

EXAMINER'S REPORT
LEVEL 03 EXAMINATION - JULY 2026
(3801) FINANCIAL REPORTING

Most of the common mistakes made by the candidates have been identified. The unsuccessful candidates should identify the mistakes which they made and learn all the principles in order to be successful at the future examinations:

SECTION A

Question No. 01

- (a) A significant weakness observed among the candidates was the widespread misinterpretation of examination action verbs, which adversely affected their ability to provide answers with the required depth and level of application. This issue was particularly evident in Question 1(a), where candidates demonstrated a limited overall understanding of the fundamental qualitative characteristics of financial information (i.e. relevance and faithful representations). Many candidates provided vague or generalized explanations rather than precise, technically relevant responses demonstrating the practical application of the concepts.
- (b) The answers provided for this part were generally satisfactory. However, a few candidates demonstrated a misunderstanding of the going concern concept and were therefore unable to adequately explain its meaning and application.

Question No. 02

- (a) Candidates performed poorly in explaining the purposes and objectives of sustainability reporting. Only a limited number of students were able to articulate the broader purpose of sustainability reporting, including the provision of information relating to an entity's significant environmental, social and governance-related impacts, risks and opportunities.
- (b) Candidates also demonstrated a significant lack of knowledge regarding SLFRS-S 1 – Sustainability Disclosure Standards. The majority of candidates was unable to identify three general requirements expected under the standard.

Overall, the performance on this question indicates that insufficient attention has been given to sustainability reporting and the requirements of SLFRS-S 1, despite these being important areas within the financial reporting syllabus.

Question No. 03

Candidates demonstrated a poor understanding of the functions and capabilities of accounting software. A key weakness identified was the inability of candidates to distinguish between the functions of accounting software and the benefits arising from automation in accounting and financial reporting. Functions relate to the specific activities and processes performed by accounting software, such as transaction recording maintenance of accounting ledgers, accounts receivable and payable management, bank reconciliation, inventory management, preparation of trial balances and generation of financial reports. In contrast, benefits of automation include improved processing efficiency, reduced manual errors, enhanced data consistency, timely reporting, improved accessibility of financial information, etc.

Question No. 04

- (a) Most candidates correctly understood the requirements of this question and provided appropriate answers. However, a few candidates did not attempt the question properly and provided irrelevant answers, such as partnership and non-profit organization, which were not relevant to the question.
- (b) In relation to the importance of adopting accounting standards in financial reporting, candidates were generally able to provide broad or generic explanations; however, the responses lacked technical depth and practical relevance. Candidates were expected to demonstrate an understanding of how accounting standards promote consistency, comparability, transparency, reliability and faithful representation in financial reporting, while also facilitating informed decision-making by investors, creditors and other stakeholders. The responses largely consisted of general statements without adequately linking the adoption of accounting standards to practical financial reporting outcomes.

SECTION B

Question No. 05

The question required candidates to prepare statement of cash flow of a company for the year ended 31st March 2026 using indirect method.

The performance of the candidates is good and following points were noted:

- (1) Some candidates had taken the profit after tax for the year ended 31st march 26 as Profit before tax and arrived incorrect answers.
- (2) Some candidates had calculated the loss on disposal of machine ignoring the sale proceeds.
- (3) Some candidates considered for the year Income tax expense as income tax payment for the year.
- (4) Some had calculated Rs.70,000/- as Gratuity provision of the year without considering Gratuity payment for the year of Rs.250,000/-.

- (5) Some candidates had calculated interim dividend payment incorrectly without considering retained earning account.
- (6) Some have incorrectly calculated purchase of PPE during the year.
- (7) Decrease or increase in working capital was wrongly identified.

Question No. 06

- (a) Revenue recognition - This is another area where candidates performance was largely unsatisfactory.

- (1) Failure to correctly allocate bundled price to standalone performance obligations.
- (2) Incorrect revenue recognition (at a point in time Vs over a period of time).

Candidates seemed to have failed to thoroughly comprehend the practical application of the five steps model used in revenue recognition. More emphasis is needed on this.

- (b) Question required to identify the Borrowing cost to be capitalized as at 31st March 2026 as per the Standard and following are the reasons candidates couldn't get full marks:

- (1) Loan utilization period was not identified correctly specially not considered date of construction commencement date.
- (2) Many candidates have taken interest for entire financial year rather than its construction period.
- (3) Candidates took incorrect principal amount as general borrowing that were not active during the period.
- (4) Incorrect treatment for temporary investment income or not identifying the investment income.

Question No. 07

- (a) Deferred tax - Most of the students failed to score adequately for this question due to lack of understanding of temporary differences pertaining to income tax. Majority of students correctly identified the temporary difference for the land, but failed to calculate that correctly for the motor vehicle and the gratuity provision. Only a very less number of students managed to obtain full marks. Some students who managed to do the calculation correctly had missed to identify the type of deferred tax balance as an asset or a liability.
- (b) Events after reporting date - Satisfactory performance was observed for this question where most of the students has correctly identified both the given scenarios as adjusting events. Nonetheless, only a few students had adequately explained valid reasons for their determination, thereby scoring full marks.

SECTION C

Question No. 08

What was Tested:

- (1) Preparation of the Statement of Profit or Loss and Other Comprehensive Income, Statement of Financial Position and Statement of Changes in Equity in a form suitable for publication.
- (2) Application of year-end adjustments relating to inventory valuation, Property, Plant and Equipment, depreciation, disposal of assets, impairment of trade receivables, taxation and outstanding expenses.
- (3) Accounting for a finance lease, including the measurement of the right-of-use asset, lease liability and finance cost.
- (4) Preparation of the note to the financial statements showing movements in Property, Plant and Equipment.

If performance was not satisfactory, possible reasons:

- (1) Approximately 40% of candidates attempted to calculate the lease liability by considering the present value of the total lease instalments without preparing a lease amortisation schedule. Consequently, the applicable interest charge and closing lease liability were not calculated correctly.
- (2) Although most candidates identified the right-of-use asset, some considered only the initial lease liability in determining the value of the right-of-use asset and failed to include the initial payment made at the commencement of the lease. This resulted in an understatement of the right-of-use asset.
- (3) More than 40% of candidates failed to calculate the correct depreciation on the adjusted assets, particularly the disposed machinery and the leased motor vehicle. These errors affected both profit or loss and the carrying amounts reported in the Statement of Financial Position.
- (4) Some candidates incorrectly recognised the gain on disposal of Property, Plant and Equipment in Other Comprehensive Income instead of recognising it in profit or loss.
- (5) Most candidates did not demonstrate an adequate understanding of the calculation of impairment of trade receivables. Common errors included failing to write off the specifically identified irrecoverable debt before calculating the allowance, applying the 10% allowance to the gross trade receivables balance, and failing to appropriately adjust the existing allowance.
- (6) Approximately 30% of candidates had not correctly identify the income tax expense for the year and the corresponding income tax liability to be presented in the Statement of Financial Position. Some candidates incorrectly treated tax paid during the year as the current-year tax expense.
- (7) Some candidates omitted or incorrectly accounted for accrued interest income and the outstanding audit fee.

Hints to improve performance:

- (1) Candidates should practise comprehensive financial statement preparation questions that integrate multiple accounting standards and year-end adjustments.
- (2) Greater attention should be given to preparing lease amortisation schedules, distinguishing between principal and interest components, and measuring the right-of-use asset by appropriately considering payments made at or before the commencement of the lease.
- (3) Candidates should strengthen their understanding of depreciation adjustments, asset disposals and the appropriate presentation of gains or losses on disposal in profit or loss.
- (4) Candidates should revise the accounting treatment of inventory write-downs, including their appropriate classification within cost of sales.
- (5) Candidates should practise trade receivables impairment calculations by first writing off specifically identified irrecoverable debts and then calculating the required allowance based on the adjusted receivables balance.
- (6) Candidates should clearly distinguish between current-year income tax expense, tax payments relating to prior periods and the closing income tax liability.
- (7) Before finalising their answers, candidates should cross-check that all adjustments have been appropriately reflected in all relevant financial statements and supporting notes.

Question No. 09

Approximately 90% of the candidates attempted Question 09, while the remaining 10% either did not attempt the question or did not attempt both **Parts (a) and (b)**.

Part (a):

Almost all candidates who attempted Part (a) calculated the required ratios correctly, with the exception of the Current Ratio.

Approximately 20% of the candidates calculated the Current Ratio incorrectly. Although these candidates stated the correct formula for the Current Ratio, they failed to consider all relevant current assets and current liabilities when performing the calculation.

Among the candidates who calculated the Current Ratio incorrectly, the majority appeared to confuse the Current Ratio with the Quick Ratio, resulting in an incorrect calculation.

Part (b)

The majority of candidates did not adequately address the requirements of Part (b), although most candidates obtained approximately 50% of the available marks.

Most candidates compared the calculated ratios with the relevant industry averages but failed to provide appropriate possible reasons for the differences identified.

Only a small proportion of candidates compared the ratios with the previous year's ratios and provided an analysis of the changes between the two years.

Recommendation:

Candidates are strongly advised to carefully read and understand the requirements of each question before attempting to answer. Particular attention should be given to the specific requirements of the question, including the need to provide appropriate explanations, comparisons and reasons, rather than merely performing the required calculations.

Question No. 10

Question required to calculate Goodwill arising on acquisition and consolidated Statement of Financial Position as at 31st march 2026. Following points were noted:

- (1) Only few candidates calculated Goodwill amount correctly because most of them had not taken land revaluation into the account correctly.
- (2) Some candidates had taken impairment in Goodwill when calculating goodwill on acquisition.
- (3) Most of the candidates had not made adjustments for stock in transit and unrealised profit in calculating the consolidated inventory value.
- (4) Only very few candidates had calculated Consolidated Retained Earnings and Non -Controlling Interest correctly.
- (5) Most of the candidates Goodwill impairment had not proportionated properly.

Recommendation:

Candidates are strongly advised to practise a wider range of consolidation questions. Regular practice will help strengthen their understanding and application of consolidation adjustments and improve their ability to prepare consolidated financial statements accurately and obtain higher marks..

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General points to be considered in developing the level of Understanding of candidates:

- (1) Many candidates were not mentioned the question numbers on the answer script.
- (2) Answers not commenced in a new page as instructed to the candidates.
- (3) It is advisable to candidates to go through all the questions during reading time and prioritize the questions based on convenience of candidates.
- (4) Candidates should read the study text of AAT and practice the examples given in the study text.
- (5) Candidates should practice past papers as much as possible within the allocated time and thus, should practice for time management.
- (6) It is advised to read the questions carefully and understand the requirements of the question with the action verbs provided in the question.

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