Examiner's report
Financial Reporting (FR)
September 2018

General comments

The Financial Reporting (FR) 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.

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. As can be seen in the following two examples, 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 Scetion A questions that proved to be particularly difficult for candidates.

Example 1
A 60% owned subsidiary sold goods to its parent for $150,000 at a mark-up of 25% on cost during the year ended 30 June 20X5. One fifth of these goods remained unsold as at 30 June 20X5.

What is the debit adjustment to be made to group retained earnings to reflect the unrealised profit in inventory at 30 June 20X5?

A $6,000
B $3,600
C $2,400
D $4,500

What does this test?
This tests whether candidates can account for the effects in the financial statements of intra-group trading. This question specifically tests unrealised profit in inventory.

What is the correct answer?
B $150,000 x 25/125 x 1/5 x 60% = $3,600

Why the correct answer is none of the other options?
Option A calculates the adjustment as if the sale was made by the parent
$150,000 x 25/125 x 1/5 = $6,000
Option C calculates using the NCI% as opposed to the group share
$150,000 x 25/125 x 1/5 x 40% = $2,400
Option D calculates using a margin as opposed to a mark-up
$150,000 x 25% x 1/5 x 60% = $4,500

Example 2

Which of the following meet(s) the recognition criteria for an asset and/or a liability?
(1) Green Co spent $100,000 providing health and safety training to its staff
(2) Green Co has been told by a brand consultancy that the value of its internally created brands is $2,000,000
(3) Green Co is suing a supplier for $450,000 for losses that it suffered due to faulty goods. Greene Co is likely, though not certain, to win the court case
(4) Green Co has sold goods subject to a five-year warranty on which it expects some claims will be made

Option A is not an asset because Greene Co does not control staff and there is not sufficient certainty of economic benefits they may leave their job

A 1 and 2
B 3 and 4
C 2 only
D 4 only

What does this test?
This tests whether candidates can apply the recognition criteria for assets and liabilities to four specific scenarios.

What is the correct answer?
The correct answer is Option D: 4 only. This is because a legal obligation (the warranty) has been created as a result of the sales contract.

What is the correct answer?
All other scenarios are not correct for the following reasons:
(1) the $100,000 expenditure on the health and safety training does not meet the definition of an asset because Greene Co does not control their staff (i.e. they could leave their jobs at any time) and it is not certain that the health and safety training will produce economic benefits
(2) as the brand has been internally generated, it cannot be reliably measured and so it does not meet the definition of an asset
(3) the court case against the supplier cannot be recognised as an asset because the economic benefits are not sufficiently certain. It may however be a contingent asset and disclosed in the notes to the financial statements.

<u>Section B</u>

This section of the exam presents three scenarios around which five (two mark) objective test questions are based. This approach allows the examining team to test a particular learning outcome in some depth. These scenarios can be based on any of the FR learning outcomes which means that future candidates need to have a knowledge of the syllabus which is both wide and deep. They also need to be able to apply that knowledge in the context of a specific scenario. In September 2018, candidates' knowledge of the following was weak: the reversal of the impairment of an asset, earnings per share and financial instruments. Whilst the reversal of the impairment of an asset is a relatively new addition to the syllabus, earnings per share and financial instruments have been tested for many years. Candidates should therefore practice as many cases as possible to ensure a wide exposure of the syllabus using these question types.

Section C

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

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

Preparation of single entity financial statements

This area of the syllabus requires candidates to prepare a set of financial statements for a single entity, from either a trial balance or an extract thereof. Candidate performance in this area was very mixed, but it was pleasing to see some very good answers being produced.

Candidates were required to produce financial statements from a trial balance incorporating a series of adjustments. In Sep 2018, they were not asked to prepare a complete set of financial statements, instead the requirements asked for a statement of profit or loss and a statement of changes in equity but not the statement of financial position. Another question required a schedule of adjustments to profit and a statement of financial position. The requirements tested the candidates' presentation of financial statements and their ability to identify the correct adjustments required.

Candidates were confident in the presentation of the financial statements with many providing the marking team with well presented workings. This enables the team to apply the 'own figure rule'. If an error is made in an earlier part of the answer, but that same balance is subsequently used correctly elsewhere then candidates will be awarded marks an 'own figure'. The marking teams work very hard to ensure the own figure rule is applied. Unfortunately, for those candidates who do not show workings or present them in a logical, legible manner, these marks are often lost. Full presentation of all workings is essential as markers are not able to mark what was 'in your head'.

Candidates coped well with adjustments for non-current assets and basic tax adjustments as expected. In addition to this, candidates generally performed very well with technical adjustments to revenue relating to a performance obligation met over time and a convertible loan.

The most technical areas of the questions continue to be challenging for some students. These include recording provisions correctly and deferred tax where the temporary difference must be calculated. In many past questions the temporary difference may be given to students but in instances where this is not provided candidates will need to calculate this themselves. This can be done by comparing the difference between the tax written down value of property, plant and equipment to the carrying amount that the candidate has calculated and included in the statement of financial position. This of course will be given the benefit of the 'own figure rule' if mistakes were made in calculating the carrying amount of property, plant and equipment.

Many candidates did not cope well with the calculation of earnings per share (EPS). When there is a full market share issue during the accounting year, candidates must 'weight' the average of the shares when calculating EPS. This is a fundamental requirement of IAS 33 and was rarely applied by candidates. All ACCA approved learning materials have examples of this. Finally, it was disappointing to see candidates were not presenting EPS correctly, often showing the result as a percentage. EPS shows the **earnings** per share and must be recorded as a monetary value. For example, if you calculate 0.42 this should be recorded as either $0.42 or 42 cents.

There are numerous past exam questions that test the preparation of single entity financial statements. It is essential that candidates practice as many of these questions as possible as it will expose them to a wide areas of the syllabus. Haveford Co from the March/June 2018 hybrid paper and Triage Co from the September 2016 exam are good examples of this type of question.

Analysis of single entity financial statements

Performance in this area was generally quite good and had improved since the previous sitting which was pleasing to see. The ratio calculations continued to be well done, with many candidates scoring full marks. For those candidates that had calculated the ratio incorrectly and not provided workings, then marks could not be awarded. This continues to be frustrating for the marking teams.

There are often 0.5 marks available for both the numerator and the denominator of the ratio, if workings were clearly shown then candidates may earn more marks for the part of the ratio that has been completed correctly. The absence of workings will then potentially have a knock-on effect to later ratios. For example, if a candidate calculated return on capital employed incorrectly by using the correct profit from operations of $30 million divided by an incorrect capital employed of $110 million then 0.5 could be awarded to profit from operations when the working is shown. But simply recording return on capital employed as 27% with no working will not be allocated any marks. If the candidate were then asked to calculate net asset turnover - using the correct revenue of $200 million divided by the candidates own capital employed figure of $110 million would achieve 1 mark with the working shown. In the absence of any workings however, a candidate recording a net asset turnover of 1.8 times would again achieve zero marks for this calculation.

The narrative part of the question continued to be very mixed with some candidates simply writing one or two sentences/paragraphs. This approach is unlikely to score many marks in the exam. It is essential that candidates do not simply rely on calculating ratios to pass this question as the discussion marks continue to be awarded the majority of the marks. This question tests candidates' ability to appraise the performance and position of an entity over time or compared to another company. This is a key skill required by accountants. The examining team are keen for candidate's performance in this area to be improved.

It was noted by marking teams that candidates continue to provide vague, 'textbook' answers for the ratios calculated. Simply stating that gross margin is bigger, and this may be because sales have increased, or costs have reduced does not constitute analysis and will score no marks. A good answer will always use the scenario to help explain why increases or decreases have occurred. Those candidates that used the scenario in their analysis generally scored very well on this part of the question as they were able to make valid suggestions for the changes that existed in the ratios. For future candidates, greater consideration of the comparison between potential 'one-off' items versus longer-term changes in profits is required.

The analysis of company performance was far superior to that of financial position with many candidates neglecting to provide an analysis on financial position discussion at all. It continues to be important that all parts of the requirement are addressed.

Many candidates are still not summarising their thoughts in a well explained conclusion. This continues to be highlighted in the exam reports and is disappointing that candidates fail to do this. A conclusion based on the analysis the candidate has done will always attract marks and candidates are strongly advised to provide this in future.

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 September 2018, candidates were asked to calculate goodwill and prepare a consolidated statement of profit or loss. It was pleasing to see that many candidates were able to achieve full marks on the goodwill calculation. For those candidates not achieving full marks for goodwill, there were common errors including the failure to discount the deferred consideration to present value when calculating the cost of investment, and when calculating net assets, the contingent liability was often omitted or was added in as an adjustment to net assets rather than being deducted. Many candidates continued to struggle to identify retained earnings at the acquisition date correctly often missing the current year profit up to the date of acquisition. This is an area that has been tested many times previously, so it was surprising to see these mistakes continue to be made.

The preparation of a consolidated statement of profit or loss was generally well attempted by many candidates with relatively few however achieving full marks. Many candidates demonstrated a sound knowledge of the consolidation process in this area dealing with intra-group sales, fair value depreciation and unrealised profit well. The most common error relating to the preparation of the consolidation continued to be the split of profit between the parent and the non-controlling interests, with a surprisingly large number of candidates failing to attempt this part of the consolidation at all. These candidates immediately missed out on 2 marks which are largely based on 'own figures' from earlier parts of the consolidation. Another common mistake was the failure to unwind the discount on the deferred consideration from part (a) but, for those that did attempt this, many forgot to time apportion the expense for the post-acquisition period.

The technical area of convertible loans was examined within the consolidated statement of profit or loss with the parent company issuing the convertible loan at the start of the accounting year. Candidates were required to include interest on the convertible loan within finance costs at the equivalent rate of 8% on a non-convertible loan. Many candidates failed to do this and, for those that did, they failed to deduct the interest that had already been included within finance costs at the coupon rate of 6%. Another common mistake was where candidates applied 8% to the par value of the liability when the loan should have been split between its debt and equity components.

There are multiple past exam questions that test the various preparation of consolidated financial statements, as this has been a large part of the Financial Reporting exam for many years. Party Co from

September/December 2017, Dargent Co from March/June 2017 and Bycomb Co from the June 2015 paper are good examples of this type of question which candidates must practice.

Analysis of consolidated financial statements

In questions where the analysis was based on group issues, candidates were asked to perform minor calculations for group companies, such as non-controlling interests, group retained earnings and gains/losses on the disposal of a subsidiary company. Candidates should expect to be tested on these routine group-related adjustments. Candidates generally performed well when preparing the non-controlling interest and group retained earnings calculations. An adjustment that many candidates omitted, related to the professional fees on the acquisition of the subsidiary company. These fees never form part of the cost of investment of a subsidiary when calculating goodwill on acquisition but are instead an expense that relates to the parent company only. These fees should therefore be deducted from group retained earnings and are not to be split between the parent and non-controlling interests. Where candidates were asked to calculate the gain or loss on the disposal of a company this was generally well attempted, although very few candidates achieved full marks. The disposal of the company was mid-year and therefore the most common mistake was where candidates omitted the current year profit up to the disposal date when determining net assets.

The requirement to calculate ratios was generally well received by candidates with many scoring full marks. However, as noted in previous examiner reports (and above in this report) candidates continue to produce ratios without supporting workings. The lack of workings means that the marking team are unable to apply the 'own figure rule'. This was particularly evident in the question where candidates were asked to calculate non-controlling interests and retained earnings to be included in consolidated financial statements.

An example of how this would be marked is shown below:

Part (a) asked candidates to calculate the non-controlling interests and retained earnings to be included in the consolidated financial statements.

Let's assume the correct balances for these per the marking scheme were:

	$'000
Non-controlling interests	3,600
Retained earnings	14,000

Now let's assume the candidate has calculated the balances as:

	$'000
Non-controlling interests	2,900
Retained earnings	13,100

The marks for these workings would then be awarded in line with the making scheme and, where candidates did not perform all parts of the calculation correctly, the marks would not have been awarded.

If Part (b) then asked candidates to calculate ratios based on the financial statements and their answers to part (a) these would be given own figure rule. For example, if asked to calculate return on capital employed (using a profit before interest and tax of $15 million) the candidate would need to take the capital employed for the group which includes:

	Per scheme	Per candidate
	£'000	£'000
Share capital (given in question)	10,000	10,000
Retained earnings (from part (a))	14,000	13,100
Non-controlling interests (from part (a))	3,600	2,900
	27,600	26,000
Long-term loans (given in question)	11,000	11,000

The return on capital employed per the scheme would be 38.9% using balances per the suggested solution (15,000/(27,600+11,000)). The candidate however would calculate return on capital employed as:

Return on capital employed 40.5% (15,000/(26,000+11,000))

The result of 40.5% in this instance would score full marks in part (b) as the workings have been clearly shown and the marker is able to apply 'own figure rule'.

If the candidate did not show any workings however and simply shows return on capital employed as 40.5%, then the marking team is forced to mark this as incorrect and the mark for return on capital employed would be lost.

In the analysis parts of the question it was surprising to see that many candidates wrote very little. Many also repeated the ratios and explained that numbers had gone up or down with no further discussion. Some misinterpreted their ratios even when they had calculated them correctly. The analysis surrounding consolidated financial statements must also include comments on group related issues however some candidates continue to avoid reference to these issues at all. Few candidates made good use of the information they had been provided with in the question for their discussion and as such scored very few marks. It is worrying to see that there continues to be a significant minority of candidates who continue to calculate ratios with no attempt at discussion, which highlights that further work and practice is required in this area of the syllabus.

Candidates should ideally look at past questions on this area such as the Perkins Group from the March/June 2018 Hybrid paper and the September 2016 question Gregory Co to provide examples of how to incorporate knowledge of consolidations into an answer.

Exam technique

Good exam technique is vital for success in Financial Reporting. Strong candidates continue to produce good workings for both the preparation of financial statements and calculation of ratios, enabling them to maximise the marks to be 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' and 'position'. 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 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 spread sheet 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 that 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 can 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 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. Candidates may feel comfortable with this type of question, but reviewing the answers can also 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 section also provides guidance for approaching the analysis question, and further guidance for resit students.