Examiner's report

Strategic Business Reporting (SBR)
June 2019

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

General Comments

Format of exam

The examination consisted of a three hour exam containing two sections with all 4 questions being compulsory. The marking scheme includes four professional marks for the clarity and quality of discussion. Two professional marks were awarded in Section A for the application of ethical principles to the scenario. In section B, the two professional marks were awarded for appropriate reference made to the relevance of financial information to investors.

Exam performance

Approach and guidance

The purpose of the SBR examination is to test candidates' ability to apply concepts, arguments, and different perspectives of stakeholders to the scenarios provided in each exam question. The examination deals with financial transactions and events and candidates are required to explain the logic of a particular transaction or event. To be able to operate in the current business environment, an accountant should have sufficient practical experience together with an understanding of generally accepted accounting principles, conventions and procedures.

There is seldom a single principle which will apply to a given scenario. Therefore, candidates need to select the correct principles of accounting which are applicable to a particular case. Accountants cannot operate without a substantial understanding and knowledge of accounting principles and practice. Thus, candidates need to organise their learning by discovering how certain principles inter-relate and how one concept or perspective builds on, or contrasts with another. This approach helps a candidate to understand how a particular concept or perspective explains real world events.

It is important that candidates have a self-awareness of their strengths and weaknesses as learners. This enables them to see, and to question, their learning behaviours and their use of various learning styles and strategies. Unfortunately, it is evident that many candidates want to know 'what' to learn without wishing to know 'why' or 'how' to apply that learning. Many candidates are still happy to rote learn information without understanding how this knowledge can be applied to a scenario. It appears that some candidates have always adopted this style of learning and are afraid that any change may affect their performance or turn a learning style into a learning handicap.

Candidates often practice by looking at past exam papers and this is one way to retain information. Practice testing improves the ability of candidates to mentally organise their knowledge, and thereby increasing the speed and efficiency of answering the examination questions. In addition, candidates should divide their studies over time rather than doing it in one large block. This practice is better for material retention and absorption which in turn will give candidates a greater chance of dealing successfully with the SBR examination. Many candidates also highlight their textbooks. This technique is popular because it is very easy to implement and requires very little training. Similarly, candidates often summarise the text books which helps in examinations that involve the production of information. These techniques can help a candidate but they need to be augmented by other methods of learning; for example, asking 'why' in an attempt to understand concepts.

The syllabus and study guide sets out the high level of understanding required for this examination by using words such as appraise, assess, critically discuss, apply knowledge and evaluate. Most of the syllabus content is at level 3 which means that candidates should be able to synthesise and evaluate material. Although a high level of understanding is required, candidates need to include relevant calculations in their answers, particularly in question 1. In this examination, some candidates did not show relevant calculations and simply explained the underlying principles.
Some candidates merged their answers to different parts of a question into a single part. Markers find it difficult to allocate marks if, for example, question 4a and 4b are answered as one part of the question. This practice makes marking especially difficult when professional marks are to be awarded for a particular part of a question. This was particularly prevalent in questions 1ai/ii, and 2. Candidates increase their chance of success in the examination if they answer all parts of all questions. Many candidates simply did not attempt all parts. This point has been raised in several examination reports but it is still prevalent practice. Additionally, it is extremely important to read the technical articles published on the SBR pages of ACCA's web site. For example, an article on IAS® 21 *The Effects of Changes in Foreign Exchange Rates* has been published which would have helped candidates answer question 4 of this examination. Often key syllabus areas are discussed in articles on the SBR site.

There is a significant ethical content in each paper and candidates will be required to demonstrate their understanding of professional and moral judgment. Simply quoting ethical guidance without application will not result in a pass mark in this part of the question. Candidates may be awarded marks for discussion of issues which do not appear in the suggested solution but are relevant to the scenario. Additionally, extra marks may be gained if a candidate discusses a point particularly well.

Generally, the performance in this examination mirrors that in the previous SBR examinations. Candidates find the application of knowledge difficult and merely discuss an IFRS® without applying their knowledge to the scenario. Candidates also seem to be spending a disproportionate amount of time on question 1 to the detriment of other questions. Each SBR examination is a unique set of questions and candidates will be required to explain concepts to third party users such as investors.
Comment on individual questions

Question 1
The first part of the question required candidates to draft an explanatory note to the directors which included an explanation and calculation of how a dividend received from a subsidiary, a holding company's investment in the subsidiary and its disposal should be treated in the holding company's individual statement of total comprehensive income. Although the treatment in the individual financial statements was set out as a separate question in 1ai, candidates often merged their answer with question 1aii which referred to the treatment of the events in the consolidated

financial statement of total comprehensive income. This practice of merging two parts of a question into one answer makes it extremely difficult for markers to allocate marks. Candidates should present their answer in the same order as the requirements and number them accordingly.
Generally, question 1ai was not well answered as they did not deal with each of the 3 elements (dividend, investment and disposal) in this part of the question. As a result, the reduction of the cost of the investment on disposal, the fact that the equity method is not used in the individual financial statements and the calculation of the profit on disposal were seldom mentioned.

However, question 1aii was generally well answered with several candidates scoring full marks. Many candidates focussed on the loss of control without dealing with the profit effect and the corresponding non-controlling interest adjustment. Additionally some candidates treated this part of the question as purely a computational exercise and did not discuss the principles behind their calculations. Surprisingly, some candidates simply discussed the principles without setting out the calculations to support them. The question quite clearly asked for both an explanation and a calculation. Few candidates mentioned the fact that there was no need to disclose the disposal as a discontinued operation as it did not constitute a major separate component of the business. Because of the nature of the computations, particularly for the calculation of the profit on disposal in the consolidated financial statements, markers were instructed to use the own figure rule.

In part b of the question, candidates were required to discuss the deferred tax implications arising from the sale of the inventory by the holding company to its subsidiary in both the individual and the consolidated financial statements whilst also considering the impact of the holding company's losses on the recognition of a deferred tax asset. The answers to this part of the question were good as there was an opportunity for candidates to demonstrate their knowledge of both deferred tax and unrealised profit in inventory. The main issue was in the calculation of the deferred tax asset as several candidates calculated this as the tax base multiplied by the tax rate instead of the amount that the tax base exceeds the carrying amount multiplied by the tax rate. It was pleasing to see that previous comments in examiners reports had been actioned by candidates as the answers to this part of the question required candidates to explain the identified principles and then apply those principles to the scenario. However, it is important to stress that candidates answers must have depth. In simple terms, the answer should identify the issue, discuss the principle, apply the principle to the issue and then conclude.

Part c of the question required a discussion of how variable lease payments should be recognised and measured in the financial statements of the holding company. Candidates recognised that the current accounting treatment was incorrect but many could not determine what the correct treatment was. Often, candidates simply discussed, in detail, the general approach of the leasing standard…which was not asked for. Very few marks were given for such a discussion. Many candidates recognised that the right-of-use asset would be significantly undervalued on initial recognition but few stated that the higher than anticipated increase in the consumer price index should not be adjusted for, as index linked variable payments are only adjusted for when there is a subsequent change to the actual payments on the lease. Unfortunately, many of the answers were descriptive with little application to the scenario.

Overall question 1 was quite well answered. The model answer sets out significantly more than was required to gain a good mark, so there was an opportunity for candidates to score well. Candidates were also awarded marks for well-argued points which were not included in the model answer.

Question 2
Question 2 will require candidates to discuss specific accounting issues provided in the scenario and to further discuss the ethical implications of certain events and circumstances which have occurred within the corporate environment. The ethical problems will not necessarily revolve around simple accounting errors and malpractice but may involve other issues; for example, personal relationships and pressures created by these relationships. In part (a) of this question, candidates were required to explain and calculate a share incentive scheme expense under IFRS® 2 Share-based Payments. Generally this was well answered. However, some candidates did not use the fair value of the option at the grant date to calculate the expense but instead used the fair value at the year-end date. Additionally, some candidates did not take into account that one of the directors had resigned and would therefore not be eligible for the share scheme. However, there were several points to discuss in the question and many candidates scored full marks.

Part b of the question tested IAS 24 Related Party Disclosures. Again, many candidates performed well on this part of the question as they outlined both the principles in IAS 24 and applied those principles to the scenario. However, some candidates merged part d with this part of the question and discussed ethical issues. The professional marks were linked with part (d) and were awarded for a discussion of professional and business ethics. It is difficult for the markers to sift through answers that combine two parts of a question particularly when professional marks are being awarded and so candidates should avoid doing this. The answers should be presented, and numbered, in the same order as the requirements.

Part (c) of the question required a discussion of the application of IFRS 8 *Operating Segments* to the scenario. Many candidates scored full marks on this part of the question although many also made an error in the calculation of 10% of the reported profit or loss. IFRS 8 states that one of the 10% test criteria to be treated as a separate reportable segment is that ‘the absolute measure of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.’ Candidates did not add back the loss of the segment concerned to the group profit to determine the combined reported profit of all operating segments that did not report a loss. In the event, the determination as to whether the segment should be reported was not affected and candidates who arrived at the correct conclusion were duly rewarded.

Part (d) required a discussion of the ethical issues arising from actions by the directors and a professional accountant. Many candidates answered this question very well scoring full or nearly full marks. There were two main elements to the discussion. First, the accountant is bound by ACCA’s ethical code and candidates needed to discuss the implications of the code for this scenario. Secondly, the directors have an ethical responsibility to run an entity in the best interests of their stakeholders and a discussion of this responsibility was also required. The professional marks were split between the two main elements of discussion. Future papers will explore ethical issues for accountants in the digital age and an article will be shortly published on the topic by the examining team.
Question 3
Question 3 tested financial instruments. The first part of the question dealt with a financial liability arising from a factoring agreement. It required candidates to set out the principles in IAS 32 *Financial Instruments: Presentation* and apply them to the scenario. In addition, wherever there is

a question that tests disclosure, candidates will normally be able to refer to the requirements of IAS 1 Presentation of Financial Statements. For example, candidates could have argued that, in order to faithfully represent the effects of the factoring agreement, the transaction should have been shown as a new financial liability in accordance with IAS 1, which requires financial statements to present the financial position fairly. The Conceptual Framework can also be a useful tool when answering this type of question.

Few candidates mentioned the implications of IFRS 9 Financial Instruments which requires that an exchange of debt instruments with different terms is accounted for as an extinguishment of the original liability and the recognition of a new financial liability.

Part (b) of the question required candidates to calculate the value-in-use of an asset and an impairment loss whilst discussing IAS 36 Impairment of Assets and IFRS 13 Fair Value Measurement. This part of the question was well answered by most candidates. Many could calculate the value-in-use correctly however they often did not then take into account the impairment loss. IAS 36 states that, if either the fair value less costs of disposal or value-in-use exceeds the carrying amount, the asset is not impaired but few of them mentioned this in their answers.

The rebuttable presumption in IFRS 13 is that an entity's current use of a non-financial asset is at its highest and best use; this was well known by candidates but few mentioned the fact that judgement is required in assessing those alternative uses. Judgement is important in applying IFRSs and its importance will be examined in future diets. Many candidates correctly set out that what is physically possible, legally permissible and financially feasible is part of this assessment.

The final part of the question required a discussion of the nature and importance of the distinction between a change in accounting estimate and a change in accounting policy and the provisions of IAS 8 when a change in an accounting policy is required by a new standard. Candidates should have discussed the issues which are created for users because of inconsistencies in the way new and existing IFRS Standards deal with the change in accounting policy. Candidates will be expected to have knowledge of inconsistencies in the application of accounting principles across different IFRS standards and should not always expect the question to give examples of these inconsistencies; i.e. the question may ask candidates to provide their own examples of these inconsistencies. Questions on an investor/user perspective should produce variations in answers because users have many different perspectives.

Candidates performed well on comparing an accounting estimate to a change in accounting policy but not so well on discussing why such a distinction is important. When a change in an accounting policy is required by a new IFRS Standard, the change is accounted for as required by that new IFRS Standard. Candidates struggled with this part of the question but often gained marks by discussing retrospective v prospective application of a standard. Many candidates set out that users of financial statements will have problems because of inconsistencies in the way new IFRS Standards deal with the change in accounting policy but failed to give examples of such inconsistencies. For example, the conceptual inconsistencies between IFRS 10 *Consolidated Financial Statements* and IFRS 15 *Revenue from Contracts with Customers*. Markers were advised to award marks for any relevant discussion, even if not covered by the model answer. As mentioned earlier in the report, the model answer is unlikely to cover all scenarios in this type of question and therefore candidates are encouraged to use their own examples in answering the question.

Question 4

The first part of this question required a discussion of the current criteria that IAS 21*The Effects of Changes in Foreign Exchange Rates* uses for the recognition of foreign exchange gains in profit or loss or OCI, setting out any conceptual inconsistencies which might exist. It further required candidates to comment on the view that the translation of an overseas subsidiary's financial statements is simply a mechanical and not a measurement process. A technical article, which is currently available on the ACCA website, identifies and discusses issues that might have helped candidates to answer this question but there was little evidence that the article had been read. There were 9 marks awarded to the first part of this question and there were many more than 9 points which could have been made. Many candidates did not deal with the recognition of foreign exchange gains but instead discussed functional v presentational currency which was not relevant. The question requirement specifically used the word 'conceptual' and so candidates' answers should have referred to the Conceptual Framework.

Many candidates discussed the fact that the exchange differences are not recognised in profit or loss but kept in a separate component of equity until disposal when they are reclassified from equity to profit or loss. Unfortunately, few candidates discussed any issues relating to non-controlling interests (NCI) nor the fact that the current accounting standards might not reflect the true economic substance (reference could also have been made to the Conceptual Framework here). Despite this, this part of the question was well answered.

The discussion as to whether the reporting of a transaction in a foreign currency is a measurement issue or a mechanical conversion was quite poor. Again there were a significant number of points which could have been made, such as discussing the Conceptual Framework definition of measurement. Although there was no reference to the Conceptual Framework in the question, candidates should always refer to it whenever it might be applicable. Even though the suggested solution does not refer to it, marks will be awarded if the answer is logical and well-substantiated. Some candidates referred to presentational v functional currency simply defining the terms but did not directly answer the question. Very few stated that it was a simple conversion process and that entities report in the presentation currency when the amount has already been measured in a different foreign currency. It is important that candidates understand the principles that support the standards. Accountants in the current digital age must have both a theoretical and practical understanding of financial information.

The final part of the question required candidates to apply IAS 21 to two scenarios. The answers to this part of the question were poor, particularly regarding the changes in a parent's ownership interest in a subsidiary. It was surprising that in part (a) of the question, candidates mentioned exchange differences recognised in equity being held until disposal of the investment but found it difficult to apply it to the scenario.

Some candidates mentioned how IFRS 10 states that transactions which do not result in the parent losing control of the subsidiary are equity transactions. The surprising element was that, if this question was asked in the context of a domestic subsidiary, then the answers would have been much better, even though the principles are exactly the same.

Many candidates recognised the need to eliminate an intra-group profit on inventory but failed to calculate it correctly as they calculated the profit based upon selling price rather than on cost as required in the question. The elimination of intra-group balances and intra-group transactions was discussed by most candidates. The answer to this question was disappointing because the principles were relatively straightforward. However, candidates seemed to find it quite difficult because of the overseas context.

Conclusion

The Digital Age has resulted in an expectation that accountants will be able to synthesis and use information to develop concise insights into the current and projected financial position of a company. Accountants will need to be able to contribute to the business on a strategic level, developing financial solutions. The Digital Age requires accountants to use existing accounting knowledge in a new context. This requires the exploration of potential outcomes by making new connections. Sound analytical skills are ineffective if the accountant is unable to convey the information provided. Therefore, accountants must develop strong written communication skills and be able to present their analysis in a compelling way.

The ACCA qualification attempts to develop these skills in ACCA candidates and SBR plays its part by requiring candidates to identify and explain the principles used in their calculations to provide a well-argued answer. There is evidence that these skills are being developed by many candidates but many candidates continue to relying on rote learning. It is important that candidates develop a sound understanding of conceptual and practical issues. SBR will continue to encourage a deep understanding of the complex way in which financial reporting interacts to influence the community.