

## Examiner's Report

### AA3 EXAMINATION - JULY 2019

#### **(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**

###### **Part (a)**

Required the candidates to explain the underlying assumption made in preparing financial statements as per the conceptual framework.

Most of the candidates stated correctly the going concern assumption and explained it. A few candidates stated accounting concepts and components of Financial Statements.

###### **Part (b)**

Required to state the recognition criteria of a Liability.

Most of the candidates stated that a liability is recognized when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.

This part was answered well by majority of the candidates.

**Areas to be improved:** Knowledge on conceptual framework.

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

Required to state the components of Integrated Reporting.

Considerable number of candidates scored full marks. While some other candidates mentioned key areas within the components instead of mentioning the key components.

**Areas to be improved:** Knowledge on integrated reporting.

### Question No. 03

**Part (a)** tested the recognition criteria of an intangible asset.

Majority of the candidates failed to state that it should be identifiable, control of the asset should be vested with the company, it is probable that the expected future benefits that are attributable to the asset will flow to the entity, the cost of the asset should be measured reliably. Instead, majority of them stated that the intangible assets cannot be touched and they are not visible.

**Part (b)** required to state whether each of the expenditure items given in the question could be recognized as an intangible asset or not.

Most of the candidates stated that research expenditure of Rs.1 million is not an intangible asset, Patent Right of Rs.100,000/- is an Intangible asset and Promotion fee of Rs.300,000/- is also not an intangible asset.

**Areas to be improved:** Knowledge and application of LKAS -38 Intangible Assets.

### Question No. 04

The question required to arrive at the net cash flow generated from investing activities .

Most of the candidates answered this question correctly. Some candidates could not arrive at the correct sale proceeds from disposal of Motor Vehicle.

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

## PART B

### Question No. 05

**Part (a)**

This question required to compute the Gross Profit Ratio, Debtors' Collection Period, Stock Residence Period and Return on Capital Employed (ROCE)

Majority of the candidates computed these ratios correctly.

Common Mistakes made by some of the candidates and comments thereon:

- (1) When computing the GP ratio, Gross Profit was divided by cost of sales, instead of the turnover.
- (2) When Computing the Debtors' collection Period, divided the closing debtors by turnover without using the average debtors.
- (3) When computing the Stock Residence Period, divided the average stock balance by turnover, instead of cost of sales.
- (4) When calculating ROCE, Profit before interest and tax was divided by only Equity without adding long term debts. While some others have divided Profit after Tax by Equity and long term debts.

### **Part (b)**

This question required to list 2 methods by which GP ratio and the debt collection period could be increased.

This part was well answered by majority of the candidates. However, some candidates stated in order to improve the debt collection period it is necessary to increase credit sales.

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

### **Question No. 06**

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

The performance was good and many candidates scored about 8 marks. There were only a few candidates who scored full marks.

But some candidates made the following mistakes:

- (1) They failed to recognize working capital changes, financing and investing activities separately.
- (2) They considered decrease in trade receivables and increase in trade payables, as cash outflows.
- (3) Some candidates failed to add the income tax expense of Rs.125,000/- to arrive at the profit before tax.
- (4) Some of them failed to arrive at the correct depreciation amount.

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

### **Question No. 07**

#### **A Part**

##### **Part (a)**

This part of the question tested on identifying temporary differences and **Part (b)** tested on computing of the Differed Tax Liability / Asset.

Performance for this question was not satisfactory. **Part (a)** of the question was attempted by many. Only a few worked out the temporary difference on gratuity provision.

##### **Part (b)**

Majority of the candidates worked out the differed tax liability by multiplying the temporary difference by the tax rate of 28%.

#### **B Part**

This question tested on Stock Valuation using Weighted Average cost method. Performance of this part was satisfactory. Most candidates scored 5 out of 5 for this part.

**Areas to be improved:** knowledge on LKAS 12.

## PART C

### **Question No. 08**

This question 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:

#### **Statement of Comprehensive Income:**

- (1) Most of the candidates, failed to adjust the stock loss of Rs.700,000/- to the Cost of Sales. Instead they charged it as an expense to the P & L.
- (2) Except a few, most of the candidates arrived at the gross profit figure.
- (3) Some candidates could not arrive at the correct disposal gain of the motor vehicle disposed. They considered only the “cash receipt” of the disposal and did not consider the accumulated depreciation of the disposed asset.
- (4) Some Candidates could not arrive at the correct rent expense applicable to the period under consideration.
- (5) There were candidates who failed to arrive at the correct depreciation charge of motor vehicles.
- (6) A few candidates failed to remove the loan interest of Rs.500,000/- incurred during the time of construction, from the finance expenses.
- (7) Some other candidates failed to show the revaluation gain of Rs.3,000,000/- under other comprehensive income of the Statement of Comprehensive Income.

#### **Statement of Financial Position:**

- (1) Some of the candidates failed to debit the interest of Rs.500,000/- to capital WIP.
- (2) Some candidates failed to remove the stock loss of Rs.700,000/- from the closing inventory balance.
- (3) Rent pre-payment was correctly adjusted only by a few candidates.
- (4) Some mixed up the current portion and the non-current portion of the loan.
- (5) Some ignored the interest payable credited to trade payable account and did not show separately as interest payable.
- (6) Some candidates failed to arrive at the Income Tax Payable amount as they did not consider the income tax expense and the amount of tax paid already correctly.

#### **Statement of Changes in Equity:**

- (1) Some candidates deducted the interim dividend paid from the share capital instead of deducting it from the retained earnings.
- (2) A few candidates removed the proposed dividend from the retained earnings. However, this need not be adjusted in the final accounts, instead a note should be stated.
- (3) Some took the net profit of the year before taxation to the retained earnings, instead of the profit after tax.
- (4) Also, some other candidates have considered Total Comprehensive Income for the year to be added to Retained Earnings.

### Areas to be improved:

- (1) Application of Accounting Standards.
- (2) Adjustments relating to Accounting Entries.

### Question No. 09

#### Part A

**Part (a)** of the question tested the ability to compute goodwill and **part (b)** tested on preparation of Consolidated Statement of Comprehensive Income with adjustments involving inter-company transactions (interest & rent), unrealized profit, depreciation, etc.

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

But following mistakes were made by a few candidates / comments are as follows:

- (1) When calculating Goodwill, some considered the fair value of net assets amounting to Rs.340 Million as investment, instead of Rs.290,000/- given in the question.
- (2) Failure to arrive at the Non-Controlling interest amount by multiplying 250,000 shares at Rs.365/- per share.
- (3) Failure to adjust the inter-company sales from **Sigma PLC** to **Beta PLC** amounting to Rs.5,500/- from Sales and Cost of sales.
- (4) Adjusted only the Rs.5,000/- without considering the 10 % markup amounting to Rs.500/- relating to inter-company sales.
- (5) Ignored the unrealized profit of Rs.100,000/- on unsold stock purchased from **Sigma PLC**.
- (6) Failed to adjust Rs.1 million unrealized profit on inter-company purchase / sale of machinery.
- (7) Failed to adjust the over charged depreciation charge of Rs.100,000/- on machinery sold by **Beta PLC** to **Sigma PLC**.
- (8) Failed to eliminate the inter-company interest of Rs.500,000/- from interest income and finance expenditure.
- (9) Most of the candidates incorrectly eliminated inter-company annual rent of Rs.600,000/- by considering the annual rent of Rs.50,000/- paid by **Sigma PLC** as monthly rent.
- (10) The most common mistake made by majority of the candidates was mixing up Rs. Thousands and Rs. Millions.

## **Part B**

- (1) But majority instead of giving 3 limitations of ratio analysis, mentioned the difficulties in ratio analysis such as time consuming, difficult to calculate, difficult to understand, etc. as answers for this part.
- (2) Even though the question required possible reasons for variations of the given 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:** Computation of goodwill, adjustments relating to Consolidated Financial Statements such as unrealized profits and inter-company transactions.

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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 and provide answers only to the question asked. They 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 similar patterns and structures may be repeated 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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