



Examiner's report

FA2 Maintaining Financial Records

For CBE and Paper exams covering January to June 2014

General Comments

Reports on previous sittings have emphasised the need for candidates to ensure that their preparation provided them with a good grasp of the technical content of the whole syllabus. In terms of approach to the exam itself, the need to think clearly, read the questions carefully and to adopt a logical and sequential approach to answering questions has also been noted in previous reports.

It is encouraging to note that this advice has been taken by a number of candidates and that overall performance has improved.

Unfortunately, not all candidates have taken the advice on board, leading to a number of incorrect answers. As has been the case in previous reports, this report considers three sample questions from the exams in the period under review in an attempt to provide guidance for candidates in future exams, so that they can avoid the most common mistakes.

Sample Questions for Discussion

Example 1

For the year to 31 March 2014, Clare's draft final accounts report a profit of \$86,528. However \$5,760 of revenue expenditure was incorrectly classified as capital expenditure on equipment. Clare depreciates equipment on a straight line basis over 6 years and charges a full year's depreciation in the year of acquisition.

When the error is corrected, what is Clare's revised profit?

- A \$91,328
- B \$80,768
- C \$92,288
- D \$81,728

This question was a test of candidates' knowledge of the impact of incorrect classification of expenditure. In this case, revenue expenditure has been incorrectly classified as capital expenditure. This means that:

assets have been overstated; and
expenses have been understated / profit has been overstated.

The next point to be considered is the value of the error. The majority of candidates answering this question did not consider the value, and simply adjusted the profit by \$5,760. In some cases this was correctly treated as an increase in expenses, and thus a reduction in profit, with choice B being selected. In other cases, the adjustment was incorrectly treated as a reduction in expenses, and this an increase in profit, with choice C being selected.

However, in both cases, these candidates did not think carefully enough about their answer.

If expenditure had been incorrectly classified as capital, there will have been a consequent overstatement of the depreciation expense. To some extent, the question provided a prompt that consideration should be given to

depreciation, as it provided information on the depreciation policy. This information was only necessary because an adjustment for depreciation was required.

The cost of the asset was \$5,760. With a depreciation policy of 6 years straight line, the annual depreciation charge is \$960. This amount would have been included in the depreciation charge when the accounts were drafted.

This means that the net adjustment is \$5,760 - \$960, or \$4,800.

A small proportion of candidates calculated the net adjustment correctly, but treated it as a reduction in expenses. Consequently, they selected choice A.

The correct answer was D (\$81,728) – the reported profit of \$86,528, less the net adjustment to expenses (\$4,800).

Example 2

Which of the following correctly describe(s) why a business entity should maintain accounting records in double entry format?

- (1) this is a legal requirement
- (2) to assist managers in exercising control
- A** both 1 and 2
- B** neither 1 nor 2
- C** 1 only
- D** 2 only

The most appropriate way to attempt a question in this format is to consider each of the statements in turn before looking at the content of the choices.

In the case of statement 1, there is no legal requirement for unincorporated entities (sole traders and partnerships) to maintain any accounting records at all, let alone double entry records. Indeed, many small entities will simply maintain daybooks. While this is not best practice, it is common. Therefore statement 1 is not correct.

A double entry system provides opportunities for checking the accuracy of accounting records through the extraction of a trial balance and carrying out reconciliations (bank, receivables, payables, personal account to supplier statement). These aspects assist managers in exercising control – for example ensuring that debts due to the entity are collected. Thus, statement 2 is correct.

Therefore, the correct choice was D.

Example 3

The balance on the receivables control account in Luis's general ledger was \$17,547 and the total of the list of balances from his receivables ledger was \$17,427. The following errors were discovered:

- (1) a payment of \$673 from a customer was entered in the cash received daybook as \$763
- (2) a debit balance of \$60 on a customer's account was treated as a credit balance

What is the corrected balance on Luis's receivables control account?

- A** \$17,457
- B** \$17,637
- C** \$17,517
- D** \$17,607

To calculate the corrected balance on the receivables control account, it is necessary to identify which of the errors affect the general ledger.

The incorrect entry in the daybook will affect the general ledger as this will lead to the incorrect amount being credited to the control account. (While it is not relevant in this question, this error will also affect the entries to the receivables ledger, and thus the listing of the balances from that ledger.)

The incorrect treatment of the customer's balance does *not* affect the general ledger – it will only affect the listing of the balances.

Thus the correcting entry required in the control account is \$90 (correct value of \$673 compared to incorrect entry of \$763). As the credit entry to the control account has been overstated, a debit entry is needed to correct it. The debit balance is therefore increased by \$90 to \$17,637 – choice B.

Candidates who selected choice A either treated the adjustment as a credit entry in the control account, or incorrectly treated the balance on the control account as a credit balance.

Choice C was selected by candidates who also included a general ledger entry in respect of the error in listing the balance. The value of the unnecessary adjustment was correctly calculated as \$120 (credit) - \$60 to remove the incorrect balance and a further \$60 to insert the correct balance.

Choice D was selected by candidates who only adjusted the general ledger balance in respect of the incorrect balance, but the value was \$60, not \$120.

Summary

As noted at the outset of this report, overall candidate performance has improved. Notwithstanding this improvement, the performance of candidates in the questions reviewed in this report suggests that while an insufficient knowledge of the technical content of the syllabus continues to lead to incorrect choices, fewer candidates are failing to read the question carefully. This is a positive sign and it is hoped that this improvement in performance will continue.