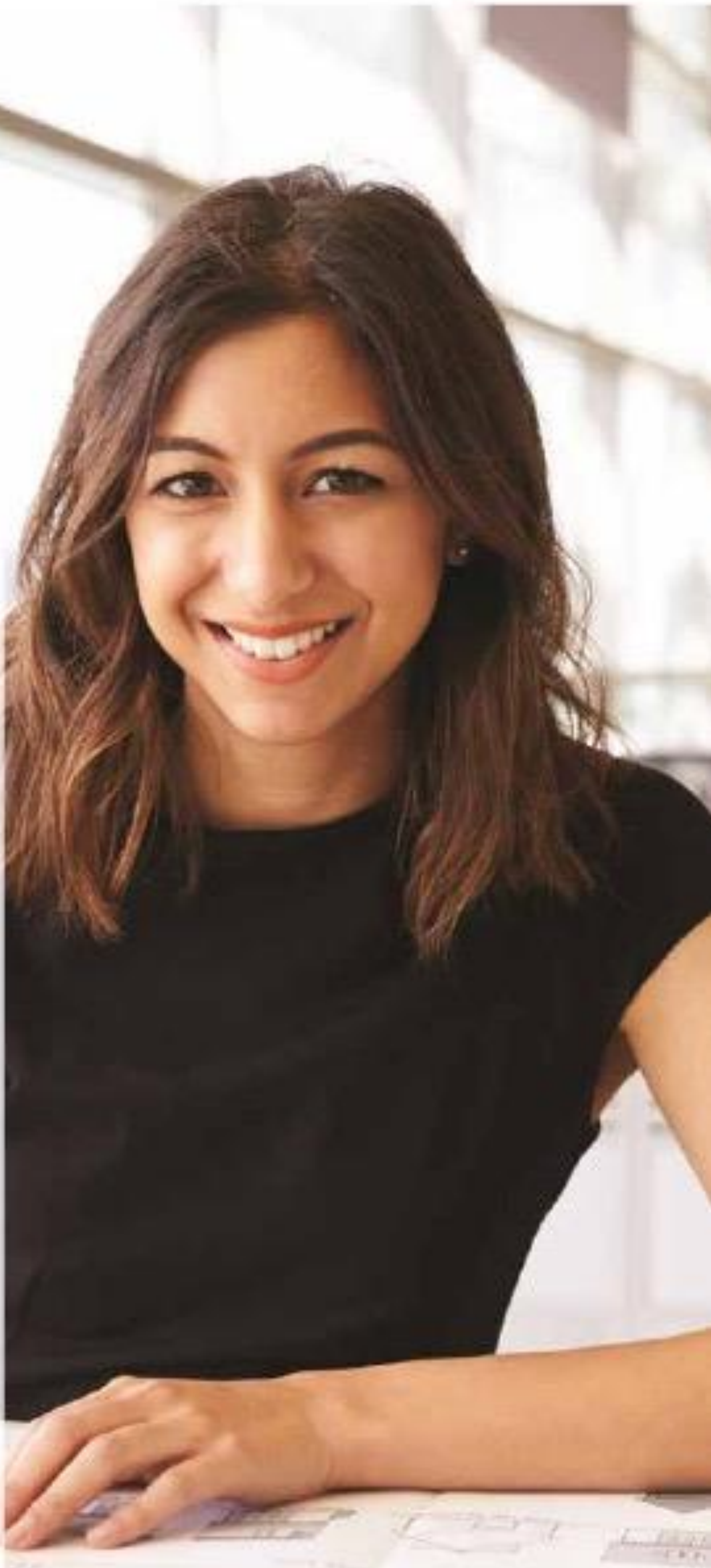
# Financial Accounting (FFA/FA) September 2020-August 2021 Examiner's report



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.

## Contents

## 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 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 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 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 a number of questions in Section A with which candidates experienced difficulties.

### Example 1

Rajesh runs a business selling computers to individuals. His terms of sale are primarily cash on delivery with large customers allowed 14 days credit.

**Which of the following transactions should be recognised as revenue in Rajesh's financial statements?**

A. **Rajesh has sold one of his delivery vans to his brother and has received payment in cash**
B. **A customer has promised to place an order next week for a new computer and has paid a refundable deposit of $100**
C. **A competitor who has run out of a particular item has asked Rajesh to fulfil a sale to a customer and Rajesh has delivered the goods**
D. **Rajesh has received payment from his largest customer for a delivery of 20 computers that took place two weeks ago**

The correct answer is **C**.

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

IFRS 15 Revenue from Contracts with Customers requires revenue to be recognised when a performance obligation is satisfied.

In C, Rajesh has entered into a contract to supply goods to another business and the goods have been delivered. Therefore, the performance obligation has been satisfied and the revenue can be recognised.

A is incorrect as the sale does not meet the definition of revenue in accordance with IFRS 15. Revenue is defined as being 'income arising in the course of an entity's ordinary activities'. Rajesh sells computers and therefore the sale of the van should be treated as the disposal of property, plant and equipment.

The receipt of the $100 deposit in B cannot be recognised as revenue. As mentioned previously, revenue can only be recognised when (or as) the performance obligation is satisfied. The performance obligation is to provide the customer with a computer. This obligation has not been satisfied and therefore the revenue cannot be recognised.

D is incorrect. Revenue is recognised when the performance obligation is satisfied. The obligation was satisfied two weeks ago when the delivery of the computers took place. This is a simple receipt from a credit customer.

**Example 2**

John sells machines and has the following transactions during March 20X8:

(1) Issues an invoice for a machine sold to Harry on credit
(2) Deposits the cash for a machine sold to Xiu in the bank
(3) Withdraws drawings from the bank
(4) Charges depreciation on plant

John keeps a full set of books of prime entry.

**In which books of prime entry should each transaction be recorded?**

| | Sales daybook | Cash book | Journal | Petty cash book |
|---|---|---|---|---|
| **1. Sale to Harry** | | | | |
| **2. Cash from Xiu** | | | | |
| **3. Drawings** | | | | |
| **4. Depreciation** | | | | |

This is an example of a multiple response matching style question. Candidates are required to select an option for each transaction and determine which book of prime entry it should be recorded in. There are four options that need to be selected and candidates must get all four correct to be awarded the marks. No partial credit is available.

The correct responses are as follows:

| | Sales daybook | Cash book | Journal | Petty cash book |
|---|---|---|---|---|
| **1. Sale to Harry** | **X** | | | |
| **2. Cash from Xiu** | | **X** | | |
| **3. Drawings** | | **X** | | |
| **4. Depreciation** | | | **X** | |

The sales daybook records all credit sales. The sale to Harry should be recorded in the sales daybook as this is a sale to a customer on credit.

John should record the cash for a machine sold to Xiu in the cash book as this is an amount received from a credit customer.

The drawings represent money 'taken' out of the business bank account by John for his own use. This transaction should be recorded in the cash book.

Finally, the depreciation is an adjustment made by John in respect of its property, plant and equipment and should be recorded in the journal book.

**Example 3**

On 1 January 20X8, a new property was acquired at a cost of $750,000. Also, on 1 January 20X8 additional associated costs incurred were as follows:

| | **$** |
|---|---|
| Legal costs of purchase | 7,500 |
| Architect's fees | 9,200 |
| Annual maintenance contract | 6,000 |
| Alterations to property | 25,000 |

The property is to be depreciated over its useful life of 20 years. The company prepares financial statements at 31 December each year.

**What is the carrying amount of the property in the statement of financial position as at 31 December 20X8?**

**$** ______

This type of question requires you to use the information in the scenario to calculate and input a correct number entry using knowledge of IAS 16 Property, Plant and Equipment. IAS 16 requires an entity to capitalise all costs to bring an asset to its present location and condition for its intended use. Therefore, you need to look at the expenditure incurred and determine if it should be capitalised or expensed to the statement of profit or loss.

In this question the initial cost of the property of $750,000 should be capitalised. In addition to this, the legal costs, architect's fees and alterations should be capitalised and added to the initial cost of the asset as these costs are incurred to get the asset ready for its intended use. The annual maintenance cost should not be capitalised as this is not required to get the asset ready for its intended use. The total amount to be capitalised is $791,700. This is not the correct number entry however as the question requires candidates to enter the carrying amount at 31 December 20X8 and so the annual depreciation charge must also be calculated.

Therefore, the correct number entry should be $752,115 calculated as follows:

| | **$** |
|---|---|
| Property cost | 750,000 |
| Legal costs | 7,500 |
| Architect's fees | 9,200 |
| Alterations to property | 25,000 |
| | 791,700 |
| Depreciation<br>($791,700 / 20 years) | (39,585) |
| **Carrying amount** | **752,115** |

**Example 4**

X Co had the following disclosure note in respect of provisions for a warranty scheme:

| | **Warranty provision**<br>**$** |
|---|---|
| Brought forward balance | 5,000 |
| Increase in provision | 1,000 |
| Payments for warranty repairs | (2,500) |
| Carried forward balance | 3,500 |

**What is the warranty expense that should be shown in the statement of profit or loss?**

**A. Debit of $1,000**
**B. Credit of $1,000**
**C. Credit of $1,500**
**D. Debit of $1,500**

A provision is a liability of uncertain timing or amount. From the information in the question, it can be seen that the warranty provision has already been accounted for. It is important to note, that both the opening and closing amounts have been estimated by X Co and are the liability balances recognised on the statement of financial position for the prior year and current year respectively. The closing balance exists simply because of the two movements that have taken place to the provision during the accounting period. It is the payments and the increase in provision for which a double entry has taken place.

The cash payment in respect of the warranty repairs would have been accounted for as follows:

| | | |
|---|---|---|
| Dr | Warranty provision | $2,500 |
| Cr | Bank | $2,500 |

The increase in the provision increases the provision liability and this is accounted for as:

| | | |
|---|---|---|
| Dr | Warranty expense | $1,000 |
| Cr | Warranty provision | $1,000 |

Therefore, the correct answer is **A**.

**Example 5**

Jamie's Cars have a balance in their suspense account of $324 debit.

**Which TWO of the following errors could, on its own, explain this?**

**A. Rent paid of $162 credited to the rent account, but correctly recorded in cash**
**B. Omitting interest paid of $324 from the trial balance**
**C. Cash sales of $162 debited to the sales account, but correctly recorded in cash**
**D. An invoice for materials for $324 debited to wages, but correctly recorded in trade payables**

This is an example of a multiple response question where candidates are required to select two options from a choice of four. The correct options are **A and B**. In this question type it is advised that you work through all options so that any incorrect options can be eliminated.

Both options needed to be selected correctly to be awarded the marks and there are no partial marks available.

For A, the rent expense has incorrectly been credited to the rent account and the payment has been correctly recorded as a credit to cash. Therefore, two credit entries of $162 have been made so a debit to suspense of $324 would have arisen.

B is correct as an interest expense of $324 has not been transferred to the trial balance. When the interest was paid there would have been a credit to the bank and a debit to the interest expense account. This has not been recognised on the debit side of the trial balance and therefore, as this is missing, a suspense balance of $324 would arise on the debit side of the trial balance.

C is not correct as the cash sale has been correctly debited to cash but incorrectly debited to sales. Two debit entries have been posted, therefore a credit of $324 will have been taken to suspense.

In D there is an equal debit and credit entry being recorded so no suspense account arises. The invoice for materials of $324 should have been debited to purchases and not wages.

**Example 6**

A fire in the offices of Oyez Media on 22 March 20X6 destroyed various accounting records. From the records that were salvaged, the following credit sales information relating to the period from 31 December 20X5 until 22 March 20X6 are available:

(1) Cash received from credit customers – $76,100
(2) Contra entries with payables ledger – $3,400
(3) Discounts allowed to credit customers – $5,200 (not expected to be taken when invoice first issued)
(4) Interest charged on overdue accounts – $3,200

On 31 December 20X5, trade receivables amounted to $65,800 and on 22 March 20X6 they were $69,400.

**What is the credit sales figure for the period from 31 December 20X5 until 22 March 20X6?**

| **$** |
|---|

The correct number entry is $85,100. This is an example of incomplete records. You need to decide if the transactions in notes (1) to (4) will increase the trade receivables balance, reduce the trade receivables balance, or have no effect.

In note (1) the cash received from the credit customers would reduce the trade receivables balance and be recorded as debit bank, credit trade receivables.

Note (2) indicates that a credit customer is also a credit supplier. As a result, a contra entry can be performed. This would be recorded as debit payables, credit receivables.

Note (3) is marginally more complex as candidates need to be aware of the IFRS 15 Revenue from Contracts with Customers guidance for discounts allowed. At the point of sale, if a discount is expected to be taken the sale is recorded net of the discount. However, if the discount is not expected to be taken the sale is recorded at the gross amount. In note (3) candidates are told the discount was not expected to be taken and therefore the sale was recorded at the gross amount. As the customer has now taken advantage of the settlement discount, Oyez Media would need to record this as debit cash, debit revenue, credit receivables.

Finally, in note (4) there is some interest charged on overdue accounts. This arises when customers have exceeded their credit period and Oyez Media is charging interest on the late payment. This would be recorded as debit receivables, credit interest income.

To find the missing sales revenue, candidates should record all of the relevant information from the question in a working and balance to find the missing amount (the credit sales figure). This working could be done in a list or in a 'T' account.

**List working:**

| | $ |
|---|---|
| Trade receivables at 31 December 20X5 | 65,800 |
| Cash received from credit customers | (76,100) |
| Contra | (3,400) |
| Discounts allowed not expected to be paid | (5,200) |
| Interest charged on overdue accounts | 3,200 |
| | (15,700) |
| **Balancing figure = credit sales revenue** | **85,100** |
| Trade receivables at 22 March 20X6 | 69,400 |

**'T' account**

| | $ | | $ |
|---|---|---|---|
| Balance at 31 December 20X5 | 65,800 | Cash received | 76,100 |
| Interest on overdue accounts | 3,200 | Contra | 3,400 |
| **Balancing fig = credit sales** | **85,100** | Discounts allowed | 5,200 |
| | | Balance at 22 March 20X6 | 69,400 |
| | 154,100 | | 154,100 |

**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 and interpretation. You may not always be required to prepare the full financial statement and may instead be asked to complete an extract. 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 statements:

**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. 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 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 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 – these 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 actual cash received on disposal should be shown as a cash inflow under investing activities.

**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 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 areas of consolidated 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, 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 replaced with the goodwill figure i.e. 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 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 areas of consolidated statement of profit or loss preparation to remember:

- 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 inventory (in the 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 a select 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 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, including through sufficient question practice. Candidates are also reminded to try and attempt all questions in the exam.