Examiner's report

P2 Corporate Reporting
September 2017

ACCA

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 Corporate Reporting examination requires a deep knowledge and understanding of the IASB's *Conceptual Framework*, IFRSs and ethical issues that may arise in given scenarios. Questions at the professional level require a candidate to demonstrate their knowledge by applying it to problems presented in the questions. A well-prepared candidate should maintain their knowledge and keep up to date with topical issues, as this exam usually contains one question focusing on a current issue. Candidates who rely on a single text book or a short revision course, therefore, may find themselves underprepared.

As in previous examinations, this examination required candidates to display more than just a rote-learned knowledge of accounting standards. Professional accountants are required to advise clients, and the Corporate Reporting examination tests a candidate's ability to apply knowledge which requires an explanation of the correct accounting treatment, the principles that underpin the treatment, and the implications of this, in complex scenarios. As in previous exams, this paper required a critical evaluation of different accounting treatments, using the *Conceptual Framework's* definitions and recognition requirements as a guide. Candidates should be mindful of the requirements of the question; for example, if the requirement states "advise the directors how the issue should be dealt with, in accordance with relevant IFRSs", then a well-prepared candidate would outline their knowledge of the issue, referring to the *Conceptual Framework* and appropriate reporting standard(s), and then apply this knowledge to the given situation. Often, less-prepared candidates omit one of these two aspects, limiting their response to a listing of reporting requirements, or jumping directly to the application element (the accounting treatment) without a clear explanation of why the method is appropriate. Professional accountants are expected by their clients to provide advice which outlines both the correct accounting treatment and also the reasons for this treatment. Candidates who failed to display both knowledge and application limited their opportunities to gain marks.

Most examination questions include narrative that can often provide more guidance on the focus of an answer, so candidates should ensure that they read the full question carefully. Candidates should also ensure that they meet the requirements in full to maximise their opportunities for gaining marks, and be aware of where to focus their attention. Where a requirement uses the word "briefly", this means that this aspect should be given less emphasis in the answer. Where the requirement asks for candidates to "prepare", then there is no need to provide lengthy explanation beyond the workings needed as a part of the preparation process.

Specific Comment

Question One

This question was divided into three parts. The first part (Q1a) required the candidate to prepare a consolidated statement of cash flows for a group with one subsidiary acquired at the start of the reporting year. The second part (Q1b) examined the accounting treatment of decommissioning costs using the underpinning principles contained in the *Conceptual Framework* and its definitions. Finally, the third part (Q1c) questioned the benefits of environmental disclosures provided in an integrated report, and the ethical implications of unsubstantiated claims included in the report.

The candidates who performed well in this question had clearly practiced these types of questions and included appropriate workings, often within the cashflow statement itself (in brackets) to save time. However, some candidates spent too long explaining accounting treatments with detailed but unnecessary narrative. Candidates should read the requirements for each question carefully. Unlike other questions in this exam, the requirement for question 1a was to *prepare,* not explain.

Question 1b was generally well-answered, provided that candidates followed the requirements to discuss the accounting principles, and then consider whether decommissioning costs should be capitalised. A good answer defined an asset (and liability) and then applied this to the scenario.

Question 1c required a *brief* discussion of the benefits of environmental disclosures in an integrated report. In many cases the answer focused too long on these benefits and too little on the ethical considerations of a report containing unsubstantiated claims. A range of possible points could have been raised by candidates relating to the ethical issues, and candidates were given due credit for relevant opinions on the subject matter of the question. However, there continues to be a tendency for candidates in such questions to provide a 'boiler plate' answer on ethics, with less reference to the situation (such as the accuracy of the financial statements and the motivation and self-interest of directors).

Question Two

This question required candidates to provide advice to a business on the accounting treatment of three issues relating to: (a) the accounting treatment of Share-based Payments to employees and non-employees; (b) an impairment test calculation; and (c) the measurement of a financial asset under IFRS 9.

The first issue examined the candidate's knowledge and application of IFRS 2 *Share-based Payment* and also a comparison of fair values with IFRS 13 *Fair Value Measurement*. Most candidates appeared well-prepared in their explanation of the treatment of transactions with employees, but a comparison with non-employees tended to be too brief, or overlooked.

Answers to the second issue on the impairment of a cash generating unit (CGU) were also well-answered in general with many candidates outlining the importance of including all assets within the CGU that generate the cash stream in an assessment of the recoverable amount. However weaker answers tended to list out the process of impairment without considering the specifics of the scenario.

Candidates' answers to the third issue (on the treatment of a financial asset – a fixed-rate loan) were mixed. Whilst many answers outlined the valuation methods of IFRS 9, including the business model test and cash flow characteristics that permit the amortised cost treatment, many answers did not apply these requirements correctly.

Question Three

Question 3 was a case study question requiring advice on the application of the relevant reporting standards. In part (a), candidates were required to discuss the correct treatment of a combined contract of a piece of equipment, a two-year warranty, and a ten-year maintenance service. The question specifically required the treatment under IFRS 15 *Revenue from Contracts with Customers*, and included individual sales prices if each were sold separately. This part of the question was relatively well-answered, although some answers tended to focus too long on the five steps of the recognition model. This aspect has been covered in previous exams and at this stage candidates are expected to go beyond the knowledge, and apply the standard (as required in Q3c, March/June 2017). Most candidates did this and correctly allocated the price to performance obligations based on stand-alone prices, as well as explaining the need for deferral where appropriate.

Part (b) required a discussion from candidates on the accounting treatment of a fixed price forward contract (in a foreign currency) to purchase steel, under normal usage requirements. The narrative asked for the accounting treatment of the contract (given stated changes in exchange rates), and whether it was within the scope of IFRS 9 *Financial instruments*. This was less well-answered as many candidates failed to recognise that the contract did not meet the scope of IFRS 9, and some answers spent too long on the accounting treatment under this standard, without making it relevant to the scenario. Very few answers applied the *Conceptual Framework* or considered whether the contract should be recognised or the implications of the changes in foreign exchange on the payable price (onerous contact aspects). Most answers brushed over this and focused instead on foreign exchange translation, albeit with minimal consideration of the treatment of the (non-refundable) non-monetary deposit.

In part (c), candidates were required to discuss the accounting treatment of expenditure that tests the prototype of an asset which should result in efficiencies. The question stated that regulatory approval had been obtained for the prototype, but there was slight doubt about the performance of the asset in extreme weather. Other recognition aspects under IAS 38 Intangible Assets were confirmed (e.g. sufficient resources). There was a minor issue of how to recognise sales in the test phase. Most candidates answered this section well, with better answers defining development, and considering whether recognition requirement under IAS 38 are met, Good answers applyied the requirements to the scenario and considered whether the technology being tested to create more efficient products met the definition of an asset. Fewer answers considered the possible inclusion of the assets as plant property and equipment (since they are productive). Weaker candidates jumped to the incorrect conclusion that the expenses are not development costs because of (slight) doubts mentioned in the question, without gaining the marks available to explain first what the requirements are. Most candidates briefly suggested how the sales made from the prototype testing should be treated, but few considered the possibility of offsetting or whether this goes against the *Conceptual Framework*.

Question Four

This question is normally the current issues question, and on this occasion the issue related to IFRS 16 *Leases*. Q4(a) had two parts that first required an evaluation of why increased disclosure requirements would not be sufficient alone to resolve the issue of ‘off balance sheet leases’. Candidates answered varied in quality, with weaker answers tending to outline the controversies of lease accounting only. Better answers discussed the impact of non-recognition of leases on ratios, and the fact that investors have to adjust the financial statements to allow a fair comparison. They also tied the issue into the arguments of information overload and the disparity in accounting treatment for what are economically very similar transactions. The second part required a discussion about how IFRS 16 may impact on the financial statements (specifically the statement of financial position, the statement of profit or loss and the statement of cash flow). Answers were, in general, good but the better answers were split into sections, and considered the impact of including a depreciable right of use asset and liability. For Q4b, candidates were required to discuss the accounting treatment under IFRS 16 of two leases, both of which had qualities specific to IFRS 16 (the option to combine a portfolio of similar leases, and an election to account for leases of less than 12 months as an expense). Most correctly identified the optional treatment of the latter.

In conclusion, candidates need to have a better understanding of what is being asked of them. As with other P level exams, the Corporate Reporting exam reflects a post-graduate level of study and so candidates need to be able to demonstrate their knowledge through its application to the given scenario. Merely writing down their knowledge will not be enough to pass.