**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN**

**EXAMINERS' COMMENTS**

| **SUBJECT** | **SESSION** |
|---|---|
| Introduction to Financial Accounting | Foundation Examination – Spring 2008 |

Q.1 (a) (i) The students were generally able to identify the components of financial statements i.e. balance sheet, profit and loss account, statement of changes in equity, cash flow statements and notes to the accounts including significant accounting policies.

(ii) Users of financial statements (IASB Framework, para 9): The users of financial statements were correctly identified but the students could not properly explain the nature of interest of each types of user, in the financial statements.

(b) Although many students explained the accounting concepts correctly in their own words, it is recommended that they should also study the explanations of accounting terms as given in IASB Framework and the International Accounting Standards, preferably from latest editions.

(c) The elements of cost to be included in the measurement of property, plant and equipment (IAS 16 para 16) were identified correctly to a great extent by many students except the costs of dismantling and restoring the site, which was mentioned by a few students only.

Q.2 **Branch accounting**: As many as 21% of the candidates did not attempt the question indicating selective study by the students. Common errors noted were:

(i) Although the opening and closing stocks were correctly recorded on the debit and credit side of  branch stock account, the corresponding credit and debit entries to 'Goods sent to branch account' were virtually missing from all scripts.

(ii) Only a few students could correctly record the return of goods of Rs. 500/- at branch which were subsequently returned to Karachi Office, by debiting Goods sent to Branch Account and crediting Branch Stock or Branch Debtors Account.

(iii) Instead of preparing a combined trading account as required in Part (d) the students drew up separate trading accounts for HO and branch.

(iv) In the trading account, the opening and closing stock of the branch were recorded at selling price instead of cost.

Q.3 **Manufacturing, trading and profit and loss account and balance sheet**: It wa an easy question of 24 marks and about 60% of the candidates secured passing marks with quite a few of them obtaining 22 to 24 marks. Mistakes noted were as follows:

(i) Some students did not draw up the manufacturing account at all and put the related figures in the trading account.

(ii) Depreciation was not correctly apportioned between manufacturing and profit and loss accounts.

(iii) Bad debts were not computed correctly. Total Debtors were Rs.8.0 million of which Rs.70,000 were confirmed as bad. 5% of the remaining i.e. Rs.396,500 were also estimated as bad whereas a provision of Rs.160,000 was already appearing in the trial balance. Hence the bad debts expense for the year should have been Rs.306,500 (70,000+396,500-160,000)

(iv) Administration expenses were often included in manufacturing account.

(v) Many students ignored the adjustment related to Advance Rent altogether whereas many others simply deducted the full amount i.e. Rs. 200,000. The correct treatments was to adjust Rs.100,000 i.e. the rent attributable to the past years end period, in arriving at the Sales Office expenses.

(vi) The students were often very careless in selecting the appropriate Headings/ head of account. For example, Cost of Goods Manufactured was referred to as Manufacturing Costs. Similarly, the term "Share Capital" was used instead of "Capital".

Q.4 **Valuation of closing stock etc. and disclosing information according to IAS 2**: 40% of the students did not attempt the question; whereas only 2% secured passing marks. Mistakes made were:

(i) Rather than arraying answer/data in columns for all 4 products , students made computations for each product separately leading to much waste of time. A large number of students prepared workings for one or two products and thereafter abandoned the question.

(ii) Non-refundable import duties and transportation charges upto the company's godown were not included in purchases/cost of sales.

(iii) Refundable duties were included as part of purchase cost.

(iv) While calculating realizable values, transportation charges upto the customers' premises (Rs. 150 per unit) were not considered.

(v) The realizable value of product C was taken as Rs. 3,200 i.e. equal to th price of a similar product available in the market. It should have been taken as Rs. 3,500 i.e. the reduced price at which the company intended to sell it.

(vi) Although it was clearly mentioned in the question that 25% of the stock of item 'A' has been damaged, many candidates applied the lower price to all the units in closing stocks, for the purpose of calculating the net realizable value. Some of the candidates were totally unaware of the concept of NRV and simply reduced the cost by 40%.

Q.5 **Reconciling debtors' subsidiary ledger balance with sales ledger control account**: This was an easy and favourite question of the students as 78% secured passing marks, whereas 30% secured full marks. However the seriousness of the problem of selective studies can be judged from the fact that even this question was not attempted by 16% of the students. The common errors were as follows:

(i) Many students were able to reconcile the total but lost marks as some of the corrections which were to be recorded in the subsidiary ledger were recorded in the control account and vice versa.

(ii) Items which were required to be added were subtracted and vice versa. Many students tried to give ambigous answers and did not specify whether the amount was being added or subtracted. In such cases, no marks were awarded.

Q.6 **Determining stock shortages / misappropriations, from incomplete records**: This question of 19 marks was the worst attempted question and the students could secure an average of 4 marks only. Mistakes noted were as follows:

(i) While preparing Creditors' Control Account to determine purchases, trade discount received, should have been ignored. Most students did not do so.

(ii) Closing balance of creditors should have been reduced by Rs. 270 (470-740) thousand to rectify the effect of casting error on the invoice. Most student did not make this adjustment whereas many of them adjusted it from the value of closing stock.

(iii) While recording bank collections in the Sales Ledger Control Account, the amount which was collected in 2006 but deposited in 2007 i.e. Rs. 500 thousand should have been deducted whereas the collections made in 2007 but deposited after the year-end i.e. Rs. 860 thousand should have been added. Very few of the students could do it correctly. Most of them ignored the adjustments altogether without giving any reasons whereas many others made the opposite adjustments i.e. added Rs. 500 thousand and deducted Rs. 860 thousand.

A proper approach to solving this question should have been as follows:

(i) Determine sales and purchases by drawing up Control Accounts of Debtors and Creditors.

(ii) From purchases, calculate cost of defective stocks being 4% of purchases. Calculate sale price of defective stock (normal sale price being 120% of such purchases less 30% mark-down).

(iii) Calculate cost of sales separately, in respect of sales to staff, sale of defective stocks and normal sales by applying standard mark-up rates as given in the question. Add the above, to arrive at Total Cost of Sales.

(iv) Compute the cost of sales as per accounting records i.e opening stock plus purchases minus closing stock.

(v) The difference between the actual cost of sales as determined in (iii) above and the cost of sales as per accounting records as referred to in (iv) above shall represent the cost of stock misappropriated.

***THE END***