



Examiner's report

F7 Financial Reporting

March 2018

General comments

The F7 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

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 and all learning outcomes carry the same degree of importance. 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 the 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 asked, guidance on how much work is involved in answering 2 mark questions and to provide a technical debrief on the learning outcomes tested by the specific questions asked.

Sample questions for discussion

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

Example 1

Platt Co has owned 60% of the issued equity share capital of Serpi Co for many years. At 31 October 20X7, the individual statements of financial position included the following:

	Platt Co (\$)	Serpi Co (\$)
Current Assets	700,000	500,000
Current Liabilities	300,000	200,000

Neither company had a bank overdraft at 31 October 20X7.

During the year ended 31 October 20X7, Platt Co made \$100,000 sales on credit to Serpi Co. Serpi Co had one-quarter of these goods in inventory at 31 October 20X7. Platt Co makes a 20% gross profit margin on all sales.

On 31 October 20X7, Serpi Co sent a cheque for \$50,000 to pay all of the outstanding balance due to Platt Co. Platt Co did not receive this cheque until 2 November 20X7.

Platt Co's policy for in-transit items is to adjust for them in the parent company.

In respect of current assets and current liabilities, what amounts will be reported in Platt Co's consolidated statement of financial position at 31 October 20X7?

A Current Assets \$1.197m and current liabilities \$0.5m

B Current Assets \$1.145m and current liabilities \$0.45m

C Current Assets \$1.195m and current liabilities \$0.45m

D Current Assets \$1.195m and current liabilities \$0.5m

What does this test?

An understanding of how group unrealised profit included in inventory held at the year-end and cash-in-transit between group companies are eliminated on consolidation.

What is the correct answer?

The correct answer is D

The unrealised profit in inventory held at the year-end is: $(\$100,000 \times \frac{1}{4}) \times 20\% = \$5,000$. Both inventory and retained earnings are reduced by the same amount – no impact on NCI as sale is from parent to subsidiary.

As the cash-in-transit is adjusted in the parent, one asset (receivables) is merely exchanged for another (cash) which means that the net effect on current assets is zero.

Current Assets = $\$700,000 + \$500,000 - \$5,000 = \$1,145,000$

Current Liabilities = $\$300,000 = \$200,000 = \$500,000$

Why the correct answer is none of the other options?

Option A adjusts the inventory by \$3,000 ($\$5,000 \times 60\%$)

Option B adjusts the correct unrealised profit in inventory but also deducts the \$50,000 cash-in-transit from both current assets and liabilities

Option C adjusts the correct unrealised profit in inventory but also deducts the \$50,000 cash-in-transit from current liabilities only

Example 2

Boat Co acquired 60% of Anchor Co on 1 January 20X4. At the date of acquisition, the carrying amount of Anchor Co's net assets were the same as their fair values, with the exception of an item

of machinery which had a carrying amount of \$90,000 a fair value of \$160,000 and a remaining useful life of five years. Non-controlling interests are valued at fair value.

What is the journal entry required to reflect this fair value adjustment in the consolidated statement of financial position of Boat Co as at 31 December 20X6?

A	Dr Retained earnings	\$25,200	
	Dr Non-controlling interest	\$16,800	
	Dr Property, plant and equipment	\$28,000	
	Cr Goodwill		\$70,000
B	Dr Retained earnings	\$8,400	
	Dr Non-controlling interest	\$5,600	
	Dr Property, plant and equipment	\$56,000	
	Cr Goodwill		\$70,000
C	Dr Retained earnings	\$57,600	
	Dr Non-controlling interest	\$38,400	
	Dr Property, plant and equipment	\$64,000	
	Cr Goodwill		\$160,000
D	Dr Retained earnings	\$42,000	
	Dr Property, plant and equipment	\$28,000	
	Cr Goodwill		\$70,000

What does this test?

An understanding of how, on acquisition, the valuation of a subsidiary's assets at their fair value impacts on the consolidated statement of financial position.

What is the correct answer?

The correct answer is A

The increase due to the use of fair value is \$70,000 (\$160,000-\$90,000) which should be adjusted in (credited to) goodwill in its entirety.

An additional depreciation charge is required for 3 years (31 Dec 20X4, 20X5 and 20X6) - $\$70,000/5 \times 3 = \$42,000$. Therefore, Property, plant and equipment is increased by \$28,000 ($70,000 - 42,000$)

As NCI are valued at fair value, the additional depreciation should be split between group retained earnings (60%) and NCI (40%).

Retained earnings ($\$42,000 \times 60\%$) = \$25,200

Non-controlling interest ($\$42,000 \times 40\%$) = \$16,800

Why the correct answer is none of the other options?

Option B charges only one year's depreciation instead of three

Option C allocates the full fair value of \$160,000 instead of the difference between fair value and carrying amount

Option D ignores the fact that NCI are valued at fair value and allocates 100% of the additional depreciation to retained earnings

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 March 2018, candidates' knowledge of the following learning outcomes was weak: events after the reporting period, leases and different types of revenue, specifically revenue from construction contracts and revenue from contracts that offer both the supply of goods at a specific point in time and services that are provided over period of time. This is surprising given that these are topics which have been highlighted in recent examiner's reports. As IFRS 16 *Leases* and IFRS 15 *Revenue from Contracts with Customers* are standards that have been issued by the IASB relatively recently, it also demonstrates how important it is for candidates to use up-to-date texts and technical articles to ensure that their knowledge is contemporary.

Section C

Candidates were presented with questions drawn from the areas of:

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

Preparation of single entity financial statements

This area of the syllabus requires candidates to be able to prepare financial statements for a single entity, generally from a trial balance. These questions were well attempted by the majority of candidates.

One of these questions required candidates to prepare a schedule of adjustments to profit/retained earnings, a statement of financial position and statement of changes in equity. As is typical in this question type, there were several adjustments that required candidates to apply their knowledge of relevant accounting standards and principles.

Many candidates made a very good attempt at the statement of financial position but did not provide a schedule of adjustments to profit/retained earnings. This meant that, unless candidate workings demonstrated that an adjustment to profit/retained earnings was required, they were not awarded the marks they might have been had a schedule of adjustments been provided.

In both the paper based and the CBE exams, workings were often muddled or non-existent. The marking team are unable to award any marks for incorrect balances where no workings exist. Showing your workings, in an organised manner is crucial to enable the marking team to award the maximum marks available. The own figure rule remains a key factor in the constructed response questions. For example, candidates who failed to deduct the issue costs from the nominal value of a loan note issued in the year would still gain credit for both the statement of profit or loss effective interest and the completion of the amortised cost method using their own figures. If no working was shown then these marks would be lost.

The clear and logical presentation of workings is crucial to the success of these questions in both formats of the exam. The ACCA website contains a video debrief of a published accounts question, Triage from the Sep 2016 exam. This video completes a published accounts question in the CBE workspace and demonstrates how to construct your workings in a clear and organised manner. This video is still applicable to candidates taking the paper based exam and is available [here](#).

On the whole the marking team was pleased to see that candidates were able to deal with adjustments to non-current assets, environmental provisions and convertible loans well. A deferred tax adjustment proved to be the most challenging calculation for many candidates resulting in numerous incorrect answers. Unlike previous diets, candidates were not provided with a temporary difference to calculate deferred tax. Instead candidates were required to use their own property, plant and equipment balance to compare to the tax base provided and calculate a temporary difference to include in the deferred tax calculation.

A surprising number of candidates were unable to complete the statement of changes in equity and so missed what are perhaps considered to be the easier marks, such as the transfer of profit from part (a) to retained earnings or the deduction of a dividend from retained earnings that had already been provided in the trial balance. The treatment of a revaluation loss was generally dealt with well, however, a number of candidates deducted the full revaluation loss, resulting in a negative revaluation reserve. Only a small number of candidates were able to deal with accounting for a bonus issue of shares.

Candidates can significantly improve their performance in these questions by continuing to attempt past questions. There are numerous past practice questions available on both the ACCA website and from approved content providers. Kandy from the F7 specimen exam and Moston from the September/December 2015 hybrid paper are good examples of this type of question. Good exam technique is crucial to scoring well on a published accounts question. However, workings must be well presented, there must be an attempt to deal with all adjustments and ensure that no balances remain in the trial balance. Each trial balance figure should be used within the financial statements or within the relevant workings.

Analysis of single entity financial statements

The calculation of ratios were often well attempted and many candidates were able to score maximum marks for these. Candidates performed less well where the question required an adjustment to the financial statements and then to produce revised ratios in line with the adjusted financial statements. It should be remembered that the own figure rule will apply to both the ratio

calculations and the analysis that is produced as a result of the adjustments made. Therefore it is important to complete the remaining parts of the question, even if you feel that you were not successful in the restatement of the financial statements.

As in previous diets, candidates continue to show a percentage or a figure with no workings. If the figures are in line with the marking scheme then the marks will be awarded per the scheme, but where no workings are shown and the figure is wrong, it is impossible for the marking team to award marks. Consequently it is crucial that workings for the restatement of financial statements and for the ratio calculations are shown so that credit can be given.

Pleasingly, there was an increasing number of candidates using the written scenarios provided in the question. This enabled these candidates to score well on the analysis part of the question. Candidates who continue to ignore the narrative in the scenario and make statements such as profit margin is lower because cost of sales increased will unfortunately score relatively few marks.

It was also pleasing to see that many candidates were attempting to summarise and draw a conclusion based on their findings. This summing up process will always score marks and is necessary to complete the analysis question.

Candidates who have completed plenty of past practice questions on this area tend to score well. Completing numerous practice questions gives you exposure to the language that is useful to use in an analysis question. Practice questions that candidates must attempt include Funject and Mowair from the March/June 2017 and the September/December 2017 hybrid papers.

Preparation of consolidated financial statements

It was good to see candidates score good marks on this question by doing the basics of consolidated statements of financial position well. Many candidates were able to complete much of the initial consolidation, goodwill, NCI and group retained earnings to a good standard. One of the more complex fair value adjustments included a contingent liability in the subsidiary at the acquisition date. This was often ignored completely or was adjusted for incorrectly.

It is worth noting again that clearly showing all workings is crucial to success in these questions. The workings were often not provided or clearly shown in the CBE constructed response workspace. A minority of candidates continue to include consolidated totals with no evidence of how the total was derived. Again incorrect totals without supporting workings cannot score any marks.

Many candidates were able to apply the equity accounting method well to the associate and the related adjustments.

It was disappointing to see that a small minority of candidates continue to proportionately consolidate the subsidiary. As previously stated this technique is considered to be a fundamental error and should not be applied in any situation. Using past practice questions such as Dargent Co and Party Co from the March/June 2017 and the September/December 2017 hybrid papers and questions provided by approved content providers will further illustrate that proportionate consolidation is not appropriate. There were also a number of candidates that attempted to incorrectly consolidate or proportionately consolidate the associate.

Analysis of consolidated financial statements

Questions that require candidates to analyse consolidated financial statements will often require minor calculations such as the goodwill on the acquisition of a new subsidiary or gain/loss on the disposal of a subsidiary. Following the calculations in the first part of the question candidates may then be asked to make adjustments to the financial statements before calculating the required ratios. In this diet candidates were required to calculate a gain or loss following the disposal of a subsidiary company. It was pleasing to see that the majority of candidates are now calculating this correctly.

Where the question required an adjustment to the statement of profit or loss for the parent company following the disposal of the subsidiary mid-way through the year, many candidates incorrectly eliminated a full year's revenue and expenses to find the parent only balances. It is important to remember that a statement of profit or loss is a summary of the performance of a business for an accounting period and therefore the candidates should time apportion as appropriate.

Many candidates calculated the loss on disposal correctly, and also scored highly on the calculation of ratios, but the analysis was often very poor. Many candidates did not actually mention comparability issues despite this being a clear requirement and in the analysis of the performance and position weaker candidates explained that one ratio was higher/lower than another which was good/bad without any more detailed discussion. Weaker discussions also often omitted any mention of the disposal of the subsidiary and the impact this might have had on the ratios and performance of the company.

As previously mentioned there were many candidates that did not show any workings at all for their ratios. If the ratios were correct, then full marks were given but candidates many lost marks which could have been awarded for partially correct calculations or own figures.

Candidates are advised to practice Tangier Co from the F7 specimen exam and Gregory Co from the September 2016 paper to see how to appraise a set of financial statements that contain group issues. In addition to this candidates are required to review the technical article entitled [Financial Reporting: Learning Outcomes](#) from the study support resources section of the ACCA website.

Exam technique

Good exam technique is vital for success in the F7 exam. Candidates who score well in section C of the exam are those that provide the marking team with clear and well-presented workings. As discussed throughout this report, candidates that do not provide workings will generally not perform as well on the calculations.

For the discursive element of the analysis questions, it was especially pleasing to see candidates that were using headings such as performance, position and conclusion/recommendation to structure their answers. This approach not only makes it easier for the marking team to identify the points that are being made, but it will also assist the candidate in reviewing their answer to ensure they have covered all of the relevant areas.

Candidates should make logical, clear points when analysing the financial statements of a company and avoid making the same points repeatedly. A strong answer will draw on the information contained within the question scenario. Once the analysis is complete, candidates should ensure that a conclusion/recommendation is provided based on the analysis completed. It was pleasing to note that most candidates attempted all exam questions. For candidates that appeared to mismanage the time available in the exam it was often the discussion part of the analysis question that was omitted.

Word processing and spreadsheet technique

When the candidate uses the word processing tool, it is often the case that workings for calculations such as the ratios are not shown. For any CBE candidate, please ensure that all workings are shown accordingly in both the word processing and spreadsheet response areas. The discussion elements of the analysis questions were presented well with many candidates using headings and paragraphs in a clear manner. It is hoped that this approach will continue to be used.

Depending on the number of marks allocated to calculation, candidates may be presented with a spreadsheet in which to perform some analysis. This was the case in this diet and candidates were required to use the spreadsheet functionality to appraise the financial statements of either a single entity or consolidated financial statements. Whilst the spreadsheet function aids candidates with the calculation part of the question, it also requires them to type the discursive elements into the spreadsheet. When doing this, candidates should think about how their answer will present to markers. For example, some candidates included their entire analysis in a single cell in the spreadsheet which either stretched across a single row and required the marker to either hold and scroll to view required the marker to 'unhide' the information. If using a spreadsheet to analyse the performance of a company, continue to use headings as already discussed and break your sentences up so that it is visible in that part of the spreadsheet area that you are able to view on screen.

When using the spreadsheet for the preparation of financial statements, candidates continue to lay out the financial statements and workings well. As in previous diets, candidates either put figures in individual cells and add the cells across for the answer or include the entire working in one cell using a formula. Both are perfectly acceptable as markers will follow both methods.

The resources available on ACCA's website to provide more guidance on how to use the spreadsheet software for CBE candidates 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 F7 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 on F7.

You should make sure you have made use of all of the resources found under [Technical Articles](#) for F7 – these include technical articles, study support videos and exam technique resources – all developed with you in mind.

The key to being successful in F7 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 F7 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