

**EXAMINER'S REPORT****LEVEL III EXAMINATION - JULY 2023****(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 which they made and learn all the principles in order to be successful at the future examinations:

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

- (a) Required to explain the two (02) fundamental qualitative characteristics as per the Conceptual Framework for Financial Reporting.

Most of the candidates described understandability and relevancy as the 2 qualitative characteristics and scored the allocated marks.

But a few listed 2 qualitative characteristics without explaining those.

- (b) Required to explain the underlying assumption in preparing the financial statements.

Majority of the candidates correctly stated & described Going Concern assumption. But a few stated "Accrual Basis" as the underlying assumption instead of Going Concern and were unable to score marks for this question.

**Question No. 02**

Required to explain two (02) key elements of an Integrated Report.

Majority of the candidates explained what integrated reporting is without explaining the purpose of integrated reporting.

There were a few answered correctly and obtained full marks.

**Question No. 03**

Required to assess the price allocation for services according to SLFRS 15 - Revenue from Contracts with customers.

Most of the candidates allocated offered fee of Rs. 7.5 million among the stand-alone services.

A few candidates wrote lengthy explanations on the requirements of SLFRS 15, but they could not score marks, due to not addressing the requirement of the question.

However, considerable number of candidates attempted this question. But a handful of candidates, obtained full marks for this question.

#### **Question No. 04**

- (a) Required to state 3 components of other comprehensive income as per LKAS 1.

Most of the candidates mentioned only the gains or losses on revaluation. Only a very few were able to name 3 components.

- (b) Required to identify two examples for short term employee benefits.

Most of the candidates answered this part well & earned the full marks allocated to this part.

### **SECTION B**

#### **Question No. 05**

Required to prepare the Statement of Cash Flow for the year ended 31<sup>st</sup> March 2023 using indirect method.

Most of the candidates performed well and scored satisfactory marks. Some even obtained full marks.

Following are the common errors made by the candidates:

- Failed to arrive at Net profit before tax balance of Rs.740/- (1,015 - 275). Many other incorrect figures were given as net profit before tax.
- Failed to correctly categorize operating activities, investments activities and finance activities based on the nature of the transaction.

Examples:

- Fixed assets purchasing expenses have been categorized under operating expenses category.
  - Gratuity provision had mentioned under investment category or finance category.
  - Loan receipts and payments under operating activities.
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- Errors in calculating fixed assets depreciation expenses.
  - Working capital changes have been adjusted inter-changing additions and minuses.
  - Many failed to arrive at the profit on disposal of fixed assets correctly. Even though some arrived at the correct figure, they failed to deduct the disposal profit, from the profit before tax. They showed it before working capital changes.
  - Many failed to show cash inflows without brackets and cash outflows within brackets.
  - Failed to correctly identify changes in the working capital as an inflow or an outflow.
  - Some had taken the closing cash balance of Rs.2,800/- as the opening cash balance in preparing the cash flow statement.

## Question No. 06

(a) Tested how the given scenarios be treated as per SLFRS for SMEs.

- (1) Most of the candidates correctly answered that stocks to be valued at the lower of cost or net realizable value whichever is low. Those who incorrectly answered, mentioned that the loss in this regard should be taken to the P&L.
- (2) Only a few answered correctly that the SMEs should charge the borrowing costs to the P&L. Most of the candidates stated that the cost should be capitalized.
- (3) Most of the candidates stated that a company should not change the depreciation policy time to time. Only a few answered correctly.

(b) Tested how the given scenarios be considered in the Financial Reporting.

- (1) Considerable number of candidates could not calculate the following correctly.
  - Depreciation for the ended year 31<sup>st</sup> March 2022.
  - Carrying value of the asset as of 31<sup>st</sup> March 2022.
  - Depreciation for the ended year 31<sup>st</sup> March 2023.
  - Carrying value of the asset as of 31<sup>st</sup> March 2023.
  - Further most of the candidates did not state that the changes to be applied from the present and the future (prospectively).
- (2) Most of the candidates identified this as an accounting error and how it should be corrected. But failed to correctly state the depreciation amount to be provided. Many failed to state that it should be adjusted retrospectively.

## Question No. 07

(a) Tested the knowledge on capitalization of borrowing cost as per LKAS 37:

- Almost all the candidates attempted this question.
- Following mistakes were made in arriving at the borrowing cost to be capitalized.
  - When calculating the interest cost of both loans separately,
  - Some candidates calculated the interest for 12 months instead of 11 months.
  - Some candidates failed to calculate the borrowing cost capitalizing rate correctly.
  - Many candidates applied the capitalizing rate on Rs. 55 million instead of 50 million.
  - Almost all the candidates who worked out the borrowing cost, deducted the full interest income in arriving at the borrowing cost to be capitalized

(b) Required to explain (i) an obligatory event and (ii) a Provision:

- This part was attempted by all.
- Most of the answers for part (1) were incorrect. They had no idea of what an obligatory event is.
- Most of the answers for part (11) were correct.

## SECTION C

### **Question No. 08**

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 Listed Company.

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

#### **Statement of Comprehensive Income:**

- (1) Stock written off of Rs.800,000/- was taken to other expenses without adjusting the Cost of Sales.
- (2) Revaluation surplus of Rs. 5 million taken to Other Income instead of Other Comprehensive Income.
- (3) Entire balance of land account of Rs. 75 million taken to Other Comprehensive Income instead of Rs. 5 million relevant reserve.
- (4) Lease rental of Rs.2,975,000/- was taken as finance expenses.
- (5) Provision for doubtful debtors of Rs.692,000/- was shown under selling & distribution expenses.
- (6) Income Tax brought forward balance was taken as Income Tax Expense for the year.
- (7) For rates, expense and pre-paid amount could not be correctly separated.
- (8) Calculated depreciation on reducing balance method.
- (9) Incorrectly calculated the current and non-current portions of the lease liability.
- (10) Rates was shown as Rs.9,000,000 instead of Rs.3000,000/-.
- (11) Income tax receivable amount was recognized as income tax liability.
- (12) Depreciation was not calculated on RTU asset.
- (13) Freehold & lease hold motor vehicle balances were not shown separately.
- (14) Lease interest was not calculated correctly either according to SLFERS 16 or according to LKAS 17.
- (15) Provision for bad debt was calculated without considering the subsequent recovery of bad debts amounting to Rs.800,000/-.
- (16) Failed to recognize the Rs.800,000/- received during the year, as other income which was written off as Bad debts in the previous year.
- (17) Entire rates payment of Rs.1,200,000/- was taken to income statement as rates expense.
- (18) Most of the candidates, failed to arrive at the over-valued amount of the slow-moving inventory as Rs.800,000/-.
- (19) Many candidates included the sale of slow moving inventory for Rs.3,000,000/- made in April 2023 in the sales of year ended 31<sup>st</sup> March 2023 (Rs.6,000/- \* 50% \* 1,000 units = Rs.3,000,000/-).
- (20) Failed to bring the calculated depreciation expenditure from the movement of Property, Plant & Equipment schedule to the income statement under expenditure.

**Statement of Financial Position:**

- (1) Failed to calculate the amount of lease liability correctly.
- (2) Provision for doubtful Debtors of Rs.692,000/- was taken as a current liability.
- (3) Failed to identify the current portion of the lease liability under current liabilities and non-current portion under non-current liabilities.

**Statement of Changes in Equity:**

- (1) Considerable number of candidates scored full marks.
- (2) Some candidates took the total comprehensive income or profit before tax of the year to the retained earnings instead of taking the profit after tax.

**Movement of Property plant & Equipment:**

- (1) Depreciation was calculated using reducing balance method instead of straight-line method which was clearly given in the question.
- (2) Entire revalued amount was taken as addition to the land amounting of Rs. 75 million.
- (3) RTU (Right to use) asset was not considered in the asset schedule.
- (4) Motor vehicle balances were not shown separately as free hold and lease hold assets (right to use asset). Did not follow the requirements of LKAS 18 and LKAS 17 / SLFRS 16.
- (5) Depreciation was not calculated on lease hold asset.

**Areas to be improved:** Knowledge on relevant LKASs and SLFRSs and preparation of Financial Statements. (Eg. LKAS 12 Income tax, LKAS 16 Property plant & equipment, LKAS 20 Borrowing cost, LKAS 1 Presentation of financial statements)

This question was answered well by majority of the candidates. Performance of this question was at a satisfactory level.

**Question No. 09**

**Part (a)** was required to compute (i) Gross Profit Ratio, (ii) Current Ratio, (iii) Quick Asset Ratio, (iv) Inventory Residence period, (v) Debtors' Collection period (vi) Gearing ratio, (vii) interest cover, (viii) Dividend Cover.

Almost all the candidates were able to compute the GP Ratio, Current Ratio, and Quick Asset Ratio correctly. A few candidates showed Stock Residence period and Debtors' collection period as a percentage.

Except for a few, others calculated gearing ratio and interest cover correctly. Some showed interest cover as a %. Considerable number of candidates could not calculate the dividend cover ratio as they could not arrive at the dividend figure from the given data.

From **Part (b)**, it was required to analyze the efficiency and liquidity of the given company with the industry averages for the year ended 31<sup>st</sup> March 2023. Considerable number of candidates obtained full marks for this part, while most of the others commented on the performance of the industry instead of the company performance.

Almost all the candidates attempted this question and majority obtained satisfactory marks. Some scored full marks.

**Areas to be improved:** Computing ratios and explaining the significance of the ratios.

### Question No. 10

(a) Required to calculate the goodwill on acquisition.

Majority obtained full marks for this part.

There were a few who made the following mistakes in arriving at the goodwill:

- Took the 80% of the net assets of acquiree as at the date of acquisition, instead of fair value of identifiable net assets of acquiree.
- Some added the net assets value and the NCI and deducted from the investment in arriving at goodwill.

(b) Required to prepare the Consolidated Income Statement for the year ended 31<sup>st</sup> March 2023.

Many candidates had no understanding of the adjustments between the parent and the subsidiary.

Following are the mistakes made by some candidates:

- Did not remove the inter-company sales of Rs. 144 million from the sales and the cost of sales.
- Unrealized profit of Rs. 7.5 million was not adjusted from the cost of sales.
- Unrealized profit was calculated incorrectly as Rs. 9 million instead of Rs. 7.5 million.
- Inter-company management fee of Rs. 24 million was not removed from other income and administrative expenses.
- Inter-company interest of Rs. 5 million was not removed from other income and Finance Expenses.
- Profit on inter-company asset sale of Rs. 2 million was not removed from consolidated comprehensive income statement.
- Did not remove Rs.400,000/- of over depreciation from distribution expenses.

Overall performance of this question was satisfactory. Most candidates scored considerably higher marks and a few even scored the full marks.

**Areas to be improved :** Preparation of Consolidated Comprehensive Income Statement.

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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 chapter 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 new 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, Articles related to subject area will definitely improve your 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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