



KB1 – Business Financial Reporting

June 2016

Examiner's Comments

Question-wise comments

Question 01

General performance

Answers to this question were very unsatisfactory. Majority of the students scored less than 50% of the marks. 70% of the students scored around 3- 4 marks out of 10 marks.

Part (a)

- The question was based on regulations applicable to the accounting profession.
- Students did not build up a properly structured answer, although lengthy paragraphs were written wasting time.
- Quite a number of students said that since RPL is a subsidiary of a multinational company, RPL is required to prepare accounts under IFRS and for local purposes they have to follow SLAS.
- It was evident that students were not aware of the fact that IFRS is **not international law, and that** Sri Lanka has converged with IFRS in our SLAS.
- Majority wrote that since for consolidation purposes, common policies have to be adopted, RPL is required to prepare accounts under IFRS for consolidation purposes.
- There were some students who built up good answers, stating that Sri Lanka GAAP include SLAS, SEC and the companies Act. They were very few and are students who had studied the study text.

Part (b)

- Performance on this part of the question, although better than the earlier part, was also not very good. Whilst the question required the students to explain the responsibility of a chartered accountant who will be employed by RPL, many students explained the role from an auditor's point of view.
- It appeared that the students have not properly read the question.
- Majority of the students who explained the role of a chartered accountant as an employee only mentioned the responsibility to prepare financial statements. Even in this, some of them did not mention the responsibility of following SLAS and other regulatory requirements and therefore lost marks.
- Most students presented badly drafted unstructured answers to question 1.

Question 02

General performance

This question carrying 10 marks had two parts. Part (a) tested the student's knowledge on IFRIC 13 and part (b) was on revenue (LKAS 18) where students were tested on how to account for revenue on a sale where a customer has been given extended credit.

Although the question was very direct and easy, the candidates did not perform to a satisfactory level. Only about 40% of the candidates managed to get 50% of the marks for this question.

Reason for Good/ Bad performance:

- Lack of understanding of the application of the Standards was seen as the main reason for the bad performance. In part (a) of the question, although students recognised that the consideration needs to be split between the sale and the loyalty awards, they split the amount incorrectly. E.g.: Instead of splitting the Rs 10 mn consideration as (Rs. 9 mn and Rs. 1 mn, some students recorded Rs. 10 mn as sales and another Rs. 1 mn as loyalty awards.
- Students were not familiar with the correct accounting treatment when loyalty points are redeemed. Considerable number of students wrote journal entries transferring the loyalty points from deferred revenue to a debtor account or from debtor account to deferred revenue account.
- Not including a narration for the journal entry also resulted in not scoring some 'easy' marks.
- In part (b), students recognised the interest component of the financial transaction under revenue, instead of under other income and lost some of the marks.
- Some others made the mistake of recording the sale as well as the interest through journal entries at end of the year. These students failed to recognize that the revenue would have been already recorded at the fair value (calculating PV of cash flows) at the time of the transaction (i.e. at beginning of year) and at end of the year only the interest has to be recorded.
- Another reason for losing some of the marks was straightaway computing the figures without explaining the relevant principles.

Question 03

General Performance

This was a question where a major part of the marks was allocated for calculations (8 marks out of 10).

Performance level was satisfactory. About 70% of the candidates scored 50% or more of the total marks for this question.

This question required the students to calculate an estimated warranty provision, and to calculate the warranty obligation to be included in the FS at year end. The scenario was based on a company following SLFRS for SME for preparation of FS. The final part of the question required the students to explain whether the measurement would change if full SLFRS is followed.

Reason for Good/ Bad performance:

- Since it was mainly computations, some of the students managed to score well compared to some other questions.

- Some of the candidates computed the estimated cost of warranty provision on the total sales value instead of considering the probability of warranty obligation based on past experiences. These students either did not have the knowledge or did not read the question properly. As a result, some 'easy' 4 marks was lost by these students.
- In computing the warranty obligation at year end, although most candidates computed the expected cash outflows correctly, they made mistakes in using the correct discount rate and hence lost some of the marks.
- In the third part in explaining whether the computation will change if based on full SLFRS, majority of the students correctly answered saying there would be no change. But did not provide justifications. Therefore they scored only 50% of the marks allocated to the question.

Question 04

General Performance

This question based on LKAS 32 has two parts. For part (a) of the question, four (04) marks had been allocated and candidates were requested to explain four different transactions given, one (01) mark for each and whether each transaction results in a Financial Asset or a Financial Liability.

Part (b) of the question has two (02) sub parts, (i) and (ii). Part (b) (i) required candidates to calculate the fair value gain/(loss) on subsequent measurement of an available- for- sale investment. Three (03) marks have been allocated for this part of the question. Candidates had to do a simple calculation to obtain the allocated marks.

Part (b) (ii) also was about subsequent measurement of an available- for- sale investment, but one which does not trade in the share market.

Performance level was average and majority scored 50% of the total 10 marks. Only a few candidates could obtain more than seven marks (i.e. more than 70%) allocated to this question.

Reason for Good/ Bad performance:

- In part (a) of the question, majority of the candidates identified whether the transaction is a financial asset or a financial liability but did not explain why. Due to this the candidates could obtain only half of the marks allocated for the question.
- The performance of candidates on Part (a) (4) was also very poor. LKAS 32 clearly explains items which do not fall under financial instruments. Only a very few candidates had given the correct answer for this part of the question.
- Part (b) (ii) required candidates to assess the impact on the subsequent measurement of an AFS investment where the investment was made in non-quoted shares. Some obtained this part of the question but very few (about 5%) had written a correct and complete answer. Majority failed to mention that LKAS 39 provides for an AFS investment to be studied at cost if fair value cannot be reliably measured. They lost 2 marks for this lapse.
- Candidates demonstrated by their answers that their knowledge on LKAS 32 is very poor and they do not have a clear understanding about the underlying concepts of the relevant Standard.
- Except for a few answers all others were not well planned. This may be because candidates have not read the question properly and understood the expectation of the examiner.
- Most of the answers contained irrelevant explanations and notes where the candidates had spent the available limited examination time for writing irrelevant explanations and descriptions. This may be due to the lack of experience in writing answers to examination questions.

- Some candidates had written correct answers and thereafter it was cut by drawing a line across the written answer. An incorrect answer has been written thereafter. This may be due to the lack of confidence in their knowledge and understanding.

Question 05

General Performance

As in the past examination, this question was mainly on financial statement analysis and interpretation using ratios. In the first 2 parts of the question students were required to (a) calculate three investor ratios, and (b) analyse the solvency of the company using the given information. The third part of the question carrying 3 marks tested the students' awareness and knowledge on integrated reporting.

Compared to some of the other questions carrying similar marks (10 marks), the performance on this question was good. Majority of the students answered well on part (a) calculation of ratios. However some students failed to provide satisfactory answers to part (b) - interpretation.

Students performed poorly in part (c) where it was required to highlight the importance of integrated reporting. Majority did not know the difference between integrated reporting and financial reporting. Most of the answers only mentioned the importance of financial reporting.

Reason for Good/ Bad performance:

- Students scored well on computation of investor ratios. However, some students lost part of the marks for not identifying what the numerator and the denominator should be.
- In the analysis (interpretation) part, majority of the students were able to identify correctly the solvency ratios from the given information. (Students were not required to compute the ratios that information was given in the question) and scored 2 marks out of the 4 marks allocated to this part. However, where some of the students did not perform well was in explaining the movement in the ratios. Some of the students explained that there is an increase or a decrease of a particular ratio from one year to another. Impact of the change in the ratio on the overall solvency of the company was not explained. Therefore they did not collect the balance 2 marks.
- Part (c) was not attempted by a considerable number of students.
- In part (c) where instead of writing about the importance of integrated reporting, many students who had attempted this part wrote about the importance of financial reporting and the details of other reports that should be included in an annual report (corporate governance report, sustainability report etc.)

Question 06

General performance

This question carried 25 marks and was in two parts, where 20 marks were given for the preparation of Consolidated Statement of Financial Position, and 5 marks for a theory question which required the students to differentiate Joint Operations and Joint Ventures.

General performance was not satisfactory. Usually what is observed is that a considerable % of students scored good marks on the computation sums; however at this examination that pattern was not seen. Generally, high marks scored on this question has helped the students a lot in achieving the pass mark of 50. Thus poor performance on this question contributed to a great extent for students not reaching the pass mark.

What is disappointing is that some of the adjustments which students performed badly were straight from the study text. Even though performance of part (b) theory question was poor, that was also directly and clearly explained in the study text (presented in a table form).

Nearly 75% of the candidates scored less than 50% of the marks for this question. Around 10%- 12% of the candidates scored only 10 marks or less out of a total of 25 marks. It was noted that there were a considerable percentage of students who did not attempt part (b) of the question. (theory part).

Reason for Good/ Bad performance:

In the consolidation sum, Some common mistakes made by the students such as mistakes and errors in calculations, principles and attempting to answer without properly reading the question cost quite a number of students some of the easily obtainable marks. Some of the common mistakes are mentioned below.

- Computation of goodwill on acquisition of the subsidiary- The deferred cash consideration was incorrectly computed by many students discounting for one year instead of 2 years. However it was noted that majority of students computed the fair value of net assets acquired correctly.
- Considerable number of students failed to identify the negative goodwill on acquisition of the associate that needs to be adjusted in the Investment.
- Students failed to do proper adjustments in the SOFP relating to some of the items. E.g.: 1. Revaluation of building and the resultant increase in depreciation. E.g.: 2 Not amortising the value of Brand name
- Weakness in presentation- Some candidates do not pay attention to classify the items in a proper manner in the SOFP and therefore lost some of the marks. E.g.: 1. Goodwill (intangible assets) was recorded before PPE (NCA).E.g.: 2 Deferred consideration shown under current liabilities.
- Errors of principle- It was noted that students are not clear on making some of the post-acquisition adjustments. E.g.: 1. Amortisation of goodwill – the entire value was taken to subsidiary retained earnings. E.g.: 2. Although students computed the unrealized profit on intercompany sales correctly, they were not clear on how to adjust it. Some students adjusted total unrealized profit in the consolidated retained earnings without allocating a portion (20%) to NCI.
- It appears that students have not studied the subject from the study text. Very similar examples together with the double entries are explained in the study text for some of the adjustments in the question. E.g.: 1. Unrealised profit on sale of PPE – (adj number (x) in the question. A similar example is there **on page 548 of the study text**. E.g.: 2 Unrealised profit on intercompany sales- adj number (vii) in the question. The same example with different figures appears **on page 576 of the study text**. These two adjustments carried an easily obtainable 4½ marks.

In part (b) majority of students performed very poorly. The students were required to differentiate between joint operations and joint ventures in terms of contractual arrangements and in terms of rights to assets and obligations for liabilities. On page 582 and page 583, this is explained very clearly in the form of a table. In fact the suggested answer was a reproduction from the study text. However at least 20%- 30% of the candidates had not even attempted this part of the question.

Question 07

General Performance

As in the previous examination, this was a question of a very high standard with 25 marks in total. Students knowledge on application of the principles in various accounting standards is tested in five different parts.

Overall performance on this question was very poor. Significant number of candidates (approx. 50%- 52%) scored less than 5 marks. Only a handful of the candidates (less than 8%) managed to score over 12 ½ marks, which is 50% of the total marks allocated to the question.

Part (e) of the question carrying 5 marks was attempted only by about 25% of the candidates. This question tested the general awareness of the students of SLFRS 15. Changes in Relation to LKAS 11.

This being a '25 marks question', weak performance would have led to quite a number of students not reaching the required pass mark.

Reason for Good/ Bad performance:

It was noted that a handful of students had not attempted the question at all.

Part (a) of the question requires the discussion of the accountant's proposed action with regard to the identification of the transformer's cost as a capital or revenue nature expenditure.

- Almost all the students had understood the requirement of the question but the way they built up the answer was not satisfactory. The action verb in the question was "discuss", but almost all the students took a stand at the outset itself that it was capital expenditure and went on to justify the capitalization. Any arguments or considerations to treat the cost as revenue expenditure was not discussed and therefore the answer was incomplete. Due to this lapse, although the question carried 5 marks, the maximum marks scored was limited to 3. This was the case with about 90% of the students.
- Most of the students who had answered based on LKAS 16, mentioned the recognition criteria of LKAS 16, but did not relate them to the scenario; only mentioned that this cost should be capitalized. (Planning of the answer was not good).
- Around 10% of candidates had adopted taken inappropriate approaches in answering the question, showing their lack of knowledge in understanding a practical scenario and applying the required standards. (E.g.: IFRIC 18, IFRIC 4, LKAS 37 (they had written this should not be charged to P&L and this is a provision), LKAS 17 (incorrectly terming this is a finance lease) and LKAS 40).
- Accordingly on the whole students scored for this part about 1½ - 2 out of 5. A considerable number of students scored 3/5, those were the ones who correctly based their answers on LKAS 16.

Part (b) of the question was based on the recognition and measurement of NCAHFS.

- Students scored well on this part and almost all the students had attempted this part. Further the candidates understanding of the question was satisfactory.
- Though the question had mentioned two sets of assets, some have not separately identified the two assets. This showed that students do not devote sufficient time to reading the question properly.
- This question tested the basic principles of NCAHFS, and seems to have be 'easy'. On average students scored well on this part hence their knowledge of this part was fair. But there were some instances where students made mistakes.

- A few students who did not understand the question properly had calculated the loss on disposal of assembling machinery and mentioned the accounting treatment for loss on disposal.
- A few others were not sure of the measurement of NCAAFS and incorrectly said it should be measured at the higher of CV or FVLCS.
- There were some others who based their answer on IP. This type of irrelevant answers shows the lack of understanding of the student in recognizing correctly a given scenario.

In part (c) students were required to explain the accounting treatments for employee benefits in two given scenarios (i.e. unused leave and profit share)

- Almost all the students had identified that the scenarios related to short term employee benefits. But a few candidates provided incorrect answers - stating 8% profit sharing plan is a long term benefit and some that it is a defined contribution plan and hence mentioned actuarial gains & losses.
- Students who understood the scenarios as short term employee benefits had answered satisfactorily. But a few had mentioned only the J/Es without any explanations, hence lost part of the marks.
- Only a few had mentioned the method of computing paid annual holiday leaves and scored full marks.(3/3)
- Some students had written the theory in detail but had not applied it to the scenario and hence lost marks.
- Lack of students' knowledge on application was high in this question.
- A few said these transactions should be recorded only on payment.
- Most of the students wrote about the liability side in both cases, by considering the existence of legal/constructive obligation but had not considered the expense aspect hence lost marks.

Part (d) of the question requires the candidates to prepare a memo to the BOD regarding the impact on its FS of introducing an ESOP (Equity based).

- This was a straightforward question which was heavily based on theory/standards. But the students' ability in writing a memo was very poor. A proper report/ memo format was not followed by majority of the students. (There was no salutation, date, topic etc.....)
- Though the question clearly says to write the memo to BOD, some have addressed it to management level employees (had not read /understood the question properly).
- Most of the students had not explained what is ESOP is only a very few had.
- Students' knowledge on ESOP was not satisfactory.
- Marks scored for this part was not satisfactory and some students had omitted this part.

The part (e) of the question was theory based, requiring the candidates to explain two key changes applicable due to SLFRS 15 replacing LKAS 11.

- A large number of students had not answered this part. Those who answered did not score above ½ (out of 5).
- Students who attempted this part had written only about LKAS 11 and nothing about SLFRS 15.
- Only two students demonstrated any awareness of SLFRS 15. One student was aware of the 5 step model and the other mentioned this SLFRS will be effective only from Jan 2018.
- Performance was very poor.



KB2 – Business Management Accounting

June 2016

Examiner's Comments

General comment about submission of workings

There were a number of instances where the marking examiner could not award marks due to the failure of the candidates to submit workings; when a candidate has made a mistake, and the particular working is not shown, it may not be possible for the examiner to award marks for the correct steps in the particular working and possibly also subsequent steps which would have otherwise earned marks.

General comment about candidates' handwriting

There were a number of instances where the marking examiner found it extremely difficult to read the candidates' handwriting. If the examiner is unable to read what has been written, then no marks can be awarded to the illegible section.

Question-wise comments

Question 01

General Comments

The average performance on question 01 ranges from 5 **marks to 6 marks** out of 10.

The question is straightforward and tests the candidates' knowledge about pricing of services and determining the appropriate markup based on costs relevant to offer of services. In particular, the question tests the ability of the candidates to identify the cost over the lifecycle of the service.

The specific comments and weaknesses observed under each part are as follows

Part (a)

Candidates' performance on part (a) was **very satisfactory** and average marks scored for this part of the question range **from 3 ½ marks to 4 ½ out of 5** marks allocated. Majority of the candidates (about 70%) had scored the **full marks** allocated to the part. Many candidates (about 60%) had calculated the **price per room night to be charged instead of the markup**. However, the Examiners were keen to award the **full marks for arriving at the correct price**. Very efficient candidates (about

20% - 30%) had worked out mark up **in three (03) steps** whereas some candidates **had explained each** step in detail in arriving at the markup to be charged, which was not expected by the Examiner and is additional “work”. A few candidates (about 10%) had applied 25% **target return on total cost** instead of on **capital employed**.

Part (b)

Average performance on this part of the question varies from **1 mark 2 marks out of 5 marks** allocated. The performance of the candidates on this part of the question **was very poor**. About 60% of the candidates had attempted to compute the cash flow forecast **which was not expected by the examiners**. Majority of the candidates **(70%) had failed to take into account the number of operating room nights over the period in which the outflow on two (02) elements of costs should be accrued in arriving at price per night**.

Question 02

General comments

The question seeks to test the ability of the candidates to translate their theoretical knowledge in balanced scorecard (BSC) into analysing a practical scenario. The question, part (a) requires the candidate to assess the extent to which the company has been successful in formulating and implementing its strategy through the given BSC. Part (b) of the question asks the candidate to outline three areas in which the given BSC could be improved upon.

The performance of the candidates was poor with the question having the second lowest average marks on the paper and having the highest percentage (23%) of the candidates not attempting the question.

Specific comments

Part (a) It is apparent the majority of the candidates have not attempted a practical BSC scenario of this type in their studies. Many had proceeded to analyse the given BSC and give a detail description of the 4 perspectives, which is not a requirement of the question. Only a very few candidates identified the company strategy first and then started evaluating whether the BSC of LPL represents that strategy. Almost all candidates concentrated only on evaluation of performance vis-à-vis BSC targets using the data given in the question.

Part (b) Instead of giving areas in which the BSC can be improved upon, many had discussed ways in which LPL could improve its performance, which is not required.

Question 03

General comments

A joint product costing question in which the candidates are required to allocate common costs according to accepted costing principles (part a) and prepare the product profitability report. Part (b) of the question involves assessment of whether further processing proposals are more profitable. The performance of the candidates was poor with an average mark of 3.1 (out of 10). A high proportion of the candidates (19%) had not even attempted the question may be due to inadequate/non-coverage of this area of the syllabus in their studies.

Specific comments

Common mistakes made by the candidates were;

- (i) Taking the same revenue and cost allocation given in the product profitability report of the question into their calculations.
- (ii) Using the selling price per unit to allocate cost for each chemical.
- (iii) Sales revenue was calculated correctly but cost allocation was taken at 2/3 the value of each product's sales revenue.
- (iv) Part (b) of the question: Some had evaluated only two of the options (100% and 50%, of processed output) ignoring the option "not further processing chemical A at all".
- (v) Some had tried to compare total loss/gain of the 50% option with incremental profit/loss of the 100% option displaying their poor knowledge of incremental costs and revenue.

Question 04

General comments

A performance evaluation question with four parts. Candidates' average marks of 1.8 marks is the lowest for the paper with 18% of the candidates not attempting the question. It is apparent the candidates have not covered this area of the syllabus sufficiently in their studies. Part (a) of the question requires the candidates to discuss the merits and demerits of ROI and RI as performance measures. Part (b) requires them to calculate ROI and RI for the two given divisions while part (c) requires them to discuss the appropriateness of ROI, RI as performance measures amongst the divisions of the company. Finally, in part (d) EVA of clothing division has to be calculated.

Specific comments

- Part (a) Only a few candidates were able to give the key merits and demerits of each method. Many had stated the ease of calculation and understanding as merits. These type of answers cannot attract marks.
- Part (b) A fairly attempt was made by some candidates. However, many had used incorrect formulae and lost marks.
- Part (c) This part was performed very poorly by almost all the candidates. Candidates using their answer for part (b) could have easily commented under which circumstances (i) ROI or (ii) RI is more appropriate as the both divisions give contradictory results for ROI and RI.
- Part (d) Very few candidates were sufficiently knowledgeable about EVA to calculate it. Some had used irrelevant formulae indicating that they have not covered this topic in their studies.

Question 05

General comments

A question with 3 parts on working capital management. Part (a) requires the candidate to determine the value of the working capital requirement, part (b) to state three alternative short term financing methods to finance the working capital requirement and part (c), to state three benefits of a proper working capital management system. The performance of the candidates was satisfactory (has the highest average marks for the paper) with an average mark of 5.7 and 65% of candidates scoring 5 marks and above.

Specific comments

- Part (a) Satisfactorily answered by the majority of the candidates. Shortcomings of the answers submitted by others were (1) profit margin included in inventory valuation (2) calculation of the length of the cash operating cycle (in months) instead of giving the value of the working capital requirement.
- Part (b) Performance satisfactory. However few candidates have stated long-term financing methods such as issue of shares and also some had given irrelevant answers such as ROI, profitability analysis etc. displaying their poor knowledge on working capital.
- Part (c) Many answers were incomplete, having mentioned only smooth operation as a benefit of a proper working capital management system.

Question 06

General comments

A question with four parts on activity based costing (ABC) and activity based budgeting (ABB). Part (a) requires candidates to work out the operating profit under present cost allocation basis and ABC basis. Part (b) requires them to give reasons based on the results from part (a) to justify ABC is more appropriate in allocating support costs. Part (c) requires an evaluation of the relevance of ABC in addressing the company's future plan of increasing store space and the possibility of reducing prices. Part (d) requires the candidates to explain the principles on which ABB is based and outline the benefits of ABB. The performance of the candidates' was fair with an average mark of 10.0 and 24% of the candidates scoring 50% or more of the marks allocated to the question.

Specific comments

Understanding the question

In part (a), some candidates had allocated support costs to product lines under the present allocation basis, based on items sold, although the question states that QSF presently allocates store support costs to product lines on the basis of cost of sales.

In part (c), some candidates recommended allocating the store space currently used by fresh products (the product line with a low percentage of operating profit over revenue) to beverages and packaged foods, although the question indicates that the need is to allocate the additional store space that would be available due to the expansion of the store.

A number of candidates failed to understand that in part (b) their reasons to justify that the ABC system is more appropriate to allocate support costs to product lines should be based on their answers to part (a).

- E.g.
- (1) Candidates stated that under ABC, support costs are allocated accurately, instead of highlighting that under the present cost allocation basis only 50% of the support units are allocated to fresh products, instead of 67% allocated under ABC when the costs are accurately allocated based on cost drivers.
 - (2) Instead of highlighting that fresh products has the highest operating margin under the present allocation basis whereas ABC correctly shows it has the lowest operating margin of the 3 product lines (based on the answers to part (a)), some candidates just stated that ABC gives the correct profit.

Position of the answer

Candidates provided poor answers to part d (i), where the candidate's knowledge of principles of ABB was tested. Most of the candidates failed to mention that all activities are not value adding and therefore, activities must be examined and split up according to their ability to add value. Nothing was mentioned on continuous improvement or that most departmental activities are driven by demands and decisions beyond the immediate control of the manager responsible for the department's budget. Some candidates provided poor answers to parts (b), (c) and d (ii) as well. In part (c), many candidates failed to point out that based on the present cost allocation basis, QSF would have made a wrong choice by allocating the additional store space to fresh products, the product line with the best operating profit margin presently, but with the lowest operating profit margin based on ABC, which would have reduced QSF's profitability and that the correct decision could be made only under ABC. In the case of reducing prices, many candidates failed to recognise that a price reduction would not have been possible under the present cost allocation basis, where the operating profit margins are low and the price reduction is possible only due to higher operating profit margins for beverages and packaged foods shown under ABC.

Subject knowledge of the student

As mentioned previously, most of the candidates lacked knowledge of the principles upon which ABB is based. Many candidates had inadequate knowledge of benefits of ABB. In part (a) some candidates hadn't calculated the operating profit margin for each product line. Under ABC basis some candidates had allocated support costs relating to bottle returns to all three product lines, either equally or based on no. of deliveries received.

Planning the answer

Poor planning was displayed by a number of candidates in answering parts (b) and (c), when they failed to build their answers to parts (b) and (c) making use of their answers to part (a), e.g. for part (b) some candidates failed to mention that both returns are apportioned only to beverages line under ABB, whereas presently it is allocated incorrectly to all 3 lines. Further in answering part (b), many candidates failed to use their answers for total support cost allocated and the operating profit margins based on the present cost allocation basis and ABC basis for each product line in part (a), to justify that the ABC system is more appropriate in allocating support costs to product lines.

In part (c) too, a number of candidates failed to make full use of their answers to part (a) in their evaluation of the relevance of ABC in addressing QSF's future plan of increasing store space and the possibility of reducing prices (discussed in detail under position of the answer). Some others made no use of their calculations in part (a) in building their answer for part (c).

Answer relevant to the question

In part (c), some candidates discussed about the increase in the hours of shelf stocking time, increase in the no. of purchase orders placed and the deliveries received resulting from the increase in store space and the need to allocate the increase in cost between beverages and packaged food product lines based on ABC, instead of stating that beverages and packaged food product lines have the best operating profit margins under ABC, whereas their operating margins are low based on the present allocation basis.

Some others discussed about the possibilities of reducing costs and the necessity to reduce costs before reducing the prices of beverages and packaged foods.

Question 07

General comments

Parts (a) to (d) require the candidates to interpret the given graphical linear programming chart and comment on the availability of resources, optimal mix/contribution and binding resources. Part (e) requires candidates to interpret the final simplex tableau. Part (f): candidates are required to evaluate (using NPV method) the feasibility in investing in a new machine. Part (g): candidates are required to demonstrate the feasibility of purchasing a binding resource (quality checking time) at a premium which will make it non-binding. The performance of the candidates was fair with an average mark of 8.5 and 24% of the candidates scoring over 50% of the marks allocated to the question.

Specific comments

Candidates' interpretation of graphs is poor with many unable to read the points in the resource straight line and connect it to the straight line equation to get the resource availability. Many were unaware that the contribution line runs parallel to line FG, which lies in the feasibility area with corner points F,G will make the whole segment FG optimal. Many could not identify the points at which resource constraints become binding.

There were candidates who could not interpret correctly the given simplex tableau. Many in working out the NPV in answering part (f) of the question had made mistakes in computing the incremental contribution, tax on sale of old assets and computation of tax liabilities for years 1 to 4. Part (g) of the question was poorly attempted by the majority of the candidates.

KB3 – Business Law and Tax

June 2016

Examiner's Comments

Question-wise comments

Question 01

Part (a) of the question requires the elucidation advantages of forming a limited liability company over sole proprietorship on partnership business. In other words what are the advantages of “limited liability” in terms of the Companies Act? In general they are known to accountancy candidate at business level. Fair percentage of candidates had furnished some satisfactory answers to earn reasonable marks whilst answers produced by some candidates had earned the full marks. In those answers the following had been covered as advantages of forming a limited liability company.

- (i) When a company is incorporated in law it will be treated as a corporate body independent of its owners, i.e. shareholders and functions as a legal personnel it can sue in its own name and can be sued by other parties.
- (ii) The liability of its owners is limited and does not go beyond the value of shares they have undertaken to contribute. Shareholders are not responsible for the liability of the company though they are the owners of the company unlike in partnerships and sole proprietorships.
- (iii) Company has perpetual succession and it will continue its legal personality irrespective of the change of its owners i.e. the shareholders.
- (iv) Some investors may prefer to invest their funds in limited liability companies rather than in partnerships or sole proprietorships due to various reasons such as limited liability and so on.
- (v) Ownership of the company can be easily transferred like in any other entity. Shareholders can sell their shares to outside parties as they wish though there are some restrictions applicable for private limited companies.

Candidates who had focused their answer in those directions have displayed their satisfactory knowledge in the subject area and earned very fair amount of marks. But there were others who had failed to understand even a simple question like this and had focused their answers in numerous irrelevant directions such as;

- (i) It can build legal environment by forming a limited liability company and get support from legal authorities for any event or incident that occurs.

- (ii) If the limited liability company is a Public Ltd Co. it can be listed on the Colombo Stock Exchange and can offer its shares to the general public.
- (iii) Enjoying Good Governance
There are more regulations applicable to the incorporated companies than sole-proprietorship businesses. Therefore, owners can ensure that there is good governance in a company and reputation also will be better than in sole proprietorship/partnership businesses.
- (iv) Companies are capable of employing experts since they are financially strong compared to the sole proprietorships/partnerships. Therefore, companies can recruit and retain experts by offering benefits. A company can therefore appoint experts as directors/managers and obtain the services of knowledgeable people in the relevant fields.
- (v) When a company is incorporated it will become a legally incorporated body and get relief from government and statutory authorities and so on.

Part (b) is easier than part (a) of the question. Any accountancy student at this level has some knowledge about an auditor of a limited liability company since this area is covered under the subject of auditing as well. Therefore, the rights and duties of an auditor are well known to any accountancy student. Further question is directly from the Companies Act which is available to candidates for reference when answering the questions under open book examination. Therefore a very high percentage of candidates had furnished in their answers the rights and duties of an auditor as given under sections 160, 161, 162, 163, 164 and 165. Although the candidates were asked to summarise 5 of the rights and duties of the auditor many had given more than 5 such rights/duties as has been laid down under aforesaid sections including the following.

- (i) Under section 160 an auditor has a right to receive prior written notice of at least 20 working days in the event the company intends to replace him and if he is not re-appointed, the auditor has a right to make representation to the shareholders in that regard. Also when the auditor make representation to the shareholders on his removal the auditor has a right to reimbursement of the cost incurred by him in that respect.
- (ii) Under section 164 the auditor is entitled to have access to the accounting books and other records of the company at all time.
- (iii) Under section 165 the auditor has following rights.
 - (a) To attend every meeting of shareholders of the company.
 - (b) To receive the notice and communication that shareholders are entitled to receive regarding the meetings of shareholders.
 - (c) To be heard at a meeting of shareholders which an auditor attends on any part of the business of the meeting which concern him as auditor.
 - (d) Under section 164 auditor of the company has a special duty to be independent and not to have any conflict of interest to ensure that the judgment of the auditor is not biased by any interest he has in the company.
 - (e) Under section 163 auditor has a duty to deliver a statement with the audit report on existence of any other relationship or interest in the company or its shareholders.
 - (f) He has a duty to make a report to the shareholders on financial statements audited by him detailing the basis of opinion, scope and limitations and all other relevant details.
 - (g) The auditor may require from a director or employee of the company any information and explanations as he thinks necessary for the performance of his duties (section 164).

Candidates who had based their answers on those points have earned a very high percentage of marks. But a minor percentage of candidates were not capable of providing their answers on contents of said sections and had furnished some answers which have nothing to do with rights and duties of an auditor. They had dealt with some areas such as:

- (i) The auditor is entitled to rely on a certificate issued by a manager if there is no suspicion but any suspicion arises he is required to make an exhaustive investigation.
- (ii) Auditor should issue the certificate of solvency in situations where the company wishes to distribute profit and buy back shares.
- (iii) Auditor should not disclose any information gathered by doing the audit to outside parties and he must comply with ethical code of ICASL.
- (iv) A company shall appoint an auditor at AGM according to section 154 of the Companies Act, and under certain specific criteria he can be removed. Otherwise he may be re-appointed as the auditor of the company for next financial year.
- (v) Auditor should conduct the solvency test of the company and if the company satisfies this test auditor should certify to the shareholders that no fraudulent acts are reflected in the financial statement of the year.
- (vi) The statement required under Companies Act shall be delivered by the auditor to the company if he is resigning after issuing of notice of resignation or if he gives notice that he does not wish to be reappointed.
- (vii) A few others had confused the provisions of auditing standards with the duties of auditor as laid down in the Act, and stated that an auditor shall exercise reasonable care and skill of a standard expected from a reasonably professionally qualified accountant. Also an auditor shall only certify to shareholders what he believes to be true and so on and had wasted their time.

Question 02

Part (a): Very simple straightforward question and candidates were expected to name different types of limited liability companies as laid down under section 06 of the Companies Act. A very high percentage of candidates had given the correct way of naming as provided under section 06 of the Act. It may be due to the fact that under open book examination candidates can extract what needed from section 06 and they had furnished answers including the following.

- (i) If the proposed company is a private company it should be named as Auto Mart (Private) Limited or Auto Mart (Pvt) Ltd.
- (ii) If the interest is to form a public company other than a listed company the name should be Auto Mart Limited or Auto Mart Ltd.
- (iii) If their interest to form a listed company it will be named as Auto Mart Public Limited company or Auto Mart PLC.

Even though this is a very simple straightforward question a handful of candidates had failed to furnish satisfactory answers due to their inability to understand the question. In their answers they had dealt with areas like;

- (i) When the name of a company is being selected it should be selected according to the Companies Act and in selecting the name it should consider the absolutely prohibited and conditionally prohibited words as given in the Act.
- (ii) After selecting the name it should be forwarded to Registrar of Companies for approval. If selected name is approved by the Registrar an approval number will be given. After the name approval 4 documents should be submitted to the registrar.

- | | |
|--------------------------------------|--|
| (a) Application form | (b) Articles of Association |
| (c) Form no. 18 consent of directors | (d) Form no. 19 consent of the secretary |

In addition to that registration fees under section 5 (i) has to be paid and thereafter the registrar shall enter the particulars of the company in the register.

- (iv) Under section 7 of the Companies Act a company name will not be registered in the following instances.
- (a) If the name is identical to a name of an existing company.
 - (b) If it consists of the words “Chamber of Commerce” unless the company is a company which is to be registered under license granted under section 34 without adding the words limited to its name.
 - (c) If the name is a misleading name in the opinion of the registrar of companies.
- (v) Auto Mart should be incorporated as a Private Ltd. Co. under Companies Act No. 07 of 2007 and they should check the name with the registrar to ascertain whether it is a name of an already existing company; if it is so that particular name of the company cannot be used and they should choose a another name and so on and wasted their time.

Part (b): A fair percentage of candidates are familiar with pre-incorporation contracts and their legal effect under the new Companies Act and had presented some satisfactory answers. They had correctly identified those contracts as pre-incorporation contracts and had briefly explained that contracts entered into by promoters on behalf of the proposed company prior to its incorporation are known as pre-incorporation contracts. Further they had explained that there are 2 implied warranties given by a person who enters into pre-incorporation contracts on behalf of the proposed company as has been laid down under section 24 of the Act. Accordingly the promoters of a company will give implied warranties to say that:

- (i) The company will be incorporated within such period as may be specified in the contract or if no such period is specified, within a reasonable time after making such contract and
- (ii) The company will ratify the contract within such periods as may be specified in the contract and if no such period is specified within a reasonable time after incorporation of such company.

As per the new Companies Act pre-incorporation contracts are clearly recognised and are legally valid subject to the above requirements.

The candidates who had focused their answers on those directions had earned over 75% of the marks allocated for the question. However a similar or higher percentage had focused answers in various other irrelevant/incorrect directions and had wasted time to deal with areas like:

- (i) If the company failed to ratify those contracts after incorporation, court on an application made on behalf of the party from whom the property was acquired makes order;
 - (a) Directing the company to return the property acquired under pre-incorporation contract.
 - (b) Validating the contract in whole or in part.
 - (c) Granting any other relief under section 25.
- (ii) If the company is not incorporated it cannot ratify the contract and promoters are personally liable to other parties under implied warranties as in a contract between the promoters and third parties.
- (iii) A pre-incorporation contract may be ratified by a company in the same manner as a contract entered into on behalf of a company under section 19.
- (iv) Sections 4 & 5 of the Companies Act state that before the incorporating of a company any person (in this case Auto Mart) has the following liabilities.
 - (a) Auto Mart (Pvt) Ltd. has liability to all the activities of the company

- (b) It has a separate personality in Law.
- (c) If the company winds up before incorporation it has the liability for all creditors and debtors.
- (d) Before company gets legal status it cannot use the name of the company.
- (e) Before incorporation it does not have opportunities to get benefits.
- (v) In case of Auto Mart after incorporation legality of the contract is high because it has good image about the company as the limited liability.
- (vi) The amount of damages recoverable in an action for breach of an implied warranty referred to in sub-section (i) shall be the same as the amount of damages that may be recoverable in an action against the company for damages for breach by the company of unperformed obligations under the contract as if the contract had been ratified by the company.
- (vii) Promoter cannot make secret profit when they enter into contract on behalf of the company and they should disclose everything and all such details if they make false statements in respect of prospectus issued, promoters are liable for such false statement and so on.

Question 03

Candidates were required to outline 2 different types of shares which can be issued to the public by public limited companies. Almost all the candidates had chosen ordinary shares and preference shares and there were hardly any candidates who had chosen other types of shares like deferred shares, non-voting shares, Redeemable shares and so on. A fair percentage of candidates in dealing with ordinary shares and preference share had discussed the following areas in their answers.

Ordinary shares

Ordinary shares are the basic form of shares and normally most of the companies issue only ordinary shares or they are the major part of the stated capital of those companies. Subject to Articles of Association of the company ordinary shareholders are the owners of the company and they vest with one role per share and are entitled to participate equally in any dividend declared. If the company is wound up ordinary shareholders can share in the proceed of sale of the assets of the company only after all the liabilities of the company have been paid. The ordinary shareholders have a right to equal participation in the distribution of the remaining assets in the event the company is wound up provided that no limitations are laid down in the Articles of the company or under any other special circumstances.

Preference shares

Section 49 (3) of the Companies Act states that any company can issue shares which are rated above ordinary shares in specified aspects such as dividend, return of capital and so on. They have the priority in receiving the fixed dividend as agreed and to return of their capital in a winding up. They also have the right to preference dividend which may be cumulative or non-cumulative. All the terms of issue of preference shares have to be clearly stated at the time of issuing them by the company.

Candidates who had furnished their answers based on the above have disclosed their satisfactory knowledge in the subject area, and earned good marks. But there were many others who are not competent to focus their answers in those directions. Their answers dealt with irrelevant matters such as;

- i. Companies can issue ordinary shares to the general public to increase their share capital.
- ii. Companies can use the Colombo Stock Exchange to publish share prices and they can easily raise share capital.
- iii. Companies pay dividend on ordinary shares in addition to other benefits of ordinary shares and those shares can be sold through the share market.

- iv. Sun Garment PLC is incorporated under Companies Act as a Public Limited Company. In this case the proposed 2 options for raising capital can be implemented by Sun Garment PLC to raise its capital requirements.
 - v. Public Companies listed on the Colombo 'Security' Exchange can raise debt/equity capital and secure the listing of their shares and they have to comply with relevant provisions of the Act in this respect.
- (b) This part of the question requires candidates to state 5 disadvantages of raising debt capital or borrowing funds for the capital of a company. Generally any average accountancy candidate at this level is familiar with this topic and they can furnish some satisfactory answers with their general knowledge. Accordingly many had furnished satisfactory answers covering the following areas for which they earned very high marks.
- (i) Loan amounts and interest payments for them can be a burden on the balance sheet and income statement.
 - (ii) For some debt instruments the terms and conditions can be complex and may be an unnecessary burdens to the business.
 - (iii) Any downward trend in the business or unexpected capital needs can mark it difficult to meet the interest payment on the loans in time.
 - (iv) If the company gets into difficulties the lenders could become adversarial
 - (v) If the loans are personally guaranteed the liabilities will extend to personal assets of the guarantor and so on.

It could be observed that some candidates had re-produced what is shown in page 57 of the study text as the 5 disadvantages of raising debt capital creating a reasonable suspicion as to whether they had copied that part from study text into the Companies Act and taken it to the examination hall under open book conditions and re-produced the same as their answers.

There were many others who are not competent to furnish some satisfactory answers for this simple question and had focused their answers in various irrelevant or incorrect directions and had furnished answers including the following.

- (i) Annual interest expenses will go up and profit will be reduced making an impact on the gearing ratio of the company.
- (ii) Power of the shareholder of the company will also reduce due to highly increased debt capital.
- (iii) When a company issues debt capital it has to face some issues such as:
 - Debt capital has to be issued under certain interest rates.
 - Even though company makes losses it has to pay interest to such parties.
 - Increasing debt capital to move than equity capital will create problems.
 - Reduce working capital/increase amount of debt capital.
- (iv) Debenture holders are creditors of the company who have the right to receive their money in the event of liquidation and wasted time.

Question 04

- (a) This part of the question requires the candidates to deal with alternatives available regarding the length of notice that should be given in calling for an AGM of a company and to deal with sub sections (1) & (3) of section 135 in this regard.

Many candidates had stated that under section 135 of the Act a minimum of 15 working days' notice in writing should be given to call for an AGM of a company. Also section 135 (1) states that any provisions contained in the Articles of the company for a shorter notice than the length of notice stipulated in the Act will be void. However under section 135 (3) a company is allowed to call for an AGM with a shorter notice than 15 working days provided that all the shareholders entitled to attend and vote at such AGM agree to such shorter notice. Accordingly Three Musketeers (Pvt.) Ltd can call for the proposed AGM with 7 days' notice if all 3 shareholders give their consent for the 7 days' notice. Candidates who had based their answers on aforesaid lines following the sections 135, 135 (1) & 135 (3) deserve a very high percentage of marks as they had disclosed their satisfactory knowledge.

But there were many others who had totally failed to refer to section 135 of the Act. They mentioned matters which have no connection to the question and had dealt with some areas like;

- (i) AGM of shareholders of a company should be held once in each calendar year and not later than 6 months after the balance sheet date of the company and not later than 15 months after previous AGM.
 - (ii) Where a company resolves that a meeting is to be treated as an AGM of the company referred in sub section (4), a copy of such resolution shall be forwarded to registrar of companies within 10 working days from the date of passing such resolution and it will be recorded by the registrar. If not the company shall be guilty of an offence and be liable on conviction by a court to a fine not exceeding one hundred thousand rupees.
 - (iii) An AGM can be called only by directors or the company AGM called by shareholders is questionable. Shareholders can call only Extra Ordinary General meetings. Therefore, AGM needs to be called through Board of Directors. Also directors should state that this AGM is held within 15 days from previous year AGM or else 6 months after balance sheet date according to sections 132 and 133 (i). Board of Directors of every company shall call for an AGM of shareholders to be held once in each calendar year.
 - (iv) Further section 133 (2) states that in the year of incorporation need not be held an AGM but it shall be held it within 18 months from date of incorporation. Accordingly three Musketeers (Pvt) ltd. can follow one of the relevant procedures. However they have to hold the AGM every calendar year except for the year of incorporation.
- (b) This part of the question requires candidates to outline the official receiver and his role in winding up (of a company) by court as has been laid down under sections 283 & 284. A fair percentage of candidates were competent to furnish some satisfactory answers by following the contents of said sections. In their answers the following areas had been covered indicating the relevant sections as well. As per the Companies Act, official receiver in the context of winding up of a company by court refers to the official receiver attached to that particular courts for insolvency purpose. If no such official receiver exists the official receiver refers to the officer the Minister in charge of the subject may appoint as official receiver to the relevant courts. Accordingly an official receiver is a person appointed to monitor a company for a short period of time to ensure that as much debts as possible are paid back to its creditors. In terms of sections 283 & 284 the role of the official receiver includes the following.
- (a) He is entitled to receive a statement of the affairs of the company in the prescribed form unless the court directs otherwise.

- (b) Also it is his task to compile reports as may be directed by court from time to time and certain other reports as stated under section 248.
- (c) In addition the official receiver has a duty to submit further reports on matters which are in his opinion desirable to be brought to the notice of the courts.

Candidates who had furnished their answers on those lines had disclosed their knowledge of the subject area and earned a high percentage of marks. But there were many others who are not sufficiently competent to follow refer to said sections and had furnished some irrelevant answers such as;

- (i) when the court appoints an official receiver he should call separate meetings of shareholders and creditors to select the liquidator.
- (ii) the main duty of an official receiver appointed by the court is to call separate meetings of creditors and shareholders to discuss matters and for appointment of a committee of inspection to work with the liquidator, and so on.

Question 05

- (a) Easy question on main objectives of the Securities and Exchange Commission of Sri Lanka which are included under section 12 of the SEC Act. Generally accountancy students have some knowledge of the functions of the Securities and Exchange Commission of Sri Lanka as the subject is very often discussed in their studies. Therefore an average candidate has some idea of the main objectives of SEC and a high percentage of candidates had furnished their answers based on correct lines and discussed the following as the main objective of SEC.

- (i) Creation and maintenance of a market in which securities can be issued and traded in an orderly manner.
- (ii) Regulation of the securities market and ensuring that professional standards are maintained.
- (iii) Protection of the interest of the investors and
- (iv) Operation of a compensation fund to protect investors from financial losses arising as a result of any licensed stock broker or stock dealer being found incapable of meeting his contractual obligations.

The answers furnished by them had revealed that they have satisfactory knowledge on main objectives of SEC and earned very high marks. However there were some others who are not quite familiar with those objectives and had focused their answers in various other irrelevant/incorrect directions and had wasted time to deal with some areas such as;

- (i) SEC is a body corporate having perpetual succession and which may sue and be sued in its own name. SEC Act also sets out provisions in relation to granting licenses to stock brokers and stock dealers who trade in securities. It also provides provisions for the creation of a compensation fund.
- (iv) To maintain 2 board price lists indexes in stock market.
- (v) The objectives of SEC include – identifying regulations for the stock market.
- setting out provisions in relation to granting licenses for trading on the Stock Exchange
- (vi) To encourage honest traders to realise that they do not need to adopt dishonest practices to compete with the dishonest traders and punish such practice.
- (viii) The main object is to help the stock market to operate efficiently in order to contribute to increase the overall wealth of society and so on as they are not familiar with the objective of SEC.

- (b) The question requires candidates to explain the key features of conciliation. A fair no. of candidates had correctly explained them and following had been discussed in their answers as they features as conciliation.
- (a) Conciliation is one of the alternative method followed in dispute resolution. Under this method the parties to the dispute nominate a neutral third party called a conciliator to assist the parties in reaching an agreement.
 - (b) In conciliation the parties to the dispute take an active part in the dispute resolution process under the guidance of the conciliator.
 - (c) Conciliation is consensual and utilises a non-binding arbitration process which does not involve a Court of Law.
 - (d) It does not derive any form of Judicial power and therefore cannot make any decision that is binding in nature.
 - (e) Accordingly the resolution of the dispute and adherence to the same is completely in the hands of the parties to the dispute.
 - (f) Therefore it takes a form of round table negotiation for settlement

Those who had furnished answers based on those features had disclosed their satisfactory knowledge of key features of conciliation and deserved a high percentage of marks. However there were some others who have no satisfactory knowledge of the subject and focused their answers in numerous incorrect directions which are not related to the subject being tested. In their answers they had explained areas like;

- (i) Conciliation is conducted by a team of consultants. First they give the opportunity to one party to present its problem. Thereafter the other party gets the chance to present its opinion. Then the committee considers the problem which has arisen between the 2 parties in a just fair way and they decide on the most appropriate option to settle the dispute.
- (ii) An independent third party separate from Amy & Nani after hearing the dispute will give his decision independently and without any influence from either party. He will state his decision to both parties without any certificates or awards.
- (iii) Civil cases other than cases which come under the purview of government authorities.
 - Mandatory referral (civil) amounts up to Rs. 250,000.
 - Cases referred by courts – Any case can be referred by the court.
- (iv) After meeting with the parties if a settlement has been arrived at on cases presented to conciliation board, it can issue the certificate of settlement and copies are given to both parties and if the case had been referred by court a copy of settlement is sent to the courts as well too. If there was no settlement a non-settlement certificate is issued with copies to the parties concerned and so on.
- (v) Some other candidates had confused with debt conciliation and had written the rules related to debt. They had dealt with certain points such as;
 - when complaints are by people who are indebted under loans obtained on documents like promissory notes cheques etc.
 - people who obtained second loans.

General

For some candidates the major problem is inadequate language skills, i.e. knowledge of English. As a result when they cannot understand the question they focus their answers in various irrelevant directions. And when they are capable of expressing their views they write lengthy sentences/paragraphs with no sense and the examiner is unable to understand the view expressed by the candidate.

Repeating the question in different words, numerous grammatical errors and spelling mistakes could be observed as usual.

Question 06

This question required candidates to:-

- (a) Assess the income tax liability tax credits and balance tax payable by a resident company engaged in the business of manufacturing steel for the domestic market. This company is also a subsidiary of another company.
- (b) State the meaning of the term 'dividend' under the Inland Revenue Act.

General comments

The subject matter tested in this question is include in the syllabus and adequately covered in a study pack published by CA Sri Lanka.

Most of the candidates made a good attempt at the question and the overall performance can be considered as quite satisfactory. Majority of the candidates scored over 50% of the allocated marks. There were some excellent answers and a few (about 7%) students obtained 20 or more marks out of the allocated 25 marks.

Standard of the question can be regarded as reasonable at this knowledge level being neither too difficult nor too easy. The question had a reasonable coverage of commonly applied sections of the Inland Revenue Act in this corporate income tax computation.

Specific comments

Part (a) Candidates made a good attempt at this part of question displaying good application skills in the construction of the structure and in identifying the statutory contents of an income tax computation of a corporate entity.

Majority of the candidates demonstrated sound subject knowledge in the application of the provisions of the Inland Revenue Act in relation to:-

- Sections 25 and 26 – allowable and disallowable expenses and charges.
- Identifying statutory/assessable/taxable income.
- Identifying available tax credits.

Where mistakes were made, these generally related to:

1. Understanding/comprehension of the question.

E.g. The question mentions separate acquisition of fixed assets (machinery and furniture) for expansion and for the existing undertaking. Such acquisitions were clearly identified in the question. However, a few candidates claimed depreciation allowance only in respect of one acquisition.

2. Lack of subject knowledge.

Part (a) (i) Trade/Business Income -

- Rent income – a good number of candidates treated this as other source of income and computed net rent under section 3 (a). Students are advised to read section 217 for the meaning of the word “business”.
- Royalty – a good number of candidates were ignorant of the fact that this expense is allowable only if paid and that no provisions is allowed. Besides a few candidates claimed this as a deduction under section 32.
- Advertisement – surprisingly a good number of candidates disallowed 75% of the expense.

Interest paid to holding company – most candidates made mistakes in computing the disallowable part of the interest.

- Depreciation allowance –
 - Machinery (power saving) – a significant number of candidates applied the 50% rate.
 - Installation cost of machinery – majority of the students did not claim the allowance.
- (ii) Interest Income – A few students treated this as income in respect of which final tax has been paid.
- (iii) Qualifying payments. Expansion – majority of the students did not know that investments not less than Rs. 50 million on fixed assets are eligible for qualifying payments relief.
- (iv) Income tax rate – quite a number of candidates applied the concessionary rate of 12% applicable to undertakings having a turnover less than 750 million (section 59B) ignoring the fact that s.59B is not applicable to a member of a group of companies.
- (v) Dividend tax - Only a few candidates computed dividend tax liability on the dividend distribution net of dividend received. Majority of the students computed dividend tax on the gross distribution.

Part (b) Overall performance was extremely poor. Only a very few candidates answered well and scored good marks. It was obvious that majority of the candidates do not devote sufficient time to read the Inland Revenue Act and / or CA Sri Lanka study pack.

Question 07

This four part question tested the candidates’ knowledge in the undermentioned areas of taxation.

- The VAT liability of an enterprise for a quarter.
- The variation in the computation of income tax liability of charitable institutions and clubs.
- Statutory obligation of a company to file a return of income and return of dividends and the due dates for filing such returns.
- The criteria that make a person liable to ESC.

General comments

The subject matter tested in each part of this question was within the syllabus and adequately covered in the study pack published by CA Sri Lanka.

Standard of the question can be considered as reasonable at this knowledge level being neither too difficult nor too easy. The question tested certain sections of the Inland Revenue Act that are commonly applied to business enterprises.

Overall performance in this question was quite unsatisfactory; less than 10% of the candidates scored more than 50% of the marks allocated to the question while a majority of the candidates scored less than 40% of the allocated marks. 60% of the marks for the question is allocated to theory and administration provisions. As mentioned in earlier comments, this poor performance can be attributed to candidates' failure to devote adequate time to read the Inland Revenue Act/CA Sri Lanka study pack.

Specific comments

Part (a) Majority of the students made a good attempt at this question displaying excellent skills in the computation of VAT liability. The undermentioned shortcomings are noteworthy.

- Understanding the question.
E.g. 01. Import of raw materials and machine. The question clearly states that "VAT paid" (i.e. VAT was paid) in respect of the above imports. However a few candidates treated these as supplies.

E.g.02. Locally purchased materials and accessories – the question clearly states that these purchases are "excluding VAT". However, some candidates treated these as supplies and calculated VAT thereon.

E.g. 03 A good no. of candidates claimed the payment made on 20th October, 2015 (payment made in respect of previous quarter) as a credit against current quarter VAT liability.

Lack of subject knowledge.

Input tax b/f from previous quarter – a good no. of candidates treated this as a payment of VAT against the current quarter VAT liability.

Shortcomings in technical knowledge – the question states that 70% of the supplies are liable for VAT and the balance is in relation to exempt supplies. Majority of the candidates computed 70% for every item of allowable input VAT. This would be an onerous, if not impossible task in reality. Candidates should apply the single formula covering all such input VAT for ascertaining the allowable input VAT.

Part (b), (c) & (d) - These 3 parts of the question tested theory and administration provisions in taxation. Overall performance in all the 3 parts was extremely poor due to not understanding the question.

E.g. (b) The question requires students to discuss how the computation of income tax of a charitable institution varies from that of a club.

A good number of candidates wrote about the nature of activities (including the meaning of charitable purpose) of a charitable institution and that of a club. Further, some candidates furnished tax computation statements. This is clearly a waste of valuable exam time earning no extra marks. A good number of candidates mentioned the similarities (e.g. rate of income tax – 10%)

Common difficulties faced by students

As in previous exams, there were a number of instances in the scripts where the examiner found it extremely difficult to –

- (a) Read the candidates handwriting
- (b) Understand the candidates' language.

If an examiner cannot read or understand what has been written then no marks can be awarded.

KB4 – Business Assurance & Ethics

June 2016

Examiner's Comments

Question-wise comments

This paper consists of seven questions It is required to answer all. There are two sections

Section 1-Five questions carrying 10 marks each

Section 2-Two questions carrying 25 marks each

Majority of the candidates have answered all questions. The following common deficiencies were observed;

- Writing too little when asked to explain
- Wasting time writing irrelevant answers
- Illegible handwriting
- Not planning the answer according to the question requirement

The general performance was not satisfactory. It is evident that the candidates have not studied the text book

Question 01

Part (a) Candidates were expected to explain the purpose of a letter of engagement, as to why it is sent before any new audit appointment is accepted. This question is based on the study text and SLAuS. It is disappointing to note that many have not produced relevant answers. The common answer was that it is sent in order to minimize the expectation gap. Though it is not wrong it is not the answer expected from the candidates. Therefore they were unable to secure full marks. Candidates are expected to study the text book and produce relevant answers. Some have written that it is a legal document to claim audit fees.

Part (b) It was expected that candidates would state four main contents of a letter of engagement. Most have written that it should contain the responsibilities of the auditors and management but failed to state other main contents. There were irrelevant points such as;

- Audit expenses

- Audit will be carried out on a sample basis
- Audit would not give absolute assurance
- The documents required for the audit

Part (c) Candidates were required to discuss actions which should be taken in response to non-reply by the management to the draft letter of engagement. Most of the answers were satisfactory.

Question 02

Part (a) Candidates were expected to outline two benefits of having an audit committee to test their knowledge about audit committee in the context of corporate governance. There were good answers but some have written irrelevant answers such as;

- Ensure major transactions are relevant
- Deal with external auditors
- Improve the quality of the internal auditors and external auditors

Part (b) Candidates were required to analyse the composition of the audit committee in the given scenario. The candidates were expected to write a summary of significant features. Most of the candidates have written about the composition in general without referring to the scenario. They only stated that the chairman should be independent; the most appropriate answer would have been that the finance director of the company chairing the committee will result in a conflict of interest. Only a small number was able to analyze the composition accurately.

Part (c) Candidates were required to explain how the auditor should respond to the statement given by the chairman of the audit committee in connection with the impairment. Most of the candidates failed to state that the auditor is required to obtain independent evidence and arrive at a conclusion further, the chairman is in charge of preparation of accounts. Most of the candidates have written without explaining that the audit committee chairman's statement cannot be accepted. It reflects that the candidates have not understood the question requirement.

Candidates were also asked to explain how the auditor should respond in forming the opinion; the answer expected is steps the auditor should take. Most of the candidates have written that the auditor should qualify the report

Question 03

Part (a) An explanation of the reason for maintaining professional skepticism throughout the audit was expected. There have been similar questions on professional skepticism during the past few years, but the performance was not satisfactory. It reflects that the candidates have not studied the study text and not done past papers. Most of the answers produced carried general points not specific relevant points. The following are such points;

Helps to:

- get an overall knowledge of the entity
- to find material misstatements
- to assess audit risks
- to find human errors
- to find ineffective internal controls
- protect the auditor

- Part (b) Candidates were required to outline three procedures that can be used to identify the risk of material misstatements in the financial statements of Q&L. Most of the candidates have misunderstood the question. They have written that there will be material misstatements due to inherent risk and control risk and wasted time in explaining such risks. The question requirement is to outline 3 procedures to identify the risk of material misstatements. Some who have understood that have written the audit procedures but due to lack of technical knowledge wrote irrelevant answers such as;
- Audit the overall audit strategy
 - Check previous audit working papers
 - Plan the audit
 - Increase supervision
 - Use experienced persons for the engagement
 - Use professional skepticism.

Question 04

- Part (a) This part of the question is based on gathering audit evidence through external confirmation. It is required to identify two assertions for that purpose. Many candidates have ignored the action verbs and written assertions without explaining. Further many have not identified the relevant assertions .They have ignored that it is required to obtain evidence through external confirmation. Many have written existence as an example of assertion, but failed to mention rights and obligation as an assertion. Most of the answers carried irrelevant assertions such as;

- Accuracy
- Completeness
- Valuation

This reflects that the candidates have no idea about the purpose of calling for external confirmation and further that they have not studied the text book.

- Part (b) Discussion of three important points to consider from details given in the table in selecting the sample to send out requests for confirmation was expected. The candidates demonstrated the knowledge but they failed to plan the answer according to the requirement of the question. As it is asked to discuss, the candidates should have examined in detail the different aspects. Instead they have listed the points. As a result they were unable to secure full marks.

- Part (c) The candidates were required to outline the audit work to be performed based on the responses. Balance agreed- The question requirement is to consider the adequacy of any allowances made for long-standing balances and check the subsequent settlements. Instead many have written irrelevant answers such as;

- Inquire, and discuss with the client about the settlement
- Check the arithmetical accuracy of the balances
- No further action is required as the balances have been agreed

Balances not agreed-Candidates are expected to write on further substantive work to determine whether material adjustments are required. But many have written irrelevant answers such as;

- Reconcile the difference
- Discuss with the management
- Check a sample of invoices

Question 05

Part (a) Candidates were required to assess the potential impact on the financial statements arising from issue given in the scenario. Although there are two issues which have an impact on financial statements candidates have identified only one issue which is risks and rewards have not been transferred to the customers. Most of the candidates failed to understand the impact of the law suit.

Part (b) Candidates were required to recommend the views on the audit opinion as a result of such issues. Most candidates have just written that the opinion should be modified with regard to the inventory. Most of the candidates failed to analyze the issue and explain the best course of action. Many candidates have expressed correct views with regard to the law suit although they were unable to assess the potential impact on the financial statements.

Majority have not referred to LKAS 18. The candidates who mentioned LKAS 18 were unable to apply that knowledge to suit the question requirement. It reflects that they lack adequate knowledge of LKAS 18.

Question 06

This question is based on a scenario.

Part (a) It required the assessment of the threat to independence and objectivity faced by the auditor if they accept the assignment. Many have identified the threat of self-review if they undertake a detail system study of the internal controls of the client. Although they have identified the threat they were unable to determine the value, nature, and quality of the threat as the auditor has to form a judgment. Some have identified the issue and given satisfactory answers.

Part (b) It required listing of two safeguards for the threat mentioned in part (a). Most of the candidates have given satisfactory answers.

Part (c) It required the discussion of two weaknesses in the purchasing and inventory process. The average performance was good but there were irrelevant answers such as;

- Production budget should be prepared by the production department
- Purchasing order should be prepared by the purchasing dept.

Part (d) Many have not identified and assessed possible risk areas. They demonstrated poor knowledge in identifying risk areas which require further audit work.

Part (e) Many have written general answers as they were unable to identify the risk areas referred to in part (d), and thus failed to write satisfactory answers for part (e).

Question 07

The examiner expected to test the knowledge of the candidate's on related party transactions and their effect on the financial statements.

- Part (a) The question required demonstration of the importance of identifying related parties and their transactions in preparation and presentation of financial statements. A fair number of candidates has fared well. Some knew the answer but due to poor communication skills have written that the related party transactions are at 'arm's length' instead of writing not at 'arm's length'. There were irrelevant answers such as;
- To avoid related parties getting secret profits.
 - Safeguard entity's assets
 - The management will favor related parties
 - Avoid conflict of interest
- Part (b) The question required the analysis of possible related party transactions for obtaining audit evidence. Majority has identified the related parties but failed to analyze their transactions to enable the auditor to gather audit evidence. There were incomplete answers such as;
- Madapatha is the chairman and he has 40% of shares
 - Madapatha's wife is a director of the company
 - GP and other institutions are related parties
- Part (c) A list of procedures that an auditor should carry out when auditing accounting estimates in order to assess whether the estimates are reasonable was required. This part had been poorly answered. There had been irrelevant answers such as;
- Test objective to use estimates and the technical knowledge to carry out such estimates
 - Compare the estimates with similar industries
 - Review board approval for estimates
 - Compare estimates with prior years
- Part (d) (i) Candidates were required to calculate the decline in value of investments. Many have not calculated the decline in value. Some have calculated on net assets instead of on capital. There were some good answers and this reflects that these candidates were prepared for the exam.
- (ii) The examiner expected an analysis of accounting and auditing issues. The question requirement is to consider impairment indicators. There were poor answers such as;
- The investment cannot be measured on stated capital
 - Related earnings are not considered
 - Mistakes in calculating net assets and investments
- Part (e) (i) Candidates were required to recommend to the management the method available to substantiate the value of investment in ML. Many candidates have written irrelevant answers such as;
- Investments should be properly valued
 - Management has to identify the 'substantiate value' of investment. (this may be unsuccessful attempt to re-phrase the question)

- (ii) Candidates were required to recommend to the audit senior the procedure to be followed in auditing the investment in ML. The question requirement is to determine the value and decide whether a provision is required for impairment. Many have written irrelevant answers such as;
- Check recoverability and market value
 - Check bank accounts to verify value
 - Review budget.

Conclusion

The average performance has been poor. The paper is within the syllabus and 'straight' from the text book. It reflected that most of the candidates have sat for the paper without being prepared.



KB5 – Business Value Creation

June 2016

Examiner's Comments

Question-wise comments

Question 01

General comments

Overall performance of candidates was good.

- (a) Candidates were required to explain the importance of the value chain model.
- (b) Candidates were required to discuss two support activities in relation to the given scenario with a view to improve student enrolment and profits.

Specific comments

- (a) The model will help to understand the activities that add value to customers, activities that add value over rivals, activities that add no value etc. Some students had drawn the value chain diagram and just described the activities without the importance of the model to a business being explained.
- (b) Some stated under HR Management that "Apex" should strengthen HR activities to improve student enrolment and profit without specifying the ways in which improvements could be being done.

Question 02

General comments

Overall performance of candidates was satisfactory.

- (a) This requires analysis of various applications of Information Technology for improving the efficiency of the supply chain process of "Super Mart".

- (b) Part (b) requires candidates to convince the management of the importance of implementing an e-procurement system for Super Mart.

Specific comments

- (a) Internet, Intranet, EDI and RFID are the main applications of IT which the examiner expected the candidates to analyse. Nevertheless, some students came out with systems/ concepts like ERP, bar-code, e-procurement etc. by which supply chain process could be improved, according to them. Most of the students who mentioned the main applications correctly, could not analyse these applications as required by the examiner.
- (b) Most of the students stated cost reduction, reduced inventory levels, wider source of suppliers, quicker ordering etc. as benefits of e-procurement. But they were unable to elaborate the benefits. Some explained as to how inefficiencies and overhead costs could be reduced under e-procurement which earned marks.

Question 03

General comments

Overall performance of candidates was satisfactory.

- (a) Requires candidates to analyse factors to be considered when choosing South Africa as a location to set up a new factory, according to the given scenario.
- (b) Requires candidates to explain two different methods of choosing a new location.

Specific comments

- (a) A few students analyzed correctly the factors like cost, availability of infrastructure facilities, close to key suppliers and customers. Some just mentioned these factors without examining in detail. E.g.: They were unable to reason out that the better location could be South Africa as far as transport cost is concerned.
- (b) Some have correctly put forward different methods i.e. CVP analysis, centre of gravity method and factor rating method. Based on availability of vehicles and price of raw materials & production, a new location could be selected according to some students, who earned no marks.

Question 04

General comments

Overall performance of candidates was very poor.

- (a) Requires candidates to outline four features of a learning Organization.
- (b) Requires candidates to analyse how a learning organisational culture can enhance the performance of "Protect" i.e. the Institute as per the given scenario.

Specific comments

- (a) Only a handful of students outlined features of a learning organization i.e. a learning approach to strategy, participation in policy making, learning culture, accounting system etc. Some did not answer at all. Some just mentioned that learning Organizations involve in innovations, research & development activities etc.

- (b) Only a few could analyze that learning culture would enhance performance of the Organization. Projects could be implemented faster minimizing resistance due to the fact that employees participate in decision making. Some opined that performance could be enhanced by engaging experts, innovative activities etc. which earned little marks.

Question 05

General comments

Overall performance was not satisfactory.

- (a) Requires to explain the meaning of situational approach to leadership.
 (b) Requires to recommend leadership style for each project team given in the scenario using Hersey and Blanchard's Situational Leadership Theory.

Specific comments

- (a) Almost all stated only that situational leadership depends on the work situation. They did not provide further explanations. E.g.: "There is no one right way to lead that will fit all the situations". "Effective leadership depends on the particular situation and leadership style". Some argued incorrectly that situational leader should delegate authority, listen to others etc.
 (b)

		Amount of directive activity	
		Low	High
Amount of Supportive Activity	Low	Delegating (Team A)	Telling
	High	Participative (Team B)	Selling

Only a few correctly identified the appropriate leadership style for each team i.e. Delegating style for Team A and participative style for Team B. Most of the students have reproduced the question as the answer for appropriate leadership styles for Team A & Team B which earned no marks.

Question 06

General comments

Overall performance was satisfactory. This question requires candidates to:

- (a) recognize the stage of a PLC in the given scenario i.e. Riverside Hotel.
 (b) explain 7 Ps with reference to Riverside Hotel.
 (c) recommend at least one modification to each element of marketing mix for the purpose of increasing sales of the hotel.
 (d) explain the benefits to the hotel of having CRM strategy.

Specific comments

- (a) Most of the students recognized the stage of the hotel correctly as "Maturity stage" citing the reasons given in the scenario. i.e. slowdown of the growth rate and generating positive cash flows even though market share and profits have entered the declining stage. Nevertheless a

few identified declining stage incorrectly as the present stage of the hotel citing that market share and profits have faced a declining trend.

- (b) Some did not explain adequately the terms “price”, “processes”, “physical evidence” and gave general meanings. E.g.: “Price is very important to continue the operation”. “Promotion is maintaining customer data-base” etc.
- (c) Some correctly recommended arranging payments by different channels, offering seasonal discounts etc. under “price” as well as designing new advertising campaigns and new PR programs to develop credibility towards the hotel under promotions. Nevertheless some recommended that employees should treat customers well once they come to the hotel rather than special training to employees being proposed to cater to the needs of guests.
- (d) CRM will help to generate positive word of mouth and revisits and in turn boost revenue and occupancy. It will also help to avoid negative comments and preferences of the customers could be taken into consideration to ensure effective decision making according to some students who earned the full marks allocated. Nevertheless, some candidates just mentioned increase in revenue, reduction of cost, increase of market share without giving reasons.

Question 07

General comments

Overall performance was not ‘that’ satisfactory. This question requires candidates to:

- (a) discuss the issues if Sukitha wants to start an on line business division for Denuma, a Sri Lankan bookstore details of which are given in the scenario.
- (b) prepare a SWOT analysis in relation to the online business.
- (c) outline elements to be considered when planning the online business using Mc Kinsey’s 7S Model.

Specific comments

- (a) Value proposition, revenue generation, market size and segmentation, market strategy etc. are some of the issues to be considered, according to some candidates who earned full marks when answers were elaborated. Issue in relation to market strategy in an environment where more people prefer buying from physical stores has been discussed by most of the students stating need for creation of awareness of advantages of on-line business. Nevertheless some identified purchasing behavior and, IT knowledge of customers as issues which earned no marks.
- (b) “Denuma” was engaged in the industry for more than 22 years and Sukitha getting involved in setting up online sales channels are strengths as per most of the students who scored the full marks allocated. Since authors are friends of Sukitha’s father, some students identified it as a strength, which earned no marks. Some identified limited popularity (only 12%) of on line purchasing as a threat which earned no marks.
- (c) A considerable number of candidates had not attempted this part. Of the students who attempted, some have just mentioned elements in the 7S Model without any “outlined”. Some inadequately outlined the, E.g.: Structure is how an entity operates and skills are abilities to achieve targets as per some students who earned a few marks only.