

## Examiner's Report

### AA3 EXAMINATION - JULY 2018

#### **(AA31) FINANCIAL ACCOUNTING AND REPORTING**

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Most of the common mistakes made by candidates have been identified and given below. The unsuccessful candidates should take steps to avoid making these types of mistakes in order to be successful at the future examinations:

#### **PART A**

##### **Question No. 01**

Required the candidates to explain any two qualitative characteristics that enhances the usefulness of information.

Only a very few candidates answered correctly. Majority explained the concepts of relevance and faithful representation, instead of comparability, verifiability, timeliness and understandability. It was observed from the answers that most of the candidates were unaware of the enhancing qualitative characteristics.

**Areas to be improved:** Knowledge on Conceptual Framework.

##### **Question No. 02**

Required to state 2 key areas in business model and 3 key areas in organizational overview and external environment of an integrated report.

This question was very poorly answered by majority of the candidates. Some candidates were able to provide only the 3 key areas in organizational overview and external environment. It was also noted that most of the candidates have not attempted this question.

**Areas to be improved:** Knowledge on Integrated Reporting.

##### **Question No. 03**

Tested the knowledge on Accounting for leases.

Majority of the candidates attempted this question and prepared the amortization schedule. But some of them did not know that the closing capital balance of the schedule represented non-current portion and not the current portion of the lease creditor. Though they prepared the amortization schedule correctly, non-current liability and current liability amounts were not shown in the extract of the statement of financial position. Some others considered the value of lease vehicle as 5M instead of 6.5M and calculated the depreciation on 5M. There were a very few candidates who have only prepared the amortization schedule correctly, but have not extracted any figures from it.

**Areas to be improved:** Application of LKAS 17 - Leases.

### **Question No. 04**

Required to arrive at the net cash flow generated from financing activities.

Most of the candidates answered this question correctly and some were able to obtain full marks. Some candidates considered the bank overdraft facility as a cash inflow from financing activities.

**Areas to be improved:** Preparation of Cash Flow statement.

## **PART B**

### **Question No. 05**

Required to analyze performance using Gross profit ratio, Net profit ratio, Quick Assets ratio, Debtors' collection period and Creditor's settlement period.

Majority of the candidates failed to analyze the performance based on the computed ratios. They only computed the ratios.

When computing Net profit ratio, some candidates failed to take correct net profit figure. Some failed to remove inventory balance from current assets when computing the quick assets ratio. Several candidates failed to arrive at the correct credit sales and average debtors balance when computing debtors' collection period. Many candidates were unable to use the correct formula in computing the creditors' settlement period.

**Areas to be improved:** Computing ratios and analyzing the performance based on the computed ratios.

### **Question No. 06**

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

The performance was good and many candidates scored more than 7 marks.

But some candidates made the following mistakes:

- Failed to recognize the working capital changes, financing and investing activities separately.
- Considered decrease in trade and other payables, increase in trade debtors, and increase in inventory as cash inflows.
- Some candidates considered the tax expense of Rs.450,000/- given in the question as the amount of tax paid.
- Failed to arrive at the correct depreciation amount.

**Areas to be improved:** Preparation of Cash Flow Statement and related adjustments.

## Question No. 07

**Part (a)** required the candidates to explain the accounting treatment for the given instance as per the LKAS 8.

Performance for this question was at a very poor level.

Part (a) of the question was attempted by many. Only a few were able to work out the correct carrying value as at 01.04.2017 and arrive at the correct annual depreciation figure.

Even though the study pack contained examples similar to this question, only a few were able to answer this part correctly.

Only a handful of candidates were able to correctly identify that this is a change in accounting estimate and the adjustment is required to be made prospectively.

### **Part (b)**

It was required to explain how the given instances should be recognized in the financial statements as per LKAS 37.

- (1) Many failed to recognize that a provision is required to be made for 2% of sales amounting to Rs.600,000/-.
- (2) A few candidates answered correctly by stating that a provision of Rs.2,000,000/- to be recognized as income tax liability in the current year .
- (3) Many failed to identify that it's a contingent liability and only a disclosure is required to be made in the financial statements.

**Areas to be improved:** knowledge on LKAS 37.

## **PART C**

## Question No. 08

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

Mistakes that were made by the candidates are as follows:

- (1) Were not able to correctly identify the investment income.
- (2) Were not able to arrive at the allowance for bad debts amount to be charged to Income Statement.
- (3) Failed to capitalize the loan interest of Rs.500,000/- to the building and did not state the reason for not considering it as a qualifying asset.
- (4) Failed to correctly calculate the depreciation charge for Building & office equipment.
- (5) Were adjusted value of the closing inventory to the NRV which was higher than the cost.
- (6) Failed to calculate the depreciation of the disposed computers correctly. Therefore arrived at incorrect loss on disposed computers.

- (7) Although the taxation expense was given in the question, it was not considered as tax expense for the year.
- (8) Failed to arrive at the tax payable amount correctly.
- (9) Proceeds due from sale of computers were shown as trade debtors.
- (10) Short term investments were not shown under current assets.
- (11) Failed to show the current portion of the loan as a current liability and the rest of the loan as long term liability.
- (12) Revaluation surplus was shown under equity or under share capital.
- (13) Revaluation surplus amount was shown as other income instead of showing it under other comprehensive income.
- (14) Failed to give the note relating to the final dividend proposed. Instead of giving a note, adjusted proposed dividends in the statement of changes in equity.
- (15) Total comprehensive income was taken to retained earnings column in the statement of changes in equity instead of taking only the profit for the year.
- (16) Some candidates did not show the workings in support of figures they have arrived at.

**Areas to be improved:**

- (1) Time management.
- (2) Practice in doing similar questions.
- (3) Knowledge on relevant accounting standards.

**Question No. 09**

**Part A** of the question tested the ability of computing the goodwill and preparation of Consolidated Statement of Financial Position.

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

But following mistakes were made by a few candidates:

- (1) When calculating the goodwill, proportionate net assets were taken.
- (2) Parent company's and subsidiary's PPE were added without adjusting for the motor vehicle bought and sold between them.
- (3) Unrealized profit on buying & disposing of motor vehicle was not adjusted in the consolidated retained earnings account.
- (4) Depreciation overcharged was not adjusted in the consolidated retained earnings and in non-controlling interest (NCI).
- (5) Unrealized profits on inter-company transactions relating to buying and selling of goods were not adjusted in the consolidated retained earnings and in NCI.
- (6) Inventory balance in the Statement of Financial Position was not adjusted for unrealized profit.
- (7) Inter-company receivables and payables were not eliminated.

**Part (B)** tested the understanding of gearing ratio, ROCE and Assets Turnover Ratio.

Even though the question required possible reasons for variations in ratios, some candidates instead of giving reasons, just compared the ratios of the two years and stated that gearing ratio has increased, ROCE has dropped and Assets turnover has increased.

**Areas to be improved:**

- (1) Computation of goodwill.
- (2) Adjustments relating to unrealized profits and inter-company transactions.
- (3) Understanding the significance of changes in ratios.

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

- (1) Studying well the full contents of the syllabus completely and develop a thorough understanding about the level of knowledge expected from each unit or area.
- (2) Candidates should read the question carefully several times and should show all the relevant workings related to the computations with clarity.
- (3) State the assumptions clearly if there are any assumptions involved in answering the questions.
- (4) Handwriting should be legible and the numbers of questions should be correctly written. Re-checking of question numbers etc. before handing over answer script is a must.
- (5) Following correctly the instructions given in the question paper.
- (6) Perusal of past question papers and suggested answers would help sharpening of knowledge, skills and experience. It is always advantageous because the similar patterns and the structures may repeat in the real examination papers.
- (7) Refer Accounting Standards, Articles and Magazines in relation to this subject and other reading materials related to the relevant subject areas.
- (8) Time Management is crucial in the examination. By looking at the marks allocated to each question candidates can make an estimation of the time they require to spend in answering.
- (9) Appearing for the examination with a firm determination of passing the examination with due preparation.

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