INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Financial Accounting	Intermediate Examinations -Autumn 2008

Overall Feedback

Performance in this paper was an improvement on the previous examinations. However, it was commonly observed that many students did not study the questions carefully which resulted in loss of valuable marks.

It was observed in many scripts that while explaining their point of view on IASs/IFRSs, the students just quoted paragraph number of the relevant IAS/IFRS instead of producing the required portion on their answers scripts. All students are advised to avoid such practice in their future examinations.

Question-wise Comments:

Q.1 This was a very straight forward question which required the candidates to work out the number of shares to be issued to the partners of a firm on being converted into a limited company. A large number of candidates performed well and secured full marks.

The following mistakes were however observed :

- The correct way to compute the number of shares was to revalue the assets, distribute the profit on realization between the partners using their existing profit sharing ratio, adding the profit to the existing capital of the partners and then dividing the outcome with the par value of the shares. Instead, some candidates worked out the value of net assets of the partnership after revaluation and allocated the whole of it to the old partners without considering the original values and the existing capital of the partners.

- Some candidates treated the amount of Rs. 200 million brought in by Mr. Cee as the goodwill of the firm. This was quite surprising as students at this level are not expected to make such mistakes, more so when the amount of the goodwill was clearly mentioned in the question.

- Few of the students could not understand the meaning of unrecognized liabilities and **deducted** these from the accrued liabilities instead of **adding** them.

Q.2 (a) An average response was observed in this part of the question which tested the application of IAS-8. Situation (i) tested the application of change in accounting estimates whereas situation (ii) tested the application of change in accounting estimates and errors in prior periods.

Following mistakes were commonly observed:

- While recalculating the depreciation, some of the students revised the residual value but did not revise the remaining useful life of the machine and vice versa.
- According to the question the revised residual value of the machine was 10% of cost. Some students took it as 10% of written down value.
- According to the question, the **remaining** useful life was to be revised to 6 years. Instead, many candidates revised the **total** useful life as 6 years.
- In situation (ii), many candidates did not know that the effect on prior year's retained earning was required to be worked out.

(b) In this question the candidates were asked to discuss the requirements of IASs in respect of estimation and revision of useful life of an item of property, plant and equipment. Although the question was attempted well by the majority yet many candidates wasted their time in writing lengthy replies rather than sticking to the exact requirements of the question. Few candidates incorrectly declared that change in accounting estimates shall be applied retrospectively.

Q.3 A very poor response was witnessed in this question related to leasing and impairment of property, plant and equipment in which the candidates were required to prepare journal entries in respect of sale and lease back of three generators.

Some of the common errors observed in the answer scripts are discussed below:

- Many candidates correctly worked out the impairment loss and loss on sale of generators but did not prepare the required journal entries.
- Instead of recording the amount of financing as the sales proceeds, a large number of candidates considered the fair value of the generators as the proceeds from the sale and lease back transaction.
- Many candidates correctly prepared the entries to record the gain or loss on sale and the impairment of assets but did not prepare the entries to record the lease back of assets.
- A large number of candidates did not prepare the journal entries to record impairment loss, in case of generator A and B.
- When there is a gain on sale and lease back transaction, it should be deferred and amortized over the lease period. Very few students could demonstrate their knowledge in respect of the above.

Q.4 In this question eight different situations were given and in respect of each situation, the candidates were required to identify whether a related party relationship existed, along with appropriate arguments to support their point of view.

An average performance was witnessed and the common mistakes were as follows:

- A large number of answers were limited to identification of related party relationship without providing adequate supporting arguments, which was an important requirement of the question.
- Most of the students were influenced by the definition of Associated Undertaking as given in the Companies Ordinance, 1984 and included all such relationships as related party relationships. They failed to realize that the scope of related party relationship as given in IAS-24 is quite different.
- Many students incorrectly classified the major supplier and distributor as related party whereas according to IAS-24, a supplier or distributor cannot be treated as related party only by virtue of resulting economic dependence.
- In item (v), few students did not treat Mr. Tee as a related party although being a Key Management Personnel and having responsible for all major decisions made in respect of sales prices and discounts, he was very much a related party.
- Many candidates identified Mr. Zee, the brother of the company's CEO as a related party. They failed to give due emphasis to the fact that Mr. Zee can only be treated as a related party if he is in a position to influence his brother i.e. the CEO of the company.

Q.5 It was a very simple question requiring the candidates to prepare a balance sheet in accordance with the disclosure requirements of IAS and the Companies Ordinance, 1984. These type of questions are a regular feature of almost every paper yet it seems that the amount of efforts that is put in by the candidates in this area is quite inadequate. In order to improve their performance, it is important that they should have in-depth knowledge of the Accounting Standards and Companies Ordinance, 1984. Many of the students however feel and quite rightly so, that the disclosure requirements as given in the IASs and the Companies Ordinance are too exhaustive. The students are therefore advised that a relatively easy way to grasp at least the important requirements is to study the financial statements of some of the good listed companies. Another important point to remember is that while answering such questions, adhering to all aspects of the disclosures is important. For example, many students tend to ignore some or more of the following:

- Headings and sub-headings such as Assets, Equities and Liabilities, Current Assets and Current Liabilities are ignored.
- Some of the columns of the note on property, plant and equipment are ignored.

- Authorized Share Capital is not disclosed.

- Some of the relatively unimportant details are ignored although they do carry marks. For example, many students didn't write "40,000,000 shares of Rs. 10 each" while disclosing the paid-up capital of Rs. 400 million.

- Inappropriate terminology is used, for example most of the candidates write "Fixed Asset Revaluations" instead of Surplus on Revaluation of Fixed Assets.

- Secured and unsecured Trade Debts and those considered good and bad are not segregated.

All of the above disclosures are important and carry marks. In addition to the above discrepancies which are witnessed whenever such a question is framed, following are the mistakes which were noted in this question:

- It was clearly indicated that the trial balance given in the question was a post closing trial balance. Very few of the students seemed to know the difference between a pre-closing and a post-closing trial balance and therefore calculated many figures, specially those related to fixed assets incorrectly.

- Many students did not read the requirements of the question carefully which clearly stated that note on accounting policies was not required. They wasted time in writing detailed accounting policies relating to each component of the balance sheet and lost valuable time.

- A large number of candidates incorrectly classified surplus on revaluation of fixed assets as a component of equity whereas it should have been shown as a separate line item before non-current liabilities.

- Deferred taxation was incorrectly disclosed as a current liability instead of deferred liability.

- Majority of the candidates included intangible assets in property plant and equipment instead of showing them as a separate line item.

- As discussed previously also, very few candidates were able to segregate the account receivable into secured and unsecured or those considered good and considered doubtful. Most of them also failed to disclose the movement in provision for bad debts.

- Most candidates failed to segregate the advances to suppliers between short term and long term.

Q.6 (a) It was a very simple question from IAS-10 and well attempted by majority of the candidates.

(b) Another simple question on the application of IAS-37 and most of the candidates were able to secure passing marks.

The comments on each of the situation are given below:

(i) The candidates correctly mentioned that the conditions attached to the sale gave rise to a constructive obligation on the date of balance sheet and therefore a provision for sales return should be made @ 5% of sales. However, the point that cost of sales and other related costs will also have to be revised, was mostly ignored.

(ii) The students were able to explain correctly that a provision of Rs. 400,000 was required because the law suit was in progress at year end and a reliable estimate of the liability was also possible.

(iii) The situation was quite straightforward. Almost all those who attempted could easily identify that no provision was necessary.

(iv) Many candidates seemed confused. In fact no provision was required because in such situations, a constructive obligation is only created after the decision is made public.

(v) The situation proved difficult for most candidates. Very few of them could identify that in the given situation all the unavoidable payments should be provided in the period in which the warehouse was shifted, because the contract became onerous.

(vi) Most of the candidates correctly answered that it was a non adjusting event as dividend was declared after year end. However, few could mention about the requirement to disclose the details of such dividend in the financial statements, for the year ended June 30, 2008.

(THE END)