

INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Financial Accounting and Reporting-I	Certificate in Accounting and Finance – Autumn 2015

General:

The overall performance in this paper was poor mainly because of extremely poor performances in question 2, 5 and 6. Majority of the students made mistakes even in the simpler areas. The candidates also seemed to lack in practice as it was observed that many students displayed good understanding of a concept in one question but made mistakes on similar issues in the other question(s). For example, many students addressed the issue of accrued expenses in question 1 correctly but made errors in similar type of adjustments in question 2 and vice versa.

Question-wise comments:

Question 1

This question required computation of cash defalcated and preparation of income statement and balance sheet for a sole proprietorship business. The opening balance sheet and summary of receipts and payments along with other necessary information was provided in the question.

Though it was a simple and routine question, the overall performance was average because many students made errors on the easier aspect of the question also.

The errors observed are discussed below:

- Majority of the students were unable to understand the calculation of cash shortage because they computed credit sales on the basis of movement in debtors account and purchases on the basis of movement in creditors account; whereas, the other information which was provided in the question i.e. the discount on the cash and the credit sales and the ratio of credit sales as a percentage of total sales and margin on gross sales, was ignored.
- Net cash sales i.e. after deducting the discount was given and the cash sale before discount should have been computed by working back the discount as 0.1/0.9 of the net sales. Many students calculated the discount incorrectly as 10% of net sales.
- While computing the cost of goods sold, many students applied the percentage of gross margin on the net sales instead of gross sales.
- Adjustment on account of NRV of damaged goods was mostly ignored whereas many students deducted the expenses incurred in July from cost, to arrive at the NRV.

- Many students added the opening balance of accrued expenses to the amount of payments and deducted the closing balance to arrive at the amount of expenses.
- Many students calculated depreciation on equipment on opening WDV instead of cost.
- Many students arrived at the closing balance of cash by including amount of expenses in their workings, instead of the amount of payments.

Question 2

This was a straight forward question on preparation of statement of financial position and statement of comprehensive income of a company. The only difficult item in the whole question was the effect of revaluation. However, a poor response was witnessed. Some of the common mistakes were as follows:

- Effects of goods shipped on sale or return basis was correctly adjusted from sales but no adjustment was made in closing stocks whereas some students added the invoice price to the cost of ending stock instead of adding the cost of the goods.
- Many students reported closing stocks at realizable value which was higher than cost.
- Most of the students did not seem to have appropriate understanding of how expenses are recorded in the ledger. Consequently, in calculating repairs and maintenance and utilities expenses for the period, many students wrongly added opening accruals and deducted closing accruals from the recorded expenses whereas many students only added the closing accruals to recorded expenses and ignored the opening accruals.
- In the statement of comprehensive income, actual write-offs were included as expenses i.e. opening and closing provisions were ignored. Many students added the closing balance of the provisions and the write-offs, to arrive at the amount of expenses and ignored the opening balance.
- Most of the students failed to understand that the amount paid as advance warehouse rent must have been included in the warehouse rent expenses account. They considered it as an additional adjustment and added Rs. 450 thousand to the amount recorded in the ledger instead of deducting Rs. 150 thousand therefrom.
- Most of the students were unable to correctly calculate the adjustment required to properly record the loss on sale of equipment. Many students ignored it altogether whereas a large number of students ignored the depreciation for the year i.e. upto the date of disposal.
- Most of the students failed to calculate the depreciation correctly mainly because of the following reasons:
 - Ignored the depreciation for the year on equipment disposed of.
 - Ignored the impact of revaluation in their calculations.
- Most of the students made adjustment for income tax in Statement of Comprehensive Income but did not adjust it in the amount of liability disclosed in the Statement of Financial Position.
- Many students did not show accruals and accumulated profit in the statement of financial position.
- Many students appeared to waste time in trying to reconcile the balance sheet which does not contain any mark.

Question 3

This question on revaluation of fixed assets was better attempted and the overall performance was relatively better. However, about 13% of the students did not attempt it altogether. Performance in each part is discussed below:

Question 3(a)

The performance in this part was mixed. About 15% of the students were well prepared for this type of question and scored full marks. Among the rest, majority could only point out the requirement to disclose the revaluation surplus and the amount thereof. Some of the students also mentioned about the simultaneous disclosures of carrying amounts under the cost model. However, only few could mention the remaining two conditions i.e. about the effective date of revaluation and the involvement of independent valuer.

Question 3(b)

The performance in this part was good except in the case of very poor students who either did not attempt it altogether or did not seem to know anything. The average students made one or more of the following mistakes:

- Entry related to transfer of surplus to retained earnings was ignored.
- Majority of the students calculated incremental depreciation as difference of depreciation before revaluation and after revaluation rather than allocating the revaluation surplus over the remaining useful lives of the assets.
- The loss on impairment and revaluation surplus were not recorded separately as the net amount was recorded as surplus.
- Depreciation for 2013-14 was ignored.
- Depreciation for 2015 was computed on the original life instead of remaining life.
- The entry to close the accumulated depreciation balances against the cost of assets was ignored.
- Impairment and surplus on revaluation were calculated on the basis of cost instead of written down value.
- Many students did not read the question carefully. The revalued amount pertained to year-end whereas they assumed that it pertained to the beginning of the year.

Question 4(a)

In this question on branch accounting, the candidates were required to compute the separate profit and loss of a head office and its two branches and also the combined profit and loss. The overall performance was quite good. Some of the common mistakes are discussed below:

- Provision for unrealized profit on 1 July 2014 was either ignored or deducted from the opening inventory of the head office instead of adjusting it for the purpose of opening inventory in the combined profit and loss account.
- Unrealized profit at year-end was ignored.
- Many students prepared individual profit and loss statements for head office and branches but either ignored the combined profit or loss calculation or committed mistakes in adjusting the impact of mark-up on stocks and goods in transit.

Question 4(b)

This part was quite easy and most of the students were able to reconcile the balances as required.

Question 5

This question on revenue recognition proved too difficult for majority of the students and the overall performance was very poor. Performance in each part is discussed below:

Question 5(a)

This was a theory based question and at least in this part about 25% of the students scored passing marks and a reasonable number of students scored full marks also.

Question 5(b)

- (i) In the context of the overall performance in Question 5, the performance in this sub-part was relatively better. About 15-20% of the students were able to identify the key issue i.e. where the installation process is simple in nature, the revenue may be recognized when the buyer accepts the goods.
- (ii) This proved to be the most difficult part. In IAS 18 this situation is termed as bill and hold but very few students were able to analyze the situation correctly.

Question 5(c)

- (i) A very important logic was tested in this part i.e. when an item is sold as a package deal, the revenues and costs associated with various components of the deal are to be recorded separately. It was satisfying to note that at least half the students seemed to understand the broader principle though difficulty was faced in its practical application.

Deferred revenue of Rs. 10,000 was correctly recorded at the time of sale. However, adjustment at year-end related to recognition of services income and provision of cost thereof was generally missed or the amounts were calculated incorrectly.

- (ii) This part was based on principle of revenue recognition in situations where recovery of the amount of sale is deferred. As in part c(i), generally the students seemed to understand the principle but failed to apply it correctly. The common mistakes were as follows:
 - Most of the candidates correctly calculated the interest element as the difference between sale price and the present value. However, they recorded the entire interest income at the end of the year instead of recording it separately for the two half yearly periods. Many candidates divided the interest income equally between the two half yearly periods. The correct method was to allocate it on the basis of amount outstanding.

Question 6

In this question, the candidates were required to compute the value of inventory based on weighted average method under perpetual inventory system and prepare relevant disclosures as per IAS-2.

Quite surprisingly, the performance in this part remained very poor mainly because very few candidates seemed to be aware of perpetual inventory system and went on to compute the value of inventory under the periodic inventory system. There were many other types of mistakes which indicated a serious lack of conceptual understanding. These are described below:

- Majority of the students failed to understand that non-refundable portion of import cost has to be included in the cost of inventories. Some assumed purchase price as the total cost and deducted refundable import cost from it.
- Some students used FIFO method instead of weighted average method.
- Many candidates showed the issue of inventory at selling price instead of cost.
- Majority of the students considered sale of damaged units as additional transaction in that month whereas it was clearly mentioned in the question that sales for the month includes the sale of damaged units.
- Many students took the cost of stocks written off as zero.
- In NRV calculation, significant number of students considered the reduced selling prices as NRV instead of the expected sales value less modification cost.
- Very few students made appropriate disclosures.

Question 7

This was a straightforward question on developing relationship between production expenses and machine hours and predicting production expenses for given machine hours. The overall performance in this question was very good as about 77% of the students secured passing marks whereas 29% students secured full marks.

Most of the errors were on account of incorrect formula. Selective study was quite evident in this case as 13% of the students did not attempt it altogether.

THE END