# Financial Reporting
## F7 Examiner's report
## June 2018

**General comments**

The Financial Reporting exam is offered in both computer-based (CBE) and paper formats. The structure is the same in both formats but our model of delivery for the CBE exam means that candidates do not all receive the same set of questions. In this 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 future candidates.

- Section A objective test questions – we focus on two specific questions that caused difficulty in this sitting of the exam
- Section B objective test case questions – here we look at the key challenge areas for this section in the exam
- Section C constructed response questions - here we provide commentary around some of the main themes that have affected candidates' performance in this section of the exam, identifying common knowledge gaps and offering guidance on where exam technique could be improved, including in the use of the CBE functionality in answering these questions.

## Section A

Here we take a look at two Section A questions that proved to be particularly difficult for candidates.

Example 1
A company purchased an item of plant for $40,000 on 1 September 20X1. The plant had an estimated life of five years and an estimated residual value of $5,000. The plant is depreciated on a straight-line basis. Local tax law does not allow depreciation as an expense, but a tax allowance of 60% of the cost of the asset can be claimed in the year of purchase and 20% per annum on a reducing balance basis in the following years. The rate of income tax is 30%.

**REQUIRED:**
**What charge or credit for deferred taxation should be recorded in the company's profit or loss for the year to 31 August 20X2?**

A $17,000 charge

B $5,100 charge

C $5,100 credit

D $17,000 credit

*What does this test?*
This question tests that a candidate knows how to calculate both the amount of the deferred tax provision and how it should be adjusted in the statement of profit or loss.

*What is the correct answer?*

The correct answer is B
To answer this question, candidates need to calculate the amount of deferred tax required by taking the difference between the carrying amount and the tax base of the asset at 31 August 20X2 and multiplying it by the appropriate tax rate. They then need to establish the direction of the adjustment required. The calculations required are as follows:

|  | Carrying amount($) |  | Tax Base($) |
|---|---|---|---|
| Cost at 1 Sep 20X1 | 40,000 | Cost at 1 Sep 20X1 | 40,000 |
| Depreciation year 1 (40,000-5,000)/5 | (7,000) | Tax allowance year 1 40,000 x 60% | (26,000) |
| Carrying amount at 31 Aug 20X2 | 33,000 | Tax Base at 31 Aug 20X2 | 16,000 |
| Temporary difference (33,000-16,000) = 17,000 x 30% = 5,100 | | | |

As the tax allowances are in advance of the depreciation, a deferred tax provision is required. Therefore, a charge of $5,100 will be required to the statement of profit or loss.
Candidates need to understand both how to calculate the deferred tax amount and how to adjust for it.

*Why the correct answer is none of the other options?*
A This option does not take account of the rate of tax but the direction of the adjustment is correct
C This option is the correct amount of deferred tax but it has been adjusted for the wrong way in the SOPL(i.e. the direction of the adjustment is incorrect)
D This option does not take account of the rate of tax and the direction of the adjustment is incorrect

**Example 2**
On 1 July 20X5, Pull Co acquired 80% of the equity of Sat Co. At the date of acquisition, goodwill was valued at $10,000 and the non-controlling interest was measured at fair value. In conducting the fair value exercise on Sat Co's net assets at acquisition, Pull Co concluded that property, plant and equipment with a remaining life of ten years had a fair value of $300,000 in excess of its carrying amount. Sat Co had not incorporated this fair value adjustment into its individual financial statements. At the reporting date of 31 December 20X5, the goodwill was fully impaired. For the year ended 31 December 20X5, Sat Co reported a profit for the year of $200,000.

**REQUIRED:**
**What is the Pull Group profit for the year ended 31 December 20X5 that is attributable to non-controlling interests?**

A $16.000

B $12,000

C $35,000

D $15,000

*What does this test?*
This question tests that candidates understand the impact on non-controlling interests (NCI) of a mid-year acquisition, the write-off of goodwill and the additional depreciation required by accounting for the net assets of the subsidiary at fair value.

*What is the correct answer?*

The correct answer is D.

|  | $ |
|---|---|
| Subsidiary profits ($200,000 x 6/12) | 100,000 |
| Write-off of goodwill | (10,000) |
| Additional depreciation (300,000/10 x 6/12) | (15,000) |
|  | 75,000 |
| NCI @ 20% | 15,000 |

*Why the correct answer is none of the other options?*

**A The write-off of goodwill is time apportioned in error (100-5-15) x 0.2 = 16**
**B The depreciation is not time apportioned in error (100-10-30) x 0.2 = 12**
**C The profits are not time apportioned in error (200-10-15) x 0.2 = 35**

**Section B**
This section of the exam presents three scenarios around which 5 (two mark) objective questions are based. This approach allows the examining team to test a particular learning outcome in some depth. These scenarios can be based on any of the F7 learning outcomes which means that future candidates need to have a knowledge of the syllabus which is both wide and deep. They also need to be able to apply that knowledge in the context of a specific scenario. In June 2018, candidates' knowledge of the following learning outcomes was weak: provisions and contingencies, change in accounting policies and construction contracts.

- Here are some tips when practicing case questions: Read the case through in its entirety without looking at the questions associated with it. Then read it through again…these cases are not lengthy and so do not take long to read.
- Read the requirement of each question carefully to ensure that you understand what is being asked of you. Some questions in the case may test similar issues but from a different perspective.
- Some questions in the case will be quicker to answer than others; for example, there will be some questions where you are required to input the answer as a number (i.e. the question will not be a multiple choice). You will need to take more care with these questions. Ensure that you work the answer through either in the scratchpad or on a piece of paper (with workings if necessary).
- Ensure that you understand the numerical denominations required in the case; for example, you may be required to input all of your answers in $millions or in $000s.
- Double check your answer against both the scenario and the requirement before you input/select your answer.

The cases are used to test a syllabus area in-depth which means that they cannot be rushed. Each case is designed to take about 18 minutes to work through. If you are working through them quicker than that, then it is likely that you are not thinking about the subject matter in sufficient depth. A candidate that reviews their answer and double checks their workings is more likely to score higher marks on a case than a candidate who does neither.

## Section C

Candidates were presented with questions drawn mainly from the areas of:

- Preparation single entity financial statements
- Analysis of consolidated financial statements
- Preparation of consolidated financial statements
- Analysis of single entity financial statement

### Preparation of single entity financial statements

This area of the syllabus requires candidates to prepare a set of financial statements for a single entity. This is a fundamental skill for an accountant, and has been a large part of the financial reporting syllabus for many years. Performances in this area were generally good, although possibly not as good as in previous sittings.

As in previous questions on single entity financial statements, candidates were required to produce financial statements from a trial balance incorporating a set of adjustments. Also common to previous sittings, candidates were not necessarily asked for full sets of financial statements, with requirements such as producing a statement of adjusted profit, or being asked to produce a statement of profit or loss, statement of changes in equity but not a statement of financial position. This tests the candidates' knowledge of the presentation of financial statements, their ability to identify the correct elements accordingly and also tests knowledge of a variety of accounting standards.

Candidates were generally able to prepare well-presented sets of financial statements, maximising the marks available due to the 'own figure rule' where candidates were asked to produce a statement of adjusted profit and a statement of financial position. This means that students who made a calculation error over an item such as depreciation gained credit for following that figure through in the statement of financial position. Students who show good workings and neatly presented financial statements are often able to pick up these marks. Candidates who do not show how they have arrived at a final answer for an item containing numerous calculations continue to miss out on these marks. This is a fundamental approach that should be adopted to produce a set of financial statements in the exam, and workings must be clearly shown.

Candidates generally coped well with adjustments relating to revaluations, inventory and depreciation, as expected. In addition to this, candidates performed reasonably well with technical adjustments to revenue, and made a noticeably improved attempt at calculations of non-current

assets held for sale. This had been an area previously noted as poorly performing, so this was reassuring to see.

The most technical areas of the questions proved challenging for some students. These included professional fees incurred on a financial instrument, and deferred tax relating to a revaluation. Both have featured regularly in previous exams, but can be challenging due to their technical nature.

By some distance, candidates did not cope well with entries in respect of leases. As International Financial Reporting Standard (IFRS®) 16 is the newest standard released in relation to the Financial Reporting exam, it was expected that candidates would be better prepared to deal with this. A surprising number of candidates were unable to deal with a lease with payments made in advance. Even fewer candidates were able to deal with the low value lease. All of the approved texts have examples of these in, so it would appear that some candidates need further question practice on this area.

There are multiple past exam questions that test the preparation of single company financial statements, as this has been a large part of the Financial Reporting exam for many years. Triage Co from the September 2016 exam and Moston Co from the September/December 2015 are good examples of this type of question which students must practice. As this type of question has possibly the widest areas of syllabus coverage, candidates should be attempting the preparation of numerous single entity financial statements before sitting this exam.

## Analysis of consolidated financial statements

In questions where the analysis is based on group issues, candidates may be asked for minor calculations, such as goodwill or group-related adjustments to the financial statements. These are core items that candidates are expected to be able to produce. Candidates scored well on the calculation of goodwill, as expected, with many candidates scoring full marks on this. The questions that required candidates to make adjustments were less well received. This was surprising, given that the adjustments involved were standard such as intra-group sales, unrealised profits and goodwill impairment.

Candidates continue to be able to score well on the calculation of ratios. Many candidates were able to score full marks on this, showing that they had learned the ratio calculations well.

The worrying trend of producing ratios without workings has continued, particularly in CBE, with many candidates failing to score marks through the 'own figure rule' because it is impossible for markers to establish how ratios have been calculated. This was particularly evident in the question where the candidate was asked to redraft figures and then recalculate ratios.

An example of how this would be marked is shown below. The table below shows draft figures of a group, before adjustments:

|  | $000 |
| --- | --- |
| Revenue | 34,000 |
| Cost of sales | (18,000) |

Gross profit                16,000

Giving a gross profit margin of 47%

Let's say the question required the candidate to remove an intra-group sale of $5,000 and make an adjustment for unrealised profit of $1,000. Correcting for these would give the following result:

|  | $000 |
| --- | --- |
| Revenue (34,000 – 5,000) | 29,000 |
| Cost of sales (18,000 – 5,000 + 1,000) | (14,000) |
| Gross profit | 15,000 |

Giving a revised gross profit margin of 51.7%

The marks for the adjustments would be given in part (a) of the question, and these would be marked as either right or wrong.

If part (b) asked the candidates to calculate ratios based on the draft and recalculated figures, these would be given as an own figure rule. Ideally, this is how we would like to see candidates show these workings:

|  | Draft | Restated |
| --- | --- | --- |
| Gross profit margin | 47%<br>(16,000/34,000) | 51.7%<br>(15,000/29,000) |

This clearly shows the ratio and the workings, and would obtain full marks. Let's say a candidate forgot to adjust the unrealised profit in cost of sales. This would make cost of sales $13m. This would give the following results:

|  | $000 |
| --- | --- |
| Revenue (34,000 – 5,000) | 29,000 |
| Cost of sales (18,000 – 5,000) | (13,000) |
| Gross profit | 16,000 |

|  | Draft | Restated |
| --- | --- | --- |
| Gross profit margin | 47%<br>(16,000/34,000) | 55.1%<br>(16,000/29,000) |

This would lose a mark in part (a), as the candidate has made an error there. However, they would score full marks in part (b) for the ratios under the own figure rule, as it is clear which figures a candidate has used in the restated calculation.
However, candidates often show their answer as:

| | Draft | Restated |
|---|---|---|
| Gross profit margin | 47% | 55.1% |

in such a case, a marker is forced to mark these figures as either right or wrong because there are no workings to show what the candidate has done. The marker cannot assume the mistake that the candidate has made, as this is not clear. Therefore this candidate would score 0.5 for the draft calculation (47%), as this is correct, but nothing for the restated (55.1%), as this is incorrect.

By not showing workings as in the example above, candidates can lose up to 2.5 marks. It is imperative that workings such as these are shown to inform markers and maximise the marks to be gained.

The analysis surrounding consolidated financial statements must involve comments on group-related issues. A significant minority of students continue to answer these questions without reference to group-related issues. A disappointing number of students produced very limited or zero commentary. Generic statements will continue to score very few marks, as the question is looking for the candidate to bring in the information provided in the scenario, particularly focusing their answers on group-related topics.

Candidates must look at Perkins from the March/June 2018 hybrid paper and the September 2016 question Gregory Co as an example of how to incorporate knowledge of consolidations into an answer. This type of question is one which can often divide candidates. Those who are well prepared can often score good marks, but sadly far too many individuals are picking up either very limited marks or no marks at all for their discussion. A significant minority continue to attempt ratios with no attempt at discussion, which highlights that further work and practice is required over this area by some.

**Preparation of consolidated financial statements**

The preparation of consolidated financial statements remains an area that candidates perform well on. Candidates with clear workings often scored highly on this area. There was an improvement in the number of candidates showing their workings, either within the cell or shown separately in different lines of the spreadsheet. Both are acceptable methods, and both will be marked by the marking team.

The preparation of a consolidated statement of financial position was performed particularly well, with a number of candidates able to score very highly. Only the very highest scoring candidates were able to correctly deal with the fair value adjustment of a contingent liability, which was the most technically challenging aspect of the question. A common error occurred when candidates forgot to unwind the discount in relation to any deferred consideration that was payable for a subsidiary. Many candidates calculated the initial present value correctly, but then did not process any subsequent adjustments for the unwinding.

A surprising number of students are still using proportionate consolidation in relation to the subsidiary, which is a fundamental error at this stage and should not be happening. This has been a problem which has been in decline, but the last couple of sittings have now displayed a rise in

candidates doing this, which is disappointing to see. This might be overcome if candidates attempted multiple consolidation questions in practise and compared their answer to the suggested solution where it would be clear that a subsidiary should be consolidated 100% and not proportionately.

The preparation of a consolidated statement of profit or loss was generally well answered. Candidates displayed good knowledge of intra-group sales, fair value depreciation and unrealised profits.

The most common error by far was the omission of the profit split between the parent's shareholders and the non-controlling interest. This is a key part of a consolidated statement of profit or loss, but continues to be missed by too many candidates. Individuals who did not attempt to split the profit or other comprehensive income between the parent and the non-controlling interest missed out on a potential 3 marks. This has been also been highlighted in previous examiner reports, so it would be nice to see progress on this.

In one particular question, candidates were asked to produce the consolidated statement of profit or loss and a total of consolidated assets. This tests the knowledge of double entry, ensuring the candidate is thinking fully of the dual effect that adjustments will have had on the financial statements. This was the worst answered part of the question, and it is perhaps because many candidates were over-thinking it.  Total assets is simply non-current assets and current assets added together  and these numbers are subject to the normal adjustments which would be required during the preparation of  a consolidated statement of financial position.

There are multiple past exam questions that test the preparation of consolidated financial statements, as this has been a large part of the Financial Reporting exam for many years. Party Co from September/December 2017, Dargent Co from March/June 2017 and Bycomb Co from the June 2015 paper are good examples of this type of question which candidates must practice.

**Analysis of single entity financial statements**

Performance in this area was not as good as it has been in previous sittings, which was disheartening - it is a key part of the syllabus and has been for many years.

The ratio calculations were often done well, with many candidates scoring maximum marks for the calculation of ratios. However, it has become noticeable in recent sittings that some candidates do not know the formulas for calculating net asset turnover and interest cover. This was again in evidence here, as the most likely ratios to be calculated incorrectly. The other most common errors included a failure to include lease liabilities as part of debt, despite specific instruction from the question to do so.

Again, the most common problem here is candidates simply showing a percentage or figure with no workings. If candidates do this, it is often impossible to see how they have arrived at the figure, meaning that credit cannot be given for follow through marks. For example, a student may have calculated return on capital employed incorrectly in year 1 by applying the incorrect figure for capital employed. Applying the own figure rule, a candidate who repeated this mistake in year 2 but showed their workings would only lose a half mark in year 1. Similarly, candidates who then repeated the same mistake on capital employed into net asset turnover would obtain full  marks

because they have already lost a half mark for the initial error. However, if no workings are provided, unless the answer is absolutely correct, no marks can be awarded because the marker is unable to tell how candidates have calculated the ratios.

Markers are not able to recalculate ratios in an attempt to work out what candidates have done. The candidate must show the marker how the figure has been obtained. This is advice which has been repeated many times in previous reports, and it is frustrating to see that candidates are still not following this advice.

It also appears that the improvement in candidates narrative answers on analysis noted in previous sittings was less evident here. Fewer candidates were using the narrative information from the scenario, with many simply stating that decreased profit margins meant worse performance – there was no attempt to analyse why a company may have recorded this change in margins. Similarly there were far too many 'textbook' answers relating to gearing, explaining that high gearing is bad for the business rather than considering the reasons for the high gearing.

Far too many answers were too brief. Candidates should be working on the basis of scoring one mark for each well explained point. Too many candidates wrote one or two paragraphs, which is always going to be some way short of the required standard for scoring 14 marks.

Consistent with previous feedback, the highest scoring candidates used the scenario in their answer. After providing similar comments for numerous sittings, it was disappointing that more candidates did not do this, reversing a recent positive trend.

An area of continuing weakness is that candidates too often fail to summarise their thoughts in a well explained conclusion. A sensible summary of the analysis that the candidate has already written will always score marks, and candidates must ensure that they include this in their answer.

There are multiple past exam questions that test the analysis of single entity financial statements, as this has been a large part of the Financial Reporting exam for many years. Mowair Co from September/December 2017 and Funject Co from March/June 2017 are good examples of this type of question which students must practice.

**Exam technique**

Good exam technique is vital for success in Financial Reporting. Strong candidates continue to produce good workings for both the preparation of financial statements and calculation of ratios, enabling them to maximise the marks to be gained here. As stated earlier, candidates who failed to provide workings often scored much lower marks on all aspects of calculation.

The analysis discussion points should be laid out clearly, using headings for each area requested, such as 'performance' and 'position'. Candidates should make clear statements, and avoid repetition. Numerous candidates continue to repeat the same point two or three times when explaining the movement on a ratio. It is much better to make comments on a wider range of figures than to repeat similar points over one specific balance.

Candidates should also ensure they include a conclusion on the analysis discussion. A sensible conclusion summarising the main points of the analysis is important, and marks will be given here.

The completion rate of questions continues to be high, suggesting that many candidates are able to manage time well. The majority of candidates attempted all sections. The most commonly omitted sections tended to be areas where candidates were asked to explain issues. The exam will involve elements of discussion, so candidates cannot afford to neglect these sections as they practise questions.

**Word processing and spread sheet technique**

As stated earlier, candidates using the word processing tool for the analysis question were less likely to show their workings for calculating ratios than those sitting the paper-based exam, which needs to be improved so marks are not lost.

Conversely, the narrative answers were often well presented, with headings and spacing used well.

For the preparation of financial statements question, candidates often laid out the financial statements and workings well. Some candidates tended to put figures in individual cells and add the cells across for the answer, whereas others did the entire working in one cell using a formula. Both are perfectly acceptable as markers will follow both methods.

There are resources on ACCA's website giving more guidance on how to use the spreadsheet software. A video introducing the main functionality and how to make best use of these in Financial Reporting can be accessed here.

**Guidance and Learning Support resources to help you succeed in your exam**

There are many resources available to candidates to help with the exam. Many of the common themes discussed in this report regarding exam technique and ways to improve are comments that are commonly made across sittings. Previous examiner's reports can be found here and will give good, consistent guidance in what the examining team is looking for from well prepared candidates.

One of the keys to Financial Reporting is question practice, attempting questions and reviewing the answer to see any areas you may have missed. This is particularly relevant on the analysis questions. Often on this question candidates feel comfortable, but reviewing the answers can show the depth of discussion that is being sought here. We strongly recommend that you use an up to date question and answer bank from one of our Approved Content Providers but if this is not possible then work through the most recent past exams on our website. However, please note if you are using the past exams that these are **not** updated for syllabus changes or changes to the exam format and so should be used with caution – so check the latest syllabus and study guide for changes.

Some of the more challenging areas of the syllabus have specific articles describing them in more depth in the technical articles section and these should provide greater understanding. The exam

technique section also provides guidance for approaching the analysis question, and further guidance for resit students.