



Examiner's report

Financial Reporting (FR)

December 2019

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 (FR) exam is offered as a computer-based exam (CBE). 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 to offer constructive advice for future candidates.

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

Section A

Here we take a look at **TWO** Section A questions which proved to be particularly difficult for candidates.

Example 1:

A company's statement of financial position at 31 December 20X4 included land at a cost of \$200,000 and a deferred tax liability of \$60,000.

On 1 March 20X5, the land was professionally valued at \$250,000. This valuation was incorporated into the financial statements for the year to 31 December 20X5. No other non-current assets have been revalued. Other taxable temporary differences increased during the year to 31 December 20X5 by \$40,000. The relevant rate of tax is 20%.

What are the balances at 31 December 20X5 on the revaluation surplus and the deferred tax liability?

- A Revaluation surplus of \$50,000 and deferred tax liability of \$68,000
- B Revaluation surplus of \$50,000 and deferred tax liability of \$78,000
- C Revaluation surplus of \$40,000 and deferred tax liability of \$78,000
- D Revaluation surplus of \$40,000 and deferred tax liability of \$62,000

What does this test?

This question tests candidates' knowledge of the provision of deferred tax on the revaluation of a non-current asset (in this case land). IAS 12 states that if an adjustment giving rise to deferred tax is recognised in the statement of profit or loss (SOPL) then so too should its related deferred tax be recognised there. Likewise, if the adjustment is recognised outside the SOPL (for example in Other Comprehensive Income (OCI) or equity), then its related deferred tax should also be recognised there. In this case, the gain on the land is recognised in OCI and the revaluation surplus. This means that the associated deferred tax should also be recognised in the same place (in this case, OCI and revaluation surplus).

What is the correct answer?

The correct answer is C

The gain on the land revaluation is \$50,000 and the associated deferred tax is \$10,000 (20%). The journal entries for the land revaluation and its associated deferred tax are:

Dr Land	\$50,000	Dr Revaluation Surplus	\$10,000
Cr Revaluation Surplus	\$50,000	Cr Deferred tax	\$10,000

The closing balance on the revaluation surplus should then be \$40,000

The opening balance on deferred tax is \$60,000 which will be increased by the adjustment of \$10,000 (above) for the land revaluation and \$8,000 for the increase in taxable temporary differences (\$40,000 x 20% per question). The closing balance on deferred tax should then be \$78,000.

Why the correct answer is none of the other options

Neither option A nor B take account of the deferred tax on the land revaluation. Option D deducts the deferred tax on the taxable temporary differences instead of adding it on.

It was clear that many candidates were not aware of the fact that a deferred tax provision was required on the revaluation of land. Also, candidates should take time to produce the accounting entries and ensure that they work through all aspects of these entries to get a final answer.

Example 2:

Which of the following should be accounted for as subsidiaries in the consolidated financial statements of Preece Co?

(1)	Gilber Co	Preece Co currently owns 40% of the share capital of Gilber Co and holds options to purchase another 20% which it can exercise immediately
(2)	Grovez Co	Preece Co owns 60% of Grovez Co and has appointed the majority of the board of directors
(3)	Roge Co	Preece Co owns 80% of Roge Co. Roge Co is loss-making and Preece Co is considering selling it in the near future.

A 1 and 2 only

B 2 and 3 only

C 1 and 3 only

D 1, 2 and 3

What does this test?

This question tests that candidates understand the concept of control and can recognise when a subsidiary does not meet the definition of held-for-sale.

What is the correct answer?

The correct answer is D and all three companies should be consolidated as subsidiaries. Gilber Co should be consolidated because the options are currently exercisable and so Preece Co could take immediate control if it chose to. Preece Co has control of Grovez Co because it is already appointing directors to the board. Roge Co appears to be a subsidiary by virtue of the fact that Preece Co owns 80%. It is not a held-for-sale asset because it has not met the criteria of International Financial Reporting Standard (IFRS®) 5 Non-current assets held for sale and discontinued operations. Roge Co should therefore continue to be consolidated.

Why the correct answer is none of the other options

The other three options only identify two subsidiaries instead of all three.

Many candidates did not believe that Gilber Co was a subsidiary because Preece Co only holds 40% of the share capital. Candidates need to appreciate that the definition of control is not limited to just the number of shares held.

Section B

Section B tests candidates' knowledge on a number of IFRS standards in more depth than section A, with three case questions containing five two-mark objective test questions. The range of topics tested in the December 2019 examination was:

- Intangibles, impairment and government grants
- Provisions
- Leases
- Events after the reporting period
- Financial instruments
- Deferred tax
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Candidates appeared to struggle with Leases, Events after the reporting period and deferred tax. Candidates should make sure that they are studying with up-to-date materials (i.e. those published by approved content providers). For example, they should ensure that they are using the latest leasing standard (IFRS 16 Leases). They should also ensure that the whole of the syllabus is revised including IAS 10 Events after the reporting period. They should also ensure that they have revised and understand some of the more technical IFRS standards such as IAS 12 Deferred Tax.

Read the case scenario and its requirements carefully. As these questions score either 2 marks or zero marks, it is important that you do not misread or miss any information in the scenario. Close reading of the requirements is also important to identify specific instructions such as rounding.

The FR exam aims to test your ability to apply your knowledge – this is a very important skill which you will continue to develop in Strategic Business Reporting. Consequently you need to understand why you are producing accounting adjustments and try not to rote learn them.

Section C

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

- Preparation of individual company financial statements
- Preparation of consolidated financial statements
- Analysis of individual financial statements
- Analysis of consolidated financial statements

Preparation of individual company financial statements

Some candidates were required to present a Statement Of Profit or Loss (SOPL) and Other Comprehensive Income (OCI) using the trial balance (TB) supplied and a list of relevant notes, from which they could work out what adjustments to make to the TB figures. Presentation, on the whole, was fairly good, with line items in the correct order.

The most common mistake related to a change in use concerning property, moving from PPE to investment property. This needed to be revalued in accordance with IAS 16 Property, Plant and Equipment before being measured in accordance with the fair value model in IAS 40 Investment Properties. Unfortunately, very few candidates knew how to account for this, which was disappointing as this is topic tests good technical knowledge which can be used to support Strategic Business Reporting (SBR). It was also surprising to see some candidates struggle with simple depreciation calculations.

A number of candidates were confused with revenue adjustments relating to deferring income or contracts which are satisfied over time. Specifically, candidates were very poor at providing an explanation of their accounting adjustments. This is a specific skill which FR uses to prepare candidates for SBR. If candidates did not calculate the correct accounting numbers some marks might be lost, however, marks might still be awarded if markers can use the candidate's explanation to understand their thought processes behind their accounting numbers. However, if no explanation, or a poor explanation is provided then this process is not possible and so more marks are lost.

Students were more able to cope with adjustments relating to convertible loan notes and tax workings, highlighting that good question practice has occurred prior to the exam. These are both areas which have been tested regularly, so it was good to see a stronger level of performance here.

Candidates that were asked to produce a statement of adjusted profit appeared to struggle with what was required. This has been examined on numerous occasions in the FR exam, so

candidates should practice this requirement. Haverford Co from the March/June 2018 hybrid paper is a good example of this examining approach.

There are multiple past exam questions looking at the preparation of single company financial statements, as this has been a large part of the FR syllabus for many years. In addition to the suggestion above, Vernon Co from the March/June 2019 hybrid paper and Duggan Co from the September/December 2018 hybrid paper are good examples of this type of question which students must practice.

Overall, there was slight improvement in the use of the CBE software and layout from previous sittings, and many candidates provided workings which could be easily followed by markers. Those who continue to use a calculator and simply type the answer into a spreadsheet continue to receive 'all-or-nothing' marks, as it is impossible for markers to give credit if workings are not shown.

Whilst there was a slight improvement in layout, there was a noticeable decline in the knowledge of some students. There were too many students scoring very low marks, and struggling on areas that should not be challenging students at this level. For example, Earnings per Share. The FR exam will remain technically challenging, and it is essential that students have a thorough working knowledge of IFRS standards. This knowledge is necessary to pass this exam and progress to further studies.

Preparation of consolidated financial statements

The core principles of the preparation of consolidated financial statements remains an area that candidates perform well on. Candidates with clear workings often scored highly on this area. As noted within the discussion of the preparation of single company financial statements above, 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 profit or loss was done reasonably well, with candidates able to process adjustments relating to intra-group sales, unrealised profits, mid-year acquisitions and fair value depreciation. These are all core areas for consolidated financial statements so it was pleasing to see students performing well here.

However, many candidates neglected to split the profit between the parent's shareholders and the non-controlling interest. This is a fundamental part of a consolidated statement of profit or loss and too many students lost three marks by not attempting this.

The weakest element in these questions related to 'non-group' accounting adjustments, such as foreign currency adjustments in the parent financial statements or lease accounting. Both of these would be elements we would expect to see students perform strongly in when producing financial statements for individual companies, but candidates struggled to translate that to consolidated financial statements. It is important that candidates understand a wide variety of accounting issues, rather than simply rote learning the common group-related adjustments.

The preparation of a consolidated statement of financial position continues to be an area that candidates perform well on, with some 'core' adjustments on fair value adjustments and impairment done well. It was surprising to see a number of students struggle with goodwill calculations and share-for-share exchanges, as these have been examined regularly in the FR exam. It was also disappointing to see basic errors such as the time-apportionment of the assets/liabilities of the subsidiary in a mid-year acquisition and using proportionate consolidation. Candidates who adopt either of these approaches have clearly not practiced enough questions and tended to score very low marks.

As always, many candidates neglected the narrative/discussion marks, meaning that they lost up to three marks immediately. The FR exam is essential preparation for the SBR paper, where candidates are expected to be able to discuss and explain accounting principles. Candidates should learn that skill at this stage so that they are able to perform well at the higher level.

There are multiple past exam questions looking at the preparation of consolidated financial statements, as this has been a large part of the FR 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 individual company financial statements

The calculation of basic ratios continues to be an area where many students score full marks, which is good to see, but candidates must show workings when asked to redraft some figures and prepare recalculated ratios. This is not an uncommon situation in FR, and many candidates continue to show no workings for their thought processes. If students continue to do this, they are likely to lose marks through the inability of a marker to apply the own figure rule.

Candidates often perform either really well or rather poorly in these types of questions.

Those who perform well attempted to use the information provided in the scenario to explain the movement in ratios, and these candidates tend to score very well. The only weakness is that sometimes answers were too brief, and if candidates had continued to develop their thoughts they would have been able to score more marks. Candidates should be working on the basis of scoring one mark for each well explained point.

Those who perform less well tend to ignore all information provided in the scenario. These candidates often use 'textbook' answers to explain what a ratio means, or to suggest generic reasons for movements. Candidates who simply state that an increase in gross profit margin could be due to an increase in the price charged or a better management of costs will not score marks when there are clear reasons for the movement provided in the scenario. The aim of these questions is to provide evidence that candidates are able to deal with the information provided and provide a good in-depth analysis of realistic scenarios. These questions cannot simply be rote learned and copied from notes. Candidates must understand what the ratios are and potential reasons for their movement, but ultimately they need to be able to apply these to the scenario to provide a substantial and robust level of analysis.

The use of the CBE software is providing evidence that candidates are thinking about how they lay out their solutions, and the higher performing candidate often used short paragraphs and headings – this shows that they are carefully identifying the specific points that they want to make. Some weaker candidates type everything in one huge block of text. This often reads poorly as it feels like students are just throwing anything they can think of into the answer. It is far better to make one or two points per paragraphs. This would also help candidates to know how many points they have made and will give a good guide to how much more they should be writing.

The largest weakness in these question types related to the calculation of Earnings Per Share. The brevity of some answers evidenced that some candidates may have attempted to 'question spot' and simply had not revised this topic. A disappointing number of students also scored zero on this part of the question.

There are multiple past exam questions that test the analysis of single entity financial statements, as this has been a large part of the FR 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.

Analysis of consolidated financial statements

Candidates continue to find this question difficult and often neglect the consolidated element of this question. In this case, candidates were specifically asked to discuss why a set of consolidated financial statements would differ from those of a single entity, and surprisingly struggled with it. They would have been expected to discuss the inclusion of a subsidiary in the consolidated financial statements, the inclusion of a non-controlling interest, intra-group transactions versus none of these being accounted for in a single entity's financial statements etc. This should be an area that candidates score highly in but surprisingly that this was not the case.

Problem areas for candidates in these types of question are similar to those noted in the analysis of individual financial statements above; i.e. candidates do not use the scenario in their analysis or do not show workings when required to perform redrafted accounting numbers. For instance, many candidates lost marks by failing to produce workings in the following example:

Draft extracts of group financial statements 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 part (a) of the question required the removal of an intra-group sale of \$5,000 and make an adjustment for unrealised profit of \$1,000. Accounting for these group adjustments would provide the following result:

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

Giving a revised gross profit margin of 51.7%

The marks for the adjustments would be given in part (a) of the question, and these would be marked as either right or wrong. If part (b) asked the candidates to calculate ratios based on the draft and recalculated figures, these would be marked according to the own figure rule. Ideally, this is how the FR examining team would like to see candidates show these workings:

	Draft	Restated
Gross profit margin	47%	51.7%
	(16,000/34,000)	(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 (i.e. with no workings):

	Draft	Restated
Gross profit margin	47%	55.1%

then 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.

The omission of workings like this can cost candidates up to 2 marks. It is imperative that workings such as these are shown to maximise the marks to be gained.

The discussion related to the analysis of consolidated financial statements will always have group elements associated with it, something which the weaker candidates continue to neglect. Items such as intra-group trade, rental agreements, shared property arrangements, preferable terms are all included to provide information to analyse the underlying performance and position. If these are ignored, candidates are missing the point of the question and will score a poor mark.

Candidates must look at Pirlo Co from the March/June 2019 hybrid paper, 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.

Exam technique

Good exam technique is vital for success in FR. Strong candidates continue to use good 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.

The analysis discussion points should be laid out clearly, using headings for each area requested, such as 'performance', 'position' or 'cash flow'. Candidates should also ensure they include a conclusion on the analysis discussion. A sensible conclusion summarising the main points of the analysis is important, and marks will be given here.

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

Word processing and spreadsheet technique

As stated earlier, candidates were asked to use the word processing tool for the analysis question and were less likely to show their workings, which needs to be improved so marks are not lost. Conversely, the narrative answers were often well presented, with headings and spacing used well.

For the preparation of financial statements question, candidates often laid out the financial statements and workings well. Some candidates tended to put figures in individual cells and add the cells across for the answer, whereas others did the entire working in one cell using a formula. Both are perfectly acceptable as markers will follow both methods. As stated earlier, the candidates who perform workings on a calculator and simply type in the final answer often lose marks and so should be careful with this.

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 FR 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 FR 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.

As always, exam technique is an important aspect of success in any exam. Throughout this report the importance of reading and interpreting requirements very carefully has been reiterated many times; failure to do this is often the cause of poor scores. The tendency for some candidates is to answer the question that they want to get rather than answering the question which they have been given.

Candidates should ensure that they have read all the requirements and note the mark allocation for each requirement; this is especially important in CBE as the requirements might be split over several screens. Each requirement should be properly broken down so that it can be established what is being asked. A recommended approach to this would be that at the start of an answer, candidates should do a small plan in which they have broken down a requirement and asked themselves how many things they are being asked to do, making sure that they consider all aspects of the requirement.

Finally, please remember to use the spreadsheet functionality available. Totals should be calculated by inserting formulae rather than typing in the number.