Examiner's report
FA2 Maintaining Financial Records
For CBE and Paper exams covering July to December 2016

General Comments

The intention of this report is that, when considered in conjunction with previous reports, candidates at future sittings will have a resource which maximises their chance of success. The most effective way to use the reports is to consider both the technical content of each question, and the approach to answering the question – noting that different question types will require slightly different approaches.

In considering the technical content, candidates should make sure that they have a clear understanding of that content. While not every candidate will use exactly the same approach, it is important to ensure that a logical and sequential approach is applied, based on relevant technical knowledge.

Sample Questions for Discussion

Example 1
At 31 December 20X6, Hamza had only two items in inventory. Data relating to the items are:

	Item 1	Item 2
	$	$
Purchase cost	3,524	4,158
Expenditure on improvements		
before 31 December 20X6	220	588
after 31 December 20X6	80	660
Expected sales value	4,600	5,200

In accordance with IAS2 *Inventories*, what is the value of Hamza's inventory at 31 December 20X6?
> A $8,490
> B $7,682
> C $8,284
> D $9,024

This question tested candidates' ability to apply the key requirement of IAS 2 – that 'inventories should be measured at the lower of cost and net realisable value'. IAS 2 goes on to provide definitions of both cost ('all costs incurred in bringing the inventories to their present location and condition') and net realisable value ('estimated selling price less the estimated costs of completion and the estimated costs necessary to make the sale).

The definitions in the standard could be simplified as follows:
> Cost = all costs <u>that have been</u> incurred up to the date of the statement of financial position
> NRV = selling price less cost that <u>will be</u> incurred after the date of the statement of financial position

Using the data in the question:
Item 1: Costs of $3,524 plus $220 have been incurred, leaving the total cost of the inventory at 31 December 20X6 at $3,744. The NRV of the inventory would be the selling price of $4,600 less the further cost to sell of $80, leaving a NRV of $4,520. The cost is lower therefore inventory item 1 would be measured at $3,744.

Item 2: Costs of $4,158 plus $588 have been incurred, leaving the total cost of the inventory at 31 December 20X6 at $4,746. The NRV of the inventory would be the selling price of $5,200 less the further cost to sell of $660, leaving a NRV of $4,540. The NRV is lower therefore inventory item 2 would be measured at $4,540.

Based on this, the total value of the inventory in Hamza's books should be $8,284 (£3,744 + $4,540), therefore answer C.

Candidates who selected A had correctly calculated cost, but did not apply the rule that this value should only be used if it is less than net realisable value.

Candidates who selected B did not recognise that conversion costs should be included in the cost of the inventory.

Candidates that selected answer D incorrectly included costs which had not yet been incurred in their calculation of cost.

Example 2
In which of the following circumstances would a suspense account be required?

(1) When the trial balance was extracted, the totals of the debit and credit columns did not agree, and the bookkeeper thinks he knows what has caused this
(2) A cash receipt was recorded in the cash received day book, but the bookkeeper does not know what the cash was for

        A Neither 1 nor 2
        B 1 only
        C 2 only
        D Both 1 and 2

This question is testing the candidates' knowledge of suspense accounts and when they should be used. In general, a suspense account should be used when the original double entry didn't balance or if the bookkeeper does not know what the opposite side of the double entry is. A suspense account is a temporary solution until the transaction or error can be investigated further.

Statement 1: if the trial balance does not balance, this indicates that there has been an error in the accounts and the debits and credits do not agree, suggesting that at least one of the bookkeeping transactions did not balance when originally posted. Therefore this would give rise to a suspense account.

Statement 2: as the bookkeeper does not know what the transaction if for, it cannot be posted to the correct account, therefore a suspense account should be used until the cash receipt has been investigated.

Thus the correct answer is D.

Candidates who selected any of the incorrect choices appear to have misinterpreted some of the information and / or not thought carefully about how a suspense account should be used.

This kind of question clearly illustrates the need for candidates to read the question carefully and to think carefully and logically before choosing their answer.

Example 3
Which of the following errors will be detected by extracting a trial balance?

    A A cash receipt of $624 was recorded in the cash received daybook as $642
    B An invoice issued to David Ellis was posted to Elliott Davis's account
    C The sales tax column of the sales day book was overcast by $99
    D A credit note issued to a customer was recorded as an invoice

Errors that can be detected by a trial balance are those in which the double entry transactions did not balance. If one of the totals in the books of prime entry (i.e. the sales day book) has been incorrectly cast, this would cause the original double entry to be out of balance. Therefore this would be detected when extracting a trial balance, thus answer C is the correct answer.

Transactions that have been incorrectly recorded in the books of prime entry would not cause an imbalance in the trial balance as both sides of the double entry would have been incorrectly posted. Therefore answer A is incorrect. Answer B does not relate to the double entry, this is referring to an invoice being posted to an incorrect memorandum account, so is also incorrect. D is referring to the whole entry being treated incorrectly; this would not cause an imbalance in the trial balance.

Summary
Based on the performance of candidates in these questions, it can be observed that there were two major reasons for incorrect choices being made.

The first is that there were gaps in candidates' knowledge caused by a lack of understanding of fundamental issues in the syllabus (eg valuation of inventory and the use of suspense accounts). The second is that the questions were not read carefully enough, which led to rushed or confused thinking.

These reasons have been highlighted in reports for every previous sitting. Candidates preparing for future sittings are strongly encouraged to ensure that they have developed a clear understanding of the key points of each area of the syllabus and that they read carefully and think logically when attempting questions.