Financial Reporting March/ June 2024 Examiner's 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 those sitting the exam in the future.

Contents

General comments

This examiner's report should be used in conjunction with the published March/ June 2024 sample exam, which can be found on the ACCA Practice Platform.

In this report, the examining team provide constructive guidance on how to answer the questions whilst sharing their observations from the marking process, highlighting the strengths and weaknesses of candidates who attempted these questions.

Future candidates can use this examiner's report as part of their exam preparation, attempting question practice on the ACCA Practice Platform and reviewing the published answers alongside this report.

The Financial Reporting (FR) exam is offered as a computer-based exam (CBE). The model of delivery for the CBE means that candidates do not all receive the same set of questions.

This report includes the following:

- Section A: Objective test questions – we focus on four specific questions that caused difficulty in these sittings of the exam.
- Section B: Objective test case questions – here we look at one specific question that was challenging for candidates.
- Section C: Constructed response questions – here we provide detailed commentary around two constructed response questions and identify some of the main issues that affected candidates' performance in this section, identifying common knowledge gaps and offering guidance on where exam technique could be improved, including in the use of the CBE functionality where appropriate.

Section A

Here we look at **FOUR** Section A questions which proved to be challenging for candidates. These objective test questions examine syllabus learning outcomes in a lower level of detail than those in Sections B and C.

Question 1

On 1 May 20X5, the directors of Hooved Co entered a five-year lease for equipment. The present value of future lease payments was $185,000 at 1 May 20X5, prior to the first payment. The terms of the agreement require annual instalments of $45,000 to be paid in advance and these commenced on 1 May 20X5. The rate of interest implicit in the lease is 11% per annum.

What is the total lease liability at 30 April 20X6 (to the nearest $'000)?

$ _____ ,000

What does this test?

This question tests syllabus learning outcome (SLO) B6(a) and IFRS® 16 *Leases*. Candidates needed to know that, for lease payments in advance, the lease payment must be deducted from the opening liability prior to calculating finance costs.

What is the correct answer?

The correct answer is **$155**.

The total lease liability for the year ended 30 April 20X6 can be calculated as follows:

Year ended 30 April	**Opening liability**	**Payment in advance**	**Adjusted liability**	**Finance costs (11%)**	**Closing liability**
	$'000	**$'000**	**$'000**	**$'000**	**$'000**
20X6	185	(45)	140	15	**155**

Note that the finance costs of $15,400 were calculated as 11% of $140,000 (**after** the lease payment was deducted). Also note that, although the total closing liability is $155,400, the question specifically asks for the **answer to the nearest $'000**.

Where did candidates go wrong?

Only a third of candidates correctly answered this question. Most candidates answering incorrectly had selected $160k, treating the payment as in arrears instead of in advance.

The total lease liability, calculated **incorrectly** and with the payment treated as 'in arrears', is as follows:

Year ended 30 April	**Opening liability**	**Finance costs (11% x $185k) (incorrect)**	**Payment in arrears (incorrect)**	**Closing liability (incorrect)**
	$'000	**$'000**	**$'000**	**$'000**
20X6	185	20	(45)	160

Question 2

Jentil Co is a company which manufactures ovens and supplies them to retailers. There are no direct sales to the public.

Which TWO of the following would indicate that Jentil Co should recognise revenue at the point of delivery?

A. The retailer must pay a penalty to Jentil Co if it returns new ovens which are in full working order

B. The retailer has signed proof of delivery and unconditionally accepted the delivery of the ovens from Jentil Co

C. Jentil Co has a statutory right to request the return of the ovens in exchange for the original consideration, without further compensating the retailer

D. Obsolete models of ovens may be returned by the retailer to Jentil Co in exchange for the original consideration, without being further compensated

What does this test?

This question tests SLO B10(b) and IFRS 15 *Revenue from Contracts with Customers*. Candidates needed to know that for revenue to be recognised, the both the risks and rewards of the ovens must have transferred substantially to the customer. Although this is normally at the point of delivery, more complex factors were included in this question.

What are the correct answers?

The correct answers are **A** and **B**.

For A, the **customer** is **exposed to the <u>risk</u> (a <u>penalty</u>)** should they return new ovens which are in full working order. They also have the **<u>reward</u> through <u>direct use</u>** of the ovens.

For B, the **customer has signed proof of delivery** and **<u>accepted</u> the delivery** of the ovens, taking control of the asset and, therefore, indicating that this is the point at which they are exposed to risk and entitled to reward.

Where did candidates go wrong?

Over half of candidates answered this question correctly. Nearly all candidates selected B as one of two correct answers.

However, of the candidates who incorrectly selected options, those selecting B and C accounted for approximately half of the incorrect answers.

If Jentil Co has a statutory right to request the return of the ovens in exchange for the original consideration and without further compensating the retailer, this is a ‘call option’ and must be recognised as a financing arrangement.

The **rewards** of ownership have **not** been transferred to the customer as **Jentil Co, effectively, still control the ovens as they may purchase them back**. (C)

If obsolete models of ovens may be returned to Jentil Co in exchange for the original consideration and without being further compensated, this is a forward contract and must also be recognised as a financing arrangement.

The **risks** of ownership have **not** been transferred to the customer as **Jentil Co, effectively, must purchase back ovens if the customer chooses to**. (D)

Both C and D are accounted for in accordance with IFRS 9 *Financial Instruments*.

Question 3

Swimmy Co purchased 60% of the 32,000 ordinary (equity) shares of Landern Co on 1 May 20X6.

The consideration included a share exchange of two shares in Swimmy Co for every five shares acquired in Landern Co. The fair value of a Swimmy Co share at the date of acquisition is $15.

Also included in the consideration is a cash payment of $157,500 which is to be paid on 1 May 20X7. Swimmy Co has a cost of capital of 5%.

Calculate the fair value of the consideration to acquire Landern Co on 1 May 20X6.

A. $265,200

B. $272,700

C. $280,575

D. $342,000

What does this test?

This question tests SLO D2(a) and IFRS 3 *Business Combinations*. Candidates needed to know that the share exchange is calculated based on only the group shareholding and not entire ordinary (equity) share capital of the subsidiary.

What is the correct answer?

The correct answer is **A**.

The consideration is calculated as follows:

Consideration
= (60% x 32,000 shares x 2/5 issue x $15) share exchange + ($157,500 ÷ 1.05^1) present value
= (7,680 shares x $15) + $150,000
= $115,200 + $150,000
= **$265,200**

Where did candidates go wrong?

Over half of candidates answered this question correctly. Most candidates who answered incorrectly, selected D.

Ignoring the 60% group shareholding incorrectly provides the following consideration:

- **Incorrect** consideration, taking 100% of shareholding (D)
  = (**100%** x 32,000 shares x 2/5 issue x $15) + ($157,500 ÷ 1.05^1)
  = $342,000

Remaining candidates answering incorrectly either failed to discount the deferred payment or did not know how to calculate present value:

- **Incorrect** consideration, **ignoring discounting** on the deferred payment (B)
  = (60% x 32,000 shares x 2/5 issue x $15) + **$157,500**
  = $272,700
- **Incorrect** consideration, **multiplying** cash payment by discount factor (C)
  = (60% x 32,000 shares x 2/5 issue x $15) + ($157,500 **x** 1.05^1)
  = $280,575 (C)

Question 4

Procker Co held 270 units of work in progress (WIP) within inventories at 31 May 20X3. To date, WIP has cost a total of $21,600. It is estimated that costs to complete are $19 per unit and that the finished goods would sell for $114 per unit.

Direct selling costs are estimated at $5 per unit.

In accordance with IAS 2 Inventories, what is the correct valuation of Procker Co's WIP at 31 May 20X3?

A. $21,600

B. $24,300

C. $26,730

D. $29,430

What does this test?

This question tests SLO B4(a) and IAS® 2 *Inventories*. Candidates needed to know that, in accordance with IAS 2, inventories shall be measured at the **lower** of **cost** and **net realisable value**.

However, there is an added complication in that we are addressing **work in progress** (WIP). When calculating WIP, it is important to note that ‘cost’ refers only to costs to date; that is, we are **not** valuing the total cost of finished goods and goods for resale.

Future costs are, therefore, considered only when calculating ‘net realisable value’ (NRV).

What is the correct answer?

The correct answer is **A**.

As we are given most information as an amount per unit, we first calculate cost per unit as **$80 per unit** ($21,600 ÷ 270 units).

With costs to complete, we must remember that the calculation of NRV takes account of **both** costs to sell and costs to complete. NRV is **$90 per unit** ($114 - $19 - $5) and so we have an expected profitable final product.

<u>**Cost is lower**</u> and, therefore, the total valuation is <u>**$21,600**</u>.

Where did candidates go wrong?

Less than half of candidates selected the correct answer. Approximately a quarter of candidates selected option B and the same was true for option C.

Those candidates had either used **NRV** or had **added** costs to complete to the costs to date:

- **Incorrect** selection of NRV
  = 270 units x $90 per unit
  = $24,300 (B)

- **Incorrect** addition of costs to complete to cost incurred to date
  = 270 units x ($80 **+** $19)
  = $26,730 (C)

A very low percentage of candidates selected the selling price less selling costs **only** (D):

- **Incorrect** subtraction of **only** selling costs
  = 270 units x ($114 - $5)
  = $29,430 (D)

Section B

Section B tests candidates' knowledge on several IFRS Accounting Standards in more depth than Section A, with three case questions worth 10 marks each. Each case contains five, two-mark objective test questions.

We have selected a case that examined IFRS 15

Candidates must **read the case scenario and its requirements carefully**. Each objective test question is worth two marks and so it is important that candidates do not misread or miss information in the scenario. **Close reading of the requirements** is also important to identify any specific instructions, **such as rounding**.

Scenario

Dunkz Co manufactures and sells 3D printers and related software. During the year ended 30 November 20X6, Dunkz Co expanded its operations into another territory. The currency in this new territory is the Bred (Bd). Both Dunkz Co's functional and presentation currency is the Dollar ($).

To fund the expansion, Dunkz Co issued the following financial instruments at their nominal value and did not incur any transaction costs:

Financial instrument	Date of issue	Nominal value
		$'000
4% convertible loan notes	1 December 20X5	5,500
7% redeemable preference shares	1 February 20X6	2,500

The interest on loan notes is payable on 30 November each year. Similar loan notes without conversion rights carry an interest rate of 9%. The loan notes must be redeemed on 30 November 20X8 by either a cash payment (at the nominal amount) or conversion into a fixed number of ordinary (equity) shares.

The redeemable preference shares are redeemable in five years at a premium and have an effective rate of interest of 10%. Payments are made on 31 January each year.

The following discount rates are presented:

Year	4%	9%
1	0.962	0.917
2	0.925	0.842
3	0.889	0.772

Question 1

Which of the following statements regarding how transactions in Bred (Bd) should be dealt with in Dunkz Co's financial statements are correct?

(1) Sales and purchases should be translated into dollars at the closing rate

(2) Closing trade receivables, trade payables, cash and cash equivalents should be translated into dollars at the spot rate at the date of the related transaction

A. 1 only

B. 2 only

C. Both 1 and 2

D. Neither 1 nor 2

What does this test?

This question tests SLO B12(a) and IAS 21 *The Effects of Changes in Foreign Exchange Rates*. Candidates needed to know which spot exchange rate was appropriate for income and expenditure and which was appropriate for balances.

What is the correct answer?

The correct answer is **D**.

Neither statement is correct. Income and expenditure must be translated either at the spot exchange rate on the date of each transaction or, if impracticable, at an average rate ‘for the period ended’ in the reporting date.

Balances must be translated at the spot exchange rate ‘as at’ the reporting date.

Where did candidates go wrong?

Most candidates answered this question correctly, however, half of those candidates who incorrectly answered this question selected statement 1 only (A).

Question 2

In accordance with IFRS 9 *Financial Instruments*, under which classification should the redeemable preference shares be subsequently measured?

A. Amortised cost

B. Fair value through profit or loss

C. Fair value through other comprehensive income

D. Historical cost

What does this test?
This question tests SLO B5(e) and IFRS 9. Candidates needed to know that a mandatory redemption creates a legal obligation and, therefore, makes the issue of redeemable preference shares a liability and not equity.

What is the correct answer?

The correct answer is **A**.

A preference share that provides for mandatory redemption by the issuer is a financial liability. With few exceptions, an entity shall classify all financial liabilities as subsequently measured at amortised cost.

Where did candidates go wrong?

Approximately half of the candidates selected the correct answer. Half of the candidates who selected the incorrect answer selected B.

Classification at fair value through profit or loss (B) may be appropriate for issued preference shares **without** redemption rights; however, the mandatory redemption by the issuer makes this a liability and a classification as amortised cost.

Neither fair value through other comprehensive income nor historical cost are appropriate classifications.

Question 3

What is the initial measurement of the equity element for the convertible loan notes (in $m, to two decimal places)?

A. $0.56m

B. $0.66m

C. $0.70m

D. $0.87m

What does this test?

This question tests SLO B5(f) and IFRS 9. Candidates needed to know how to calculate the debt element of a compound instrument to then calculate equity as a balancing amount.

What is the correct answer?

The correct answer is **C**.

The liability element for the convertible loan notes is calculated by discounting the cash flows to present value, using the rate of interest for similar loan notes without conversion rights. The equity element is the nominal amount less this liability:

- Nominal interest
  = 4% x $5.50m
  = $0.22m

- Liability
  = ($0.22m x 0.917) + ($0.22m x 0.842) + ([$5.50m + $0.22m] x 0.772)
  = $4.80m

- ∴ Equity
  = $5.50m proceeds - $4.80m liability
  = **$0.70m**

Where did candidates go wrong?

Most candidates answered this question correctly. Candidates who answered incorrectly selected mostly D and B:

- **<u>Year 3</u>** interest payment ignored (D)
  = (\$0.22m x 0.917) + (\$0.22m x 0.842) + (\$5.50m x 0.772)
  = \$4.63m

  ∴ Equity
  = \$5.50m - \$4.63m
  = \$0.87m

- **<u>Un</u>**discounted interest payments **<u>only</u>** (B)
  = 3 years x \$0.22m
  = \$0.66m

Few candidates selected A:

- Discounted interest payments **<u>only</u>** (A)
  = (\$0.22m x 0.917) + (\$0.22m x 0.842) + (\$0.22m x 0.772)
  = \$0.56m

Question 4

What amount should be recognised as finance costs in respect of the redeemable preference shares for the year ended 30 November 20X6 (in $m, to two decimal places)?

A. $0.15m

B. $0.18m

C. $0.21m

D. $0.25m

What does this test?
This question also tests SLO B5(f) and IFRS 9 but, in this instance, covers the calculation of finance costs. Candidates needed to recognise that the redeemable preference shares were issued two months into the year and, therefore, finance costs needed to be time apportioned.

What is the correct answer?
The correct answer is **C**.

Finance costs = 10/12 months x 10% x $2.5m = **<u>$0.21m</u>**

Where did candidates go wrong?

Less than half of candidates answered this question correctly and this was the least well-performed question within the case. Candidates answering incorrectly were equally spread across the remaining choices:

Incorrectly using the nominal rate (A)
= 10/12 months x 7% x $2.50m
= $0.15m

No time apportionment and incorrectly using nominal rate (B)
= 7% x $2.50m
= $0.18m

No time apportionment (D)
= 10% x $2.50m
= $0.25m

Question 5

You have been asked by your finance assistant how to account for transaction costs on any future issues of financial instruments, should they arise.

Which of the following statements is true regarding how transaction costs should be treated when they relate to financial liabilities classified as amortised cost?

A. Added to the fair value of the liability

B. Deducted from the fair value of the liability

C. Expensed into the statement of profit or loss

D. Presented in other comprehensive income

What does this test?

This question also tests syllabus learning outcome B5(f) and IFRS 9 but, in this instance, addresses the accounting treatment of transaction costs. Candidates needed to know how transaction costs are treated across different classifications of financial instrument.

What is the correct answer?

The correct answer is **B**.

Transactions costs on financial liabilities classified as amortised cost should be deducted from the proceeds received.

Where did candidates go wrong?

Less than half of candidates selected the correct answer. Approximately a quarter of candidates selected option A and the same was true for option D.

Section C

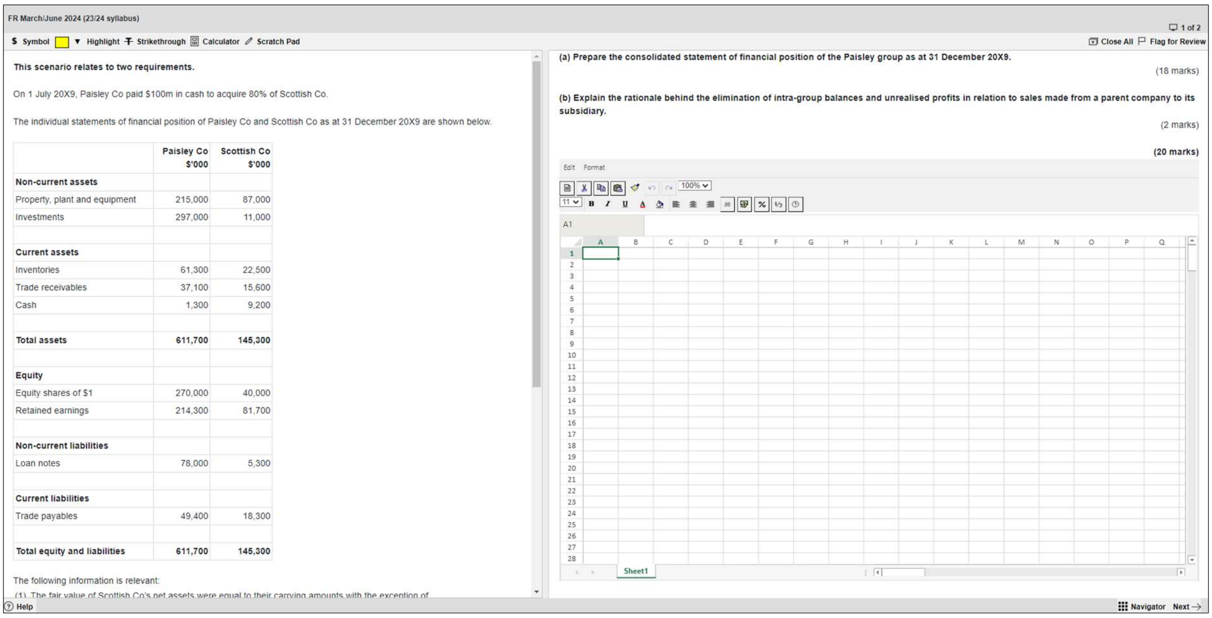
We have selected two constructed response questions, Rey Co and Paisley Co, that are available on the ACCA Practice Platform.

Rey Co is a financial statements analysis and interpretation question for an individual entity. This tests mainly syllabus learning outcomes C2(a) and C2(c) but, also, B9(e) for the calculation of earnings per share.

Paisley Co is a consolidated financial statements preparation question. This tests syllabus learning outcome D2(a).

When using the following detailed commentary, it would be helpful to consult the questions and answers available to you here. The scenario is not re-produced in this report.

Rey Co



FR March/June 2024 (23/24 syllabus)

This scenario relates to two requirements.

On 1 July 20X9, Paisley Co paid $100m in cash to acquire 80% of Scottish Co.

The individual statements of financial position of Paisley Co and Scottish Co as at 31 December 20X9 are shown below.

	Paisley Co $'000	Scottish Co $'000
Non-current assets		
Property, plant and equipment	215,000	87,000
Investments	297,000	11,000
Current assets		
Inventories	61,300	22,500
Trade receivables	37,100	15,600
Cash	1,300	9,200
Total assets	**611,700**	**145,300**
Equity		
Equity shares of $1	270,000	40,000
Retained earnings	214,300	81,700
Non-current liabilities		
Loan notes	78,000	5,300
Current liabilities		
Trade payables	49,400	18,300
Total equity and liabilities	**611,700**	**145,300**

The following information is relevant:

(a) Prepare the consolidated statement of financial position of the Paisley group as at 31 December 20X9.

(18 marks)

(b) Explain the rationale behind the elimination of intra-group balances and unrealised profits in relation to sales made from a parent company to its subsidiary.

(2 marks)

(20 marks)

Rey Co required candidates to demonstrate and apply knowledge from the ‘analysing and interpreting financial statements’ area of the syllabus (section C). The question had both numerical information and additional information relating the entity. Candidates were asked to complete several tasks using this information.

The first task was, in fact, a calculation of earnings per share (section B) and so it is shown that different sections of the syllabus may be examined within an interpretations question.

The analysis and interpretation of an individual company is an important area of the syllabus and will continue to be examined. As in previous examination sessions, most candidates failed to score high marks on this question. The reason for this seemed to be poor exam technique:

- not addressing the requirement; or
- not adequately using the information in the scenario.

The focus for this detailed commentary, rather than simply recreating the suggested solution, will highlight the importance of using the scenario when constructing an answer to an interpretation question.

Rey Co contains three requirements.

Requirement (a) – 4 marks

Using the information in note (vi), calculate the basic earnings per share figure for Rey Co for the year ended 31 December 20X9 and the restated earnings per share figure for 20X8. (4 marks)

This requirement tests syllabus learning outcome B9(e) and required candidates to calculate basic earnings per share (EPS). Some candidates did not provide a response to requirement (a) and for many that did, there appeared to be confusion over the share issues that had taken place in the year.

In its simplest form, basic EPS is calculated by dividing profit for the year (earnings) by ordinary share capital (weighted average number of shares). Many candidates applied this calculation using the profit for the year provided in note (iv) and the 40 million ordinary shares in the statement of financial position. This was incorrect but some credit was awarded for using the correct profit for the year. The marking team noted that many candidates incorrectly used the operating profit figure that was provided in the statement of profit or loss extract.

The challenge with this question was recognising that Rey Co had two separate share issues during 20X9 and how these should be dealt with in the EPS calculation:

- The first issue of shares, on 1 March 20X9, raised cash for Rey Co as the shares were sold at market price. When there is a full market (or a rights issue) of shares, candidates are required to calculate a weighted average number of shares, reflecting the portion of profit for the year that was attributable to the opening share capital and the proportion that relates to the closing share capital.

- The issue of bonus shares, on 1 September 20X9, raised **no additional funds** for Rey Co as free shares were issued to existing shareholders in the proportion of one-for-three. As this type of issue contributes no additional resource, it is deemed that the issue of bonus shares had been there from the beginning of the financial period.

  In most questions, where the issue of bonus shares is the only share issue in the year, candidates would simply add the issued shares to the opening share capital when calculating EPS. However, in this question the issue of bonus shares occurred **after the issue at market value** and, therefore, to calculate the weighted average number of shares we require both the opening 20 million shares and the 30 million shares (following the full market issue) to be adjusted by the bonus fraction. This is to show the effect that an issue of bonus shares has on EPS.

This is calculated as follows:

	No. of shares	Bonus fraction	Fraction of year	Average
1 Jan X9	20 million	4/3	2/12	4.44 million
1 March X9	30 million	4/3	6/12	20 million
1 Sep X9	40 million		4/12	13.33 million
				37.77 million

Requirement (b) – 5 marks

Calculate the following ratios for Rey Co for the years ended 31 December 20X8 and 20X9:

- **Gross profit margin;**
- **Operating profit margin;**
- **Return on capital employed (excluding deferred income);**
- **Current ratio (excluding deferred income); and**
- **Trade receivables collection period.**

(5 marks)

This requirement tests syllabus learning outcome C2(a) and was generally well answered, with many candidates scoring full marks. Correct ratios attract marks in full even without a working being provided. For example, a candidate that shows gross profit margins for 20X9 and 20X8 of 70.5% and 61.1% will earn 1 mark. A different candidate may present gross profit margins as 70.5% and 60.3%. This would only attract half a mark as the 20X8 figure is incorrect. It may be that the candidate transposed a figure when calculating the margin in 20X8 by using $38,750 ÷ $64,300. If the candidate had shown the working, the marking team would be able to see that it was a simple transposition error and the full 1 mark would be awarded. To avoid marks being lost, the examining team encourage candidates to show all workings and to use any pre-formatted responses provided.

The examining team continue to stress the importance of showing workings for all calculations.

Candidates were not required to adjust the financial statements before calculating the ratios. However, several candidates incorrectly adjusted amounts such as cost of sales and share capital and this resulted in incorrect ratios. It is important that the scenario and requirements are read carefully. If adjustments are required to financial statements prior to the calculation of ratios, candidates will specifically be asked to do this.

Some errors were made when calculating return on capital employed and the current ratio. **The requirement specifically asked for deferred income to be excluded from the calculations.** While many candidates followed the instruction, there were others that ignored this or instances where mistakes in the calculation occurred.

Requirement (c) – 11 marks

> **Comment on the performance and position of Rey Co for the years ended 31 December 20X9 and 20X8.**
>
> (11 marks)

This requirement tests syllabus learning outcome C2(c) and candidates were required to analyse the performance of Rey Co in 20X9 compared to the prior period, using both the financial statements and the information given in the scenario.

This style of question features in every FR exam and so it continues to be surprising that many candidates either do not provide any analysis or provide an analysis that is extremely brief.

Candidates must be prepared for this style of question.

The examining team recommend that candidates structure their analysis using headings that address the question requirement. In this question, there should be a separate heading for both performance and position. Candidates should be confident in the ratios that fall into each category. In Rey Co, gross profit margin, operating profit margin and return on capital employed will be discussed under ‘performance’ and current ratio and trade receivables collection period will be discussed under ‘position’.

The marking team noted that many candidates continue to copy the scenario from the question directly into the response field and do not attempt to develop this. While the examining team encourage candidates to use the information in the scenario to shape their appraisal, **copying directly from the scenario will not be awarded marks and should be avoided.**

As in previous exam sessions, many candidates included generic comments in their analysis which did not link to the case. For example, many candidates, when appraising the current ratio, simply stated that the ideal current ratio is 2:1. Others then supplemented this by claiming that as Rey Co’s current ratio is far higher than 2:1, they must be doing well. **Both comments are generic and will not be awarded marks.**

There was a large amount of information included in the case for Rey Co that would enable a strong analysis to be prepared, for example:

- The impact of the departure of a director at the beginning of the year which increased direct competition and forced Rey Co to reduce prices by 5% and how this may impact both profit margins and cash flow.

- The impact the competitor adverts would potentially have on sales and the compensation of $4m which would increase both cash and profit (but is expected to be a one-off cash inflow).

- The government grant has had a positive impact on both cash flow and profit during the year. However, staff numbers have been reduced and so consideration of the impact of grant repayment should be explored.

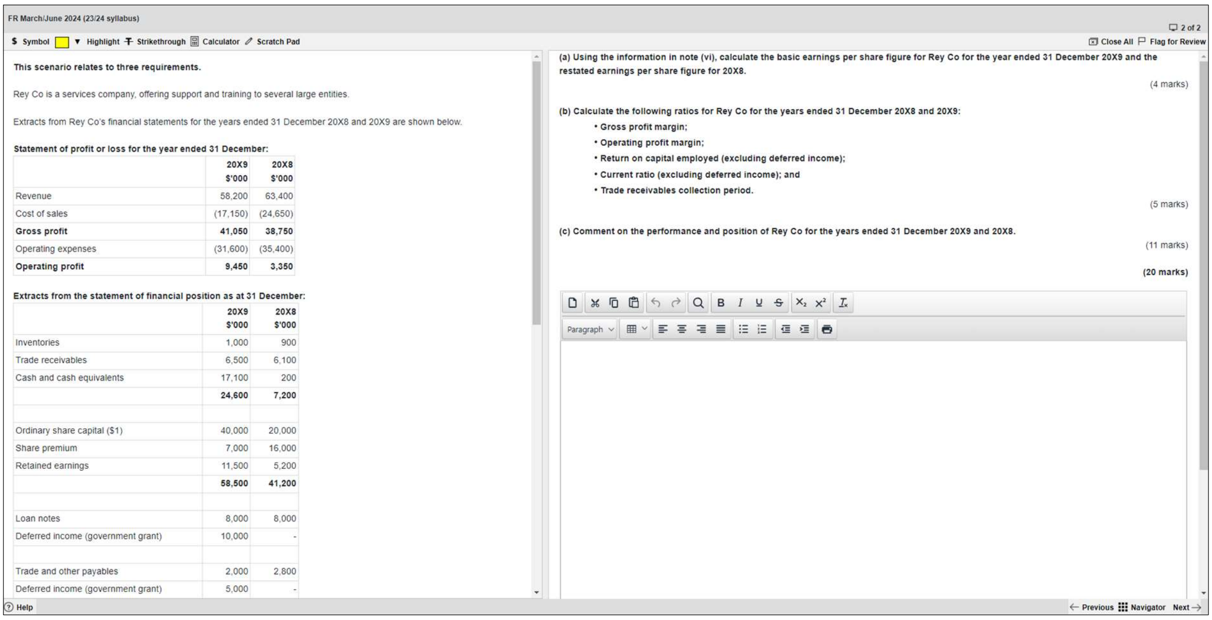
- The loan notes are not due for immediate repayment, however, the interest rate had been renegotiated in the year. The scenario indicates that the loan interest rate had increased as the bank is concerned about Rey Co's cash flow. The impact that this would have both in the current and future years should be considered.

- The share issue on the 1 March 20X9 also helped with the cash flow of Rey Co, this was after the bank loan interest rate was renegotiated and may confirm the banks concerns relating to cash flow. The two share issues would increase capital employed and candidates could explore the impact on return on capital employed.

A good answer will use these key points from the scenario to provide a plausible rationale for any changes in performance and position in the year. Candidates should also be mindful to consider the underlying performance where some transactions are deemed to be 'one-off'. For example, what would the cash position of Rey Co be if there was not a government grant or no share issue during the year.

Candidates should note that all appraisal questions should include a final heading for a 'conclusion' or 'recommendation' with a short, suitable conclusion/ recommendation. In the case of Rey Co, it is worth considering their overall performance/ position during the year with a particular emphasis on cash flow following the renegotiation of the bank interest rate.

Paisley Co


FR March/June 2024 (23/24 syllabus)

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This scenario relates to three requirements.

Rey Co is a services company, offering support and training to several large entities.

Extracts from Rey Co's financial statements for the years ended 31 December 20X8 and 20X9 are shown below.

Statement of profit or loss for the year ended 31 December:

	20X9 $'000	20X8 $'000
Revenue	58,200	63,400
Cost of sales	(17,150)	(24,650)
Gross profit	**41,050**	**38,750**
Operating expenses	(31,600)	(35,400)
Operating profit	**9,450**	**3,350**

Extracts from the statement of financial position as at 31 December:

	20X9 $'000	20X8 $'000
Inventories	1,000	900
Trade receivables	6,500	6,100
Cash and cash equivalents	17,100	200
	24,600	**7,200**
Ordinary share capital ($1)	40,000	20,000
Share premium	7,000	16,000
Retained earnings	11,500	5,200
	58,500	**41,200**
Loan notes	8,000	8,000
Deferred income (government grant)	10,000	-
Trade and other payables	2,000	2,800
Deferred income (government grant)	5,000	-

(a) Using the information in note (vi), calculate the basic earnings per share figure for Rey Co for the year ended 31 December 20X9 and the restated earnings per share figure for 20X8.

(4 marks)

(b) Calculate the following ratios for Rey Co for the years ended 31 December 20X8 and 20X9:

- **Gross profit margin;**
- **Operating profit margin;**
- **Return on capital employed (excluding deferred income);**
- **Current ratio (excluding deferred income); and**
- **Trade receivables collection period.**

(5 marks)

(c) Comment on the performance and position of Rey Co for the years ended 31 December 20X9 and 20X8.

(11 marks)

(20 marks)

Paragraph

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This question is worth 20 marks in total and candidates are encouraged to spend approximately 36 minutes in the exam to answer the question (180 minutes ÷ 100 marks = 1.8 minutes per mark; 20 marks x 1.8 minutes = 36 minutes).

The examining team suggest that this is further broken down into the component parts of the question. For example, requirement (a) is worth 18 marks and candidates would spend approximately 30 minutes on this part of the question. Part (b) is worth only two marks, but candidates must ensure that they address all requirements and approximately 3-4 minutes could be spent here.

In the numerical style questions, it is vital that you present your workings clearly for the marking team. Workings can either be shown separately or can be included within a cell in the response area (spreadsheet). Some candidates use the calculator tool instead of the spreadsheet functionality and do not provide workings. When this happens, candidates will score full marks for a correct answer but, if the answer is incorrect and in the absence of a relevant working, no marks will be awarded. The marking team always award credit for 'own figure' marks but this is only feasible with accompanying workings.

Paisley Co is a typical example of a financial statements preparation question – covering syllabus areas D. Additional information is presented that will require adjustment in accordance with relevant IFRS Accounting Standards and accounting principles.

The requirements of the question will vary; however, you can expect to be asked to prepare one or more of the following:

- statement of profit or loss (SPL);
- statement of profit or loss and other comprehensive income (SPLOCI);
- schedule of adjusted profit;

- statement of financial position (SFP);
- statement of changes in equity (SCE); and/or
- extracts from statement of cash flows (SCF).

Paisley Co contains two requirements.

Requirement (a) – 18 marks

> **Prepare the consolidated statement of financial position of the Paisley group as at 31 December 20X9.**
>
> (18 marks)

This part of the question was generally well answered. When asked to prepare a consolidated statement of financial position (SFP), the examining team recommend that candidates set up the pro forma for the consolidation immediately. Once the pro forma has been set up, candidates should include the results of the parent and subsidiary for assets and liabilities and the share capital of the parent only.

This can either be done as a separate working on the worksheet or by using the functionality of the spreadsheet, such as:

C4 =(215000 + 87000)

	A	B	C
1	**CSFP for Paisley Group as at 31 December 20X9**		
2			
3	**Non-current assets**		
4	Property, plant & equipment (215,000 + 87,000		302000
5	Investments (297,000 + 11,000		
6	**Investment in associate (W)**		100,200
7			
8			
9	**Current assets**		
10	Inventories (61,300 + 22,500		
11	Trade receivables (37,100 + 15,600		
12	Cash (1,300 + 9,200		
13			
14			
15			
16	**Equity**		
17	Equity shares of $1 (40,000		
18	Group retained earnings (W)		
19	NCI (W)		
20			
21			
22	**Non-current liabilities**		
23	Loan notes (78,000 + 5,300		
24			
25			
26	**Current liabilities**		
27	Trade payables (49,400 + 18,300		

The above example leaves lines between each category so that there is space to include balances that are not currently in the single entities' financial statements. For example, in a consolidated SFP, 'Goodwill' or an 'Investment in associate' may be required. Leaving blank rows makes it easier to include these amounts as and when candidates are ready to calculate them:

1	**CSFP for Paisley Group as at 31 December 20X9**		
2			
3	**Non-current assets**		
4	Property, plant & equipment (215,000 + 87,000		302000
5	Investments (297,000 + 11,000		
6	**Investment in associate (W)**		100,200
7			
8			
9	**Current assets**		
10	Inventories (61,300 + 22,500		

The marking team noted that an increasing number of candidates adjusted the subsidiary's assets and liabilities incorrectly. These errors included time-apportioning the subsidiary's balances for six months, multiplying the results by the 80% group share and, in some instances, adjusting for both.

Candidates should note that a SFP is 'as at' the period-end date and so is **at a point in time;** therefore, **balances should never be time apportioned.**

Also, to multiply the subsidiary results by the group share **is a fundamental error.** This technique should **never** be applied to a subsidiary's results.

The consolidation adjustments, including the fair value adjustment of the head office and the intragroup balance, were generally dealt with well. Some candidates did not time-apportion fair value depreciation and some did not adjust property, plant and equipment. It was pleasing to see that the intragroup receivable and payable were adjusted for but some errors were made relating to the cash in transit. This is a common adjustment and candidates are advised to revise assets in transit.

Goodwill in this question was relatively non-complex and the marking team noted that this was calculated correctly by most candidates. However, many candidates did not recognise that a 'gain on bargain purchase' should be recorded as an increase in profit and, therefore, in group retained earnings (not non-current assets). When goodwill was not calculated correctly, this was generally due to the loss that was made in the year. Candidates needed to recognise that a proportion of this loss (six months) was incurred before acquisition and the remainder was a post-acquisition loss.

Using note (2), to purchase the 40% share of Angus Co, Paisley Co paid an immediate cash amount of $30m and issued 30 million shares. Many candidates calculated the value of the share issue ($69m) correctly but did not record the entries to share capital and share premium within the consolidated SFP.

Some candidates attempted to adjust for the share issue but often adjusted share capital only. When a share exchange takes place, the nominal value of the share issue should be added to share capital and the remaining amount recognised as share premium.

	A	B	C	D	E
1		$'000			
2	Share issue - 30 million shares x $2.30	69,000	To investment in associate		
3					
4	Share capital - 30 million shares x $1	30,000	To share capital		
5	Share premium - balance	39,000	To share premium		
6					
7					
8					

Note (4) in the question required candidates to apply IFRS 9 to other investments in equity instruments. The value of the investments had increased year-on-year. This gain was generally added onto investments correctly but many candidates included the full gain in the group retained earnings and did not consider part of the gain attributable to non-controlling interests.

Requirement (b) – 2 marks

Explain the rationale behind the elimination of intragroup balances and unrealised profits in relation to sales made from a parent company to its subsidiary. (2 marks)

Many candidates did not attempt this part of the question. This could possibly be due to poor time management.

This part of the question required candidates to **explain** why both intragroup balances and unrealised profit were to be eliminated. Some candidates did not think about the verb in the question requirement and, instead, simply repeated the numbers or produced journal entries that had already been completed in requirement (a).

Candidates are encouraged to read the question carefully and answer what is required.