ACCA

# Revising for the September 2020 exam session

## Part 1

## Strategic Business Reporting (SBR)

Due to the change in timing of the ACCA exams, there are now a few extra weeks before the next exam session. With this in mind, the SBR examining team highlight a few areas of the syllabus that have caused candidates problems in recent exams and give some pointers on exam techniques, specific IFRS standards and current issues.

Think Ahead

# Contents

## Introduction

This article addresses two issues: first, the application of accounting principles in contemporary contexts (an exam technique issue) and secondly the impairment of financial instruments (a technical knowledge issue). It is expected that SBR candidates will follow the guidance in this document to understand how they can assist their revision.

## Applying accounting principles to different contexts

Many candidates perceive accounting to be a technical practice and believe that SBR tests 'how you do accounting'. Whilst some of this is true, SBR also tests the application of accounting principles in different contexts because accounting is fundamentally a social practice, which guides and influences the behaviour of people in organisations and society. As such, accounting needs to be studied and understood in the contexts within which it operates. The SBR syllabus therefore focuses on the concepts, principles and practices that underpin the preparation and interpretation of corporate reports in different contexts (including ethical contexts). This is because the application of knowledge is a skill that employers' value and therefore seek… after all, an employer will not present you with a problem that has already been solved or one that you have seen before. Understandably, candidates struggle with this because they are expected to be able to use knowledge in new situations, make connections, explore outcomes and generate ideas.

# Crowdfunding

SBR candidates should be prepared for exam questions to test accounting concepts within different accounting contexts that they may not necessarily have encountered before. This section considers crowdfunding as one such context and describes the process that candidates should go through to apply their knowledge to this particular context.

Crowdfunding is the funding of a new start-up or project by collecting cash from a variety of individuals/entities often via the Internet. There are 4 common ways of raising funds:

- Equity-based crowdfunding: The equity-based approach is targeted at investors who receive shares in the new company.
- Debt-based crowdfunding: With debt-based crowdfunding, a contributor makes a loan to a business that's looking to crowdfund, with the intention of subsequently being repaid with interest.
- Reward-based crowdfunding: This involves promising specific items (rewards) to contributors before the launch of a new project, product, or business. A reward-based campaign isn't generally targeted at contributors who are looking to profit from their investment but at those who want to own a new product.
- Donation-based crowdfunding: Contributors make "donations" to a project or company and may receive existing 'rewards' in return. Some forms of donation-based crowdfunding don't involve any sort of reward as donors wish to contribute to further a particular cause.

## Considerations

Using the question scenario, candidates would be expected to breakdown a scenario and understand the information provided i.e. candidates may not have considered the crowdfunding context before, however, they should be able to understand the accounting implications of the four options above. They should be able to apply their knowledge to the context provided; for example, if the crowdfund is considered to be a debt instrument it will fall within the scope of IFRS 9, Financial Instruments, whereas if it gives rise to an issue of capital, it will fall within the scope of IAS 32, Financial Instruments Presentation.

If the crowdfunding campaign involves the issuing of 'rewards', then IFRS 15, Revenue from Contracts with Customers, should be used to determine when to recognise revenue. For each performance obligation, the company will need to determine whether the performance obligation is satisfied over time (i.e. control of the good or service transfers to the customer over time). If one or more of the criteria in IFRS 15 are met, then the company recognises revenue over time. If none of the criteria is met, then control transfers to the customer at a point in time and the company recognises revenue at that point in time. However, if the company cannot reasonably measure the outcome but expects to recover the costs incurred in satisfying the performance obligation, then it recognises revenue to the extent of the costs incurred.

**Example**

On 1 September 20X9, Burnett Co decided to undertake a crowdfunding campaign to finance the production of a new racing bike, the Cracken. They made a short film with famous cyclists which set out the qualities of the Cracken bike and posted it on the PeddleStarter crowdfunding platform. The campaign raised $4 million on which PeddleStarter charged 7% commission. The contributors to the crowdfunding campaign were promised a reward of 1 Cracken bike for every $4,000 dollars contributed. At the financial year end of 31 December 20X9, Burnett Co had manufactured only 50 Cracken bikes at a total cost of $240,000 but none had been delivered to contributors. There was some doubt as to the capability of the company to develop, manufacture, and deliver the bikes promised but Burnett Co is sure that the funding will cover any costs incurred.

**Suggested answer**

IFRS 15, Revenue from Contracts with Customers, should be used to determine when to recognise revenue. At 31 December 20X9, it is difficult to know what the outcome will be as only 50 bikes have been manufactured out of a promised 1000 bikes ($4 million/$4000) and there is a doubt as to whether the company has the capability to develop, manufacture, and deliver the bikes promised. However, Burnett Co expects to recover the costs incurred in satisfying the performance obligation, thus it will recognise revenue to the extent of the costs incurred to date $520,000 ($240,000 + commission $280,000) as at 31 December 20X9. The balance remaining from the crowd funded amount will be shown as accrued revenue in the financial statements ($3,480,000). The commission ($280,000) would be charged against profit or loss for the period.

**Guidance**

Many SBR candidates may now have some extra time to reflect and rethink values, concerns and routines, one of which may be their approach to study. It may be a time to not focus on accounting techniques but on accounting principles, to maybe read around the subject and gain an understanding of what lies behind it. Remember the following:

- The importance of a robust conceptual framework
- An understanding that rules will not be able to cover all situations
- Use of reasonable judgement is always needed in the decision-making process

To further help understand what is expected of you, SBR candidates should read all of the examiner's reports that are available at each exam diet; for example, the examiner's report for March 2020 observed that there was a lack of knowledge of some basic accounting concepts and many candidates did not have an understanding of ‘equity accounting’. A significant number of candidates did not know that ‘the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets.’ If candidates do not understand the basics, it will be almost impossible to apply that knowledge to different accounting contexts. Therefore, it is important that the basic principles of FR Financial Reporting are understood by candidates BEFORE attempting the SBR exam. See ‘Stepping up from Financial Reporting’ for more information.

## The Impairment of Financial Instruments

One technical area of the SBR syllabus that candidates often struggle with is the impairment rules of IFRS 9, Financial Instruments. IFRS 9 uses an Expected Credit Loss (ECL) model which requires a calculation of the expected value decrease in a financial asset. Essentially, a provision is required for expected credit losses on the financial asset over a period of time. Expected losses should be discounted to the reporting date using the effective interest rate of the financial asset that was determined at initial recognition.

The impairment model of IFRS 9 introduces a three-stage approach:

- Stage 1 deals with financial instruments that have not had a significant increase in credit risk since they were first recognised or that have low credit risk at the financial year end. For these assets, 12-month ECL are recognised which means that the entity has to calculate the expected losses in the next 12 months taking into account the risk of default. Any interest revenue is calculated on the gross carrying amount of the asset without the deduction of the credit loss.
- Stage 2 deals with financial instruments that have had a significant increase in credit risk since they were first recognised unless the credit risk is still low at the financial year end. These instruments are not credit-impaired. The expected losses over the life of the financial instrument are recognised (lifetime ECL) taking into account the risk of default. Interest revenue is still calculated on the gross carrying amount of the asset.
- Stage 3 deals with financial assets that are credit-impaired, which is where events have occurred that have a detrimental impact on the estimated future cash flows from the financial asset. For these assets, lifetime ECL are also recognised. However, interest revenue is calculated on the carrying amount less the ECL allowance.

**Example**

On 1 January 20X6, Lunar Co granted Skyzer Co a $5 million secured loan repayable on 31 December 20X9 with an interest rate of 3% payable annually at the reporting date.

| Stage 1 | Stage 2 | Stage 3 |
|---|---|---|
| On 31 December 20X6, there has been no increase in credit risk and the probability of default in the next 12 months is 5%. The present value of the cash shortfalls expected over the life of the instrument if the default occurs in the next 12 months is $200,000. | On 31 December 20X7, the credit risk of the loan has increased significantly.<br>The probability of default occurring over the remaining life of the loan is 45%. The present value of ECLs from default events over the life of the loan are expected to be $400,000. | On 31 December 20X8, the loan is credit impaired. The estimated present value that is expected to be recovered (less costs) is $4 million.<br>The gross carrying amount of the loan is $5,150,000 which is the loan plus unpaid interest for the year. |
| 12-month ECLs = $10,000 ($200,000 × 5%).<br>Interest revenue = $150,000 (3% × $5m i.e.no adjustment for any loss allowance). | Lifetime ECLs = $180,000 ($400,000 × 45%)<br>The change of $170,000 in the cumulative impairment allowance is recognised in profit or loss.<br>Interest revenue = $150,000 (3% × $5m i.e.no adjustment for any loss allowance). | Lifetime ECLs = $1.15 million ($5.15 - $4) million<br>The change of $970,000 ($1.15-$0.18)m in the cumulative impairment allowance is recognised in profit or loss.<br>Interest revenue for 20X8= $150,000 (3% × $5m)<br>20X9 interest revenue = $120,000 (3% × $4 million) which is based on gross carrying amount minus loss allowance |

For trade receivables or contract assets that do not contain a significant financing component, the loss allowance should be measured, at initial recognition and throughout the life of the receivable, at an amount equal to lifetime ECL. As an exception to the general model, if the credit risk of a financial instrument is low at the reporting date, management can measure impairment using 12-month ECL, and so it does not have to assess whether a significant increase in credit risk has occurred.

**Guidance**

If you are struggling with a technical issue in the SBR syllabus, try to pair it back to basic principles that you can use in any context. For example, the suggested solution above relies on an understanding of the accounting principles that apply at each stage of credit impairment. Understanding and applying these principles in an exam context will demonstrate a deep understanding of the issue and an ability to apply it to the question scenario. It is these skills that employers are looking for and examiners will award marks for.

## Conclusion

This article addresses two issues that SBR candidates have struggled with in recent exam diets; one relates to exam technique and the other a more technical issue. Given that some ACCA exams have been delayed, candidates should use the guidance provided here to aid their revision. Finally, a plea for SBR candidates to answer **all** parts of **all** questions. Please help the examining team to pass you!