



Examiner's report

F3 Financial Accounting

For CBE and Paper exams covering July to December 2014

General Comments

There were two sections to the examination paper, with all the questions being compulsory. Section A consisted of 35 multiple choice questions of two marks each, covering a broad range of topics on the syllabus. Section B had two longer questions (15 marks) testing the candidates' understanding and application of financial accounting skills in more depth.

The following paragraphs report on each section and focuses on some of the key learning points.

Section A

This section tested a wide range of the syllabus and the majority of candidates attempted all the questions as required. Candidates preparing for the next examination of FFA/F3 are advised to work through the sample of questions discussed below and previous examiner's reports. Carefully review how each of the correct answers were derived. The sample questions are reviewed with the aim of giving future candidates an indication of the types of questions asked.

Sample questions for discussion

Example 1 (based on question 11)

During the year ended 30 September 2014 recorded the following cash transactions:

- (i) Payment of an annual insurance premium of \$12,000. This covered the period to 31 December 2014.
- (ii) Receipt of \$6,000 in respect of rent from a tenant covering the three month period to 30 November 2014.

What is the impact on the profit and net assets of making the year end adjustments for prepaid income and expenditure at 30 September 2014?

	Profit	Net Assets
A	Decrease \$1,000	Increase \$1,000
B	Decrease \$7,000	Increase \$7,000
C	Decrease \$1,000	Decrease \$1,000
D	Increase \$7,000	Increase \$7,000

This question is designed to test a candidates understanding of prepaid expenses and prepaid income and their impact on the statement of profit or loss and the statement of financial position.

A prepayment occurs when the following years expenses have been paid in the current year. In these situations it is necessary to remove the part of the expense which does not relate to the current year.



In this question the prepaid insurance can be calculated as \$3,000 (i.e. $\$12,000 \times 3/12$). A prepayment will increase profit in the statement of profit or loss and create a current asset in the statement of financial position.

The impact of the prepaid rental income which can be calculated as \$4,000 (i.e. $\$6,000 \times 2/3$) is to reduce income in the statement of profit or loss and hence reduce profit. It also creates a current liability in the statement of financial position.

The net impact of the two adjustments in this question is to reduce profit and net assets by \$1,000 (i.e. \$3,000 less \$4,000). The correct answer is therefore C.

Example 2 (based on question 14)

During the year to 30 September 2014 K Co made the following payments:

- (i) \$40,000 interest on \$800,000 10% loan stock issued on 1 January 2014.
Interest is payable on 30 June and 31 December.
- (ii) \$12,000 dividend on 200,000 \$1 6% irredeemable preference shares.
- (iii) \$5,000 dividend on 100,000 \$1 5% redeemable preference shares.

What should be the finance cost in the statement of profit or loss for the year ended 30 September 2014?

- A \$45,000
- B \$60,000
- C \$65,000
- D \$77,000

This question is testing the candidate's technical ability to recognise the need to accrue for expenses, in this case interest and the candidates' knowledge of the different accounting treatments of irredeemable and redeemable preference share dividends.

The interest on loan stock is a finance cost and needs to be calculated for the accounting period i.e. 1 January 2014 – 30 September 2014 (9 months only). Therefore, the interest calculation is $\$800,000 \times 10\% \times 9/12 = \$60,000$.

The \$12,000 dividend on the irredeemable preference shares is treated the same as dividend from ordinary shares, i.e. it is charged against retained earnings and disclosed in the statement of changes in equity NOT the statement of profit or loss. They can therefore be ignored in answering this question.

The \$5,000 dividend paid on the redeemable preference shares should be included in the statement of profit or loss because redeemable preference shares are treated the same as a loan. Therefore, the dividend on redeemable preference shares is treated as a finance charge.

The correct answer is therefore C i.e. \$65,000 ($\$60,000 + \$5,000$).



Example 3 (based on question 18)

The total of a list of balances in R Co's receivables ledger was \$633,700 on 30 September 2014. This did not agree with the balance on R Co's receivables ledger control account. The following errors were discovered.

- (i) A credit balance on an individual customer's account of \$200 was incorrectly extracted as a debit balance
- (ii) An invoice for \$3,223 was posted to the customer account as £3,232
- (iii) The total of the sales returns day book was overcast by \$500

What amount should be shown in R Co's statement of financial position for accounts receivable at 30 September 2014?

- A \$633,291
- B \$633,409
- C \$633,491
- D \$633,791

This question tests whether a candidate understands the difference between the receivables ledger and the receivables ledger control account.

The receivables ledger control account summarises large numbers of transactions in the general ledger. It is part of the double entry system and used to prove the accuracy of the ledger accounting system.

The receivables ledger is a memorandum account or list of individual transactions for so the company knows how much a customer is due to pay. This helps with credit control and cash flow management.

To answer this question, carefully consider each error and decide if and how it affects the receivables ledger, then make the correct adjustment. In this question only errors (i) and (ii) require correction, error (iii) would not be recorded in the receivables ledger.

The calculation is:

	\$
The balance as per the receivables ledger is	633,700
Error (1) correction	(400)
Error (2) correction	(9)
	633,291

The correct answer is therefore A.

Section B

In this section candidates are required to prepare various financial statements. However, many candidates were unsure of the format in which to present their answer and how to apply various accounting techniques.



The following comments explain how candidates might be able to improve their performance in future.

Cashflow statements

Have a thorough understanding of how to prepare a statement of cash flow in accordance with IAS7:

- Use the appropriate headings for example “Cash flow from operating activities”
- Use the correct notation to indicate the movements in cash e.g. state an increase or decrease and use brackets where necessary.
- Understand how to calculate the tax paid during the year.
- Remember to adjust the profit before tax for depreciation and any profit on the disposal of an asset.
- Always prepare workings that support figures in the statement. If you have a wrong final answer the script markers will always carefully scrutinise workings to identify if any credit can be given for method.

Consolidated Statements of Profit or Loss

Know the format for a consolidated statement of profit or loss and understand consolidation techniques. Some questions may require you to calculate key figures such as a profit figure when given a mark-up percentage, before you can calculate unrealised profit. Some of the common errors when preparing the consolidated statement of profit or loss include NOT:

- adjusting the revenue figure and cost of sales figure for the intra-group transactions.
- adjusting the cost of sales for the goods remaining unsold at the year end.
- clearly showing the profit attributable to the parent company and the non-controlling interest.
- adjusting the subsidiary profit for unrealised profit.
- showing workings for the calculation of the non-controlling interest.

Candidates also need to have an understanding of IAS 28 Accounting for investments in associates and joints ventures, in particular the application of the equity accounting.

Conclusions

Overall, many candidates might still be able to improve their marks by learning the format of the key financial statements, and focusing on their exam technique so that all questions are answered.