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Examiner's report
P2 Corporate Reporting
March 2018

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 understanding and knowledge of the Conceptual Framework, IFRSs and Code of Ethics. Questions at professional level will challenge the candidate to demonstrate this knowledge and then to apply it to a particular scenario - this requires extensive preparation. Candidates' learning should extend beyond reliance on a single textbook or revision course; the required knowledge and understanding does not come through rote learning but through a deeper understanding - and application - of the subject matter. A well-prepared candidate would have reviewed relevant websites including those of the standard setters (IASB), the profession, and the ACCA to maintain their knowledge and keep up to date with topical issues. Practice of past papers and exam-standard questions under timed conditions will better prepare candidates for allocating their time in the exam. Candidates with good exam technique (allocating time appropriate to available marks, preparing a plan, and reading the scenario and requirements carefully before answering) are more likely to succeed.

This examination required candidates to display more than just a rote knowledge of accounting standards. A professional accountant *advises* clients, and the Corporate Reporting examination tests the candidate's ability to apply knowledge to a scenario. The examination tests a candidate's' ability to explain the correct accounting treatment, the principles that underpin the treatment, and the implications of this, in complex scenarios. Whilst the examination contains technical material, a significant part of the exam is based around the application of the fundamental principles within IFRS, based upon the Conceptual Framework.

In the optional questions, the key requirement is to *discuss* the accounting issue. A well-prepared candidate would approach this requirement by first outlining their knowledge of the issue, referring to the Conceptual Framework and the appropriate reporting standard(s), and secondly applying this knowledge to the given situation. Less-prepared candidates tended to 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 would be expected by their clients to provide advice which outlines both the correct accounting treatment and also the reasons for this treatment. In answering a P2 exam question, candidates should read the requirements carefully, and ensure that all aspects are answered in order to maximise potential marks.

Specific Comment

Question One

This question was divided into three parts. The first part (Q1a) required the candidate to prepare a consolidated statement of financial position for a group with two subsidiaries, one of which was to be treated as a disposal group, held for sale under IFRS 5. The second part (Q1b) questioned why the decision to treat the proposed sale of the subsidiary under IFRS 5 in Q1a was correct, and the third (Q1c) questioned the accounting and ethical implications of a proposal to retrospectively change the valuation of non-controlling interest (NCI) from a proportional share of fair value of net assets to a fair value measurement. The subsidiary acquisition relating to this proposal occurred some years ago.

As in previous exams, more than half of the marks in question 1a were allocated to the group accounting part of the question. Candidates were expected to complete appropriate workings for goodwill on acquisition (and subsequent impairment review) for both subsidiaries, and for group retained earnings (RE), other components of equity (OCE) and NCI. Candidates performed relatively well in answering question 1a: workings for goodwill and impairment were generally well-answered, although relatively few candidates identified the need to notionally gross up goodwill for the impairment review in the case of the subsidiary whose NCI was based on the 'partial goodwill' method. A significant minority of candidates treated the held for sale subsidiary as a disposal, and failed to account for an impairment review and subsequent impairment allocation. Candidates should, at this level, be well-prepared to present clearly cross-referenced workings for RE, NCI and OCE. Other syllabus areas tested within the consolidation requirement included accounting for defined benefit scheme transactions, a share option scheme, and a joint operation. Whilst the pension scheme was generally well-answered, some candidates struggled to calculate the correct allocation to income for the share option; and some were unsure on the treatment of the joint operation.
A few 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 the exam, the requirement for question 1a was to *prepare* and there was no need to explain.

Question 1b required candidates to discuss why the decision to treat one of the subsidiaries as 'held for sale' was correct. The question clearly stated that this was the correct decision, and candidates were required to outline the case for this decision. Most candidates described the conditions under which a disposal group is held for sale, and then attempted to apply each condition to the scenario. A minority of candidates claimed that the decision was wrong, but still gained marks by first outlining the requirements for recognition. However, candidates that jumped straight to an incorrect conclusion without displaying knowledge of the standard had little chance of gaining marks.

Question 1c required an appreciation of the potential impact on the financial statements of a retrospective change in accounting policy from partial goodwill method to full goodwill method. Many candidates explained the difference, and the fact that using the full goodwill method (taking a fair value of NCI at acquisition) would result in higher net assets/goodwill than using the partial method (where NCI at acquisition is based on their share of the fair value of net assets). The question suggested the directors' motivation for this change to be to maximize profitability and equity, and that directors had a history of regularly changing accounting policies to this end. Good answers tended to be broken into paragraphs that responded to each comment from the question. For example: when an accounting policy change is permitted and a description of how this should be done; the potential impact of such a retrospective change to profitability and other ratios (better answers considered the impact on goodwill impairment); and ethical considerations. Weaker answers tended to focus on one aspect (either accounting implications or ethical considerations), thereby limiting their marks by not answering the whole requirement.

Question Two

This question required advice on the accounting treatment of three issues, with reference to relevant IFRSs. Part (a) described an issue with the translation of an overseas subsidiary (in a non-hyperinflationary economy) whose functional and local currency is not traded in markets, and

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where the two available rates changed only once in the year. The translation rate was changed from official to government rate on the basis that this was the most appropriate rate for the flow of future economic benefit. Advice was required on whether the change in rate was appropriate and whether an average rate could be used for translating the subsidiary's statement of profit or loss. Many candidates struggled with this part of the question, although most gained marks by outlining the method of translation of an overseas subsidiary's financial statements under IAS 21. Better answers considered each aspect of the scenario: which rate is most appropriate; whether an average rate is required depending on the fluctuations in the year; and whether a retrospective change would be required. Weaker answers focused too much on an irrelevant aspect of the scenario: the determination of the functional currency.

Part (b) described a vehicle leasing business which proposed an extension in the useful life of their vehicles, and the non-depreciation of unleased vehicles. Most candidates answered this part well, describing the requirements for depreciation under IAS 16, and the conditions where depreciation may cease when reclassified as held for sale under IFRS 5. Few candidates considered the usage method of depreciation (where a zero rate can apply if there is no production), although most described the principles behind depreciation, and the fact that a diminution of future economic benefits can also arise when idle (through obsolescence, for example). Weaker answers focused on the irrelevant lease aspect of the scenario rather than considering the proposed changes to the depreciation policy detailed in the requirement.

Part (c) required candidates to explain the implications of an entity's business model for valuation of its assets. The requirement was broad, allowing candidates to consider both IFRS 9 and IAS 40 in their answer. A good answer began with a description of the business model, its dependence on how the business generates cash from the asset's use, and the relevance of this when considering the asset's measurement. Most candidates described the alternative accounting treatments of IFRS 9 well (fewer described IAS 40); however merely listing these alternatives without describing the relevance of the business model (and contractual cashflow characteristics) limited the marks that could be awarded, since this was the requirement.

Question Three

Question 3 was a case study question (involving an entity operating in the property business) which required the application of IFRSs. In part (a), candidates were required to discuss how to account for the sale of a retail park (under IFRS 15) with an element of variable consideration. The scenario outlined a single price for the retail park and a right to receive 10% of future operating profits from the park's first year; providing information from which expected values can be calculated. Weaker answers tended to list out the recognition requirements of IFRS 15 (the "five steps") with little application to the scenario thereby limiting their opportunity to gain marks. Better answers focused on the transaction price – the key aspect of this question – and its allocation to a satisfied performance obligation. Many candidates identified the need to determine an estimate of the variable consideration (and to update this by the reporting period), but a significant number suggested that this should not be recognised.

Part (b) described the proposal for an investment property's reclassification under IFRS 13 from level 3 (whilst under construction) to a proposal of level 1 valuation (now complete). The directors were suggesting using an average price per square meter as a valuation basis, although the building had unique qualities suggesting this may be inappropriate. Most candidates answered this part well, describing the three fair valuation levels in IFRS 13, and in most cases coming to the

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conclusion - with reasons - why level 2 is more appropriate.

Part (c) of the question required a discussion of the first-time application of IFRS 16. Details were provided for candidates to be able to calculate the gearing ratio for the entity prior to the applying IFRS 16. Details on a continuing lease agreement were also provided (lease payments, interest rate and present value of the lease payments at the start of the period), and candidates were asked to advise on how to account for the lease under IFRS 16, and its impact on gearing. Candidates performed well in this question generally. Marks were available for explaining the process by which the lease should be accounted for, and the impact that the lease treatment would have on the gearing ratio.

Question Four

In part 4a(i), candidates were required to describe the effect of uncertainty on the existence and recognition of assets and liabilities as defined by the Conceptual Framework. Despite a clear reference to the Framework, a significant minority of candidates struggled to provide a full definition of an asset or a liability, thereby omitting the relevance of “expected” inflow or outflow of resources embodying economic benefits. Better answers identified the requirement to comment on uncertainty in terms of both existence and recognition, whilst weaker answers provided examples of uncertainty without reference to the Framework. Part 4a(ii) required candidates to explain how uncertainty affects the definition, recognition, classification and disclosure criteria in IAS 37 and IFRS 5. A good answer focused on the important aspect – uncertainty – and then broke their answer down into sections on definition, and recognition. Many answered this part well, although most answers focused more on IAS 37 at the expense of available marks for IFRS 5.

Part 4(b) required a discussion on the nature of materiality and whether practising accountants will use similar principles as preparers of financial statements when making judgements in applying materiality to financial statements. The majority of candidates provided a good definition of materiality, with better answers expanding into considering implications of aggregation, for example. A minority of candidates referred to the IASB’s Exposure Draft of an IFRS *Practice Statement Application of Materiality to Financial Statements,* and the criticisms of current judgement on materiality, such as: a checklist approach to disclosures or basing accounting policies on IFRS wording (rather than being entity-specific). Weaker answers described the use of materiality from an auditing perspective only, without describing the importance of materiality to the decision-maker, or preparer of financial statements.

Part 4(c) described a scenario in which an entity has significant foreign currency gains and losses in a jurisdiction whose currency has devalued and whose stock market forecasts have significantly fallen. The entity disclosed a small net exchange gain, although this comprises a single significant exchange loss (as a result of a speculative forward foreign exchange transaction) as well as other exchange gains. Candidates were asked to discuss the issues with reference to IFRS. Most candidates identified the need for disclosures on the entity’s risk exposure, although a description of appropriate disclosures was often limited. Whilst many were aware of the possible need for an impairment review under IAS 36, very few candidates outlined possible disclosure requirements from other standards (IFRS 7 or IFRS 13 for example). Candidates in general identified the need under IAS 21 to report separately the significant loss, although fewer outlined its importance to users whose opinion on management’s stewardship may be altered (given the loss arose from speculative activity).

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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 listing their knowledge will not be sufficient to pass.