Examiner's report

F3/FFA Financial Accounting

For CBE and Paper exams covering January to June 2013

General Comments

Candidates continue, as in past exams, to perform well in those syllabus areas which are brought forward from FA1 and FA2 and built upon at this level. It is also pleasing to see candidates demonstrating a solid understanding of the *Framework for the Preparation and Presentation of Financial Statements*, as performance on these questions is particularly good. The other questions with the highest pass rates on this paper included:

- Processing of ledger accounts
- Bank reconciliations
- Correction journals
- Calculation of ratios

There has been some improvement in June 2013 on questions testing preparation of simple consolidated financial statements, with particularly good performance on questions involving the calculation of the provision for unrealised profit. Candidates still appear more fluent in questions testing the consolidated statement of financial position, with the consolidated income statement questions still proving to be more of a problem.

Questions with the lowest pass rates included:

- Calculation of consolidated income statement extracts
- Calculation of opening capital
- Accounting for redeemable preference shares
- Accounting effects of a revaluation of a non-current asset

The following examples were three questions with the lowest pass rates on the paper. The aim of reviewing these questions is to give future candidates an indication of the types of questions asked and guidance on dealing with exam questions, as well as a technical debrief on the topics covered by the specific questions selected.

Sample Questions for Discussion

Example 1

Bob used the following balances to prepare his final accounts as at 30 April 2013.

	$	$
Receivables	6,000	
Bank loan		3,000
Bank overdraft		2,500
Drawings	4,100	
Capital		12,500
Revenue		22,000
Purchases	19,200	
Rent	5,400	
Bank interest	825	
Heat and light	4,475	
	40,000	40,000

The business does not hold inventory. No further adjustments were required.

What is Bobs' opening capital figure as at 1 May 2013?

A $12,500
B $ 8,400
C $16,300
D $ 500

The correct answer is D but a significant number of candidates did not select this even though this topic is also covered in the earlier FA exams. The most popular incorrect answer was A, closely followed by B.

To calculate the opening capital for the next period, the candidate must apply their knowledge of the accounting equation and realise that:
Capital (the figure per the trial balance) plus Profit/less Loss less Drawings= Closing capital, which therefore becomes the opening capital for 1 May 2013.

Candidates needed to use the trial balance to calculate the profit/loss for the year as follows:

Revenue	$22,000
Purchases	($19,200) (note: the question confirms the business does not hold inventory)
Rent	($ 5,400)
Bank interest	($ 825)
Heat and light	($ 4,475)
LOSS for the year	($ 7,900)

Therefore closing capital/opening capital for the next accounting period 1 May 2013 =
$12,500 - $7,900 - $4,100= $500, answer D.

Many candidates had just taken the figure from the trial balance and assumed this would be opening capital 1 May 2013, rather than understanding that the trial balance would show the opening capital balance brought forward at the start of the current year (1 May 2012). Those candidates who had also incorrectly chosen B, had only taken the capital figure from the trial balance and deducted drawings of $4,100, again ignoring the calculation of the profit and loss items that needed to be taken into account.

Example 2

Which TWO items within the statement of financial position would change immediately following an issue of redeemable preference shares?

(1) Cash

(2) Retained earnings

(3) Finance cost

(4) Equity

(5) Long-term debt

A 1 and 5
B 1 and 4
C 2 and 4
D 3 and 5

This topic is not as frequently tested as some of the other areas, but is still part of the syllabus requirements under D10 a)ii) which is an understanding of the capital structure of a limited liability company including, ordinary shares, preference shares (redeemable and irredeemable) and loans.

The correct answer to this question is A, with the most popular incorrect answer being C.

On issue of redeemable preference shares, the two items effected would be cash, as money is coming in from the issue of shares and secondly, long-term debt. This is because, although legally they are shares, in substance redeemable preference shares are more like debt (as they have fixed return and are repayable/redeemable at a future point).

Example 3

Panther Co acquired 80% of the equity shares in Seal Co on 31 August 2012.

The income statements of Panther Co and Seal Co for the year ended 31 December 2012 showed:

	Panther Co	Seal Co
	$	$
Revenue	100,000	62,000
Cost of sales	25,000	16,000

During October 2012, sales of $6,000 were made by Panther Co to Seal Co. None of these items remained in inventory at the year-end.

What is the consolidated revenue for Panther Group for the year ended 31 December 2012?

A $156,000
B $118,667
C $144,800
D $114,667

The correct answer is D, with the most popular incorrect answer being A. The correct approach to the question and common errors are discussed below.

When answering questions on the preparation of consolidated financial statements, there are two important facts to establish quickly:

1) What is the size of the holding acquired?
2) What is the date of acquisition?

Panther Co has acquired 80% of the equity shares in Seal Co, and therefore has a controlling interest as it has acquired >50% of the equity shares. This means that Seal Co will be consolidated as a subsidiary, on a 100% line by line basis to reflect control.

However the interest in Seal Co was acquired on 31 August 2012, which means that during the year ended 31 December 2012, Seal Co had only been a subsidiary for 4 months of the year, therefore only the *post acquisition* results of the subsidiary should be consolidated.

Intra-group sales should also be eliminated, and as all these were made in October, they are all in the post-acquisition period and hence need eliminating.

This means the consolidated revenue for Panther Group would be calculated as:
$100,000 + (4/12 x $62,000) - $6,000 = $114,667 – correct answer D.

It is interesting to note that by A being the most popular incorrect answer, candidates had correctly eliminated all of the intra-group sales but omitted to deal with the mid-year acquisition and incorrectly consolidated all of Seal Co's revenue of $62,000.

Conclusion

The continued advice for the preparation for this is exam, is for candidates not to try and rote learn syllabus/subject areas. Question practise of objective test questions and longer questions to test their understanding are vital in helping candidates to learn and understand topics and to enable them to apply their knowledge to any questions presented to them.