INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Financial Accounting	**SESSION** Intermediate Examination - Autumn 2013

General:

Overall performance in the paper was better than previous attempts. The paper consisted of shorter questions and covered a wide range of topics of syllabus. Hence those students who had not covered the entire syllabus were unable to perform well. Consequently, poor performances were witnessed in Questions 4 and 7.

Other weaknesses were as follows:

- Students did not read the questions carefully, resulting in mistakes that can be avoided.
- They also produced additional information which was beyond the requirement of the question.
- Generally the candidates lacked practice as they performed simple calculations using lengthy methods which resulted in time pressures.

Question 1 (a)

This question tested the knowledge and understanding regarding presentation of related party disclosures in the financial statements as required under IFRS and Companies Ordinance 1984. Most of the candidates performed very well and scored high marks.

The common mistakes observed were as follows:

- The justification for arriving at a particular decision was not provided.
- In part (i), majority of the candidates believed that economic dependence always creates a related party relationship.
- Most of the students mentioned that the trustees of gratuity fund are the related party, whereas the related party was the gratuity fund.
- Many students did not know that uncle is not considered a close member of a person's family, under IFRS or Companies Ordinance and hence is not a related party.

Question 1 (b)

Performance in this part was not as good as in part (a) because the candidates lacked complete knowledge of the disclosure requirements. Following disclosures were not covered by most of the candidates:

- That the transactions are carried out in ordinary course of business at commercial rate/arm's length except when stated otherwise.

- That markup of 20% of cost was charged from the subsidiary as against the company's policy of markup of 30% of cost.

Question 2

The question required journal entries for transactions involving purchase of assets and subsequent revaluation and impairment. A large number of candidates performed well and secured good marks. Several students got full marks also. Some of the mistakes that were generally observed were as follows:

- While recording reversal of impairment in July 2012, most of the students failed to record the revaluation income to the extent of revaluation expense previously recognized. Many of those who did consider the prior years impairment of Rs. 8 million did not realize that recognition of income should be limited to Rs. 7 million i.e. Rs. 8 m / 8 years x 7 years (remaining useful life).

- Many students did not transfer the incremental depreciation charged due to revaluation, from Surplus on Revaluation to Retained Earnings.

- Many students did not keep track of the credit balance in the "Surplus on revaluation account" and consequently while writing down the value of plant on 01 July 2011 they debited the entire decrease in the value of plant to surplus on revaluation account whereas amount of Rs. 8,000 should have been debited to P&L account.

Question 3

The students' performance in this question was below average. Students are so accustomed to indirect method of cash flow that whenever a question is asked about direct method most of them fail to perform well.

This time also most of the students seemed to lack the practice of preparing cash flow statement through direct method and made various errors. Some of the common errors are enumerated below:

- Various students ignored explicit instructions for adopting the direct approach and prepared cash flow statement based on indirect method.

- A large number of candidates did not know the correct format of the cash flow statement.

- Most of the students did not know the correct way of calculating the cash paid to suppliers. A key step in this process was the calculation of cost of sales and expenses which should have been calculated by deducting the profit before tax from the Sales Revenue.

- In computing tax paid, many students ignored opening and closing balance of deferred tax.

- Most of the students failed to gross up the profit after tax by dividing it with 65% to arrive at profit before tax. Consequently, they also failed to correctly compute the taxation expense for the year.

- Majority of the candidates did not adjust non-cash items while calculating cash paid to suppliers and employees.

Question 4

This question required preparation of projected financial statements using relationships involving various ratios. However, the overall response was well below par and very few students were able to secure passing marks which clearly indicated a lack of practice in solving such questions. The commonly observed errors were as follows:

- Most students failed to realize that current ratio of 1.5 means that current assets are 3 times the working capital. Consequently, they were unable to compute current assets as well as current liabilities. As a consequence, such students were also unable to compute other current asset and liabilities which were balancing figures in current assets and current liabilities respectively.

- Very few students knew that the difference between current ratio and quick ratio is due to the value of inventory. Therefore, they were unable to compute the closing inventory and consequently they could not calculate opening inventory as well as purchases.

Question 5

The question contained three parts. In each part details of certain expenses were provided and the candidates were required to discuss their accounting treatment.

Question 5 (a)

This part was quite easy and several students got very good marks. However, there were several students who did not read the question carefully and somehow discussed revenue recognition instead of discussing treatment of expenditure incurred on development of vaccines.

Some of the students who correctly mentioned that cost of Vaccine A would be amortized over five years, failed to provide appropriate justification.

In respect of vaccine B, most of the students correctly mentioned that the cost could not be amortized since its life is indefinite, but failed to mention that the cost would be subject to impairment test.

Question 5 (b)

Most of the students incorrectly mentioned that advertising campaign should be capitalized and amortized over the period of two years. Only few students were able to clarify that cost are recognized when incurred. However, since the advertisement campaign was to continue over two different accounting period, the cost pertaining to next year should be treated as prepaid.

Question 5 (c)

Most of the students correctly mentioned that the training costs shall be recognized as expenses immediately.

Question 6

Considering the repeated nature of this question the overall response was quite poor as only limited number of students were able to secure passing marks.

The following points were important in the given scenario:

- The construction contract covered two different accounting periods but borrowing cost was to be computed in respect of accounting year ended 30 June 2013.
- There were 2 types of financing. Whereas the long term loan remained outstanding for the entire accounting period, the running finance account showed positive as well as negative balances. Borrowing cost was to be calculated when the balance became negative whereas income at 8% per annum could be earned on positive balance and the income was required to be set off against the borrowing costs.
- The construction work was suspended for a period of one month.

Most of the students made following types of errors.

- Many students ignored the receipts from customers and consequently they could not arrive at the correct balances for calculating borrowing costs. Quite obviously, such students missed the income altogether.
- Many students calculated the borrowing costs related to long-term loan on the entire period instead of the relevant accounting period.
- Many students computed borrowing costs on entire running finance facility.
- The impact of suspension of construction work was ignored.
- Most of the students computed borrowing expense for each payment @ 14% and income on all receipts @ 8%. This was an incorrect approach.
- Some students tried to compute the average rate of borrowing by weighted average or other incorrect approaches.

Question 7

This question required preparation of relevant extracts from correction of error note and retained earning column as would appear in the Statement of Changes in Equity (SOCE). A poor response was observed as students seemed to lack the knowledge as well as the practice required to deal with this question. The most common errors were as follows:

- While computing the opening balance of retained earnings in July 2011 most of the students failed to add up the dividend for the year 2011 in the closing balance of retained earnings. Many candidates started the SOCE from Ist July 2012 instead of Ist July 2011.
- Most of the students did not mention the word 'restated' against the profit for the year 2012 and retained earning balance as at June 2012. This is an important disclosure as it clarifies a very important fact.
- While computing the corrected profit after tax, many students ignored deferred tax.
- Many students did not adjust dividend in either years.
- Presentation of correction of errors note was incorrect in most of the cases whereas many students omitted this part altogether.
- Some students correctly identified the impact on Profit and Loss but did not disclose the impact on balance sheet.

Question 8

The overall response to this question on Lease accounting and disclosures was quite satisfactory. The common mistakes were as follows:

- Most of the students did not disclose the discount rate and the fact that lease installments are paid annually in advance.
- Most of the students allocated depreciation over a period of six years instead of five years as depreciation is allocated on the basis of lease period or useful life whichever is lower.
- Many students included the entire profit on sale of plant in one year instead of allocating it over the lease period.

THE END