

# **Examiner's Report**

**December 2009 Session**

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**Paper 7**

**Financial Accounting**

## **General Comments**

The overall performance of the candidates in this examination was not satisfactory. Most candidates did not prepare well enough to cover the knowledge that is examined in this paper.

It is surprising to note that most candidates failed to work out journal entries for the accounting transactions given in the question, despite the fact that journal entries are a fundamental step in the double entry accounting system. On some occasions, candidates have written an answer such as "... debit / credit to comprehensive income ...", this type of answer is unsatisfactory as candidates are required to identify the specific account to record the transaction.

Compared to the previous examination, there is a marked improvement in the candidate's ability to prepare financial statements. Most candidates were able to produce a Statement of Comprehensive Income and a Statement of Financial Position in the format stipulated in HKAS 1 (Revised) "Presentation of Financial Statements".

Another observation was the poor performance of the candidates in the preparation of extracts of financial statements. Candidates should note that in the study of accounting standards apart from understanding and acquiring knowledge of the definitions, concepts, accounting treatments and numerical operations concerning a particular accounting issue, it is equally important to know how to disclose the accounting information in the financial statements, which is the final step of the accounting process.

## **Section A – 15 Multiple-choice Questions**

The overall performance in the multiple-choice questions was not satisfactory. Most candidates failed to achieve the passing mark in this section of the examination. The multiple-choice questions covered a wide range of topics in the syllabus, including both conceptual and computational types. The performance of the candidates in the computational questions was particularly poor.

## **Section B – 1 Compulsory Question**

### **Question B1**

This is a compulsory question aimed at examining a candidate's ability to prepare a financial statement. In addition, the candidate has to identify and explain the accounting treatments for two accounting issues that relate to revenue recognition and prior period adjustment.

As previously mentioned, there was an improvement in the preparation of financial statement by the candidates. The majority of the candidates could produce the proper format as stipulated by the accounting standard. However the part of the question focused on the identification of accounting issues was poorly performed. Most candidates failed to identify the sale and re-purchase arrangement between the two companies as a secured borrowing meaning that the transaction should not be recognised as a sale. For the question on prior period adjustment, despite the situation being straightforward, very few candidates were able to explain that since the bad debt was related to the previous year and the writing off the debt should be made as adjustment against the opening balance of retained earnings.

Other common errors for this question included:

- Failure to calculate the revaluation surplus and depreciation correctly.
- The interim dividend was erroneously treated as an expense item in the statement of comprehensive income. Candidates did not realise that a dividend is a distribution to shareholders and should be treated as a charge against retained earnings.

## **Section C – 3 Optional Questions**

### **Question C1**

This question is based on HKAS 11 “Construction Contracts”. This was the least chosen and the worst performed question in Section C.

Most candidates who attempted this question were not quite familiar with both the numerical operations as well as the disclosure requirements for construction contracts in the financial statements.

The part of the question covering the concept regarding the recognition of revenue for construction contracts based on the stage of completion was also poorly answered.

### **Question C2**

This is the best performed question in section C.

Most candidates were able to achieve satisfactory results in both part (a) and (b).

The overall performance of the candidates for part (c) and (d) was not satisfactory. The preparation of journal entries and the extracts of financial statements were poor. In particular, many candidates demonstrated poor knowledge regarding the presentation of a lease item in the statement of financial position.

Very few candidates were able to calculate the initial recognition value of the leased asset correctly as most candidates failed to include the option purchase cost and the residual value in their calculation. Many candidates did not realise that the lease payments are in advance so that no discounting is required for the first lease payment. In addition many candidates could not work out the correct figures to answer parts (c) and (d) of the question. Candidates attempting this type of calculation should prepare a lease amortisation table in order to present the working clearly and to minimise errors.

For part (d), most candidates failed to explain the issue of off-balance sheet financing as the corner-stone concept underlying the implementation of HKAS 17 “Leases”.

### **Question C3**

This question is based on the concept of the treatment of properties governed by various accounting standards.

For part (a), many candidates did not answer the question despite the question being straightforward, i.e. it asked for the classification of the properties as well as whether depreciation is required for each of the given situations. It is a common observation that candidates are not focused enough when answering essay type questions. Most candidates failed to recognise that the properties in situation (4) should be classified as inventory as they are developed properties awaiting to be sold by the developer. Further many candidates explained that depreciation is not required in situation (2) because the property is an investment property. The answer for the part on depreciation is correct but with a wrong explanation. In this case depreciation is not required because the company has adopted a fair value model to measure its investment property.

For part (b), this part focuses on the preparation of journal entries and again the performance on double entries is poor. In particular, many candidates failed to produce correct journal entries for situation (3) that relates to the revaluation of property, plant and equipment.

For part (c), this part focuses on the preparation of extracts of financial statements to present the properties as stated in the four independent situations. Again, this was poorly performed. Items being presented were not properly classified and labelled.

For part (d), this part focuses on the concept of depreciation and is straightforward. Most candidates were able to suggest the reasons of matching as well as the wear and tear of property, plant and equipment.

**[ END OF EXAMINER'S REPORT ]**