Examiner's report
F7 Financial Reporting
September 2017

ACCA

General Comments

The F7 Financial Reporting paper continues to be offered in both computer-based (CBE) and paper-based (PBE) formats. The structure of both formats is the same, but the 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 offer constructive advice for future candidates.

The exam consisted of three sections

- Section A – 15 objective test questions of 2 marks each (30 marks) – the report focuses on two questions that caused specific difficulties for candidates
- Section B – 3 scenarios each with five 2 mark questions (30 marks) – the report focuses on the key challenges for this section of the exam
- Section C – 2 constructed response questions of 20 marks each (40 marks) – the report provides commentary around some of the main issues that affected candidates' performance, including knowledge gaps, common errors and offering guidance on where exam technique could be improved. The report also offers guidance in the use of the CBE functionality in answering questions in this format.

Section A

Section A questions test a broad range of the syllabus and candidates need to be prepared for this. They should avoiding 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 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
Jetsam Co entered into a lease for an item of plant on 1 April 20X0 which required payments of $15,000 to be made annually in arrears. The present value of the lease payments was estimated to be $100,650 at the inception of the lease and the rate of interest implicit in the lease was 8%. Both the lease term and the plant's estimated useful life was ten years.

What is the total amount that should be charged to profit or loss for the right-of-use asset for the year ended 31 December 20X0?

A $11,250
B $6,039
C $7,549
D $13,588

What does this test?

An understanding that, as the leased asset is capitalised as a non-current asset, the charge to the Statement of profit or loss in respect of the right-of-use asset will include both depreciation and the finance cost.

What is the correct answer?

The correct answer is D

Depreciation for the year: 100,650/10 = 10,065
Finance cost for the year: 100,650 x 8% = $8,052
Total charge for the year: 10,650 + 8,052 = $18,702
1 April – 31 December 20X0 = 9 mths so 9/12 x $18,702 = $13,588

Why the correct answer is none of the other options?

- Option A is 9/12 x $15,000. This option uses the lease repayment as the basis of the SOPL charge. It therefore fails to recognise that the asset has, in substance, been purchased and financed by a loan.
- Option B is 9/12 x $8,052 and so recognises the finance cost only, thereby ignoring the depreciation
- Option C is 9/12 x $10,065 and so recognises the depreciation only, thereby ignoring the finance cost

Example 2

Paprika Co purchased 75% of the equity share capital of Salt Co on 30 April 20X4. Non-controlling interests are measured at fair value.

The cost of sales of both companies for the year ended 30 April 20X6 are as follows:

	Paprika $	Salt $
Cost of sales	60,000	100,000

The following additional information is provided:

1) Salt Co had machinery included in its net assets at acquisition with a carrying amount of $120,000 but a fair value of $200,000. The machinery had a remaining useful life of eight years at the date of acquisition. All depreciation is charged to cost of sales.
2) During the year, Salt Co sold some goods to Paprika Co for $32,000 at a margin of 25%.

Three-quarters of these goods remained in inventory at the year end.

What is the cost of sales in Paprika Co's consolidated statement of profit or loss for the year ended 30 April 20X6?

A $144,000
B $132,000
C $176,000
D $140,000

What does this test?

The ability to process routine consolidation adjustments; in this case (i) additional depreciation when an increased fair value is used to measure non-current assets at acquisition; (ii) the elimination of intra-group sales and (iii) the adjustment of unrealised profit which may arise as a result of intra-group sales of inventory.

What is the correct answer?

The correct answer is A

Additional depreciation: (200k-120k)/8 = $10,000
Unrealised profit in inventory: (32k x 25%) = $8,000 x $^3/_4$ = $6,000
Consolidated Cost of sales = $60,000 + $100,000 + $10,000 - $32,000 + $6,000 = $144,000

Why the correct answer is none of the other options?

- Option B deducts the unrealised profit instead of adding it on
- Option C omits to cancel the intra-group sales
- Option D calculates unrealised profit assuming ¾ of goods sold to third parties (instead of ¾ remaining in inventory)

<u>Section B (questions 16 to 30)</u>

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 September 2017, candidates demonstrated a superficial knowledge of the following learning outcomes: intangible assets; leases and revenue recognition. This is surprising given that IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* are standards that have been issued by the IASB relatively recently and so should have been well understood by candidates as they are topical. There have also been recent technical articles written by the examining team and published on the ACCA web-site to address these topics. However, it demonstrates that candidates need to use up-to-date texts and technical articles to ensure that their knowledge is contemporary.

Section C (questions 31 and 32)

Across both PBE and CBE formats, questions covered the following topics:

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

This report makes comment on one question type from each of the above topics.

Analysis of single entity financial statements

Questions asking for the analysis of financial information will continue to be asked in the F7 exam. Unfortunately, this is consistently the weakest area for many candidates and this diet was no exception.

Candidates continue to score well on the calculation of ratios although net asset turnover (revenue/capital employed) is sometimes overlooked/misunderstood. Candidates should show their workings for all ratios calculated so that markers can understand the figures used and allow for any obvious arithmetic errors. CBE candidates were noticeably reluctant to provide workings to the six ratios asked for.

The level of discussion for the analysis of performance and position required more than merely saying that a ratio was higher or lower than the previous year or represented a percentage improvement or deterioration. Many candidates explained how the ratio was calculated or what the resulting figure represented. None of this is analysis of the financial statements because it doesn't use the scenario provided.

When marking interpretation questions, markers look for meaningful use of the scenario provided. For example, it does not make sense to use an investment in non-current assets during the year to explain the change in an accounting ratio when the scenario clearly states that no such investment took place. Had candidates properly read the financial statements, they would have seen that the increase in non-current assets was almost entirely attributable to a revaluation during the year.

Indeed, the company had a worse set of results in the second year (for five of the six ratios) but it required a combination of the ratios, the financial statements and the additional information in the scenario to provide a coherent commentary on the issues facing the company. Possible reasons for key changes between the two years reported should have been identified and discussed.

In a discussion question of this sort candidates are expected to finish with a brief conclusion. Separate headings for key sections of the answer (including a conclusion) were used by some candidates but more use of this technique is encouraged.

Many attempts at the analysis questions (particularly the CBE responses) were very brief which may be indicative of poor time management. Candidates are encouraged to use the marks clearly indicated within the questions to plan their time.

Where the interpretation question is based on a set of consolidated financial statements, candidates must think about the impact of the consolidation on the ratios. Please look at the suggested solutions provided in the specimen exams (http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f7/specimen-exams.html#) and consider similar issues in the context of the question being asked.

Preparation of consolidated financial statements

The main principles behind the preparation of consolidated financial statements is an area of the syllabus where candidates generally perform well. The importance of clear workings to support answers to this type of question cannot be over-emphasised and there has been an improvement over recent diets. CBE candidates are also encouraged to provide workings because markers still need to be able to understand where numbers have come from.

The goodwill calculation was generally done well although some candidates were unclear about dealing with fair value adjustments and the split between the position at the dates of acquisition and consolidation. Many candidates used a three-column table (at acquisition, at consolidation, post-acquisition) to analyse the subsidiary's net assets. Whilst this approach is not required, it is an example of making it easy for the examiner to understand where the candidates' numbers are coming from. Other alternative approaches may also be used provided they can be substantiated with appropriate workings.

A small number of candidates used proportional consolidation however this is a fundamental error and entirely inconsistent with the principle of control on which consolidation is based. Candidates who show share capital other than that of the parent only, quickly reveal a lack of understanding of the nature of consolidation processes.

The deferred consideration calculation was not well attempted. Candidates were required to discount this for the goodwill calculation and then "unwind" (in this case) the first year's interest which should be deducted from the parent's retained earnings (or added to finance costs) and added to the discounted liability. Mark-up and margin continue to confuse many candidates when calculating the unrealised profit on inventory transferred within the group.

Candidates should know how to treat a revaluation surplus that is reported by the subsidiary. Many candidates correctly reported the pre-acquisition element in their goodwill calculation and then included this amount again in the consolidated statement of financial position. The revaluation surplus of the group is all that of the parent plus the group's share of the post-acquisition revaluation surplus of the subsidiary (the remainder of this is part of any non-controlling interest).

Exam technique for both PBE and CBE formats

As for any exam, good technique is important for success. Strong candidates used good and clear workings for ratios and in preparing financial statements.

For analysis and discussion, all points made in PBE should be legible (spelling errors, particularly on CBE answers, are not penalised) and good use of ordered paragraphs should be made. As suggested above, headings (such as "performance", "position" and "conclusion") are indicative of well organised answers.

It was pleasing to note that most candidates attempted all exam questions. Where time did seem to be an issue it was the discussion part of the analysis question that saw the greatest impact; this seemed to be more evident on CBE responses than on the paper-based format.

Word processing and spreadsheet technique for the CBE format
As noted earlier, candidates using the word processing tool were less likely to show workings; this issue should be addressed so that marks are not lost. Narrative answers were often well presented although the use of headings would improve them further.

For those preparing financial statements layout was generally good (there are no specific format marks awarded). For those using the spreadsheet tool, workings were often provided on either the spreadsheet itself or in the cells using formulae. These different approaches are all acceptable as markers will check cells for workings and formulae.

There are extensive resources on the ACCA website to support the use of CBE functionality and candidates are encouraged to engage with this material as part of their preparation for the exam.

Guidance and learning support resources

There are a range of resources available to candidates to help with the F7 exam. Many of the themes noted in this report regarding exam technique, and ways to improve answers, are comments commonly made from previous diets. Previous examiner's reports can be found at http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f7/examiners-reports.html and offer good and consistent guidance for what the examining team are looking from well-prepared candidates.

A key to success in this exam is question practice by attempting questions and reviewing the answers available to check points of difference. This approach is particularly relevant to the analysis questions. Although candidates may feel comfortable with their own attempt, a review of answers available can show the depth of the discussion that is sought. An up-to-date question and answer bank from one of the Approved Content Providers (and/or the selection of recent past exams on the ACCA's website – *http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f7/past-exam-papers.html*) is strongly recommended as a study and revision aid. If using past exam papers, it should be noted these will not have been updated for changes to the syllabus, format of the paper or accounting standards – so should be used with caution.

Using the latest syllabus and study guide *(http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f7/syllabus-study-guide.html)* is essential from the start of studying for this paper. Technical articles *(http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f7/technical-articles.html)* describe recent changes and the more challenging areas of the syllabus and the exam technique section provides guidance for approaching the analysis question and further guidance for resit candidates.