

EXAMINER'S REPORT
LEVEL III EXAMINATION - JANUARY 2025
(301) 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 to be successful at the future examinations:

SECTION A

Question No. 01

- (a) The requirement of this question was to identify three new trends in the accounting profession. Most of the candidates demonstrated a general understanding of emerging trends. A few candidates provided outdated trends rather than recent developments in the profession. Such as Globalization, Integrated Reporting, Digital Transformation, AI technology, Remote Work Force, etc.
- (b) This part required candidates to state two measurement bases used for the measurement of the elements of financial statement as per the Conceptual Framework for Financial Reporting. A significant number of candidates failed to correctly identify the measurement bases, and some candidates have written qualitative characteristics of financial statements instead of measurement bases such as historical cost, fair value, current value, value in use, current cost etc. This demonstrates lack of knowledge about conceptual framework for financial reporting and lack of understanding of the question.

Question No. 02

- (a) The requirement of this part of the question was to state the main purpose of sustainability reporting. Most of the candidates had stated the main purpose of sustainability reporting correctly.
- (b) This part required candidates to state three guiding principles of Integrated Reporting. Most of the candidates have not correctly stated the principles, with some confusing them with content elements of Integrated Reporting. This demonstrates a lack of knowledge about integrated reporting.

Question No. 03

- (a) This part tested the knowledge about gross profit ratio and debtor's collection period. Candidates were expected to list possible actions for improving the gross profit ratio and debtors' collection period. Many candidates provided relevant actions, such as better cost control and enhanced credit management. However, answers of very few candidates lacked specificity and justification.

- (b) The requirement of this question was to list three limitations of ratio analysis. Most candidates correctly listed key limitations, such as differences in accounting policies and the exclusion of qualitative factors. However, some answers included irrelevant points, indicating a lack of understanding about ratio analysis limitations. Some candidates have listed advantages of ratio analysis instead of limitation due to overlooking the question.

Question No. 04

This question required candidates to explain whether certain cost could be recognized as intangible assets under LKAS 38. Most of the candidates correctly applied the standard and stated whether cost is intangible or not. However, average number of candidates have not explained the reasons for such recognition. Some candidates failed to recognize training cost as an expense.

While candidates demonstrate a general understanding of the topics, they are advised to provide structured responses, avoid vague explanations, and ensure accuracy of knowledge in technical concepts and accounting standards.

SECTION B

Question No. 05

The question was required to prepare a Statement of Cash Flows for the year ended 31st March 2024 using indirect method.

Most of the candidates performed well and obtained satisfactory marks. The following are the common errors made by the candidates:

- (1) Some candidates failed to classify as operating, investing and financing activities separately and stated as common activities
- (2) Although some have classified the activities separately, they failed to pinpoint the correct activities. For Eg: Long term loan obtained was identified as investing activities which should be classified under financing activities.
- (3) Many failed to show cash inflows without brackets and outflows within brackets.
- (4) Depreciation adjustment was calculated incorrectly. Depreciation for the disposed machine has not been removed from the accumulated depreciation account. This has resulted in incorrect depreciation charges and loss of disposal of machine instead of profit.
- (5) Profit from disposal of the vehicle was incorrectly calculated. A noticeable number of candidates had not considered the fact that the asset was fully depreciated. It resulted in deriving an incorrect depreciation charge as well.
- (6) Some candidates were not correctly calculated to the payment made to purchase the new machine due to not transferring the cost of disposed machine from relevant asset account.
- (7) Some candidates had incorrectly calculated of profit before tax, Income tax payment and Interest expense on loans. Some candidates have subtracted tax expenses from profit after tax to calculate profit before tax which must be added instead.
- (8) Few candidates have taken Statement of Financial Position figures directly to the Cash Flow Statement instead of the movement.

Question No. 06

The candidate's performance was not satisfactory, especially for **part (b)** of the question only around few candidates scored 50% or more of the allocated marks.

- (a) It was required to explain short term employee benefits with two examples. Only a few candidates explained the short-term employees benefits correctly. Most of them failed to state that these benefits to be fully settled before 12 months after the end of annual reporting period in which the employees render the related service. It is noted that most of the candidates have different incorrect views due to lack of knowledge in this area.

Some answers included post-employment benefits and termination benefits as a part of short-term benefits. For example, EPF, ETF and gratuity payments were given as examples for short-term benefits.

- (b) This part of the question required to prepare Lease Receivable ledger account and Unearned Finance Income ledger account for the year ended 31st March 2024 of Lessor. Only a few answered this part correctly. The following mistakes were done by many candidates:

- (1) Candidates had changed the debit and credit sides when preparing lease receivable account by entering advance received, annual lease installment, Fair value of Motor Vehicle.
- (2) Many candidates had recalculated the present value of minimum lease payments by discounting the payments and showed the lease amortization schedule for the entire five years. They would have spent a long time unnecessarily.
- (3) A noticeable number of students failed to include the ledger account despite having derived the relevant amounts correctly.
- (4) A very few answers included the Unearned Interest Income Account, but most of them were incorrect.
- (5) Some candidates had not written the balance carried forward and brought forward, although they had got the other elements in the account correct.

Question No. 07

- (a) This question was tested the candidates' knowledge on LKAS 37 – Provisions, Contingent Liabilities and contingent assets. Based on the below given three instances' students were requested to explain how each instance should be recognized as per the LKAS 37. An average mark was scored by many candidates for this part of the question.

- (1) A customer has filed a case for compensation of Rs. 1 million on health deterioration after using a product sold by the company. Majority of the candidates had proposed to make a provision of Rs. 1 million even though the company lawyers have stated that there is a low probability of paying this amount. However, a few candidates had correctly mentioned that the disclosure should be made as a contingent liability in the notes to the financial statements explaining the nature and amount of the claim along with the assessment of low payment probability.

- (2) Company declared its dividends on profit for the year ended 31st March 2024 on 10th April 2024. An average number of candidates answered correctly explaining that disclosure should be made in the financial statements.
- (3) An assessment was made by the Inland Revenue Department disallowing some expenses of Rs. 2 million which were considered as allowable expenses by the Company when calculating income tax liability. After several discussions, IRD agreed to disallow up to Rs. 1.5 million on 30th April 2024. The average number of candidates correctly mentioned that a provision should be made in the financial statements. However, the majority had failed to understand question whether to increase in provision due to disallowable expenses amounting to Rs 1.5 million.

Following are the common weaknesses observed in the answers provided by candidates:

- (1) Without stating that incidents should be adjusted, not adjusted or disclosure, candidates had mentioned that it is a contingent liability or contingent asset only and some mentioned to be provided or not to be provided.
- (2) Some candidates provided vague answers like 'this should be recognized in the financial statements without concluding the type of phenomena (provision, contingent liability, contingent asset or none of them) or at least explaining how those should be recognized i.e. making a disclosure or posting an adjustment.
- (3) A few candidates have confused LKAS 37 versus LKAS 11 (events after the reporting date) as some answers primarily emphasized principles of the latter.

(b) (i) Qualifying Assets:

Required to explain the term a "Qualifying Asset as per LKAS 23- Borrowing Cost with an example. Majority of the candidates had not answered correctly for this part of the question. Overall performance for this question was not at a satisfactory level.

Some candidates have assumed Qualified Assets were assets that meet the characteristics and recognition criteria for assets as specified in LKAS 01. Only a very few candidates included the key term 'substantial period' in their answers. Further some candidates were unable to provide examples for the same due to lack of knowledge on LKAS 23 – Borrowing cost.

- (ii) This part of the question required to state a condition that is to be met for commencing the capitalization of borrowing cost as per LKAS 23. Most of the candidates have not correctly stated the condition of commencing the capitalization of borrowing cost. Instead of listing criteria for commencement of capitalization, some had stated one of the primary conditions to satisfy to consider capitalizing borrowing cost. Eg: funds have been borrowed specifically for developing the asset.

SECTION C

Question No. 08

This question was related to the preparation of Financial Statements including notes to the financial statements showing movement of Property, Plant and Equipment. Most of the candidates scored good marks and it is noted a very few had not attempted to this question. Common mistakes made by the candidates are as follows:

- (1) Most of the candidates failed to calculate interest on borrowing cost correctly and to identify the amount to be capitalized.
- (2) Some candidates had not identified the Income Tax expense for the year and considered the payable amount as income tax expense for the year.
- (3) Some were negligently forgot to record dividend and profit for the period in the statement of changes in the equity.
- (4) Some candidates have adjusted the dividend paid to share capital. Additionally, a few added the dividend paid to retained earnings, which was incorrect.
- (5) Most of the candidates failed to calculate the disposal profit correctly due to erroneous depreciation calculations for the disposed motor vehicle.
- (6) A considerable number of candidates failed to distinguish between the current and noncurrent portions of term loans.
- (7) Most of the candidates failed to calculate impairment loss of machinery. Some candidates have not recorded impairment in the PPE schedule as well as in the income statement. This may be due to a lack of knowledge about impairment.
- (8) Provision for bad debt was calculated without adding recovery of bad debts amounting to Rs. 1,400, which was erroneously credited to debtors' account. Additionally, many candidates failed to recognize the reversal that should have been made to the provision for bad and doubtful debts. Further, there was a noticeable poor knowledge regarding the proper treatment of the reversal of over-provision of bad debts, as well as the recognition of the recovery of previously written-off debts.
- (9) A considerable number of candidates have failed to show interest receivable and prepayment balances, accrued expenses, inventory in the Statement of Financial Position.
- (10) Failed to bring the calculated depreciation expenditure from the movement of the Property Plant & Equipment schedule to the income statement under administration and distribution expenditure.

Question No. 09

This question is requested to calculate five ratios and to prepare a summary report comparing the company ratio with the industry average while explaining the possible reasons for variances. Most of the candidates had calculated the ratios and scored allocated marks for the calculation part. Few candidates had obtained full marks for preparation of summary report.

(a) The following mistakes were made by some of the candidates when computing the ratios:

- (1) Some candidates had considered the cost of sales instead of sales when calculating the gross profit ratio.
- (2) Some candidates had used the profit before tax or profit before tax and interest instead of profit after tax to calculate net profit ratio.
- (3) Some candidates used total sales to calculate debtors' collection period instead of credit sales and some had used closing debtors instead of average debtors.
- (4) Some candidates have used total purchases instead of credit purchases to calculate creditors settlement period and also instead of average creditors they have considered closing balance or total of opening and closing creditors balance.
- (5) Some candidates have calculated the earnings per share using share holders' equity, profit before tax, profit before interest and tax instead of net profit after tax.

(b)

- (1) Some candidates had compared the ratios and stated whether the company's performance was favorable or unfavorable compared to industry performance without giving possible reasons for the variance.
- (2) Some candidates compared the company ratio and the industry average ratio from the point of industry view instead of the company.
- (3) Many candidates were of the view that early settlement of creditors was favorable to the company.
- (4) It was observed that many candidates are not knowledgeable about the reasons for the variances in debtors' collection period and creditors settlement period.
- (5) Some candidates discussed about the effects of having lower earnings per instead of giving reasons for the variance with industry average earnings per share.

Question No. 10

The question was requested to calculate the goodwill on acquisition and prepare the Consolidated Statement of Financial Position.

Generally, it was well answered by candidates obtaining above average marks. Majority have understood the concept of consolidation and relevant adjustments have done correctly. **Part (a)** was well answered by the candidates.

Following were the mistakes made by the candidates:

- (1) Few candidates have given the Statement of Financial Position of two companies separately.
- (2) Errors in calculating profit on disposal of machinery and relevant depreciation.
- (3) Unrealized profit was not calculated correctly and not recorded.
- (4) Consolidated retained earnings and non-control interest were not accurate.
- (5) Most of the candidates have failed to allocate goodwill between the parent and Non Control Interest using the fair value method.
- (6) When calculating retained earnings, some candidates failed to understand debits and credits correctly.
- (7) Most of the candidates had attempted the question simply by adding the figures of the parent and subsidiary without eliminating intercompany transactions.
- (8) A few candidates had added the stated capital of both the parent and subsidiary, which indicated a lack of knowledge about consolidation.

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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) Candidates attempted to answer the questions in an orderly manner starting with question 01 and ended up with question 10. Thus, many candidates do not have to do question no. 10.
- (4) It is advisable to candidates to go through all the questions during reading time and prioritize the questions based on convenience of candidates.
- (5) Candidates should read the study text of AAT and practice the examples given in the study text.
- (6) Candidates should practice past papers as much as possible within the allocated time and thus, should practice for time management.
- (7) 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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