

Examiner's Report

AA3 EXAMINATION - JULY 2015

(AA31) FINANCIAL ACCOUNTING AND REPORTING

Question No. 01 (Marks Allotted 20)

Rationale

The main objective of this question is to check the knowledge on conceptual framework for the preparation and presentation of financial statements.

Marking Guide

Part (A),

1.1	Three objectives of the conceptual framework for the preparation and presentation of financial statements	03 marks
	Meaning of general purpose financial statements	02 marks
1.2	Assess the value of finished goods	05 marks
1.3	Events occurring after the Balance Sheet date	05 marks
1.4	Obligations of a company to prepare financial statements	05 marks
Total		20 marks

Examiner's Comments all the parts of this question were answered satisfactory, with many achieving reasonable marks. This was extremely positive as this question was a test of application of skills – the ability to use technical knowledge.

1.1 Matters dealt by the conceptual framework and the meaning of General Purpose Financial Statements:

- (a) Very few candidates had the complete knowledge regarding the conceptual framework. However, most of the candidates scored reasonable marks for this part.
- (b) General purpose financial statements had been defined correctly by most of the candidates. However, many answers were not included regarding the time period considered for the preparation of General Purpose Financial Statements.

1.2 Assessing the value of finished goods:

Only a very few candidates had scored full marks for this part. Common mistakes done by candidates are as follows:

- Many have not considered the normal capacity of production to allocate the fixed production overhead portion for the year.
- Some candidates had not deducted the idle labour cost from the total direct labour cost in arriving at the value of finished good.

1.3 Events occurring after the Balance Sheet date:

Many candidates successfully identified that the reported events as adjusting events. However, candidates should improve themselves in explaining the answer correctly. Because it was noted in certain instances, though they have mentioned it as an adjusting event, their explanations do not support to the given answer which causes reduced marks.

1.4 Obligations of a company to prepare financial statements:

Candidate's knowledge about the Company Act and application of the same to a company has to be improved. Most of the candidates answered this question using their general knowledge, without referring to the provisions of the Companies Act.

Around 99% of the candidates attempted the question number 01 and most of the candidates performed satisfactorily.

SECTION B

Question No. 02 (Marks Allotted 10)

Rationale

The objective of this question is to test the knowledge on ratio analysis which is useful to decision making process of management.

Marking Guide

Compute the following ratios for the two consecutive years:

- (a) Gross profit ratio
- (b) Return on capital employed
- (c) Asset turnover ratio
- (d) Average turnover ratio
- (e) Average inventory residence period
- (f) Average debtors collection period

Total 10 marks

Examiner's Comments

This question was attempted by many candidates very well and able to score full marks .

Common mistakes:

- (1) Gross profit ratio- To calculate GP ratio, few candidates had taken cost of sales and net profit instead of gross profit.

- (2) ROCE - Most of the candidates failed in adjusting long term liability in to the capital employed and they have considered net profit instead of Profit before interest and tax (PBIT).
- (3) Assets turnover ratio - Some candidates had calculated current ratio or quick asset ratio instead of Assets Turnover Ratio and few others had calculated percentage instead of number of days.
- (4) Average inventory ratio- Most of the candidates used the year end stock instead of average stock for the calculation.
- (5) Average debtors collection period- Most of the candidates used cost of sales instead of sales as denominator.

Candidates are advised to read the question more carefully and workout the required calculations only. Special attention should be drawn on the numerator and denominator for the ratio calculation. Also, make sure to present ratios correctly. i.e. in correct units.

Eg: GP Ratio \longrightarrow %
 Average debtors collection period \longrightarrow No. of days

Question No. 03 (Marks Allotted 10)

Rationale:

This question tested the knowledge of accounting standards LKAS 17 – Leases and LKAS 37 - Provisions, Contingent Liabilities and Contingent assets.

Marking Guide

(a) (i)	Prepare the relevant ledger accounts in the books of Dudly & Sons (Pvt) Ltd. to record lease transaction	3 marks
(ii)	Prepare the extracts of the statement of Financial Position as at 31 st March 2015 and the Statement of Comprehensive Income for the year ended 31 st March 2015	3 marks
(b)	Explain “constructive obligation” with an example according to LKAS 37 Provisions, Contingent Liabilities and Contingent Assets	4 marks
Total		10 marks

This question was poorly attempted by many candidates. Candidates’ in particular were not prepared for this type of questions and lack of knowledge on accounting for leases. The common mistakes identified during the marking process are stated below for the benefit of candidates.

- Only a few candidates had correctly ascertained the depreciation amount of Rs.200,000/- for the year and charged to the Income statement.

- Lot of failures were noted in the allocation of interest for the lease period of 5 years.
- Only a handful of candidates had identified the lease creditor (Gogo Finance) non-current liability of Rs. 668,810/- and current liability of Rs.175,336/
- Most of the candidates were not provided the depreciation for the leased lorry which will result in a net book value of Rs.800,000/-, if provided correctly.
- Lack of understanding of the term “constructive obligation”, hence they have defined the term “contingent liabilities” instead “constructive obligation”. “Constructive obligation is an obligation that derives from an entities action where, by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity indicated to other parties that it will accept certain responsibilities”. if a company announces a constant dividend payment and it has been in the practice of paying Rs. 1.50 per share as dividends for the past few years, then the company has a constructive obligation.

Overall, most of the candidate’s performance for this part was very poor.

Question No. 04 (Marks Allotted 10)

Rationale:

This question tested the knowledge of accounting standard LKAS 08 Accounting policies , changes in Accounting estimates and error and accounting treatment related to revaluation of office equipment.

Marking Guide

(a) (i)	Record all necessary entries required to account for the above revaluation as at 30 th June 2015 in the general journal	3 marks
(ii)	Compute the net book value of office equipment after incorporating revaluation as at 30 th June 2015	3 marks
(b)	Differentiate the terms, “prospective application and retrospective application with reference to LKAS 8 Accounting policies, changes in Accounting estimates and errors”	4 marks
Total		10 marks

This question was poorly attempted by many candidates. Candidates’ in particular were not prepared for this type of questions and lack of knowledge on accounting for revaluation. The common mistakes identified during the marking process are stated below for the benefit of candidates.

- Most of the candidates were not able to identify the correct amounts to be journalized and had used the “T” accounts without honoring the examiners request of necessary journal entries.
- Majority of the candidates failed in calculating depreciation for revalued office equipment amounting to Rs.4,500/- for the period covering 01/04/2015 to 30/06/2015. (Rs.90,000 x 20% x 3/12).

- Only a handful of candidates were able to record the correct journal entry of;

	Dr.	Cr.
Accumulated depreciation	22,500	
Depreciation	4,500	
Revaluation – Office Equipment	23,000	
Office equipment		50,000

(Being recording of revaluation of office equipment)

- Less than 1% of candidates were able to ascertain the NBV of office equipment as Rs.239,950/-.
- Most of the candidates were not attempted part (b) of the question which was very straight forward question requiring them to differentiate the terms, “prospective application and retrospective application with reference to LKAS 8 Accounting policies, changes in Accounting estimates and errors”

Overall, candidates performance for this question was very poor. Lack of knowledge hinders the performances of the candidates.

SECTION C

Question No. 05 (Marks Allotted 25)

Rationale

Main objective of this question is to check the knowledge of candidates regarding the Preparation of Financial Statements of a company in accordance with the Sri Lanka Accounting Standards. This question is set covering the entire syllabus.

Marking Guide

Preparation of;

Statement of Comprehensive Income Statement for the 31 st March 2015	09 marks
Statement of Financial position	09 marks
Statement of Changes in equity	04 marks
Notes to Property, Plant and Equipment	03 marks
Total	25 marks

Examiner’s Comments

This question was answered satisfactory, with many achieving reasonable marks. Majority of the answers were satisfactory and got 50% to 75% from 25 marks allotted. Though the answers were satisfactory, some of the adjustments were not correctly done and candidates did not know where to record certain entries in the Financial Statements for example, most of the candidates did NRV adjustment of the stocks correctly, but have not recorded correctly.

Common mistakes of the candidates are given below:

Income Statement

- Fewer number of candidates did NRV adjustment of the closing stocks correctly. However, they have not correctly adjusted to the cost of sales. Majority of the candidates did not answer this part and those who had answered also incorrectly calculated COS and GP.
- 99% of the candidates have not accounted the preference share dividends under the finance cost.
- Classification of expenses under administration, selling and distribution, Finance and other expenses had not been understood by most of the candidates.
- Some candidates made a provision for doubtful debt under the caption of administration expenses instead of selling and distribution Expenses.
- The loss on exchange of lorry was not correctly computed due to lack of understanding of the accounting entries to be passed and incorrect calculation of depreciation for disposal by majority of candidates. However, some candidates correctly calculated the exchange loss but considered it as a selling and distribution expense instead of other expense.
- Candidates have not adjusted the premium of 5% on debenture redemption and preference dividend paid by the company to arrive at finance expenses. However, few of them had mentioned under the Statement of Changes in Equity that preference shares should be considered as cumulative liability and not as equity.
- Some candidates presented their answers without workings as single figures for finance, admin and selling and distribution expenses in the statement of Comprehensive Income and Trade receivable, Trade payables and accrued expenses in the statement of Financial Position. In these circumstances, when the answer is incorrect, there was no way to award marks for any correct parts of the adjustments.
- Majority of the candidates have not adjusted over provision of income tax of the last year in calculating the income tax expenses for the year 2014/15 and income tax payable amount at the end of the year.
- Dividend declaration of the company had not been disclosed by most of the candidates by way of a note, instead they have adjusted for the same.
- Motor vehicle depreciation has not been calculated accurately by most of the candidates.

Statement of financial position:

- The non-current portion of the bank loan have not been separated and shown under the current liabilities by most of the candidates.
- Most of the candidates have not correctly recorded the preference shares under Non-current liabilities.
- In preparation of PPE note, majority of the candidates have not adjusted the cost of the motor vehicle exchanged and acquired to opening balance and accordingly have computed depreciation for the exchange and for the new addition incorrectly.

- Classification of Equity and Non-Current Liabilities in the statement of Financial Position had not been understood by most of the candidates, thereby preference share capital has been recognized as share capital under equity instead of recognizing under non-current liability.
- Majority of the candidates had not computed the amount paid for debenture redemption and had not credited it to the trade payable balance in the statement of financial position.

General

1. Most of the candidates showed their inability to select correct categorization of assets, liabilities and expenses.
2. There were considerable number of candidates who had used the headings of “profit and loss account” and “Balance sheet” instead of “Comprehensive Income Statement” & “Statement of Financial Position”

Hints to improve performance:

- Notes to the financial statements to be provided whenever necessary,
- The relevant workings to the final answer to be shown appropriately in order to earn more marks. Eg: some candidates had not given the supporting calculations of disposal of motor vehicle, calculation of depreciation, arriving at the final figure of each expenditure category without workings.
- The opening balance, adjustments for opening balance, additions during the year, carrying value of the cost and accumulated depreciation of the PPE should be clearly stated in the PPE statement.

Question No. 06 (Marks Allotted 25)

Rationale:

The main objective of this question is to check the candidate’s knowledge and understanding regarding the preparation of Consolidated Financial Statements as per revised LKAS 27.

Marking Guide

Part (a)

Defining the terms of “consolidated financial statement”, “Non-controlling interest” and “control”.

– 6 marks

Part (b)

(i) Compute Goodwill on consolidation.

(ii) Prepare Consolidated Retained Earnings account.

(iii) Prepare Non-controlling Interest Account.

(iv) Prepare Statement of Consolidated Financial Position as at 31st March 2015. - 19 marks

Total - 25 marks

Calculation of NCI caused problems – a number of candidates presented a hybrid calculation of NCI at fair value and then added to this NCI's share of total net assets. The common mistakes identified during the marking process are stated below:

- Most of the candidates have not calculated the goodwill accurately as they were not taken the non-controlling interest at its fair value.
- Most of the candidates have not correctly accounted for the adjustment of depreciation in the consolidated reserve account.
- The impairment of goodwill is not charged to both NCI and Group reserves. Most of the candidates have charged the total amount to consolidated reserve account.
- Few had failed to show the money in transit correctly in the consolidated statement of financial position.
- Even though marks can be awarded for the workings in case where the final answer is incorrect, some candidates have not clearly shown their workings in the answer scripts.
- In calculating Goodwill and Non-Controlling Interest, majority of the candidates had not considered fair value and instead considered value of net assets. When NCI is valued based on fair value, goodwill is relevant to both the parent and the minority, so impairment also has to be attributed between the two. 99% of the candidates had not understood this concept and impairment of goodwill have been debited only to Consolidated Retained Earnings account.
- Unrealized Profit on stocks: Majority computed and adjusted the values correctly but some candidates incorrectly divided between the NCI and the Consolidated Retained Earnings account.
- Few candidates had lack of understanding of the consolidation concept. The share capital of the subsidiary company was added to the parent and shown in the Consolidated Statement of Financial Position.
- Majority of the candidates have not adjusted fair value change of motor vehicle and depreciation to the PPE and some have not adjusted cash in transit value to the cash balance in the consolidated statement of financial position.

In order to present a correct answer, candidates are advised to read the question properly.

Most of the candidates had not selected this question, instead they have selected other two. Overall, candidates' performance for this question is poor and due to that candidates were unable to score high marks for this question.

Question No. 07 (Marks Allotted 25)

Rationale:

This question required candidates to prepare the cash flow statement in accordance with LKAS 07 using indirect method.

Marking Guide

Preparation of Cash Flow Statement using indirect method.

25 marks

Examiner's Comments

This question was answered satisfactorily by majority of the candidates with much ease. Those who have selected this question able to score nearly 1/5th of the 100 marks, very easily. However, fewer number of candidates have gone wrong in following areas:

Common mistakes are stated below:

- Classification of cashflows under operating, investing and financing had not been understood by most of the candidates correctly.
- Majority of the candidates did not adjust impairment of investment, gratuity provision and gratuity payment for net cashflows from operating activities.
- Cashflows from disposal of PPE was not correctly computed due to lack of understanding of the accounting entry passed. Correct calculation of depreciation for disposal of office equipment.
- Few has not shown the interest paid during the year correctly
- Without preparing the cashflow statement using indirect method, few candidates had prepared it using direct method. Some candidates have not followed the correct format of cashflow statement and as a result they have not correctly stated the cashflows arising from operating activities, investing activities and financing activities separately and correctly.
- Some candidates have started the cashflow statement from profit after taxation instead of profit before taxation.
- Few candidates erroneously identified the changes in working capital. Example: Decrease in inventories deducted as cash outflow.
- Opening and closing balances of ledger accounts have not taken correctly by few candidates
- Candidates are advised to pay more attention on adjustments such as proceeds from disposal, tax payments, investments, loan interest payments etc.

Overall, most of the candidates have a good understanding on preparation of cash flow statement.

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