

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

SECTION A

Question No. 01

- (a) The requirement of this question was to explain the two fundamental qualitative characteristics as per the Conceptual Framework for Financial Reporting. Most of the candidates have not correctly explained the fundamental qualitative characteristics, with some confusing them with enhancing qualitative characteristics of financial information. Furthermore, although the question required an explanation, many students merely listed the characteristics without providing explanations, which resulted in lower scores.
- (b) This part required candidates to state two enhancing qualitative characteristics that enhance the usefulness of financial information. A significant number of candidates failed to correctly state the qualitative characteristics. This demonstrates lack of knowledge about conceptual framework for financial reporting and lack of understanding of the question.

Question No. 02

This question focused on Integrated Reporting and required candidates to state the key content elements of an integrated report. It was attempted by a limited number of candidates, with most achieving average scores. Some candidates have confused the content elements with the general components of an annual report. This demonstrates a lack of knowledge about Integrated Reporting, even though it has been tested continuously at this level.

Question No. 03

This question required candidates to calculate goodwill arising from consolidation. Most candidates performed well and achieved satisfactory marks. However, some approached the calculation by simply adding investment and non-controlling interest, then deducting the fair value of net assets, without providing supporting workings. Common errors made by the candidates were neglecting to use the fair value of net assets and omitting either the controlling or non-controlling interest from the total investment when computing goodwill.

Question No. 04

The requirement of this question was to state the recognition criteria for Property, Plant and Equipment (PPE) according to **LKAS 16**.

- (a)** Majority of the candidates failed to correctly answer this part of the question. Most candidates misunderstood the question and incorrectly stated the general asset recognition criteria from LKAS 01, rather than the specific recognition criteria for Property, Plant and Equipment (PPE) under LKAS 16, as required. Additionally, many candidates were unable to clearly distinguish between the recognition criteria and the classification criteria for PPE, resulting in incomplete or inaccurate answers.
- (b)** This part of the question tested candidates' understanding of Accounting Policies, Changes in Accounting Estimates and Errors, as well as the inventory valuation principles under SLFRS for SMEs.
 - (1) Most candidates correctly identified the scenario as a change in accounting policy, but some of them failed to explain that such changes must be applied retrospectively. A common weakness was the inability to clearly distinguish between a change in accounting policy and a change in accounting estimate, which is crucial in determining whether the adjustment should be made retrospectively or prospectively.
 - (2) Most of the candidates correctly applied the inventory valuation rule under SLFRS for SMEs, explaining that inventory should be measured at the lower of cost and net realizable value, which was Rs.250,000/- in the given case.

SECTION B

Question No. 05

It was required to prepare the Statement of Cash Flow for the year ended 31st March 2025 using indirect method.

Most of the candidates performed well and scored a higher mark, while some candidates obtained total marks allocated to the question. However, the shortcomings given below were observed from the answers:

- (1) Certain candidates showed cash outflow without brackets and cash inflow with brackets.
- (2) Depreciation and profit on disposal were not properly calculated by many candidates, as they failed to account for the current year's depreciation. This omission led to both an inaccurate depreciation charge and an incorrect profit on disposal.

- (3) Some cash flow items were presented with the wrong sign, particularly in the section on changes in working capital. Such as items that should have been deducted were added, and vice versa.
- (4) Although some candidates correctly separated the activities, they failed to classify them accurately. For example, obtaining a bank loan was incorrectly identified as an investing activity instead of a financing activity, and purchases of property, plant, and equipment (PPE) were wrongly recorded under financing activities instead of investing activities.
- (5) Few candidates demonstrated insufficient knowledge of the purpose and general format of a cash flow statement. In some cases, their answers were incorrectly presented in the profit and loss (P&L) format or other non-standard formats.
- (6) Many candidates incorrectly calculated the net profit before tax without adjusting for interest expense.

Question No. 06

- (a) It was expected to identify the revenue for the years ended 31st March 2025 and 31st March 2026 for the given scenario. Average mark was scored by many candidates as they have not concentrated on SLFRS 15, Revenue from Contracts with Customers.

Following were the mistakes made by the candidates:

- (1) Many candidates failed to consider the maintenance cost for both years, with some only accounted it for one year.
 - (2) Several candidates have not calculated the total transaction cost correctly.
 - (3) It was observed that some candidates struggled to correctly allocate the transaction cost proportionately based on the stand-alone selling prices, leading to incorrect revenue recognition across performance obligations.
- (b) This part of the question required to prepare the extracts of the Statement of Comprehensive Income for the year ended 31st March 2025 and Statement of Financial Position as at 31st March 2025 of **Lak Ltd.** (Lessee).

Most of the candidates were unable to attempt the question effectively, indicating a weak understanding of the key principles of lease accounting.

The following mistakes were made by many candidates:

- (1) Many candidates had recalculated the present value of minimum lease payments by discounting the payments and showed the lease amortization schedule for the entire four years. This approach was not required for full marks and may have resulted in poor time management, limiting candidates' ability to complete other parts of the exam effectively.
- (2) However, a noticeable number of students failed to present the extracts of the Statement of Financial Position and the Income Statement, which resulted in no marks being awarded.
- (3) Many answers contained debit / credit reversals, highlighting that candidates had confused the accounting treatment for lessees with that of lessors.
- (4) Most candidates failed to correctly identify the right-of-use asset cost, which led to incorrect calculations of both depreciation and lease interest. Only a handful included depreciation in their answers, and even then, most calculations were inaccurate, reflecting a weak understanding of lease accounting principles.
- (5) Most students did not correctly classify short-term and long-term lease liabilities.

Question No. 07

- (a) This question was tested the candidates' knowledge on LKAS 10 – Events after the Reporting Period. Based on the given three instances' candidates were requested to explain how each instance should be recognized as per LKAS 10. Many candidates scored good marks for this part of the question. Most candidates demonstrated knowledge of the relevant accounting standard and applied the correct principles, but some responses were too brief, which limited their ability to achieve full marks.
- (b) This question related with deferred tax, and it was required to calculate deferred tax asset / liability and tax expenses for the year. Candidates' performance was at a very poor level. Although many candidates correctly calculated the current year's income tax provision using taxable profit, most struggled with identifying the tax base and temporary differences. Some incorrectly included land value or treated it as a temporary difference, but a majority were able to calculate the temporary difference for buildings accurately. Only a small number of candidates successfully computed deferred tax liabilities and tax expenses, indicating a significant gap in understanding key deferred tax concepts and their application.

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 this question. Common mistakes made by the candidates are as follows:

- (1) Some candidates failed to calculate the revaluation gain for the year, even though it was a relatively simple adjustment.
- (2) Many candidates made errors in depreciation calculations, which affected the accuracy of disposal profit. Additionally, depreciation for newly constructed buildings and motor vehicles up to the disposal date was omitted.
- (3) A considerable number of candidates failed to distinguish between the current and noncurrent portions of term loans.
- (4) Many candidates showed confusion between capitalizing borrowing costs during the construction period and treating interest as a finance expense. As a result, loan interest was either incorrectly expensed or not accounted for at all, leading to errors in the cost of the building.
- (5) Some candidates had not identified the Income Tax expense for the year and considered the payable amount as income tax expense for the year.
- (6) Many candidates calculated the provision for bad debts without deducting the Rs. 1,500,000 written-off bad debt, resulting in incorrect provisions.
- (7) Some candidates have 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.
- (8) A considerable number of candidates failed to adjust for compensation payable to employees related to ongoing legal cases.

Question No. 09

This question tested knowledge of participation in consolidated income statements, 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) The intercompany sales figure was not calculated correctly by many students. Instead of using Rs.75,000,000/-, they took Rs.60,000,000/-.
- (2) Depreciation on Unrealized Profits on Machinery was recorded as Rs.1,900,000/- instead of Rs.100,000/-. This error affected the calculation of over-depreciation and the profit on disposal.
- (3) Although the subsidiary obtained the loan midway through the financial year, many candidates calculated interest for the full year instead of just the six-month period.
- (4) Several candidates failed to eliminate intercompany transactions, leading to incorrect consolidation by merely adding parent and subsidiary figures.

Question No. 10

This question is basically to calculate five ratios and to prepare a summary report to the management of Rex PLC comparing the two-year period with possible reasons for the variances.

- (a) This part required to compute (i) Gross Profit Ratio, (ii) Net Profit Ratio, (iii) Debtors' collection period (iv) Stock Residence period (v) Earnings per share (EPS). Majority of the candidates have attempted this part of the question and performed well.

Following were the mistakes made by some candidates:

- (1) Some candidates have used cost of sales instead of sales when calculating the gross profit ratio.
- (2) Few candidates have not used the correct Profit After Tax figure when calculating the Net Profit Ratio.
- (3) Several candidates failed to calculate average debtors and credit sales when determining the debtors' collection period. Instead, some candidates used total or closing debtors in the calculation, leading to inaccuracies.

- (4) Some candidates did not use average inventory and cost of goods sold when calculating the stock holding period, resulting in incorrect computations.
 - (5) Some candidates incorrectly applied time-based ratios by multiplying by 100 instead of using 365 days, leading to inaccurate results.
 - (6) In calculating Earnings Per Share, many candidates used incorrect profit figures instead of profit after tax. Such as profit before tax, profit before interest and tax, or even total equity.
 - (7) Some candidates used the share capital amount instead of the number of ordinary shares, resulting in incorrect EPS calculations.
- (b)** This part required to prepare a summary report comparing two years while explaining possible reasons for variances. Most candidates could not give possible reasons for variances. Many students failed to address the requirement properly, focusing on possible solutions instead of explaining the reasons for the variances. Furthermore, many students failed to indicate whether the ratios were favourable or unfavourable. Some candidates were unaware of the implications of the ratios, even though they were able to calculate them correctly.

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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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