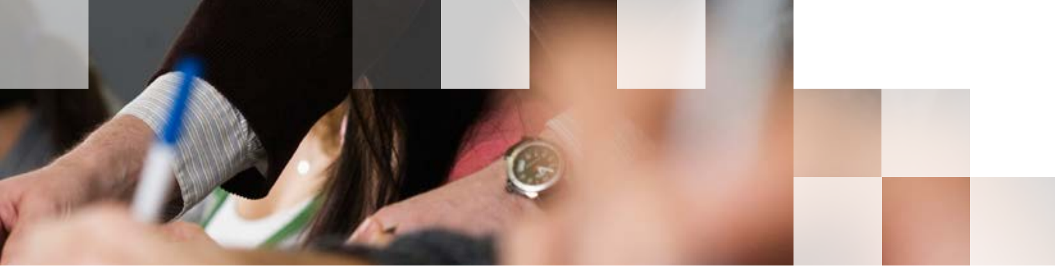
Strategic Business Reporting

Read the mind of an SBR marker – Part 2

Think Ahead



Contents



Introduction

This article has been written to complement *Read the mind of an SBR marker – Part One* and to give further insight into how the marking team award marks in this exam.

This article has been based on extracts from student answers to questions 3 and 4 of the December 2018 exam and explains the thinking behind how the marks were awarded. The examining team has explained that this section of the SBR exam tests the specific skills and qualities that accountants are required to have in the workplace.

> **What is required to achieve a pass.**

The questions will require judgement to be applied to complex reporting scenarios, with insight into numbers and an appreciation of the perspective of stakeholders. The marked answers should help students and tutors understand what is required to achieve a pass in questions of this type.

To support your reading of this article, you should refer to the Strategic Business Reporting exam from the December 2018 session. **Click the link here**.

Question 3

Question 3 uses a very common style of requirement, namely to "advise the directors" on the accounting treatment of some specific transactions. You are asked to refer to relevant standards, and parts of the question also refer to the *Conceptual Framework* and its proposed revision. The examining team has emphasised that the *Conceptual Framework* is a core area of the syllabus, and when this exam was sat, the revision of the *Framework* was one of the current issues within the scope of the exam.

> **Required:** Advise the directors of Fill on how the above transactions should be dealt with in its financial statements with reference to relevant IFRS Standards and the *Conceptual Framework* and its proposed revision where indicated.
> (25 marks)

The Conceptual Framework is a core area of the syllabus

Observations on the requirements

The 25 marks were split between three separate issues:

Part (a) for 7 marks asked for advice on:

(i) whether the *Conceptual Framework* affects the valuation of inventories;

(ii) how to calculate the net realisable value of the coal inventory, including the low quality coal

Part (b) for 8 marks asked for advice on:

how to treat the reconditioning costs and whether the decline in the price of coal is an impairment indicator

Part (c) for 10 marks asked for advice on:

Whether the proposed revision to the *Conceptual Framework* will affect the decision as to whether Fill controls the mine, and

whether the acquisition of the interest would be considered a business combination under International Financial Reporting Standards.

In this style of requirement, marks are normally awarded on the basis of one mark for each relevant and well explained point, but as shown in the marking scheme, a large proportion of the marks are allocated to application to the scenario. Good answers to these requirements would take a broad approach, always being aware that more than one accounting standard may have relevance. The ability to select relevant technical points is key, as is the ability to link these to the facts in the scenario. As you will see when you look at the marked answers in this article, it is not possible to achieve a pass mark in these questions by simply listing out all that you can remember about a particular accounting standard.

A large proportion of the marks are allocated to application to the scenario.

Notes on candidate one's answer to Q3

Follow this link to see candidate one's answer to Q3

View it here

Note 1
Mark given for stating the basic rule that is relevant – despite the incorrect number for the standard.

Note 2
No marks given for reproducing information from the scenario with no value added.

Note 3
The mark has been given here for the attempt to use some of the scenario information, ie the 20% reduction to explain how the NRV would be calculated (although other parts of the explanation are clearly incorrect).

Note 4
Mark given for application of the "obligation" principle to the scenario.

Note 5
Mark for correct application of IAS 36 to the scenario. Note no marks have been given for simply listing out all of the impairment indicators mentioned in the standard.

No marks have been given for simply listing out all of the impairment indicators mentioned in the standard.

Note 6
Mark given for explanation of the impairment review that would follow the identification of an impairment indicator, as applied to the mining equipment.

Note 7
Mark given for applying the definition of value in use to the coal in the scenario.

Note 8
Mark given for partially correct analysis of current relationship.

Note 9
Two marks given for the correct explanation that the 72% ownership does not give control, and the conclusion that this means that the transaction would not lead to the mine being fully consolidated by Fill.

The mark for candidate one for Q3 is 9/25.

TOTAL:

9/25

Notes on candidate two's answer to Q3

Follow this link to see candidate two's answer to Q3

View it here

Note 1

1. Two marks awarded in part (a)(i) for

   - The attempt to say something relevant about the *Conceptual Framework*
   - explaining that it is IAS 2 rather than the *Conceptual Framework* that sets out the basic valuation rules for inventories

Note 2

A further mark awarded for taking the definition of NRV and clearly applying it to the coal in the scenario. This is a good example of how to demonstrate application.

Note 3

No mark given here as this paragraph does not make a point relevant to the accounting issue. It sounds more like financial management advice. It is not clear whether the answer is arguing that the NRV is the spot rate or the future rate.

Note 4

This point is not relevant (and the unwinding of discount on an asset would not be an expense).

Note 5

Two marks given in total for referring to a relevant technical point about provisions and correctly applying it to the scenario.

Note 6

Three marks given in total for referring to relevant technical points from IAS16 and correctly applying these to the scenario.

Note 7

Two marks given in total for referring to a relevant technical point about impairment indicators and correctly applying it to the scenario. No additional mark given in final paragraph of answer to (b) as nothing of substance has been added. "PAG" is a marking abbreviation which means "point already given" (in relation to identifying a potential impairment indicator).

Note 8

A mark has been allocated to this paragraph for its explanation of control.

Note 9

A mark has been given for the attempt to address the point in the scenario about the directors wishing advice on whether the revised *Conceptual Framework* will affect decisions around control.

Note 10

No mark awarded here as it is not relevant to talk about 50% as the control threshold in this scenario. The decision about whether control exists is based on factors other than the ownership percentage.

Note 11

A mark given for the correct conclusion re the 72% threshold.

Note 12

A mark given for correctly identifying that the relationship is joint control.

Note 13

No further marks awarded as the answer goes on to describe full consolidation, which does not align with "joint control".

The mark for candidate two for Q3 is 14/25.

TOTAL:

14/25

Question 4

This highlights how the examining team takes a holistic view of business reporting, covering non-financial as well as financial aspects. Another feature of the SBR exam is that you will have to consider aspects of reports from the perspective of stakeholders.

> **You will have to consider aspects of reports from the perspective of stakeholders.**

Observations on the requirements

Part (a)

This part focused on the Management Commentary, identified in the syllabus as a current issue that is within the scope of the exam. The importance of the *Conceptual Framework* in the SBR exam is also underlined by the fact that it appears again in this question, requiring a discussion of the qualitative characteristics in the context of the management commentary.

Required:

(i) Discuss briefly the arguments for and against issuing the IFRS Practice Statement *Management Commentary* as a non-binding framework or as an IFRS Standard. **(4 marks)**

(ii) Discuss how the qualitative characteristics of understandability, relevance and comparability should be applied to the preparation of the management commentary. **(5 marks)**

Although this requirement is not based on a scenario, it is not asking for a simple repetition of rote learned knowledge. In the first part of the requirement, the marks are awarded for "arguments for and against" the statement being non-binding or a standard. The key to gaining marks here is to take time to think of some pros and cons, rather than to write out everything you may have learned about the Management Commentary.

In the second part of this requirement the marking scheme allocates three marks to a discussion of the characteristics, but to gain the other two marks you had to apply these to the Management Commentary.

Part (b)

Required:

With reference to the above information, explain to the investor, the nature of accounting for taxation in financial statements.

Note: Your answer should explain the tax reconciliation, discuss the implications of current and future tax rates, and provide an explanation of accounting for deferred taxation in accordance with relevant IFRS Standards. **(14 marks)**

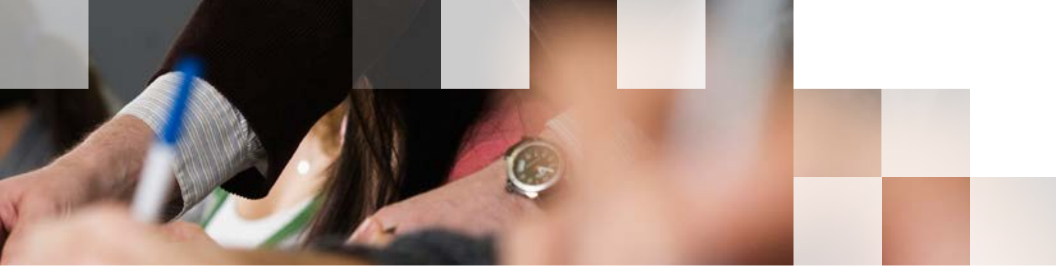
Professional marks will be awarded in question 4(b) for clarity and quality of discussion. **(2 marks)**

This requirement asked you to explain accounting for taxation to an investor. The scenario included the disclosure note analysing the tax charge, as well as some additional information. Two professional marks were available, as will be the case in the section B question that deals with any aspect of analysis and communication with stakeholders.

The marking scheme splits the 14 technical marks over the various issues, weighted towards the aspects covered in most detail in the scenario, so 5 marks for explaining the deferred tax aspects, 4 marks for explaining the items in the reconciliation, 3 marks for explaining the effect and relevance of the various tax rates mentioned, and 2 marks for explaining why taxable and accounting profits are different. The most effective way to pass this requirement would be to use the "clues" in the requirement and the scenario and try to find one or two things to say about each of these aspects, rather than spending too much time on one single aspect.

In deciding whether to award the full two professional marks, markers would consider whether the answer showed consideration of the investor, and what would be relevant to them, as well as the general clarity, logic and professionalism of the answer.

> **Clarity, logic and professionalism.**



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Notes on candidate one's answer to Q4

Follow this link to see candidate one's answer to Q4

View it here

Note 1
Two marks given for these points that demonstrate some application to the requirement, identifying problems with the guidance being non-binding.

Note 2
A mark has been awarded for each of the points about the qualitative characteristics, as each shows at least an attempt to apply these to the Management Commentary.

Note 3
Shows some relevant understanding of how the group tax charge is calculated.

Note 4
Mark awarded although the link to the points in the scenario about the company's history of losses has not been developed. More marks would have been available for this so this is a missed opportunity.

Note 5
The final three marks are awarded for making correct technical points that are relevant and make use of the scenario.

Note 6
No professional marks were awarded. The answer lacks clarity as a variety of technical points are made with little logic to their order. Also, there is no attempt made to address the investor perspective of the question.

The mark for candidate one for Q4 is 10/25.

TOTAL:

10/25

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Notes on candidate two's answer to Q4

Follow this link to see candidate two's answer to Q4

View it here

Note 1
The answer does partly address the requirement, linking some basic knowledge to the requirement for "arguments for and against", so as the points have been applied in this way, two marks are given.

Note 2
Credit has been given for all three points here, again due to the fact that an attempt has been made to apply the points to the Management Commentary.

Note 3
Two marks awarded here as points are being made that are relevant to explaining the information to the investor.

Note 4
Mark given here as there is some application apparent in reference to foreign subsidiaries.

Note 5
Two separate marks awarded to this paragraph as there is an attempt to explain two separate entries in the reconciliation.

Note 6
No marks given for copying question information with no further value added.

Note 7
Mark given for attempt to explain impact of changing tax rates in future.

Note 8
Two marks given for some basic description of deferred tax, but capped at two due to lack of application to question. The "MAX" annotations show where this cap has been applied. There is always a limit to the number of marks that can be given for pure rote learned knowledge.

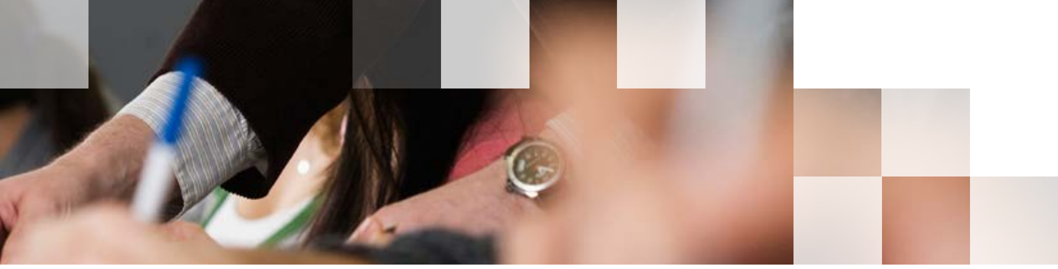
Note 9
Mark given for application of knowledge to scenario.

Note 10
One professional mark given as the answer shows some clarity of argument and presentation, but would need to demonstrate more consideration of the "stakeholder" perspective to get the full two marks.

The mark for candidate two for Q4 is 15/25.

TOTAL:

15/25



December 2018 exam marked answers

Question 3 – Candidate one

	Marks	Notes
<u>Q3 (a)(i)</u> The Conceptual Framework for financial accounting does not affect the valuation of inventory.	0	
IAS12 Inventory - inventory is valued at the lower of cost and net realisable value.	1	← Note 1
<u>(a)(ii)</u> 30 November 20x6 - low carbon content - low quality 3 year forecast → price of coal to be 20% less than the current spot price	0	← Note 2
Calculate the net realisable value: 1. Cost of removing coal from mine 2. Multiply x 3 years to get forecast price 3. Apply 20% reduction in price 4. Once price for coal is generated, the price for the lower carbon content coal can be generated.	1	← Note 3

TOTAL – Part (a): 2/7

Relevant notes

Marks

Notes

Q3 (b)

Under IFRS, a liability exists where an obligation arises.

In Fill however, we can see that there is no legal obligation to maintain the mining equipment and so the proposition by the directors should be disregarded. **1** ← *Note 4*

However, if these costs are material to Fill then it is possible to create a provision. However without knowing the materiality of these costs it cannot be advised. **0**

However, the essential maintenance costs may be, again on the materiality. **0**

IAS 36 Impairment of assets lists indications of assets, for example:

1. Decreases in the asset's market value
2. Adverse changes in the technological, market or economic environment
3. Obsolescence or damage
4. Reduction in usage.

The decline in the price of the coal is an impairment indicator, because it indicates an adverse change in the market for the coal. **1** ← *Note 5*

Fill should then perform an impairment review, to work out whether the carrying value of the mining equipment is more than its recoverable amount. Recoverable amount is the higher of: **1** ← *Note 6*

- Fair value less costs to sell, and
- Value in use

Value in use is the future cash flows from use of the asset (estimated future sales of coal, discounted to present value). **1** ← *Note 7*

TOTAL – Part (b): 4/8

Relevant notes

Marks

Notes

Q3 (c)

Under IFRS 3 Business Combinations any acquisitions must be reported by the Standards.

The current share hold of Fill of the coal mine, of 28% gives rise to an influence. This arises where a shareholding is above 20%, but below 50%, and so although there is influence, there is no control. **1** ← Note 8

However, the additional purchase of the 24% will give Fill a 52% ownership which might indicate control in some situations, but there is an operating agreement in place which requires 72% ownership prior to the approval of any major decisions. **1** ← Note 9

As Fill does not have control of the mine, it would not need to produce consolidated financial statements for itself and the coal mine. **1**

TOTAL – Part (c):
3/10

TOTAL Q3:
9/25

Relevant notes

Question 3 – Candidate two

Marks

Q3 (a)(i) Conceptual Framework and valuation of inventories

The Conceptual Framework has a chapter on Measurement. This describes various measurement methods, including historic cost, current cost and realisable value. **1**

The valuation of inventory is set out in IAS 2 Inventories, so the Conceptual Framework does not apply. The basic rule in IAS 2 is that Inventory should be held at the lower of cost and net realisable value. **1**

(a)(ii)

Net realisable value is the expected sales value less any costs to sell so to calculate the NRV of the coal now we would need to know the current spot rate and use this to value the coal less any costs needed to get the coal ready to sell and to deliver it to customers. **1**

Fill would want to fix the NRV of the lower quality coal now based on the spot rate and take out a future that fixes the guaranteed price of the coal probably at a slightly lower rate than the current spot rate. This would guarantee the NRV of the coal in three years time. **0**

The time value of money should be accounted for by using a suitable discount rate to get the present value of the future C/F and then at each year end for 3 years unwind the discount expense through P/L Finance Costs. **0**

TOTAL – Part (a):
3/7

Notes

← Note 1

← Note 2

← Note 3

← Note 4

Relevant notes

Marks

Notes

Q3 (b)

A provision should be made when it is virtually certain that an outflow of economic resource from the entity will take place and it can be reliably measured. **1**

In this scenario it would not be correct to make a provision for the reconditioning cost because there is no obligation to do the work. **1** ← Note 5

IAS 16 Property Plant and Equipment states that where an asset has a significant component with a shorter life or where periodic inspection and overhaul is required, this component should be depreciated over the period up to the overhaul. **1**

So, instead of the whole cost of the mining equipment being written off over the same useful life, $3 million should be written off over two years. **1**

Then when the reconditioning work is done, the costs of the reconditioning should be debited to the cost of the equipment and written off over the period to the next reconditioning. **1** ← Note 6

An impairment indicator is something that could suggest the value of the asset has declined. Examples are:

- Decline in market value
- Obsolescence of product through technical advances **1**

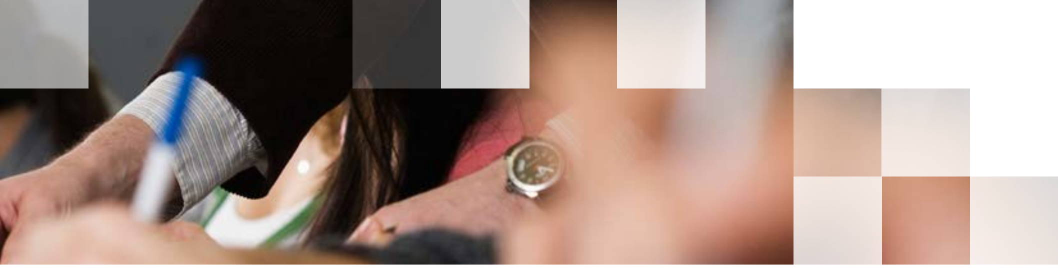
The decline in the price of coal could potentially be an indicator of impairment. **1**

← Note 7

The asset should be tested if an impairment indicator is present but without knowing more about the volatility of coals sales prices it is difficult to say if this definitely is an indicator or not. **PAG**

TOTAL – Part (b): 7/8

Relevant notes



Marks | **Notes**

Q3 (c)

Control is generally assumed to exist if one party has a 50% or more holding in an entity.

The would normally give them the highest number of voting rights within the entity which then gives them power of decisions made over dividend payments which in turn gives them control over the returns made to them by the parent entity i.e. control of the board. — **1** ← Note 8

The revised Conceptual Framework uses a similar definition of control to IFRS 10 so this will not change whether or not control exists. — **1** ← Note 9

If Fill acquire an additional 24% this will take their holding above the 50% threshold to 52% which would suggest they do then have control because they have substantially the largest holding of the entity. — **0** ← Note 10

However it would not take them over the 72% consensus needed as per the operating agreement regarding the major decision making. — **1** ← Note 11

This is a joint control relation so the % holding is irrelevant unless the operating agreement is amended. — **1** ← Note 12

The additional acquisition would be classified as a step acquisition.

Whereby an entity acquire another in stages, perhaps to reduce the risk exposure or due to insufficient funds at the time. — **0**

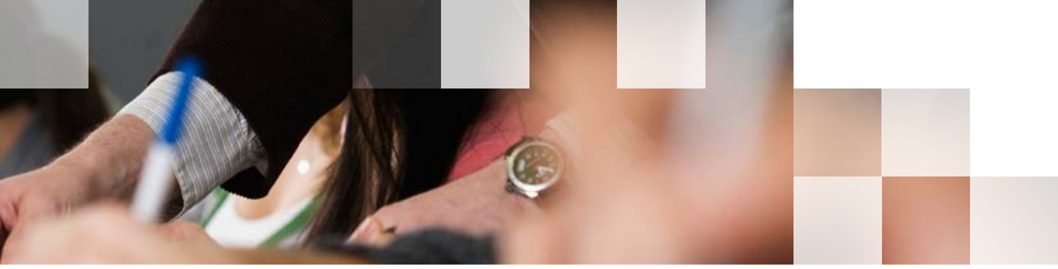
In this scenario Fill will go from having an associate to subsidiary, Associate would be one line in P&L (equity accounting) for Fill share of Associate's Profits and showing the value of the investment in the SOFP. — **0** ← Note 13

When subsidiary consolidation must take place. This means adding all of the entities' assets and liability together on SOFP and working out the Goodwill and Non Controlling Interest. — **0**

TOTAL – Part (c):
4/10

TOTAL Q3:
14/25

Relevant notes



Marks

Question 4 – Candidate one

Notes

Q4 (a)(i)

With there not being a binding framework this may mean that different companies may produce the commentaries differently which may mean it may be difficult to compare.

1

Also the company may not produce the report the same year on year so the comparison may be difficult. With the comparison being difficult this may mean the user may not be able to understand.

1

Note 1

The management may only provide information which it considers favourable.

0

(a)(ii)

The management commentary should be produced on the same basis every year so comparability can be obtained when reviewing previous versions and future versions.

1

The information should be relevant when the commentary is produced. This means it will help the users to make informed decisions.

1

Note 2

The information in the commentary should be in a layout and language a normal person can understand, not filled with large amounts of technical information.

1

TOTAL – Part (a): 5/9

Relevant notes

Q4 (b)	Marks	Notes
Firstly the tax charge is not based on the group but on the accounts of the individual companies. This is shown by the notional charge at local tax rate but the second item, difference in overseas tax rate brings the notional charge in line with the individual.	1	Note 3
When tax is calculated it also gives rise to deferred tax. This can either be an asset or liability. The reason for this is because the companies and tax authorities use different rates.	0	
When a company has a deferred tax asset these can only be applied if the company is making a profit or going to make a profit in the future.	1	Note 4
Also there will be an adjustment to the tax charge to take into account any under or over-estimate in the previous period.	1	
With the proposed change to the tax rate in future periods the tax charges in future years financial statements will increase.	1	Note 5
The $95m shown as current tax paid in the statement of cash flows is not equal to the tax charge for the year because payments are not made at the same time as the amounts are charged. The amount paid in the year will have included some of last year's tax charge and not all of this year's charge will have been paid.	1	
Prof	0	Note 6

TOTAL – Part (b): 5/16

TOTAL Q4: 10/25

Relevant notes

Question 4 – Candidate two

Marks

Notes

Q4 (a)(i)

The practice statement should be an IFRS because:

Management Commentary is an important tool to help investors determine the performance of a company and enhance their understanding of the financial performance of a company. **1**

However, the commentary can sometimes be biased and incomplete. Important bits of information can be omitted and due to there being no real control over the commentary, users can be misled. **1** ← Note 1

(a)(ii)

Management commentary can be a useful tool if it is of good quality. The three characteristics to ensure this are:

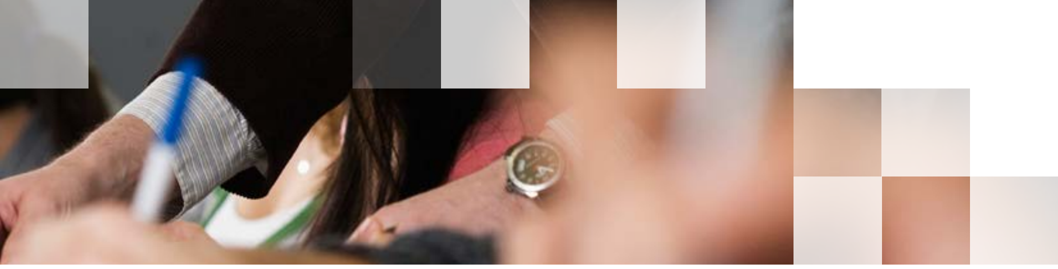
Understandability – present information in a clear and concise manner, using terminology the end user can understand. **1**

Relevance – only include information the user needs and not too much information. **1** ← Note 2

Comparability – year on year the commentary needs to link and show a progressive picture of performance. **1**

TOTAL – Part (a): 5/9

Relevant notes



Think Ahead ACCA

Marks

Notes

Q4 (b)

Taxation is calculated and recognised in the financial statements using the accruals basis, and will include some estimates. **1**

Holls Group is subject to tax audits which can change the tax paid so that is one reason why the statement of cash flows showed tax paid of $95m and the tax charge for the year was $87m. **1** ← Note 3

The tax reconciliation attempts to adjust the corporation tax which is 22% of profit to include all the other elements within the financial statements that affect tax. E.g The difference in overseas tax rates is only applicable during foreign exchange conversion and consolidation of overseas subsidiaries. **1** ← Note 4

There are some gains which are non-taxable and these have been adjusted for. Also an impairment is not recognised by tax authorities and only exists in an entity's books. Therefore this is added back as well. **1** **1** ← Note 5

The current tax rate is 22% as at November 20X7. There will be a new tax rate of 25% applicable from January 20X8. **0** ← Note 6

Holls has failed to make a disclosure informing investors of the change in tax rates which will reduce Holls Group's profit after tax most likely. **1** ← Note 7

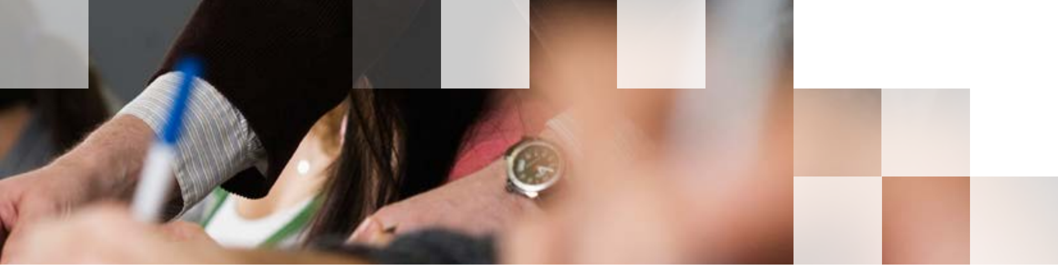
Deferred taxation arises when there is a difference between the accounting treatment of an item and its tax treatment in accordance with the relevant tax authority. **1**

If there is a difference between the carrying value of an asset and its tax base this creates a taxable temporary difference and wold be recognised on the statement of financial position. **1** ← Note 8

If the carrying value is higher than the tax base it would be recorded as s deferred tax liability. **MAX**

If the carrying value is lower than the tax base it is a deferred tax asset. **MAX**

Relevant notes



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Marks

Notes

The tax rate used for deferred tax is an estimate, based on rates enacted by the year end. So the rate of 25% should be used as the legislation was approved on 12 November 20X7.

1 ← Note 9

The current tax liability in the statement of financial position is adjusted for the deferred tax liability/asset before reaching the current tax payable in the statement of profit or loss.

0

Prof

1 ← Note 10

TOTAL – Part (b):
10/16

TOTAL Q4:
15/25

Relevant notes

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