INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	**SESSION**
Financial Accounting	Intermediate Examination - Spring 2008

Overall feedback

Overall performance of the candidates was very disappointing and only very few were able to score good marks. Lack of in-depth reading of International Accounting Standards as well as inadequate practice was evident in most of the scripts. It was noted in many scripts that candidates performed exceptionally well in one or two questions but their performance in other questions was equally bad. It was indicative of the fact that the students had resorted to selective studies.

Q.1 It was an easy question requiring the candidates to prepare Cash Flow Statements in accordance with the requirements of IAS-7. This question was fairly attempted by many candidates. However, following mistakes were commonly observed in many scripts:

- The profit before tax was required to be calculated by reconciling the opening and closing balances in the un-appropriated profit and loss account. In the reconciliation many candidates incorrectly adjusted the provision for gratuity and financial charges whereas no adjustment was made in respect of dividend.

- Provision for gratuity was classified as financing activity instead of operating activity. Many candidates correctly included gratuity paid in the outflows but did not add back the provision for gratuity as non-cash item.

- The final dividend of 2006 which was paid during the year 2007 should have been incorporated in the Cash Flow Statement. Instead, many candidates recorded the final dividend of 2007 which was paid after the close of the year 2007.

- While computing the effect of changes in working capital, many students did not adjust the impact of Advance Income Tax and Accrued Markup on Long Term Finance while computing increase/decrease in "Advances, Deposits and Prepayments" and "Creditors, Accrued and Other Liabilities", respectively.

- Increase in share capital was due to issuance of bonus share out of share premium account. Still, a number of students recorded the increase as proceeds from issue of shares.

- Many candidates classified the movement in current maturity of long term loan as increase/decrease in current liability.

Q.2 The question aimed to test student's understanding on Current and Deferred Taxation. Most of the candidates were able to work out the tax expense for the current and corresponding period but failed to compute the deferred tax expense of the same periods.

Following errors were commonly noted in many answer books:

- While computing the tax charge for 2006 and 2007, the brought forward losses of the company were not considered.
- Few candidates added the capital gain as an inadmissible deduction instead of deducting it as income exempt from tax.
- Many candidates did not calculate the deferred tax liability as on January 1, 2006 and therefore failed to compute the deferred tax expense for the year 2006.
- Some of the candidates calculated the deferred tax expense as the difference between tax on taxable profit and tax on accounting profit, without giving due consideration to permanent differences.
- Most of the candidates ignored carried forward losses for the purpose of determining deferred tax expense.

Q.3 This question tested the concept of capitalization of borrowing costs. Few of the students were able to perform exceptionally well by demonstrating their clear understanding of IAS-23. However, following common mistakes were observed in many scripts:

- Many students added the cost of equity i.e. dividend in the borrowing costs which is in contravention of paragraph 3 of IAS-23.
- While capitalizing the borrowing costs, many candidates did not take into consideration the suspension period in line with paragraph 23 of IAS-23.
- Instead of deducting the interest earned on unutilized portion from borrowing costs, many students incorrectly adjusted it while computing the effective borrowing rate.
- A large number of candidates computed the borrowing costs on total borrowings. In fact, only the amount of loan utilized for the project and the related time period; should have been considered for determining the borrowing costs for capitalization.
- Few candidates incorrectly calculated the capitalization and suspension periods and thus lost valuable marks.

Q.4 This was the easiest question of the paper. Students were required to re-arrange the available information in accordance with the requirements of IAS-24. Although it was an open book examination, a large number of candidates did not attempt this easy question.

Common mistakes included the following:

- Nature of related party relationship such as Subsidiary, Associate, Director Entity having significant influence, Key Management Personnel etc. was not mentioned (Disclosed).
- Nature of transactions like sale, purchases, discount etc. was not disclosed.
- Loan to Chief Executive was classified under the head "Key Management Personnel" instead of "Director".
- Very few students disclosed the correct movement in the advance given to the Chief Executive. The opening balance should have been computed by adding the closing balance of Rs. 1.1 million and the amount paid during the year i.e. Rs. 0.3 million thus arriving at Rs. 1.4 million. Instead, most of the candidates deducted Rs. 0.3 million from the original amount of loan to arrive at Rs. 1.7 million as the opening balance. Surprisingly, few candidates disclosed the difference of Rs. 1.7 million and Rs. 1.4 million as bad debts.
- All related party transactions were made on commercial terms and conditions except the special discount given to M/s Sami Motors Limited. Most of the candidates failed to disclose the above fact in their answers.

Q.5 This question required preparation of journal entries and disclosure in the books of lessor in accordance with the requirements of IAS-17. The overall performance was very disappointing specially in view of the fact that it was an open book examination. It seemed that most of the students had not studied this important topic of the syllabus.

The common mistakes were as follows:

- Some candidates worked out the amortization schedule on the basis of useful life instead of lease term.
- While computing the Gross Investment in Leases, many students added the value of the machine at the end of lease term i.e. Rs. 300,000 to the future lease payments, instead of adding the price at which bargain purchase option was exercisable i.e. Rs. 100,000.
- Net Investment in Leases is determined by deducting the unearned income included in future payments, from the Gross Investment in Leases. Many students were altogether unaware of it whereas many of them could not calculate the unearned income correctly.
- Many candidates did not split the Net Investment in Leases between long term and current portion.
- IAS 17 requires the lessor to disclose amount of Net Investment in Leases and Gross Investment in Leases in three broad categories i.e. less than one year, over one year but less than five years, and over five years. Most of the candidates failed to comply with this requirement.

- Installments received from the lessee were adjusted against unearned finance income instead of being debited to bank/cash.
- Surprisingly, few candidates made journal entries in the books of lessee instead of lessor as clearly required in the question.

Q.6 This was an easy question and most of the students could draw the projected Profit and Loss Account and the Balance Sheet correctly. However, the following mistakes were witnessed in some of the answers:

- Total of equity and liabilities were worked out on the basis of opening balance of share holders equity.
- Current liabilities were shown as a consolidated figure. The data available in the question could have been used to bifurcate it further between Trade Creditors and Other Current Liabilities.
- Totals of balance sheet were missing. Since adequate data was available in the question to arrive at the total of the balance sheet, and many of the other figures were balancing figures, such totals were important and should have been given.

THE END