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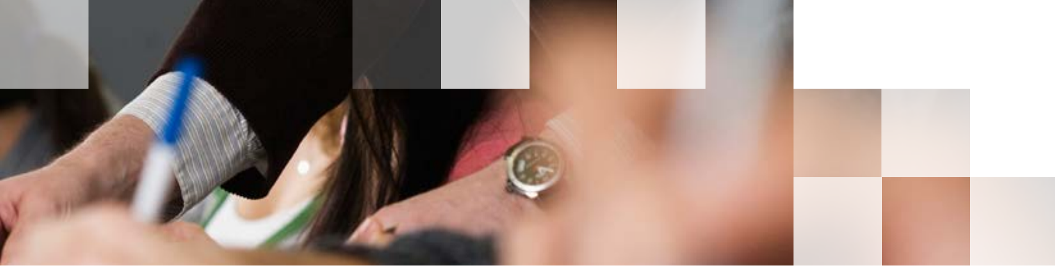
Financial Reporting

Read the mind of an FR marker

Think Ahead



Contents

Think Ahead ACCA

Introduction

I am a member of the team who will mark Financial Reporting. This article is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Financial Reporting script.

Insight into a marker's thinking – appreciating what we are trained to look for, what we award marks for, the reasons why marks may not be awarded – will help you fulfil your potential and gain the necessary marks to pass.

It will help you appreciate the points that will attract marks so that you can better assess your answers when practicing questions.

This article uses two sets of candidates' answers to requirements selected from the September 2017 exams.

To support your reading of this article, you should refer to the September/December 2017 – Sample Questions. **Click the link here**.

Fulfil your potential and gain the necessary marks to pass.

Question 31

The 20-mark constructed response questions in Section C will require the preparation of financial statements for a single entity or a group and interpretation of the financial statement of a single entity or a group.

Analysis and interpretation questions may require the calculation of certain ratios. The examining team advises that candidates must be prepared to interpret comparative performance (e.g. over periods of time, against a competitor entity or against industry averages). Interpretation requires candidates to demonstrate an understanding of how certain transactions or events may have affected a **valid** comparison.

Analysis of single entity financial is consistently the weakest area for many candidates.

The examiner reports that analysis of single entity financial is consistently the weakest area for many candidates. This is a typical question:

(a) Calculate the following ratios for the years ended 30 June 20X6 and 20X7:

(i) Operating profit margin;
(ii) Return on capital employed;
(iii) Net asset turnover;
(iv) Current ratio;
(v) Interest cover;
(vi) Gearing (Debt/Equity).

Note: For calculation purposes, all loan notes should be treated as debt. (6 marks)

(b) Comment on the performance and position of Mowair Co for the year ended 30 June 20X7.

Note: Your answer should highlight any issues which Mowair Co should be considering in the near future. (14 marks)

20 marks

You must read carefully any note to requirements.

Observations on the requirements

There are only 6 marks for calculating 6 pairs of ratios. When the formula for a calculation is specified (typically for gearing) this formula **must** be used.

Showing your workings for **all** ratios calculated is essential; otherwise markers cannot give partial credit to allow for errors.

You must read carefully any **note** to requirements. For part (a) there is clear instruction on how the debt is to be treated. Failure to follow the instruction will lose marks. There is also a prompt here relevant to part (b). The note focusses attention on the amounts of debt which is relevant to the interpretation.

The comments called for in part (b) require more than merely stating that a ratio was higher/lower or represented a percentage improvement/deterioration on the prior year. This only states in words the results of the calculations – it is not a comment on performance or position.

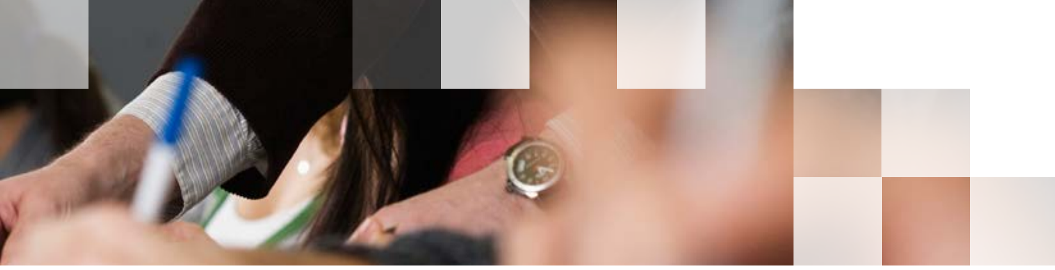
As the requirement is to comment on the performance and position of the entity in question, the answer must use the specific information provided in the case scenario. Simply stating textbook knowledge (e.g. what a ratio represents) without any application to the scenario provided will earn no marks. When marking interpretation questions, markers look for meaningful use of the scenario provided.

Markers look for meaningful use of the scenario provided.

The note to this part called for any issues that should be considered in the near future to be highlighted. This was a prompt to look out for issues which could affect future performance and position which provided an opportunity for more marks.

In a discussion question of this sort candidates are expected to finish with a brief conclusion, for which one mark would be available.

The examiner encourages the use of separate sub-headings (e.g. performance, position, future issues and conclusion). Identifying suitable sub-heading is point of exam technique in planning a clear and logical structure for your answer. It should help you identify all aspects of the requirement(s), keep you 'on track' in answering the question set and reduce the risk of repetition. All of which will increase the mark-earning potential of your answer.



Notes on candidate one's answer to Q31

Follow this link to see candidate one's answer to Q31

View it here

Note 1
One mark is given for the correct calculation of both ratios. The candidate has not been penalised for the incorrect rounding (7.987% rounds to 8.0%).

Note 2
The instruction "For calculation purposes, all loan notes should be treated as debt." has been ignored, so the full mark cannot be awarded. Capital employed should have included the current portion of the loan notes. However, as the calculations are otherwise correct, partial credit has been given.

Note 3
The candidate has already been penalised for the incorrect calculation of capital employed in (ii), so cannot be penalised again under the 'own figure rule'. The full mark is therefore given for this pair of ratios.

Note 4
One mark is given for the correct calculation of both ratios.

Note 5
Only partial credit can be given as the ratio for 20X7 is incorrect. It can be seen at a glance that interest has been shown at the same amount in both years (10200). This is most likely due to carelessness arising from the fact that although the question set out amounts under headings 20X7 then 20X6, the candidate has swapped the order and presented the ratios 20X6 then 20X7.

Note 6
The full mark cannot be awarded because the calculations are incorrect; the amounts of debt do not include the current portion of the loan note (see Note 2). Partial credit has been given for using the ratio specified (i.e. Debt/Equity).

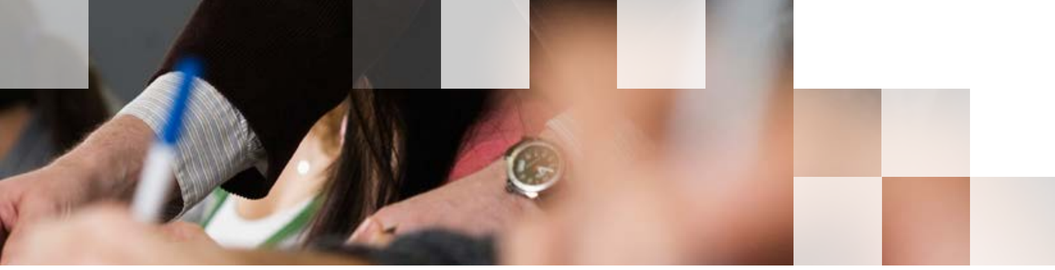
Note 7
Overall, this calculation part has been done quite well. The answer has been clearly presented in a columnar format. The candidate made only one careless error but lost a mark for failing to pay attention to the instruction in the note to the requirement.

Note 8
A mark has been awarded for a plausible reason why revenue may have fallen.

Note 9
A mark is given for relating the fall in operating profit margin to the information in the scenario which indicated an increase in costs. Note that no marks were available for merely stating the difference between the operating profit percentages (11.7 – 7.9).

Note 10
Credit given for attributing the decline to the revaluation. This observation needed further development (e.g. stripping out the revaluation from the calculation and commenting on what is then a marginal increase in this ratio).

Note 11
A mark has been given for identifying the two factors that have contributed to the fall in ROCE.



Note 12
Two marks have been awarded as two good points are made here – the most likely reason for the reduction in cash, based on the case scenario, and the concern that it raises. Note that no marks would be given for merely stating that the ratio fell or by how much.

Note 13
Credit given for the observation. (Further credit is given later when this is developed in later comments.)

Note 14
Credit given for a valid inference. It does not matter that it was not possible to quantify the effect. For a full mark, the candidate could have mentioned the impact on the comparability of the margin.

Note 15
One mark for comment on the main reason for the change in gearing ratio.

Note 16
One mark for the valid observation clearly linked to a change in ratio and supported by other information.

Note 17
No credit is given for restating the ratios calculated in part (a). One mark awarded for a correct interpretation of the reduction and identifying an implication for the future.

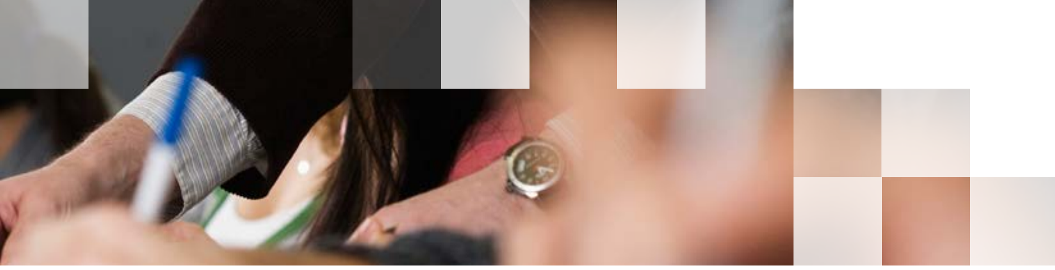
Note 18
One mark for identifying an issue for the future.

Note 19
Overall, this part has been done very well. A range of valid answer points have been presented in a logical sequence that broadly follows the order of calculations in part (a). The style of writing is clear and concise. The candidate has clearly thought about what they will write and has been well rewarded (for fewer than 20 sentences).

The mark for candidate one for Q31 is 15/20.

TOTAL:

15/20



Notes on candidate two's answer to Q31

Follow this link to see candidate two's answer to Q31.

View it here

Note 1
One mark is given for the correct calculation of both ratios. The candidate has not been penalised for the incorrect roundings on the calculations (11.698% rounds to 11.7% and 7.987% rounds to 8.0%).

Note 2
As for candidate one, the instruction to treat all loan notes as debt has been ignored. The current portion of the loan notes should not have been included in the candidate's current liabilities adjustment. However, as the calculations are otherwise correct, partial credit has been given.

Note 3
As for candidate one, the full mark is given for this pair of ratios under the 'own figure rule'.

Note 4
One mark is given for the correct calculation of both ratios.

Note 5
The correct formula is 'Profit from operations/Finance costs'. That the candidate has inverted the formula shows that they did not understand its meaning. It is not the task of the marker to rework a candidate's answer to determine how or where errors have arisen. However, for the purpose of this article it can be noted that 'interest payable' amounts are in fact the total amounts of the loan notes. So this part of the answer is entirely wrong and no credit can be awarded.

It is not the task of the marker to rework a candidate's answer to determine how or where errors have arisen.

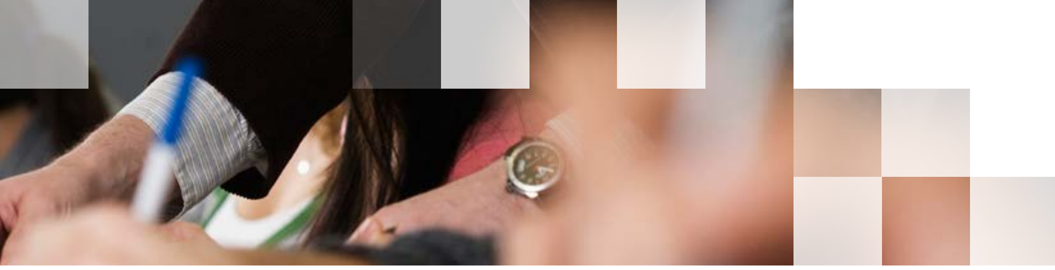
Note 6
Although the requirement prompted the calculation Debt/Equity, the candidate appears to be calculating (Debt + Equity)/Equity. Again, it is not the marker's task to rework the answer, but for the purpose of this article we can see there is another error. $29,920 is not the amount of debt but total current liabilities, which has no place in the calculation of gearing.

Note 7
No marks awarded as this summary is a mere repetition of the results of the calculations made in part (a), for which marks have already been awarded.

Note 8
No marks for further repetition of the results or the mere statement of the difference between the two years.

Note 9
Credit given for relating the fall in profit to the renegotiation of the licence.

Note 10
Although the comparison shows whether a business is earning more or less than prevailing interest rates, merely stating that numbers are more or less is not a comment on the company's performance. The comment about revaluation suggests that revaluing non-current assets would *improve* ROCE. This is incorrect as the revaluation during the year is one of the reasons why ROCE has declined. So no marks are given.



Note 11
There are no marks for implausible reasons that contradict the scenario. The increase in the carrying amount of property, plant and equipment in the statement of financial position is 82% and can be wholly attributed to the revaluation (ignoring depreciation).

There are no marks for implausible reasons that contradict the scenario.

Note 12
The first sentence copies the information from note (ii) in the case scenario. One mark is awarded for a plausible explanation why revenue may have fallen due to the increase in licence costs.

Note 13
One mark awarded for a plausible explanation why the current ratio has deteriorated. Note that the first 'sentence' looks more like an idea for an answer point, for which no credit would be awarded.

Note 14
No marks for repetition. Marks have already been awarded for this point (see Note 12).

Note 15
One mark for correct identification of this as an issue for concern.

Note 16
Again, the first 'sentence' looks more like an idea for an answer point, for which there is no credit (see also Note 13). According to the candidate's calculations, interest cover has increased, which is 'good' rather than an issue. (The major issue is that the company already has too much debt and so needs equity finance. Even if the company needed or could take on more loan finance, it is highly unlikely that could be obtained more cheaply, given the risk involved.)

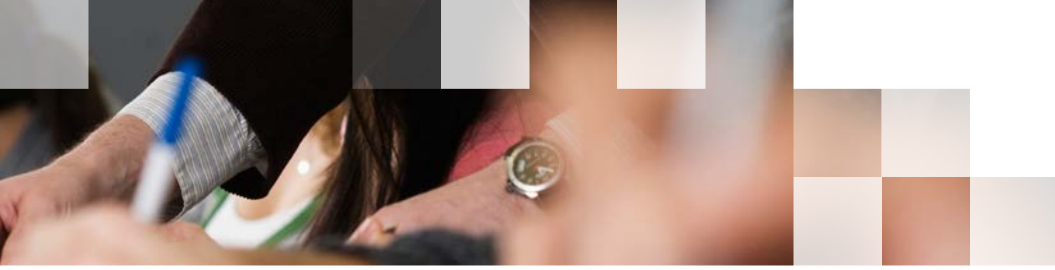
Note 17
Ignoring the completely unnecessary summary of the results of calculations in part (a), the candidate has written more than 30 sentences. The answer has no clear structure and sentences are mostly statements that ratios were higher/lower or an increase/decrease on the prior year. The candidate should have taken time to read carefully the information given and think how that information affected the ratios – this is what it meant by 'interpretation'. Thinking and planning is an effective use of exam time – as shown by candidate one's answer.

Thinking and planning is an effective use of exam time.

The mark for candidate two for Q31 is 7/20.

TOTAL:

7/20



Question 32

The preparation of financial statements question may be for a single entity or a group. The concept of business combinations and the preparation of consolidated financial statements are important elements of the FR exam. Consolidation questions will be limited to a parent with only one subsidiary, with the possible inclusion of an associate that will require equity accounting. Note, however, that a question that tests the *interpretation* of the financial statements of a group may be based on a group which has more than one subsidiary. Joint ventures are not examinable in FR.

A consolidation question may require the consolidated statement of profit or loss or the consolidated statement of financial position or 'extracts' of financial statements rather than full financial statements.

Important consolidation topics include accounting for post-acquisition profits, goodwill and non-controlling interests, fair value adjustments and intra-group transactions and balances. All these topics are examined in the following question:

(a) Prepare the consolidated statement of financial position of the Party group as at 30 September 20X5. **(15 marks)**

(b) Party Co has a strategy of buying struggling businesses, reversing their decline and then selling them on at a profit within a short period of time. Party Co is hoping to do this with Streamer Co.

As an adviser to a prospective purchaser of Streamer Co, explain any concerns you would raise about making an investment decision based on the information available in the Party Group's consolidated financial statements in comparison to that available in the individual financial statements of Streamer Co. **(5 marks)**

20 marks

Observations on the requirements

Although the question is largely computational, there is also a short written element.

Bearing in mind the important consolidation topics you should be alert to, and highlight, information about the following as you read the scenario:

- Date of acquisition (1 October 20X4) and reporting date (30 September 20X5).
- Any deferred consideration (relevant to the calculation of goodwill).
- The method used to value the non-controlling interest (in this case, fair value method).
- Any fair value adjustments (in this case on inventory).
- Any intra-group trading (in this case sales by Party Co to Streamer Co).

Once you have identified all the possible adjustments, think about the workings you need before you start typing out your answer. Showing all necessary working has the potential to earn more marks than taking a short-cut which results in errors.

Part (b) concerns the limitations of using financial statements for investment decisions. Although there was a clear pointer to using "information available", the examiner reported that few candidates referred to any numbers in this part of the question.

Important consolidation topics include accounting for post-acquisition profits, goodwill and non-controlling interests, fair value adjustments and intra-group transactions and balances.

Notes on candidate one's answer to Q32

Follow this link to see candidate one's answer to Q32.

View it here

Note 1
Half a mark is given for simply summing the carrying amounts of property plant and equipment as given in the statements of financial position of the parent (P) and subsidiary (S).

Note 2
The 2½ marks available were for (i) summing the amounts in the individual statements of financial position (½ mark), (ii) including the fair value adjustment on inventory still held by S (1 mark) and (iii) deducting the unrealised profit on intra-group sales (1 mark). (i) and (iii) were correct. Although (ii) was incorrect, the candidate recognised the need for an adjustment here and has been given partial credit (½ mark).

Note 3
The goodwill figure, for which 4 marks were available, is incorrect. However, it is referenced to a working so the marker must look at this and see how much credit to award. W3 shows that the only error in the calculation is in the total net assets at the date of acquisition. W2 (also referenced) shows that the only error is that the fair value adjustment on the inventory acquired (600) has been included in the reporting date column. So 3½ marks are awarded as only ½ a mark is lost due to the error.

Note here that the candidate has misplaced goodwill in the statement (after current assets). Although this is incorrect, there was no mark for where it should be presented, so this is cannot be penalised because there is no 'negative' marking.

Note 4
Half a mark is available, and given, for including only P's share capital.

There is no 'negative' marking.

Note 5
The figure for retained earnings is incorrect but the referenced working (W5) shows correct inclusion of P's retained earnings (½ mark), unrealised profit (½ mark) and unwinding of the discount on the deferred consideration (1 mark). There are two errors. (i) There is no penalty for the incorrect inclusion of the property revaluation as the marks for correct treatment of the revaluation surplus are not awarded here (see Note 6). (ii) P's share of S's post-acquisition retained earnings is incorrect. W2 (also referenced) shows that it does not include the *movement* in the inventory fair value adjustment (540) because the candidate did not calculate the 10% remaining at the reporting date. So the candidate is given 1 mark for having calculated a correct share (80%) on post-acquisition retained earnings (2,500 included in incorrect amount of 3,100). The candidate is therefore awarded 3 of the available 3½ marks.

Note 6
The available ½ mark was for the correct treatment of the revaluation surpluses (i.e. a consolidated statement of financial position includes P's revaluation surplus plus *P's share* of any *post-acquisition* revaluation surplus of S.) Since there was no post-acquisition revaluation, this was $0. So the ½ mark cannot be given.

Note 7
The non-controlling interest is also incorrect. However, W4 shows that the error is in the amount of S's post-acquisition retained earnings. This is the same error that resulted in the loss of a ½ mark in W5 (see Note 5) so cannot be penalised again. So the candidate is awarded the 1½ marks available in full under the 'own figure rule'.

Note 8
On acquisition, the deferred consideration is to be paid in two years' time. At the reporting date, it will be paid in one year's time. The correct answer could have been calculated in two ways. (i) By taking the amount included in the calculation of goodwill (28m x 0.857 = 23,996) and adding the unwinding of the discount (23,996 x 8% = 1,920). Or (ii) calculating the present value of the payment in one year's time (28m/1.08 = 25,926). (A small difference arises because the discount factor is to only 3 decimal places.) There was no mark for including deferred consideration at the amount to be paid (28,000) but the candidate correctly unwound the discount (1 mark).

Note 9
As in Note 1, half a mark is given for summing the current liabilities of P and S.

Note 10
You can see that good marks have been given to the referenced workings. Although the analysis of S's net assets (W2) is not specifically required, it makes it easy for the marker to see how numbers used in other working (W3 – W5) were derived.

The analysis of S's net assets makes it easy to see how numbers were derived.

Note 11
Although the consolidated statement included many incorrect amounts, the candidate failed to earn only 2½ marks. These related to the inventory fair value adjustments (½ in current assets, ½ in goodwill calculation and ½ in post-acquisition retained earnings), revaluation surplus (½ mark) and deferred consideration (½ mark).

Note 12
One mark given for the most obvious point that the individual company's financial statements would provide more detailed information.

Note 13
One mark given for identifying a relevant impact of intra-group trading.

Note 14
For 5 marks, more needed to be said. Having effectively recognised a related party transaction issue, the candidate could have spelt this out. There was also information in the scenario that was not relevant to part (a) which should have been used here – the total amount of sales to S and the normal margin to third party customers. If given numbers, try to make use of them.

The mark for candidate one for Q32 is 14½/20.

TOTAL:

14½/20

Notes on candidate two's answer to Q32

Follow this link to see candidate two's answer to Q32.

View it here

Note 1
The amount of goodwill is incorrect. The amounts in the referenced working (W2) are mostly correct. However, the deferred consideration has been discounted for only one year (so only ½ mark given) and the fair value adjustment for the inventory (worth ½ mark) is the amount for the reporting date, not the acquisition date. The working has therefore been awarded 3 of the 4 marks available.

Note 2
Half a mark is given for summing the carrying amounts of P and S.

Note 3
There should be no amount for investments since this is replaced on consolidation with the net assets of S and goodwill. For the purpose of this article it can be noted (in W6) that the initial cash payment has been incorrectly discounted as well as the deferred consideration. However, the fundamental error was not having eliminated it entirely.

Note 4
1½ marks have been given as the fair value adjustment on inventory still held by S has been omitted (which was worth 1 mark).

Note 5
The available half mark is given for including only P's share capital.

Note 6
Looking at the referenced working (W3). P's retained earnings should be 210,000 not 21,000. This careless error loses the available half mark. There are two other errors: (i) the unwinding of the discount on the deferred consideration has been ignored (1 mark) and (ii) the change in fair value adjustment for inventory has been ignored in calculating the post-acquisition retained earnings of S. As for candidate one, there is 1 mark for P's share of post-acquisition retained earnings and the unrealised profit is correct (½ mark). So, this working is worth 1½ marks.

Note that although the separate working (W5) for URP was unnecessary (since '$1m x 25%' was all that was needed), the marker will turn to it and, as here, label it 'PAG' ('point already given') to indicate that the mark(s) have already been given.

Note 7
There is no mark as including S's surplus was incorrect (see Note 6 to candidate one's script).

Note 8
Applying the own figure rule, NCI is awarded the full 1½ marks (see Note 7 to candidate one's script).

Note 9
The candidate has taken the direct approach to calculating the deferred calculation and has been awarded the full 1½ marks available. (A rounding difference of 10 arises because the discount factor is rounded to three decimal places.)

Note 10
Half a mark is given for summing the current liabilities of P and S.

Note 11
Although there were no marks for these totals, they include arithmetic errors. These have not been penalised as there is no negative marking. However, it shows that numbers have been typed into the spreadsheet cell. Using simple CBE functionality, like SUM, not only avoids introducing careless human errors but will automatically change if you add a line of computation or change an amount.

Using simple CBE functions avoids introducing human errors.

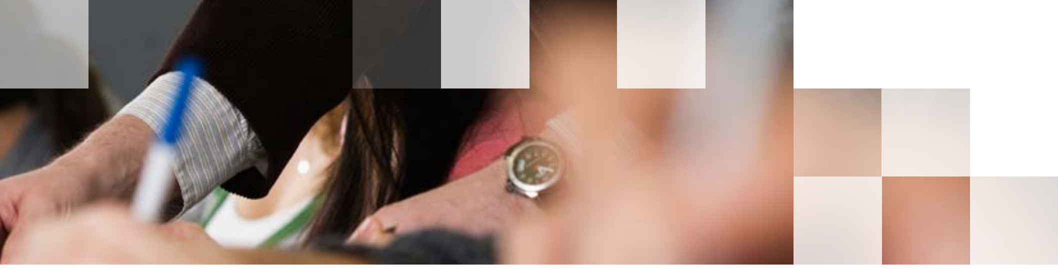
Note 12
This candidate's workings did not include a separate table/analysis for S's net assets (at acquisition/at the reporting date/post-acquisition). Although it was not a required working, the candidate may have made fewer errors if they had adopted this approach.

Note 13
No marks have been awarded for part (b). The candidate did not read the question. The requirement had nothing to do with how the sale of the subsidiary might be accounted for. Just a couple of sensible points answering the question set would have been enough to earn a clear pass mark on this question, rather than a marginal pass mark.

The mark for candidate two for Q32 is 10½/20.

TOTAL:

10½/20



September/December 2017 exam marked answers

Question 31 candidate one

Marks

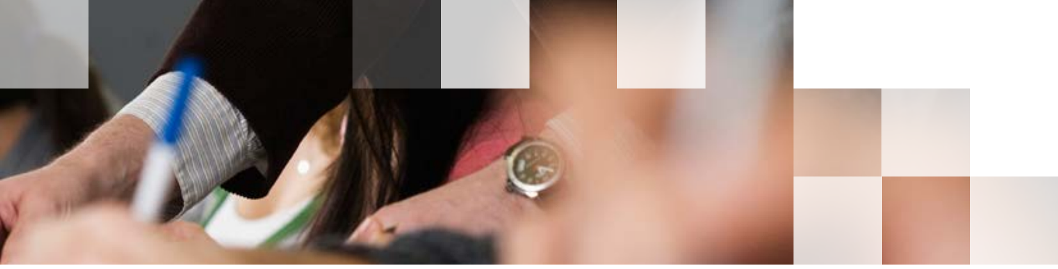
Notes

a)

			Marks	Notes
i) Operating profit margin				
30 June	X6	X7		
PBIT/Sales	18600/159000 = 11.69%	12300/154000 = 7.9%	1	Note 1
ii) Return on capital employed				
	X6	X7		
PBIT/CE	18600/195200 = 9.2%	12300/323060 = 3.8%	½	Note 2
iii) Net asset turnover				
Sales/CE	159000/195200 = 0.81 times	154000/323060 = 0.47 times	1	Note 3
iv) Current ratio				
Current asset/ Current liability	28890/23690 = 1.21	15980/29920 = 0.53	1	Note 4
v) Interest cover				
PBIT/Interest	18600/10200 = 1.82 times	12300/10200 = 1.20	½	Note 5
vi) Gearing				
Debt/Equity	150400/44800 = 3.35	130960/192100 = 0.68	½	Note 6

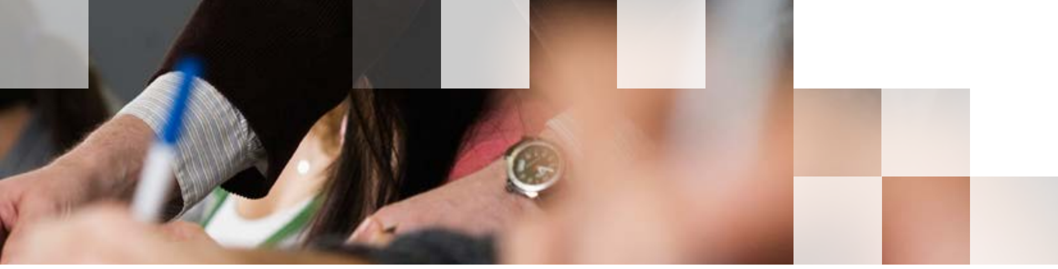
TOTAL – Part (a): **4½/6** ← Note 7

Relevant notes



	Marks	Notes
b)		
Performance		
Given the overall number of flights and destination remain the same in both years, decrease of revenue might be due to excessive proportion of discounts being given in 20X7.	1	← Note 8
The operating profit in 20X7 had reduced by 3.8% mainly due to higher cost of licences to operate in 5 major airports where they were recently renewed.	1	← Note 9
Net asset turnover declined sharply due to significant increase in capital employed influenced by revalued assets.	½	← Note 10
Return on capital employed has also fallen. The fall in operating profit as well as the increase in assets due to revaluation are factors here as well.	1	← Note 11
Position		
The liquidity ratio declined sharply. The current ratio fell from 1.22 : 1 to 0.53 : 1 from 20X7 to 20X6. This is because more cash is being used to make loan repayments. Mowair does not have enough cash to repay debts. The only way to prevent liquidity problem is to inject new capital to the company.	2	← Note 12
No new current assets have been acquired, the increase value of PPE is the result of revaluation that took place in the year 20X7.	½	← Note 13
The increase in revaluation surplus has contributed to the decline in profit before tax as increasing depreciable amount increases depreciation expense.	½	← Note 14
With the revaluation it has improved the gearing ratio significantly thus bringing the risk of the company down thus may be more attractive for future investors.	1	← Note 15
Also the company has repaid $19440 of its 6% loan notes (150400 – 130960) which reduced gearing and this is shown also in the decrease in finance costs.	1	← Note 16
In terms of interest cover, the cover has reduced from 1.8 times to 1.2 times. Mowair Co is less able to cover its interest obligation. This could pose a liquidity threat if the trend continues.	1	← Note 17
With the up coming 10 more expiry, potentially these could further increase the cost of operation resulting in further decline of profit.	1	← Note 18
	TOTAL – Part (b): **10½/14**	← Note 19
		TOTAL – Q31 **15/20**

Relevant notes



Marks

Notes

Question 31 candidate two

a)

<u>i) Operating profit margin</u>

= PBIT/sales x 100%

Operating profit margin in 20X6 = 18600/159,000 x 100% = 11.6% **½** Note 1

Operating profit margin in 20X7 = 12300/154,000 x 100% = 7.9% **½**

<u>ii) Return on capital employed</u>

= PBIT/CE x 100%

CE (capital employed) = Total assets – current liabilities **½** Note 2

Return on capital employed 20X6

= 18600/(218890 – 23690) x 100% = 18600/195200 x 100% = 9.5%

Return on capital employed 20X7

= 12300/(352,980 – 29,920) x 100% = 12300/323060 x 100% = 3.8%

<u>iii) Net asset turnover</u>

= Sales/CE

Net asset turnover in 20X6

= 159,000/195200 = 0.81 times **½** Note 3

Net asset turnover in 20X7

= 154,000/323060 = 0.47 times **½**

<u>iv) Current ratio</u>

= Current asset/current liability

Current ratio in 20X7

= 15980/29,920 = 0.5 **½** Note 4

Current ratio in 20X6

= 28890/23,690 = 1.2 **½**

<u>v) Interest cover = Interest payable/PBIT</u> **0** Note 5

Interest cover in 20X6

169840/18600 = 9.1

Interest cover in 20X7

150400/12300 = 12.2

Relevant notes

Marks

Notes

vi) Gearing = Debt/equity

Gearing in 20X7

(29920 + 192100)/192,100 = 160880/192,100 = 0.83

0

← Note 6

Gearing in 20X6

174090/44800 = 3.8

TOTAL – Part (a):

3½/6

b) Comment on the performance and position of Mowair Co for the year ended 30/June/20X7

In 20X6 Mowair Co experienced strong growth but the recent year the growth was stuck for some reasons.

In 20X6 Mowair Company's

0

← Note 7

Operating profit margin	= 11.6%
Return on Capital Employed	= 9.5%
Net asset turnover	= 0.81 times
Current ratio	= 1.2
Interest cover	= 9.1
Gearing	= 3.8

In 20X7 Mowair Company's

Operating profit margin	= 7.9%
Return on Capital Employed	= 3.8%
Net asset turnover	= 0.47 times
Current ratio	= 0.5
Interest cover	= 12.2
Gearing	= 0.83

By comparing this we can understand the profit in 20X6 (11.6%) is higher than 20X7 (7.9%). The profit is decreased by 3.7%.

0

← Note 8

In 20X7, we compare with 20X6, we can see that revenue decreased and profit from operation in 20X7 also decreased. Due to the liabilities the profit must be decreased by the renegotiation of Mowair Co's licences.

½

← Note 9

By comparing the ROCE in 20X6 and 20X7 to 20X6 9.5% and 20X7 3.8%. There is decrease of 5.7%.

0

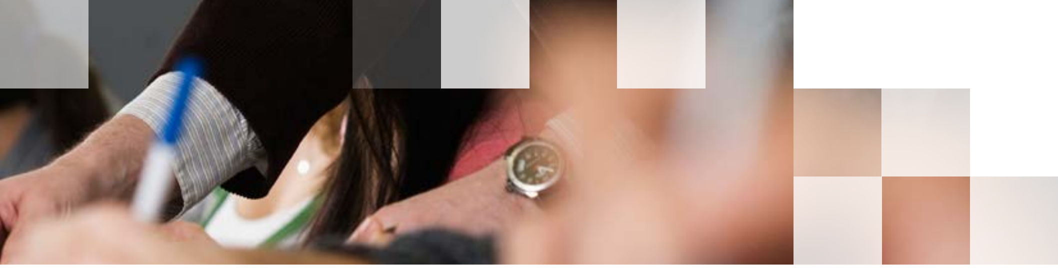
← Note 8

ROCE is 2.3 times greater than interest market rates. In 20X6 it is greater than interest rate (6%) but in 20X7 it is less than interest rate. If the ROCE is low due to the undervalued non-current asset it is necessary we can carry out revaluation.

0

← Note 10

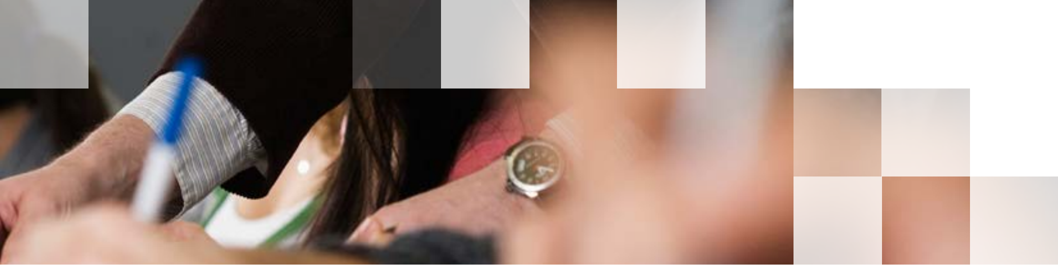
Relevant notes



	Marks	Notes
In 20X7 capital employed amount is little but large ie, the ROCE becomes less than 20X6 ROCE.	0	← Note 8
In 20X7 property, plant and equipment is higher than 20X6. There is 30% increase in comparing 20X6 and 20X7. This increase is due to buying any new part of aircraft on the repairing. Due to this mainly total assets increased.	0	← Note 11
Inventories are increased in 20X7 than 20X6. As comparing 20X6 and 20X7 the revenue of 20X7 is slightly less than 20X6. In 20X6 net asset turnover is 0.81 times but 20X7 0.47 times.	0	← Note 8
Revenue was decreased due to the renegotiation of licences with the five major airports due to this price increase Mowair Co airlines in April 20X7 had to pay for the right to operate flights to major airports. Increase in ticket price caused the decrease in the revenue by decreasing the number of customers.	1	← Note 12
The comparison between current ratio in 20X6 and 20X7. In 20X6 1.2 and in 20X7 0.5. Greater than 1 current ratio is good for the company. Their current capacity is higher than less than 1. 0.7 decrease by comparing 20X6 and 20X7.	0	← Note 8
This decrease is due to liquidity (cash) and payable. In 20X7 Mowair Co had to pay for the right to operate flights in major airports due to this cash position become decreased and increased the payables.	1	← Note 13
Due to the renegotiation and payment for the right to operate, increase the ticket price and decrease the revenue.	0	← Note 14
There is another issue to resolve ie, 10 more major airports licences are due to expire in December 20X7. Due to this profit margin become less in future years.	1	← Note 15
Increased interest cover. Growth of the company become low. Therefore it affects the performance and position of the company. Therefore take any loan with less interest as otherwise not increase the flight charges.	0	← Note 16
	TOTAL – Part (b): 3½/14	← Note 17

TOTAL – Q31
7/20

Relevant notes



Think Ahead ACCA

Marks

Notes

Question 32 candidate one

a) Consolidated statement of financial position of Party group as at 30 September 20X5

		Marks	Notes
ASSETS			
Non-current asset			
Property plant and equipment (392000 + 84000)	476000	½	Note 1
Current assets (94700 + 44650 + 600 – 250)	139700	2	Note 2
Goodwill (W3)	32996		Note 3
	663196		
Equity and liabilities			
Share capital	190000	½	Note 4
Retained earnings (W5)	214310		Note 5
Revaluation surplus (41400 + 4000)	45400	0	Note 6
Non-controlling interest (W4)	15620		Note 7
Deferred consideration (28000 + 1920)	29920	1	Note 8
Current liabilities (137300 + 28150)	165450	½	Note 9

Relevant notes

			Marks	Notes
Workings				← Note 10
(1) Establishing group structure				
Party → Streamer	1st Oct 20X4			
80%	to	1 year		
20% NCI	30th Sept 20X5			
(2) Net assets of Streamer	Acquisition (DOA)	Reporting (DOR)		
Share capital	60000	60000		
Retained earnings	34000	36500		
Revaluation surplus	4000	4000		
Inventory	_____	600		
	98000	101100		
Post-acquisition (PAR)		3100		
(3) Goodwill				
Purchase consideration	= cash	92000		
Deferred payment	= 28000/1.08	23996		
(+) FV of NCI at DOA		15000		
(–) Net assets at DOA (W2)		–98000		
		32996	3½	← Note 3
(4) NCI				
Fair value at DOA		15000		
Share in PAR (W2)	3100 x 20%	620		
		15620	1½	← Note 7
(5) Group retained earnings				
Parent retained earnings		210000		
PURP		-250		
Property revaluation		4000		
Unwinding of discount		-1920		
Share in PAR (W2)	3100 x 80%	2480		
		214310	3	← Note 5

TOTAL – Part (a):
12½/15

← Note 11

Relevant notes

Marks

Notes

(b) Concerns about investment decision

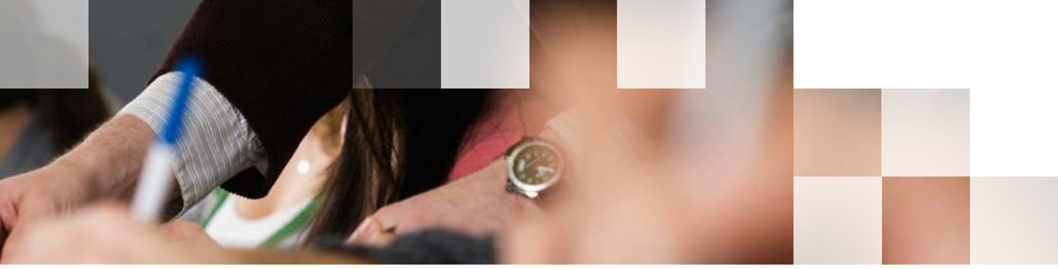
It is not possible to see in the consolidated financial statements the net assets of Streamer Co. The purchaser will need the individual financial statements of Streamer Co to see this. **1** ← *Note 12*

But the adjustments for unrealised profit in Party Group's financial statements will not be made in Streamer's financial statements, so inventory and profit will be inflated. **1** ← *Note 13*

TOTAL – Part (b): 2/5 ← *Note 14*

TOTAL – Q32 14½/20

Relevant notes

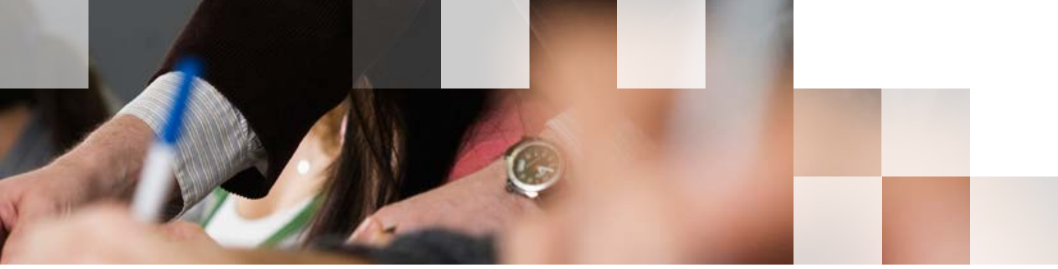


Question 32 candidate two

a) Consolidated statement of financial position of as at 30 September 20X5

Assets	$	Marks	Notes
Non-current asset			
Goodwill (W2)	34926		Note 1
Property plant and equipment (392000 + 84000)	476000	½	Note 2
Investments (W6)	102840	0	Note 3
	593766		Note 11
Current asset (94700 + 44650 – 250)	139100	1½	Note 4
	732866		
Equity and liabilities			
Equity shares	190000	½	Note 5
Retained earnings (W3)	22750		Note 6
Revaluation surplus (41400 + 4000)	45400	0	Note 7
Non-controlling interest (W4)	15500		Note 8
	273650		
Deferred consideration (28000 x 1/1.08)	25926	1½	Note 9
Current liabilities (137300 + 28150)	165450	½	Note 10
	464526		Note 11

Relevant notes



			Marks	Notes
Workings				← Note 12
W1. Group structure				
P ------------> S				
01.Oct. 20X4 80%				
W2. Goodwill		$'000		
Initial cash payment		92000		
Deferred consideration 28000 x 1/1.08		25926		
NCI		15000		
		132926		
SNA @DOA				
Shares	60000			
Ret. earnings	34000			
Revaluation surplus	4000			
Fair value adj:				
Inventory				
((3.6 – 3) x 10%	60			
		–113060		
Goodwill		34926	3	← Note 1
W3. Consolidated ret. earnings				
	P's	S's		
As per question	21000	36500		
Pre-acq		-34000		
P's share	2000	2500 x 80%		
less: PURP (W5)	-250			
	22750		1½	← Note 6
W4. Non-controlling interest		$		
Fair value		15000		
Post-acq share (2500 x 25%)		500		
		15500	1½	← Note 8

Relevant notes

Marks

5. Calculation of unrealised profit		
Total sales	$8000	i.e. 8000
Therefore 25% on margin		x
		25% on 8000
		= 2000
Therefore	Cost	6000
Therefore	Unrealised profit	250
W6. Investment		
120,000 x 0.857		102,840

PAG

TOTAL – Part (a): **10½/15**

b) Selling Streamer Co

Streamer Co is a disposal group and should be separately classified as held for sale non-current asset.

It is likely that the sale will be classified as a discontinued operation. Profit or loss on the disposal will be included in a single line in profit or loss and disclosed in the notes.

0

TOTAL – Part (b): **0/5**

Notes

Note 6

Note 3

Note 13

TOTAL – Q32 **10½/20**

Relevant notes

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