

EXAMINER'S REPORT**AA3 EXAMINATION - JANUARY 2020****(AA31) FINANCIAL ACCOUNTING AND REPORTING**

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

SECTION A**Question No. 01**

This question required the candidates to explain two qualitative characteristics that enhance the usefulness of financial information.

Marks were awarded for any two of; comparability, variability, timeless, understandability. Most of the candidates explained two qualitative characteristics that enhance the usefulness of the qualitative characteristics correctly. There were a few candidates who just named two qualitative characteristics without explaining them. They failed to obtain full marks allocated to the question.

Areas to be improved: Knowledge on conceptual framework.

Question No. 02

This question required to,

- (a)** State two key objectives of Integrated Reporting
- (b)** State key areas included in Organizational overview and external environment

Most of the candidates could not state key objectives of integrated reporting. Many were able to state only the objective of improve quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital. Further, most of them were unable to state key areas included in organizational overview. But most of the candidates stated 3 key areas included in the external environment.

Areas to be improved: Knowledge on integrated reporting

Question No. 03

This question required to state the 5 steps followed in recognizing revenue from contracts with customers as per SLFRS 15.

Only a few candidates were able to state correctly the 5 steps in recognizing revenue from contracts with customers. Instead, most of the candidates stated the criteria in recognizing revenue.

Most of the candidates could not score even a single mark for this question. This question was very poorly answered by majority of the candidates.

Areas to be improved: Knowledge and application of SLFRS 15

Question No. 04

This question required to prepare cash flows from investing activities.

Most of the candidates answered this question well. However, there were candidates who did not differentiate cash inflows and outflows. Thereby, they could not arrive at the net cash flows from investing activities correctly. Most of the candidates were able to show the proceeds from disposal of motor vehicle correctly but not the amount spent on acquiring furniture.

Areas to be improved: knowledge on preparation of Cash Flow Statement

SECTION B

Question No. 05

Part (a)

This question required to analyze performance of **Medi Tec (Pvt) Ltd.** by calculating Gross Profit (GP) Ratio, Net Profit (NP) Ratio, Stock Turnover Ratio, debtors' collection period and Return on Capital Employed (ROCE).

Majority of the candidates computed ratios correctly but failed to analyze the performance. Some candidates just mentioned that a ratio has increased / decreased compared to the previous year without giving possible reasons for such increase / decrease.

Common Mistakes made by the candidates in calculating ratios:

- When computing the GP ratio, Gross Profit was divided by cost of sales, instead of the turnover. While some others divided Gross Profit by total assets.
- When calculating NP ratio, some divided Net profit before tax by Turnover.
- When Computing the Debtors collection Period, divided the debtors at the yearend by turnover without considering the average debtors.
- When calculating ROCE, Profit before interest and Tax was divided by only Equity without adding long term debts. While some others have divided the profit after Tax by Equity and long term debts.

Areas to improved: Computing ratios correctly and analyzing their performance correctly.

Question No. 06

This question required to prepare the Statement of Cash Flows using indirect method.

The performance was good and many candidates scored 9 marks. There were a few candidates who scored full marks.

But some candidates made following mistakes:

- Failed to recognize working capital changes, financing and investing activities separately.
- Considered increase in trade receivables as cash inflow and increase in trade payables as cash outflows.
- Failed to arrive at the profit before tax correctly. Some considered it as Rs.900,000/- or Rs.1,260,000/-.
- Failed to arrive at the correct depreciation amount, amount spent on acquiring fixed assets, profit on disposal, etc.
- Omitted Rs.300,000/- paid as interim dividend from the cash flow.

Areas to be improved: Preparation of Cash Flow Statement.

Question No. 07

(A) Parts (a) & (b) of this question tested application of LKAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Part (a) - Many candidates failed to identify **part (a)** as a change in accounting policy that has to be adjusted retrospectively. The correct treatment would be to adjust the 2017/2018 comparative figures and restate the stock balance in the financial statements by reducing 6.7 Million. However, only a handful of candidates have done this treatment correctly.

Part (b) - Majority failed to identify this as an Accounting Error. Most of the candidates mentioned this as a change in accounting estimate. Most of them stated that this has to be adjusted prospectively, whereas it should have been adjusted retrospectively.

This question was very poorly answered by majority of the candidates.

Areas to be improved: Knowledge of application of LKAS 8.

(B) Part (a) and (b) of this question tested the knowledge on application of LKAS 37- Provisions, Contingent Assets and Contingent Liabilities.

Most of the candidates identified **part (a)** to be recognized as a Contingent asset. Some of those who identified this as a provision, were not able to state correctly the amount of the provision to be made.

Part (b) - Some candidates correctly stated that **part (b)** to be recognized as a Contingent Liability and it is to be disclosed. While some other candidates stated only a disclosure is sufficient but did not mention that it is a contingent liability.

Areas to be improved: knowledge and application of LKAS 37.

SECTION C

Question No. 08

This question tested the knowledge on preparation of Statement of Comprehensive Income Statement, Statement of Financial Position, Statement of Changes in Equity and Depreciation Schedule.

Common Mistakes that were made by the candidates are as follows:

Statement of Comprehensive Income:

- Most of the candidates, failed to adjust the obsolete stock of Rs.700,000/- and subsequent sale of this stock at the Cost of Sales. Instead they expensed it to the P&L. Some candidates did not provide workings for cost of sales.
- Instead of deducting of Rs.500,000/- incurred for installation & testing expenses of the machinery from the Administrative expenses, added back Rs.500,000/- to Administration expenses .
- Failed to show the revaluation gain under other comprehensive income
- A few candidates failed to remove the loan interest of Rs.360,000/- incurred during the time of construction, from the finance expenses.
- Failed to identify the tax expenses even though this was clearly given in the question. Mixed up with the paid and payable amounts.

Statement of Financial Position:

- Failed to capitalize Rs.500,000/- amount spent on testing and installation of plant & machinery.
- Failed to capitalize the interest of Rs.3,600,000/- to capital work-in-progress.
- Failed to show the net realizable value of inventory correctly.
- Mixed up the current portion and the non- current portion of the loan.
- Failed to arrive at the correct Income Tax Payable amount as they failed to account for the income tax expense and tax paid amounts correctly.

Statement of Changes in Equity:

- Considerable number of candidates have deducted the interim dividend paid from the share capital instead of deducting it from the Retained Earnings.
- Further, sum candidates have removed the proposed dividend of Rs.4,500,000/- from the retained earnings.
- Considerable number of candidates have taken the total comprehensive income of the year to the retained earnings instead of the profit after tax.

Areas to be improved: Knowledge on relevant LKASs and SLFRSs

Question No. 09

Part A (a) of the question tested the ability to compute goodwill arising from consolidation and **part (b)** tested on preparation of Consolidated Statement of Financial position involving inter-company transactions & unrealized profit.

Almost all the candidates attempted this question. In general, overall performance of this question was very satisfactory.

However, following mistakes were made by a few candidates:

- When calculating goodwill, proportionate net assets were taken.
- Instead of debiting Consolidated Retained Earnings account with full amount of unrealized profit of Rs.750,0000/- , 80 % of Rs.750,0000/- was taken to Consolidated Retained Earnings Account and 20 % was taken to Non-Controlling interest Account.
- Failed to eliminate inter-company trade receivables and trade payables.
- Failed to eliminate inter-company short term loan payable and receivable.

Areas to be improved: Knowledge on Consolidated Financial Statements and related adjustments such as computation of goodwill, adjustments relating to unrealized profits and inter-company transactions.

Part (B)

This question tested possible reasons for the variations in current ratio, ROCE, Stock residence period over two years. Some candidates instead of giving reasons, compared the ratios of the two years and stated that current ratio has increased, ROCE has dropped and Stock residence period has increased .

Areas to be improved: Comprehensive knowledge on ratios

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

- (1) Studying well the contents of the entire syllabus and develop a thorough understanding of the level of knowledge expected for each unit or area.
- (2) Candidates should read the questions carefully and provide answers to the question asked.
- (3) Should show all workings for the figures arrived at.
- (4) Should state all the assumptions if there are any.
- (5) Should start each question on a fresh sheet of paper and question number should be clearly stated.
- (6) Hand writing should be legible.
- (7) Practicing past questions many times will help sharpening knowledge, skills and gaining speed. This will also be advantageous as similar types of questions may be repeated in the future examinations.
- (8) Reference to Accounting standards, suggested answers, articles related to subject will definitely improve knowledge.
- (9) Time management is crucial at the examination. In answering questions, candidates should spend time based on the marks allocated to each question.
- (10) Should sit at the examination with due preparation and with firm determination of passing the examination.