INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Financial Accounting	**SESSION** Intermediate Examination - Spring 2014

General:

The overall result was average and almost the same as in the last attempt. The students performed poorly in question 5 which pertained to intangible assets and in question 7 which required preparation of statement of changes in equity. Both are frequently tested topics and a much better performance was expected.

The question-wise comments are as under:

Question 1

This question required the students to prepare a statement of financial position along with a note on contingencies and commitments in accordance with the requirements of Companies Ordinance 1984 and IFRS. The overall performance was below average. Despite the fact that these types of questions are a regular feature of almost every paper, it seems that the amount of effort that is put in by the candidates in this area is quite inadequate. A focused study of financial statements of some listed companies is strongly advised.

General mistakes noted were as follows:

- Cost of software and the previously charged depreciation were not excluded from PPE.

- Outstanding purchase orders for capital expenditure were not reflected in the note on commitments. Most of the students treated the amount as a liability.

- Sales return and cost of sales were not properly recalculated while arriving at Retained Earnings.

- Bifurcation of long term loan into current and non-current portions was missing in many cases.

- Goods sent on sale or return basis amounting to Rs. 26 million should have been recorded as sales because the last date for return of goods was December 30. Many candidates did not book the sale whereas many among those who booked it, ignored the corresponding debit side adjustment.

- While separating the computer software from property, plant and equipments, many students adjusted the cost of computer software instead of adjusting the WDV.

- In respect of contingency and commitments, significant number of students showed the amount only. Information in respect of nature of event, future expectation of the outcome of the event and the amount provided in the financial statements was not given.

Question 2

Most of the students were able to correctly deal with the given situations; however, most of the students did not fully explain the reasons and lost quite easy marks. Part wise comments are as under:

Question 2(a)

The performance in this part was good as large majority of students fulfilled the requirement of the question by properly explaining the term "Events after the reported date" and the difference between adjusting and non-adjusting events.

Question 2(b)

This part of the question consisted of five sub-parts in which different situations were given in respect of a super store and the candidates were required to explain the treatment thereof in the financial statements. The performance in each sub-part is discussed below:

Situation (i): Goods returned by customers after year-end.

Most of the students correctly mentioned it as an adjusting event but very few could properly explain what adjustment was required. Many students who correctly mentioned about reversal of sales and accounts receivables, ignored reduction in cost of sales and increase in inventory. Some students mentioned that provision should be made in respect of cost of removing the defect without realizing that the cost was recoverable from the manufacturer.

Situation (ii) Value of investments fell after year-end, on the announcement of trade policy.

Generally it was correctly adjudged as a non-adjusting event. However, a large number of students failed to mention that if the effect is considered material then it should be disclosed in the financial statements.

Situation (iii) A customer was declared bankrupt 10 days after the year-end.

Most of the students correctly answered this part with proper reasons.

Situation (iv): Price of a product (mobile phone) was reduced after year-end, on the introduction of a new type of mobile phone.

This part was also answered correctly by most of the candidates.

Situation (v): A guarantee had been issued against a loan obtained by the subsidiary. After year-end, the subsidiary's plant was destroyed and the subsidiary is unable to repay the loan.

A large number of students correctly mentioned the event as non-adjusting; however, most of them failed to mention that if the amount involved is material then it should be disclosed in the financial statements.

Question 3

This question was based on deferred taxation. Two situations were given and the candidates were required to pass accounting entries. The performance in each case is discussed below:

Question 3(a)

A plant purchased in January 2013 had been revalued in December 2013. Tax WDVs at 31st December 2012 and 2013 were provided in the question. The common errors were as follows:

- Entry to transfer accumulated depreciation, at the time of revaluation, was missing in many answers.

- Not knowing what to do in respect of revaluation, many students ignored it altogether.

Question 3(b)

A plant installed at the start of year had been sold and leased back immediately after the installation. The lease period was 9 years whereas the estimated useful life of the plant was 10 years.

It was answered in an average manner. Many students wasted time in discussing about the type of lease and preparing lease payment schedule which was not required. Many students worked out depreciation expense on lease period of 9 years instead of estimated useful life of 10 years. A significant number of students made various types of conceptual errors in the calculation of deferred tax.

Question 4

This was a simple question on conversion of a partnership into a company after separation of one partner. Requirements included preparation of partners' capital accounts and realization account. This question was normally well answered. The only error which most of the good students also made was that they did not understand that commission would be charged as an expense before distribution among partners.

Question 5

According to the given situation, the management of a company had found an error whereby in previous years the cost of patents had been amortized on the basis of their estimated useful life as against the stated policy of amortization on the basis of total estimated revenue, over the life of the asset. The candidates were required to prepare accounting entries at year end.

As stated before, it was a poorly attempted question. Many candidates did not attempt it. Those who attempted, made various types of errors, some of which are discussed below:

- Most of the students corrected the error prospectively instead of correcting it retrospectively.
- Many candidates who made the calculation correctly i.e. on retrospective basis, charged the entire amount of adjustment to the current year instead of charging the effect of error in prior years through retained earnings.
- Impairment expense needs to be computed by comparing the carrying value with the recoverable amount. Instead of carrying out this process on each product separately, many students worked it out on a combined basis.

Question 6

In this question four different transactions carried out by a company were given and the candidates were required to explain how and when revenue would be recorded in each case. Though such questions are a routine part of almost all papers, yet, many students did not give the criteria on the basis of which they proposed the revenue recognition. Other aspects of the performance are discussed below:

(i) A printer was sold for Rs. 6 million with the agreement that free service and maintenance would be provided for one year. The actual costs incurred on service and maintenance were provided along with the information that such services are normally billed at cost plus 20%.

The performance was below average as most students could only identify that the amount recovered on account of services and maintenance shall not form part of the sales revenue. Only about 20% candidates could elaborate further that the amount to be excluded from sales revenue should include the estimated cost of such services and a reasonable profit thereon which in this case was 20%. Moreover, very few could identify that the revenue for servicing and maintenance was to be deferred and recognized over the period during which the services are performed.

(ii) Majority of the candidates answered this part correctly which pertained to recognition of interim dividend.

(iii) Generally the candidates performed well in this part also.

(iv) Almost all the students correctly mentioned that the revenue is to be recognized on expiry of the period during which the buyer had a right to return.

Question 7

This was a routine question on preparation of statement of changes in equity but the performance was quite below standard which was surprising.

The common mistakes are discussed below and it may be noted that majority of these errors are of a very basic nature:

- Opening balances were not properly worked back in many cases.
- Timings of issuance of dividends and bonuses were incorrectly reflected.
- Share capital was increased on account of issue of bonus shares but corresponding effect on retained earnings was ignored.
- Rights issue and premium thereon were deducted from retained earnings.
- Share premium was not shown in a separate column and merged with retained earnings.
- Total comprehensive income and incremental depreciation on revaluation surplus transferred to retained earnings, for the year 2013, was not calculated net of tax.
- The word 'restated' was not mentioned against restated balances.

THE END