

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN**

**EXAMINERS' COMMENTS**

<b>SUBJECT</b>	<b>SESSION</b>
Financial Accounting and Reporting-I	Certificate in Accounting and Finance – Spring 2016

**General:**

The overall performance of the examinees was above average and much better than the previous attempt. Surprisingly, extremely poor performance was witnessed in question 7 although apparently it was an easy question. The only probable reason for it was that the topic had been introduced in the syllabus only recently. Performances in question 1, 3 and 4 were also below average.

Question-wise comments.

**Question 1**

This question required statement of financial position and income & expenditure account of a club from the Receipt and Payment Summary and other available information. Overall it was a simple question which mostly contained routine type of adjustments and disclosures. However, the performance was below average as the following mistakes were commonly observed:

- Very few students were able to bifurcate the amount of subscription correctly between subscription income and deferred income on the basis of number of months passed till year-end. Many students did not carry out this calculation altogether whereas many students took 1/3<sup>rd</sup> of the amount as subscription income. Further, even fewer students bifurcated the deferred income between the short-term and long-term portion.
- Most of the examinees failed to accrue revenue related to sale of beverages in December 2015 amounting to Rs. 150,000.
- Very few students seemed to understand the calculation of purchases of beverages and the closing stock correctly. Most of them failed to realise that according to the question, 25% of the purchases remained unsold and therefore cost of sales represented 75% of purchases and closing stock must be equal to 1/3<sup>rd</sup> of cost of sales or 1/4<sup>th</sup> of total purchases. Many students presumed the total purchases as Rs. 1,367 thousand which in fact represented the amount paid for purchases till year end. Consequently, they also failed to recognise the amount payable against purchases.
- Rent expense, insurance and depreciation were calculated based on 12 months instead of 11 months.

- Advance for land, advance for parking shed and utility deposit were included in current assets instead of non-current assets by majority of the examinees.
- Prepaid rent was not bifurcated with current and non-current.
- Sponsor's contribution was incorrectly included in income by some candidates.
- Salaries and utilities were paid in subsequent months; therefore accruals of such expenses were required but were missed generally.

### **Question 2**

This question required determination of cost of inventory under the perpetual system using FIFO and weighted average valuation methods and passing of journal entries to record defective items returned to supplier and surplus/shortfall determined as a result of stock check.

The performance in this question was very good as more than 80% students secured passing marks and a good number scored full marks. Among the rest, the following errors were observed:

- Periodic method was used instead of perpetual method.
- In weighted average method, purchase return was deducted at average rate rather than the rate of purchase.
- Value of surplus inventory was not calculated and no journal entry passed.
- Many students carelessly used the gross value as the unit price.

### **Question 3**

This question tested the concept of revenue recognition and consisted of three parts. The performance in each part is discussed below:

- (a) The question required two examples each of situations where (i) legal title passes but risk and rewards are retained and ii) legal title does not pass but risk and reward are passed on to the customer.

The overall performance was average. Generally the students were able to give proper examples in the first case but not in the second case. Many candidates gave only one example in each case. Surprisingly, many students repeated the same examples in both the scenarios.

- (b) This part contained three situations and in each case the candidates were required to explain when the revenue would be recognized. The key observations in each case are discussed below:

- (i) Most of the students correctly mentioned that revenue will be recognized when contract is secured; however they could not explain as to what would happen if the buyer is unable to secure the contract. Many students incorrectly mentioned that 10% revenue shall be recognized immediately on sale.

- (ii) About 50% of the candidates mentioned correctly that revenue shall be recognized on delivery; however, only few could specify the treatment if the customer paying the security deposit does not take delivery. Rest of the candidates mostly mentioned that revenue shall be recognised on receipt of security deposit as the demand was high and no one would like the security deposit to be forfeited. Like in sub-part (i) a number of candidates mentioned incorrectly that 25% revenue shall be recognized on receipt as the security deposit was not refundable.
- (iii) Majority answered this sub-part correctly although it didn't seem to be easy. Most of those who erred either suggested proportionate recognition on the basis of time or recommended that no revenue should be recognized.
- (c) The performance in this part was poor. The candidates were unable to understand that since sale and repurchase prices were lower than the fair value, under the principle of substance over form, it was a loan rather than a sale. Most students suggested that sale should be recorded and the asset should be credited.

#### **Question 4**

- (a) This part of the question required the condition that must be met for an item to be recognized as property plant and equipment and the amount at which such an amount would be stated after the initial recognition if an entity follows the revaluation model.

The overall performance was poor as instead of answering on the basis of recognition criteria as given in IAS 16, the candidates mostly answered on the basis of their general perception. While discussing subsequent recognition most students only mentioned revalued amount without mentioning anything about fair value or subsequent depreciation or impairment.

- (b) In this part of the question the candidates were required to ascertain from the data available in the question, the amounts which would appear under each head, in the income statement and the statement of financial position. The overall performance was average. The common mistakes were as follows:
- Staff training cost was included in cost of the asset.
  - Cost of maintenance contract was included in the cost of the asset.
  - Cost of the asset was adjusted by 3% early settlement discount.
  - Depreciation was calculated without taking into account the residual value.
  - For year-2, depreciation was calculated by using WDV of year-1.
  - In year-3, instead of adding the amount of upgrade (Rs. 1,753,000) to the WDV of the asset as on 1<sup>st</sup> January 2015, the same was added to the original cost of asset.
  - Very few examinees were able to correctly bifurcate and present the cost of maintenance contract in income statement and statement of financial position with further breakup in short-term and long-term prepayment.
  - Very few examinees showed early settlement discount in income statement and many among those who did, computed it incorrectly on the basis of list price instead of list price less trade discount.

### **Question 5**

Above average performance was witnessed in this question which required preparation of branch account in the books of head office showing profit or loss made by the branch. However, most of the students were able to secure marks on easier aspects of the account such as opening and closing balances and transfer of goods. Most of the students were unable to correctly calculate cash remitted to head office because of the following mistakes:

- Very few students had overall understanding of how the amount would be calculated i.e. that first they would have to calculate the sale by branch at head office price.
- Many of those who did try to calculate branch sale at head office price, used the price before 10% mark-up instead of the price after the mark-up while some of them ignored the goods transferred to Lahore Branch.
- Branch debtors amounting to Rs. 35,420 were ignored in the calculation.

### **Question 6**

Above average performance was witnessed in this question also which required preparation of cash flow statement using the indirect method. Some of the common errors are described below:

- Majority of the students made mistakes in classification of items between operating, investing and financing activities.
- Difference in income tax payable was mentioned along with changes in working capital instead of mentioning income tax paid separately. Some of the candidates started the cash flow from Profit after Tax instead of Profit before Tax.
- Various types of errors were seen in the calculation of amounts related to property plant and equipment. Many students ignored the profit on sale whereas many students ignored the amount of revaluation in arriving at the amount of purchases thereof.
- Many students treated increase/decrease in inventory, debtors and creditors incorrectly i.e. treated inflows as outflows and vice versa. Surprisingly, it included many such students who had correctly performed many of the more complex calculations.

### **Question 7**

This was an easy question requiring computation of variable, fixed and total costs but somehow proved to be the worst attempted question. Some of the common mistakes are listed below:

- Cost of the car was taken as fixed whereas depreciation was ignored.
- Salvage value was considered as a deduction against cost of car whereas it should have been used for the calculation of depreciation only.
- Entire vehicle tax was included as an expense i.e. the fact that 20% of the amount was adjustable against owner's income tax was ignored.

- An important requirement of the question i.e. proper justification/reasoning for considering an item as fixed/variable cost was not provided.
- Per km cost was calculated only for the total cost whereas the requirement was to calculate it for fixed costs and variable costs also.

*THE END*