Examiner's report

P2 Corporate Reporting
June 2014

Introduction

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.

Question 1 is a lengthy and difficult question and it is important that candidates do complete all sections of this question. It is surprising that often candidates do not complete part 1c, which is the ethics element of the question. In many ways this is quite worrying as it would be hoped at this level of examination that candidates would be able to discuss an ethical scenario in some detail. Additionally, marks can readily be gained for a well-argued ethically based answer. Feedback from various quarters seemed to indicate that the paper was considered to be a fair test for candidates but the results suggest that many candidates had not prepared in the best way for this exam. There are various tutors who provide students with 'tips' for the examination and invariably given the number of tutors providing theses 'tips', some will be accurate. However, the best way to prepare for the examination is to understand the key areas of the syllabus and not rely on rote learned answers to questions or 'tips'. It was evident from the answers submitted that candidates often could not apply basic mathematical principles to the questions. This was evident in question 2 parts b and c. This report will set out how candidates should apply themselves in answering this paper, and will give an insight into how marks can be gained in the examination paper.

The normal problems arose for some candidates such as failing to read the question clearly and therefore providing irrelevant answers, and poor time management where candidates spend too much time on one aspect of a question. However, many candidates do not have a basic understanding of the standards, which causes a problem, as most questions require this knowledge. Section B of the paper requires candidates to discuss various issues but many candidates simply deal with the numerical aspect of a question without the necessary explanations. The problem that arises in these circumstances is that if the calculations are incorrect then candidates will lose most of the marks for the question. Many of the questions are based around real life scenarios, and the marks are allocated for knowledge of the standard and its applications to that scenario. An accountant would not advise a client by quoting a standard to that client. An accountant would give advice that appertains to the specific circumstances of that client and this paper attempts to replicate that scenario. Many of the real issues in practice revolve around some of the core standards .So it is important that candidates understand, for example, the difference between debt and equity, the nature of an intangible asset, how assets 'held for sale' are dealt with .The examination paper always attracts comments on some of the wording and technical aspects of the answers. These comments are always taken into account in the marking of the paper. However, in determining whether a candidate passes or fails, the comments often have a marginal affect. The main reason for failure is simply lack of basic knowledge of the standards and lack of the ability to apply them. In terms of the current issues aspect of the paper, candidates should understand real issues affecting the profession and these issues will not always be EDs or DPs or new standards when they are initially released. Students should read widely and not be dependent upon a textbook or manual. The latter are a good source of material but there is a need to gain a wider understanding and to contextualise the knowledge gained#

Question One

Question 1a required candidates to prepare a consolidated statement of profit or loss and other comprehensive income for the year ended 30 April 2014 for the Merchant Group and this carried 30 marks and additionally for 5 marks candidates were asked to explain, with suitable calculations, how the sale of the 8% interest in one subsidiary should be dealt with in the group statement of financial position at 30 April 2014.This type of question is normally framed so as to test group accounting principles. Thus, candidates were expected to calculate goodwill and deal with impairment of goodwill and its reversal. Candidates dealt with the calculation of goodwill very well. However, any subsequent increase in the recoverable amount is likely to be internally generated goodwill rather than a reversal of purchased goodwill impairment. IAS 38 Intangible Assets prohibits the recognition of internally generated goodwill, thus any reversal of impairment is not recognised. Candidates did not deal particularly well with this point. Additionally there was some intra-group trading and the elimination of this element from Revenue and cost of sales. However, the loss on the sale of the inventory should not have been eliminated from group profit or loss. This is because the sale was at fair value, and therefore the inventory value must have been impaired with the loss on sale realised. Merchant sold a controlling interest in another subsidiary, with the result that a gain or loss on disposal was calculated. Additionally, the results of that subsidiary only had to be consolidated in the statement of profit or loss and other comprehensive income for the six months to 1 November 2013.Thereafter the subsidiary became an associate and should have been equity accounted. Candidates generally accounted for this disposal very well.

The question also required candidates to account for a defined benefit scheme which had not been accounted for and this included a remeasurement loss and accounting for past service costs. Past service costs arise out of a plan amendment and are the result of a change in the present value of the defined benefit obligation. In this question the past service cost was calculated at 1 May 2013 and the defined benefit obligation was stated at this date also. Therefore any past service cost must by definition have been included in the defined benefit obligation at 1 May 2013 for it to arise. As a result, when calculating the net interest cost, the past service cost need not be added to the defined benefit obligation. Past service costs should be written off to profit or loss immediately. If there was a change in a scheme half way through the financial year and a past service cost arose at that date then the treatment of the interest would be different. There was a comment that the inclusion of the past service cost in the opening defined benefit obligation was not entirely clear from the question and therefore candidates were given due credit where applicable. Additionally in this question, candidates had to deal with a revaluation of non-current assets, a share option scheme and the wrong classification of a cash flow hedge. Candidates dealt well with these elements of the question.

Because of the nature of the question, marks are given for the presentation of the consolidated statement of profit or loss and other comprehensive income. For example, marks were given for showing split between those items, which may or may not be reclassified and for showing the split between owners and NCI for profit/loss and total vomprehensive income. These marks were allocated even if candidates showed their own figures. When marking the paper, often marks are given for candidates own figures as it would be unfair to compound the effect of a candidate's mistake in, say a calculation. Thus it is important to ensure that candidates show all of their workings. Many candidates showed their workings on the face of the consolidated statement of profit or loss and other comprehensive income by bracketing a series of additions and subtractions of what could have been random numbers. Markers will look to see if there are recognisable figures in such a working but it is important to describe the calculation so that the marker can establish the principle. Marks are given for correct principles with inaccurate calculations.

In part aii of the question candidates were asked to explain, with suitable calculations, how the sale of the 8% interest in a subsidiary should be dealt with in the group statement of financial position at 30 April 2014. Marks were allocated for the explanation and the calculation. Thus if a candidate simply showed the calculation, marks were lost. Candidates generally answered this part of the question quite well.

Part 1b of the question required candidates to discuss the use of fair value in IFRSs and the fact that IFRSs do not reflect the financial value of an entity. This required candidates to answer across a range of standards and not just focus on IFRS 13.The question did not mention IFRS 13 specifically but rather an appreciation of the use of fair values in IFRS generally. The question carried 9 marks. Again, if a client asked an ACCA member about fair value in IFRS, the client would not simply expect an explanation of only IFRS 13. IFSR 13 was obviously relevant in answering this question but the marks were capped if candidates simply mentioned this IFRS.The question was not well answered as the nature of the discussion was often limited, which indicates a lack of reading by candidates and possibly an approach to learning which is individual standard based rather than principle based.

Part c of the question required a discussion of the ethical and professional issues which faced a financial controller who disagreed with a superior over the treatment of a finance lease where the correct treatment of the lease
could jeopardise the loan application. Marks were given for a discussion of
IAS 17 but to gain the marks to gain the marks candidates had to make reference to more than simply the rules as they had to comment on the fact that subjectivity and professional judgement were involved. The remainder of

the marks were allocated for the ethical discussion, which many candidates were quite poor at, choosing to spend a significant amount of time discussing the rules underlying IAS 17 rather than using professional and ethical insight.

Question Two

This question required candidates to give advice on the correct accounting treatment of several aspects of an entity's overseas operations. In part a, the entity wished advice on how to determine the functional currency of the subsidiary and this carried 7 marks. Candidates scored well on this part of the question. The marks were allocated for knowledge of IAS 21 and for its application. It was important for candidates to use the information in the question. The decision as to the functional currency was subjective and was based upon the candidate's interpretation of the information in the question.

Part b required an explanation including a calculation as to why a deferred tax charge relating to a non-current asset arose in the group financial statements and the impact on the financial statements if the tax base had been translated at the historical rate. This part carried 6 marks. Marks were allocated for the discussion of deferred tax and for the impact on the financial statements. Many candidates ignored the fact that a discussion was required and simply calculated the deferred taxation amount. Many candidates found this part of the question quite difficult. There was an understanding of the nature of deferred tax but candidates found it difficult to apply those principles.

Part c of the question required candidates to deal with goodwill arising on the acquisition of an overseas subsidiary in the group financial statements .The question carried 5 marks. There again were marks for the discussion of the nature of the calculation. The treatment of goodwill on overseas subsidiaries is fundamental to the understanding of accounting for an overseas subsidiary. Goodwill arising on acquisition of foreign operations and any fair value adjustments are both treated as the foreign operation's assets and liabilities. They are expressed in the foreign operation's functional currency and translated at the closing rate. Exchange differences arising on the retranslation of foreign entities' financial statements are recognised in other comprehensive income and accumulated as a separate component of equity. Candidates often calculated goodwill correctly but found the retranslation of goodwill quite difficult. The majority of the marks on this part were allocated to the calculation.

The final part of the question required candidates to advise the directors on how to account for a foreign currency loan and interest in the financial statements. Again marks were allocated for discussion and calculation. Generally, candidates answered this part of the question satisfactorily.

Question Three

As mentioned in the introduction to this report, many of the scenarios set out in the question paper are based upon 'real life' examples and this question was a good example of this fact. An issue for candidates where questions are based upon real scenarios is that such questions will vary from diet to diet and will differ from textbook questions. Thus, to reiterate, in order to answer these questions candidates need to fully understand the principles embodied in IFRS.

Part a of the question dealt with a property developer who purchased land and transferred ownership to a housing association before construction starts. The developer argued that the transfer of land represented a sale of goods

which fulfilled the revenue recognition criteria in IAS 18.The facts were quite complicated but were very important to the determination of the correct treatment. The question carried 7 marks. Most candidates had knowledge of IAS 18 and many applied their knowledge satisfactorily. However in part b, many candidates struggled to recognise the issues where a tennis player receives a signing bonus of $20,000, earns an annual amount of $50,000 and receives a bonus of 20% of the prize money won at a tournament. Many candidates did not recognise the intangible asset or the financial liability. Additionally, there was little discussion of the principles behind the accounting application

In part c the entity leased its head office and improved the building but there was a clause in the lease, which stated that the building had to be returned in the same condition as at the beginning of the lease. There was also a clause which enabled the landlord to recharge the entity for costs relating to the general disrepair of the building and recharge any costs of repairing the roof immediately. The question carried 5 marks. This question required knowledge of two standards, IAS 16 and IAS 37.The scenarios that appear in this exam will often require multiple IFRSs to be applied to them. Often candidates chose to discuss IAS 17.
Similarly, part d of the question required knowledge of IAS 34, IFRS 5 IAS 16 and IAS 38.In this part of the question, the entity acquired a property and an impairment loss was recognised, which resulted in the property being valued at its estimated value in use. The property was subsequently classified as held for sale but the property market improved and finally it was sold after the year-end. There was a need for candidates to calculate gains and losses at various stages of the question and thus the marks were allocated between discussion and calculation. This part of the question was quite well done in terms of the calculations but was quite weak on the discursive element.
It is not possible to prepare for this type of question by simply reading a manual and learning notes or by listening to a lecture. It requires candidates to try and answer questions without reference to material and then comparing their efforts with a model answer, and not simply auditing the answer.

Question Four

This question required candidates to discuss the key classification differences between debt and equity under International Financial Reporting Standards.
Further the question required examples to be given to illustrate the answer. This part of the question carried 9 marks. The examiners analysis video sets out the nature of current issues questions set in this exam and this issue was noted as an example in that presentation. However, very few candidates seemed to know the difference between debt and equity. Such matters as debt being determined where redemption is at the option of the instrument holder, where there is a limited life to the instrument and dividends being non-discretionary, were often not discussed by candidates. The distinction between debt and equity is fundamental to any set of financial statements. Candidates often simply gave examples of debt rather than discussing the fundamental principles underlying the classification.
The second part of the question required an explanation as to why it is important for entities to understand the impact of the classification of a financial instrument as debt or equity in the financial statements. This carried 5 marks. Again this part of the question required an understanding of the impact of the classification. The current issue question will not require a regurgitation of candidates' notes and tutors should not expect a question which allows such. Many candidates were unable to gain many marks on this part.
The final part of the question required the application of the principles in part a to two scenarios. Candidates had to discuss whether the instruments were debt or equity. The problem for candidates was that if they did not know the principles in part a then they could not really apply them in part b. The key message here is that the final decision as to whether the instrument was debt or equity was not as important as the ability to discuss the scenario. Obviously the answer should be correct but if candidates can discuss the relevant issues then they will score a good proportion of the marks.

The paper required candidates to demonstrate knowledge and application. Many marks are lost if candidates do not demonstrate the application of this knowledge. Candidates should always think that the marks are allocated for knowledge and application, and draft their answers accordingly. Candidates require wider reading so that they have a real understanding of the problems that entities face. The examiners guidance is very helpful in this regard.