

CA**THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA**

Accounting Applications and Taxation – March 2014

General Comment

The performance of candidates was fairly satisfactory but some had poorly answered due to lack of knowledge in basic principles and lack of experience in answering for questions under the examination conditions. Some candidates had spent time for some questions without due care on the marks allocated to each question. Time allocation must be considered before start answering the question.

Students are advised to read the study pack and do all the examples given in the text in order to learn the principles and their applications since the examiners are mainly testing the knowledge that could have been gathered mainly from the study pack.

Past practise in answering questions is very important specially in accounting subject. This will help students to obtain thorough knowledge on basic principles and their applications. Therefore students must do past papers of the same examination and also some equal examinations that are conducted by other professional accounting institutions.

Question No 01

This question was on consolidation accounting. The examiner has tested the knowledge of basic concepts in preparation of consolidated Financial Statements, such as goodwill arising on acquisition, calculating Non-controlling Interest and presentation format of consolidated financial statements.

Some candidates had not correctly calculated the allotment of new shares as a part of the purchase consideration and as a result they could not calculate the goodwill on consolidation correctly, on which three (3) marks had been allocated. Also most of the candidates had not shown the new share issue in the consolidated statements.

Some of the adjustments were correctly computed but students did not know where that particular item should be shown in the Financial Statements. Most students did the management fee adjustment correctly. The intercompany sales and purchases adjustment was not correctly understood by most of the candidates.

In order to present a quality and correct answer, it is essential to understand the question properly. Students should practice his/her own method to analyse the question in order to understand it properly. Some students take down important and critical areas of the question and some may be underlining them. However the method they apply, it must be practised when they prepare for the examination. This helps to present a well-structured answer.

Selecting the correct format in analysing and presentation of the answer is also very important. For an example if the question required candidates to prepare a Consolidated Statement of Comprehensive Income, they need two columns for subsidiary and parent, another column for adjustments and the last column for the consolidated figures. Selecting the correct format will assist students to produce a clear

and complete answer within the allocated time. Further this will help marking examiners also to give allocated marks to each point without any ambiguity.

Workings in arriving figures are very essential. Some candidates presented their answer without workings for which the marking examiner cannot give marks.

Students had wasted time by repeating the same adjustment over and over again. For an example the cost of capital account in "T form" and schedule form. Some students drew up the statement of equity and consolidated retained earning account of the parent company though these statements are not required to be prepared.

Few candidates had attempted the question with a plan and accordingly built up the answer. They had selected the correct format and presented the answer appropriately. They could avoid double work and managed their time effectively. They had presented relevant workings to the extent the examiner could to give marks to the correct figure.

Question No. 02

Status of the answers of this question is similar to that of the previous examination. A fair number of candidates had satisfactorily answered and were well prepared for this question. An average candidate could earn more than half of the marks allocated.

Almost all the candidates had not correctly attempted to Differed Tax adjustment and showed a poor knowledge. Further they showed lack of knowledge on the expenditure to be taken to the acquisition of Patent Right and as a result its amortisation was incorrect. Legal and Professional Fee is incorrectly written off to the income statement instead amortising.

Impairment of Plant and Machinery was not correctly done by most of the candidates. Hence the impairment loss was incorrect and further the candidates were not aware its transfer to the relevant accounts.

The gain on part exchange of vehicle was not correctly computed due to lack of understanding of the accounting entry passed.

The general provision for doubt full debtors was incorrectly computed due to incorrect entry on specific provision.

A fair number of students are not yet aware the manner in which Financial Statements should be presented under SLFRSs. Some candidates still use terms such as Income Statement, Balance Sheet etc. when presenting Financial Statements. This has resulted candidates in loosing easy marks.

Question No. 03

Most of the students were able to understand the question and plan the answer properly. Most of the answers were relevant to the question but instances were found where some candidates were confused with some areas such as part (i) (a) and (b). Instead of writing recognition criteria for current assets, candidates had written criteria for recognition of non- current assets for question (i) (a). In the question (i) (b) examiner required from candidates to highlight the treatments of contingent assets in A's book of accounts but had written treatments in B's book of accounts.

Some of the candidates have written very lengthy answers though the examiner expected only a short and precious answer. The allocated marks to each question provide guidance to students about the time they must spent for each question and the length of the answer expected from the candidates. In order to

improve these skills, students must practise more past papers before sitting the examination. This also assists students to be thorough with the subject area and the scope of the syllabus.

As a whole, this was an easy question and most of the candidates scored well. However the candidates could have been more benefitted, had they tackled this easy question satisfactorily.

Positive aspects of the answers

Question No. 04

- Almost all the candidates understood the requirement to compute the gross income tax payable and identify the tax credit available in respect of a resident individual who is a professional having income from different sources.
- The question was well answered with majority of the candidates displaying good application of skills in the construction of the structure and identifying the contents of an income tax computation of an individual.

E.g. the methodical approach adopted in the construction of the structure, and identification of the contents of the computation of income tax liability was commendable.
- All answers were relevant to the question.
- Majority of the candidates displayed sound knowledge of the adjustments tested in the question.

Question No. 05

- Majority of the candidates understood the requirement to compute the total divisible profits and other income, distribution thereof among the partners and the partnership tax payable.
- Almost all candidates furnished commendable answers displaying good computation skills by identifying allowable and disallowable items in the calculation of taxable profits of a partnership.
- Majority of the candidates displayed sound knowledge of the adjustments tested in the question.
- The question was well answered with a majority of the candidates displaying good application of skills.

Question No. 06

- All answers were relevant to the question.

Question No. 07

- A good number of candidates have understood the requirement to compute the VAT (Value Added Tax) payable by a company engaged in the manufacture of products for export and local market.

Negative aspects of the answers

Question No. 04

i A few candidates adopted short cut methods in arriving at the answers.

E.g. Some candidates merely entered the Net Rent, perhaps using the calculator, without showing the workings to support the answer. Such workings carry valuable marks.

ii Candidates displayed a lack of knowledge:

E.g. Claiming Rs. 600,000 as tax free allowance (including tax-free employment income allowance) under S.34

iiiDeducting tax credits from taxable income

Question No. 05

- Candidates displayed a lack of knowledge.

E.g. Excluding other income in computing partnership tax.

Partnership taxation – applying progressive rates.

Question No. 06

- This question tested the knowledge of candidates of the provisions of the Inland Revenue Act relating to discount for early payment of tax under the self-assessment scheme.

Only a very few understood the requirement.

- A few candidates adopted short cut methods in arriving at the answer.

E.g. Some candidates mentioned only the income tax liability without showing how the taxable income was arrived at.

- Only a very few candidates correctly identified the discount for early payment of tax.

Common difficulties faced by students

(i) Illegible handwriting

(ii) Poor communication skills.

(iii) Incorrect application of the provisions of the Inland Revenue Act.

E.g. In Question No. 04, some candidates claimed the employment tax-free allowance under section 34.

(iv) A common shortcoming was not writing enough or producing outline notes, which failed to do justice to the depth of the question.

E.g. In Question No. 06, some mentioned only the income tax liability without showing the steps on how the taxable income was arrived at. Such answers can only earn a small amount of marks.

Possible areas where majority of the candidates made mistakes

- (a) Not updating themselves with the amendments to the Inland Revenue Act.
- (b) Improper reading/understanding of the question.
- (c) Illegible handwriting and poor communication skills.



Fundamentals of Management Accounting and Business Finance – March 2014

Question No. 01

(1) **What was good in answer**

Understanding of the question

Any candidate, having basic knowledge on budgeting and treatment of absorption costing, can easily understand the Question as it does not involve any complicated costing techniques.

Position (quality) of answer

- Position or quality of answers were satisfactory.
- Position of answer was satisfactory by most of the candidates
- Answers by most candidates were good for part (a) which facilitated them to earn 9 marks out of 20 marks
- Considerable number of candidates scored around 15 to 20 marks.

Answers relevant to question

- The most of the computations were relevant to the question.
- Fair number of answers were found relevant to the question.

Subject knowledge of the student

- Knowledge of candidates were satisfactory regarding simple budgeting
- Knowledge of candidates about computation of absorption rates per unit was satisfactory.

Planning (building) the answer

Satisfactory

What was bad in answer?

Understand of the question

Some of answers indicate that candidates have not been patient enough to read questions carefully and comprehend the very simple data i.e. sales price, Rs. 6,000 and Rs. 8,000 quantity of input data 6 sq.ft. and 8 sq.ft of glasses 12 boards etc.

Inability to understand difference of nature of glass and rubber and inability to determine the total quantity (xx Glasses + xx Rubber = xxxx)

Inability to comprehend the facts given in question had led candidates to make more and more erroneous assumptions and computations.

Position (quality) of answer

Answers to part (b) were not in a better position due to lack of knowledge about computation of overhead absorption rates.

Answers to part (c) and were not in a better position due to either failure to understand the question or lack of time.

Answer relevant to question

Methods selected for computation of absorption of overhead rate by some candidates were relevant.

Planning (building) the answer

Some candidates tried answer to latter parts of questions which appeared for them easy to answer first, and were confused when they attempted the earlier parts of the question.

(2) **Common difficulties faced by the students**

Possible areas where majority made mistakes

Quite number of candidates made very simple mistake in additions of figures

Part (a)

(ii) production budget

Some candidates added opening stocks to sales quantity and deduct closing stocks in computation of production quantity of units of Standards and Deluxe incorrectly.

(iii) direct material usage

Some candidates added quantity of rubber boards and glass required for standard and Deluxe (12 boards + 12 boards = 24 boards) and (8 sq.ft. + 6sq.ft = 14 sq.ft) respectively and multiplied by total quantity of standard Deluxe (60 standard + 10 Deluxe + 70 units) in computation of raw material quantity for units of standards and Deluxe.

Some candidates computed requirements of total rubber boards and total sq.ft. of glass required for standard and Deluxe separately then add total rubber boards and total sq.ft. of glass required for standard and Deluxe together not recognising the inappropriateness of adding different raw material types together in computation of direct raw material budget.

(iv) Some candidates added opening stocks of raw materials to quantity of raw material required for production and deducted closing stocks erroneously in computing and ascertaining quantity of raw material of glasses and rubber for Standards and Deluxe.

Some candidates wrote down rubber boards required for Standards and Deluxe under two separate headings and adjusted opening and closing balances twice resulting opening balance as Rs. 140,000 (Rs. 70,000 for Standards and Rs. 70,000 for Deluxe) and closing

balances as Rs. 160,000 (Rs. 80,000 for Standards and Rs. 80,000 for Deluxe) in computation of direct material purchasing budget.

- (v) Some candidates used the quantity to be sold instead of quantity to be produced to compute labour cost budget.

Some candidate used 48 and 12 as direct labour hours per unit.

General

Most of the candidates did not show the total money value that is finally incorporated into cash budget.

Part (b)

- (i) In computation of manufacturing overhead to be absorbed per unit some candidates divided the total overhead cost by direct manufacturing labour hours per each unit separately

Some candidates divided the total overhead cost by direct manufacturing labour hours per each unit separately

- (ii) Most of the candidates did not attempt to compute the machine set up overhead.

Some candidates used different but erroneous formulas ($30,000 / (\text{Batch size } 50 \times \text{setup time} - \text{labour hours per batch } 10) + (40 \text{ Batch size } \times 10 \text{ setup time} - \text{labour hours per batch})$)

Part (c)

The most of candidates have ignored the machine set up cost as a unit cost.

Even though some candidates computed the overhead cost per labour hour or machine setup overhead per hour correctly, they failed to ascertain cost per unit correctly.

Some candidates computed the total cost of both items but failed to ascertain correct unit cost.

Part (d)

Some candidates ignored this part or computed only either direct material or finished goods. Some had computed the ending inventory level incorrectly.

Many failed to ascertain correctly the cost of goods sold.

General

The knowledge of candidates in absorption costing is weak.

Question No. 02

(1) What was good in answers?

Understanding the question

Question is on profit maximisation with limiting factor (evaluating options) and based on the contribution calculation. Since the question is based contribution calculation majority of candidates have approached on that way.

Position (quality) of the answer

Satisfactory marks have been allocated to each and every point. Therefore, quality of the answer is fair.

Answer relevant to the question

Fair.

Subject knowledge of the student

Fair.

Planning (building) the answer

Some candidates have provided quality answers by calculating contribution, identifying relevant cost etc. Identification of relevant facts is not up to the satisfactory level. Identified lack of logical presentation too by the candidates.

What was bad in answers?

Understanding the question

Understood by some candidates as a problem requiring the use of linear programming approach and thereby could not proceed further. Other mistakes observed were;

- Relevant (fixed cost) cost identification errors seen.
- Provide product mixes without having any justification.

Position (quality) of the answer

Some had calculated the total contribution by using the limited unit contribution amount instead of the per unit contribution.

Answer relevant to the question

Majority have provided irrelevant answers based on one option, instead of calculating profits of two options in part (1), (2) & (3).

Subject knowledge of the students

Majority do not have proper subject knowledge in calculation of contribution per unit, contribution calculation, relevant cost (fixed cost) identification, evaluating two options.

(2) **Common difficulties faced by the students**

Poor presentation
Using irrelevant facts.

(3) **Possible areas where majority makes mistakes**

Contribution calculation
Identifying 2 options in each scenario.
Relevant cost identification

Question No. 03

(1) **What was good in answers**

Understanding the question

More than 80% candidates attempted the question 03 and out of that 50% scored more than 10 marks. That indicates candidates have understood the question and they were able to provide a suitable answer.

Position (quality) of the answer

Good. Most of candidates have fully completed the NPV computation of both options and given the recommendation/interpretation based on their computations.

Answer relevant to the question

Question required which option to select and candidates provided relevant answers by evaluating each option.

Subject knowledge of the students

Candidates have fair knowledge in project appraisal.

Planning (building) the answer

Good.

What was bad in answers?

Understanding the question

Most of candidates failed to understand the saving on rent/rent expenses. Therefore candidates were unable to score the relevant mark (2 ½) assigned.

Position (quality) of the answer

Moderate. Most of candidates have provided only the advantages of Payback period without providing drawbacks. Though they know the computation of PV, the way they presented the computations indicates lack of practice.

Subject knowledge of the students

Some candidates evaluated options not looking at whether it is a saving or an expense as well as whether it is a relevant and irrelevant of an expense.

Planning (building) the answer

Some candidates could not plan their answers due to limited knowledge on capital appraisal.

(2) **Common difficulties faced by the students**

Saving on rent calculation and the relevant year, e.g. most of candidates provided 46.8 mn in year 0.

In external warehouse NPV computation, candidates have taken 6 years as project period.

(3) **Possible areas where majority make mistakes**

When using minus and pluses for each expense or expense cost/saving categories.

Relevant year, e.g. most of candidates correctly computed the saving on rent as Rs. 41.8 mn. But put it under year (2) or year 0 which is wrong.

Question No. 04

(1) **What was good in answers?**

Understanding the question

Most of the candidates answered part (a) to the question 04 well. Many scored full marks for the part (d).

Position (quality) of the answer

The quality for the part (d) answer to the question was very high. Most of the candidates correctly calculated the joint cost after deducting the sales of by product with the method of 'sales of split off point'.

Answer relevant to the question

Most of the candidates' answers were relevant to the part (d) requirement.

Subject knowledge of the student

The students were able to calculate cost per unit based on physical unit method and some were able to calculate profits for the period accurately. Many candidates knew how to work out the joint cost allocations.

Planning (building) the answer

Part (a) and (d) candidates had properly planned the answer and many earned full marks.

What was bad in answers?

Understanding the question

Many candidates had not attempted the part (e) of the question. Only less than five candidates out of 912 scripts understood the question and answered well and got full marks.

Position (quality) of the answer

99% of the candidates misunderstood the question and considered the 'import duty' as a cost to the SIC rather than an additional benefit and earned no marks. The quality of answers to the part (b) also was very poor. If product E is produced the gain and loss were not considered separately and logically.

Answer relevant to the question

Most of the candidates had given irrelevant answers to parts (c) and (e) and only comment made to the question by many of them were without the required supportive workings.

Subject knowledge of the student

Most of the students were weak in subject knowledge on 'how to handle' by products in a question, opportunity and relevant costs concepts, the concepts of joint cost allocation models, duty effects to the selling price etc.

Planning (building) the answer

For part (b), (c) & (e), most of the candidates given comments without supportive calculations indicating poor planning/lack of understanding.

(2) **Common difficulties faced by the students**

- Calculation, casting and posting errors.
- Illegible hand writing.

(3) **Possible areas where majority make mistakes**

- Adjustments for the sales of by-product.
- Calculation of cost per unit (should be Rs. 250). Most of the candidates answered erroneously by giving Rs. 351.38, Rs. 243.87 or Rs. 242.34)
- Adjustments for import duty to sale price.

Question No. 05

(1) What was good in answers?

Understanding the question

Some candidates have specifically understood the question that is how to calculate the profitability based on marginal costing method and absorption costing method and difference among each method of calculation.

Position (quality) of the answer

Some candidates have properly followed each and every step of answering with workings. Therefore, even though there are mistakes in the answer, marks can be given to workings which are relevant to the question.

Most of the candidates' answers were relevant to the question apart from part (d) of the question.

Subject knowledge of the students

Most of the candidates had the knowledge of calculating the fixed manufacturing overhead per unit, total manufacturing cost per unit and the knowledge of marginal and absorption costing methods.

Planning (building) the answer

Some candidates have clearly planned the answer to obtain maximum marks and also to save the time,

- e.g.
- (1) some candidates have not adjusted the opening & closing inventory but considered the same quantity rather than manufacturing quantity and calculated directly the cost of same in a one step under both method.
 - (2) when calculating the contribution, some candidates have calculated the contribution per unit and then calculated total monthly contribution, multiplying by the same quantity. This eliminated the steps of both sales value and variance cost calculation.

What was bad in answers?

Understanding the question

When understanding the question candidates have done some errors and mistakes.

- i. Even when asked to prepare the profit statement monthly some candidates have prepared one statement for all three months (not followed the instructions)

- ii. Some candidates have used production capacity of 4,000 instead of budgeted capacity of 3,000 when calculating the fixed production overhead per unit. Haven't read the question properly.
- iii. When calculating the budgeted total manufacturing cost per unit, some candidates have divided the variable cost per unit again by the budgeted capacity utilisation or production capacity.
- iv. Some candidates have calculated performance bonus not for the profit but for the total contribution or cost of same.
- v. Some candidates have applied 5% rather than 0.5% for bonus calculation.
- vi. More than 90% of the candidates have not adjusted over and under absorption when calculating the profit under absorption costing.

Position (quality) of the answer

Workings have not submitted by the candidates therefore marks cannot be given when there is a mistake in the answer. Sometime some important adjustments have been ignored. E.g. over and under absorption adjustment has not been done. When calculating the ending inventory opening inventory has been ignored.

Answer relevant to the question

For part (d) of the question candidates have written only general ideas and theory.

Subject knowledge of the students

Some students don't have the knowledge of calculating even fixed production overhead per unit and total cost per unit. Most of the candidates don't have the knowledge of adjustment of over and under absorption under absorption costing.

Candidates have lack of analytical skills on how to comment on effects of application of each method in an organisation relevant to decision making.

Planning (building) the answer

Some candidates haven't planned the answer well. For both part (b) and (c) same method was applied.

Some candidates have done the answer twice thus consuming the time to do other questions.

Some have done the correct way but the method written in the answer is wrong. For marginal costing absorption costing method has applied. Candidates are unaware of the fact that difference in bonus arises due to difference in production and sales.

(2) **Possible areas where majority make mistakes**

- Over and under absorption.
- Opening and closing inventory adjustment – ignorance
(most of the mistakes are done due to negligence in reading the question)

Question No. 06

(1) What was good in answers?

Understanding the question

Fair

Position (quality) of the answer

Fair

Answer relevant to the question

Other than part (b) and (d), other parts, candidates' answers were relevant to the question.

Subject knowledge of the students

Material price and labour rate variance calculations are understood by candidates and they are having knowledge to apply the given figures to the formula.

What was bad in answer?

Understanding the question

Part (a) - candidates have calculated per kilo or per hour rate. But they have not understood for example 2 kgs of material I is used for the production. Hence they have calculated per unit standard cost as – Material I Rs. 110, material II 160 labour Rs. 240 etc.

Part (b) – though the question asks to calculate the budgeted FPOH cost per month, some candidates have calculated the per hour absorption rate without understanding the question.

Part (c) - some candidates have calculated material variances only for material I, without understanding the question asks for price and usage variances.

- though the question asks only the usage variance, candidates have calculated material mix variances and material yield variance. This has wasted their time and they have made the answer complicated.
- Though the question mentions that ASP does not maintain material inventories, candidates have adjusted opening and closing stocks when calculating usage variances.

Part (d) -though the question asks for possible causes, candidates have given the answers as follows

e.g. – production is done in a lesser period than the standard.

-actual hours used for production is less than standard labour hours.

Further, some have given answers for favourable labour rate variance without understanding the question.

Position (quality) of the answer

Part (a) -candidates have calculated some cost components in part (a) in Rs. And some are in Rs. '000/

E.g.	Material I	220
	Material II	1,280
	Labour	0.12
	VOH	0.075
	FPOH	0.050

Part (b) Most of the candidates have not adjusted the over absorption amount of Rs. 40,000 and even the candidates who have considered the over absorption have added the Rs. 40,000 to Rs. 275,000 or Rs. 280,000.

Part (c) - some candidates have calculated material II price variance as Rs. 46,900, because of not having mathematical knowledge that OX 46900-0.

- Some have calculated material price variance as follows. (i.e. adding the prices of two materials) 58,200 (270-272)
- Two material price variances should be calculated separately and they are not having that knowledge.
- In calculating material price variance, for actual quantity purchased, some have taken the actual production which is incorrect.
e.g. 5,800 or 5,500

Answer relevant to the question

Candidates have calculated per unit profit also which is a waste of their time.

Subject knowledge of the students

Part (a) Some candidates have calculated standard cost per bag without taking the FPOH

Part (b) Candidates have no clear knowledge on how to adjust over absorption cost.

(2) **Common difficulties faced by the students**

As a whole candidates have made the question complex, because they are not having ability to do the calculations in one method, i.e. either in Rs. or Rs.'000

(3) **Possible areas where majority make mistakes**

Candidates should spend some time to plan the answers. For e.g. they should answer only for questions asked (material mix variance calculation is not required, per unit profit calculation is not required)

(4) **Any other suggestions**

It is observed that some candidates have given two, three answers for the same question and given the option to the marking examiner to identify the correct answer. At this stage such practices should be avoided.

It should be emphasised to the candidates that if they do the calculations in thousands they should mention that before the calculation, e.g. '000.

Since these candidates are expected to work with figures in the future, ability to calculate figures accurately is essential.

Question No. 07

(1) What was good in answers

Understanding the question

Majority of the candidates understood the requirements of part (a), where the candidates had to explain the sub-division of shares and rights issue of shares in relation to the stock market, part (b) (ii) where the calculation of the number of shares and stated capital just after the rights issue was required and part (c) where the candidates were required to state two instances which require valuation of shares.

Position (quality) of the answer

The answers to part (a) (ii) of the question requiring the candidates to explain the rights issue of shares and part (c) requiring the candidates to state two instances which require valuation of shares were good. Some of the candidates explained the sub-division of shares well and provided good answers to parts (b) (i) and (ii), requiring the calculation of the net assets value per share as at 31st December 2013, just after sub-division and just after rights issue and calculation of the number of shares and stated capital just after the rights issue respectively.

Answer relevant to the question

Candidates answers were relevant to the question.

Subject knowledge of the student

Candidates knowledge of instances which required valuation of shares and of rights issue of shares was good. Some of the candidates had a good knowledge of calculating the NAV per share in all three instances and calculating the number of shares in the stated capital after the rights issue.

Planning (building) the answer

Some of the candidates had planned the answer well. Many candidates had made use of their answers to part (b) (i) regarding the rights issue, in answering part (b) (ii).

What was bad in answers?

Understanding the question

Many candidates hadn't understood the requirements of part (b) (iii), where the candidates had to use the share price of the rights issue in arriving at the market price just before the rights issue, (using the information given in the question that the price of a share for the rights issue) and calculate the share price recognising the effects of the dilution in the share price due to the sub-division. Many candidates calculated the NAV for part (b) (i), instead of NAV per share.

Position (quality) of the answer

The question was poorly answered by a majority of the candidates. Very few candidates answered part (b) (iii) correctly and many candidates answered part (d) poorly. Some of the answers to part (b) (i) and (b) (ii) were not satisfactory.

Subject knowledge of the students

Majority of the candidates' knowledge of calculating the value of a share of a business utilising information regarding its future annual free cash flows was not satisfactory. A number of candidates confused stated capital with NAV in answering part (b) (ii).

Planning (building) the answer

A few candidates failed to make use of their calculation of the number of shares just after the rights issue and the increase in the stated capital due to the rights issued in part (b) (i), in answering part (b) (ii)

(2) **Common difficulties faced by the students**

Many candidates were of the view that NAV increased as a result of sub-division (candidates' answers for NAV after the out-division showed an increase over NAV as at 31 December 2013) and some candidates ignored the increase in the number of shares as a result of the sub-division in calculating the number of shares issued during the rights issue.

(3) **Possible areas where majority make mistakes**

Majority of the candidates calculated the nominal value of a share or the NAV per share as at 31 December 2013 as their answer to part (b) (iii). Many candidates failed to calculate the PV of the free cash flows in arriving at the answer to part (d). Others failed to recognise that the Rs. 30 million free cash flow was from year 5 onwards. Quite a number of candidates added the shareholders fund of Rs. 1,440 million shown in part (b) of the question to stated capital and revenue reserve of Rs. 1,000 million and Rs. 440 million respectively resulting in a NAV of Rs. 2,880 million in their answers.

(4) **General comment**

It is suggested that the candidates increase their ability to answer information question through practice of past question papers as well as question papers of other recognised accounting institutes.

Audit and Assurance – March 2014

Question No. 01

Almost all the candidates have attempted this question. Except for part (a) and (e), the other parts have been properly understood and answered fairly well by many candidates. About 60% of the candidates have obtained 50% or more of the allotted 25 marks.

- Part (b) - Many candidates correctly wrote the factors that decide the duties and responsibilities of a practitioner such as legislation or regulations in terms of engagement, quality control, ethical and professional standards etc.
- Part (c) - Most of the candidates have written the two methods to narrow the expectation gap i.e. the engagement letter and expanding the conclusion and stated precisely the inclusions therein.
- Part (d) - Most of the candidates have identified the form of conclusion as the main difference between reasonable and limited assurance engagements.
- Part (e) - Candidates who understood this question have correctly written two audit procedures to identify whether the opening balance contains material misstatements.
- Part (f) - Many candidates were successful in correctly identifying the deficiencies such as absence of segregation of duties, receiving and checking of goods for quality by the factory manager who also the authorized signatory for cheques, and earned full marks.

Thus, the subject knowledge and the quality of answers were fairly good.

Many candidates were not able to correctly understand part (a) and (b) and produced irrelevant answers. The following are some common errors made:

- Part (a) - Instead of the main characteristics of an assurance engagement i.e. independence, objectivity and professional judgment, many candidates have written about the elements of an assurance engagement such as the three party relationship, subject matter, suitable criteria, assurance report etc.
- Part (b) - Some candidates have mentioned the characteristics of an assurance engagement instead of the factors that will decide on the duties and responsibilities of the practitioner.
- Part (c) - Some candidates have explained the meaning of the expectation gap which was not required.

Some others have mentioned about conducting seminars, and giving publicity in the media about the responsibilities of the auditor and client's management, which were not relevant.
- Part (e) - Without writing audit procedures to identify whether opening balances contain misstatements, some candidates have mentioned about giving a qualified opinion, internal control weaknesses, substantive procedures such as physical verification of assets, qualification of the previous auditor, objectivity etc. which are not relevant.
- Part (d) - Many candidates have written more than what was expected by the examiners. They have spent a lot of time for just 2 marks. They were not able to manage the scope of the answer commensurate with the allotted marks.

Question No. 02

General understanding of the question was good in respect of parts (a), (c) (ii) and (d), and candidates were able to produce correct answers. Most of candidates have not understood parts (d) and (c) (i) properly and given irrelevant answers. The quality of the answers provided for part (c) (ii) and (d) was of high standard and candidates displayed thorough knowledge on the subject matter.

However, many candidates failed to provide high quality answers in accordance with SLAuS concerned.

For example, in part (a) they have mentioned the matters to be considered in relation to whether a new engagement letter is to be issued, instead of evasion of recurring audit clients envisaged in quality control standards.

The following are some of the common deficiencies observed in the answers:

- Part (b) - Some candidates have written about the audit plan, its objectives and advantages while some others have discussed about inherent risk, control risk and detection risk and internal controls in general.
- Some candidates were confused or mistaken as to what was expected by the examiner.
 - Most candidates faced difficulties in answering part (c) (i) regarding entity level risk factors of the given scenario. They have just repeated the facts given in the question without identifying the risk factors.
 - Some candidates have written irrelevant as well as lengthy answers. Hardly any candidates were able to identify the following risk factors:
 - Absence of a process in place in the Accounting Department to identify significant changes in accounting standards and address accounting issues.
 - Weakness in communication channels within the company.
 - Absence of a mechanism for approval and to identify risks that may arise from transactions such as minimum rate guarantee.

Question No. 03

Almost all the candidates have understood well when part (a) is concerned. However quality of most answers was not good due to the inability to differentiate between circumstances and examples. Although the question requires to list three instances with an example for each, a large number of candidates have offered many examples without referring to circumstances envisaged in the Code of Ethics.

Some candidates were of the view that confidentiality issues are applicable only to the auditor and not to all professional accountants and have given irrelevant answers.

Part (b) was misunderstood by many candidates with the assumption that the new recruitment is to be expected from the employees of the audit firm and presented irrelevant answers.

Hardly any candidates knew an audit firm could provide assistance to assurance clients in the recruitment of senior management personnel and the extent to which such services can be provided. Therefore, they displayed lack of knowledge on the subject matter being tested.

Some thought that the audit manager will join Saman PLC and as a result a self-review threat will arise.

Very few candidates mentioned about the type of risk that could arise, significance of the threats, safeguards to be considered and the extent to which such services could be provided.

Question No. 04

Majority of the candidates had understood part (a) and (b) and produced good answers. They displayed a fair knowledge on audit files and the evaluation of audit evidence.

Most of the candidates did not appear to have properly understood the parts (c), (d) and (e). For example, although part (d) requires to state how to assess the adequacy of the expert's work, many candidates dwelt on expert's qualification, competency, capability and objectivity which are not relevant for the question. Relevance and reasonableness of expert's findings or conclusions, assumption and methods used, and completeness and accuracy of source data were omitted by many of candidates.

A large number of candidates did not appear to have read part (d) and (e) deeply and understood what the examiner expected from the question. For example, part (e) requires to state factors to be considered in designing confirmations but many candidates discussed the process involved in obtaining confirmations.

In part (c), instead of stating factors that would influence the sample size for test of details, some candidates have described tests of control and tests of details for classes of transactions and balances and substantive procedures in detail.

Only a handful of candidates displayed a knowledge on sampling for tests of details and factors to be considered in designing confirmations although these topics are covered in the Study Text.

It was observed that a considerable number of candidates could not mention three documents or information that are included in a permanent and current audit files.

Question No. 05

There seemed to be no problems in understanding part (a) by the majority of candidates. However, quality of the answers was not up to expectation. It was apparent that candidates had no adequate knowledge on relevant SLAuS dealing with related parties, subsequent events, and going concern. Around 80% of the candidates obtained less than 8 marks out of the total 15 marks allotted.

Some candidates who seemed to be familiar with the standards in concern, had answered correctly, obtaining high marks. Many others were not able to give the required number of points to earn the full marks allotted.

For part (a) (ii), although the question required to draft 3 questions, many candidates produced essay type descriptive answers disregarding the question requirements.

Furthermore, in parts (a) (i) and (a) (iii), the question required to list audit procedures, but some candidates went on to describe them which was unnecessary and a waste of time. In some cases, more than the required number of points were given. This shows a lack of planning the answer.

Part (a) (iii), (b) and (c) were also not answered correctly by some candidates, and some answers to part (a) (iii) were not relevant.

Instead of audit procedures to obtain evidence on uncertainty of going concern, many candidates had mentioned going concern problem indicators such as financial operating indicators and other indicators.

In part (b), knowledge on the concept of materiality was very poor.

Part (c) was also not properly understood by many candidates. Thus, the quality of the answers was poor. Even though the examiner required the candidates to explain the importance of documenting conclusions in working papers, a large proportion of candidates explained the importance or advantages of documentation i.e. working papers, so the answers were not relevant to the question.

Question No. 06

Most of the candidates were able to understand the question except part (a). However, many of them could not give the required number of points to earn full marks in each part. Few candidates produced fairly good answers for parts (b), (c) and (d) and earned full marks.

Most of the candidates have not understood what was required in part (a), and they have written about types of risks, physical verification, tests of controls, confirmation from third parties etc.

The following are some of the other common deficiencies observed:

- Most of the answers to part (a) were not relevant. Instead of risk assessment procedures, candidates have written about various types of risks such as liquidity risk, exchange risk, going concern risk, and business risk, audit risk etc.
- The subject knowledge of some candidates was very weak in that, they had no idea at all about SLAuS dealing with fraudulent financial reporting (SLAuS 240), risk assessment procedures (SLAuS 315) and the application of the concept of materiality.

In part (b), although the question required to explain 2 ways of fraudulent financial reporting, some candidates had given an example of frauds:

- Some candidates repeated the same point in different ways.
- Some candidates did not appear to have carefully read and understood the question requirement in terms of action verbs of the examiner, and have written whatever they know about the subject matter tested.

Question No. 07

Most of the candidates have understood the question but scored less than 8 marks out of 15 marks. Although they have properly understood the question requirement, they could not give either complete answers or the required number of points.

For parts (a) and (b), those who were familiar and thorough with SLAuS 330 being tested, had scored high marks.

A good number of candidates found it somewhat difficult to define the terms substantive procedure and tests of controls.

Instead of definition of the terms, many have listed examples for substantive procedures and tests of controls.

Many candidates have omitted the following words in their definitions for substantive procedures:

- Material misstatement
- At the assertion level

In the tests of controls definition, the words preventing or detecting and correcting were missing.

In part (b), although the question was clear and understandable, most of the candidates (approximately 90%) have not given correct answers, despite the fact that the answers to both parts are readily available in SLAuS being referred to above and Study Text. This displayed a poor level of subject knowledge of the candidates.

In part (c), most of the candidates produced correct answers and earned full marks.

In part (d), a significant number of candidates have either not attempted or badly answered the question. Some have suggested to qualify the audit report while some others discussed what are subsequent and audit procedures are to be conducted for verification of those events.

In part (e), 80% of the answers were not relevant. Most of the candidates have written the methods of collecting evidence such as inquiry, inspection, observation etc.

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Question No. 01

Majority of the candidates well understood the part (a) of the question and given relevant answers. Subject knowledge also can be considered as well.

However part (b) of question did not understood correctly. Their answers are not relevant to the question, and subject knowledge on JAD may not good. Most of them have described advantages/disadvantages of blood bank instead of advantage/disadvantage of JAD techniques.

Question No. 02

Majority of the candidates failed to draw a DFD diagram for blood donating system. Only few of candidates were able to give good answer for part (a). Most of candidates did not understand this part.

In part (b), most of candidates given good answers. Their subject knowledge on system is good. Contracts mechanism in part (c) also well understood by candidates and given good answers.

Question No. 03

Part (a) defining a computer network and part (c) advantage of homeless network was correctly understood by most of students and given good answers. However answering in part (b) is not enough. Explanation are not enough to give full marks. In part (d) also not clearly understood by most of candidates. However some of candidates have given very good answers for part (d).

However, majority of candidates were taken more than 8 marks out of 15.

Question No. 04

Majority of candidates given better answers for part (b). Candidates' subject knowledge on source program, carry less and object programme is not sufficient. Most of answers in part (a) are irrelevant. However majority of candidates had more than 7 marks out of 15.

Question No. 05

Most of candidates understood the part (a) of the question and given correct answers. Expectations are not enough to obtain full marks. In part (b) answers are also not as expected in question, most of them given general threats to the computer system without considering e-commerce system.

Most of candidates given correct answer for part (b).

Question No. 06

Majority of candidates did not attempt this question. Their subject knowledge was very poor on cloud computing. Only a few of candidates have given relevant answers for part (b).Candidates are highly advised to read about cloud computing.

Question No. 07

Most of the candidates have given relevant answer for part (a)

Some of the candidates did not correctly understand the part (b). Their knowledge on data computing devices was poor.

Candidates should understand the question before answering it.

Question No. 08

This is easy question for candidates. Majority of candidates obtained more than 10 marks out of 15. Only a few of them did not categorise the information into difficult levels.

Candidates' knowledge on information system in this question is very well.