

EXAMINER'S REPORT
LEVEL III EXAMINATION - JANUARY 2026
(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 in order to be successful at the future examinations:

SECTION A

Question No. 01

- (a) The requirement of this question was to state three (03) economic decisions that stakeholders can make using information from general-purpose financial reporting. An average number of candidates answered correctly, and overall performance was at a moderate level. However, some candidates struggled to link specific economic decisions to the relevant stakeholder groups. In particular, they failed to identify the primary users such as investors, lenders, and other creditors and the importance of financial information in enabling them to make different decisions related to transactions with the organization, as defined in the Conceptual Framework.
- (b) This part required candidates to explain the concept of Financial Capital Maintenance. The majority of candidates failed to explain this concept, and only a very few scored full marks for the question. Furthermore, many candidates did not read the question carefully, as most responses focused on “Liquidity Management” or “Treasury Management.” These responses explained how a company should maintain sufficient cash to meet its obligations, rather than recognizing that Financial Capital Maintenance is an accounting concept. It refers to the idea that profit is earned only if the financial amount of net assets at the end of a period exceeds the amount at the beginning, excluding any distributions to or contributions from owners during the period.

Question No. 02

- (a) This question required candidates to define the term “Integrated Report.” The majority of candidates failed to provide a comprehensive definition. Some candidates explained only partial key characteristics, such as “value creation,” in their answers and were able to obtain at least one mark.
- (b) This part of the question tested the key areas to be included under the “Risks and Opportunities” section in the Integrated Report. Many candidates did not clearly understand what the question required, as they explained general risks and opportunities faced by a company rather than addressing the specific key areas to be disclosed in this section. Furthermore, some candidates incorrectly presented the key content elements of an Integrated Report instead.

Question No. 03

- (a) Most candidates provided satisfactory answers to the question, which required them to state two profitability ratios and one liquidity ratio. However, some candidates confused efficiency ratios with profitability ratios, while a few were unable to clearly identify liquidity ratios, instead confusing them with gearing ratios.
- (b) An average number of candidates were unable to clearly identify the limitations of ratio analysis. Those who attempted the question scored only average marks. Many did not provide clear answers, and common responses included “errors in ratio calculations” and “the need for specialized knowledge to perform ratio analysis,” which are not valid limitations.

Question No. 04

- (a) The requirement of this question was to state two criteria for classifying a liability as a current liability. Although the majority of candidates attempted the question, overall performance was moderate, with most scoring only average marks. Some candidates incorrectly stated timelines for non-current liabilities, giving periods such as 3 months, 6 months, or 3 years, and a few confused current and non-current assets. Most candidates mentioned only “expected to be settled within 12 months” as a criterion, without including the other required conditions.
- (b) This part of the question tested candidates’ ability to calculate the impairment loss of machinery in accordance with LKAS 36 – Impairment of Assets. Overall performance was satisfactory. Some candidates failed to compute the carrying amount (WDV) correctly, mainly due to errors in calculating accumulated depreciation. The asset was held for exactly 2 years (April 2023 to March 2025), but some candidates calculated depreciation for only 1 year, resulting in an incorrect starting point for the impairment test. Additionally, some candidates incorrectly identified the difference between the Fair Value and Value in Use (Rs. 400,000) as the impairment. In reality, impairment is the difference between the carrying amount and the recoverable amount. LKAS 36 defines the recoverable amount as the higher of Fair Value Less Costs of Disposal (Rs. 2.6 million) and Value in Use (Rs. 3.0 million). A considerable number of candidates either chose the lower value or, in some cases, incorrectly added the two values together.

SECTION B

Question No. 05

(a) This question was tested the candidates' knowledge on LKAS 38 – Intangible assets. Based on the given two instances' candidates were requested to explain how each instance should be recognized as per LKAS 38.

(1) The mobile app purchased from another company:

Most candidates correctly identified this purchase as an intangible asset, but only some explained the reasoning, citing factors such as future economic benefits and reliable cost measurement. Some candidates incorrectly argued that it could not be recognized as an intangible asset because it was not developed by **Sweet Ltd.**, indicating confusion between the recognition of internally generated development costs and the cost of externally purchased intangible assets. A few candidates incorrectly stated that the mobile app could not be considered an intangible asset because it is installed on mobile phones, which are tangible assets.

(2) The registered trademark:

Most of the candidates correctly recognized this purchase as an intangible asset, but only some of them had explained the reason (future economic benefits, reliable cost measurement). Some candidates claimed that it could not be recognized as an intangible asset because future economic benefits are uncertain. This confusion seemed to have arisen with the internally generated assets like brands which are not permitted by the standard to recognize.

(b) This question related to borrowing costs and required candidates to calculate the borrowing cost to be capitalized on the building as at 31st March 2025, in accordance with LKAS 23 – Borrowing Costs. Most candidates failed to obtain full marks, likely because they did not correctly apportion the interest expense or did not fully comprehend the question. However, most deducted the interest income earned from fixed deposits, earning at least one mark. Only a few candidates completed the calculation accurately.

Common mistakes noted in candidates' answers included:

- (1) Adding the capital amount to the borrowing cost, which is incorrect.
- (2) Applying the interest rate to the full loan amount without considering the date the loan was obtained.
- (3) Failing to recognize that construction ended on 31st January 2025, and calculating borrowing costs for the full year or for 11 months instead of the correct period for loans from **ABC Bank** and **PQR Bank**.
- (4) Failing to deduct Rs.720,000/- of investment income when calculating the borrowing cost.
- (5) Adding the amounts of two loans to the borrowing cost, which is incorrect.

Question No. 06

This question required candidates to prepare the Statement of Cash Flows for the year ended 31st March 2025 using the indirect method. Most candidates performed well and scored high marks, while some obtained full marks. However, the following shortcomings were observed:

- Failure to calculate depreciation chargeable for the disposed asset up to the date of disposal, resulting in incorrect total depreciation and gain on disposal adjustments.
- Certain candidates showed cash outflow without brackets and cash inflow with brackets.
- Incorrect calculation of profit before tax, where tax expense was deducted from the profit before tax provided in the question.

Classification errors, such as identifying the gratuity provision as an investing or financing cash flow, which led to lower marks.

Question No. 07

(a) This question was tested the candidates' knowledge on LKAS 37 Provisions, Contingent Liabilities and Contingent Assets. Based on the given three instances' candidates were requested to explain how each instance should be recognized as per LKAS 37.

(1) Compensation for alleging food poisoning:

A customer has filed a case against the company claiming compensation. Legal advisors advised that it is probable the company will not be found liable. The requirement was only to disclose this event. Majority of the candidates correctly noted that no provision is required due to the low probability of liability. However, some failed to include the required disclosure in their answers, and a few incorrectly treated it as an adjusting event.

(2) Tax assessment:

An assessment was raised by the IRD on the income tax, disallowing expenses of Rs. 1.5 million for Y/A 23/24. After submitting several replies and supporting evidence, the final disallowed amount was Rs.500,000/-. The majority of candidates who attempted this question misunderstood the scenario. They assumed that the reduction in the disallowed expenses would benefit the entity and incorrectly recognized it as a contingent asset. A considerable number of candidates stated that a provision was necessary. Only a few candidates correctly calculated the tax effect (Rs.500,000/- × 30%) and provided a complete and accurate answer.

(3) Compensation payable to an ex-employee on misconduct:

An ex-employee filed a case against the company, and the company's lawyers concluded that there was a high probability that compensation would be payable. The court subsequently ordered the company to pay Rs.800,000/- as compensation. Since the financial statements were authorized on 30th May and the court order was issued on 15th May, the company was required to recognize a provision of Rs.800,000/-. An average number of candidates answered correctly, explaining that a provision should be made.

The following mistakes were made by many candidates for all three scenarios:

- (1) While some candidates understood whether the financial statements needed adjustments, they could not distinguish between provisions and contingent liabilities, resulting in contradictory answers.
- (2) Some candidates focused primarily on LKAS 10 – Events After the Reporting Period, rather than LKAS 37. Consequently, they evaluated whether the scenarios were relevant to the current financial year but failed to explain how the scenarios should be accounted for in accordance with LKAS 37.

- (b)** This question related to LKAS 8 – Accounting Policies, Changes in Accounting Estimates, and Errors. Candidates were required to calculate the depreciation charge for machinery when its useful life changed after some years. Most candidates performed the calculation correctly. However, some incorrectly divided the original cost of the asset by the remaining useful life, instead of dividing the net book value by the remaining useful life.

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.

Common mistakes made by the candidates are as follows:

- (1) Some candidates failed to calculate the revaluation gain for the year. While most performed the basic calculation correctly, a notable number did not recognize the revaluation surplus in Other Comprehensive Income (OCI) or the Statement of Changes in Equity.
- (2) Most of the candidates were unable to calculate the disposal profit of motor vehicles. Candidates frequently failed to include the insurance claim of Rs.2,500,000/- as part of the disposal profit, incorrectly recording it as a payable, or not recognizing it at all. Profit or loss on the disposal of the damaged motor lorry was often calculated incorrectly.

- (3) A considerable number of candidates did not distinguish between the current and non-current portions of lease creditors.
- (4) Provision for bad debts was often calculated without deducting Rs.3,500,000/- due from a bankrupt customer. There was also a lack of understanding regarding the treatment of written-off bad debts, and many candidates failed to charge bad debts to profit or loss.
- (5) Several candidates failed to identify right-of-use (ROU) assets and their respective depreciation, frequently omitting the leased vehicle from the Property, Plant, and Equipment (PPE) note.
- (6) Depreciation expense calculated from the PPE movement schedule was often not correctly transferred to the Income Statement. Motor vehicle depreciation was frequently understated as Rs.3,000,000/- instead of the correct Rs.4,500,000/-, which should include adjustments for disposal and new leases.
- (7) While some candidates prepared a lease schedule, they failed to transfer the figures to the Statement of Financial Position.
- (8) Many candidates did not properly identify the impairment loss of inventory. Some incorrectly deducted the full cost of Rs.9,000,000/- from closing inventory instead of recognizing the write-down to Net Realizable Value (NRV).
- (9) Most candidates correctly recorded the Rs. 10.5 million estimated tax liability as an deduction from profit before tax. However, some added the Rs. 6.1 million payment made to settle the opening tax liability, resulting in an incorrect tax expense of Rs. 16.6 million. Others showed confusion in classification, incorrectly recording the tax liability of Rs. 100 million as an expense.
- (10) A general observation was the lack of clear supporting workings.
- (11) Not totalling the Statement of Comprehensive Income.
- (12) Not transferring net profit to the Statement of Changes in Equity.
- (13) Not transferring the revaluation gain to the Statement of Changes in Equity.
- (14) Not balancing the Statement of Changes in Equity.

Question No. 09

This question is basically to calculate five ratios of SRJ PLC. This question required to compute (i) Gross Profit Ratio, (ii) Net Profit Ratio, (iii) Inventory Residence Period (iv) Debtors' collection period (v) Creditor's settlement period. Majority of the candidates have attempted this part of the question and performed well.

Following were the mistakes made by some candidates:

- (1) Reversing formulas (applying numerator and denominator incorrectly) and calculating the last three ratios as percentages instead of as the number of days.
- (2) Calculating Gross Profit and Net Profit ratios by dividing gross profit and net profit by cost of sales rather than by sales.
- (3) Failing to use average values for debtors, creditors, and stock; some candidates added opening and closing balances but did not divide by two to obtain the average.
- (4) Incorrectly applying credit sales and purchases when calculating the debtor collection period and creditor settlement period.
- (5) Failing to calculate average inventory and credit sales correctly when computing the stock holding period.
- (6) Demonstrating limited understanding of the debtor collection period, inventory holding period, and creditor settlement period, often applying incorrect formulas or using inappropriate figures.

Question No. 10

This question tested knowledge of participation in consolidated statement of financial position, including the calculation of unrealized profit and the elimination of intra-group transactions. Majority of the candidates attempted the question and scored more than average marks. Some candidates demonstrated a clear understanding and answered the question correctly. However, a few students did not understand the question at all.

Following were the mistakes made by some candidates:

- (1) Misunderstanding the concept of goodwill calculation, particularly failing to account for revaluation and depreciation when computing goodwill.
- (2) Errors in calculating over-depreciation and profit on disposal.
- (3) Confusion between profit margin on cost and profit margin on selling price.
- (4) Attempting to combine parent and subsidiary figures without eliminating intercompany transactions.

- (5) Failing to adjust the statement of financial position value of Property, Plant & Equipment for revaluation and intercompany transactions.
- (6) Incorrect calculation of unrealized profit on inventory.
- (7) Omitting intercompany adjustments for trade receivables.
- (8) Inaccurate calculation of post-acquisition profit and unrealized profit when determining retained earnings.
- (9) Ignoring the impact of intercompany debentures.

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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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