Examiner's report

FA2 Maintaining Financial Records
For CBE and Paper exams covering January to June 2013

General Comments

The purpose of writing an examiners' report is to draw the attention of candidates at future sittings to the most common mistakes that have led to candidates at selecting incorrect answers. This is done by focussing on a small number of questions from each sitting. The expectation is that by reviewing the reports over a number of sittings, future candidates will have a resource which equips them for success.

It is noticeable that the key issues that are identified in the three questions considered in this report are the same issues that were referred to in the report on the December 2012 sitting. Moreover, that report specifically noted that these issues had been referred to in the previous report (on the June 2012 sitting). It is worth explicitly stating that these issues have, in fact, been referred to in every report I have written on the FA2 paper. Candidates preparing for future sittings are urged to recognise the importance of thorough preparation prior to the exam, as well as careful reading of the questions in the exam.

Sample Questions for Discussion

Example 1

Kina depreciates equipment using the straight line method over an asset's useful life. On 1 June 2012 she bought new equipment with a useful life of 5 years and paid the supplier $16,000. The invoice showed that the total was made up as follows:

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Equipment	12,600
Delivery	600
Installation	800
Maintenance for year to 31 May 2013	2,000

What is the total charge to Kina's income statement for the year to 31 May 2013?

A $4,800
B $5,920
C $3,200
D $2,800

Selecting the correct answer in this question required clear understanding of the nature of capital expenditure and revenue expenditure.

The question provided key information as follows:

the date on which the asset was bought (as this was the first day of the accounting period, the question did not need to specify that depreciation should be charged for a full year).

various items of expenditure (requiring a clear understanding of the difference in treatment of capital and revenue expenditure)

the basis on which depreciation is to be calculated (straight line)

and the figure which was to be calculated (the *total* charge to the income statement)

Three facts were critical in selecting the correct option. The first was that capital expenditure includes all amounts paid to bring an asset to the point where it can be used. (Thus, delivery and installation charges are part of capital expenditure.) The second was that expenditure on items which are consumed in an accounting period is revenue expenditure. (The statement that maintenance was for the year to 31 May 2013 provided an indication that this expenditure related to a specific accounting period, which meant that it was revenue expenditure.) The third was that the total charge to the income statement included both the depreciation charge and any revenue expenditure.

Based on these three points, it can be seen that the installation was revenue expenditure and that the other three items were capital.

Thus the total capital expenditure was $14,000. Given a five year useful life and straight line depreciation, the depreciation charge was $2,800. To obtain the total charge to the income statement, the revenue expenditure of $2,000 is added, giving a total of $4,800.

Those candidates who selected $2,800 (choice D) presumably understood the difference between capital and revenue expenditure, but did not read the question carefully enough, leading to the maintenance charge being omitted from the calculation.

The remaining 2 options were selected by candidates who were not thoroughly prepared and were unable to correctly classify the items of expenditure. Those candidates who treated the maintenance as capital expenditure selected $3,200 (choice C), while those who treated only the cost of the equipment ($12,600) as capital expenditure selected $5,920 (choice B).

Example 2

At 1 May 2012 Ruka's receivables allowance was $1,760. At 30 April 2013, the balance on her trade receivables account was $99,550 and she decided to write off debts of $750 as irrecoverable. She estimated that her receivables allowance at 30 April 2013 should be equivalent to 2% of outstanding balances.

What amount should be charged to Ruka's income statement for the year to 30 April 2013?

A $966
B $216
C $1,976
D $981

The topic of the receivables allowance, and particularly the movement in the allowance, is one which continues to cause difficulty for candidates.

Once again, a good knowledge of the key points of the topic will assist in selecting the correct choice.

The key points here are:

the closing allowance is calculated *after* any irrecoverable debts have been written off;

the difference between the opening allowance and the closing allowance must be taken to the income statement;

if the closing allowance is greater than the opening allowance, the difference will be a charge to the

income statement;
if the closing allowance is less than the opening allowance, the difference will be a credit to the income statement;
the irrecoverable debt written off must also be charged to the income statement;
the closing allowance is deducted from the receivables balance (after any write off) and the result is reported in the statement of financial position.

Those candidates who had a good understanding of these points *and who read the question carefully* selected the correct choice, as follows:

	Receivables balance	$99,550		
less	Irrecoverable debt	$ 750		
	Remaining balance	$98,800		x 2%
=	Closing allowance		$1,976	
less	Opening allowance		$1,760	
=	Increase (thus charge to income statement)		$ 216	
+	Irrecoverable debt		$ 750	
=	**Total** charge to income statement		$ 966	

Where a candidate had selected the incorrect choice, the main reasons were as noted in the comments on example 1.

One of the choices ($981) was the result if the closing allowance was calculated without first deducting the irrecoverable debt.

The remaining two options both arose if the closing allowance was correctly calculated, but the need to include the write off of the irrecoverable debt in the charge to the income statement was overlooked. These were the closing allowance ($1,976), or the movement in the allowance ($216).

Example 3

When preparing a bank reconciliation at 31 March 2013, which of the following should be included in the reconciliation between the balance on the bank statement and the corrected balance on the general ledger?

(1) a cheque issued in January 2013, but not processed by the bank until 5 March 2013
(2) bank interest credited by the bank on 15 March 2013, but not yet recorded in the general ledger
(3) a lodgement made on 30 March 2013 which appears on the bank statement on 2 April 2013

A 1, 2 and 3
B 2 and 3 only
C 3 only
D 1 only

A bank reconciliation is carried out by completing the following steps:
compare the entries in the general ledger with the entries on the bank statement, to highlight differences between the two records;
for each difference, decide whether it is:
an error or omission in the general ledger
an error or omission on the bank statement
a timing difference

for each omission or error in the general ledger, a correcting entry needs to be made, resulting in a corrected balance on the general ledger account

prepare the reconciliation between the balance on the bank statement and the corrected balance in the general ledger.

Timing differences are those transactions which will be processed in one of the records before the date at which the bank reconciliation is being prepared, and after that date in the other record. These will be reconciling items between the bank statement balance and the corrected balance on the general ledger.

Any errors or omissions on the bank statement will also be dealt with in the reconciliation statement.

Applying these points to the three items in the question, the following can be noted:

Item (1) this was recorded in the general ledger in January 2013. While it took some time for the cheque to be processed by the bank, it had been processed *before* the date of the reconciliation (31 March 2013). Therefore it is not a timing difference and does not form part of the reconciliation (nor is any entry required in the general ledger)

Item (2) this is an omission in the general ledger and a correcting entry is required. As this transaction will be included in the corrected balance, it will *not be* included in the reconciliation.

Item (3) the lodgement will have been recorded in the general ledger on 30 March but, at 31 March, it has not appeared on the bank statement. Consequently, it is a timing difference and must be included in the reconciliation.

Thus, the correct choice is C.

Candidates who selected other choices which included either item (1) or items (1) and (3), either
did not have a sound grasp of the approach discussed above, or had not read the information
(specifically about dates) carefully enough.

Summary

The need to prepare thoroughly across the whole syllabus is paramount in exams such as FA2 which use objective test questions. The use of objective test questions means that each paper will test all areas of the syllabus.

A further feature of objective test questions is that those candidates who do not read the question very carefully are highly likely to select incorrect answers as discussed in the examples above.

The two key pieces of advice for candidates preparing for future sittings have not changed for a number of sittings. They remain:

prepare thoroughly across the full syllabus, ensuring that your preparation means that you fully understand the key points of each syllabus area; and

read each question very carefully. It will have been carefully drafted and checked to make sure it is clear - and it is not intended to 'catch you out'. However, there will almost certainly be some key words or a key phrase which must be taken into account in order to select the correct choice.