

**EXAMINER'S REPORT****LEVEL III EXAMINATION - JULY 2020****(301) FINANCIAL REPORTING**

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Most of the common mistakes made by the candidates have been identified. The unsuccessful candidates should identify the mistakes they made and learn all the principles in order to be successful at the future examinations:

**SECTION A****Question No. 01**

- (a) Required to state the main purpose of the sustainability report.

Most candidates stated that it's a report which gives the non-financial information in respect of economic, social, environmental and governmental initiatives. They failed to mention about the past performance and future view of the company.

- (b) Required to list 2 key components in an integrated report.

Majority of the candidates were able to list 2 key components.

**Overall performance for this question was at a satisfactory level.**

**Areas to be improved:** Candidates should learn to identify the differences between financial statements, sustainability report and other reports given in annual reports.

**Question No. 02**

Required to explain three challengers faced by the accounting profession

Most candidates answered this question well, explaining 3 challenges faced by the accounting profession. But few of the candidates failed to identify 3 challenges. It shows the lack of knowledge on common areas to be learnt by candidates.

**Overall performance for this question was at a satisfactory level.**

**Areas to be improved:** Challenges faced by the Accountant in today's context.

### Question No. 03

- (a) Required to state 3 criteria to classify as asset as a current asset.

Most of the candidates stated 3 characteristics of an Asset instead of a current asset.

Some candidates stated that current assets are those assets which are disposed within 12 months.

Only a very few candidates stated that current assets are those assets which are expected to realize or intended to sell or consumed in the normal operating cycle.

- (b) Required to list 2 components included in other comprehensive Income.

Most Candidates stated revaluation gain. Some candidates stated foreign currency exchange gain or loss instead of stating the gains and losses from transacting financial statements of foreign operations.

Performance was not satisfactory due to many candidates did not know the difference between assets and current assets and also they lacked knowledge about the components of other comprehensive income.

**Overall performance for this question was at an average level.**

**Areas to be improved:** LKAS 01.

### Question No. 04

- (a) Required to state 2 indications to identify that an asset may be impaired as per LKAS 36.

Majority of the candidates did not answer correctly. Some candidates stated that impairment is due to revaluation. It shows that candidates have lack of knowledge on LKAS 36.

- (b) Required to calculate the impairment loss of the machinery for the year ended 31.03.2020.

Though a similar sum was included in pilot paper, only a few candidates answered this part correctly. Most of them compared the carrying value of Rs. 3.5 Million with the lower value of the fair value less cost of disposal (2.5) and value in use (2.0) and arrived at an impairment loss of Rs. 1.5 Million (3.5-2) instead of taking higher value of the two values and arriving at Rs. 1. Million. (3.5-2.5)

**Overall performance for this question was at a poor level.**

**Areas to be improved:** LKAS 36.

## SECTION B

### Question No. 05

Required to Prepare the Statement of Cash flows for the year ended 31<sup>st</sup> March 2020.

Most of the candidates answered this question well. However, there were candidates who could not identify cash inflows and outflows correctly. Therefore, they could not arrive at the net cash flows from each activities and final correct answer.

Other common mistakes made by the candidates are given below:

- (1) Net profit before tax of Rs.445,000/- (140 + 205 + 100) was not taken to the cash flow properly. Some took only  $140 + 205 = 345,000/-$ .
- (2) Some did not have a clear knowledge about the cash inflows and cash outflows and as a result they deducted cash inflows and added cash outflows in preparing the cash flow statement.  
Eg: Payment of interest Rs.215,000/- and loan repayment of Rs.650,000/- were added as cash inflows.
- (3) Most candidates were not able to correctly classify cash flows from operating activities, cash flows from investment activities and cash flows from financing activities.
- (4) Loan interest account was not prepared correctly considering all movements during the financial year and as a result they did not get the Rs.215,000/- interest paid amount as the cash outflow.
- (5) Some candidates compared the long term loan opening and closing balances and Rs.100,000/- was considered as the loan received during the financial year.
- (6) Some could not prepare the fixed assets disposal account correctly. As a result cash inflows from disposal was not arrived correctly.
- (7) Some could not arrive at the income tax paid amount during the financial year.
- (8) Some have not correctly shown movements in working capital.

Eg: Increase in inventories - some have considered as a positive balance instead of negative.

**Overall performance for this question was at a satisfactory level.**

**Areas to improved:** Preparation of cash flows.

## Question No. 06

(a) Required to explain how the given instances would be recognized as per LKAS 10.

- (1) Most of the candidates answered this question and stated correctly that the loss existed at the end of the reporting period on trade receivables and adjusting journal entry was also given by some candidates. A few candidates mentioned that this was an adjusting event but no reasons were given.

A few candidates stated that it had happened after the reporting period & it shouldn't be adjusted in the financial statements and only a disclosure was required.

- (2) Most of the candidates failed to identify the part (2) as an adjusting event after the reporting period. They failed to identify the constructive obligation at the end of the reporting period. They stated that the bonus was approved after the reporting period & it needs only a disclosure.

(b) Required to prepare the Extract of Statement of Financial Position as at 31.03.2020 on lease.

Most candidates did not calculate the present value of future lease rentals to arrive correctly the right to use the asset. Instead, most of them considered the sum of 3 installments of Rs.1,413,000/- as the right to use the asset. Some ignored the down payment of Rs.400,000/- as a part of the right to use the asset.

Lease liability was also not calculated and they considered interest is suspense.

Most candidates failed to show the right to use amount in the Statement of Financial Position. Some failed to separate the current and non-current portion of the lease liability.

Performance of **part (b)** was poor.

**Overall performance for this question was at an average level.**

**Areas to be improved:** Application of LKAS 10 and LKAS 17.

## Question No. 07

**Part (a)** required to identify the temporary differences as at 31.03.2020.

Majority of candidates failed to identify temporary differences correctly. Some candidates stated Rs. 10 million as temporary difference on land. They were not aware that there is no temporary difference on land.

Most of the candidates failed to arrive at the tax written-down value (Rs. 23.7 million) for the Plant & Equipment after deducting accumulated capital allowances (Rs. 16.3 million from cost of Rs. 40 million). Only a few candidates were able to obtain Rs. 8.8 million as the temporary difference of plant & machinery.

About 50% of the candidates calculated temporary difference on Gratuity Provision Correctly. Some candidates has considered gratuity as differed tax liability instead of deferred tax asset.

**Part (b)** required to calculate the differed Tax Asset / Liability

Though some candidates identified the temporary difference correctly, most of them failed to calculate differed tax asset or liability by applying the tax rate of 14%.

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

**Overall performance for this question was at a satisfactory level.**

**Areas to be improved:** Knowledge on deferred tax application under LKAS 12 – Income Tax

### SECTION C

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

(a) This part required to compute the Gross Profit Ratio, Net Profit Ratio, Debtors' Collection Period, Stock Residence Period, Current Ratio and Interest Cover.

(b) This part required to analyze the performance by comparing the ratios for the previous year.

Majority of the candidates computed these ratios correctly.

Following were the commomn mistakes made by some of the candidates:

- (1) When computing the GP ratio, Gross Profit was divided by cost of sales, instead of the turnover.
- (2) When calculating NP ratio, some divided Net profit before tax by Turnover
- (3) When computing the Debtors' collection Period, divided the closing debtors by turnover without using the average debtors.
- (4) When computing the Stock Residence Period, divided the average stock balance by turnover, instead of cost of sales.
- (5) Interest cover ratio was not properly calculated by most of the candidates
- (6) Current ratio was also not calculated correctly by some of the candidates
- (7) When interpreting the ratios most of the candidates only stated that the ratio has been increased or decreased. They did not give the possible reasons for such variations.
- (8) The purpose of current ratio was not correctly explained by some of the candidates. They stated that the standard ratio should be 1:1. Also they interpreted that the reduction of this ratio to 1.64 from 1.94 is favorable.

- (9) Though a few candidates calculated the Interest cover ratio correctly, some could not correctly interpret it. Some of them interpreted that when the ratio is increased it is not favorable.
- (10) Further it was noted that some candidates did not give possible reasons for the variations in ratios. They only gave a summary of ratios and stated either a ratio is increased or decreased and either favorable or not favorable.

**Overall performance for this question was at a satisfactory level.**

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

### **Question No. 09**

- (a) Required to calculate Good will arising from consolidation.

Most of the candidates calculated the goodwill on acquisition correctly. But some have deducted fair value of non-controlling interest instead of adding to the investment.

- (b) Required to prepare the Consolidated Statement of Financial Position as at 31<sup>st</sup> March 2020.

Following were the common mistakes made by the candidates:

- (1) Some candidates wrote figures of both companies separately in two columns without showing the column with the consolidated amounts.
- (2) Unrealized profit of Rs 300 was not eliminated in arriving the Consolidated inventory balance .
- (3) Unrealized profit on asset disposal was not eliminated in arriving at the consolidated PPE balance.
- (4) Over depreciation on fixed asset disposed was not eliminated from the accumulated depreciation when preparing the consolidated balance sheet.
- (5) Unpaid intercompany balance of trade payables and trade receivables was not eliminated
- (6) A few candidates added share capital of **Moon PLC** was added with **Sun PLC** capital & showed the consolidated share capital.
- (7) Some have failed to show the workings.

**Overall performance for this question was at an average level.**

**Areas to be improved:** Preparation of Consolidated Financial Statements.

## Question No. 10

This question tested the knowledge on preparation of Statement of Comprehensive Income Statement, Statement of Financial Position, Statement of Changes in Equity and Depreciation Schedule of a Company.

Common Mistakes that were made by the candidates are as follows:

### Statement of Comprehensive Income:

- (1) Most of the candidates, failed to adjust the cost of sales with the obsolete stock of Rs.500,000/-. Some candidates deducted the value of the lower of cost and NRV from the Cost of Sales whereas it should have been added to the cost of sales. There were candidates who expensed it to the P&L under other expenses. Some candidates did not show the workings for NRV calculation.
- (2) Most of the candidates, failed to add back the reversal of bad debt amounting to Rs.1,500,000/- as income.
- (3) Instead of deducting of Rs.2000,000/- incurred for computer software development from the administrative expenses and added it back to computer software under intangible assets, certain candidates added it back again to administration expenses.
- (4) Failed to show the revaluation gain of Rs. 3.7 million under other comprehensive income.
- (5) A few candidates failed to remove the loan interest of Rs.450,000/- incurred during the time of construction as borrowing cost, from the finance expenses.
- (6) Failed to identify the tax expenses of Rs. 2.3 million even though this was clearly given in the question. Mixed up with the paid and payable amounts.
- (7) Failed to accrue the electricity (0.3 million) and water (0.15 million) expenditure even though this was clearly given in the question.
- (8) Failed to bring the calculated depreciation expenditure to the administration and distribution expenses.
- (9) Failed to calculate correctly and reduce the over provision of doubtful debt (Rs. 0.44 million) from the distribution expenditure.
- (10) Failed to calculate correctly and deduct the pre-payment of insurance expenditure (Rs. 0.9 million) from the administration expenditure.

**Statement of Financial Position:**

- (1) Failed to capitalize Rs.450,000/- amount of borrowing cost to the work-in-progress account.
- (2) Most of the candidates, failed to add back the reversal of bad debt amounting to Rs.1,500,000/- to the trade receivable account. Some candidates arrived at the doubtful debt provision before adjusting the said bad debt reversal into the trade receivable account.
- (3) Most of the candidates, failed to deduct the inventory written off amount of Rs.500,000/- from the inventory.
- (4) Failed to show the employment benefit (Gratuity Provision) correctly under non-current Liability.
- (5) Mixed up the current portion and the non-current portion of the loan. Most of the candidates misunderstood that the loan amount of Rs. 5 million which was obtained during the year, as outstanding loan liability (Rs. 5 million) at the year-end, instead of considering the correct outstanding balance of Rs.4 million given in the question itself.
- (6) Failed to arrive at the correct Income Tax Payable amount as they failed to account for the income tax expense and tax paid amounts correctly.
- (7) Failed to identify the pre-paid portion of insurance expenditure under the current assets of the statement of financial position.
- (8) Failed to present the accrued electricity and water expenditure under the current liability of the statement of financial position.

**Statement of Changes in Equity:**

- (1) Considerable number of candidates deducted the interim dividend paid (Rs. 5 million) from the share capital instead of deducting it from the Retained Earnings.
- (2) Further, some candidates failed to present the revaluation gain (Rs. 3.7 million) under revaluation gain but showed it under the retained earnings.
- (3) Considerable number of candidates took the total comprehensive income or profit before tax of the year to the retained earnings instead of taking the profit after tax.

This question was answered fairly well by majority of the candidates.

**Overall performance for this question was at a satisfactory level.**

**Areas to be improved:** Knowledge on relevant LKASs and SLFRSs and preparation of Financial Statements.

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**General points to be considered in developing the level of Understanding of candidates:**

- (1) Studying well the contents of the entire syllabus and develop a thorough understanding of the level of knowledge expected for each unit or area.
- (2) Candidates should read the questions carefully and provide answers to the question asked.
- (3) Should show all the workings for the figures arrived at.
- (4) Should state all the assumptions if there are any.
- (5) Should start each question on a fresh sheet of paper and question number should be clearly stated.
- (6) Hand writing should be legible.
- (7) Practising past questions many times will help sharpening knowledge, skills and gaining speed. This will also be advantageous as similar types of questions may be repeated in the future examinations.
- (8) Reference to Accounting Standards, Suggested Answers, Pilot Papers, Articles related to subject will definitely improve knowledge.
- (9) Time management is crucial at the examination. In answering questions, candidates should spend time based on the marks allocated to each question.
- (10) Should sit at the examination with due preparation and with firm determination of passing the examination.

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