ACCA Think Ahead

Financial Accounting (FFA/FA) September 2022-August 2023 Examiner's report

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for those sitting the exam in the future.

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General Comments

The examination is divided into two parts, both of which are compulsory. Section A consists 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 that 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 consists of two multi-task questions (15 marks each), testing candidates' understanding and application of financial accounting skills in more depth.

This report covers each section of the examination separately and uses 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 most candidates had prepared well for the examination. Since Section A is OT based, there were no issues or problems associated with examination technique noted, although candidates must make sure they spend the appropriate amount of time on each question and each section of the exam overall.

This section of the report discusses six questions in Section A with which candidates experienced difficulties.

Example 1

At 1 April 20X8, Companies Co had a $300,000 6% loan note in issue. On 1 June 20X8, Companies Co issued a $500,000 9% loan note. On 1 January 20X9, Companies Co repaid the $300,000 6% loan note in full.

What figure should appear in the statement of profit or loss for finance cost for the year ended 31 March 20X9?

A. $51,000
B. $55,500
C. $58,500
D. $63,000

The correct answer is option **A**.

This is an example of a multiple-choice style question where candidates are required to select one from four options.

In the scenario, Companies Co repaid a loan note during the year and issued a new loan note. To successfully answer this question, candidates are urged to look very carefully at both the repayment and issue dates.

The existing loan note of $300,000 was in issue between 1 April 20X8 and 1 January 20X9 (i.e., nine months). In this style of question, a common error made by candidates is to incorrectly calculate the interest on this loan note for 10 months. However, there is no need to include interest for the month of January as the loan note was repaid on the first day of a new month and, therefore, no interest has been incurred. You could, instead, treat this as 31 December 20X8 (the day before official repayment took place).

The new loan note of $300,000 began on 1 June 20X8 and was still in issue at the reporting date of 31 March 20X9 (i.e., 10 months).

Once the correct number of months are known, the interest to be recorded as a finance cost can be calculated as follows:

	$
1 April 20X8 – 31 December 20X8 ($300,000 x 6% x 9/12)	13,000
1 June 20X8 – 31 March 20X9 ($500,000 x 9% x 10/12)	37,500
	51,000

Option B is incorrect as the interest on the existing loan note has been included for a full year. Similarly, option C in incorrect as the interest on the new loan note includes the annual interest amount. Option D is incorrect as no interest has been time apportioned.

Example 2

The following extracts are taken from the financial statements of Companies Co for the year ended 31 December 20X6:

	20X6 ($)	**20X5 ($)**
Revenue	500,000	450,000
Trade receivables	45,900	51,300

Which of the following conclusions could be drawn from the above information?

(1) Credit customers are now taking less time to pay their debts

(2) The business has improved its profitability as revenue has increased

(3) Trade receivables days have deteriorated

(4) The credit control department has been more efficient

A. 1 and 4
B. 3 and 4
C. 1, 2 and 3
D. 1, 2 and 4

The correct answer is option **A**.

In this question, candidates are given information relating to both revenue and trade receivables for two years and are then required to use this information to determine if the statements in options (1) – (4) are correct.

To answer this question, candidates must calculate the trade receivables period:

20X6 = 34 days ([$45,900/$500,000] x 365 days)

20X5 = 42 days ([$51,300/$450,000] x 365 days)

Using the trade receivables days above, it can be determined that option (1) is correct. Customers are now paying their debts, on average, nine days quicker.

Option (2) is incorrect as an increase in revenue will not necessarily result in an increase in profitability. More information about the costs incurred by Companies Co would be needed to determine if this statement is true.

Option (3) is incorrect. The trade receivables days in 20X6 are lower than the trade receivables days in 20X5. Companies Co is now able to collect payment from its credit customers more quickly, which reduces the risk of irrecoverable debts and helps to improve cash flow. Therefore, this is an improvement to trade receivables days and not a deterioration.

Option (4) is correct. As customers are paying earlier, the credit control department are being more efficient at collecting outstanding debts from its credit customers.

Example 3

A business buys a machine on 31 August 20X5:

Cost	$50,000
Expected useful life	Seven years
Estimated residual value	$1,000

On 1 January 20X8, the machine is revalued to $41,000 with no change in residual value or useful life.

The accounting policy for depreciating machinery is straight line, with a full year's charge in both the years of acquisition and disposal.

What should the depreciation charge be in the statement of profit or loss for the year ended 31 December 20X8?

$

The correct number entry is **$10,000**.

This type of question requires you to use the information in the scenario to calculate and input a correct number entry.

Ordinarily, to calculate the annual depreciation charge using the straight-line method, candidates would apply the straight-line formula: (cost - residual value)/useful life.

However, in this question, the business decided to revalue the machine at the beginning of the year and, therefore, depreciation will be calculated as follows:

$$\frac{\text{Revalued amount - residual value}}{\text{Remaining useful life}}$$

Before the above formula can be applied, candidates firstly need to calculate the remaining useful life of the machine. The original useful life was seven years, and no change was made to the original estimate. The machine was purchased on 31 August 20X5 and in accordance with the business's accounting policy, a full year's depreciation was charged in the year ended 31 December 20X5. The machine was subsequently depreciated (before being revalued) in both 20X6 and 20X7. Therefore, prior to the revaluation, the machine had been depreciated for three years and four years now remain.

Depreciation can therefore be calculated as follows:

$$\frac{\$41,000 - \$1,000}{4 \text{ years}} = \mathbf{\$10,000}$$

Example 4

According to IAS 37 Provisions, Contingent Liabilities and Contingent Assets, should the following situations result in the recognition of a provision in the statement of financial position?

		Yes	No
1.	A manufacturer gives warranties to its customers. The terms of the warranty require the company to repair any defects in its products that arise within two years of the date of sale. The company expects that around 2% of sales each year will result in claims under the warranty.		
2.	A coal-mining company operates in a country where there is no legislation requiring the company to repair environmental damage. The company causes environmental damage but has a widely publicised policy of repairing this damage.		

The answer to each statement is **Yes.**

This is an example of a multiple response matching question and candidates will be required to select either the 'yes' or 'no' box for the two statements.

In this question, candidates were required to look at the information provided to determine if a provision should be recorded in the financial statements. When looking at each statement, you need to determine if a present obligation exists as a result of past events. The present obligation can be either legal or constructive.

Statement 1 would result in a provision. A legal obligation exists at the point of sale. The warranty is a legal requirement of the entity to repair any defects within a two-year period.

Statement 2 would also result in a provision. In this example a constructive obligation exists, rather than a legal one. A constructive obligation arises if past practice creates a valid expectation on the part of a third party. The coal-mining company has widely publicised that it will repair any environmental damage, therefore, has raised a valid expectation of a third party.

Example 5

A business produced draft financial statements for the year ended 31 December 20X7 that showed a profit for the year of $78,500. Subsequent investigation of the accounting records revealed the following:

(1) Closing inventories, which cost $120,000 and had a net realisable value of $112,000, were shown at cost in the financial statements.

(2) A motor vehicle, purchased for $30,000 during the year, had been posted to the motor expenses account with no entry made in the asset register. Motor vehicles held at the year end are depreciated at the rate of 25% per annum on cost, with a full year's charge in the year of acquisition.

What will be the revised profit for the year after taking account of the above?

$

The correct number entry is **$93,000**.

In this question you will need to identify the errors that exist and consider the impact on profit when rectifying the error.

The information in note (1) outlines the current accounting treatment of inventories. Inventories should be recognised at the lower of cost or net realisable value. In this example, net realisable value is lower and, therefore, inventories have been overstated by $8,000 ($120,000 - $112,000).

To rectify this error, the following journal entry would be required:

Dr	Cost of sales (P/L)	$8,000
Cr	Inventories (SOFP)	$8,000

Profit will, therefore, be reduced by $8,000 (a debit entry in the statement of profit or loss will reduce profit).

In note (2) the motor vehicle has incorrectly been recorded as an expense. Assets should be capitalised and depreciated over their useful lives.

Two adjustments will be required to rectify this error. Firstly, the expense of $30,000 will be reversed and then a depreciation charge included of $7,500 ($30,000 x 25%). The net impact will be to increase profit by $22,500.

Revised profit:

	$
Draft profit	78,500
Inventories write down	(8,000)
Capital expenditure (incorrectly expensed)	30,000
Depreciation charge	(7,500)
Adjusted profit	**93,000**

Example 6

Companies Co's retained earnings were $119,460 at 31 March 20X5 and $145,710 at 31 March 20X6. During the year ended 31 March 20X6, Companies Co undertook the following transactions:

(1) Paid a dividend of $0.45 per share on each of its 100,000 redeemable preference shares
(2) Paid a dividend of $0.25 per share on each of its 200,000 ordinary shares
(3) Made a rights issue of 50,000 shares at a price of $1.10 per share
(4) Made an issue of bonus shares of $25,000 out of retained earnings

What is Companies Co's profit for the year ended 31 March 20X6?

A. $26,250
B. $101,250
C. $146,250
D. $201,250

The correct answer is option **B**.

In this question, candidates are trying to find a balancing amount, profit for the year. The profit can be calculated by looking at the movement in retained earnings and considering whether options (1) – (4) will impact retained earnings directly.

Note (1) provides information about a dividend on a redeemable preference share. Redeemable preference dividends are expensed directly in profit or loss and has already been deducted from profit for the year. This does not impact retained earnings directly.

The dividend in note (2) relates to ordinary shares. Dividends paid on ordinary shares are distributions of profit and will not have been recognised as an expense. A dividend of $50,000 (200,000 x $0.25) was deducted from retained earnings.

Note (3) provides information about a rights issue. When recording a rights issue, it is the share capital and share premium accounts that are updated and, therefore, this transaction will have no impact on retained earnings.

The issue of bonus shares in note (4) was made from retained earnings and so directly impacts retained earnings, reducing it by $25,000.

The missing profit figure can now be calculated as follows:

	$
Retained earnings at 31 March 20X5	119,460
Ordinary dividend (200,000 x $0.25)	(50,000)
Bonus issue	(25,000)
Profit for the year (balance)	**101,250**
Retained earnings at 31 March 20X6	**145,710**

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, drop-down list 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 to 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, you might be asked:

Should each of the following amounts be used to determine the figures to be reported on the statement of financial position (SOFP) as at 31 October 20X7 before any year-end adjustments?

To answer this question, you might be given a trial balance and have the option of selecting 'Yes' or 'No' from a drop-down list. For example, buildings at cost would require you to select 'Yes', whereas buildings accumulated depreciation as 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.

You will need to be familiar with the relevant journal entries for transactions as there may be a specific requirement within the question related to adjusting figures in the trial balance. Typically, you will need to calculate the depreciation charge on some of the assets, perhaps using two different depreciation methods.

This question style focusses on your understanding of accounts preparation and the double-entry system; attempting numerous practice questions is essential.

Single entity statement of cash flows

You may be required to prepare a statement of cash flows using both number entry and drop-down lists. It is important that you know the format of a statement of cash flows as you may be required to select appropriate headings. For each cash flow identified, you may be required to indicate whether you need to ‘add’ or ‘subtract’ the amount calculated; you must sufficiently prepare for this.

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

- Understand, for the indirect method, whether movements in working capital have a positive or negative impact on cash generated from operations.
- Know how to calculate the tax and dividends paid during the year. Dividends are not always given in the question and so you may need to reconcile retained earnings to work out this balancing amount.
- Be careful with the impact of a profit (or loss) on disposal – these are non-cash items 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 when calculating the purchase of property, plant and equipment.

Consolidated financial statements

When preparing 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 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 Accounting Standards); 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 things to remember when preparing a consolidated statement of financial position:

- 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, even if the parent company owns less than 100% of the subsidiary.
- The investment in the subsidiary (shown in the statement of financial position of the parent company) is removed and the goodwill figure added.

- The share capital and share premium balances of the subsidiary are not consolidated; only the balances related to the parent are used in the consolidation.
- The pre-acquisition retained earnings of the subsidiary are not included in the consolidated statement of financial position. Instead, the group share of the subsidiary's profit in the post-acquisition period is calculated and added to the group's retained earnings.

Below are some important things to remember when preparing a consolidated statement of profit or loss:

- The revenue and expenses are added together on a line-by-line basis **in full**, even if the parent company owns less than 100% of the subsidiary (although be mindful that the subsidiary results must be time apportioned if control was achieved mid-year).
- Eliminate intra-group sales and purchases.
- Eliminate unrealised profit held in closing inventories (in the statement of financial position and as part of cost of sales) related to intra-group trading.
- Ensure you know how to calculate the profit attributable to the group and the non-controlling interests in the subsidiary.

Conclusion

It is imperative that candidates study and prepare well for all topics in the syllabus and not just a select few as the exam will cover the full breadth of the syllabus.

Equipping themselves with adequate knowledge of all topics will 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 attempt all questions in the exam.