Examiner's report

F3/FFA Financial Accounting

For CBE and Paper exams covering July to December 2013

General Comments

In the December 2013 exam, candidates continued to improve and demonstrate a good understanding of simple consolidated financial statements and interpretation questions.
The other questions with the highest pass rates on this paper included:

- Processing of ledger accounts
- Bank reconciliations
- Questions on the *Framework*

Unusually, candidates appeared to struggle with some of the areas in the syllabus which are brought forward from FA1 and FA2 and built upon at this level.

Questions with the lowest pass rates included:

- Accounting for discounts
- Calculation and accounting for sales tax
- Accounting for shares, particularly rights issues
- Calculation of goodwill

The following examples were three questions where many candidates lost marks. 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

The following transactions took place during Alan's first month of trading:
(1) Credit sales of $121,000 exclusive of sales tax
(2) Credit purchases of $157,110 inclusive of sales tax
(3) Cash payments to credit suppliers of $82,710 inclusive of sales tax

Sales tax is 20%.

What is the balance on Alan's sales tax control account at the end of his first month of trading?
A $1,985DR
B $1,985CR
C $15,770DR
D $15,770CR

The correct answer is A however a significant number of candidates incorrectly answered C.

This question tests a candidates' knowledge on sales tax and preparing a sale tax control account.

Candidates need to read the questions carefully to determine if the figures are inclusive or exclusive of sales tax. It also involves realising that the cash payments to suppliers would not have any sales tax accounted for at that point in time. Sales tax is accounted for (i.e. analysed out in the daybooks) when the transaction first takes place.

In this case, the sales tax will have been recorded when the credit purchase is first recorded in the purchase day book. To then account for the sales tax at the time the cash is paid to the supplier, would result in double counting.

Therefore, the balance on the sales tax account is calculated as:

Credit sales ($121,000/100 x 20)	= $24,200
Credit purchases ($157,110/120 x 20)	= ($26,185)
	($1,985)

Therefore, the correct answer is A. The sales tax on the credit purchases (input tax) exceeds the sales tax on sales (output tax), the balance on the account represents an amount due to Alan, therefore is an asset, a debit.

In error, many candidates had chosen C, which incorrectly deducts the further sales tax on the cash payments to credit suppliers (($1,985)- ($82,710/120 x 20=$13,785)=$15,770).

Example 2

Honey Co acquired 75% of Bee Co on 1 April 2013, paying $2 for each ordinary share acquired. The fair value of the non-controlling interest at 1 April 2013 was $300. Bee Co's individual financial statements as at 30 September 2013 included:

	$
Statement of financial position	
Ordinary share capital ($1 each)	1,000
Retained earnings	710
	1,710
Income statement	
Profit after tax for the year	250

Profit accrued evenly throughout the year.

What is the goodwill on acquisition on 1 April 2013?

A $715

B $90

C $517

D $215

This topic is frequently tested. The correct answer is D, with the most popular incorrect answer being B. The correct approach to the question and common errors are discussed below.

When calculating goodwill on acquisition, it is important to determine:

1.) The date of the acquisition (this is the date that control was gained, i.e. 1 April, not the year end date of 30September)
2.) Consideration transferred to gain control
3.) The fair value of the non-controlling interest (given in the question as $300)
4.) The fair value of the net assets at the **acquisition date** (1 April 2013)

The question tells us that Honey Co acquired a 75% holding by paying $2 per share. In Bee Co's individual financial statement extracts, share capital is shown as 1,000 $1 ordinary shares.

Therefore consideration transferred is:
(75% x 1000) x $2 = $1,500

The next tricky part to the question involves calculating the fair value of Bee Co's net assets at acquisition. Although there are no fair value adjustments to the assets, the financial statement extracts are given at the year end date of 30 September 2013. Therefore, the net assets at the acquisition date (1 April 2013) must be calculated by deducting the amount of retained earnings that was earned in the 6 months since the acquisition:

	$
Ordinary share capital	1,000
Retained earnings ($710- (6/12 x $250)	585
	1,585

Therefore, Goodwill is calculated as:

	$
Consideration transferred	1,500
FV of NCI	300
	1,800
Less FV of NA at acquisition	(1,585)
Goodwill	215

Therefore the correct answer is D. The most popular incorrect answer was B, which calculated goodwill using incorrectly the net assets at 30 September. ($1,500+$300 -$1,710=$90)

Example 3

Which of the following statements is/are correct in relation to a rights issue made by a company?

(1) A rights issue capitalises the company's reserves, which can be a disadvantage, as this can reduce the amount of reserves available for future dividends
(2) A rights issue is offered to the company's existing shareholders and is usually at a discounted price compared to the nominal value of a share

	Statement 1	Statement 2
A	Correct	Correct
B	Correct	Incorrect
C	Incorrect	Correct
D	Incorrect	Incorrect

The correct answer is D, with answer C being the most popular incorrect option. This question required candidates to understand a rights issue rather than just preparing journals which has also been tested in the past.
Statement 1 is actually describing a bonus issue and is therefore incorrect. A rights issue does not 'capitalise company reserves', as a rights issue still brings in extra cash resources, but just at a discounted amount.

Statement 2 then goes on to test this point, as a candidate needs to appreciate that a rights issue is being offered to existing shareholders and does bring in cash but at a discounted price compared to the **market** value of a share. As statement 2 refers to a discounted price compared to nominal value this is incorrect.

Therefore both statements are incorrect and it is answer D. Many candidates were confused by the discounted price and incorrectly answered C.

Conclusion

The continued advice for the preparation for this exam, is for candidates not to try and rote learn syllabus/subject areas and always to read the question carefully. Question practice of objective test questions and longer questions to test 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.
Also, although candidates clearly need a thorough understanding of the core areas of consolidation, preparation of financial statements and interpretation of accounts, they must also devote appropriate attention to other areas of previously acquired knowledge, such as sales tax, discounts and accounting journals, during their studies and exam preparation time.