Examiner's report
FA2 Maintaining Financial Records
December 2012

General Comments

The purpose of this report is to assist candidates at future exam sittings so that they can avoid the mistakes which are most often made by candidates. The means of doing this is to focus on three questions which were correctly answered by the lowest number of candidates at the December 2012 sitting. Observations on how to select the correct answer, and why the other choices are incorrect are made on each of these questions.

Example 1
Iona's cash takings of $2,468 for 30 November were not banked until 4 December.
At 30 November, her bank balance was an overdraft of $1,573 and she had a balance of $44 in her petty cash box.

What amount should be included in current assets in Iona's statement of financial position at 30 November?

A $939
B $44
C $2,512
D $895

This question tested candidates' ability to correctly classify assets and liabilities. The question also required careful reading in order to avoid selecting the wrong option.

The key to obtaining the correct answer was to note that, at the date of the statement of financial position (30 November), the trader had three separate items which needed to be classified – cash takings, an overdraft and a petty cash balance. Once this is clarified, it can be seen that the cash takings (£2,468) and the petty cash balance ($44) are current assets and that the total value is $2,512 ($2,468 + $44). The bank overdraft is a liability and, therefore, it is not part of current assets.

Option A was chosen by candidates who did not pay sufficient attention to the date on which the takings were banked. If the takings had been banked on 30 November, the overdraft would have become a balance of cash at bank of $895. When the petty cash balance of $44 is added, the result is $939. However, as the takings were not banked by 30 November, the overdraft at that date remains and the takings were in the form of cash.

Option D was chosen by candidates who made the error discussed in the paragraph above *and* also omitted the petty cash balance.

Option B was chosen by candidates who assumed that only the petty cash balance should be reported as a current asset.

Example 2
Luka and Eden have been in partnership, sharing profits and losses equally.
Greg was admitted to the partnership on 1 December 2012. At that date Luka and Eden each had a credit balance of $22,000 on their capital accounts.
It was agreed that:

(1) Goodwill, which would not be carried in the books of the new partnership, had a value of $42,000
(2) Profits and losses in the new partnership would be shared between Luka, Eden and Greg in the ratio 2:2:1
(3) Greg would introduce cash so that, immediately following his admission, the capital account balances of all three partners were equal

How much cash was Greg required to introduce?

A $34,600
B $26,200
C $30,400
D $17,800

Those candidates with a good understanding of the principles of accounting for a change to a partnership were able to successfully answer this question. The key knowledge that was required was that, on the admission of a new partner, the asset of goodwill is created through a debit entry in the goodwill account. The double entry is completed through credit entries in the capital accounts of the original partners. The value credited to each partner's capital account is calculated by dividing the goodwill in the old profit and loss sharing ratio. In this case, the old ratio was an equal share ($21,000) to each partner.

If goodwill is not to be carried in the books of the new partnership, it follows that a credit entry is required in the goodwill account to bring the balance on that account to nil. The double entry is completed through debit entries in the capital accounts of the new partners, with the value of each entry being calculated by sharing the goodwill in the new profit and loss sharing ratio. In this question the new profit and loss sharing ratio meant that the following debit entries were required:

Luka	2/5	$16,800
Eden	2/5	$16,800
Greg	1/5	$8,400

These entries lead to capital balances as follows:

Luka	$22,000 (Cr) + $21,000 (Cr) - $16,800 (Dr)	=	$26,200 (Cr)
Eden	$22,000 (Cr) + $21,000 (Cr) - $16,800 (Dr)	=	$26,200 (Cr)
Greg	$8,400 (Dr)	=	$ 8,400 (Dr)

Thus Greg must introduce $34,600 ($26,200 + $8,400) to bring his capital balance to a credit of $26,200.

Option B was selected by candidates who correctly calculated the closing balances on the capital accounts of Luka and Eden, but omitted the debit entry for goodwill in Greg's account. This can often arise when a candidate calculates a value which is included in the options, but fails to realise that their calculation is incomplete.

A few candidates calculated the adjustments on the original partners' accounts correctly, but swapped the debit and credit entries leading to revised balances of $17,800. Once again, the inclusion of this value in the choices meant that they stopped their calculation at that point.

One way of avoiding this is to ignore (or even cover up) the choices until the calculation has been completed.

Many candidates simply calculated the value of the debit entry required in Greg's account ($8,400) and used this in conjunction with the starting balance on each of Luka and Eden's accounts to obtain a value of $30,400.

Example 3
According to IAS 2 *Inventories*, which of the following is an acceptable basis for calculating the value of inventory?

A Always use the realisable value of each individual item
B Value all items at the most recent purchase price
C Value all items at the earliest purchase price
D Use the average cost of items purchased in the period

To successfully answer this question, candidates needed to have a good knowledge of the key principles used when valuing inventory.

IAS 2 recognises two methods of valuation, first in, first out and weighted average. In the case of weighted average, the two acceptable approaches are continuous weighted average and periodic weighted average. Choice D describes periodic weighted average, and is thus the correct answer.

The inclusion of 'realisable value' in choice A caused a problem for candidates whose knowledge of the principles was not sufficiently detailed. They did not appreciate that there is a difference between 'net realisable value' and 'realisable value'. Moreover, net realisable value should only be used if this is lower than the cost value.

For those candidates who did not read the question carefully, choices B and C caused some problems. In this case, B appeared to describe first in, first out and C appeared to describe last in, first out. Given that last in, first out is specifically prohibited by IAS 2, choice C could be ruled out as incorrect.

However, the fact that these choices suggested that all items would have the same unit value meant that both were incorrect. If the items in inventory had been bought at different dates and at different prices, then only the most recently purchased items would be valued at the most recent purchase price.

Summary
The report on the June 2012 session noted that same observations have been made over a number of sittings. These observations were that the two main reasons why candidates are not successful are:
- a lack of clarity about the key points of the topic; and
- not reading the question with sufficient care.

These observations remain valid following this session.