Examiner's report

P2 Corporate Reporting
June 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 principle-based nature of IFRS is not always understood by candidates. Often candidates' answers reflect inexperience in the use of judgement in reporting under IFRS. It is important that candidates have an understanding of IFRS based on the Conceptual Framework whilst developing the capability to make judgements. The issue is how to create a learning environment that promotes high-quality learning. Candidates should construct their learning through engaging in relevant learning activities. Candidates are often criticised because their perception is that the objective of their education and training is to know facts. This leads to candidates perceiving and tackling problems from a narrow perspective. The retention of information is important to those students. However, candidates who interpret the meaning of the information and adopt a deeper approach are likely to be more successful in the examination. Candidates should think critically about the subject, which as a consequence means that it is more likely that the information will be retained long-term. Effective study methods coupled with the above approach will achieve the best possible scores in the examination.

The Conceptual Framework sets out the concepts upon which the Standards are based. The majority of IFRS requirements are deemed to be consistent with the concepts set out in the Framework. However, the application of the cost constraint has resulted in some IFRS being inconsistent with the Framework. For example, there are certain underlying definitions that are currently used in IFRS but not dealt with by the Framework.It is important that candidates appreciate this problem with the Framework and can identify those standards that are inconsistent with the Framework. This knowledge is relevant to all questions in the examination. Further, candidates should realise that some decisions on accounting issues have been based more on expediency than on concepts. Often, candidates' answers appear quite naïve in terms of the practical application of the standards.

Currently, the Framework assists preparers in dealing with transactions that are not the subject of an IFRS. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* sets out the role of the Framework in this situation. There are several standards such as IAS 8 that may not immediately seem relevant when answering a question but which have to be considered if fair presentation is to be achieved. Such standards may include IAS 1 *Presentation of Financial Statements*, IAS 10 *Events after the Reporting Period* ,IAS 24 *Related Party Disclosures* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This is not an exhaustive list and candidates should consider the relevance of the standards when looking at the scenarios in the examination paper.

Candidates should understand the objective of financial reporting and the other main concepts set out in the Conceptual Framework plus the economics of the particular transaction or event. They should understand the extent to which the requirements of a standard are consistent with the objective and concepts set out in the Conceptual Framework. Furthermore, there should be discussion as to why it was not cost effective to maximise the main concepts in the Conceptual Framework.

IFRS financial statements are based on estimates, judgements and models. Candidates need to have awareness of IFRS judgements and estimates, and develop competence in making IFRS judgements and estimates. In order to facilitate this approach, there are several video/web clips issued by firms of accountants, which may be helpful. In addition tutors should facilitate class discussions, and use case studies, extracts from published financial statements, and press reports to give students this deeper knowledge. This approach will help even those candidates that take a strategic approach to study looking upon the educational process as being purely success driven.

Question One

This question generally requires candidates to prepare a consolidated financial statement. Where this question is a statement of cash flows, there are certain key factors, which candidates should take into account (The March /June 2016 sample paper includes a question on a statement of cash flows). Question 1 is key to candidates' success in the examination. Unlike the general guidance given above, part 1a of this question relies mainly upon accounting technique. Statements of cash flows offer the candidate an opportunity to gain relatively straightforward marks if they have an understanding of the principles behind the preparation of the statement. Marks are not awarded for the presentation of the statement of cash flows and thus it is important that candidate's workings are clear. Workings are acceptable on the face of the statement and inaccurate references to the workings are not penalised as the markers examine all workings recorded in the script for relevance to the question. Even the simplest of calculations should be shown. For example sometimes, candidates can inaccurately sum two figures. If there were a correct working, then candidates would not be penalised for the summation error. This part of the question 1 does not require a discussion of the calculations performed. When marking the question, credit is given for the method used by the candidates and this does not require an explanation. Thus candidates can save time by simply laying out their workings in an orderly manner. Marks are awarded on the face of the statement of cash flows or in the workings. If a candidate has correctly shown the element on the face, then no further marks will be awarded in the workings. However, if there is an incorrect calculation on the face of the statement, then the workings will be scrutinised and marks awarded if the workings show that the calculation is partially correct. Invariably, there is an adjustment to be made to arrive at 'Profit for the year'. This calculation should always be clearly detailed in the workings as marks are awarded for picking up the correct opening figure from the financial statements. The calculation of 'Cash flow from operating activities' gives candidates an opportunity to score well. Candidates should understand the principles behind the adjustment of 'Profit for the year' to arrive at 'Cash flow from operating activities'. Such elements as depreciation, impairment, amortisation and finance costs are likely to appear as an adjustment in most statements of cash flow.

The 'movements in working capital' section of the statement is generally well answered by candidates but often problems arise with the signage of the movements with the result that positive movements are inaccurately shown as negative movements. Candidates receive no credit for inaccurate calculations in this regard even though the numbers used in the calculation may be correct.

The 'Cash generated from operating activities' will invariably include finance costs and income taxes paid. Income Taxes paid is often a difficult calculation and hence the need for a clear working to be shown. Marks can then be awarded for the elements of the working rather than simply the final figure for income taxes paid.

'Cash flows from investing activities' will normally require significant workings. The elements normally would include the calculation of payments for PPE and intangibles, dividends received from associates, purchase of an associate and the disposal proceeds/consideration from/for the sale/purchase of a subsidiary. These types of cash flows are standard to this type of question. The treatment of a subsidiary acquired or disposed partially signifies the difference between the F7 paper and the P2 paper and thus would almost always be included in this type of question. Generally, candidates find this section quite difficult. This is particularly so as regards the purchase of PPE.

The next section of the statement involves 'Cash flows from financing activities'. This section includes repayment of borrowings, cash arising on the issue of shares and dividends paid to the NCI. Relatively easy marks can be gained here particularly with the repayment of borrowings, and cash arising on the issue of shares. However, some candidates seem to ignore the easier marks in favour of the more difficult calculations. It makes sense to gain the easy marks before spending time on the more difficult sections. Finally, it is important to ensure that the final section of the statement is completed, that is the net increase/decrease in cash and cash and cash equivalents and the opening and closing balances. Credit is normally given for this section.

Question 1b is generally based upon the same subject area as question 1a and it will require a critical discussion of the area. For example with statements of cash flows, the limitations of the statements are always a good examination topic as are the problems of the direct and indirect methods. Candidates need to come to the examination with an understanding of the limitations of corporate reporting as well as the nature of it. In the latest sample paper, statements of cash flows and Integrated Reporting were combined in a single question 1b. The various elements of corporate reporting are not distinct but are interrelated. Thus the information content of a statement of cash flows can be compared to the information content of an Integrated Report and candidates should be capable of giving a view on the two reports.

Question 1c links ethics with the reporting of transactions. Inevitably there will be a scenario where the entity or its employees are acting unethically and candidates will be required to discuss the reporting and ethical issues involved. Surprisingly, many candidates focus on the reporting issues to the detriment of the ethical issues. The marks in this part of the question are often split equally or maybe there is one mark difference for the two elements. Therefore to not discuss the ethical issues is a serious omission by candidates.

Question Two and Three

The approach to these two questions is quite similar, although the nature of the questions can be different. Question 2 would normally have a theme. For example in the latest sample paper the theme was fair valuation. Question 3 would normally be based around a specific industry or setting. For example in the latest sample paper, the question was based around a sports organisation. Specialist knowledge of the organisation is not required.

In question 2 of the sample paper, the question was based around the principles of IFRS 13 Fair

Value Meausrement. Prior to this standard there was no single definition or *framework* to be applied. The IASB Conceptual Framework discussion paper discusses the use of fair value in the context of IFRS 13, which in turn is based upon the level of activity in the exit market, or the valuation technique(s) used. Fair value is a market-based exit price that considers the current market conditions as at the measurement date. Hence candidates when answering the question should be aware of the principles behind the standard. These principles include 'highest and best use'', 'principal and most advantageous market' and the use of valuation techniques. There is no hierarchy of valuation techniques. Candidates often simply quote the valuation hierarchy without really understanding the nature of it. Candidates need to understand exactly what level 1,2,3 inputs actually are.

IFRS 13 affects nearly all IFRS s where fair valuation is required. The exceptions are IFRS 2 *Share-based payment* and leases under IAS 17.IAS 2 *Inventories* uses net realisable value which is not the same as fair value and IAS 36 *Impairment of Assets* utilises value in use which again is a different valuation technique. This question also required a valuation of unquoted investments essentially using the principles of IFRS 13.The prospect of answering such a question may seem quite daunting but if candidates use their general knowledge and experience in answering such a question is not quite so problematical. For example, if a fair valuation were to be placed upon a motor car, the market prices for a similar car would be used and adjusted if the mileage on the car was significantly different. The same principle applies to shares. That is, look at an equivalent transaction price for a similar share and use that as a starting point.

In question 3, invariably, there are several events to discuss. The approach to be taken is to discuss the principles and then apply them to the scenario. The mark allocation can vary between principles and application, although as a general rule the marks are split equally between the two elements of the answer.
In the sample paper, question 3 dealt with IAS 23 *Borrowing Costs*. This standard meets the criteria of understandability, relevance, reliability and comparability set out in the Framework. The model answer does not mention this point but an inclusion of such a sentence would score marks. The question required knowledge of the standard and application to a simple scenario. This principle applied to parts b and c.
In part b IAS 38, IAS 36 and IFRS 5 *Non Current Assets Held for Sale* were the main standards to be discussed. In this type of question, candidates should break down the scenario into its main components and answer each component separately. In this way marks will not be lost by omitting some of the elements of the question. IAS 38 is consistent with the Framework as regards the definition of an asset.
Part c of the question dealt with IFRS 13 and IAS 24.The same principles as above applied to this question.

Question Four
This question generally deals with 'current issues'. The determination of what constitutes a current issue is obviously quite subjective. A new IFRS would constitute a current issue as would an ED if the subject matter were significant for example the ED on Leases, which was examined in June Additionally problems relating to an accounting standard would be categorised as a current issue as would regulatory issues. Regulatory issues may relate to pronouncements by bodies such as ESMA (European Securities and Markets Authority). However there would not be a need to have studied those pronouncements in detail as the subject matter would be standards that are within the syllabus.

The effects of new standards on business reporting would be considered a current issue and this topic formed the basis of question 4 in the sample paper as did the focus of regulators upon problems of impairment and deferred tax. There are certain general problems that most standards face. Consistency with the Framework is one as set out above. Other problems would include assumptions used in estimates, judgements used by directors, valuation issues, the use of discount rates, the age of the standard and its current application, the nature of the evidence needed to apply the standard and lack of clarity in the standard. Lack of clarity can be evidenced by recent changes to the standard by the IASB in their Update series. Also, some standards seem to remain at the ED stage for a disproportionate amount of time, thus indicating problems with the subject area. A useful source of information about a standard is the Project Summary and Feedback statement issued by the IASB after a standard is issued.

Thus in order to answer this question, candidates should be prepared to read around the subject and gain an understanding of the issues involved. It is not a rote-learned area of the syllabus.