Examiner’s report

P2 Corporate Reporting
June 2010

General Comments

The paper dealt with a wide range of issues and accounting standards. The paper was quite testing but candidates responded well resulting in a satisfactory pass rate. Candidates generally applied good examination techniques in answering the paper. However yet again there was evidence of candidates only answering two questions rather than the three questions required. This was particularly true of those candidates sitting the Malaysian and Hong Kong papers. Candidates seem to be answering the 50 mark question quite well but often the ethics section is not being answered. This would seem to suggest that either candidates have a problem with ethical issues which is a concern or candidates do not appreciate the importance of attempting all of the examination paper. An additional issue that was apparent was that candidates still do not have a good understanding of accounting for financial instruments which are examined frequently in this paper. An understanding of the accounting treatment of financial instruments is a fundamental pre-requisite for sitting this paper.

Specific Comments

Question One

The question required candidates to prepare a consolidated statement of comprehensive income, describe the amendments to the rules regarding reclassification of financial assets, and discuss how these rules could lead to ‘management of earnings’. Further candidates were asked to discuss the nature of and incentives for ‘management of earnings’ and whether such a process could be deemed to be ethically acceptable. Candidates generally performed well in this question. Candidates were required to calculate goodwill on the purchase of a subsidiary in order to determine the impairment of goodwill to be charged in the income statement. Candidates seemed to have a good knowledge of the calculation of goodwill under the full goodwill method. The question also dealt with the sale of an equity interest in a subsidiary which resulted in a positive movement in equity which was dealt by a movement on equity and not through other comprehensive income. Finally as regards the group accounting, candidates had to deal with the sale of a controlling interest which resulted in the retention of an associate interest. Generally candidates performed well this part of the question. The question also required candidates to deal with the accounting for an available-for-sale financial instrument using amortised cost. Candidates made a reasonable attempt at this element of the question. Other elements of the question included dealing with revenue recognition, revaluation gains/losses on property, plant and equipment, calculating non controlling interest and accruing holiday pay for the entity. In a question such as this, it is very easy to make a mistake in calculation. Thus it is always important to show workings in a clear concise manner so that marks can be allocated for the principles and method used by the candidate.

Part b of the question required knowledge of the recent change in accounting for the reclassification of financial instrument. Candidates did not perform well on this part of the question. It is important that candidates keep abreast of recent developments as the paper frequently examines recent pronouncements. Management of earnings was the topic which linked parts b and c. Candidates would benefit from wider reading in this area and also in the area of ethics. Often candidates’ answers are narrow and seem to lack application. A few hours researching management of earnings and ethics could be very beneficial. Candidates who answered part c on ethics performed satisfactorily.

A good performance on question 1 by candidates is key to success in the paper. Good performance always s linked to answering all parts of the question and to a fundamental understanding of group accounting. However, candidates should not spend a disproportionate amount of time on the question.

Question Two

This question dealt with real world scenarios taken from corporate financial statements. It is important that the exam paper reflects actual issues in financial statements and that candidates can apply their knowledge to these scenarios. The first scenario dealt with deferred tax assets and their recognition in financial statements. This part of the question was well answered. Part b dealt with impairment of assets where an entity wished to use a method not in accordance with the standard. It required candidates to apply their knowledge to the situation and not just repeat the rules in the standard. This part of the question was well answered.

Part c looked at a situation where a company had a direct holding of shares and the subsidiary issued new shares which were not subscribed for by the holding company with the result that the interest was reduced to that of n associate. The question required candidates to determine whether the results should be presented based on principles provided by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Candidates performed quite well on this part. The key to success is to set out the principles in the standard and then to apply each one to the case in point.

The final part dealt with the existence of a voluntary fund established in order to provide a post-retirement benefit plan to employees. The entity considered its contributions to the plan to be voluntary, and had not recorded any related liability in its consolidated financial statements. The entity had a history of paying benefits to its former employees, and there were several other pieces of information in the question. Candidates had to apply their knowledge of defined benefit schemes to the scenario. It did not require an in depth knowledge of the accounting standard but an ability to apply the principles. The question was answered satisfactorily by candidates.

Question Three

This question was a case study type question based around a company in the edible oil industry. The company processed and sold edible oils and used several financial instruments to spread the risk of fluctuation in the price of the edible oils. Additionally, the company was unclear as to how the purchase of the brands and certain entities should be accounted for.

It involved knowledge of derivatives, hedging and embedded derivatives at a fundamental level. Candidates did not have to apply their knowledge to any degree but simply had to recognise the nature of the various financial instruments involved and discuss their accounting treatment. This knowledge is essential knowledge and will be examined in future diets. Candidates' answers were satisfactory in the main but few candidates recognised the embedded derivative. The accounting for the brands was quite well answered with many students gaining high marks. The final part required candidates to apply IFRS 3 *Business Combinations* to a scenario. The answers were often quite poor with the main weakness being the application of the knowledge and the understanding of the nature of the purchase of the entities.

Question Four

This question required candidates to discuss the reasons why the current lease accounting standards may fail to meet the needs of users and could be said to be conceptually flawed. The second part of the question required a discussion of a plant operating lease in the financial statements met the definition of an asset and liability as set out in the *'Framework for the Preparation and Presentation of Financial Statements.'* Candidates' answers were quite narrow in their discussion of the weaknesses in the accounting standards. The definitions of asset and liability were well rehearsed and candidates scored well on this part of the question. It is apparent that very few candidates read widely. This question always deals with current issues which mean that a wider reading base is required to achieve a good mark. Accounting and Business, and the *student accountant* are just two examples of magazines that provide wider exposure to current issues.

The final part of the question required candidates to show the accounting entries in the year of the sale and lease back assuming that an operating lease was recognised as an asset in the statement of financial position and to state how an inflation adjustment on a short term operating lease should be dealt with in the financial statements of an entity. The purpose of this question was to show how a change in the current accounting standards (by recognising operating leases in the statement of financial position) would affect their accounting treatment. The question was well answered and candidates scored well generally on this question.