

## Examiner's Report

### AA3 EXAMINATION - JANUARY 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**

It was required to explain the two fundamental qualitative characteristics "Relevance" and "Faithful Representation" of financial information. Only a few candidates answered correctly and obtained full marks. Many candidates stated "relevance" as preparation of financial statements according to accounting standards.

Candidates should read the question well and should provide answer only to what is required. Writing unnecessary details will not add any marks but it will only affect the time that could be spent on other questions.

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

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

It was required to identify temporary differences and calculate the differed tax liability.

Considerable number of candidates were able to obtain full marks, while some were able to work out only the temporary difference but not the differed tax liability. Further some candidates defined the temporary difference without calculating it. The rest of the candidates could not calculate both temporary difference and differed tax liability.

**Areas to be improved:** Application of accounting standards.

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

This question was very poorly answered by majority of the candidates. There were only a handful of candidates who could state an objective of integrated reporting and key components of an integrated report. The candidates who answered in English medium did better in answering this question than those who did in other media.

Only a handful of candidates were able to get full marks while the rest failed to obtain a single mark.

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

## Question No. 04

It was required to prepare the Net Cash Flows generated from investing activities showing separately cash received from disposal of old machinery and cash paid to purchase new machinery.

Considerable number of candidates could not arrive at the cash received from disposal and cash paid for purchase of new machinery, as they were not able to prepare the disposal account using the provision for depreciation account balances, depreciation account balance, machinery cost balances and the profit on disposal amount given in the question.

Some candidates considered disposal profit as a cash inflow.

**Areas to be improved:** Preparation of Disposal Account using incomplete records.

## PART B

## Question No. 05

It was required to assess the amount to be charged as expenses and the amount to be capitalized as an Intangible asset in the financial statements. Most of the candidates considered Research expenses of Rs. 3 million as a capital expenditure though it should have been considered as a revenue expenditure. Further, some candidates considered Rs.300,000/- on staff training and Rs.50,000/- on sales promotion expenses also as capital expenditure. However, those should have been treated as expenditure in the financial statements.

This question was very poorly answered by majority of the candidates. Only a handful of candidates were able to score full marks for this part. This was mainly due to not studying and understanding the relevant accounting standards properly.

**Part (b)** It was required to compute the borrowing cost that could be capitalized when constructing the manufacturing plant.

Majority of the candidates calculated borrowing cost for the whole year, instead of calculating it for the 11 months.

Some candidates added the investment income of Rs.300,000/- to the borrowing cost instead of deducting it from the borrowing cost. There were candidates who completely ignored the investment income of Rs. 300,000.

This question was very poorly answered by majority of the candidates.

**Areas to be improved:** Application of relevant accounting standards

### **Question No. 06**

It was required to analyze the performance of two companies commenting on Profitability, Liquidity and Efficiency in debt collection. This was a very simple question where candidates could have earned high marks without much effort. Examiner's expectation was to compute those financial ratios and to analyze those with that of the other company.

Considerable number of candidates computed all the ratios correctly while some other candidates could not compute ROCE, quick assets ratio and debtors collection ratio correctly. There were handful of candidates who could compute only the GP ratio correctly.

Almost all the candidates stated that a ratio of one company has increased/decreased compared to the same ratio of other company but failed to comment on the possible reasons for such changes in ratios.

Some candidates wrote lengthy answers without giving the possible reasons for variation of ratios. Such candidates did not score marks but only wasted their time.

**Areas to be improved:** Computation of ratios and their significance.

### **Question No. 07**

It was required to prepare the Statement of Cash Flows using indirect method. The performance for this question was good and many candidates scored more than 7 marks.

However, some candidates made following mistakes;

Some candidates failed to recognize working capital changes, financing and investing activities separately.

They considered decrease in trade and other payables and increase in trade debtors as cash inflows.

They failed to consider the tax expenses given in the question to arrive at the profit before tax.

Further, they failed to make adjustments to non-cash items such as Depreciation.

**Areas to be improved:** Application of relevant accounting standards.

## **PART C**

### **Question No. 08.**

It was required to prepare Company Accounts for publication purpose including Statement of Profit or Loss and Other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Statement of movements of PPE. Some of the common mistakes that were made by the candidates are as follows:

- (1) Considerable number of candidates not adjusted the proceeds from disposal included in the sales figure.
- (2) Majority of the candidates did not adjust the cost of sales with fall in value of inventory. It was taken to expenses.

- (3) Many candidates failed to calculate depreciation of the disposed vehicle correctly. Therefore they arrived at incorrect amount for gain on disposal.
- (4) Adjusting entry relating to the debt which became bad in the current year but which was provided in the previous year was not correctly done by majority of the candidates.
- (5) Preference share capital was shown under equity instead of showing under long term liabilities. Many made this error.
- (6) Preference dividend was shown as a deduction from retained earnings in the statement of changes in equity instead of charging to Statement of Comprehensive Income as a finance expense.
- (7) Failed to give the note relating to the final dividend proposed. Instead of showing the final dividend as a note, some candidates adjusted it in the statement of changes in equity.
- (8) Some candidates disclosed the proposed dividend in a note, but did not indicate that the dividend will be Rs. 1/- per share.
- (9) Total comprehensive income was taken to the retained earnings column in the Statement of changes in equity instead of taking only the profit after tax figure. Most of the candidates did this mistake.
- (10) Some candidates did not show the workings in support of the figures they have arrived at relating to the Statement of Comprehensive Income.

**Areas to be improved:** overall understanding of Accounting Standards and their application.

### **Question No. 09**

**Part (A)** of the question tested the ability of candidates to compute the goodwill arising from the consolidation and preparation of Consolidated Statement of Comprehensive Income.

Almost all the candidates attempted this question. In general overall performance of this question was satisfactory and nearly half of the candidates scored full marks. Majority of the candidates scored full marks for part (A) (a).

However, for Part (A), following mistakes were made by some candidates:

- (1) When Calculating the Goodwill, proportionate net assets were taken by considerable number of candidates.
- (2) Sales amount was not adjusted by eliminating inter-company sales.
- (3) Cost of sales amount was not adjusted for inter-company purchases and unrealized profits on closing stock.
- (4) Inter-company transactions relating to other income, interest and dividend were not adjusted correctly by most of the candidates.
- (5) Some took proportionate sales and expenses of the subsidiary when preparing the consolidated statement of comprehensive income.

**Part (B)** tested understanding of current ratio, debt collection period and stock residence period and possible causes for their variation.

Even though the question required possible reasons for variations, some candidates instead of giving reasons, just compared the ratios of the two years and stated that current ratio has dropped, debt collection period has increased and stock residence period has increased. Majority of the candidates stated that the current ratio is good. Debt collection period is not good in 2017 as more days have been taken to collect debts, stock residence period is not good in 2017 as residence period is high.

**Areas to be improved:**

- (1) Computation of goodwill
- (2) Adjustments relating to unrealized profits and inter-company transactions.
- (3) Understanding the significances 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 for 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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