Examiner's report

Strategic Business Reporting (SBR)
December 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 SBR exam requires candidates to demonstrate their ability to make strategic business reporting decisions. Thus, candidates are required to appraise, assess, critically discuss, and apply their knowledge. In addition, the examination requires some calculation and explanation of accounting standards, however, several candidates did not do this. Candidates will not be able to successfully answer SBR questions by rote learning and reproducing textbook answers and so, when answering questions, candidates should always explain the relevant principles which underpin their answers. Marks are always awarded firstly for an explanation of the principles and then for their application. The principles set out should be those which relate specifically to the question. For example, there is no need to set out the five-step model in IFRS 15 in every question that relates to revenue recognition as often it will only be the principles relating to one step which are applicable. An understanding of the principles will allow candidates to deal with the many variations in circumstances that arise in practice and to cope with the changes in the business environment. Candidates should be prepared to apply their knowledge in different business contexts.

Question 1 is based on the financial statements of group entities, or extracts thereof and, in addition, may require consideration of financial reporting issues. Candidates should be aware that the number of marks allocated in question 1 to numerical calculations is restricted (see marking guidance at the end of the specimen exams). However, candidates should be aware that they are still required to demonstrate their computational ability. For example, in question 1, there was a need to calculate the investment in an associate, a calculation of reserves and the impact on a revaluation gain, a goodwill calculation and a gain on step acquisition calculation. Some candidates did not attempt any calculations in question 1 and therefore struggled to gain a pass mark. Question 1 can require candidates to prepare calculations from any aspect of group accounting (**including statements of cash flow**) and discuss or explain the accounting principles behind their calculations. Thus, both calculation and a discussion of the principles that support those calculations are required.

Question 2 involves the consideration of the reporting and ethical implications of accounting issues in a specific business scenario. Candidates must demonstrate their understanding of the fact that ethics and integrity are central to the accounting profession and be able to exercise sensitive professional and moral judgments. Ethics will feature in every SBR exam, and it is essential that candidates understand the implications of these ethical issues. As with other questions in this examination, candidates should discuss the ethical principle involved, apply it to the scenario and offer a solution to the ethical problem. Very few marks (if any) will be awarded for the repetition of the ethical guidance without its application to the scenario. Two professional marks are awarded to this question for a realistic, sensible and practical assessment of the ethical dilemmas and their resolution. For example, if a candidate's solution is for the accountant to immediately go to the legal authorities without obtaining advice or without discussion, then it is unlikely that professional marks will be awarded because this advice is not realistic. The accountant should seek to resolve any ethical issues internally before resorting to external resolutions.

This question also requires a discussion of accounting practices. An issue which arises regularly is that candidates discuss the accounting issues in depth in the ethical part of the question and then this discussion is repeated in the accounting part of the question. This practice makes the answer difficult to mark and is one of the reasons why candidates may feel that the examination is time pressured. Candidates should plan their answers by reference to how the requirements have been written.

Section B always contains either a full or part question that requires the understanding of financial and/or non-financial information from the perspective of a stakeholder. Two professional marks are awarded to this question that relates to the stakeholder's perspective. Candidates should remember that they will not be awarded the professional marks if they do not discuss the issue from the stakeholders prospective. I.e. if the question is asked from an investor's perspective then it must be answered from the investor's perspective. Many candidates simply discuss the accounting issues without considering the effect on the investor or other stakeholder.

Candidates are losing marks because they are not completing the examination or not allowing enough time to answer all questions. In this examination, it was evident that a disproportionate amount of time was spent on question 2. If there are 10 marks for the ethics question, then only 18 minutes should be spent answering the question. Some candidates wrote 4-5 pages on this part of question. It is impossible to write 4-5 pages in 18 minutes and then complete the rest of the examination in time. Hence these candidates would have felt that the examination was time pressured.

To pass this exam, candidates require an in-depth knowledge of the Conceptual Framework which describes the concepts upon which International Financial Reporting Standards (IFRS®) are based. The principles of group accounting can be examined in either section A or B. For example, in Section B of this paper, there was a question on control and the impact on KPIs of accounting for an asset acquisition or business combination. Detailed knowledge of an industry, will not be required however, candidates should be prepared to apply their knowledge to contemporary business scenario's which will include digital businesses. Environmental and social considerations are also becoming increasingly important. In this context, it is important to continually review SBR technical articles. There are some candidates that continue to write brief narrative answers that do not meet the full requirement of the question or ignore numerical content that is required. A thorough reading of the question requirements is vital.

Comment on individual questions

Question 1

The first part of the question required candidates to draft an explanatory note to the directors as regards the classification of an investment in an associate, how the associate should be equity accounted for and whether the classification of the associate should change in the event of a fresh purchase of shares by the holding company.

Candidates answered the first part 1(a) of the question very well by discussing the nature of significant influence but failed in many cases to discuss why the investment should not be classified as a subsidiary. The question specifically stated that candidates should contrast associate and subsidiary status, and this required a discussion of what constitutes 'control' in IFRS 10 Consolidated Financial Statements. A discussion of the principles that support equity accounting for the associate in the consolidated financial statements was not answered well, particularly as this technique is required by the Financial Reporting (FR) examination. Candidates should ensure that they have a sound knowledge of the skills required by the FR exam before attempting SBR. Under equity accounting, the initial investment in the associate is measured at cost and the carrying amount is increased to recognise the investor's share of the profits and other comprehensive income after the date of acquisition. Candidates often mentioned that the associate would be included as a one-line entry within non-current assets but failed to calculate correctly what that entry would be.

The final element of this question required candidates to discuss the implications of the acquisition of an additional holding of shares and share options. Many candidates realised that the investment should be reclassified from an associate to a subsidiary and discussed the fact that the other shareholdings were owned by many unconnected and dispersed shareholders. Some candidates failed to recognise that potential voting rights relating to the share options, should be considered in the assessment of control. For example, some candidates failed to understand the terms 'in the money and out of the money' which basically means that it is either worthwhile or not worthwhile for the investor to acquire the extra shares.

Some candidates did not attempt this final element of this part of this question and some did not show an equity accounting calculation. Both actions make it more difficult for the candidate to be successful in the examination. The exam states that all questions are compulsory and question 1a stated that all relevant calculations should be included in candidates' answers. Although candidates are required to draft an explanatory note, this does not mean that calculations should be ignored in that note.

The second part (1b) of the question assumed that the holding company gained control of the entity set out in part a of the question and thus required candidates to discuss how the fair value of the non-current and current assets at acquisition (including any deferred tax adjustments) should be calculated together with a calculation of goodwill/gain on bargain purchase. Surprisingly, many candidates failed to mention IFRS 13 Fair Value Measurement. In previous examiners reports, it has been stated that there are very few marks for simply stating the general principles of an IFRS standard without applying those principles. The principles which apply to the circumstances of the

case study should always be mentioned but it is important to realise that these principles should be specifically those that are relevant and not just the general principles of the IFRS standard.
Candidates answered this part of the question quite well, identifying that the fair value of the land would be the amount which market participants would be willing to sell the asset in an orderly transaction under current market conditions. The additional deferred tax liability was identified but the corresponding increase in goodwill was often not discussed.

The accounting treatment of the fair valuation of the finished goods was surprisingly poorly answered. The fair value would be their estimated sales price less the sum of the costs of disposal and a reasonable profit allowance for the selling effort of the acquiring entity. Many candidates simply quoted IAS 2 Inventory and stated that the finished goods would not be fair valued. The question also required candidates to recognise an internally generated intangible asset (a database) which was not recognised in individual financial statements. Many candidates stated that the group financial statements should not recognise the database as a separate intangible asset from goodwill in the consolidated financial statements and thus did not mention the further increase in the deferred tax liability.

The second element of this part of the question required a calculation of goodwill, whilst considering a piecemeal/step acquisition. Many candidates recognised that the entity must remeasure its previously held equity interest at its acquisition fair value and recognise the resulting gain or loss in profit or loss. However, candidates often failed to calculate the NCI correctly, often using the holding company's shareholding in the calculation. Very few candidates calculated goodwill correctly, mainly due to the incorrect treatment of the NCI and the fair valuation of the net assets including deferred taxation.

Generally, the question was quite well answered but candidates seemed to spend a disproportionate amount of time on this question because it awards 30 marks. As set out in the introduction, candidates should manage their time effectively and this question should be allocated only 54 minutes of the 3-hour examination.

Question 2
Question 2 requires candidates to discuss specific accounting issues provided in a scenario and to further discuss the ethical implications of the 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.

There were several ethical dilemmas in this question. The accountant was in a difficult position as his wife (a student accountant) worked for the company, making it difficult for him to make independent decisions as regards any dealings with her. Many candidates mentioned this fact but often failed to mention that both persons had a duty to comply with ACCA's Code of Ethics. The question dealt with illegal acts and the professional standing of the two individuals at risk.

Candidates often mentioned self-interest, self-review, familiarity threats, and intimidation. However, some candidates defined these threats in detail. This is not required as, at the strategic professional level, where these types of description will be awarded minimal marks. It is the resolution of these threats and therefore the application of the ethical principles that is important in SBR. However, few candidates provided advice on how to eliminate these threats or even to reduce them to an acceptable level. Although there was mention of consultation with senior staff within the organisation, or those charged with the governance of the organisation, or with a relevant professional body, these recommendations were not often made in the context of reducing the threat but more often in informing relevant bodies. There was little discussion as to what would happen when the bodies were informed.

There was also an issue of insider trading if the accountant sold his shares in the entity.. In all scenarios, it is important for accountants to document the steps taken to resolve their ethical dilemmas, in case, their ethical judgement was challenged in the future. This point was seldom mentioned in answers. However, this part of the question was answered very well with many candidates scoring maximum marks.

The main issues with this question were that candidates answered part b whilst answering part a and some candidates simply regurgitated the scenario in their answers without discussing the ethical issues in any depth.

Part b of the question required candidates to discuss the principles that under support IAS 16 Property, Plant and Equipment (PPE), whereby an entire class of PPE should be revalued at fair value regularly. This helps to ensure that revaluation increases are recognised in other comprehensive income and accumulated in equity or profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss. Secondly, a discussion was required of the fact that large items of PPE must be separated into significant component parts and depreciated over the useful lives of these separate components. This part of the question was very well answered, with many candidates setting out the above principles. However, there seemed to be a major misunderstanding as regards the treatment of major overhaul costs which are generally capitalised as part of the asset and depreciated until the next overhaul. Entities should identify the cost of the assumed overhauling and depreciate it separately as a component. The costs are not provided for as there is no obligating event as the entity could sell the asset before the overhaul is carried out. Many candidates incorrectly stated that a provision should be made for the overhaul costs.

Very few candidates mentioned the implications of IAS® 1 Presentation of Financial Statements which states that an entity should not aggregate or disaggregate information in a manner which obscures useful information.

Generally, this question was very well answered but many candidates spent a disproportionate amount of time on the question. Part a attracted 11 marks which should be answered in roughly 20 minutes. Many candidates wrote 4-5 pages in answering this question and this must have taken those candidates much longer than 20 minutes, thus creating time pressures later in the examination.

Question 3

The first part of this question required candidates to discuss the criteria used by the Conceptual Framework for Financial Reporting (2018) and IFRS standards which could be used to recognise diverse production costs as assets.

The question required candidates to apply the revised Conceptual Framework definition of an asset to the scenario. Unfortunately, many candidates used the previous definition of an asset in their answers. However, credit was given if candidates applied their definition to the scenario.

Other IFRS standards which needed to be considered were IAS 2 Inventories, IAS 38 Intangible Assets and IFRS 15 Revenue from Contracts with Customers. Candidates often realised that some of the costs required the entity to recognise an intangible asset, but few realised that where the costs were incurred on assets produced for sale in the ordinary course of business, then these production costs would be treated as inventory in accordance with IAS 2. Similarly, where an entity is commissioned to produce an asset for a third party then this constitutes revenue from a contract with a customer and thus IFRS 15 should be used to account for these costs.

This part of the question was not well answered as many candidates could not draw upon their knowledge from a range of different accounting standards. Candidates should be aware that often, the discussion of more than one accounting standard is relevant to the scenario.

Part b of the question required candidates to advise the directors on the principles which should be used to conduct the impairment testing of two non-current assets. Surprisingly, many candidates did not set out the principles of impairment testing even though this was specifically required by the question. The scenario set out impairment indicators such as actual costs being substantially in excess of budgeted costs, issues with the usability of the asset and a revised cash flow forecast which valued the asset differently. Candidates did not recognise the fact that the impairment test should be performed at the individual asset level nor that at each reporting date, the entity should determine whether there is any indication that any impairment indicator either no longer exists or has decreased.

Part c of the question required candidates to discuss whether an entity controls another entity and whether it should consolidate it in its financial statements. Candidates often thought that the arrangement constituted a position where the parties jointly controlled an arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. In this question, this was not the case. Instead, candidates where required to use the control definitions in IFRS 10 Consolidated Financial Statements which should have led candidates to the conclusion that the entity controlled the subsidiary and should consolidate it. It is difficult to allocate marks to a discussion about joint arrangements that is fundamentally flawed from the outset but marks were awarded where a reasonable discussion of some relevant principle were applied to the scenario.

The final part of the question required candidates to discuss why an investment in a company should be classified as debt, and not non-controlling interests (NCI) in the group financial statements. Candidates often focused on defining the nature of NCI without realising that NCI constitutes an equity holding in an entity. Therefore, candidates should have contrasted debt and equity. Few candidates discussed the fact that there was an unavoidable contractual obligation to make payments and thus the investment should be classified as debt. If there had been discretion over making payments, the investment would have been equity and classified as NCI.

Candidates often find it difficult to apply accounting principles to a scenario which they may have been unfamiliar; for example, a contemporary digital context. However, the SBR syllabus stresses that a detailed knowledge of different businesses is not required. In the work place, professional accountants will be required to deal with unfamiliar business contexts on a daily basis and these are the types of skills that employers seek. Candidates should be prepared for this and remember that that the accounting principles are constant regardless of the context within which they are examined.

Question 4

Question 4(a) required candidates to advise the directors as to whether the entity was acting as principal or agent in a relationship with a third party. Additionally, advice needed to be given as to how to account for the non-refundable upfront fee paid by an entity. The question required candidates to use the principles in IFRS 15 Revenue from Contracts with Customers for both elements of the question. The answer required the application of IFRS 15 to the scenario. Many candidates arrived at an incorrect conclusion but gained marks for their discussion if they were applying relevant principles to the scenario. The question was quite well answered especially where candidates discussed the fact that IFRS 15 uses a control-based model under which a company is defined as a principal if it obtains control of the goods or services of another party or conversely, is an agent if its performance obligation is to arrange for another party to provide the goods or services.

As regards the upfront fee, candidates often discussed correctly that the entity will need to assess if the non-refundable fees relate to a separate performance obligation. This part of the question was well answered.

Part b of the question required candidates to discuss and compare the accounting treatment of an asset acquisition and a business combination. The purpose of the question was for candidates to reflect on the impact that such an accounting treatment can have on the calculation of an entity's KPIs by considering the difference in treatment of depreciation and amortisation, the direct costs of acquisition, contingent consideration and goodwill.

The question was not well answered as it seemed in some cases that candidates had run out of time because they had spent too much time on question 1 and/or 2.

Many candidates discussed the differences in accounting treatment but failed to calculate the impact on the KPIs which was the main purpose of the question. The first step in accounting for an acquisition is to determine what has been acquired or purchased. The question arises as to whether the entity has acquired a business or purchased an asset or group of assets. This matters because accounting for a business combination is different than accounting for an asset purchase. This issue is a current issue for all accountants in practice.

Part c of the question required candidates to discuss any impact for investors of treating the purchase as an asset acquisition or a business combination. This part of the question was often omitted by candidates with the result that they lost the professional marks also. Few candidates stated that it is unlikely that investors will understand the difference between the accounting for the acquisition of a business and the purchase of a group of assets. Similarly, few candidates stated that investor decisions could be significantly influenced by the accounting methods used by the entity.

Conclusion

In SBR, knowledge of a few individual accounting standards will be of little use to candidates. There is a requirement to think across standards, connect principles and construct solutions to accounting problems. As an accountant, there is a requirement to deal with many different and separate data sets at a time and apply knowledge. In the digital world, many things become obsolete very quickly, but accounting principles should be consistent, regardless of the business context. Continuous learning for accountants is vital as this provides accountants with an advantage in a world that is subject to much change. Continual learning facilitates the development of an accountant which in turn helps develop effective strategies to deal with emerging issues. Accounting has moved from a mechanical approach to a more holistic one. The expectation is that accountants will be able to synthesis and use information to develop concise insights into the current and projected financial position of a company. Thus, candidates should engage in continuous learning for this examination. As has been said before, rote learning and late 'cramming' for the examination simply does not work. This examination again showed that many candidates cannot apply simple concepts such as control, impairment etc. An encouraging aspect of the examination was the ethical understanding of many candidates.

SBR requires candidates to identify and explain principles used in calculation to provide a well-argued solution. There is evidence that these skills are being developed by some candidates and the examining team will continue to encourage a deeper understanding of the way in which financial reporting supports the business community.