



Think Ahead

Maintaining Financial Records (FA2) September 2022- August 2023 Examiner's report

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for those sitting the exam in the future.

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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 this report 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. This computer-based examination consists of 50 compulsory objective test questions worth two marks each. In addition to multiple-choice questions, candidates may be presented with number entry, multiple response and multiple response matching questions in the FA2 exam.

This report discusses six questions with which candidates experienced difficulties.

Example 1

Which TWO of the following accounting treatments are examples of the application of accrual accounting?

- A Accounting for inventories at the lower of cost and net realisable value
- B Accounting for unsold goods as closing inventories in the year-end financial statements
- C Accounting for non-current assets by capitalising only the directly attributable costs
- D Accounting for depreciation charges on non-current assets

The correct answers are options **B** and **D**.

This question requires you to select the two options that apply accrual accounting. In simple terms, accrual accounting ensures that accounting transactions are recorded in the period to which they relate, rather than simply when cash is received or paid.

When a company purchases goods (cash or credit) for resale they are recorded as purchases within cost of sales. At the reporting date an adjustment is made for closing inventories if any items have not been sold:

Dr Inventories – SFP
Cr Cost of sales – P/L

This adjustment is made to reflect that the goods will now (probably) be sold in the next accounting period. The purchase cost is effectively removed from cost of sales in the current accounting period and included in the costs of the next accounting period (opening inventories). By adjusting for inventories in this way, the sale and the purchase can be matched in the period that they are sold so that the gross profit can be recognised in that period.

Accounting for depreciation is also an application of accrual accounting. When a non-current asset is purchased, the associated cost is not shown as an expense immediately. Instead, it is capitalised and recognised on the statement of financial position before expensing over the useful life of the asset. For example, if the asset has a useful life of five years, then the cost of this asset relates to the five-year period. The application of depreciation spreads this cost over five years to match the cost of the asset to the period over which it generates economic benefits.

Option A is incorrect. Accounting for inventories at the lower of cost or net realisable value is an application of prudence.

Option C is not correct. Capitalising only directly attributable costs is an application of the recognition criteria of IAS 16 Property, Plant and Equipment.

Example 2

Is each of the following statements about IAS 16 Property, Plant and Equipment true or false?

	True	False
1. All non-current assets accounted for in accordance with IAS 16 must be depreciated		
2. Depreciation is the process of putting money aside to replace an asset when it has expired		

The answer to each statement is **False**.

This is an example of a multiple response matching question and candidates will be required to select either the 'true' or 'false' box for the two statements.

Statement (1) is false. Land, generally, is deemed to have an indefinite useful life and so would not be depreciated.

Statement (2) is false. The asset has already been purchased. Depreciation is an application of accrual accounting and spreads the cost of the asset over its useful life.

Example 3

David's draft financial statements show a profit of \$8,000 for the year ended 30 June 20X4.

David's inventories at 30 June 20X4 were valued at \$25,000. This valuation includes a quantity of product H, valued at a cost of \$3,000, which is now obsolete. David expects to be able to sell product H during the year ended 30 June 20X5 for \$1,200.

Which **TWO** of the following statements are correct?

- A David should write down inventories by \$1,800 as an application of prudence
- B David will record the loss in relation to product H in his financial statements for the year ended 30 June 20X5, when they are sold
- C Closing inventories at 30 June 20X4 should be valued at \$23,800
- D David's adjusted profit for the year ended 30 June 20X4 should be \$6,200

The correct answers are options **A** and **D**.

Option A is correct. Inventories should be recorded at the lower of cost or net realisable value in accordance with IAS 2 Inventories. This is an application of prudence as assets must not be overstated.

Option D is correct. Inventories must be adjusted by \$1,800 (\$3,000 - \$1,200) to reflect the lower net realisable value of product:

Dr Cost of sales – P/L
Cr Inventories – SFP

The adjustment in profit or loss is a debit entry and, therefore, profit will reduce (reflects the future loss expected on the sale of inventories).

Adjusted profit for the year is calculated as follows:

	\$
Draft profit	8,000
Inventories adjustment	<u>(1,800)</u>
	<u>6,200</u>

Option B is incorrect as this does not apply the measurement criteria per IAS 2.

Option C is incorrect. Inventories should be recorded as \$23,200 (\$25,000 - \$1,800).

Example 4

Joshua rents out part of his warehouse to Marie. The rental agreement began on 1 October 20X5 and Joshua has received payments, quarterly in advance, as follows:

	\$
1 October 20X5	1,500
1 January 20X6	1,500
1 April 20X6	1,500
1 July 20X6	1,800
1 October 20X6	1,800

Joshua is preparing the financial statements for the year ended 31 October 20X6.

What is the amount of rental income to be included in Joshua's statement of profit or loss for the year ended 31 October 20X6?

\$

The correct number entry is **\$6,400**.

The rental on 1 October 20X5 was paid and accounted for in the previous accounting period. This related to the three-months to 31 December 20X5. At the reporting date of 31 October 20X5, an adjustment would have been made for deferred income of \$1,000 ($\$1,500 \times 2/3$). This will be reversed in the current accounting period so that the rental income for November and December 20X5 can be recognised.

From the rental on 1 October 20X6, only one month relates to the current accounting period and two months must be recorded as deferred income.

The rental income to be recorded in the statement of profit or loss can be calculated as follows:

	\$
Opening deferred income (see above)	1,000
Cash received in year (1,500 + 1,500 + 1,800 + 1,800)	6,600
Closing deferred income ($\$1,800 \times 2/3$ months)	<u>(1,200)</u>
Rental income in profit or loss	<u>6,400</u>

Alternative presentation:

		Rental income	
	\$		\$
Income in profit or loss (bal)	6,400	Opening deferred income	1,000
		Cash received	6,600
		(1,500 + 1,500 + 1,800 + 1,800)	
Closing deferred income	<u>1,200</u>		
	<u>7,600</u>		<u>7,600</u>

Example 5

On 1 June 20X7, one of Susan's customers had ceased trading and Susan recorded an irrecoverable debt expense of \$500. By the year end of 30 September 20X7, Susan had subsequently received \$300 of this amount which has been correctly accounted for. There were no other irrecoverable debts in the year.

The total expense related to irrecoverable debts and allowances for irrecoverable debts recognised in profit or loss for the year ended 30 September 20X7 was \$2,400. The allowance for irrecoverable debts balance at 1 October 20X6 was \$1,600.

What is the allowance for irrecoverable debts balance at 30 September 20X7?

\$

The correct number entry is **\$3,800**.

This question requires you to apply your knowledge of irrecoverable debts. It is important to note that the question asks for the balance on the allowance for irrecoverable debts. Many candidates incorrectly answered this question by giving an answer for the irrecoverable debt expense.

Firstly, calculate the amount of the irrecoverable debt expense that relates to the movement in the allowance. The total irrecoverable debt expense in profit or loss is \$2,400. Some of this relates to the irrecoverable debt from the customer in the scenario and the remainder will relate to the movement in the allowance. This can be calculated as follows:

	\$
Irrecoverable debt	500
Irrecoverable debt recovered	(300)
Increase in allowance (balance)	<u>2,200</u>
Irrecoverable debt expense	<u>2,400</u>

Secondly, calculate allowance balance at 30 September 20X7:

	\$
1 October 20X6	1,600
Increase in allowance (see above)	<u>2,200</u>
30 September 20X7	<u>3,800</u>

Example 6

The following are reasons for differences between the bank balances on a bank statement and the bank account in the general ledger.

Will entries be required in the general ledger for each of these differences when preparing a bank reconciliation?

	Yes	No
1. Bank charges which the bank had not told the business about		
2. A cheque sent to a supplier on the last day of the year which was not received until after the year end		
3. A deposit credited to the account in error by the bank		
4. A cheque lodged by a business one day before the year end		

The answer is 'Yes' to (1) and 'No' to (2) to (4).

This question is an example of a multiple response matching question and candidates are required to select the appropriate responses (as can be seen above). The question tests candidate knowledge of bank reconciliations

When looking at each of the four options, you need to decide if an adjustment would be made in the general ledger when performing a bank reconciliation.

The answer to statement (1) is yes. When reconciling the bank, the bank charges would need to be adjusted in the general ledger as the charges appear on the bank statement but were not known to the business and so no accounting will have taken place yet.

Statements (2) and (4) are examples of timing differences and would require an adjustment to the bank statement balance per the reconciliation, not the general ledger. The error in statement (3) has been made by the bank, not the business, and would also require adjustment to the bank statement balance per the reconciliation but not to the business' own accounting records.

Conclusion

Many candidates can score very well in this exam. Poor performance is generally a result of insufficient revision of the syllabus and not reading the question scenarios or requirements carefully enough.

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 to answer the questions.