

Examiner's report

F3/FFA Financial Accounting
June 2012

The ACCA logo is a black square with the letters 'ACCA' in white, bold, sans-serif font.

General Comments

It was pleasing to see that candidates continued to perform well on questions associated with syllabus areas which are brought forward from FA1 and FA 2 and built upon at this level. Candidates had a particularly good grasp on questions associated with books of prime entry (including recording returns and discounts), inventory, non-current assets and incomplete records.

However, as reported in the last examiner's report (December 2011), some of the newer syllabus areas still remain problematic for candidates. There has been little improvement in June 2012 on questions testing preparation of simple consolidated financial statements and preparation of company disclosure notes.

Questions with the lowest pass rates continued to include:

- Calculation of goodwill
- Identification of associates and describing the principle of equity accounting
- Explanation of the purpose of disclosure notes and identification of what gets included

These topics were all covered in the examiner's report from December 2011. In May 2012, an examiner's article on preparation of simple financial statements had also been written.

It is disappointing not to see an improvement in the pass rates on these topics and candidates must make sure they devote enough time to understanding these syllabus areas.

Interpretation of financial statements continued to be an area that candidates performed well in, although one particular ratio gave many candidates difficulties in this exam. This particular question/ratio is debriefed below.

Other longer-established topics keep recurring as low scoring questions, and it is these syllabus areas which this report also revisits.

The following three questions have been taken from the International paper and were three of the questions with the lowest pass rates on the paper. The aim of reviewing these questions is to give future candidates an indication of the types of questions asked and guidance on dealing with exam questions, as well as a technical debrief on the topics covered by the specific questions selected.

Sample Questions for Discussion

Example 1

Extracts from the financial statements of Miller Co are shown below:

	31 May 2012
	\$000
Revenue	475
Cost of sales	<u>(342)</u>
Gross profit	133
Expenses	(59)
Finance cost	<u>(26)</u>
Profit before tax	<u>48</u>

What is the interest cover ratio for the year ended 31 May 2012?

- A 2.85
- B 1.85
- C 5.12

D 0.35

The correct answer is A. Option B was the most popular incorrect answer.

The key to calculating interest cover is to think about what the ratio is trying to show – i.e. whether the company can comfortably meet the current level of interest costs and whether a fall in profit would have a significant effect on the ability to meet such payments and therefore affect the profits available for ordinary shareholders.

The formula to calculate interest cover is;

Profit before interest and tax

Finance cost

The complication in this question is that the profit before interest and tax is not given in the information and so must be calculated.

Profit before interest and tax	$(133-59)$	$= 2.85$ (Answer option A)
Finance cost	26	

The majority of candidates (46%) selected answer option B, which incorrectly uses the profit before tax.

i.e. $\frac{48}{26} = 1.85$

Remembering what the ratio is trying to show should prompt candidates to think of the profit that is available to use to cover the finance charges, i.e. the profit before interest and tax.

Option C incorrectly uses gross profit to calculate interest cover ($133/26$), whereas option D incorrectly calculates interest cover by taking finance costs and dividing them by profit before interest and tax ($26/(133-59)$)

In ratio questions, be prepared to have to calculate a profit before interest and tax figure to use in a calculation of ratios such as interest cover, operating profit margin or return on capital employed.

Example 2

Marlon created a suspense account with a debit balance of \$1,250 in order to balance his trial balance.

He subsequently investigated and found the following errors:

- (1) The closing balance of the purchase ledger control account at the current year-end has been undercast by \$160**
- (2) Cash received of \$450 from customers has only been entered into the cash account**
- (3) The purchase returns day book has been overcast by \$300**

What is the remaining debit balance on the suspense account after these errors have been corrected?

- A \$640**
- B \$2,160**
- C \$1,860**
- D \$1,560**

The correct answer option is C

Suspense account			
b/f	1,250		
(1)Purchase ledger control	160		
(2)Receivables	450	Bal c/f	1,860
	<u>1,860</u>		<u>1,860</u>

Candidates struggle to deal with suspense account questions. The most efficient way to deal with these types of questions is to consider each transaction individually and establish if the transaction causes an entry to be made in the suspense account. This will only occur if an imbalance has been caused.

Transaction (1) - an addition error in a general ledger account will cause an imbalance. As a closing liability balance has been undercast this will have caused a credit entry to the suspense and will need correction by debiting the suspense account and crediting the purchase ledger control account with \$160.

Transaction (2) - Again, an imbalance has occurred as there has been a one sided transaction. The only entry has been to debit cash and therefore the credit has been made to the suspense account. In order to clear this off the suspense account, the adjustment would be to debit the suspense account and credit receivables.

Transaction (3)- Does not require an entry to the suspense account as the incorrect total from the purchase returns daybook has been posted into the ledger accounts and therefore will not need adjusting through the suspense account as no imbalance has occurred. The correction journal would be to debit purchase ledger control account and credit purchase returns.

Example 3

In the year ended 31 May 2012, Galleon Co purchased non-current assets with a cost of \$140,000, financing them partly with a new loan of \$120,000. Galleon Co also disposed of non-current assets with a carrying value of \$50,000 making a loss of \$3,000. Cash of \$18,000 was received from the disposal of investments during the year.

What should be Galleon Co's net cash flow from investing activities according to IAS 7 *Statement of cash flows*?

- A \$45,000
- B \$75,000
- C \$69,000
- D \$48,000

The correct answer option is B:

	\$
Purchase of non-current assets	(140,000)
Disposal proceeds of non-current assets	
(50,000-3,000)	47,000
Disposal proceeds of investments	<u>18,000</u>
Cash flow from investing activities	<u>(75,000)</u>

Option A was the most popular incorrect answer.

The key to answering statement of cash flows questions is to read the question stem to identify which section of cash flows is being asked for. In this question, it can be quickly identified that it is the investing section we are concerned about.

Then as you read through the question data, think about:

- 1) The cash effect of each transaction
- 2) Whether that cash flow would appear in that particular section of the cash flow - here in investing activities.

The purchase of a non-current asset of \$140,000 would be included in the investing section as a cash outflow. The common error that many candidates made in selecting answer option A, was to think that financing that asset purchase by proceeds from a loan of \$120,000 would mean that only \$20,000 would be the net cash outflow shown in the investing section. This is incorrect, as the whole \$140,000 purchase would be recorded in the investing section and the \$120,000 cash inflow from the loan would be shown separately in the financing section.

When disposing of non-current assets it is common in these question types to have to calculate the cash flow, i.e. the cash proceeds, from the information given in the question. In incorrectly selecting answer option D, candidates would have made two errors, in dealing with the net \$20,000 associated with the non-current asset and incorrectly using the carrying value of \$50,000 as the cash inflow from the sale of the asset.

As the carrying value of the asset disposed of is \$50,000 and having made a loss of \$3,000- it can be deduced that the sales proceeds must be \$47,000. ($\$50,000 - \$3,000$). Another common error would be for candidates to add the \$3,000 to the carrying value, incorrectly dealing with it as a profit on disposal and therefore arriving at \$53,000 sales proceeds, which is the error made in answer option C.

The receipt of \$18,000 from the disposal of investments is the easiest part of the question, as this is the cash flow which has been given. Candidates needed to realise this would be included in the investing section.

Conclusion

In this exam, some of the worst answered questions involved topics such as suspense accounts and cash flow statements which have featured in many previous examiner's reports. This suggests that more work is still needed. Careful reading of all the answer options and applying a methodical approach should help candidates improve their attempts.

However, as mentioned, preparation of simple consolidated financial statements and preparation of company disclosure notes continue to prove challenging and candidates are advised to read the December 2011 examiner's report and the recent examiner's article to help with their understanding of questions on these topics.