Examiner’s report
P2 Corporate Reporting
June 2015

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 .In order to pass this examination, there is a significant cost in terms of time, discipline and energy in order to obtain the required level of knowledge and application. Candidates should manage their own learning and not be totally reliant on a single textbook or revision course for their knowledge. Candidates are unlikely to be successful if they simply rely on a short revision course without having dedicated many hours to the subject area.

Knowledge and understanding does not come quickly in this subject. It does not come through rote learning but through a deeper understanding of the subject matter. The subject lends it to a principles approach whereby the candidate understands the principles used in a range of accounting standards. IFRSs can be taught through a series of principle-based lectures/seminars. An example is the principle of measurement. Various types of measurement system are used across IFRSs and candidates could develop their knowledge of, for example, fair value by looking at the various IFRSs that use this as a basis for measurement. The IASB themselves advocate this way of teaching the standards.

Further, IFRSs can be taught through the medium of the Conceptual Framework. This method of teaching will demonstrate to candidates, for example, the inconsistency of the application of the fundamental principles of corporate reporting. In this way, candidates will learn the principles underpinning the IFRSs and be capable of critical appreciation of the subject area. An accountant giving advice to a client needs to have an appreciation of the subject area and not specific knowledge of a handful of standards. Teaching methods need to adapt to the demands of the examination, which in itself is being driven, by the demands of employers. The examination is not based upon traditional textbook type questions but on the reality that is corporate reporting and issues therein. Accountants advise clients, they do not act in the capacity of bookkeepers and therefore the examination reflects this. A client would not thank ACCA, if their graduates simply quoted by rote, an accounting standard when asked for advice on a certain matter.

The examination of necessity does contain a certain amount of technical material but a significant part of the examination is based around the application of the fundamental principles within IFRS. The comments below will reflect the above points.

Specific Comments

Question One

This question required the candidates to prepare a consolidated statement of financial position. In this question candidates were required to deal with the purchase of two subsidiaries and the sale of another subsidiary. Additionally, non controlling interest (NCI) was calculated using both the fair value method and the partial goodwill method in this question and additionally the valuation of NCI in the two acquired subsidiaries was based respectively on market prices and a valuation based upon the PE ratio. Candidates seemed to be able to calculate NCI using market prices but struggled with the calculation involving the PE ratio. The understanding of the PE ratio is fundamental to corporate reporting. Analysts use this ratio extensively and it is one of the simple ways to value an entity. In terms of the syllabus, it is dealt with at Paper F7 as well as being included in syllabus section C1(a) ‘Prepare reports relating to corporate performance for external stakeholders’.

As stated above, candidates should be able to understand the principles of corporate reporting and be able to apply them. The calculation using the PE ratio to value a business is very straightforward and as such only carried one mark in the marking scheme but if candidates do not understand the meaning of the ratio, then it is understandable that they could not calculate the value of the entity. There was some comment in the media about the use of the own figure rule. (OFR) The OFR is only used when a candidate has wrongly calculated a ‘figure’ which is subsequently used in another calculation. The candidate will lose the marks for the original calculation but if the ‘own figure’ is subsequently used correctly, then marks will be given for the correct principle being used. It is unfair to penalise a candidate on more than one occasion for an incorrect calculation.

In addition to the purchase and disposal of subsidiaries, the holding company also decided to restructure one of its business segments which affected the employees’ pension benefits in two locations. Candidates were expected to show the impact on profit or loss of the restructuring. This part of the question was quite well done

Additionally the holding company leased out equipment under a finance lease but had incorrectly accounted for the lease. Again candidates performed quite well on this part of the question. Finally, the holding company impairment tested its non-current assets and it was decided that a building located overseas was impaired because of major subsidence. Candidates were expected to calculate the impairment loss and the deferred tax asset, which arose because of the impairment. This part of the question was quite well answered.

More than half of the marks in question 1 are normally allocated to the group accounting part of the question. Therefore it is imperative that candidates not only understand group accounting techniques but also complete the workings for goodwill, retained earnings, other comprehensive income (OCI) and NCI.

Question 1b required candidates to discuss the difference between equity and liabilities, and the proposed accounting treatment of the contingent payments on acquisition of NCI .The Framework and IAS 32 *Financial Instruments; Presentation* set out the fundamental differences between equity and liabilities and this question has been posed before in this examination paper. The definition is fundamental to the presentation of financial statements and performance reporting. Candidates however still struggle with this difference. Also, it would seem sensible that if the question required a discussion of the above then, the second part of the question might require the use of this distinction. Hence the contingent payment was in fact a financial liability, which very few candidates recognised.

Question 1c required a discussion of the philosophy behind ‘rules based’ and ‘principles based’ accounting standards together with a discussion of the ethical challenges faced by accountants if there were a switch in a jurisdiction from ‘rules based’ to ‘principles based’ accounting standards. This part of the question was well answered by candidates, which was very pleasing. It is important to realise in answering this type of question that there is a range of possible points, which could be raised by candidates, which may or may not be included in the model answer. Candidates were given due credit for relevant opinion on the subject matter of the question.

Question Two

This question dealt with the measurement and disclosure of the fair value of assets, liabilities and equity instruments. It did not focus specifically upon IFRS 13 *Fair Value Measurement*, but of course this standard is the basis of fair value measurement for many IFRS s.

Part (a) of the question required the application of IFRS 13 to agricultural vehicles. The main principles involved were the application of principal and advantageous market definitions to a set of data. Candidates were awarded marks based upon the principles involved and the application of those principles. Answers were quite disappointing considering the fact that the market definitions are the cornerstone of IFRS 13. As mentioned above, the principles involved in this part of the question were quite basic and fundamental to the standard.

Part b of the question required candidates to apply a valuation technique to the valuation of short-lived crops where there was no active market for partly grown crops. A discounted cash flow method was used to value the crops and the entity wished to know how they should account for the biological asset at various quarterly dates and when the crops were sold. Candidates needed to use discounted cash flow techniques to value the crops. This part of the question was not well answered. Valuation techniques are used extensively in corporate reporting and therefore candidates must become accustomed to using such techniques in answering questions.

Part (c) of the question was well answered. It involved calculating and discussing the valuation of share appreciation rights (SARs) under IFRS 2 *Share-based Payment* and not IFRS 13. However part (d) of the question was surprisingly poorly answered. One of the fundamental principles of IFRS 13 is that of 'highest and best use' as long as the alternate uses are physically, legally and financially permissible. In this question, the non-current asset had more value if it were used for residential purposes rather than for farmland providing that planning permission was granted. A discussion of this principle and its application was required but was seldom forthcoming from candidates.

Question Three

Question 3 was a case study question which required the application of the fundamental principles of several accounting standards. In part (a), there were two laboratories which carried out research and development activities for the entity. The activities of the laboratories were set out in the question as was the reporting structure of the entity. Candidates were required to discuss whether the research and development laboratories should be reported as two separate segments under IFRS 8 *Operating Segments*.

Candidates often discussed the principles of IFRS 8 very well and many felt correctly that the second laboratory should be reported as a separate segment. However few students realised that the first laboratory was in fact simply supporting the business of the entity and was not actually a separate segment.

Part (b) of the question dealt with the valuation of publicly listed shares in exchange for and received on transactions concerning the acquisition and sale of patent rights. In addition candidates had to deal with the accounting for a royalty. Few students discussed IFRS 9 in this context or IFRS 2.This part of the question was not well answered by candidates.

Part (c) of the question required a discussion of the accounting for the costs of developing certain drugs. The knowledge and application of IAS 38*, Intangible Assets*, was required in terms of which costs should be capitalised and which costs should be expensed. The question was quite well answered as regards the principles but the application particularly in the case of the first contract was not well discussed. In this case, the payments were to a third party who was carrying out the development of the drug and should have been expensed.

Question Four

This question is normally the current issues question. Candidates were required to describe the current presentation requirements relating to the statement of profit or loss and other comprehensive income (OCI) and to discuss, with examples, the nature of a reclassification adjustment and the arguments for and against allowing reclassification of items to profit or loss. Additionally, candidates were asked to discuss the principles and key components of the IIRC's Framework, and any concerns, which could question the IIRC Framework's suitability for assessing the prospects of an entity. The principles behind the use of OCI have not been fully determined by the IASB and they are currently discussing them as part of the Conceptual Framework project. The arguments for and against reclassification adjustments were quite well answered by candidates as was the current presentation requirements of IAS 1.However the IIRC's Framework, which is a recent addition to the syllabus, was often confused with the IASB's Framework, with the result that some candidates scored poorly on this part of the question.

Part(b) required the application of part (a in terms of determining which elements of a profit or loss should be reported in OCI and which elements in profit or loss. The first part of this question dealt with a cash flow hedge and the treatment of gains and losses .The second part of the question dealt with the revaluation of property, plant and equipment and was very well answered by most candidates. The cash flow hedge was not as well answered.