

Examiner's report

Financial Reporting (FR)

June 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 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.

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

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

Section A

Section A questions test a broad range of the syllabus and candidates should be prepared for this. They should avoid question spotting as there are no "core" learning outcomes – all learning outcomes are equally important. Candidates should resist looking at answer options 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 an aim of giving future candidates an indication of the types of questions that can be asked, guidance on how much work is involved in answering 2 mark questions and to provide a technical debrief on the learning outcomes tested.

Sample questions for discussion

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

Example 1

Flute Co undertakes drilling activities and has a widely publicised environmental policy stating that it will incur costs to restore land to its original condition once drilling activities have been completed.

Drilling commenced on a particular piece of land on 1 July 20X8. At this time, Flute Co estimated that it would cost \$3m to restore the land when drilling was completed in five years' time. Flute Co's cost of capital is 7% and the appropriate present value factor is 0.713.

At what amount will the provision for restoration costs be measured in Flute Co's statement of financial position as at 31 December 20X8?

A \$2.14m

B \$3m

C \$2.29m

D \$2.21m

What does this test?

This tests learning outcome B7(f) environmental provisions. In this case, the calculation of an environmental provision is required.

What is the correct answer?

D is correct: Provision at 1 July 20X8 = (\$3m x 0.713) = \$2,139,000
 Interest to 31 Dec 20X8 = 7% x \$2.139m x 6/12 = \$74,865
 Provision at 31 Dec 20X8 = \$2,139,000 + \$74,865 = \$2,213,865 rounded to \$2.21m

Why the correct answer is none of the other options?

\$2.14m is the initial carrying amount at 1 July 20X8

\$2.29m is based on unwinding the discount for 12 months instead of 6

\$3m is the undiscounted amount

Example 2

An investor company assesses control to determine whether or not it is the parent of an investee company.

According to IFRS 10 Consolidated Financial Statements, which three of the following are required to determine whether an investor has control of an investee?

- (1) The ability to use its power over the investee to affect the amount of the investor's returns
- (2) Exposure, or rights, to variable returns from its involvement with the investee
- (3) Acquisition of 50% or more of the share capital
- (4) Power over the investee

A 1, 2 and 3

B 2, 3 and 4

C 1, 3 and 4

D 1, 2 and 4

What does this test?

This question tests an understanding of the concept of “control” in accordance with IFRS 10 which then requires a group to prepare consolidated financial statements.

What is the correct answer?

D is correct in accordance with IFRS 10 paragraph 7

Why the correct answer is none of the other options?

IFRS 10 makes no reference to a holding of more than 50% of the equity shares of an investee company

Section B

This section of the exam presents three scenarios around which five (two mark) objective test questions were based. This approach allows the examining team to test a particular learning outcome in some depth. These scenarios can be based on any of the FR learning outcomes which means that future candidates need to have knowledge of the syllabus that is both wide and deep. They also need to be able to apply that knowledge to the context of a specific scenario. In June 2019, candidates' knowledge of the following was weak:

- i. intangible assets and fair value measurement
- ii. non-current assets held for sale (particularly the application of the definition)
- iii. diluted earnings per share
- iv. contracts that are for goods and services (combined contracts) and the allocation of revenue

These are areas of the syllabus that are technically challenging but candidates need to be aware that they will meet their fair share of these difficult questions and they should be prepared for that challenge.

Section C

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

- Single entity accounts preparation
- Analysis of consolidated financial statements
- Preparation of consolidated financial statements
- Analysis of single entity financial statement

Single entity accounts preparation

This area of the syllabus requires candidates to prepare a set of financial statements for a single entity. This is a fundamental skill for an accountant, and has been a large part of the financial reporting syllabus for many years. Performances in this area were generally quite good, with candidates able to make a decent attempt at many areas of the question.

As in previous questions on single entity financial statements, candidates were required to produce financial statements from a trial balance and set of adjustments. Also common to previous sittings, candidates were not necessarily asked for full sets of financial statements, such as being asked to produce a statement of profit or loss or statement of adjusted profit, alongside items such as a statement of changes in equity and calculation of earnings per share.

Candidates were generally able to prepare well-presented financial statements, thereby producing good answers. The requirements surrounding foreign currency transactions and provisions were dealt with particularly well, with a good number of candidates able to make a strong attempt at tax and deferred tax calculations.

Calculations around depreciation were slightly disappointing, with a sizeable minority unable to deal with a disposal alongside the calculation of depreciation. Calculations of impairment were split between the candidates who knew the rule and scored full marks and candidates who completely omitted it from their answer, scoring zero.

The big issue for markers was that many candidates simply typed their answer into the spreadsheet rather than showing workings to explain how items were calculated. This is very dangerous, particularly in relation to items such as cost of sales, which are often made up of many marks. Without showing a working, candidates only need to make one mistake to be awarded zero marks (from a potential 3 marks), due to the marker not being able to see how the number was calculated.

For example, let's say cost of sales and administrative expenses were made up of the following:

Cost of sales: \$4,000 + \$400 depreciation + \$950 impairment + \$140 inventory write off = \$5,490
 Administrative expenses: \$1,600 + \$460 depreciation + \$60 foreign exchange loss = \$2,120

A candidate may calculate cost of sales at \$5,810 due to missing the inventory write off and including depreciation of \$460 in cost of sales rather than admin.

If a candidate does this and shows the full workings, they would lose maybe 1 or 1.5 marks for the two errors. They will have shown that they have taken the \$4,000, added the depreciation and

impairment correctly, and taken the correct \$460 depreciation but to the wrong category of cost. This may mean that they still score 4 or 5 marks.

A candidate who simply writes \$5,810 with no workings will score zero. They may have done the same thing, but the marker is unable to fully assess as different errors may have been made. Unfortunately, markers cannot interpret what the candidate may have done. Therefore, two candidates making the same mistakes could end up with vastly differing marks due to the differences in their exam technique.

Some candidates simply copied figures from the trial balance with no adjustments, and those who do this will score no more than a small number of marks. This displays that these candidates are probably not ready for the exam as they are probably not comfortable with the adjustments required in this question. This highlights a lack of preparation over a fundamental area of the exam, and candidates must not attempt the FR exam without having good exam technique and practise in this style of question.

There are multiple past exam questions that demonstrate how single company financial statements are tested. For example, Vernon Co from the March/June 2019 hybrid paper, Duggan Co from the September/December 2018 hybrid paper and Haverford Co from the March/June 2018 hybrid paper are good examples of this type of question which candidates must practice. As this type of question has possibly the widest areas of syllabus coverage, candidates should be attempting numerous single entity accounts preparation questions before sitting this exam.

Analysis of consolidated financial statements

Performance on these questions continues to be mixed, and is particularly poor where discussion is required. In this diet, it was surprising that weak candidate performance was apparent when they were required to adjust accounting numbers for consolidated items (such as intra-group sales or goodwill) and then recalculate ratios. It is surprising because, if this requirement were included as part of a full consolidated financial statements question, these would be areas that candidates perform well on. This suggests that candidates are rote learning a set technique, often based on a standard layout of traditional workings. Candidates must avoid rote learning and attempt to develop a real understanding of consolidation adjustments in preparation for Strategic Business Reporting rather than being simply able to mechanically produce a set of consolidated financial statements.

Despite this, candidates continue to be able to score well on the calculation of ratios. Many candidates were able to score full marks on this, showing that they had learned the ratio calculations well. However, some candidates failed to produce the ratios requested, and instead produced different ratios, which will always score zero marks.

Candidates also continue to produce ratios without workings, particularly in CBE, with many candidates failing to score marks through the 'own figure rule (OFR)'. If workings were provided, a marker would be able to apply the OFR and a candidate would only be penalised for their first error, but not for any knock-on effect of that error on other calculations. This was particularly evident where candidates were asked to redraft figures and then recalculate ratios.

The following example was used in the June 2018 and December 2018 examiner's reports, but continues to be relevant in the light of the lack of workings produced for ratios. This example shows draft figures of a group, before adjustments:

	\$000
Revenue	34,000
Cost of sales	(18,000)
Gross profit	16,000

Giving a gross profit margin of 47% (16,000/34,000)

Let's say the question required the candidate to remove an intra-group sale of \$5,000 and make an adjustment for unrealised profit of \$1,000. Correcting for these would give the following result:

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

Giving a revised gross profit margin of 51.7%

The marks for the adjustments would be given in part (a) of the question, and these would be marked as right or wrong.

If part (b) asked the candidates to calculate ratios based on the draft and recalculated figures, these would be given as an own figure rule. Ideally, this is how we would like to see candidates show these workings:

	Draft	Restated
Gross profit margin	47% (16,000/34,000)	51.7% (15,000/29,000)

This clearly shows the ratio and the workings, and would obtain full marks. Let's say a candidate forgot to adjust the unrealised profit in cost of sales. This would make cost of sales \$13m. This would give the following results:

	\$000
Revenue (34,000 – 5,000)	29,000
Cost of sales (18,000 – 5,000)	(13,000)
Gross profit	16,000

	Draft	Restated
Gross profit margin	47% (16,000/34,000)	55.1% (16,000/29,000)

This would lose a mark in part (a), as the candidate has made an error. However, they would score full marks in part (b) for the ratios under the own figure rule, as it is clear which figures a candidate has used in the restated calculation.

If a candidate simply shows the ratio calculations as:

	Draft	Restated
Gross profit margin	47%	55.1%

A marker would mark these figures as right or wrong, as there are no workings to show what the candidate has done. The marker cannot assume the mistake that the candidate has made, as this is not clear. Therefore this candidate would score 0.5 for the draft calculation, as this is correct, but nothing for the restated, as this is incorrect.

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

The quality of analysis surrounding consolidated financial statements continues to be disappointing. Standard things such as knowing that an acquired subsidiary would have different margins should be things that candidates are able to discuss and explain. Far too many candidates continue to answer this question by simply looking at numbers and completely disregarding the scenario provided. It is essential that candidates use the scenario provided to produce their discussion, rather than learning what ratios may mean and repeating that in the exam. This is a common complaint in these reports and it is disappointing to see this continue.

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. In particular, analyse the solutions to see how the scenario is used and 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.

Preparation of consolidated financial statements

The core principles of the preparation of consolidated financial statements remain an area where candidates perform well. Candidates with clear workings will score highly on this area. Happily, 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, as both will be seen and therefore marked by the marking team.

The preparation of a consolidated statement of profit or loss was well done, with candidates displaying a good knowledge. Commonly seen items such as intra-group sales, unrealised profits and fair value depreciation were dealt with well. The areas candidates struggled more with were generally the more technical areas, such as interest on financial instruments and unwinding discounts.

Most candidates were able to split the profit between the parent and the non-controlling interest, however, only a small number were also able to split the total comprehensive income including the OCI.

The discursive elements of this type of question continued to be challenging for candidates. However, candidates should be prepared to discuss areas of accounting within an accounts preparation question, much as they should be prepared to provide calculations within an analysis question.

The principles underpinning consolidated financial statements are a key part of the Financial Reporting syllabus, directly linking to similar topics within Strategic Business Reporting, and candidates are expected to be able to discuss these. Candidates should be able to explain the different methods of valuing the non-controlling interest or the principles behind accounting for an associate.

There are multiple past exam questions looking at the preparation of consolidated financial statements, as this has been a large part of the Financial Reporting exam for many years. Party Co from the September/December 2017 hybrid paper, Dargent Co from the March/June 2017 hybrid paper and Bycomb Co from the June 2015 paper are good examples of this type of question which candidates must practice.

Analysis of single entity financial statements

The ratio calculations were often done well, with many candidates scoring maximum marks for the calculation of ratios. However, a surprising number of candidates were unable to produce revenue per employee, which suggests rote learning of ratios rather than really stepping back and thinking about what the ratios are attempting to show.

The issue of CBE candidates being less likely to show their workings for the calculation of ratios remains, and this is a situation which needs to be addressed as it can lead to the loss of OFR marks. This problem was discussed in more detail above in the 'analysis of consolidated financial statements' section.

Candidates dealt reasonably well with the issue of a convertible loan note, but possibly less well than if this had been asked as part of a published financial statements question. This is a similar problem as noted in the calculation element required in the analysis of consolidated financial statements question. Candidates should not be surprised to see some accounting standards tested within an analysis question. FR requires a rounded set of knowledge and it is important that candidates understand the range of topics in the syllabus rather than applying set approaches and techniques to certain questions.

There is evidence in the questions that use word processing software that candidates are thinking about how they lay out the points made, and the better performing candidates often used short paragraphs to carefully structure their specific points. Some weaker candidates type everything in one huge block of text. Unfortunately, this reads poorly as it feels like candidates 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.

Often answers were just too brief. Candidates should be working on the basis of scoring one mark for each well explained point. Too many candidates wrote one or two paragraphs, which is always going to be some way short of the required standard for scoring between 11 and 15 marks.

There are multiple past exam questions that demonstrate how the analysis of single entity financial statements are tested, as this has been a large part of the Financial Reporting exam for many years. Mowair Co from the September/December 2017 hybrid paper and Funject Co from the March/June 2017 hybrid paper are good examples of this type of question which candidates must practice.

Exam technique

Good exam technique is vital for success in Financial Reporting. 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 make clear statements, and avoid repetition. Numerous candidates continue to repeat the same point two or three times when explaining the movement on a ratio. It is much better to make comments on a wider range of figures than to repeat similar points over one specific balance.

Candidates should also ensure they include a conclusion on the analysis discussion. A sensible conclusion summarising the main points of the analysis is important, and marks will be given here.

The completion rate of questions continues to be high, suggesting that many candidates are able to manage their time well. The majority of candidates attempted all sections. 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 using the word processing tool for the analysis question were less likely to show their workings for calculating ratios than those sitting the paper-based exam, which needs to be improved so marks are not lost.

Conversely, the narrative answers were often well presented, with headings and spacing used well.

For the preparation of financial statements question, candidates often laid out the financial statement 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 can allocate marks to both methods. As stated earlier, the candidates who do workings on a calculator and simply type in the final answer often lose marks.

There are resources on ACCA's website giving more guidance on how to use the spreadsheet software. A video introducing the main functionality and how to make best use of these in Financial Reporting can be accessed [here](#).

Guidance and Learning Support resources to help you succeed in your exam

There are many resources available to candidates to help with the exam. Many of the common themes discussed in this report regarding exam technique and ways to improve are comments that are commonly made across sittings. Previous examiner's reports can be found [here](#) and will give good, consistent guidance in what the examining team is looking for from well prepared candidates.

One of the keys to Financial Reporting is question practice, attempting questions and reviewing the answer to identify any areas 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 the ACCA [Approved Content Providers](#) but if this is not possible then work through the most recent past exams on the ACCA 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 candidates.