



# Examiner's report

## Financial Reporting (FR)

### March 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.

- 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. Where answer options are available, candidates should resist looking at these until they have fully worked the question. Some of the distractors can appear genuine but may miss a stage of a 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 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 which proved to be particularly difficult for candidates.

### Example 1

Zayn Co spent \$500,000 on 1 January 20X6 sending its key staff on a one-day training course which took place at the beginning of the current financial year. Zayn Co is expected to benefit from this training for the next two years.

This training course was partly funded by a government scheme and Zayn Co received \$50,000 from the government before the training commenced. The remaining balance of \$50,000 is due to be received on 31 December 20X7. Current circumstances indicate that the receipt of the second instalment is virtually certain.

**What amount should be charged to Zayn Co's statement of profit or loss for the year ended 31 December 20X6 to reflect the above transactions?**

- A \$150,000
- B \$200,000
- C \$450,000
- D \$400,000

*What does this test?*

This tests a candidates understanding of the nature of an intangible asset and their knowledge of how to treat a government grant that is awarded to off-set revenue expenditure.

*What is the correct answer?*

The correct answer is D.

An asset is defined as "a present economic resource **controlled** by the entity as a result of past events". The staff training does not meet the definition of an asset because the employer does not control its employees; the employer cannot control whether or not an employee chooses to leave employment. If an employee leaves, the employer will not receive the full benefit of the staff training. If the staff training is not an asset, then \$500,000 should be charged to profit or loss. As the second instalment of the government grant, is virtually certain then the full \$100,000 can be offset against the \$500,000 staff training costs.

*Why the correct answer is none of the other options?*

A staff training costs (treated as an intangible asset an amortised over 2 years)  $\$500,000/2 \text{ years} = \$250,000$  less \$100,000 (revenue grant received and receivable)

B staff training costs (treated as an intangible asset an amortised over 2 years)  $\$500,000/2 \text{ years} = \$250,000$  less \$50,000 (revenue grant received)

C total staff training costs \$500,000 less \$50,000 (revenue grant received)

**Example 2**

Tonton Co acquired 9,000 shares in Pogo Co on 1 August 20X3 at a cost of \$6.40 per share. Tonton Co incurred transaction costs of \$9,000 for this transaction. Tonton Co elected to hold these shares at fair value through other comprehensive income.

At 31 December 20X3, the fair value of the Pogo Co shares was \$7.25 per share and selling costs were expected to be 4%.

**What is the value of the Pogo Co shares in Tonton Co's individual financial statements at 31 December 20X3?**

- A \$65,250
- B \$74,250
- C \$62,640
- D \$66,600

*What does this test?*

Although it might look like this question is testing IFRS 9: Financial Instruments, it is actually testing an understanding of IFRS 13: Fair Value measurement. This is because it tests whether candidates know how to measure the investments at 31 December 20X3 and whether or not to include the original transaction costs. IFRS 13 states that "...the fair value of an asset shall not be adjusted for transaction costs"

*What is the correct answer?*

The correct answer is A

$9,000 \text{ shares} \times \$7.25 = \$65,250$

*Why the correct answer is none of the other options?*

B  $\$65,250 + \$9,000 = \$74,250$

C  $9,000 \text{ shares} \times (96\% \times \$7.25) = \$62,640$

D  $(9,000 \text{ shares} \times \$6.40) + \$9,000 = \$66,600$

**Section B**

Section B tests candidates' knowledge on a number of topics in more detail than section A, with three case questions containing five two-mark objective test questions. 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 mean 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 2019, candidates' demonstrated some knowledge that was weak in the following syllabus areas:

(i) leases – IFRS 16 is a relatively new standard and so candidates should ensure that they are using an up-to-date text. Also, pay particular attention to dates as not all leases will be started on

the first day of the financial year which means that this will restrict the expenses charged to profit or loss.

(ii) Research and development – these questions usually involve detailed information being provided about the amount of expenditure on specific dates and then it being written off to profit or loss. Therefore, candidates need to pay attention to the detail of the scenario and use timelines where possible to organise that information.

(iii) Revenue recognition – by their nature, these types of questions will be detailed and make use of dates. Candidates should ensure that they understand the question scenario and learn how to un-pack the detail and organise it effectively. This topic area is also widely spread and may include questions that test more complex areas such construction contracts.

A few key points to emerge from an analysis of the section B responses are:

- Read the case scenario and requirements very carefully. Although this advice is relevant for the whole exam, candidates need to appreciate that 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. This applies also to instructions on how to round your answers.
- Ensure that your revision covers the whole syllabus. The list above should highlight this – FR has a large syllabus which can be daunting, but it is essential to have a broad knowledge. If, for example, a section B case tests IFRS 16 Leases and you haven’t covered this in your studies, the 10 marks available in this case are left to chance.
- Be able to apply your knowledge of theories/techniques to the scenario provided. It is important that you understand why you are applying a concept or theory rather than performing the calculations by rote.

## **Section C**

Candidates were presented with the following question types:

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

Although the specifics of individual questions will not be discussed, the common areas in which candidates either performed either well, or not so well, will be highlighted. Advice is provided to improve exam performance.

### **Preparation of single entity financial statements**

This area of the syllabus requires candidates to prepare single entity financial statements which is an essential skill for an accountant that will continue to be examined. In the March 2019 exam, candidates were asked to prepare some combination of (i) a statement of profit or loss and other comprehensive income; (ii) a schedule of adjusted profit, (iii) a statement of changes in equity and, (iv) a statement of financial position. As in previous sittings, these financial statements are prepared from a trial balance and a list 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 those candidates that did not provide relevant workings to support their financial statements markers were unable to apply the own figure rule and marks could not be awarded.

Candidates who performed well tended to do so in depreciation, interest accruals and tax calculations. The areas that candidates found more challenging related to share issue costs, foreign currency transactions and the deferred tax relating to a revaluation. These are the more technical areas so it is unsurprising that candidates found these the most difficult.

It was pleasing to see that many candidates were able to demonstrate their knowledge of IFRS 15 where revenue should be recognised in full in the statement of profit or loss when the five steps have been met. However, candidates should note that marks will not be awarded for the replication of an IFRS standard (for example the five steps of IFRS 15) without that knowledge being applied to the scenario provided. In this type of question, many candidates failed to recognise the financing element associated within a contract where revenue will be received in more than one year. For those candidates who were able to correctly deal with the financing element, many treated the unwinding of the discount incorrectly as a finance cost rather than as finance income.

A slightly disappointing feature of the single entity accounts preparation question was that a significant minority put the bank overdraft as a negative asset within current assets. At this stage, we would expect candidates to know that this should be a current liability and this was disappointing to see.

A minority of candidates seemed to struggle with the concept of adjusting a draft profit figure, despite this style of question being examined numerous times in the past. These candidates often showed haphazard workings, making it difficult for markers to award credit.

There are multiple past exam questions looking at the preparation of single company financial statements, as this has been a large part of the Financial Reporting exam for many years. The examining team recommend that you attempt 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 not as good as in previous diets. Candidates were required to make some minor adjustments to a set of financial statements before calculating relevant financial ratios for two potential acquisition targets. Candidates were then required to compare and contrast the performance of the two entities before concluding on the most appropriate investment.

Part (a) to the question required candidates to apply their knowledge of IAS 16 to adjust one of the entity's financial statements. Many candidates added the revaluation to the existing figures rather

than removing it. Others ignored the question requirement - which was to show the adjustments - and simply calculated the revised year-end figures. These were often incorrect as candidates had not appreciated that there were other non-current assets that had not been revalued.

Frequently the adjustments/year-end figures were incorrect and often with no clear workings being shown so that markers were unable to give credit for candidates adopting the right approach. Occasionally more basic errors were made – e.g. land was depreciated, the wrong number of years and incorrect dates were used. Candidates also failed to deduct the extra depreciation that had been charged to operating expenses as a result of the revaluation. Similarly, the extra depreciation (for two years) was not added back to equity – nor was the correct revaluation amount deducted from equity.

The requirement to calculate some financial ratios for both entities was generally well answered. Remember to always show workings for your ratio calculations as an incorrect ratio result cannot be given own figure marks if the marking team does not know how the answer has been arrived at. This advice is especially true where the answer space is a word document – when the answer is in a spreadsheet, markers can see the cell formulae.

A common error that was made was where candidates did not use their amended figures from part (a) when calculating the operating profit margin and gearing. A worrying number of candidates made more basic errors. Some were unable to calculate the inventory and receivable day's ratios which are considered to be basic ratios and have been present in many previous exam questions. Others calculated gearing as  $\text{debt}/(\text{debt}+\text{equity})$  rather than  $\text{debt}/\text{equity}$  as clearly indicated in the question.

There was mixed performance in the analysis part of the question. Many candidates picked up on the bigger picture that, whilst one company was more profitable, it also had serious liquidity and working capital issues. However candidates were often unable to elaborate on these points and perform a more in depth analysis. Basic errors were also observable here. For example, one entity had a much lower operating profit margin. However this was entirely due to the lower gross profit margin. Many candidates then commented that this entity therefore had poorer control over its operating expenses, when the figures showed the opposite – where their ratio of operating expenses to sales was much better than the other acquisition target.

It was pleasing to see that an increasing number of candidates did refer to the information provided in this question such as a new app being launched, just in time developments and the different business models - but again were often unable to analyse the impact of these factors on the reported results.

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**

In the March 2018 exam, candidates may have been asked to prepare a statement of financial position or a calculation of goodwill followed by a consolidated statement of profit or loss.

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, consistent with performance in previous sittings. Students were able to produce good calculations in relation to fair value adjustments, goodwill and unrealised profits, highlighting that this is an area that has been well practised.

Students generally struggled with the consideration of a contingent liability, applying rules per IAS 37 rather than applying the fair value consolidation rules per IFRS 3. Other common mistakes arose around the acquisition of the subsidiary in a share-for-share exchange, and an adjustment relating to cash-in-transit, which many students treated as goods-in-transit.

It was disappointing to see that some candidates continue to use proportionate consolidation within their answer by adding only 80% of the subsidiary assets and liabilities within the consolidation. This continues to be a fundamental error and other wise 'easy' consolidation marks end up not being earned.

Overall candidates did not perform as well when preparing a consolidated statement of profit or loss, although there were many that were able to achieve high marks. Most candidates were happy with the initial consolidation process, although a number failed to time apportion the results of the subsidiary company for the nine month post-acquisition period.

Common consolidated profit or loss adjustments such as the elimination of intra-group sales and purchases, fair value depreciation and unrealised profits were generally dealt with well by most candidates.

Some candidates appeared to struggle with the elimination of the dividend that the parent received from the subsidiary, with many eliminating the full dividend paid rather than the 80% that was received by the parent. The unwinding of the discount on the deferred consideration was often omitted altogether or, when included, many failed to time apportion for the nine months. Only the highest scoring candidates were able to deal with the inventory fair value adjustment correctly.

The most disappointing area of this question was the failure to complete the split between the profit attributable to the parent company shareholders and the non-controlling interests' share. This part of the consolidation was largely based on own figures. The consolidated profit or loss has been tested on numerous occasions and the profit split is considered to be a critical aspect of the preparation of these statements. Future candidates must ensure that this profit split is addressed to give themselves a better chance of scoring well on these questions.

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**

When candidates are required to appraise the performance and position of a group of companies they are often required to produce minor calculations. In March 2019, candidates were asked to calculate the gain or loss on the disposal of a subsidiary company. For the candidates that attempted this part of the question this was generally dealt with well. The most common error was the inclusion in the disposal calculation of an increase in goodwill. Increases in goodwill are never accounted for and therefore it is only unimpaired goodwill that should be included.

Many candidates were able to score full marks on the calculation of the ratios which was particularly pleasing to see, although many candidates did not provide workings so were lucky that their ultimate answers were correct. For those that didn't earn all of the available marks this was often due to the wrong formula/numbers were being used. For example, if you are asked to produce an operating profit margin, you must use profit before interest and tax, any other profit used will mean the marks for that ratio cannot be awarded. It continues to be disappointing that many candidates still fail to show their workings for their ratio calculations and the marking team are unable to apply the own figure rule.

The analysis section often produced vague, general answers and in many cases no commentary was provided at all. Needless to say, marks earned for these answer types are limited. The candidates that scored well on this section showed that they were well prepared and made use of the information contained within the scenario to discuss and provide reasons for obvious changes in performance and position. For example, disposing of a subsidiary mid-way through the year would impact both the current and the following year results, meaning that comparison of performance year-on-year is distorted or that inclusion of a gain or loss on disposal is a one-off event that will not be present in future or prior year financial statements.

The examining team recommends that previous questions containing group analysis issues are considered such as 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 on FR exams**

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.

In analysis-type questions, 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.

In questions that tested the preparation of financial statements, 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 will follow both methods. 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

### **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.

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

Preparing for the PM exam may appear daunting but there are many resources available to help you. There are many technical articles available on the topics in this report. In addition all the past exams referred to are available for your use. You should refer to these throughout your studies. Please make sure that you visit the ACCA's website and look at everything available to you. There are also plenty of support materials to help you feel confident about taking your exams on CBE.

<http://www.accaglobal.com/uk/en/student/exam-support-resources/fundamentals-exams-study-resources/f5.html>