



Examiners' report

F3 Financial Accounting June 2008

General comments

This diet had a disappointing pass rate of only 48% compared with 67% in December 2007. It appears that candidates are not studying the breadth of the syllabus and are missing out on the opportunity to gain valuable marks. It must be stressed that the nature of a multiple choice / CBE exam means the entire syllabus can and will be examined so candidates should be aware of this when planning their studies.

Sample Questions for Discussion

Question 1

Charles entered into the following transactions:

1. He sold goods on credit to Cody with a list price of \$3,200. He allows a 10% trade discount and a further 2% discount for payment within seven days. Cody paid within two days.
2. He made a credit sale to Mary allowing a 5% trade discount on the list price of \$640.
3. He purchased goods for \$600 and paid \$590, receiving a discount for immediate cash payment.

How much discount should be recorded in the Discount Allowed account as a result of the above transactions?

- A \$57.60
- B \$10.00
- C \$352.00
- D \$409.60

The correct answer to this question is A which only records the early settlement discount allowed (see working 1 at the end of this report). However, more students selected D as the answer than those who correctly chose A. Option D included both the trade and early settlement discounts which was incorrect.

This suggests that candidates have a lack of knowledge in the treatment of discounts. There are two types of discounts that have to be dealt with – trade discounts and early settlement discounts. A trade discount is one which reduces the amount of money required from customers. The discount is not recorded in the accounts as the sale is recorded at the price charged net of the trade discount. In this question, items 1 and 2 include trade discounts which can be ignored as only the reduced sales price is accounted for in Charles' accounts.

An early settlement discount is a discount that is given or received for early settlement of an amount owed. It is up to the individual business whether they take this discount or not. In item 1, the early settlement discount allowed to Cody should be recorded in discounts allowed as Cody took advantage of the discount and paid early. This is the only discount that should have been recorded in the scenario.

Item 3 related to an early settlement discount that is received by Charles and therefore would be recorded in the discounts received account and not in discounts allowed.

Question 2

Johnsons use the imprest method of accounting for petty cash.

The petty cash was counted and there was \$57.22 in hand. The following petty cash slips were found for the following:

	\$
Stamps	16.35
Sale of goods to staff	12.00
Coffee and tea purchase	18.23
Birthday cards for staff	20.20

What is Johnsons' imprest amount?

- A \$124
- B \$100
- C \$112
- D \$80

The correct answer is B, although the majority of students selected A. This suggests that the question wasn't read carefully enough.

The way to answer the question was to work from the petty cash in hand and add back expenditure and deduct receipts to establish the opening balance. This technique was followed to arrive at answer A which suggested that students were aware of what they needed to do, but those who answered A missed that the sale of goods to staff would be a cash receipt for petty cash. Therefore, it is assumed that the question was not read carefully enough. This is an important factor for exam success as the questions need to be read carefully to understand both the requirement and the scenario information given. Candidates who selected A worked out most of the answer but lost marks by not reading the given information with sufficient care.

Question 3

Joanna has prepared her draft accounts for the year ended 30 April 2008, and needs to adjust them for the following items:

- Rent of \$10,500 was paid and recorded on 2 January 2007 for the period 1 January to 31 December 2007. The landlord has advised that the annual rent for 2008 will be \$12,000 although it has not been invoiced or paid yet.
- Property and contents insurance is paid annually on 1 March. Joanna paid and recorded \$6,000 on 1 March 2008 for the year from 1 March 2008 to 28 February 2009.

What should the net effect on profit be in the draft accounts for the year ended 30 April 2008 of adjusting for the above items?

- A \$1,000 decrease
- B \$1,500 increase
- C \$1,000 increase
- D \$1,500 decrease

The correct answer is C although only 30% of students who answered this question correctly selected this answer. The remaining responses were evenly spread across the other three answers. This suggests that students have problems dealing with the effect of accruals and prepayments.

The actual calculation of the accrual and prepayment is straightforward as reading the information carefully should enable students to arrive at an accrual for rent and a prepayment for insurance. It is very important to read the dates carefully to avoid unnecessary errors.

The question asks for the net effect on the profit for the year, so once the accrual and prepayment have been calculated the last step should be very easy and it is worrying that so many students failed to work this out. An accrual is an additional expense and hence will reduce profit, whereas a prepayment is an expense paid in advance so when adjusted will increase profit.

This is a key area in this paper and questions will often go beyond the simple calculation of an accrual and prepayment to ask for the effect on profit or assets / liabilities so students must ensure they are prepared for this.

Workings for answers

1.
 $\$3,200 \times 90\% = \$2,880$ selling price. Early settlement discount of $2\% = \$57.60$.
 As trade discounts are not recorded in the accounts; only the early settlement discount will be included in the discounts allowed account.

2.

Petty cash account			
	\$		\$
b/f	100.00		
Staff sales	12.00	Stamps	16.35
		Coffee and tea	18.23
		Birthday cards for staff	20.20
		c/f	<u>57.22</u>
	112.00		<u>64.15</u>

3.
 Rent accrual $4/12 \times \$12,000 = \$4,000$ additional expense
 Insurance prepayment $10/12 \times \$6,000 = \$5,000$ reduction in expense
 Net effect on profit = $\$5,000 - \$4,000 =$ increase in profit of $\$1,000$.