

# **Financial Accounting & Reporting (1) 2009**

# **Exam suggested solutions and examiners' feedback**

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# Examiners' feedback

Congratulations on completing the *Financial Accounting & Reporting (1) 2009* exam.

Now that you have received your exam result, we have provided you with this document to help you understand your mark.

In addition to the candidate learning pack (CLP), the following key resources are available on *myCA* to support you:

- > *Financial Accounting & Reporting (1) 2009* exam
- > *Financial Accounting & Reporting (1) 2009 exam links to CLP* – provides links from the exam paper to material covered in the CLP
- > *Exam self-reflection template* – designed for use with the above two resources
- > *Learning & assessment guide (LAG)* – contains general information regarding exams in the Chartered Accountants Program (the LAG is issued to all candidates when they start the Program)
- > CLP activity solutions.

We recommend that you use all five resources in tandem to help you reflect on your exam performance.

## Marking process

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Marking of exam scripts (exam answers) involves detailed quality control procedures. The marking process involves each exam script being individually assessed against the specified criteria for the respective question. Exam marking is undertaken in one location for each question and over one weekend.

Before marking commences, all Chartered Accountants on the respective marking panels meet and discuss the question they will be marking. This discussion ensures that each member of the marking panel understands the marking criteria against which that question is being assessed. Each member of the marking panel then individually marks the same script for that question.

When each member of the marking panel has marked the same script, the marking panel re-groups to discuss the marks awarded and any areas of the marking criteria that require further clarification. This process is then repeated until all members of the panel are marking consistently. Each marker is then assigned a batch of scripts to mark.

During the marking process, a minimum of 10% of the scripts is audited. This involves one of the marking auditors independently assessing a script without any knowledge of the mark already assigned to it by the original marker. If a discrepancy exists between the original mark and the auditor's mark, both markers review the script and come to a consensus. If necessary, a second auditor may be asked to mark the script.

A further re-mark is, therefore, not required. Requests for re-marks will not be accepted.

## Overall feedback

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The pass rate for the *Financial Accounting & Reporting (1) 2009* exam was 77.2%. The highest overall mark was 87.0 out of 100.

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	Highest marks awarded per question	Maximum score
Question 1	12	13
Question 2	9	9
Question 3	15	15
Question 4	13	13

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## Overall comments

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The reasons why marks may not have been awarded to candidates in this exam include:

- > not reading the requirements of the question and responding appropriately
- > not applying the facts from the questions to their responses
- > not completing all parts of the exam paper.

# Question 1 – suggested solution (13 marks)

## Part A (5 marks)

Item	Calculation	Amount A\$
Initial deposit (US\$1m)	$1,000,000 \div 0.95$	1,052,631.58
Instalments (A\$5m)		5,000,000.00
Interest on A\$4m facility	$19/12 \times 7.5\% \times 4,000,000$	475,000.00
Interest on US\$500,000	$1/2 \times 500,000 \times 5\% \div 0.75$	16,666.67
Interest on US\$500,000	$1/2 \times 500,000 \times 5\% \div 0.63$	19,841.27
Carrying value of the plant as at 30.9.09		6,564,139.52

## Part B (8 marks)

### Event 1:

As the event that triggered the product recall, and the subsequent correspondence from the lawyers, occurred on 17 June 2008, the following are the impacts of this event on Yoda's accounts:

- > potential inventory write-down for Yoda's 'Robot Extreme' as per AASB 102 para. 9 which states: 'Inventories need to be measured at the lower of cost and net realizable value'.
- > provision for recall costs (AASB 137)
- > provision for legal claims or contingent liability (AASB 137) as Yoda was informed of the issue via the lawyers for John Brown

### Event 2:

This event will impact on the accounts – as the decision has been made to close the Doll division, the requirements of AASB 5 need to be considered. As per the Standard, the division will now be classified as a discontinued operation and measured in accordance with para. 13. The required disclosures for a discontinued operations are to be made in accordance with paras 32 and 33.

### Event 3:

This event will impact on the accounts by requiring consolidated financial statements to be prepared. This means taking up profit and loss of Vada from the date of acquisition and accounting for the minority interest, as per AASB 3 and AASB 127. Yoda will also then need to:

- > have an accounting policy for consolidations (AASB 101)
- > reflect any related party transactions (AASB 124)
- > complete a consolidated cash flow statement (AASB 107)
- > reflect the investment in Yoda's accounts (as the parent company of Vada)

### Event 4:

For this event, either one of the two following answers were marked correct:

1. This event will have no impact on the accounts. There was no constructive obligation to book provision as at 30 June 2008 because the staff impact was not communicated until after year end, even though the decision was made to shut down the Doll division on that day (AASB 119 paras 133–134).
2. As the decision had been made but no provision was booked and the event was material, a subsequent event note will be required (AASB 110 paras 21–22).

# Question 1 – examiners' feedback

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## General comments

### Part A

#### Areas done well

- > Most candidates recognised that the payment of the US\$1 million to Vada had to be converted at 1 July 2008, and that there were A\$5 million of payments that had also been made.
- > Candidates who showed calculations with short explanations did well in this part of the question.

#### Common mistakes

In this part of the question, the mistakes that candidates made included the following:

- > not reading the question carefully and not calculating the interest in accordance with the interest payment terms of the relevant loans.
- > converting the Australian dollar amounts into Australian dollars.
- > being unable to determine the correct rate at which to convert the relevant amounts.
- > multiplying the US dollar amounts by the relevant exchange rate instead of dividing them
- > writing long descriptions straight from the Standards.

### Part B

#### Areas done well

- > With regard to event 1, most candidates recognised that AASB 137 would be applicable in relation to the costs of either a legal claim or a product recall. Few candidates recognised both.
- > With regard to event 3, most candidates identified that, as a result of acquiring Vada Pty Ltd, consolidated accounts would need to be prepared and would need to comply with the requirements of AASB 127.
- > With regard to event 4, most candidates recognised that there was no impact on the 30 June 2009 financial statements.

#### Common mistakes

In this part of the question, the mistakes that candidates made included the following:

- > incorrectly interpreting the question as being about subsequent events and not considering what actions needed to be taken regarding the Yoda Limited financial statements for the year ended 30 June 2008. As Yoda is a listed company, it has to produce general purpose financial statements and, therefore, the company needs to comply with all applicable Accounting Standards
- > not providing any references to Standards when the question specifically asked for them. A number of those candidates who did provide references did not read over their work as the references provided were not complete (i.e. 'AASB para. 5')
- > not reading the part of the question which stated that each event 'should be considered separately' and then linking event 2 and event 4 together
- > restating elements of the Standards, rather than drawing conclusions and/or applying the relevant Standards.

Few candidates identified that:

- > a faulty toy and product recall would mean that you would have to consider whether or not the existing stock of the Yoda Robot Extreme is being carried at the lower of cost or net realisable value in accordance with the requirements of AASB 2 para. 9
- > the discontinuation would mean considering the requirements of AASB 5
- > in addition to preparing consolidated accounts in accordance with AASB 127, there were a number of other Standards that would also impact on the accounts at 30 June 2008 as a result of the acquisition of Vada
- > AASB 137 did not apply to termination benefits and that they should have applied AASB 119.

## Links to the CLP

Question	Part	CLP unit	CLP; Worked examples; activities; other references
1	A	1	CLP pp. 74, 82–83; Activity 13
	B	1	CLP pp. 29–30, 83 and 87; Worked examples 12, 14 and 15
		2	Activity 1
		4	CLP p. 37; Worked example 9

## Question 2 – suggested solution (9 marks)

### Part A (5 marks)

(a) (3 marks)

	Initial 10% interest \$	Subsequent 5% interest \$	Further 15% interest \$	Total \$
Cost of investment	534,000	300,000	850,000	1,684,000
Fair value of identifiable net assets and contingent liabilities (FVINA)	5,040,000	5,340,000	5,600,000	
Wisteria's increase in the % share in Cherry	10%	5%	15%	
Share of FVINA	504,000	267,000	840,000	
Goodwill	30,000	33,000	10,000	73,000

(b) (2 marks)

Date	Description	Dr \$	Cr \$
30.06.09	Investment in associate	56,000	
30.06.09	Share of associate's profit after tax		36,000 <sup>1</sup>
30.06.09	Revaluation reserve		20,000 <sup>2</sup>

Recognising share of post-acquisition retained earnings and reserves in Cherry on adoption of equity accounting in relation to the initial 10% investment in Cherry

1. This entry recognises the 10% share of post-acquisition retained earnings in Cherry's books  $(\$2,600,000 - \$2,240,000) \times 10\% = \$36,000$ .

2. This entry recognises the 10% share of post-acquisition revaluation reserve movements in Cherry's books  $(\$2,000,000 - \$1,800,000) \times 10\% = \$20,000$ .

Date	Description	Dr \$	Cr \$
30.06.09	Investment in associate	13,000	
30.06.09	Share of associate's profit after tax		3,000 <sup>1</sup>
30.06.09	Revaluation reserve		10,000 <sup>2</sup>

Recognising share of post-acquisition retained earnings and reserves in Cherry on adoption of equity accounting in relation to the additional 5% investment in Cherry

1. This entry recognises the 5% share of post-acquisition retained earnings in Cherry's books  $(\$2,600,000 - \$2,540,000) \times 5\% = \$3,000$ .

2. This entry recognises the 10% share of post-acquisition revaluation reserve movements in Cherry's books  $(\$2,000,000 - \$1,800,000) \times 5\% = 10,000$ .

## Part B (4 marks)

You would advise Wisteria's management that it should not elect to early adopt the revised AASB 3R for the following reasons:

- > Management wishes to minimise the impact of the acquisition on the Statement of Comprehensive Income.
- > Under AASB 3R, the independent valuer's fees of \$15,000 and the solicitor's fees of \$10,000 are required to be expensed. Under the current version of AASB 3, they form part of the cost of the combination (and, therefore, increase the value of goodwill)
- > Under AASB 3R, any subsequent changes to the cost of the business combination, arising from contingent consideration, are required to be expensed. Under the current version of AASB 3, they are able to be capitalised into the carrying amount of goodwill. Any contingent consideration payable due to a subsequent fall in the share price of Wisteria would have an impact on the Statement of Comprehensive Income under AASB 3R.

**Note:** The treatment of share issue costs is the same under both AASB 3 and AASB 3R where they are treated as a reduction in equity.

## Question 2 – examiners’ feedback

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### Part A

On the whole, Part A was well answered. Most candidates correctly calculated the amount of goodwill. Many candidates also correctly identified the equity journal entries required.

#### Common mistakes

In this part of the question, the mistakes that candidates made included the following:

- > using the retained earnings account, rather than the share of associate profit account, to take up the share of prior year earnings once significant influence was achieved for the first time
- > omitting the \$20,000 share of the asset revaluation reserve arising as a result of the initial 10% interest from the equity journal entries
- > providing consolidation eliminations entries rather than equity journal entries to account for the investment.

### Part B

On the whole, Part B was reasonably answered.

#### Common mistakes

In this part of the question, the mistakes and omissions that candidates made included the following:

- > treating the share issue costs as part of the cost of the combination under AASB 3, and as an expense under AASB 3R (when they are treated as a reduction in equity under both versions of the Standard)
- > referring to an earn-out agreement rather than to the change in the share price when discussing the issue of contingent consideration
- > not discussing the contingent consideration at all.

### Links to the CLP

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Question	Part	CLP unit	CLP; Worked examples; activities; other references
2	A	2	Worked example 22
	B	2	CLP pp. 123–4; Activities 2 and 3

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## Question 3 – suggested solutions (15 marks)

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### Part A (6 marks)

Year	Calculations	Annual expense \$	Cumulative expense \$
2007	7 employees × 1,000 shares × \$3.50 × 1/3	8,167	8,167
2008	7 employees × 1,000 shares × \$3.50 × 2/3 – \$8,167	8,166	16,333
2009	8 employees × 1,000 shares × \$3.50 × 3/3 – \$16,333	11,667	28,000

### Part B (9 marks)

Reconciliation	\$
Operating profit after tax	3,058
Depreciation and amortisation	1,706
(Gain)/Loss on disposal of non-current assets	25
Share of profit of associate	(328)
(Increase) decrease in trade debtors	(306)
(Increase) decrease in inventories	(442)
Increase (decrease) in trade creditors	1,398
Increase (decrease) in current tax liabilities	236
Increase (decrease) in employee entitlement provisions	166
<b>Net cash provided by operating activities</b>	<b>5,513</b>

## Question 3 – examiners’ feedback

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### Part A

#### Overall assessment

On the whole, Part A was reasonably answered with some candidates obtaining full marks for this part of the question.

#### Common mistakes

In this part of the question, the mistakes that candidates made included the following:

- > failing to identify that the scenario was a market condition (i.e. the achievement of a target share price of \$7.00) and consequently failing to apply the fair value of \$3.50 (i.e. the value of the option, when the target share price of \$7 may not be achieved, is taken into account)
- > in view of the point above, applying a fair value of \$4.10 which was the ASX trading price of the shares at the grant date of the options
- > applying different fair values of the option in 2007, 2008 and 2009, consequently failing to understand that the fair value is established at grant date
- > applying the incorrect number of employees in 2007, 2008 and 2009
- > applying a non-market condition, thereby reversing in 2009 the amounts that were recognised in 2007 and 2008. To answer the question correctly, candidates should have instead recognised a further expense in 2009 and not reversed any of the amounts that were required to be recognised in 2007 and 2008
- > providing journal entries for each year when the question did not require journals.

### Part B

#### Overall assessment

Part B was generally well answered with a few candidates obtaining full marks for this part of the question.

#### Common mistakes

In this part of the question, the mistakes that candidates made included the following:

- > omitting the deduction of the non-cash item of \$328 in respect of share of profit of associate
- > adding back the provision for doubtful debts into the reconciliation
- > adding back the depreciation expense into the reconciliation but omitting to add back the amortisation expense
- > including movements in lease and HP liabilities when these movements are required to be disclosed under cash flows from financing activities
- > confusing the effects of movements in current assets – this resulted in candidates incorrectly showing increases in trade receivables and inventories as pluses rather than minuses in the reconciliation of net cash provided by operating activities to profit from ordinary activities after income tax expense
- > confusing the effects of movements in current liabilities – this resulted in candidates incorrectly thus showing increases in trade creditors, current tax liabilities and provision for employee entitlements as minuses rather than pluses in the reconciliation of net cash provided by operating activities to profit from ordinary activities after income tax expense

- > using 'reconciling item' or 'balancing item' to reconcile the net cash provided by operating activities to profit from ordinary activities after income tax expense.

## Links to the CLP

Question	Part	CLP unit	CLP; Worked examples; activities; other references
3	A	3	Activity 6
	B	1	Activity 3

## Question 4 –suggested solutions (13 marks)

### Part A (7 marks)

(a) (4 marks)

Financial period	Opening balance \$	Cash flows \$	(i) Profit or loss \$	(ii) Closing balance \$
31.12.09	929,930	(30,000)	52,076	952,006
31.12.10	952,026	(30,000)	53,312	975,318

(b) (3 marks)

Date	Description	Dr \$	Cr \$
01.01.09	Loan asset	929,930	
01.01.09	Cash		929,930
To recognise fair value of loan asset at initial date			

Date	Description	Dr \$	Cr \$
31.12.09	Loan asset	52,076	
31.12.09	Interest income		52,076
To recognise interest income incurred from the loan asset for the period			

Date	Description	Dr \$	Cr \$
31.12.09	Cash	30,000	
31.12.09	Loan asset		30,000
To recognise cash received relating to the loan asset for the period			

Date	Description	Dr \$	Cr \$
31.12.09	Income tax expense	6,623	
31.12.09	Deferred tax asset/liability		6,623
To recognise timing difference arising from interest income compared to cash received			

### Part B (4 marks)

Item	Recommendation	Justification
(a) Type of hedge relationship	Cash flow hedge on highly probable foreign currency transaction	Hedging of cash flow variability against adverse movement in A\$/US\$ (or foreign exchange risk)
(b) Nature of hedge risk	Foreign exchange risk	The hedged item is exposed to adverse movement in A\$/US\$  To minimise ineffectiveness, the intrinsic component of the hedging instrument should be designated. The time value of options cannot be designated as an effective hedge and should be excluded

### **Part C (2 marks)**

The convertible bond should be not classified as a held-to-maturity (HTM) financial asset. It should be classified in the 'financial asset at fair value through profit or loss' category of financial asset (AASB 139 para. 9).

The information from the background to Question 4 states that the company's principal activity is to actively buy and sell domestic and international fixed-income and equity securities products with the intention of making short-term profits. As such, investment in these bonds is made with a view to making short-term profits. This satisfies the definition of a 'financial asset at fair value through profit or loss' under AASB 139 para. 9.

## Question 4 – examiners' feedback

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### Overall assessment

The majority of candidates who attempted this question obtained reasonable marks, with Part B being the part of the question that was answered best by candidates. The majority of candidates demonstrated a better understanding of the basic concepts of financial instruments and performed well, although their ability to apply and interpret these concepts was not as good. Many candidates still demonstrated a lack of understanding of the basic concepts. Some candidates performed unsatisfactorily on basic tasks, such as conducting simple calculations of movement in accounts.

Candidates who completed the prescribed activities and reading specified in the CLP would have noted that this was a similar question to one that was covered.

Many candidates failed to attempt various parts of this question. This shows poor time management and exam technique.

### Common mistakes

Common mistakes made by candidates are usually due to either a lack of understanding of the basic concepts or to a failure to analyse the information provided and reaching a conclusion too quickly.

### Part A

Most candidates attempted Part A(a) using the format provided. In this part of the question, the mistakes that candidates made included the following:

- > struggling with the basic accounting concept of 'opening balance +/- cash flow +/- profit and loss = closing balance'
- > failing to understand the difference between the effective interest rate, used for recognising profit and loss, and the coupon interest rate, used for recording cash flows
- > failing to understand that the loan issued in Part A is a loan receivable (asset) from the issuer's perspective and, as a result, preparing incorrect journal entries
- > not checking their journal entries to ensure that the debits were equal to the credits
- > not preparing their answers based on the format provided. This meant that some of those candidates who did not use this format missed answering all the components of the question.

### Part B

This part of the question was generally well answered. Better answers identified the risk of adverse foreign exchange movements. Some candidates failed to demonstrate an understanding of the various types of hedge relationships and how they should be applied.

### Part C

This part was poorly answered. In this part of the question, the mistakes that candidates made included the following:

- > not reading the background information provided to Question 4, which contained important information for answering the question
- > failing to answer the question – you were asked whether you agreed or disagreed with the proposed classification of the convertible bond

- > failing to conclude which classification is appropriate for the convertible bond
- > spending too much time reiterating the definitions in AASB 139 without applying them to answering the question.

## Links to the CLP

Question	Part	CLP unit	CLP; Worked examples; activities; other references
4	A	4	Worked example 9
	B	4	Worked example 13
	C	4	Worked example 5, Activity 6