



Examiner's report

Financial Reporting (FR)

September 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

According to the Conceptual Framework for Financial Reporting of the International Accounting Standards Board (IASB), verifiability means that "...different knowledgeable and independent observers could reach a consensus of faithful representation..."

Which of the following procedures directly verifies that the relevant balances are faithfully represented?

A Confirming the cash balance by conducting a physical count of cash

B Confirming the inventory by reviewing the year end list of inventory

C Confirming a revaluation of land by agreeing the revaluation surplus to a minute of the board meeting where the directors agreed its estimate

D Confirming the carrying amount of receivables by reviewing the year end statements issued to customers at that date

What does this test?

This question tests Learning Outcome A1(e) “Discuss what is meant by understandability and verifiability in relation to the provision of financial information”

What is the correct answer?

The correct answer is A. The question provides candidates with the definition of verifiability which refers specifically to independence. Option A is the only option that objectively verifies the existence of cash.

Why the correct answer is none of the other options?

All other options verify the asset against an internal document; i.e. a “list of inventory”, a “board minute” and a “receivable statement”. Often, as in this case, the question stem contains some guidance for candidates. It is important therefore that candidates read the question stem and try to make the best use of any guidance provided.

Example 2

During the year ended 31 December 20X4, Bloop Co incurred expenditure on two projects

Project 1 costs relate to the evaluation of alternatives for improved production systems to be implemented during 20X5 and 20X6. The company spent \$1m on related salaries and materials and \$2m on design equipment (which had an expected life of four years).

Project 2 involves the testing of a new product which will be introduced to the market in 20X5 and is expected to generate profits over a four-year period. The company spent \$4m on salaries and materials.

The policy is to charge a full year’s depreciation on assets.

What is the TOTAL charge to profit or loss for the year ended 31 December 20X4?

A \$5.5m

B \$3.0m

C \$1.5m

D \$1.0m

What does this test?

This tests Learning Outcome B2(f) “Describe and apply the requirements of relevant accounting standards to research and development expenditure”

What is the correct answer?

The correct answer is C. Project 1 expenditure on the “evaluation of alternatives” could never be classified as an asset. Therefore the full \$1m relating to salaries and materials should be charged to profit or loss. Also, the depreciation for the design equipment should be expensed (\$2m/4); \$1.5m in total. The project 2 costs associated with the “testing of a new product which will be introduced to the market in 20X5” should be capitalised in 20X4 and written off from 20X5 for the

next four years. Consequently, there will be no project 2 costs charged to profit or loss during 20X4.

Why the correct answer is none of the other options?

A Charges \$1.5m for project 1 and \$4m for project 2

B Writes off all costs associated with project 1 (including the design equipment)

D Charges the \$1m for project 1 salaries and materials only

Section B

Section B tests candidates' knowledge on a number of International Financial Reporting Standards (IFRS®) in more depth than in section A, with three case questions containing five two-mark objective test questions. The range of topics tested in the September 2019 examination was:

- Deferred tax and revaluations of non-current assets
- Accounting policies
- Non-current assets and cash generating units
- Revaluation of non-current assets and government grants
- Leases
- Revenue

A few key points that came out of section B were:

- Read the case scenario and requirements very carefully. This goes for the whole exam, but any objective test question is 'all or nothing' – if you misread the requirement or miss a vital piece of information from the scenario and get the answer incorrect you score zero for that question. Close reading is also important for identifying the instructions in the question on how to round your answers.
- Cover the whole syllabus. The list above should highlight this – FR has a large syllabus which can seem daunting, but it is essential to have a broad knowledge. If, for example, a section B OT case covering variances comes up and you haven't covered this in your studies, the 10 marks available are left to chance.
- Be able to apply your knowledge of theories/techniques to the scenario given, as in the OT case questions these areas will often be examined in the context of the case. It is important that you are able to apply the logic of a concept or theory to a problem and so you need to understand the method and why you are doing the calculations and not just focus on how to do the calculations.

Section C

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

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

These will be discussed in turn. Although the specifics of individual questions will not be discussed, common areas candidates either performed well on or struggled with will be highlighted. Advice will be provided to improve exam performance.

Single entity accounts preparation

This area of the syllabus required candidates to prepare single entity financial statements which is an essential skill for an accountant and has been a large part of the financial reporting syllabus for many years. Performances in this area were generally good with many well prepared candidates able to score high marks.

As in previous questions on single entity accounts preparation, candidates were required to prepare financial statements from a trial balance and a set of adjustments. Many candidates produced well-presented financial statements and for those that provided clear workings, markers were able to apply the 'own figure rule'. For example, if a calculation error was made (such as an inventory adjustment) candidates still gained credit for following the incorrect figure through and accounting for it correctly in either the statement of profit or loss or the statement of financial position or both.

However, despite previous guidance in the examiners reports, markers have reported that there are still many candidates who continue to type their answer into the spreadsheet rather than show workings or use formula in the cell to explain how their answer is calculated. Where a candidate presents an incorrect figure and in the absence of a working, or cell formula, markers are unable to award relevant marks.

For example, let's say finance costs of \$9,000 in the statement of profit or loss were worth 2.5 marks and are made up of $\$7,500 - \$3,500 + \$5,000$.

A candidate may calculate the finance costs as \$2,150 by deducting \$350 (instead of \$3,500) and deducting \$5,000 in error.

If a candidate does this and shows the full working they will lose possibly 0.5 or 1 marks. However, a candidate that simply writes \$2,150 and does not provide supporting workings or cell formula, they will score zero for finance costs.

It is therefore crucial that candidates provide workings to show how an answer is arrived at for appropriate credit to be given.

Candidates were generally able to prepare well-presented, basic financial statements using the trial balance figures. The requirements relating to earnings per share and convertible loans were dealt with particularly well. Common adjustments such as tax and depreciation were also generally dealt with well by the majority of candidates.

The areas that candidates found more challenging included the recognition of a provision from an onerous contract (with many mistaking the adjustment as a revenue issue per IFRS 15) and disappointingly, the accounting treatment of a held-for-sale asset. Many candidates failed to recognise an impairment loss on the reclassification of the manufacturing equipment as a held-for-

sale asset in cost of sales and depreciation on the remaining plant and machinery was often calculated incorrectly with candidates calculating depreciation using the reducing balance method rather than the straight line method indicated in the question. This should act as a reminder to ensure you read the question carefully. It was pleasing however to see the majority of candidates attempting to record the held-for-sale asset within current assets on the statement of financial position.

There are multiple past exam questions that demonstrate how single company financial statements are tested. The examining team recommend that you attempt 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. These are good examples of this type of question which students must practice. As this type of question has possibly the widest areas of syllabus coverage, candidates should attempt the preparation of the financial statements of a single entity multiple times before sitting this exam.

Analysis of single entity financial statements

Performance in this area was disappointing compared to previous diets however the ratio calculations were often done well, with many candidates scoring maximum marks for these. The calculation of asset turnover produced the widest variation of incorrect responses with errors made to both the numerator and denominator. Candidates should ensure they are familiar with the ratio formulas commonly used within the financial reporting questions.

Some ratio calculations required the use of balances from part (a) following on from adjustments to profit, retained earnings and inventory. Unfortunately, many candidates did not use these balances in their ratio calculations and were unable to achieve full marks. For those that did use the information from part (a) the 'own figure rule' was applied accordingly.

There are still many candidates that continue to provide results from ratio calculations without providing the underlying working. This leads to the loss of marks where the answer provided does not agree with the marking scheme. If you have calculated gross profit margin as 30%, you must show the marker how you have arrived at this result. For example, $\text{gross profit margin} = \frac{\text{gross profit}}{\text{revenue}} \times 100 = \frac{\$30}{\$100} \times 100 = 30\%$. Or use cell formula. There are numerous ways that the working may be presented in your workspace, such as in a list format, in a table etc. the most important thing is to ensure that the working is clear and visible for the marker.

The responses to the appraisal part of the question were often disappointing. The marking team reported an increase in the number of candidates providing no answer or very brief answers (often only one or two paragraphs). Candidates should be aware that markers are unable to award full marks if they have written very little.

It continues to be the case that the candidates that make use of the scenario to provide a rationale for ratio results (year on year or compared to a sector average etc.) are the ones that score highly on these question types. Generic comments that are not related to the scenario or performance of the entity will continue to earn relatively few marks.

The examining team recommend that candidates practice past questions in this area. There are multiple past exam questions that test the analysis of single entity financial statements, as this has been a large part of the Financial Reporting exam for many years. Mowair Co from September/December 2017 and Funject Co from March/June 2017 are good examples of this.

Preparation of consolidated financial statements

Candidates were required to prepare a consolidated statement of financial position in the September 2019 session which accounted for a proportion of the marks available. This was then followed by an explanation of a consolidation issue such as equity accounting for an associate or the elimination of intra-group balances.

The preparation of a consolidated statement of financial position continues to be completed to a high standard with many candidates able to score high marks. The marking team noted that the majority of candidates continue to show the core workings for the consolidation (such as goodwill, non-controlling interests and group retained earnings) as noted in previous diets. This approach enables markers to apply the 'own figure rule' and as a result candidates perform well.

An area of difficulty experienced by many candidates was the issue of a share exchange on the acquisition of an associate company. The share exchange had not been recorded by the parent company and therefore candidates were required to include the cost of this investment within the investment in associate working and to record the issue of the shares within share capital and share premium. This type of adjustment is common (albeit usually in a parent-subsidary scenario) and candidates should familiarise themselves with the various ways that a parent may acquire shares in an associate.

Some consolidated accounts preparation questions will require candidates to make adjustments for transactions in the parent's financial statements, the subsidiary financial statements or both. In this diet both the parent and the subsidiary held investments that needed to be accounted for in accordance with IFRS 9 Financial Instruments. The most common mistake relating to this transaction occurred where candidates recorded the entire gain on the subsidiary investment within group retained earnings. The gain should be recognised as an increase in subsidiary net assets and therefore a proportion of the gain should be allocated to group retained earnings and non-controlling interests respectively.

There are multiple past exam questions that test 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 students must practice.

Analysis of consolidated financial statements

This question type will often require candidates to produce minor calculations in the early part of the question before calculating a series of ratios and then to provide an analysis of the performance or position of a group or a group in comparison to a single entity. In the September 2019 diet, candidates were either required to calculate the group gain or loss following the disposal of a subsidiary or to calculate non-controlling interests.

It was disappointing that many candidates are unable to correctly identify the gain or loss on the disposal of a subsidiary despite this being part of the syllabus for many years now. The most common error noted by the marking team occurred within the calculation of non-controlling interests at the disposal date, with many candidates not including the non-controlling interests in the disposal calculation at all.

A large proportion of candidates were able to score full marks on the ratio calculations in these questions. For the candidates that did not score full marks on the ratios there were often errors in the formula used or no workings were provided for the marker. As already noted in this report, candidates need to record all workings when calculating ratios.

The analysis section of the question produced answers that varied in quality. Disappointingly, the answers of many candidates were scant or had little substance. The best performing candidates were those that used information from the scenario and incorporated it into their reasons for changes in performance and position. It was pleasing to see that there is slight increase in candidates recognising that an acquisition or a disposal of a subsidiary part-way through the year, or one-off transactions (such as a gain on disposal or acquisition costs relating to a new subsidiary) will distort the results when comparing to previous years.

Far too many candidates however continue to ignore the scenario given in the question and produce vague, general answers. It is essential that candidates use the scenario to support their analysis. It is disappointing that this trend continues.

The examining team recommends that previous questions containing group analysis issues are considered such as Pirlo 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. To score well on this question type, candidates **MUST** ensure that they use and apply the information provided in the question scenario.

Exam technique

Good exam technique is vital for success in the Financial Reporting exam. Strong candidates continue to use clearly presented 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 in a ratio which will waste time and not provide any further marks. 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 awarded for a decent attempt to do this.

The completion rate of questions continues to be high, suggesting that many candidates are able to manage time well. In this diet, it was pleasing to see that the majority of candidates attempted all sections of the exams. The most commonly omitted questions in section C 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 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 approaches 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 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.