Strategic Business Reporting (SBR) March/June 2023 Examiner's report

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

Contents

General comments

This examiner's report should be used in conjunction with the published March/June 2023 sample exam which can be found on the ACCA Practice Platform.

In this report, the examining team provide constructive guidance on how to answer the questions whilst sharing their observations from the marking process, highlighting the strengths and weaknesses of candidates who attempted these questions. Future candidates can use this examiner's report as part of their exam preparation, attempting question practice on the ACCA Practice Platform and reviewing the published answers alongside this report.

Often non-technical factors have an impact on candidates' chances of passing the Strategic Business Reporting (SBR) examination. One such non-technical skill is time management. Good time management skills will help relieve pressure and stress particularly in the later stages of the examination. Candidates should prioritise the questions that they are going to answer and strategically divide their time. This does not necessarily mean answering question one first. Question one can be complex and long and, by answering this question first, candidates can put themselves under pressure early in the examination, particularly if too much time is spent on the question. Question 2 which focuses on accounting and ethics is probably a better place to start. Candidates should be realistic about what they can achieve in the time allocated to a question. It is a mistake to set the scope of the answer too wide and too general. Answers like this often bring in lots of knowledge-based facts and little application of knowledge to the scenario. Very few marks are allocated to rote-learned knowledge. Answers that are concise, relevant and applied will score better than answers that are broadly conceived and not answering the question.

Candidates should also make sure that they know exactly the format of the paper before they take the examination. For example, question one is based on the financial statements of group entities (including statements of cash flow) and requires consideration of financial reporting issues. It is important to note that candidates are often required to discuss the principles behind any calculations they provide. The preparation of a full set of group financial statements or group statement of cash flows from scratch is not required. Candidates are unlikely to obtain a pass mark on this question by simply preparing numerical solutions.

Note: from September 2023, the format of question one will change and candidates will be given a pre-formatted spreadsheet on which they will answer part of the question.

Question 1 – Greer Co

(a) Using exhibit 1, evaluate the reasons why Greer Co, rather than Layout Co, can be identified as the acquirer in the business combination. (10 marks)

Part (a) of this question required candidates to evaluate why a company (Greer Co) was deemed to be the acquirer in a business combination. This requirement carried 10 marks.

Candidates gained marks for two key elements. The first was for setting out the principles of control, IFRS 3 *Business Combinations* 'substance over form' approach and how an acquirer is identified. The second area where marks were obtained was the application of these principles to the scenario. The arguments were finely balanced, but the question did advise candidates as to which company was actually the acquirer. Therefore, candidates' answers should have been written with this in mind, whilst at the same time discussing why the circumstances might point to the other company (Layout Co) being deemed to be the acquirer.

This question was answered well by those candidates who discussed relevant IFRS Accounting Standards and then applied the principles to the scenario. Other candidates did not fully understand the control relationship, or simply gave information from the scenario without adding any further reasoning as to how this information demonstrated acquisition or control.

(b) Using exhibit 2, explain, with calculations, how the goodwill on the acquisition of Layout Co on 1 April 20X7 will be determined within the consolidated financial statements of the Greer Group for the year ended 31 December 20X7. (5 marks)

Part (b) of the question required candidates to explain, with calculations, how goodwill on acquisition was determined within the consolidated financial statements.

Candidates were asked to explain and calculate. This means that candidates were expected to describe in more detail the calculation of goodwill by stating relevant facts. There were 5 marks in total for this part of the question with the principles being awarded 2 marks. This element was answered reasonably well by most candidates. However, very few candidates gave any explanation or discussed the principles behind the calculation of goodwill as the requirement asked for. This meant that many candidates unnecessarily limited their marks. Many correctly calculated the amount of the consideration value of the shares issued and also stated correctly the fair value of the net assets. The weakest element of the answer was the calculation of the fair value of the equity interest before the business combination. This was unfortunate, given that this is a well-established and often examined element of the syllabus. There was a loss on the previously held interest which was recognised in profit or loss.

As an illustration of the way marks can be lost by not discussing the calculation, a mark would be awarded for not only calculating the loss but also for stating that the loss is recognised in profit or loss.

(c) Using exhibit 3, explain, with calculations, how the Greer Group would account for the investment in Gae Co in the consolidated financial statements for the year ended 31 December 20X7.

(9 marks)

Part (c) of the question required candidates to explain how an investment of 10% and a further investment of 12% in a company would be dealt with in the consolidated financial statements.

As the original equity investment was not held for trading, candidates needed to discuss that an entity can make an irrevocable election at initial recognition to measure it at fair value through other comprehensive income (FVTOCI) with only dividend income recognised in profit or loss. Any changes in fair value are never recycled to profit and loss if this election is made.

The additional investment created an associate relationship and therefore, the investment would be accounted for using equity accounting in the consolidated financial statements from the date of the additional purchase. Candidates were expected to discuss that, under equity accounting, the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets.

The problem arises as to what constitutes ‘cost’ but the question stipulated that the company used fair value as ‘deemed cost approach’ and, therefore, on the acquisition of the second tranche of shares, a fair value gain was measured and recorded in OCI. Candidates were then expected to calculate the subsequent value of the investment in associate in the consolidated statement of financial position at the year end. Marks are always given for an explanation of the equity method as well as, in this case, the calculation of share of post-acquisition profits attributed to the associate.

Most candidates made a good attempt at this part of the question. However, the discursive element of the answers was often limited to an explanation of what constitutes an associate rather than the wider issues concerning the treatment before the company was an associate and deemed cost at fair value. Many candidates did not realise that the fair value of the original holding should be used in the calculation of the investment in the associate, but most candidates made a good attempt at the calculation of the post-acquisition profits with the most common error being not to time-apportion. Very few candidates discussed the issues surrounding the recognition of the dividend generally and in profit or loss specifically.

(d) Using exhibit 4, calculate and briefly outline, in accordance with IFRS 9 *Financial Instruments*, how the loan would be accounted for during the period 1 January 20X6 to 31 December 20X7.

(6 marks)

Part (d) of the question required candidates to calculate and briefly outline how a loan would be accounted for in the financial statements over a two-year period.

The majority of the marks were allocated to an amortised cost calculation. However, many candidates did not correctly treat the transaction costs at initial recognition and did not appear to understand the difference between the effective interest rate and the interest paid. The interest expense recognised in profit or loss was calculated using the effective interest rate, but many candidates treated the interest paid as the interest expense.

Marks were awarded for candidates' own figures if they adjusted the current carrying value of the liability to the present value of the modified cash flows and recognised a gain in profit or loss in the financial statements. Surprisingly some candidates treated the loan as a financial asset. Overall, the performance was disappointing.

Conclusion

Generally, the performance was good for this question, but some core areas of syllabus knowledge still need improvement.

Question 2 – Cutherd Division

Question 2 involves the consideration of the reporting and ethical implications of some accounting issues presented in a specific scenario. ACCA's Code of Ethics and Conduct defines responsibilities in terms of the duties of students and members and provides guidance on ethical issues that can arise. It is impossible to set out a response to every situation, and therefore ACCA have to rely on the students and members to deduce what is right or wrong. In this exam, therefore, 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.

Two professional marks are awarded to this question and the requirement within the question always clarifies how the professional marks will be awarded.

(a) Discuss how the advancement of information technology impacts on the ethical responsibilities of an accountant.

Note: There is no need to refer to any specific exhibit to answer part (a).

(4 marks)

Part (a) required candidates to discuss how the advancement of information technology impacts on the ethical responsibilities of an accountant. There was a range of answers which were possible and acceptable in answering the question. Generally, candidates were awarded 1 mark for each valid discussion point. There was no need to refer to any specific exhibit to this part.

Part (a) was generally answered well with a significant number of candidates achieving full marks. Candidates tended to be knowledgeable regarding advancements in technology and were able to apply themselves by mentioning that accountants need to be competent, up to date, and undertake continuing professional development. Candidates also demonstrated their understanding of the principle of confidentiality.

Some candidates answered part (a) and part (b) in one section, which causes problems for the marker. Candidates must make it clear which requirement they are answering.

(b) Discuss the ethical issues faced by the accountant (Mr Ebrima) and the internal auditor (Mr Franklin) in Herding Co and any actions they should take to address these issues.

(6 marks)

Professional marks will be awarded in part (a) and (b) for the quality of the ethical discussion and identification of appropriate actions.

(2 marks)

Part (b) required candidates to discuss the ethical issues faced by an accountant and an internal auditor and any actions they should take to address these issues. The scenario included a centralised procurement system that was inefficient and did not meet the needs of the organisation as a whole. The question also dealt with ethical issues relating to dominance by one figure in the organisation, the effect of personal relationships and pressures placed upon individuals.

Candidates needed to discuss the fundamental principles of ethics that could potentially be threatened by a broad range of circumstances. For example, intimidation threats, lack of objectivity, and lack of professional competence. Candidates were required to identify both actual and perceived ethical threats. Candidates should always discuss the ethical principle and then apply this principle to the scenario. It should be noted that simply cutting and pasting elements of the scenario without appropriate discussion will not attract any marks.

Professional marks were awarded in part (a) and (b) for the quality of the ethical discussion and identification of appropriate actions. The actions identified by candidates need to be realistic and specific to the circumstances. The accountant should take whatever actions might be available, as soon as possible, to address the consequences of the breach of the ethical code. These actions will differ depending upon the circumstances in the scenario. Therefore, when a candidate simply gives a standard set of actions such as resign, call ACCA etc without application to the scenario, the candidate will score very few marks. It is true that an accountant should determine whether to report the breach to the relevant parties. However, the relevant parties are not just ACCA but include those who might have been affected by the breach, as well as another professional or regulatory body, or an oversight authority. There are also actions which should be considered before a breach of the ethical code is reported to the relevant authorities.

This part of the question was generally answered well. In the past candidates have struggled with applying specific ethical principles and more importantly mentioning any threats to those principles. This was not the case with this question. However, there were still many candidates who cut and paste the exhibit into their answer without relevant comment.

(c) Explain the possible effects of IAS 38 *Intangible Assets* and IAS 36 *Impairment of Assets* on the accounting treatment of the purchase of the Cutherd division's procurement system and development costs, in the financial statements for the year ending 31 December 20X8.

(8 marks)

Part (c) required candidates to explain the possible effects of IAS 38 *Intangible Assets* and IAS 36 *Impairment of Assets* on the accounting treatment of the purchase of a procurement system and development costs. Part (c) was answered well with the majority of candidates able to present the definition of an intangible asset and the conditions required to capitalise development costs. However, as discussed previously, rote-learnt knowledge does not attract many marks, so it is a mistake for candidates to simply give definitions without applying them to the scenario. Of the marks available for this part of the question only 2 marks were given for IAS 38 and IAS 36 definitions.

This requirement gave candidates a good opportunity to achieve full marks. The lack of possible future benefits of the system and potential technological obsolescence cast doubt on its classification as an asset. As a result, the expenditure on the system may have been correctly expensed in the statement of profit or loss. However, if candidates discussed reasons why the system should have been classified as an intangible asset, then due credit was given.

The cost of the procurement system, if capitalised as an intangible asset, would have to be tested for impairment at the year end, although it is difficult to calculate the recoverable amount of a procurement system. The recoverable amount of additional internal development costs is more likely to be zero thus justifying the write off to profit or loss.

Candidates often didn't discuss the arguments for and against capitalisation, simply stating that the system and development costs should or should not be capitalised.

Conclusion

Overall, the question was answered well.

Question 3 – Fernanda Co

Question 3 examines the candidates' knowledge and application of a range of IFRS Accounting Standards, specifically in this case, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* IAS 32 *Financial Instruments: Presentation,* IAS 1 *Presentation of Financial Statements* and IAS 7 *Statement of Cash Flows*.

(a) Discuss the acceptability of Fernanda Co's decision not to record any liability for the roof collapse in the consolidated financial statements for the year ending 31 December 20X7. (7 marks)

Part (a) of the question dealt with an industrial accident and the consequences from a financial reporting perspective. This is an application of IAS 37, a core topic from the ACCA Financing Reporting module. However, a surprising number of candidates appeared ill-prepared to deal with the requirement, which asked for a discussion on whether the decision not to record a liability for a roof collapse in a building the company had constructed was acceptable.

The scenario described how "no legal action" had been brought against Fernanda Co by the reporting date (relating to the existence or not of an obligation), and that "investigators were assessing the responsibilities" for the collapse which was expected two months after the reporting date (relating to the determination of probable outflow). A well-presented answer applied this information to the recognition criteria to conclude that no liability was required at the reporting date. Whilst not explicitly mentioned in the requirement, it is expected that candidates should then apply the IAS 37 decision tree to further consider whether disclosure of a contingent liability is needed (or whether the outcome is remote). This was often discussed in answers, although a surprising number of candidates confused contingent liabilities with provisions, and disclosure with recognition. Even when successfully concluding that a contingent liability existed, answers sometimes incorrectly proposed it would be recognised as a liability in the statement of financial position.

Where candidates considered the offset issues relating to a successful insurance claim, they often failed to identify the insurance claim as a separate issue from the implications of the accident.

(b) Discuss the acceptability of Fernanda Co's decisions, in the consolidated financial statements: **(i) to disclose a contingent liability for the estimated cost of redeeming the put options** (4 marks)

Part (b)(i) related to put options in a business combination. Candidates were required to discuss the acceptability of disclosing a contingent liability for the cost of redeeming put options.

Good answers began with a definition of financial instruments (the title of this exhibit) to consider whether the put options meet the definition of a financial liability.

Candidates who picked up that the scenario stated that the company "would be obliged" to purchase the shares if the options were exercised by another party, often gained full marks, provided they then explained **why** (the obligation is under the control of another party) and **how** this should be recognised (at the present value of the redemption amount).

IAS 32 is regularly examined at this level, however a surprising number of answers either ignored this part of the question or failed to identify the obligation and the subsequent impact on the financial statements, instead incorrectly agreeing with the accounting treatment taken by the company.

(b) Discuss the acceptability of Fernanda Co's decisions, in the consolidated financial statements:

(ii) to record the non-redeemable preference shares as equity rather than a compound financial instrument.

(6 marks)

Part (b)(ii) The requirement here related to a complex financial instrument. The scenario describes how a "fixed cash dividend" was payable, and that the company argues that compliance with IAS 32 "would conflict with" the *Conceptual Framework*. The majority of answers correctly explained how the preference dividend represented, in part, an obligation to transfer cash flows which created a financial liability, with the equity element being the residual part of the share issue. However, very few candidates discussed whether the remote chance that a Conceptual Framework override could apply here or what disclosure requirements would arise should such treatment take place.

(c) In accordance with IAS 7 *Statement of Cash Flows*:

- explain the importance of and the distinction between classification of cash flows from investing activities and cash flows from financing activities;

- outline the circumstances where cash flows may be reported on a net basis; and

- discuss the issues with Fernanda Co's treatment of the cash flows for the year ended 31 December 20X7.

(8 marks)

Part (c) comprised three short requirements relating to IAS 7. The first two did not require reference to the related exhibit but questioned the candidate's knowledge and understanding of the uses of cash flow classifications and rules about reporting on a net basis. Answers to these first two requirements should be relatively straightforward at this level. The third requirement raised more challenging application aspects relating to the accounting treatment described in the exhibit. Candidates may have picked up on the fact that this third requirement applies the knowledge relating to the first two requirements (classification and reporting on a net basis) and could use this to help present their answer to the third requirement.

In the first bullet requirement, candidates were asked to explain the importance and distinction of cash flow classifications (investing and financing activities). A surprising number of answers were limited to rather simplistic statements that investing cash flows related to the investing part of the business and financing cash flows to business financing. Better answers supported this with appropriate examples, and further marks were earned where answers were expanded to describe the importance of investing and financing activities to an entity, in terms of capital expenditure commitments and overall funding and its sources.

In the second bullet requirement, candidates were asked to outline when cash flows can be reported on a net basis. Answers were varied, with a surprising number of candidates not answering this section. Where answered, candidates often provided only one circumstance in which cash flows can be netted off.

In the third bullet requirement, candidates needed to consider the exhibit and discuss the issues relating to the company's treatment of cash flows for the reporting period. Well-presented answers explained how an existing loan to a now disposed subsidiary would no longer be eliminated on consolidation. This cannot be recorded as a cash flow, and so should not be included in investing activities (the exhibit states there was no cash movement on the loan during the year).

A second issue relating to the incorrect netting of cash inflow from the subsidiary disposal with a cash outflow to acquire another subsidiary was better answered. However, weaker answers failed to spot the implications of the cash held by the disposed subsidiary, which should be netted against consideration received to present the net cash inflow on disposal.

Question 4 – Eloa Co

A common theme of the examiner's report from previous sittings relating to question 4 is that this is often the final question attempted. Candidates with weak time management may fail to allocate the appropriate time to plan and write their answer to their final question and struggle to earn sufficient marks to gain a pass on this question. The marking team saw evidence of this again in answers to this question.

A relatively high number of submissions were noted as providing no answer for one (or more) parts to the question. Candidates risk losing out on the 2 professional marks awarded in question four if requirements are not attempted.

Candidates who are taking this examination should be mindful that it is much easier to gain the first marks from a new question (or part of a question) than the final (higher level) marks in another question in which they have overallocated their time.

Allow yourself time to think, plan and answer *each* question to increase your opportunity to earn the most marks. Be strict with your time and use the mark allocation as an indication of the time to spend. Translating marks into minutes and noting the time by which each part of a question should be completed is good exam technique. Within this time, set aside a few minutes to identify what is required and plan your answer to ensure you keep on track and make the most of your time allocation on question. If you don't answer all parts of a question, you are more likely to struggle to pass it.

(a)(i) Using exhibit 1 only, discuss, in accordance with IFRS 8 *Operating Segments*, whether the four divisions owned by Eloa Co should be classified as <u>operating segments.</u>

(a)(ii) Using exhibits 1 and 2, determine, in accordance with IFRS 8:
- whether the four divisions owned by Eloa Co should be identified as <u>separate reportable segments</u>; and
- whether it is necessary or possible for any of the divisions to be combined into a single reportable segment for Eloa Co.

(9 marks)

Part (a) of this question comprised two requirements (i) and (ii) which together combined 9 marks.

Generally, part (a)(i) was well-answered, particularly where the candidate's answer presented knowledge first, and then applied that knowledge to the scenario. Candidates should carefully review the scenario description, as marks might be available for discussing specific issues raised in the narrative. In this case, Eloa Co has not disclosed segment information on the basis that this "might affect its competitive position and be misleading." Whilst relatively few answers considered this, those that commented on how IFRS Accounting Standards are designed to provide information that is transparent, useful and not misleading would gain a mark. Likewise, credit would be given for an explanation on how Eloa Co, being a listed entity, should comply with IFRS 8 and make appropriate disclosures on operating segments.

As with any question asking for a discussion on an accounting treatment under IFRS Accounting Standards, an answer should begin with the candidate's relevant knowledge. In this case, the discussion should first outline IFRS 8's definition of an operating segment, as this would then be applied to determine whether each division meets that definition. It may be tempting to leap to a conclusion without first considering the attributes of an operating segment; but without first identifying these attributes, the discussion may be limited. Marks are therefore likely to be lost without this discussion as it is key to the requirement (which is to "discuss").

A good answer first describes the attributes of an operating segment: that its activities incur expenses and generate revenue, for which discrete financial information is available which are regularly reviewed by the chief operating decision maker (CODM). Candidates should have noted, when reading through the scenario, how one division sells 90% of production to the other three divisions. This should be commented upon, although some answers overlooked it. Even if you are not sure if this should be included as an operating segment, a discussion of whether the CODM would value such information (in terms of a vertically integrated business) may well lead you to the correct conclusion. The discussion should also consider the implications of this division operating overseas to the CODM and, more generally, the user of the financial statements. Separate disclosure of this division is likely to help users to better assess its performance and significance to the group.

Weaker answers to part a(i) merely copied and pasted chunks of the exhibit information, without adding any substance or comments to their answer, before concluding. This approach scores few, if any, marks as it fails to meet the requirement of a *discussion*. Furthermore, some answers struggled to distinguish between defining an operating segment and determining which segments are reportable (the requirement for part (a)(ii)).

In part (a)(ii), most candidates correctly outlined the reportable criteria under IFRS 8, although some answers merely referred to the "10% rules" (relating to sales, net assets and profit) and some answers seemed confused about how to apply the "75% rule" (relating to total revenue reported by operating segments). Calculations and conclusions for part a(ii) were, on the whole, correctly reached provided the right rules were applied. Those who described the reportable criteria, including aggregation of divisions, applied the criteria to the scenario and scored very well on this part. Many produced a table with calculations to support their conclusions.

(b) Discuss how the investment in Ganic Co should be accounted for in the consolidated financial statements of Eloa Group and discuss whether Ganic Co can be classified as an operating segment.

(7 marks)

Part (b) required a discussion on how to account for a joint venture in the group financial statements and whether it can be classified as an operating segment. Candidates who had a good understanding of IAS 28 *Investment in Associates and Joint Ventures* generally answered this well. As with most requirements, the best answers were divided into a display of knowledge of IAS 28 and then an application of this knowledge based on the information from the scenario, leading to a conclusion. Candidates familiar with the concept of joint control and joint arrangement came to the right conclusion, although some incorrectly suggested that it was an associate.

Candidates should review the scenario for descriptions that flag the arrangement to be a joint venture. All key decisions require a unanimous vote all three shareholders. Each venturer owns their share of the net assets. Weaker answers seemed confused by the implications of the option to purchase a further 5% of the other two venturers in the future. Many answers failed to discuss how control would not be achieved if the option was exercised, as shareholding would only rise from 33% to 43%, still below 50%.

Marks were often missed by failing to address the issue of whether the venture should be classed as an operating segment. Where this was discussed, it tended to be very brief, and conclusions were often incorrect. It is important that candidates attempt all parts of the requirement to maximise opportunities for marks. In this case, a good answer would quickly apply the operating segment characteristics (from ai) to this case. The aspect that candidates tended to struggle with was whether joint control might influence the determination of an operating segment. Even where candidates were unsure of this, a discussion on the fact that the joint venture's activities incur expenses and generate revenue, whose discrete financial information is regularly reviewed by the CODM would earn marks.

(c) Segmental reporting provides information about an entity's operations which enables users of financial reports to assess and make informed decisions on the true position and performance of an entity with diversified segments.

Explain why segmental information is important to investors.

Note: You do not need to refer to any exhibit when answering part (c).

(7 marks)

Professional marks will be awarded in part (c) for clarity and quality of the explanation of the importance of segmental information to investors.

(2 marks)

Part (c) was a general requirement, without the need to refer to exhibits, to explain why segmental information is important to investors. Candidates often scored well in this part, provided their focus was on how segment information addresses the needs of the investor. The question provided some guidance by referencing the need for investors to make "informed decisions" and citing an entity with "diversified segments."

Answers often generated some good points, provided the focus remained on the investor's needs. Where this was done, candidates were able to achieve the two professional marks (in which the guidance specifically mentions the importance of segmental reporting "to investors"). Weaker candidates overlooked the investor focus requirement, either expanding their answer to wider stakeholders' needs, or considering only the perspective of management.

Part (c) amounted to a total of 9 marks including the professional marks, and candidates should be allocating the same amount of time to this answer as they do to part (a). However, some answers were provided in brief bullet point format, which indicated a lack of time management. Since there is no need to refer to an exhibit, candidates could have answered this part first had they felt this would have aided their time management.