

Examiner's Report

AA3 EXAMINATION - JANUARY 2016

(AA31) FINANCIAL ACCOUNTING AND REPORTING

The following common mistakes, deficiencies were identified during the evaluation process. The unsuccessful candidates should take steps to avoid following mistakes to be successful in the future examinations:

PART A

Question No. 01

Objective: *Tested students' knowledge on definition of liability as per the conceptual framework for financial reporting and recognition criteria of a liability.*

- (1) Many students attempted the question and earned full marks allocated.
- (2) However, some students have written liability as a cash inflow instead of cash outflow.
- (3) Students are advised to read the question more than once and avoid writing irrelevant answers.

Question No. 02

Objective: *Tested students' knowledge on LKAS 23 - Borrowing Cost.*

Tested students' knowledge for applying Weighted Average Borrowing Cost for interest calculation.

Only a handful of students calculated weighted average borrowing cost. Question was very poorly answered.

- (1) Period applicable for borrowing cost capitalization was not correctly applied by many students. Many used one year period instead of 16 months for interest calculation.
- (2) Some students considered cost of plant instead of borrowed amount for interest calculation.
- (3) Some students used borrowed amount for capitalization instead of cost of plant.

Question No. 03

Objective: Calculation of EPS, PE & Earning Yield ratios were tested.

- (1) Performance of students was good in answering this question.
- (2) Some students deducted dividend from PAT and calculated EPS.
- (3) It was noted that DPS was calculated instead of EPS.
- (4) Price Earnings Ratio was calculated as a %, and not as number of times, by many students.
- (5) Students seemed to have mixed up numerator and denominator when calculating ratios.
- (6) Instead of calculating Earning Yield Ratio, irrelevant ratios were calculated by many students.
- (7) Students are advised to attach workings to get marks for calculation.

Question No. 04

Objective: Tested students' knowledge on duties of Specified Business Enterprises.

- (1) It was a straight forward question, and many students had written only 2 points though question required 3 points.
- (2) It was commonly noted that many have written irrelevant answers.
- (3) Some students have written process of preparing Financial Statements instead of duties of SBE's.
- (4) Instead of duties, some students have given examples for SBE's.

PART B

Question No. 05

Objective: Tested students' knowledge on:

1. Recognition criteria of intangible assets.
2. Accounting treatment for internally generated brand name and acquired brand name.
3. Accounting treatment on research and development expenditure.

Observed following weaknesses in students' answers:

- (1) Irrelevant answers were given for recognition of intangible assets by many students. Reasons for not recognizing internally generated intangible assets were not given by many students.
- (2) Majority had not earned full marks on question on recognition criteria on intangible assets.
- (3) Most of the students had not written correct answers for accounting treatment for research & development expenditure. Approximately 50% of the students have written correct answers.
- (4) Reasons for recognizing research expenditure as an expense were not mentioned by the majority.

Question No. 06

Objective: Tested knowledge on preparation of cash flow statement from operating activities based on indirect method.

- (1) Most of the students attempted the question and earned reasonable marks.
- (2) Since question has given adjustments for some of the figures given in the Statement of Financial position, for example incentive payables, etc. many students appear to have been confused of those adjustments.

However, students' performance was satisfactory.

Question No. 07

Objective: Following areas were tested:

- (1) Computation of differed tax liability / asset.
- (2) Accounting for differed tax liability / asset.
- (3) Features of a finance lease.

Following points were noted from students' answers:

- (1) Majority of the students have not done differed tax computation correctly.
- (2) Those who did differed tax calculation correctly, could not do it for future years properly.
- (3) Most of the students answered satisfactory for recognition criteria for finance leases.

PART C

Question No. 08

Objective: Test students' knowledge on the following areas:

- (1) Preparation of Statement of Comprehensive Income.
- (2) Preparation of Statement of Financial Position.
- (3) Preparation of Statement of Changes in Equity.
- (4) Tested the accounting knowledge on LKAS 16 Property, Plant & Equipment and notes to PPE.
- (5) Tested students' knowledge on LKAS 08 – Accounting Policies, Changes in Accounting Estimates and Errors.

During the marking process Examiners observed the following weaknesses in students' answers:

PROPERTY PLANT AND EQUIPMENT

- (1) Most of the students have poor knowledge on depreciation calculation, for example to compute depreciation for the additions made during the year, they have not considered the number of months correctly. Specially, with regard to the sold vehicle, depreciation relevant to the six month period has not been taken into account.

- (2) Most of the students have not done the opening balance adjustment to the property, plant and equipment as required in the question when preparing notes to PPE. Trial balance has given the cost of PPE as at 31.03.2015, and therefore it is required to deduct the cost of additions during the year from it to arrive at the opening balance of PPE.
- (3) Majority of the students was unable to identify the cost of old van sold as at 01.04.2011. Majority considered the book value of the sold vehicle as the cost of it. Therefore, they had not accurately calculated the disposal gain or loss. Cost of sold vehicle should have been computed as follows:

$$\text{Eg: } 576/1.5 \times 5 = \text{Rs.1,920/-}$$

INVESTMENT & IMPAIRMENT

Most of the students have correctly done the impairment adjustment against the investment and shown it under Non-Current Assets. Only a handful of students treated impairment as an expense in the P&L account.

TRADE RECEIVABLE

Most of the students accurately calculated the value of trade receivables as at 31.03.2015 and most of the students were unable to calculate the provision for doubtful debtors correctly because, they have not understood the additional information given in the question properly.

INVENTORY

Majority of the students had not correctly adjusted the over valuation of previous year closing stock to retained earnings, instead they have deducted it from the current year closing stock.

TAX LIABILITY

Considerable number of students had not done calculation of actual income tax liability as at 31.03.2015 correctly, even though the question provided adequate information such as opening tax liability, income tax paid during the year and the tax provision for the year.

GENERAL COMMENTS

- (1) Considerable number of students had not attached their supporting calculations with the answer sheet hence examiner was unable to give marks to those points and some of the students had done their supporting calculations and cut it off using one line.
- (2) Some students have set off the amount of bank overdraft from the favourable bank balance whereas the correct presentation is to present it under current liabilities.
- (3) Majority of students failed to identify accrued rent as an administration expense and bonus to sales staff as selling and distribution expense.
- (4) Proper note have been given for proposed dividend by most number of students
- (5) Many students calculated debenture interest correctly and shown it as finance expense.
- (6) Interim dividend paid had been shown in the statement of changes in equity correctly by many students, however some students have deducted interim dividend from ordinary share capital.

Overall Performance

All the students attempted this question and majority of them got more than 15 marks.

Students' answers were satisfactory.

In order to improve performance it is recommended to:

- * Practice more questions of this nature,
- * Practice to manage time (Time management),

by students.

Question No. 09

Objective: Tested students' knowledge on,

- (1) Computation of goodwill arising on consolidation.
- (2) Adjustments for consolidated property, plant and equipment.
- (3) Computation of the value of non-controlling interest/Consolidated retained earnings/Consolidated general reserves.
- (4) Computation and adjustments for unrealized profit in inventory and unrealized profit of asset disposal.
- (5) Adjustment for impairment of goodwill.
- (6) Defining the terms 'parent' and 'subsidiary' according to LKAS 27.
- (7) Identifying the limitations of ratio analysis.

Comments:

Part (a)

Students have made following mistakes when writing the answers for part (a).

- (1) Fair value of the land has to be considered for Net assets of K Ltd. Many students have not considered that when taking the net assets of K Ltd.
- (2) The fair value of NCI has to be added to obtain the total cost of investment. 50% of the candidates have not added this amount.
- (3) Some students have not accounted for goodwill impairment. Some have accounted the full impairment to group retained earnings without allocating a part to NCI value.
- (4) Some students have not adjusted the goodwill impairment in both group profits and in the Goodwill account.
- (5) Some have shown the impairment of goodwill only in one account. (in goodwill account only).

- (6) Many candidates were able to compute the unrealized profit on inventory correctly and most of them have charged that amount in to correct accounts. Few have taken the total inventory value of Rs.66,000/- as the unrealized profit.
- (7) Many candidates have computed the unrealized profit on sale of Motor vehicle correctly. But they had adjusted that amount only for Group PPE but have not debited consolidated Retained earnings.
- (8) Most of the candidates have not correctly shown the depreciation adjustment in the consolidated retained earnings account and in the PPE balance of the consolidated Statement of Financial Position.

Part (b)

- (1) Almost all the students were not able to write the exact definition given in the standard. However, students had managed to get marks writing important points related to the terms “a Parent” and “a Subsidiary”.
- (2) Some have written irrelevant answers such as examples for ‘parent’, etc.

Part (c)

Most of the students have not written the actual limitations of the ratio analysis. Number of irrelevant answers were given for this question.

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