



Examiner's report

Financial Reporting (FR)

December 2018

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

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.

- 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.

There were three sections to the examination and all the questions were compulsory. Section A consisted of fifteen OT questions for a total of 30 marks, which covered a broad range of syllabus topics. In Section B candidates were presented with three case studies of 5 OT questions worth 30 marks and two constructive response questions worth 20 marks each; testing the candidates' understanding and application of financial reporting in more depth.

In order to pass this examination, candidates should ensure they devote adequate time to obtain the required level of knowledge and application. Candidates who do not spend sufficient time practicing questions are unlikely to be successful as the constructed response questions in particular aim to test candidate's application skills

Section A

Section A questions test a broad range of the syllabus and candidates should be prepared for this. They should avoid question spotting as there are no "core" learning outcomes – all learning outcomes are equally important. Where answer options are available, candidates should resist looking at these until they have fully worked the question. As can be seen in the following two examples, some of the distractors can appear genuine but may miss a stage of a calculation, thereby offering an incomplete answer. The following two questions are reviewed with the aim of giving future candidates an indication of the types of questions that can be asked, guidance on how much work is involved in answering 2 mark questions and to provide a technical debrief on the learning outcomes tested.

Sample questions for discussion

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

Example 1

On 1 September 20X8, Paper Co acquired 75% of Stone Co's ordinary share capital. The fair values of the net assets of Stone Co at the date of acquisition were equal to their carrying amounts, with the exception of a liability, which had a carrying amount of \$20,000 below the fair value. Stone Co had not accounted for this fair value adjustment in its individual financial statements.

It is the group policy to measure non-controlling interests at acquisition at fair value.

As a result of the above consolidation adjustment, what would be the impact on the goodwill amount at the date of acquisition?

- A. Increase by \$15,000
- B. Decrease by \$15,000
- C. Increase by \$20,000
- D. Decrease by \$20,000

What does this test?

This question tests that candidates understand the fair value consolidation adjustments required and it tests both the amount of the adjustment and its direction.

What is the correct answer?

Candidates should know that any fair value adjustments made in the Statement of Financial Position are made at 100%; i.e. it is not the group share of individual asset or liabilities that are adjusted for their fair value but the full amount. In this case, this is the full \$20,000. Where the carrying amount of a liability is below its fair value, this means that the liability needs to be increased to reflect its fair value; i.e. the liability needs to be credited by the full amount of \$20,000. The impact of this is to reduce net assets and therefore increase goodwill by a corresponding amount. The correct answer is C.

Tip: if candidates are unsure of the direction of the adjustment, then use fake figures to calculate a fake goodwill figure and then account for the fair value adjustment to see what happens to goodwill.

Why the correct answer is none of the other options?

Both options A and B are incorrect because they use the group share of the fair value adjustment. Option D is incorrect because the adjustment is in the wrong direction.

Example 2

Cornet Co entered into an eight year lease agreement on 1 July 20X4. The lease requires annual payments of \$750,000 in arrears. The present value of the lease payments at 1 July 20X4, discounted at a rate of 6% is \$4,657,500. Additionally Cornet Co paid directly attributable costs of \$37,500 on 1 July 20X4.

What is the total charge to the statement of profit or loss for the year ended 30 June 20X5 in respect of the right-to-use asset?

- A. \$586,875
- B. \$866,325
- C. \$279,450
- D. \$1,029,450

What does this test?

This question tested that candidates knew to (a) capitalise the directly attributable costs of the lease, (b) charge depreciation on the right-of-use asset to the statement of profit or loss and (c) charge the lease interest to the statement of profit or loss.

What is the correct answer?

		Right-of-use asset
Cost 1 July 20X4	(\$4,657,500+\$37,500)	4,695,000
Depn to 30 June 20X5	(\$4,695,000/8)	586,875

Lease liability

1 July 20X4	6% interest
4,657,500	279,450

Total charge to SOPL = 586875 + 270,450 = 866,325

Why the correct answer is none of the other options?

Option A is the depreciation only

Option C is the lease interest only

Option D is the lease interest plus the lease repayment (treated as rental)

Section B

This section of the exam presents three scenarios around which five (two mark) objective test 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 FR learning outcomes which mean 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 December 2018, candidates' knowledge of the following was weak:

- (i) leases – IFRS 16 is a relatively new standard and so candidates should ensure that they are using an up-to-date text. Also, pay particular attention to dates as not all leases will be started on the first day of the financial year which means that this will restrict the expenses charged to profit or loss.
- (ii) Research and development – these questions usually involve detailed information being provided about the amount of expenditure on specific dates and then it being written off to profit or loss. Therefore, candidates need to pay attention to the detail of the scenario and use timelines where possible to organise that information.
- (iii) Financial instruments – Candidates need to avoid a superficial understanding of this subject area. If this topic makes you nervous then you need to practice more questions.
- (iv) Revenue recognition – by their nature, these types of questions will be detailed and make use of dates. Candidates should ensure that they understand the question scenario and learn how to un-pack the detail and organise it effectively. This topic area is also widely spread and may include questions that test more complex areas such as sale and leaseback.

Section C

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

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

Single entity accounts preparation

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 and a list of adjustments. Candidates were able to produce well-presented financial statements, maximising the marks available due to the 'own figure rule'. This means that candidates who make a calculation error (such as depreciation) still gained credit for following that incorrect figure through and accounting for it correctly in either the statement of financial position or the statement of profit or loss or both. Candidates who show clear workings and produce 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. The use of workings is a good exam technique and is fundamental to producing a set of financial statements in the exam. Workings must be clearly shown to allow markers to award marks accordingly.

Candidates generally coped well with adjustments relating to depreciation and tax. However, candidates found entries relating to a long-term contract challenging, with a large numbers omitting the contract asset from the statement of financial position.

There were some weak attempts in respect of leases, which was sadly consistent with recent sittings. As IFRS 16 is a relatively new standard, it was expected that candidates would be better prepared to deal with this. All of the approved content provider texts have relevant examples, so it would appear that some candidates need further question practice on this area. A minority of candidates simply used the figures from the trial balance, making no attempt to adjust for the information provided in the question. This highlights a lack of preparation in a fundamental area of the syllabus.

There are multiple past exam questions looking at the preparation of single company financial statements, as this has been a large part of the Financial Reporting exam for many years. Duggan Co from the September/December 2018 hybrid paper and Haverford Co from the March/June 2018 hybrid paper 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 attempt the preparation of the financial statements of a single entity multiple times before sitting this exam.

Analysis of consolidated financial statements

Candidates tend not to perform well in interpretation questions but especially so when they are based on the financial statements of a group. Frustratingly, many candidates do not attempt all question parts which suggests that some candidates are question spotting. This behaviour is dangerous and should not be something that candidates attempt in the FR paper.

In questions where the analysis is based on group issues, candidates may be asked for minor calculations, such as goodwill, gain/loss on disposal, or group-related adjustments to the financial statements. These are core items that candidates are expected to be able to produce. Candidates tended to score reasonably well on the adjustments and goodwill calculation, with many who attempted scoring high marks on this. The performance on the disposal tended to be less good, with many candidates not really displaying a clear answer or set of workings.

Candidates continue to be able to score well on the calculation of ratios with many able to score full marks. This demonstrates that they had learned the ratio calculations well. However, some

candidates failed to produce the ratios requested, and instead produced different ratios, which will always score zero marks.

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'. This was particularly evident in a question where the candidate was asked to redraft figures from the financial statements and then to recalculate certain ratios.

The following example was used in the June 2018 examiner's report, but continues to be relevant in the light of the lack of workings produced for ratios. This example 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% (16,000/34,000)

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 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% (16,000/34,000)	51.7% (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%	55.1%
	(16,000/34,000)	(16,000/29,000)

This would lose a mark in part (a), as the candidate has made an error. 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.

If a candidate simply shows the ratio calculations as:

	Draft	Restated
Gross profit margin	47%	55.1%

A marker would mark these figures as right or wrong, as 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, as this is correct, but nothing for the restated, as this is incorrect.

Not showing workings like this cost candidates up to 2 marks if they had made errors redrafting their financial statements. It is imperative that workings such as these are shown to maximise the marks to be gained.

The analysis surrounding consolidated financial statements must involve comments on group-related issues. A significant minority of candidates continue to answer these questions without reference to group-related issues. A disappointing number of candidates 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 Duke Co from the September/December 2018 hybrid paper, Perkins from the March/June 2018 hybrid paper and the September 2016 question Gregory Co as examples 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 because they are not applying the information provided in the question scenario.

Preparation of consolidated financial statements

The core principles of the preparation of consolidated financial statements remain 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 done 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. Another common error was candidates forgetting to unwind the discount in relation to deferred consideration payable for a subsidiary. Some candidates calculated the initial present value correctly, but then did no subsequent adjustments for the unwinding. Calculations relating to contingent consideration, where the consideration should be included at fair value, proved challenging to many students, as did the calculation of unrealised profit on goods in transit at the year-end.

The largest error, and possibly the most surprising omission, arose from candidates failing to deal with a government grant correctly. This may be because students have attempted to learn a mechanical process in preparing consolidated financial statements and were therefore unprepared for an accounting adjustment that they may have expected in a question that tested the preparation of the financial statements of a single entity. This is an essential skill to develop for Strategic Business Reporting, as candidates will be expected to apply IFRS requirements in a group context.

A surprising number of candidates used proportionate consolidation in relation to the subsidiary. Proportionate consolidation is where the group share of the subsidiary's individual assets and liabilities (say 70%) are added to those of the parent which is fundamentally incorrect. This has been a problem which has been in decline in recent years, but the last couple of sittings have now displayed a rise in candidates doing this, which is disappointing to see. It is likely that candidates who do this have not practiced enough consolidation questions and/or are failing to fully compare their answer to the correct answer provided.

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 the September/December 2017 hybrid paper, Dargent Co from the March/June 2017 hybrid paper and Bycomb Co from the June 2015 paper are good examples of this type of question which students must practice.

Analysis of single entity financial statements

Performance in this area was often good, with many candidates showing an improvement in technique.

The ratio calculations were often done well, with many candidates scoring maximum marks for these. CBE candidates are often less likely to show their workings, and this is a situation which needs to be addressed as it can lead to the loss of follow-through marks from the application of the own figure rule.

It was very pleasing to see candidate attempts to analyse cash flow information, something which has not been examined frequently in recent sittings. There has been a key article released on the ACCA website, and there was good evidence that candidates have read this, with the analysis often being the strongest part of some answers.

However, the discussion around profitability and interest cover was often of a lower quality, with candidates using more generic discussion points such as profit improving being a good thing, with no attempt to explain why. The question scenario provides candidates with the key information about the business and it is essential that candidates use this to produce their answers.

Often 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 up to 15 marks.

Consistent with previous feedback, the highest scoring candidates did demonstrate that they are bringing the scenario into the answer more and more. After providing similar comments for numerous sittings, it was disappointing that more candidates did not do this, reversing a recent positive trend.

There are multiple past exam questions looking at 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 the September/December 2017 hybrid paper and Funject Co from the March/June 2017 hybrid paper are good examples of this type of question which students must practice.

Exam technique

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

In analysis-type questions, discussion points should be laid out clearly, using headings for each area requested, such as 'performance', 'position' or 'cash flow'. Candidates should make clear statements, and avoid repetition. Numerous candidates continue to repeat the same point two or three times when explaining the movement in a ratio which will waste time and not provide any further marks. 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 awarded for a decent attempt to do this.

The completion rate of questions continues to be high, suggesting that many candidates are able to manage time well. In this diet, it was pleasing to see that the majority of candidates attempted all sections of the exams. The most commonly omitted questions in section C 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 spreadsheet 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.

In questions that tested the preparation of financial statements, 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 approaches 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.