



Think Ahead

# Maintaining Financial Records (FA2) September 2021- August 2022 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 these reports 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 a number of questions with which candidates experienced difficulties.

### Example 1

Harvinder is registered for sales tax. His customers and suppliers are also all registered for sales tax. The tax authority has just increased the rate of sales tax from 18% to 20%.

**Which of the following is/are TRUE for Harvinder as a result of the change in the rate of sales tax?**

- (1) His customers will each have a higher purchases figure in their statement of profit or loss**
  - (2) His sales figure will increase in his statement of profit or loss**
  - (3) His purchases figure will increase in his statement of profit or loss**
  - (4) His sales and purchases figures in the statement of profit or loss will be unchanged**
- A. 1 and 4 only**
  - B. 2 and 3 only**
  - C. 1 only**
  - D. 4 only**

The correct answer is **D**.

This question tests your knowledge of sales tax and how it affects the recording of transactions in the accounting system. There has been an increase in the rate of sales tax during the year. Subsequently, all parties will experience an increase in the gross amount they have to pay for goods and services subject to sales tax.

However, sales and purchases are always recorded net of sales tax when those entities are registered for sales tax. For example, if Harvinder sold goods to a credit customer for \$100 (excluding sales tax) when the rate of sales tax is 18%, the sale would be recorded as follows:

Dr Trade receivables	\$118	
Cr Sales		\$100
Cr Sales tax		\$18

Following the increase in sales tax to 20%, the same sale of \$100 will be recorded as follows:

Dr Trade receivables	\$120	
Cr Sales		\$100
Cr Sales tax		\$20

Therefore, you can see that the amount recorded within sales remains unchanged. This is also the case from a purchase perspective. Any sales tax on purchases would also be recorded in the sales tax control account.

Options 1, 2 and 3 are not relevant as sales and purchases will be unaffected and the correct answer is D.

### Example 2

Jane and Michael are in partnership sharing profits 60:40 respectively. 5% interest on capital is credited to each partner based on their capital account balance at the beginning of the accounting year.

Profit for the year ended 31 August 20X2 was \$32,000. Jane and Michael made drawings of \$19,000 each during the year. No interest on drawings is to be charged.

The balances on the partners' accounts as at 1 September 20X1 were:

	Current accounts (\$)	Capital accounts (\$)
Jane	20,000 Cr	20,000 Cr
Michael	18,000 Cr	10,000 Cr

**What was the balance on Michael's current account as at 31 August 20X2?**

\$

The correct number entry is **\$11,700**.

To calculate the balance on Michael's current account you first need to appropriate the profit for the year. There are no salaries or interest on drawings in this question so the only adjustment before the profit-sharing ratio can be applied relates to interest on capital.

The interest on capital for both Jane and Michael will need to be calculated first. This is then deducted from the profit of \$32,000 to find the remaining profit to be allocated according to the profit-sharing ratio.

Interest on Jane's capital account is \$1,000 ( $\$20,000 \times 5\%$ ) and interest on Michael's capital account is \$500 ( $\$10,000 \times 5\%$ ). Therefore, the remaining (residual) profit after interest on capital to be appropriated is \$30,500 ( $\$32,000 - \$1,000 - \$500$ ). As the profit-sharing ratio is 60:40 in Jane's favour, Jane would receive \$18,300 ( $\$30,500 \times 60\%$ ) of the residual profit and Michael would receive \$12,200 ( $\$30,500 \times 40\%$ ).

An appropriation of profit working can be used to find the amount to transfer to Michael's current account:

	<b>Michael</b>
	<b>\$</b>
Interest on capital – 5%	500
Profit-sharing ratio – 60:40	12,200
Drawings	<u>(19,000)</u>
	<u>(6,300)</u>

Once you have calculated Michael's share of profit for the year, the balance on the current account can be found as follows:

<b>Michael's current account</b>			
	<b>\$</b>		<b>\$</b>
Profit share (less drawings)	6,300	Balance b/f	18,000
Balance c/f	<u>11,700</u>		
	<u>18,000</u>		<u>18,000</u>

Alternatively, each individual item in the appropriation of profit working could have been entered separately into Michael's current account.

However you calculate it, the balance to be entered as the answer to this question is \$11,700.

### Example 3

Devi, a sole trader, bought a new motor car for \$15,000. Devi took out a business loan of \$9,600 and paid the balance from her personal bank account.

**What journal entry should Devi use to account for this transaction?**

- |           |                          |                 |                          |                 |
|-----------|--------------------------|-----------------|--------------------------|-----------------|
| <b>A.</b> | <b>Dr Loan</b>           | <b>\$9,600</b>  | <b>Cr Motor vehicles</b> | <b>\$15,000</b> |
|           | <b>Dr Capital</b>        | <b>\$5,400</b>  |                          |                 |
| <b>B.</b> | <b>Dr Loan</b>           | <b>\$9,600</b>  | <b>Cr Motor vehicles</b> | <b>\$15,000</b> |
|           | <b>Dr Cash at bank</b>   | <b>\$5,400</b>  |                          |                 |
| <b>C.</b> | <b>Dr Motor vehicles</b> | <b>\$15,000</b> | <b>Cr Loan</b>           | <b>\$9,600</b>  |
|           |                          |                 | <b>Cr Capital</b>        | <b>\$5,400</b>  |
| <b>D.</b> | <b>Dr Motor vehicles</b> | <b>\$15,000</b> | <b>Cr Loan</b>           | <b>\$9,600</b>  |
|           |                          |                 | <b>Cr Cash at bank</b>   | <b>\$5,400</b>  |

The correct answer is **C**.

This question tests your knowledge of recording transactions in the accounting system by posting a journal entry. Devi has purchased a new car for the business, and this has been financed with both a business loan and by using some of Devi's personal funds.

As a result, non-current assets (motor vehicles) will increase by \$15,000. When an asset increases it is recorded in the accounting system as a debit entry. The business loan of \$9,600 will increase the liabilities of the business and an increase in a liability is recorded as a credit entry. Finally, Devi financed the remainder of the motor vehicle using funds from her personal bank account. This is an example of capital introduced for a sole trader. The business now owes this money back to Devi and therefore the capital account will increase. When there is an increase in capital, this is recorded in the accounting system as a credit entry.

### Example 4

Roger bought a non-current asset for \$40,000 with an estimated useful life of four years. The asset was depreciated on a straight-line basis with a residual value of \$4,000. The asset was scrapped after three years.

**What was the loss on disposal?**

\$

The correct number entry is **\$13,000**.

To calculate a gain or loss on disposal the carrying amount of the asset at disposal is compared to the disposal proceeds. If the disposal proceeds are greater than the

carrying amount of the asset, then there is a gain on disposal. If the disposal proceeds are less than carrying amount, then there is a loss on disposal. In this example the sales proceeds are zero because the asset has been scrapped and therefore there must be a loss on disposal of the asset.

It is important that you pay attention to any residual value in questions like this and understand how to calculate the carrying amount of the asset at the date of disposal. This will then allow you to calculate the loss on disposal:

	\$
<b>Depreciable amount of asset:</b>	
Cost	40,000
Residual value	<u>(4,000)</u>
Depreciable amount	<u>36,000</u>
 <b>Carrying amount at disposal:</b>	
Cost	40,000
Accumulated depreciation (\$36,000 x 3/4 years)	<u>(27,000)</u>
Carrying amount	<u>13,000</u>
 Disposal proceeds	 0
Loss on disposal	<u>13,000</u>

Note that although the annual depreciation charge (and therefore the accumulated depreciation at the date of disposal) is calculated using the depreciable amount of the asset, the carrying amount at disposal is calculated by deducting the accumulated depreciation from the **cost** of the asset. It is not deducted from the depreciable amount of the asset.

It is also important to note that the residual value represents Roger's estimate of how much the asset would have been worth at the end of its useful life. It does not represent any guaranteed proceeds from disposing of or scrapping the asset.

### Example 5

The following errors have been detected in a bookkeeping system:

- (1) \$1,000 paid for purchase of plant has been debited to plant repairs.  
Depreciation for a full year at a rate of 20% per annum has yet to be charged
- (2) \$10,000 of additional capital received from the owner has been credited to the sales account

**What is the net increase or decrease in profit when these errors are corrected?**

- A. \$9,200 increase
- B. \$9,200 decrease
- C. \$10,800 increase
- D. \$10,800 increase

The correct answer is **B**.

Although there are only two notes in this question, there are actually three errors. Firstly, recording the purchase of plant as a repair is an example of an error of principle and results in expenses being overstated initially. The second error results from the fact that, in the absence of an asset, depreciation has not been calculated. The third error relates to an error in recording capital introduced which should not be recorded as a sale.

The requirement to the question is not to provide a journal entry to correct the errors but to consider the impact on profit that the correction of errors would have. In your workings, a good way to answer this type of question is to think about what has happened, what should have happened and what will the correcting journal be. If there is an adjustment to a profit or loss account, remember debit entries reduce profit and credit entries increase profit.

(1) Purchase of plant

The original journal has been posted as:

Dr Plant repairs (expense)	\$1,000	
Cr Bank		\$1,000

The journal that should have been recorded is:

Dr Plant (asset account)	\$1,000	
Cr Bank		\$1,000

To correct the original error:

Dr Plant (asset account)	\$1,000	
Cr Plant repairs		\$1,000

Note: the credit to plant repairs will increase profit.

Depreciation of \$200 ( $\$1,000 \times 20\%$ ) will also need to be charged for the year as follows:

Dr Depreciation expense	\$200	
Cr Plant accumulated depreciation		\$200

Note: the debit to the depreciation expense account will reduce profit.

(2) Additional capital received

The original journal has been posted as:

Dr Bank	\$10,000	
Cr Sales		\$10,000

The journal that should have been recorded is:

Dr Bank	\$10,000	
Cr Capital		\$10,000

To correct the original error:

Dr Sales	\$10,000	
Cr Capital		\$10,000

Note: the debit to the sales account will reduce profit.

Overall, the impact on profit is a decrease of \$9,200 (+\$1,000 - \$200 - \$10,000).

### Example 6

Jane invested \$20,000 to start a new business. At the end of the first year of trading she had the following assets and liabilities:

	\$
Motor vehicle	15,000
Equipment	2,300
Inventory	950
Trade receivables	2,468
Cash at bank	1,723
Trade payables	3,005

During the year Jane had taken drawings of \$1,000 per month.

**What is Jane's profit for the year?**

\$

The correct number entry is **\$11,436**.

In this question, you are required to consider the information contained within the question to calculate Jane's profit for the first year of trading. A good way to do this is to use the accounting equation where assets – liabilities = capital introduced + profit – drawings. This can be done as follows:

	Assets	-	Liabilities	=	Capital	+	Profit	-	Drawings
	\$		\$		\$		\$		\$
Capital introduced					20,000				
Motor vehicle	15,000								
Equipment	2,300								
Inventory	950								
Trade receivables	2,468								
Cash at bank	1,723								
Trade payables			3,005						
Drawings									12,000
	22,441	-	3,005	=	20,000	+	?	-	12,000

Once the information has been input into the accounting equation working, the balancing amount will be the profit for the year of \$11,436. The accounting equation can also be rearranged to calculate the missing profit figure: profit = assets - liabilities - capital + drawings.

### 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.