Examiner's report

Strategic Business Reporting (SBR)
September 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.

Format of exam

The 3-hour exam comprises 2 Sections, with all questions compulsory. Section A contains two questions for 50 marks and includes 2 professional marks for the candidate's ability to reflect on ethical issues (for the clarity and quality of ethical reasoning and discussion) contained in the second question. Section B contains two questions of 25 marks each, with 2 professional marks relating, in this case, to the candidate's clarity and quality of discussion on the usefulness to investors of the return on equity and its component ratios.

General Approach to the SBR examination

The accounting profession requires a combination of professional and ethical judgement in addition to specialist knowledge of generally accepted accounting principles, conventions and procedures. The SBR examination tests a candidate's ability to apply accounting concepts and principles to given scenarios and explain the appropriateness of a particular accounting treatment for a given transaction or event. The SBR exam also includes ethical aspects requiring candidates to demonstrate their understanding of the professional and moral judgments that accountants must make in practice. Candidates should be aware of the different perspectives of stakeholders and be prepared to provide advice from these perspectives.

At this level, candidates are expected to apply concepts and principles to complex real-life events which invariably extend beyond a single principle. Candidates must be able to select applicable accounting principles based on the scenario and assist in strategic business reporting and decision-making. The examination is therefore much more than a memory test: it requires an appreciation of how accounting principles are applied to explain real-world events.

Reliance on a single textbook or revision course is often insufficient preparation for this examination: the required skills come through a deeper understanding - and application - of the subject matter. Most SBR syllabus content is set at level 3 (an ability to synthesise and evaluate material), and candidates should be expanding their reading beyond the textbook, to include sources such as International Accounting Standards Board, the profession, and ACCA. As mentioned in previous examiner reports, technical articles are published on the SBR pages of ACCA's web site that provide additional insight. For example, an article on the impact on the impairment process of alternative measurements of goodwill under IFRS® 3 *Business Combinations* would have helped candidates answer question 1 of this examination. Key syllabus areas are invariably discussed in articles on the SBR site. A broader reading challenges the candidate to fully understand the concepts and approaches to business reporting and brings the subject to life.

The previous June 2019 examiner's report outlines typical techniques that aid learning (such as preparing a study plan over time, summarising the textbook and practising past papers). It also emphasises the importance of *self*-evaluation: candidates should be continuously questioning to themselves *why* a particular accounting treatment is most appropriate. This reinforces learning, helps to reveal the inter-relationships of accounting principles and concepts, and better prepares candidates for the high level of understanding required for the SBR examination (as indicated by words such as appraise, assess, critically discuss, apply knowledge and evaluate).

The ACCA website offers examining team's guidance including helpful articles on recommended exam techniques, exam debriefs and a retake guide. The ACCA's Student Accountant e-magazine is another source to improve study skills and exam technique. Candidates are advised to avoid merging their answers to different parts of a question into a single part, as this makes the allocation of marks more challenging for markers. For example, Question 2 part (a) comprised a set of accounting transactions for discussion, and then part (b) a discussion on ethical issues and actions. Candidates often merged both (a) and (b) into one answer which made marking challenging, particularly when professional marks were awarded for part (b). Where answered separately, candidates should avoid the temptation to mention the ethical aspects in their answer to (a) as this will use up valuable time. Answering all parts of all questions will increase a candidate's chance of success in the examination. Many candidates simply did not attempt all parts. Time should be set aside for reading the question and requirements carefully because there were occasions where not all requirements were met. For example, one question required a comment on the impact on gearing of a series of accounting treatments, however, a significant number of answers did not consider this. It is vital that the requirements and scenario are read carefully as these can often provide a guide to an answer.

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 to the scenario provided 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, whilst there was a slight improvement in the overall performance of this examination compared to previous SBR examinations, some candidates continue to find the application of knowledge to a given scenario challenging.

Comment on individual questions

Question 1

Part (ai) required candidates to draft an explanatory note to the directors which included an explanation of how the fair value of a factory site is determined as part of a subsidiary acquisition, given information on local property prices and the conversion of nearby sites into residential use. Answers to this part were generally good, with most candidates outlining the methods by which fair value is determined under IFRS 13. Part (aii) required the calculation of goodwill on acquisition measuring the non-controlling interest (NCI) under both the fair value and proportionate share of net assets, for 3 marks. No explanation was needed to support these goodwill calculations, however a number of candidates provided one, and used up valuable time in doing so. This shows how important it is for candidates to read and understand the requirements. Part (b) then required a discussion and calculation of an impairment loss relating to the same subsidiary some years later, including an explanation of how the impairment would differ depending upon the measurement of non-controlling interest. 11 marks were available for part (b) and most answers allocated an appropriate amount of their answer to this part. Whilst almost all answers described the basic impairment process, a surprising number of candidates excluded goodwill from their impairment calculation. This may have limited their opportunities for marks, particularly where their explanations did not explain the process by which an impairment loss is allocated to assets of a cash generating unit. Very few candidates explained the need for grossing-up goodwill under the net assets NCI valuation method, and how this is then allocated between group and NCI. Explanations of how the impairment loss is apportioned between group and NCI were generally quite basic. Indeed, most candidates identified that there is no goodwill attributable to NCI under the proportion of net assets valuation, but then suggested none of the impairment need be apportioned to NCI (failing to distinguish between the impairment of goodwill and impairment of other assets).

Part (ci) required an explanation of how consideration in the form of shares in a second acquisition should be valued, including an obligation to replace an existing share-based payment scheme with a scheme containing market and non-market based vesting conditions. Most answers correctly calculated the fair value of the share exchange. Part (cii) asked for the resulting share-based expense and a discussion of the vesting conditions; unfortunately this was less-well answered.

Overall question 1 was well answered: marks were available for well-argued points which were not included in the suggested solution. Although a high level of explanation is required at this level, candidates need to include relevant calculations in their answers, particularly in question 1. Some candidates continue to present no relevant calculations and simply explained the underlying principles, which limits their scope for marks. Where the requirement asks for “a calculation” then this does not require explanation unless included in the requirement. Candidates should use the mark allocation as a guide to the time to allot to each section of the question.

Question 2

Question 2 required a discussion of specific accounting issues provided in the scenario (for 11 marks) and a further discussion of the ethical implications of events and circumstances arising within the corporate environment (for 9 marks and 2 presentation marks).

Part 2(a) described a company with challenges including increased competition, the approaching of debt covenants (based on gearing) and overdraft limits, and three issues requiring discussion as to their appropriate accounting treatment. These issues included the treatment of a cash advance from a company (under control of the finance director), the issuing of preference shares in the year (recorded as equity) and the recording of a deferred tax asset. Candidates were required to discuss the appropriate accounting treatment of each aspect, and their impact upon gearing. A surprising number of candidates failed to comment on the impact of gearing; otherwise however, answers to this section were good. Most candidates identified the accounting errors in the described scenario; although in some cases failed to identify the need for a related party disclosure. Candidates’ explanation for the accounting treatment of convertible preference shares often lacked application to the scenario: the directors argued that conversion into a fixed number of ordinary shares on a fixed date (‘fixed for fixed’) with certain conversion justified treatment as equity. Fewer answers argued why this was not correct in this situation.

The ethical problems in question 2 are more likely to test issues beyond basic accounting errors and malpractice; for example, the scenario could involve personal relationships and pressures that such relationships create. Merely quoting ethical guidance without application to the scenario will therefore restrict the candidate's marks for both the question and the associated professional marks. In this case, part 2(b) asked for a discussion of ethical issues including an intimidation threat by the financial director to her accountant, an advocacy threat compromising objectivity, and reporting bias led by the pressures of breaching debt covenant and overdraft limits. Marks were divided between identification of these ethical issues and action that the accountant should take to resolve the issues. Answers were generally good, with a clear identification of the ethical issues and suggestions to resolve them. However candidates that combined both parts (a) and (b) tended to repeat themselves; and some answers to part (b) were segmented on the basis of the accounting issues, which again lead to repetition, since the ethical issues in most cases related to all of the three accounting issues. Despite these issues, question 2 was very well-answered in general.

Question 3

Question 3 was based on a company selling music licences to other companies who then provide digital music to customers. The question had three parts. Part (a) related to income recognition: a licence sold in exchange for shares in a new start-up company, and royalties based on future revenue sales made by the same start-up. Part (b) related to a joint venture formation involving investment contributions to the joint venture by the company in the form of own intellectual property, cryptocurrency and a building. Part (c) related to a pension plan curtailment and the implications of IAS®19 *Plan Amendment, Curtailment or Settlement* (Amendments to IAS 19). Part (c) was the least well-answered, with many candidates choosing to avoid answering altogether, despite the question guiding candidates with a requirement to advise on the impact on "the calculation of net interest and current service cost". Candidates who were unaware of the amendments should at least have been in a position to critically describe the previous method by which each cost was calculated. Appropriate discussion would have been awarded marks. Part (a) required a valuation of the equity investment, and was generally well-answered, as was aspects of subsequent changes in valuation of the investment, and income recognition over the term of the licence. The royalties' aspect also required a demonstration of how the revised Conceptual Framework for Financial Reporting (2018) supported the suggested treatment. Answers tended to focus on the more general aspects of the revised Framework, whilst the answer called for those aspects relating to the scenario; such as revenue versus gains, or recognition requirements relating to uncertain future revenue compared to current reported revenue. In part (b) most candidates identified the entity as a joint venture, and correctly identified the derecognition of assets as investment contributions. However, very few recognised that the disposal was effectively 50% of the assets contributed (relating to the part attributable to the other party of the joint venture). The final requirement of part (b) tested whether cryptocurrency can be classified as a financial asset or intangible asset, and whether valuation movements should appear in profit or loss. Answers to this were generally weak; and again, some answers ignored this requirement altogether. This is surprising given that there is a technical article on Cryptocurrency. Candidates should at least be able to compare a financial asset or intangible asset, and then consider these against the characteristics of cryptocurrency, an asset without contractual right to cash or cash equivalents, whose value is exposed to significant changes in market value.

Question 4

Question 4 presented two years' of summarised accounting data (net profit before tax, sales, assets and equity) and a description of the method used by a company to analyse Return on Equity (ROE) and the fundamental drivers of value creation (net profit margin, asset turnover and equity ratio). Further details were then provided on the accounting treatment of a special purpose entity (SPE) set up in the current year, into which property had been transferred but incorrectly charged to revaluation reserves rather than as an investment. Other transactions during the year were then described, some of which reduce comparability of the ROE calculations between the two reported years.

Part (a) required a discussion of why a reporting entity may choose a particular accounting policy where IFRS allows a choice, and the impact of faithful representation and comparability on the choice (for 6 marks). Part (bi) then required a discussion on the usefulness of the ROE and its components, based on the reported data (5 marks, with a further 2 marks for clarity and quality of discussion); whilst part (bii) then asked for a discussion of the impact of the accounting transactions on ROE and its components, and a recalculation of a more comparable ROE between the two years (12 marks).

Answers to part (a) were generally well-presented, with a good description of the need to reflect the characteristics of assets and liabilities, although at a potential cost to comparability (an enhancing qualitative characteristic). Fewer answers considered the need to best represent the business model of the entity. Part (bi) was also well-answered in general, although surprisingly few candidates provided a clear description of the component elements of ROE, despite the requirement clearly asking for it. In part (bii), most candidates identified the impact that the transactions had on the comparability of the current year's ROE. Better answers included a description of the impact on each component as well as the ROE (meeting the question's whole requirement) and provided a table in which the original accounting data is adjusted for each transaction. A methodical approach yielded good marks; whilst weaker answers presented unclear workings without any referencing or commentary.

Overall, this question was well-answered.

Conclusion

Accountants are expected to have strong written communication skills to contribute to the business on a strategic level. A candidate's ability to identify and explain accounting principles and apply them in calculations is tested in the SBR examination. This requires a deep understanding of how - and *why* - conceptual and practical issues are applied in the complex real world. Future candidates should be aware of this approach.