



Examiner's report

FA/FFA Financial Accounting

Based on exams from January to June 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 examination was divided into two parts, both of which were compulsory. Section A consisted of 35 objective test (OT) questions (two marks each) and covers a broad range of syllabus topics. The OT questions can take the form of multiple choice, multiple response, number entry or multiple response matching. Students should ensure they use the practice tests available on the ACCA website so they are familiar with all the different styles of OT questions. You are not asked to insert text but may be asked to identify the correct text.

Section B consisted of two multi-task questions (15 marks each) testing the candidates' understanding and application of financial accounting skills in more depth.

The following paragraphs report on each section of the examination and use some illustrative examples to demonstrate the type of questions candidates are expected to be able to answer.

Comments about Section A performance

Many candidates achieved reasonable marks in Section A, suggesting that the majority of the candidates had prepared well for the examination. Since Section A is objective-test based, there were no issues or problems associated with examination technique.

This section tests a wide range of the syllabus and the majority of candidates usually attempt all of the questions. Candidates are therefore advised to have a thorough knowledge of the entire syllabus and to practice objective test (OT) questions. It is important to read the questions carefully and calculate any figures required before choosing or entering a response.

This section of the report discusses six questions from Section A with which candidates experienced difficulties. Carefully review how each of the correct answers are derived.

Example 1 – Number entry

A business prepared draft financial statements for the year ended 31 December 20X7, which showed a profit for the year of \$240,000. Subsequent investigation of the underlying records found the following errors and omissions:

- (1) An annual insurance premium of \$12,000 payable in advance and due on 1 January 20X7, had been paid on that date but the transaction had been completely omitted from the books
- (2) Rent receivable of \$50,000, which is receivable annually in advance and due on 1 July 20X7, had been received on that date and had been credited in full to the current year's statement of profit or loss

What would be the revised figure for profit following the corrections of the above errors and omissions?

\$

This question required candidates to use the information provided to arrive at an adjusted profit figure. The most common reason for an incorrect answer in this question was due to the adjustment being incorrectly added. For adjustments to profit style questions it is worth remembering that debit entries reduce profit in the profit or loss whereas credit entries increase profit. To answer this question candidates needed to review the information carefully and consider the impact on profit. This is explained below.

Note (1) indicates that an error of omission has occurred. The transaction has not been recorded and will therefore require adjustment in the financial statements, for example:

		\$
Dr	Insurance expense (P/L)	12,000
Cr	Cash (SFP)	12,000

Accruals and prepayments do not need to be considered for this adjustment as the insurance premium is in line with the financial year. Therefore an expense of \$12,000 should be recorded. This will result in a reduction in profit.

Note (2) required candidates to use their knowledge of prepaid income (sometimes known as deferred income). On 1 July 20X7 the cash received would have been recorded as follows:

		\$
Dr	Bank	50,000
Cr	Other income (P/L)	50,000

Six months of the rental income received relates to the next accounting period and therefore needs to be removed from the current year's profit or loss as follows:

		\$
Dr	Other income (P/L)	25,000
Cr	Prepaid income (SFP)	25,000

Again, this adjustment will result in a reduction in profit.

The closing profit should therefore be:

	\$
Draft profit	240,000
Insurance receipt	(12,000)
Prepaid rental income	(25,000)
	<u>203,000</u>

Example 2 – Multiple response

Assuming that each of the following occur after the year end but before the financial statements are authorised for issue, which TWO must be disclosed according to IAS 10 Events After the Reporting Period?

1. A significant share issue
2. The announcement of a major restructuring
3. The discovery of an error in the financial statements which is not

material

4. A significant decline in trading after the reporting date, although the going concern assumption is still appropriate

It is important to note that this question required the selection of TWO correct responses. The question was worth 2 marks and each correct response was worth 1 mark. Per IAS 10, there are two types of event after the reporting date – adjusting events and non-adjusting events. This question requires knowledge of non-adjusting events. Per IAS 10, non-adjusting events are events after the reporting period that are indicative of conditions that arose after the end of the reporting period. These events should be disclosed if they are of such importance that non-disclosure would affect the ability of users to make proper evaluations and decisions.

The correct options were **1** and **2** as both of these events arose after the reporting date and would be significant to the users of the financial statements. Option **3** would be an adjusting event as the conditions existed at the reporting date. Option **4** is a non-adjusting event that does not require disclosure. In this question the decline in trading does not impact the going concern assumption, however if the going concern assumption was no longer valid IAS 10 would require a fundamental change in the basis of accounting.

Example 3 – Multiple choice

A business has a year end of 31 December 20X8. On 1 July 20X8 the business received a five-year bank loan of \$30,000 and is required to repay \$500 on the last day of each month. The first payment was made on 31 July 20X8 and the business has paid each monthly instalment on time.

How will the loan be reported in the statement of financial position at 31 December 20X8?

1. \$27,000 as a non-current liability
2. \$6,000 as a current liability and \$21,000 as a non-current liability
3. \$3,000 as a current liability and \$24,000 as a non-current liability
4. \$6,000 as a current liability and \$24,000 as a non-current liability

This was a typical multiple choice style question where candidates were required to select one from four options. The presentation of a liability in the statement of financial position was being tested. The business initially borrowed \$30,000 and had repaid \$3,000 between July and December (\$500 per month x 6 months) and therefore \$27,000 was outstanding by the reporting date. The business will repay \$6,000 in the next 12 months to the year ended 31 December 20X9 (\$500 per month x 12 months) and this therefore will be recorded as a current liability. The non-current liability will be reported as \$21,000 which is the difference between the outstanding balance of \$27,000 and the current liability of \$6,000.

The correct answer is therefore **2**.

Example 4 – number entry

Rackit had a receivables allowance of \$50,000 at 31 December 20X7. At 31 December 20X8 trade receivables totalled \$970,000. It has been decided to write off debts totalling \$20,000 and to adjust the allowance for receivables to 10% of trade receivables at 31 December 20X8.

What figure should appear for trade receivables in the statement of financial position as at 31 December 20X8?

This question is testing both irrecoverable debts and allowances for receivables. This continues to be an area of the syllabus where performance is mixed with many candidates not providing the correct response. This question required candidates to show the amount recorded for trade receivables on the statement of financial position. At the reporting date the total for trade receivables was \$970,000 but this will be subject to a write off of \$20,000. Trade receivables will now be recorded at \$950,000. However, there is a requirement to adjust the allowance for receivables to 10% of trade receivables at 31 December 20X8. The allowance will therefore be \$95,000 (\$950,000 x 10%). Trade receivables will be reported as follows on the statement of financial position:

	\$	\$
Adjusted trade receivables (\$970,000 – 20,000)	950,000	
Allowance for receivables	<u>(95,000)</u>	
		855,000

Therefore, the correct number entry is the net trade receivable of **\$855,000**.

Example 5 – number entry

Punit has identified the following reasons for his cash book balance of \$1,200 debit being different to the balance on his bank statement:

- (1) Uncleared lodgements of \$400
- (2) The bank has mistakenly recorded a direct debit payment of \$300 twice
- (3) Unpresented cheques of \$200

What is the balance on Punit's bank statement, prior to any of the above items being adjusted?

This is another example of a question that requires a number entry for the missing bank statement balance. The cash book balance of \$1,200 includes both the uncleared lodgements and the unpresented cheques but these balances have not yet cleared the bank and will need to be adjusted for in the reconciliation. The bank has also incorrectly recorded a direct debit twice and this will have only been recorded in the cash book once. The balance on the bank statement prior to the adjustments was \$700 and can be calculated by working from the cash book balance:

	\$
Balance per cash book	1,200
Uncleared lodgements	(400)
Bank error – direct debit	(300)
Unpresented cheques	200
Balance per bank statement	<u>700</u>

Therefore, the correct number entry is **\$700**.

Example 6

A business prepared a trial balance at the year end. The debit and credit totals did not agree and a suspense account was opened for the difference. Subsequent checking uncovered the following errors:

1. A credit purchase of \$500 had been entirely omitted from the books
2. A credit sale for \$200 had been debited to the sales account and credited to the sales ledger control account

3. The bank overdraft had been incorrectly recorded as \$5,100 in the trial balance rather than \$1,500

What was the original debit balance on the suspense account before the errors were discovered?

This question attracted a lot of incorrect entries. When thinking about errors, it is important to identify those that will have an impact on a suspense account as opposed to those that will not. A suspense account will be affected by unequal debit/credit entries. The information in (1) has been completely omitted from the books and therefore a double entry had not been recorded and so an adjustment to the suspense account was not required. For (2) an equal debit and credit has been made and therefore no adjustment was made in the suspense account (although the error would require adjustment in the financial statements, it is not relevant for the purpose of this question). Finally, in (3) the bank overdraft has incorrectly been recorded as \$5,100 on the trial balance. The impact of this is that credit balances are overstated by \$3,600 (\$5,100 – 1,500). This therefore would require a debit entry to be made in suspense of \$3,600 in order for the trial balance to agree.

Therefore, the original balance on the suspense account before discovery of the errors was **\$3,600**.

Comments about Section B performance

In this section candidates are required to provide answers which test their understanding and ability to draft financial statements. Candidates may be required to prepare financial statements for a single entity or for a group of companies. There may also be some element of ratio calculation/interpretation. You may not always be required to prepare the full financial statement and may instead be asked to complete a partial statement. In this situation there will be additional elements to the question.

Candidates will be required to prepare the financial statements using a variety of number entry, pull down menus and multiple response matching. It is vital that candidates familiarise themselves with the computer based exam format for section B using the specimen exam (and extra multi-task questions) and practice tests that are available via the ACCA website.

The following comments explain how candidates might be able to improve their performance in future when producing the different types of financial statement:

Single entity financial statements

It is advised that you become familiar with the presentation of the financial statements as per IAS 1 *Presentation of Financial Statements*. You will not be asked to insert text to construct a statement of profit or loss or statement of financial position but you may be required to determine the correct position of a ledger balance within the financial statements or maybe identify the correct titles of the financial statements. For example, a statement of profit or loss is 'for the year ended' and not 'as at' a point in time.

Always carefully read through the information in the question and answer what is being asked. For example, on the specimen paper, question 37, task 1 has the following question:

Do each of the following items belong on the statement of financial position (SFP) as at 31 October 20X7?

To answer this task you are given a trial balance and have the option of selecting Yes or No from a drop down list. Buildings at cost would require you to select yes, whereas Buildings accumulated depreciation at 1 November 20X6 would require you to select no as this is the opening accumulated depreciation and not the accumulated amount at 31 October 20X7.

Remember, not everything given in a trial balance will be needed and you will need to be familiar with the relevant double entries for transactions as this may be a specific requirement within the question. Typically you will need to calculate the depreciation on some of the assets, perhaps using two different depreciation methods.

This question style really focusses on your understanding of accounts preparation and the double entry system so numerous practice questions are essential.

Statement of Cash flows

You may be required to prepare a statement of cash flow using both number entry and drop down lists. It is important that you know the format of a statement of cash flow as you may be required to select appropriate headings. For each cash flow identified you may be required to identify if you need to 'add' or 'subtract' the amount calculated so ensure you have sufficiently prepared for this.

Below are some important areas of cash flow preparation to remember:

- Do not get the cash flows 'back to front' – make sure you identify movements between this year and last year correctly.
- Know how to calculate the tax and dividends paid during the year (dividends are not always given in the question).
- Be careful with the impact of a profit (or loss) on disposal. Profits/(losses) on disposal are non-cash and need to be adjusted in operating activities. The cash received on disposal should be shown as a cash inflow under investing activities and the carrying amount of the disposed asset must be removed from property, plant and equipment (generally, one asset disposal will have 3 effects in the statement of cash flow).

Consolidated financial statements

When preparing the consolidated financial statements you may also be required to identify the appropriate heading for the relevant financial statement from a drop down list. Just like the preparation of single entity financial statements, candidates may not be required to prepare the entire statement. In addition there may be aspects of this question that require you to demonstrate your knowledge of groups from the relevant International Financial Reporting Standards (IFRS), for example the definition of control.

If you are dealing with a consolidation you may be asked to calculate goodwill and then complete certain aspects of the statement of financial position or the statement of profit or loss. This may be in the form of calculating a relevant balance, or by selecting the appropriate formula from a drop down list that would enable a balance to be determined.

Below are some important areas of consolidation statement of financial position preparation to remember:

- The assets and the liabilities of the parent and the subsidiary are added together in full on a line-by-line basis (do not use proportional consolidation)
- The investment in the subsidiary (shown in the statement of financial position of the holding company) is replaced with the goodwill figure e.g. investments are nil (unless any other, external investments exist).
- The share capital and share premium balances are **not** added together; only the balances related to the parent are used in the consolidation.

- The group share of the subsidiary's profit is calculated and added to the groups retained earnings.

Below are some important areas of consolidation statement of profit or loss preparation to remember:

- The revenue and expenses are added together on a line by line basis in full (with the subsidiary results being time apportioned if control was acquired mid-year).
- Eliminate intra-group sales and purchases (usually through cost of sales)
- Eliminate unrealised profit held in closing inventory (in statement of financial position and as part of cost of sales) relating to intra-group trading
- Ensure you know how to calculate the profit attributable to the controlling and the non-controlling interests in the company.

Conclusion

It is imperative that candidates study and prepare well for all topics in the syllabus and not just select a few. Candidates must bear in mind that questions in the examination will include questions from all topics of the syllabus. Equipping themselves with adequate knowledge of all topics will certainly maximise and improve the performance of candidates in future examinations. Thus, candidates are advised to plan their revision timetable so that they have sufficient time to revise all the topics in the syllabus. Candidates are also reminded to try and attempt all questions.