

## KE1 – Financial Accounting & Reporting Fundamentals

March 2016

### Examiner's comments

### Question-wise comments

#### Question 01.

##### Overall performance of the question

10 multiple choice questions were given to test the Student's knowledge on theory and principles of accounting. students were required to choose the most appropriate answer out of four given options.

Except for a handful of candidates, almost all students have attempted this question

Overall performance of the candidates was good. Majority scored more than 60% of the marks allocated to this question. **Reason for good/ bad performance of candidate**

Many students failed to identify the correct answer for questions 1.7 and 1.8. It appears that the student's knowledge on these standards is poor. (Leases and employee benefits).

#### Question 02.

##### Overall performance of the question

This question contained 10 parts, each part addressing different topics and students were required to provide short answers/ calculations to all parts of the question. In the overall paper, this question carried the highest total marks allocation (30 marks) for the 10 parts.

Overall performance on this question was a mixed one. It was observed that majority of the students have understood most parts of the question well. Majority had attempted 6-7 parts of the question. While there were some good quality answers for at least 6 sections, it was also observed that a fair number of candidates have not properly understood the questions on section 2.1 (ii), 2.4, 2.5, 2.9 and 2.10. Out of the sections mentioned, performance on section 2.9 (deferred tax) and 2.10 (financial instruments) was extremely poor. The % of students who had not attempted these two sections of the question was also notably high.

Average marks for the overall question obtained by the students varied between 14-18. Only About 4% - 5% of the students scored over 20 marks out of the total 30 marks. None of the students scored above 25 marks.

### **Reason for good/ bad performance of candidates**

- Lack of adequate knowledge of some of the subject areas- specially deferred tax and financial instruments
- Some of the short answer questions could have been answered easily had the students studied the study pack well. For e.g.: question number 2.5- an almost identical question and answer is in the study pack under topic 4.2.
- It was noted that many students did not have the required understanding of the terms "Parent" and "Subsidiary".
- Students were confused on question 2.6 and provided irrelevant answers. It appeared that majority have not understood this question Less than 15 candidates scored full marks for this section.
- It appears that students study only a few sections of the syllabus. As this question carrying 30 marks addresses 10 separate areas not studying the full syllabus led to unsatisfactory performance of this question.
- Lack of practice in writing short answers is also another reason for poor performance of this question.

### **Question 03**

#### **Overall performance of the question**

Overall performance was a mixed one. Part (a) tested the knowledge on reconciliation of control account balances with the totals of the individual accounts. The students performed well on this section.

However the performance on the second part (Part b) of the question was not satisfactory. There were quite a number who did not complete this part where the question was to test the student's knowledge on reconciling the cash book balances with the bank statement. The structure of the question was not in one to one matching form which is the standard format familiar to the students. It was a good question where the students were required to apply the knowledge on bank reconciliations and arrive at the opening and closing balances in the cash book. Out of the students who attempted this part, only about 35% managed to score marks between 2 – 2.5 out of a possible 5 marks.

Average marks obtained for this question was between 5-6.

This was one of the optional questions under section 2 of the paper and it was noted that about 20% of the students have not attempted this question.

## Reason for good/ bad performance of candidates

Part (a) of the question (on control accounts) was answered well by the majority of the students. However following common mistakes were made by some of the students. Some corrections identified were to be done only in the sub ledger and some others were to be done only in the general ledger control account.

- Some students failed to correctly identify these separately. Entries that should have been adjusted only in the sub ledger was posted to the control account.

Part (b) of the question (bank reconciliation) was not answered well by a majority. Common mistakes made are as follows.

- Writing up the cash book starting from the bank statement balance instead of a reconciliation statement. The information on the value of entries that reconciled with the cash book was not given in the question and hence the students who took this approach could not arrive at the correct cash book balance.
- . Without planning the answer, adjusting the figures on a trial and error basis was observed where students have prepared several "T" accounts.
- Trying to follow a mechanical process which is familiar to them in trying to match one to one entries, but comprehensive information was not available for that.
- Some students did not understand that a credit balance in the bank statement means a favourable balance in the cash book. They have treated the credit balance in the bank statement as an overdraft (negative balance) and hence failed to score the relevant marks for the adjustments. This was a costly mistake where they lost about 3 marks out of the total 5 marks for this question.
- In the question, using the principles of bank reconciliation, the students were required to compute the opening cash book balance (i.e. closing balance as at 30.11.2015) and closing cash book balance (i.e. closing cash book balance as at 31.12.2015). Many students made errors in computing the opening cash book balance.
- When you start from the bank statement balance and compute the cash book balance, there is no need to make adjustments for bank charges separately, as the bank statement balance is after charging that. Some students made the mistake of adjusting the bank charges of Rs 2,500/= again in computing what the cash book balance should have been.

## Question 04.

### Overall performance of the question

The question was on Partnership accounting and was fairly straightforward and easily understandable. Students scored fairly well on this question. This was also one of the optional questions; however almost all students have attempted this question.

Majority scored between 70% and 80% of the marks allocated to this question. However, lack of knowledge on basic principles in accounting for partnerships was noted (summarized under 4.3 below).

Question was well within the syllabus.

## **Reason for good/ bad performance of candidates**

The area where students lost some of the marks are highlighted below.

- Some of the students were confused about the partners' salaries paid and payable. Two different types of mistakes were made by the students in this adjustment.
  - Some students showed in the appropriation account only the unpaid salaries (i.e. 6 months salaries) from the partnership profit; salaries agreed for the full year need to be appropriated prior to distribution of the balance profits among the partners in their profit sharing ratio.
  - Other students made a different error. The appropriation of salaries was correctly done and credited properly in the relevant partner's current account. However, the amount paid during the year was debited to the current account as well. An entry need not be passed in such a manner as the current account balances as at 31.12.2015 in the trial balance was after debiting the salaries paid during the year. Students lost some marks due to these errors as the partners' current account closing balances taken to the balance sheet were incorrect.
- One other common mistake by a considerable number of students was to take the interest on loan under appropriation account instead of in the P & L account.
- In the question it was not separately required to prepare the partners' current accounts. However, the students had to draw up the current account in order to arrive at the final balance to take to the statement of financial position. Some students did not show this working. In the instances where students arrived at an incorrect closing balance, they could not score the marks even for the correct entries even as workings were not available.
- Students were not clear on what entries should go through the appropriation account. Some students showed the drawings as an appropriation, some others showed interest on partner's loan under appropriation account and a few others showed the interest on capital account under the P & L account. It appears that candidates lack proper understanding of the basic principles.

## **Question 05**

### **Overall performance of the question**

In this 10 mark question, the examiner tested the Student's knowledge on preparation of financial statements from incomplete records. Almost all students have attempted this question (This is also one of the optional question)

Almost all students have understood the question well. Answers were of a high standard, and except for a meager handful, others exhibited a very sound knowledge of the subject matter. Overall performance of the candidates was very good. Majority scored 70% or more of the allocated 10 marks. A few candidates scored full marks for this question. Very few candidates scored less than 4 marks.

### **Reason for good/ bad performance of candidates**

- Credit purchases for the year had to be computed by drawing up the trade payable account. This was done correctly by the majority of candidates. However in arriving at the cost of sales the cash purchases figure had to be added (which was to be picked up from the summarized bank account given in the question). Some students have missed out on this and lost some easy marks.

- A fair number of students made mistakes in computing the total depreciation charge for the year.
- Some students mixed up the opening and closing balances of trade receivable and trade payable accounts and therefore arrived at incorrect figures of credit sales and credit purchases.
- Lack of workings cost some of the students' easily obtainable 2 – 3 marks.

## **Question 06**

### **Overall performance of the question**

The question tested the knowledge of students on preparation of financial statements of nonprofit entities. This was a 10 mark question which came under the optional questions category. Majority of the students have selected this as the question to omit. Therefore approximately about 65% - 70% of the candidates have not attempted this question.

The question was an easy one and from the 30% - 35% candidates who attempted the question, performance level was good. Majority scored between 7-8 marks.

### **Reason for good/ bad performance of candidates**

Not very much to comment as very few candidates have attempted. Following common mistakes were seen.

- Incorrect presentation in the Statement of Financial Position- Excess of Income over Expenditure for the year should have been shown as an addition to the brought forward balance of the accumulated fund. Instead some students showed this as a separate item below the building fund.
- Income and Expenditure account - Some students incorrectly recorded the donations received for the construction of pavilion under Income and Expenses account.
- The main income item in a sports club is the membership subscription and that should be recorded as the first line item under income. However it was observed that students do not give attention to the presentation and some have showed membership subscription after other sundry income items such as rent and interest income.

## **Question 07**

### **Overall performance of the question**

Majority of the students had understood the question which required the students to prepare Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Notes to PPE.

This was one of the compulsory questions carrying 20 marks. Except for a handful of candidates, almost all students have attempted this question.

Preparation of financial statements is an integral part of the knowledge component of the students at this level. However it was noted that most of the students faced difficulties in making the necessary adjustments in the financial statements correctly. The students knew how to work out the values (adjustments) but did not know how to adjust it in the correct manner in the financial statements. This resulted in some students losing a considerable portion of marks. (Details given below)

Due to reasons stated above, overall performance level was a mixed one. About 55%- 60% of the students performed satisfactorily and scored above 10 marks. (i.e. 50% of the total marks). Only about 10%- 12% of the students were able to score more than 15 marks out of the allocated 20 marks. It was disappointing to note that there were some very poor performances as well. Approximately 6% of the candidates fared badly and produced very poor answers. They were not able to score more than 5 marks for the question.

### **Reason for good/ bad performance of candidates**

- Students were unable to correctly identify and record the transactions in the correct places. Students showed lack of understanding of the content of OCI. Revaluation gain recorded in other income, Motor vehicle disposal profit shown under OCI, preference dividend shown under OCI.
- Another common error was recording the redeemable cumulative preference shares under equity whereas the substance was to record it as liability.
- Interim dividend paid shown under stated capital column in the statement of Changes in Equity.
- Non adjusting event of Rs 300,000/= was adjusted in the FS as bad debts by many students. Accordingly they ended up with an incorrect balance for bad debts, bad debts provision and the closing balance of trade receivables.
- Some students lost marks due to not having workings showing how the balances have been arrived at. When there were multiple adjustments on one line item, even when the final value is incorrect, students could have scored some marks for any correct adjustment had the workings been given. This opportunity was lost by a considerable number of students.



## KE2 – Management Accounting Information

March 2016

### Examiner's comments

### Question-wise comments

#### General comments 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 comments about candidate's 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 no marks can be awarded to the illegible section.

#### Question 01

Consists of 10 multiple choice question (MCQs) with each MCQ carrying two marks. Candidates' performance was very variable within the average of 8.5 marks out of a total of 20 marks for the question.

#### Q.

- 1.1. 21% of the candidates had indicated the correct answer C. 77% (A), 1% (D), 1% (B)
- 1.2. 33% of the candidates had indicated the correct answer B. 15% (A), 23% (C), 29% (D).
- 1.3. 72% of the candidates had indicated the correct answer B. 3% (A), 23% (C), 1% (D)
- 1.4. 52% of the candidates had indicated the correct answer B. 20% (A), 22% (C), 6% (D).
- 1.5. 27% of the candidates had indicated the correct answer C. 57% (B), 15% (D), 1% (A)
- 1.6. 62% of the candidates had indicated the correct answer A. 7% (B), 28% (C), 5% (D).
- 1.7. 82% of the candidates had indicated the correct answer B. 5% (A), 8% (C), 5% (D).
- 1.8. 50% of the candidates had indicated the correct answer B. 20% (A), 12% (C), 18% (D).

- 1.9. 32% of the candidates had indicated the correct answer B. 23% (A), 23% (C), 22 (D).  
1.10. 50% of the candidates had indicated the correct answer A. 17% (B), 27% (C), 6% (D).

## Question 02

This is a compulsory question consisting of 10 parts, each part carrying 3 marks. The question covered many areas of the syllabus and sought to test the knowledge on basic concepts in various units of the syllabus. Average marks scored by the candidates was 13 out of 30 and it had the second highest average marks for the paper.

### General Comments

Overall (on average) performance was somewhat satisfactory. A handful of candidates (about 4%) had been able to score **more than 20 marks out of 30 marks allocated to question number 02**. It was observed that the majority of the candidates has been able to **score around 15 marks**. Certain parts of the question, for example questions requiring **computations (quantitative sums) were well answered**. However, the performance on the questions requiring **qualitative answers was not satisfactory**. A few candidates (about 10%) scored **less than 5 marks** allocated to the question.

- 2.1 The performance of the candidates **was 1 ½ to 2 marks**. About 40% of the candidates had scored 2 ½ marks whereas about 8% of the candidates had scored the full marks allocated to the questions. Many candidates (about 50%) had marked part (e) as **“true” displaying lack of understanding** about different order levels maintained in inventory management. Overall performance was **on average**.
- 2.2. The question seemed simple and straightforward. However, the performance of the candidates **was not satisfactory**. The average marks scored by the candidates vary from **1 ½ marks to 2 marks**. Majority of the candidates (about 65%) had stated the features of services instead of service costing. Large number of candidates (about 80%) had **missed out the important features of service costing** such as the differences in the time involved in the provision of services and the fact that the use of raw material is very low in service costing etc.
- 2.3 Overall performance of the candidates **was satisfactory**. Average marks scored by the candidates for this part of the question were around **2 marks to 2½ marks**. However, about 40% of the candidates had failed to calculate the **production overhead cost allocated to the job based on labour hours**. About 50% of the candidates who had attempted the question had failed to **multiply production overhead cost per labour hour by the direct labour hour required for the job to arrive at the total production cost for the job**. About 40% of the candidates had **incorrectly calculated the selling and distribution cost** though the computation seemed simple (i.e. 50% of the cost of production)
- 2.4 The performance of the candidates for this part of the question **was satisfactory**. Majority of the candidates had scored good marks and the **average performance ranged from 2 marks to 2 ½**. Charge on the **usages of machinery was computed incorrectly** by many candidates (about 40%). These candidates had not identified the fact that the **cost should be charged over the period of the effective working life of the machine (i.e. 10,000 hours)**. A good number of candidates (about 35% of above who had failed to identify the effective working life) had also failed to **eliminate the scrap value in arriving at the net carrying value of the asset for depreciation**. Though the question had very simply given the details required to compute the **charge on power consumed**, the candidates had failed to **extract this information into the computation (i.e. 10 x Rs. 2.5)**

- 2.5 Performance of the candidates on this question was **very poor**. The average marks scored by the candidates varied from **1 mark to 1 ½ marks**. About 30% of the candidates who had attempted this part **appeared to have a poor knowledge in ABC costing** and some candidates (about 40%) had failed to understand the **main features of ABC costing which is useful in the discussion**. Many candidates (50%) had given general answers such as **“the use of ABC costing is more effective than charging fixed cost to output”** and about 3 candidates had discussed repeatedly these views at great **length**. The main shortcomings noted by the examiners were the candidates’ **failure to identify the basic features** (i.e. activity based costing) and lack of understanding of the **requirement of the question**. A very few candidates had **distinguished between the ABC costing and standard costing**. All candidates had not identified the fact that **fixed production cost is considered fixed in the short run and some components might vary based on cost drivers rather than the output**. Also, a large number of candidates (about 60%) had failed to identify the fact that **apportionment of the cost is based on the utilization of cost drivers in the process and not on the ultimate output** which is a more prudent and rational way of cost accounting.
- 2.6 Performance of the candidates on this part of the question was **very good**. The average performance varied **from 2 ½ marks to 3 marks**. However, some candidates (about 30%) had failed to apply **budgeted utilization for product P on cost per each driver computed based on the budgeted cost driver quantity (i.e. budgeted utilization)**. About 2 -4 candidates tried to calculate the standard fixed cost per unit of product P by an equation.
- 2.7 Average marks scored for this part of the question varied from **¾ of a mark to 1 ½ marks**. Most of the candidates (about 60%) had mixed up the **nature of the expenses rather than understanding the use of (when it is used) incremental budgeting and zero based budgeting**. Some candidates (about 40%) had just mentioned the **technique without explaining the reasons** for such and thus failed to secure full marks.

The major weaknesses identified in the answers include the **failure to mention that next year rent is usually based on the last year rent plus an increment** thus incremental budgeting is more appropriate for rent expenses. On the other hand, a large number of students (about 50% who had attempted) had **failed to identify the fact that training and development for the next year will probably not depend on the last year spending** but be based on the **training needs of the organization** which is a largely dependent upon the **success of the training programs and the personnel**. Thus, it is **discretionary expense**. These facts have been missed out by many candidates (about 50%).

- 2.8 The performance ranged **from 1 mark to 2 marks**. A number of candidates (about 60%) had failed to identify the **correct quarters in which the first two quarters in 2016 fall**. This shortcoming was observed in many answer scripts. Majority of the candidates had **taken 1 and 2 as the first two quarters** respectively displaying poor reading and comprehension of the requirements of the question. In forecasting the quarterly sales units, many **candidates (50%) had taken 70 and the 120 as the seasonality and multiplied there by the coefficient applicable to time period (independent variable)**.

A good number of candidates (30%) had taken **the seasonal variation index values** correctly into the forecast and scored the full marks allocated to the question. It was observed that a few candidates (20%) had been able to compute the forecast correctly identifying correct quarters but **failed to proceed with rest incorporating seasonal variation index** to arrive at the seasonality adjusted forecasts.

- 2.9 Performance of this part of the question was **very satisfactory**. Except for a few candidates who had demonstrated **very poor knowledge in identifying the correct cash receipt in the acquiring month**, overall performance was well above the average performance on other parts and **ranged from 2 ½ marks to 3 marks**. A very few candidates (30%) had not been able to **identify the cash receipts from debtors (or credit sales) correctly**. About 80% of the candidates who had attempted this part of the question had been able to score full marks allocated to the computation of cash receipts from sales on cash basis.
- 2.10 Again, the performance of the candidates **was exceptionally good**. Most of the candidates (80%) had scored the **3 marks** allocated to this part of the question. However, some **candidates (20%) candidates had taken the difference between standard cost and actual cost and stated the difference as variances for each cost element**. Out of the candidates who had failed to earn good marks as above, majority (about 40%) had failed to calculate the flexed budget correctly for each cost element by multiplying actual units by standard cost.

### Question 03

#### General comments

A two parts question testing the candidates' knowledge on contribution/high low method. Performance was average with 40% of candidates scoring 5 marks and over.

Part (a) Overall poorly answered. Many were content to describe information given in the question without answering what is required from them. Some had given irrelevant answers by trying to explain what contribution and profit are, without focusing on explaining why management decisions in the short-run are better supported by contribution per unit rather than profit per unit.

Part (b) Overall satisfactorily answered by the majority of the candidates. However some had omitted adjusting step-up costs and had difficulty in selecting the high, low points when calculating the variable and fixed costs.

### Question 04

Performance of the candidates was poor with the question having the second lowest average marks. 45% of the candidates have not attempted the question. This may be due to them not sufficiently covering probability/expected values area of the syllabus in their studies.

Part (a) Many could not calculate the joint probability. Some had drawn decision tree and explained the probabilities (conditional) relevant to each branch. Some could not identify the 4 possible outcomes.

Part (b) Many were content to work out profit under each scenario, but could not relate them to the expected profit.

Parts (c) & (d) Candidates who had not worked out the joint probabilities failed to correctly answer these parts. Some had tried to attempt part (d) of the question by calculating the break-even level under each of the four scenarios but could not determine the probability of achieving at least the break-even level.

## Question 05

### General comments

The question had the highest average marks for the paper with majority of the candidates scoring 5 marks or more.

It is a three parts question testing the candidates' understanding of the standard costing section in the syllabus. Part (a) requires the candidates to explain the purpose of standard costing, part (b), to explain ideal and attainable standards and part (c) to discuss difficulties in applying standard costing in a service organization.

### Specific comments

Part (a) Although well answered by the majority of the candidates, there were some who had given irrelevant answers such as identifying the variances that could be determined under a standard costing system.

Part (b) Some could not explain all the main points relevant to ideal standard. (i.e.) optimal use of resources, without wastage, no idle time, no break downs, and also failed to state that such a standard can demotivate staff.

When explaining attainable standard, many missed out key words such as efficient operations and allowance for wastage.

Part (c) Some candidates showed poor knowledge when discussing the difficulties in applying standard costing to a service organization. They failed to comment on the absence of having respective operations, difficulty in establishing measurable cost units, labour constituting a significant element of the total cost which differs from one service order to another.

## Question 06

### General comments

The performance of the candidates was very poor indeed and the question had the lowest average mark for the paper. 36% of the candidates failed to answer the question and out of the balance who had attempted the question only a handful managed to score more than 5 marks with the majority of the candidates scoring only the marks allocated to part (a) of the question. It is apparent candidates have not worked out this type of question during their studies.

**Parts (b), (c), (d) (e)** Majority of the candidates had not attempted these parts or answered in correctly. Candidates seem to be unfamiliar with the terms "effective rate of interest", "amortization schedule", "reducing balance basis". Candidates were unaware that parts (b) and (d) could be worked out using discount tables. Many had attempted to use formulae in working out these parts and have applied incorrect or irrelevant formulae. In drawing up the amortisation schedule [part (c)] some have ignored, either the interest column or principal column and therefore lost marks.

## Question 07

### General comments

The answers to the question varied. Most of the candidates had performed poorly in part (a), whereas the performance of many in parts (b) and (c) were good. More than half the candidates failed to score 50% of the marks allocated to the question, mainly due to their poor performance in part (a).

The question consisted of three parts and tested the candidates' knowledge of calculating the mark up in a scenario including stock losses and discounts (when the required margin on sales revenue was given), selecting the better option after considering price and quantity variations, revenue, cost and profit functions and the use of differential calculus in maximisation decisions and the functions of marginal revenue and marginal cost.

Part (a) (i) of the question required the candidates to calculate the mark up that should be added to the purchase price in determining the tag price, in a scenario including stock losses and discounts, when the required margin on sales revenue was given. Part (a) (ii) required the candidates to interpret the answer derived in part (a) (i), applying it to a stock purchase of Rs. 100,000 to derive the gross margin required.

In part (b), candidates were asked to explain which type of fuel is more beneficial, considering two types of fuel with variations in prices and efficiency levels.

Part (c) (i) required the candidates to calculate the floor area which maximises revenue and part (c) (ii) required the calculation of revenue, cost and net revenue at the point that was determined in part (c) (i). The candidates were required to identify the functions of marginal revenue, marginal cost of floor space and net revenue in part (c) (iii). Part (c) (iv) required the candidates to calculate the profit maximising floor area. Part (c) of the question was the best answered.

### Specific comments

Candidates' performance in part (a) was poor. In part (a) (i), many candidates hadn't calculated the discounted sales correctly. Some candidates had thought that the discounted items were to be sold at 25% of the tag price, instead of 75% of the tag price. Some candidates considered discount sales to be 20% of the stock remaining after the losses, instead of 20% of the stock purchased and considered the sales at tag price to be 76% of the stock purchased. Some of the candidates, after calculating the discount and normal sales correctly hadn't proceeded further, failing to relate it to the mark up to obtain the sales revenue and thereafter, derive a formula to find the mark up necessary to earn a 40% margin on sales revenue. Many of the answers to part (a) displayed a lack of analytical thinking. Further, part (a) wasn't attempted by quite a few candidates.

In part (b), some candidates had taken the cost of 'normal' fuel as Rs. 75 per liter in their calculations, after taking the cost of 'super' fuel as Rs. 100 per liter, when the question stated that 'super' fuel is 25% more expensive than 'normal' fuel. Similarly, some candidates had taken the quantity of 'normal' fuel required as 120 litres in their calculations, after taking the 'super' fuel requirement as 100 litres, when the question stated that the 'super' fuel needed is 20% less than the quantum of 'normal' fuel. Some candidates after recognising that the cost of using both types of fuel was the same from their calculations and acknowledging that both are equally beneficial, recommended 'super fuel' due to its superior quality, when the question required the candidates to consider only the differences in price and quantity. Further, part (b) wasn't attempted by some candidates.

Part (c) of the question was the best answered. However, some candidates had calculated the profit maximising floor area, which was required as the answer for part c (iv), as the answer for part c (i) and the revenue maximizing floor area requested in part c (i) for part c (iv). Some others had calculated the revenue maximizing floor area, the required answer for part c (i), for both parts c (i) and c (iv).

It was noted that some candidates had left this question to be answered last and not attempted some of the parts. It is recommended not to leave such a 20 mark question to be answered last.

## **KE3 – Fundamentals of Taxation and Law**

**March 2016**

**Examiner's comments**

### **Question-wise comments**

#### **Question 01**

This is a five part multiple choice question requiring candidates to identify the most appropriate answer out of four (04) given options.

The question tested candidate's knowledge in the following areas of taxation:

Part 1.1. Interpretation (section 217) meaning of the term "person".

Part 1.2 and part 1.5 – Computational ability – Income tax and Nation Building Tax.

Part 1.3 – Tax administration – due date for filing income tax return.

Part 1.4 – Tax administration – essentials of a valid appeal.

#### **General comments**

Overall performance in this question was fairly satisfactory. About 10% to 15% of the candidates scored 100% of the allocated marks while approximately 50% of the candidates scored between 60% to 80% of the allocated marks.

#### **Specific comments**

Where mistakes were made, those generally related to:-

- Lack of subject knowledge:-

- ✓ Part 1.3. Majority of the candidates chose option 'A' as the due date for submitting an Income Tax Return. This is in fact the due date for the payment of final instalment of income tax.
- ✓ Part 1.4. Most of the candidates chose option 'D' as the answer. However, this option is a requirement for a valid appeal.
- ✓ Part 1.5. Most candidates chose option 'B' as the answer. These candidates did not know that only 50% of the liable turnover of a wholesale or retail trade is chargeable to Nation Building Tax.

## **Question 02**

In this five part question the candidates were required to:-

- 2.1. Explain the term 'person' as per the interpretation given in section 217 of the Inland Revenue Act No. 10 of 2006.
- 2.2. Calculate the total statutory income of a company having income from the following sources:-
  - i) trade
  - ii) interest
  - iii) dividends
- 2.3. Calculate the gross tax payable by a company which is in the business of exporting shoes. The company has a taxable income and also distributed dividends during the relevant year of assessment.
- 2.4. To explain how an individual can make a valid claim for refund of income tax paid in excess.
- 2.5. To calculate the Value Added Tax (VAT) payable by a garment manufacturer for a given quarter.

### **General comment**

Overall performance in this question was quite unsatisfactory. Only about 30% of the candidates scored 50% or more of the allocated marks while the majority scored between 30% to 50% of the allocated marks.

### **Specific comment**

- 2.1. While there were some very good answers to this question on the interpretation section, majority of the candidates referred to the meaning of residence and non-residence in relation to individuals and companies. A few even mentioned 'person includes a child". Most students, failed to mention "any government".
- 2.2. Majority of the candidates displayed sound knowledge of the concept "total statutory income". It was surprising that a good number of students excluded interest income from the total statutory income stating that since withholding tax (WHT) has been deducted it does not form part of the total statutory income. This is true in the case of an individual but not for a company. A few candidates correctly excluded dividend income but failed to mention the reason for the exclusion. Students should display their knowledge for the examiner to award marks.
- 2.3. Most candidates made a poor attempt at this question due to poor subject knowledge of taxation of a company undermentioned examples are noteworthy.
  1. Adding taxable income and distributed dividend and applying progressive rate of tax to resulting figure.

2. Adding or deducting distributed dividend to or from taxable income and applying a single tax rate to the resulting figure.
  3. Claiming tax-free allowance (Rs. 500,000)
- 2.4. Only a very few did well in this part of the question. Majority of the candidates mentioned that the refund can be carried forward to be set off against future income tax liability. Some candidates mentioned the requirements for a valid appeal!
- 2.5. Most candidates made a good attempt at this VAT question. However the following shortcomings are noteworthy.
1. A few students have not updated with amendments to VAT rates.
  2. Some candidates deducted VAT input from taxable supplies to calculate the VAT payable.
  3. Some candidates charged VAT on input VAT before deducting from output VAT. This is a clear instance of poor subject knowledge.

### Question 03

The question required candidates to :-

- (i) Calculate the gross income tax payable by a resident individual who is also a professional for the purpose of the Inland Revenue Act. The question included calculation of the statutory income from the following sources.
- (a) Employment. This included calculation of:
    - vehicle benefit
    - bonus
    - second employment income
  - (b) Property. This included calculation of:
    - income from letting a house on rent.
    - income from owner occupied house (Net Annual Value)
  - (c) Trade. This included an adjustment to profits.
  - (d) Dividends
  - (e) Profit on sale of company shares.

The question also included identification of items deductible under section 32 and qualifying payments relief under section 34.

- (ii) Identify tax credits
- (iii) Compute balance tax payable/refund due.

### General comments

Majority of the students made a good attempt at the question and scored over 80% of the allocated marks. There were some excellent answers scoring over 80% of the allocated marks. Unlike in the previous exam there were a noticeable number of candidates scoring full marks in this question. Generally candidates displayed excellent skills in the presentation, and identification of the statutory contents of an income tax computation of a resident individual. They demonstrated sound subject knowledge in:-

- Identifying the benefits and receipts taxable under employment income.
- Identifying the statutory income from different sources.

- Identifying allowable/disallowable expenses and charges under S.25 and S.26 of the Inland Revenue Act.
- Identifying deductions under S.32.
- Identifying qualifying payments relief under S.34.
- Applying progressive tax rates.
- Identifying tax credits.

Where mistakes were made, those generally related to:-

### **Employment income**

- Lack of subject knowledge :-
  - ✓ A good number of candidates mentioned that the income from second employment (director's fee) is not liable to further taxation since withholding tax has been paid.
  - ✓ Employment allowance – a significant number of candidates were not aware that this is a qualifying payment under section 34 with effect from year of assessment 2013/14.
- Not displaying knowledge :-
  - ✓ A good number of students merely mentioned that the vehicle allowance was exempt or not taxable without mentioning the limit to exemption.

### **Income from property**

- Improper reading of the question.
  - ✓ Rent income. The house was rented out only for eight (08) months. A good number of candidates calculated rent income for twelve (12) months and rates paid was not apportioned to the occupied period. Consequently, comparison of net rent was made against net annual value for the full year. Considerable marks was lost due to this oversight.
  - ✓ Net Annual Value. Only a very few candidates identified that there are two houses to be considered. Most students ignored the fact that the owner was the occupier of the second house for four months for the purposes of the Inland Revenue Act.

### **Income from Trade**

- Commencing the computation of adjusted trade profit from the turnover figure.
- Lack of subject knowledge
  - ✓ VAT included in rent expense most students treated this as a disallowable expense.
  - ✓ Salary paid to wife – a good number of students treated this as a disallowable expense.

### **Qualifying payments**

- Not updating the knowledge with recent amendments to the Inland Revenue Act:
  - ✓ Employment allowance – this is a qualifying payment relief with effect from year of assessment 2013/14. Some candidates claimed this as a deduction from employment income.
  - ✓ Capital repayment of a housing loan by a professional – only a very few candidates claimed this relief which is available only from the year of assessment 2014/15. Some candidates claimed this as a deduction from employment income.

- ✓ Capital repayment of a housing loan by a professional – only a very few candidates claimed this relief which is available only from the year of assessment 2014/15.
- Not displaying knowledge.  
Almost all candidates knew that life insurance premium and donation to an approved charity are entitled to qualifying relief. However, majority of the candidates failed to mention the limits to the claim.

### **Calculation of income tax liability**

Only a very few candidates knew that the maximum rate (applicable to official involvement of an employee who is a professional is 16%.

### **Tax Credit**

Surprisingly, few candidates did not know that payments like PAYE, self-assessment tax are advance payment of income tax. Such candidates claimed such payment as deductions from statutory income or as qualifying payments.

### **Question 04**

Performance of this easy question (multiple choice) is satisfactory and a large number scored 100% marks i.e. the total of 10 marks. Further a very high percentage had scored between 6 to 8 marks whilst a low percentage had scored 4 marks or less and only a handful of candidates had scored zero marks or not attempted it. This is mainly because this is an easy multiple choice question where an average candidate with a general knowledge of the subject can guess the correct answer by going through the alternative answers given under each part of the question and they can even try by taking a chance.

However there was a minor percentage who were not well prepared for the examination and did not have the average knowledge but had sat for the examination for the sake of sitting for it without any aim or hope and had scored 2 marks or no marks or not attempted even this easy question. They were not competent even to guess the most appropriate statement out of the given 4 under each part of the question. Some candidates had furnished incorrect answers as they were not sure of the correct answer.

What is clear is that those few candidates do not even have the average knowledge expected from an Executive Level candidate on the subject area tested. It is obvious that any average candidate with some general knowledge at this Executive Level can definitely score a reasonable percentage of marks on these types of questions provided they have reached to that level. But when their knowledge is below the average and they do not have even the basic knowledge on the subject area it is obvious that they are not capable of scoring marks or not even of attempting the question. So those candidates must take some interest and get ready before appearing for the examination.

### **Question 05**

Only a very few had scored some reasonable marks on this question which has covered 5 different subject areas. A few of them had earned some marks on certain parts of the question like 5.1, 5.2 or 5.5 and rarely there was anyone who had earned some reasonable marks for the balance 2 parts indicating that only a handful of candidates have the knowledge expected from Executive Level candidates on the subject areas tested by the question.

- 5.1. Only a few who had scored a fair percentage of marks had correctly identified that in civil cases the person who initiates legal action against someone is called the “plaintiff” and the person against whom the legal action is initiated is called the defendant. Also some of them were familiar with the basis on which a civil case is to be proved in a Court of Law and in their answers they had stated that the plaintiff has the burden of proving the case (civil) on the basis of balance of probability and some had even earned full marks for the part.

But the majority had failed to furnish some acceptable answers as they were not well prepared for the examination and failed to understand the question properly or the standard of their knowledge on the subject areas is below the expected average. Under the circumstances numerous irrelevant/incorrect answers had been furnished including the following;

- i. The parties in a civil case are:-
  - (a) An individual who has been brought to the court to compensate an innocent party for e.g. breach of contract.
  - (b) Under the civil cases a persons who have rights and obligations on people and remedies are available to them.
  - (c) The party or individual who has been referred from district courts.
- ii.
  - (a) The basis on which a civil case has to be proved in a court of law is that the contract should be in writing.
  - (b) The contract should have been a commercial contract and not a domestic one.
  - (c) There should be evidence that the two parties have actively participated in it.
  - (d) Under Civil Law there are rights and obligations to any affected party in order to go to the district court. First of all the innocent party needs to file a case against the other party in a court of appeal. Then this case will be taken to district courts. The innocent party needs to prove how he/she was cheated or as to how his/her rights were misused by the relevant party through an Attorney at Law or by a legally authorised person. If the innocent party is not satisfied with the decision of the district court then the innocent party can appeal to the High Court.
  - (e) Roman Dutch Law is the Common Law used in civil cases.
  - (f) File a case and give the proper evidence and submit to the courts and so on and had wasted their time.

- 5.2. Here again there were very few candidates who were conversant with the provisions of the prescription ordinance No. 22 of 1871 and had furnished satisfactory answers for this part. In dealing with prescriptive period available for an aggrieved party in relation to breach of a written agreement they had explained that the ordinance provides a time frame of 6 years from the date of breaching the agreement and within which the aggrieved party can initiate legal action and if the party does not take action during the prescriptive period then there will be no further recourses in the eyes of the law. The candidates who have focused their answers in those directions deserved a fair percentage of marks as they had displayed satisfactory knowledge in the subject area.

But the majority was not conversant with the provisions of the ordinance and had wasted time to furnish various irrelevant/incorrect answers such as;

- (a) The aggrieved party should wait until the prescriptive period is over and thereafter he can sue the party who has breached the contract.
- (b) He can claim damages from the party who has violated the agreement during the prescriptive period and appeal to the district court if he is not satisfied with the decision given by the first court.
- (c) Also he can directly claim relief from the court without informing the party who is liable to make relevant payment to him within a specific period of time and so on.

5.3. Only a handful of candidates have properly understood the question and were competent to furnish satisfactory answers for part 5.3 of the question. Those few had dealt with the following as the main defences available to a defendant in relation to the offence of negligence for which they have earned good marks.

- (a) Contributory negligence.
- (b) Voluntary assumption of risk.
- (c) Inevitable accident and
- (d) Illegality of the act.

Very high percentage of candidates were not familiar with these defences and had furnished completely irrelevant/incorrect answers and had dealt with some areas/points like;

- (a) Affirm the contract/rescind the contract at any time as he wishes.
- (b) Claim damages for his suffering due to negligence of the other party.
- (c) Go for an injunction from the court or get the contract revalidated by the court.
- (d) and so on.

5.4. A minor percentage of candidates had furnished some satisfactory answers for this part (5.4) of the question which deserved reasonable marks. In their answers they had included the following main types of LCs disclosing their knowledge in the subject area.

- (a) revocable and unconfirmed LC
- (b) irrevocable and unconfirmed LC.
- (c) irrevocable and confirmed LC and
- (d) transferable letter of credit.

But the majority was not familiar with the main type of LCs and had stated names of various documents in trying to gain some marks. Some others had given names of shipping documents or names of some other documents clearly indicating their poor knowledge in the subject area. Some had given following documents as Import LCs/Export LCs.

- (a) Open LCs/closed LCs/Clean LCs/Pure LCs/Conditional LCs
- (b) Bill of Lading/Bill of Exchange
- (c) General LCs/Specific LCs/Restrictive LCs/Simple letter of credit.
- (d) Unrecoverable and predictable LCs/Recoverable LCs and so on and had wasted their time.

5.5. A minor percentage has some idea on remedies available to a buyer against a seller who has breached the contract for the sale of goods and had furnished some satisfactory answers to earn reasonable marks. They had explained the following as remedies available to a buyer against a seller for breaching the contract for sale.

- To maintain actions
- (a) for damages for non-delivery of goods when the seller has failed to deliver the goods.

- (b) for recovery of the price of the goods he has already paid to the seller in the event the seller delivered the goods to him.
- (c) for specific performance of the contract of the sale of goods.
- (d) against the seller for damages for breach of a warranty in the contract of sale.
- (e) against the seller for damages for the breach of a condition in the contract of sale.

But the majority does not have the expected knowledge or has not understood the question properly and had furnished some irrelevant answers such as;

- (a) Some general statements like “can sue the seller/can claim damages”.
- (b) To retain the price to be paid if the goods have not been delivered yet.
- (c) Rescind the contract/terminate the contract/refuse further performance on it.
- (d) Get a guarantee from consumer affairs authority.
- (e) and so on and had wasted their time.

### Question 06

- (a) A good no. of candidates were competent to analyse the question correctly as they had understood that the given scenario falls within the scope of contract made under mistake. Also they have correctly identified that both parties have made a mutual mistake in identifying the subject matter of the contract. As a result no contract between Pravin and Markar has been formed. Under the circumstances the contract entered into between the two parties becomes null and void in the eyes of the law. Further they were familiar with the relevant case law *Raffles vs. Wickelhouse* which too has similar features where it had been decided that the two parties entering into the contract had made a mutual mistake in identifying the subject matter of the contract. Candidates who had focused their answers in those directions have earned a fair percentage of marks as they had displayed their knowledge in the subject areas tested by the question.

But a higher percentage of candidates were not competent to analyse the question on those correct lines or they did not have the expected standard of knowledge on the subject area and had focused their answers in various incorrect/irrelevant directions and had dealt with various areas which are not relevant to question such as;

- (a) There are 3 types of mistakes namely;
  - (i) Common mistake made by both parties.
  - (ii) Mutual mistake. Both parties make mistakes but each party makes different mistakes in identifying the subject matter and
  - (iii) Uni-lateral mistake. Only one party has made the mistake in identifying the subject matter and the other party is not aware of that mistake.  
Due to these mistakes the contract become void or voidable.
- (b) The following elements should be there for a contract to be a valid contract. Agreement/consideration/intention/consent/capacity/legality etc.

- (c) There are some requirements for a contract to be valid contract. They are :
  - (i) There should be valid offer and valid acceptance.
  - (ii) Contractual capacity of the parties.
  - (iii) Intention to create legal agreement.
  - (iv) Genuine consent of the parties i.e. before entering into contract the parties should have real consent for the contract.
  - (v) But there are certain instances in where consent goes against genuine consent i.e. due to mistake, misrepresentation, undue influence, threat and so on there the consent is not genuine.

It is clear they had wasted time as they are not familiar with the subject area tested.

- (b) There were candidates who had understood the question correctly and had furnished some satisfactory answers to the question. They have realised correctly that Pravin has entered into the contract under the genuinely mistaken belief that he is entering into a contract of totally different nature. Since Pravin was not negligent in making the endorsement on the bill the contract is not binding on him and the contract is void. Therefore he is not liable for the endorsement he made on the bill of exchange. The candidates were also familiar with the relevant case law i.e. Foster vs. Mackinnon which they had quoted in supporting their answers. The answers based on those lines deserved good marks for this simple question as they had displayed satisfactory knowledge on the area tested.

A similar number of candidates had failed to understand the question correctly or they did not have a satisfactory knowledge of this area and had furnished some answers explaining various irrelevant areas or facts such as and had wasted their time.

- (a) In law if a person signs a document without reading it he cannot repudiate it, and if a person signs a document without reading it but signs it under eye blindness, and the contents of which not match with the original contents of the document he was to sign then he is not liable for his signature.
- (b) If a person has the intention to refuse his liability on a document he has signed he should prove that his signature was obtained fraudulently and his identity has been mistaken by that party who induced him to sign it.
- (c) When entering into a contract both parties to it should be thoroughly aware of the terms and conditions of the contract. When someone is required to sign a document whether he has read it or not he is bound by terms and conditions of that contract. However there are exceptions such as if the party has weak eyesight or if the document is written in an unknown language, then he can 'escape and so on.

### Question 07

- (a) Fair percentage of candidates were familiar with provisions of Sale of Goods Ordinance applicable to sale by auction and had explained the following.
  - (i) unless the seller has given prior notice that he too has a right to bid for his own item which was put under auction he cannot bid for his own goods.
  - (ii) in the given scenario it appears that no evidence is available for giving prior notice of his intention to bid for his land put up for auction.
  - (iii) under the given circumstances the objections raised by Channa and David are valid and Kamal will be prevented from making bids for his own land at the auction.

- (iv) however if there is any evidence to prove that Kamal had given prior notice of his intention to bid for his own land at the auction then the objections of the other 2 persons are not valid and Kamal too can make bid for the land.

Candidates who were capable of presenting their answers on these lines deserved a higher percentage of marks as they have satisfactory knowledge in the subject area. But the majority had failed to present their answers in the said direction and had dealt with various other areas which are not relevant to the question. some irrelevant answers were;

- (a) according to Sale of Goods Ordinance No. 11 of 1896 given situation is considered an auction of own land.
- (b) in an auction the offer or may be called the bidder and the acceptance will be at the fall of the hammer. Just turning up that does not indicate acceptance. Any party can object before the hammer falls.
- (c) Law relating to auctions indicates that selling a property in an open space by disclosing the price publicly.
- (d) and so on and had wasted their time.
- (b) Candidates were expected to explain the requirements that should be fulfilled to be “a holder in due course” of a bill of exchange (cheque). A minor percentage had furnished some satisfactory answers as they have the expected knowledge on the subject area.

Some had stated that a holder who has taken a bill complete and regular on the face of it, before it was due and without noticing that it had been previously dishonoured (if any) and in good faith and for fair value and without notice at the time that the bill was not with any defect in the title of the person who negotiated it has a good title. Further they have dealt with the following.

- The cheque given to Ruwani seemed to be complete and regular on the face of it.
- There was no indication that it had been previously dishonoured.
- Ruwani deposited the cheque into her bank account before its validity expired.
- Ruwani was not aware of any defect in the title of Samanthi to the cheque before it was given to her and so on.

Candidates who had focused their answers on those lines had earned good marks as they have some satisfactory knowledge in the subject area tested. some irrelevant answers were such as;

- (a) The cheque granted by Samanthi should be an order cheque. The cheque should be a crossed not negotiable. In this case Ruwani got the cheque without any crossing as not negotiable. If there is a crossing on it, it will be prevented being a holder in due course.
- (b) The holder of the bill can sue in his/her own name. (No notice of assessment)
- (c) Some others had defined and explained as to what Bills of Exchange are and many others had not attempted this optional question.

### Question 08

- (a) Very easy question in law of agency which can be even answered with the general knowledge of an accountancy candidate. Candidates were expect to discuss whether an agency of necessity has been created under the given scenario. Some candidates were conversant with the requirement for creating an agency by necessity had explained whether those

requirements have been fulfilled to create an agency by necessity in the given case and had dealt with following points in their answers.

Requirements for creating an agency by necessity are:-

- (i) It must be impossible to get instructions from the principal.
- (ii) There must be an actual and direct commercial necessity for creating an agency.
- (iii) The agent must act in good faith in the interest of all the parties

In the case given in the question whilst the last 2 requirements have been satisfied the first one has not been complied with by the transport company as Herman (principal) had indicated his contact telephone No. to the company. Therefore no agency by necessity has been created and the transport company is liable to pay damages to Herman for the loss he sustained. Also they had quoted the relevant case law i.e. Springer vs G.W Ry. Candidates who were capable to present their answers in those directions were deserved good marks as they have satisfactory knowledge in subject areas tested by the question.

Some irrelevant answers were:

- (a) An agency can be created by express agreement by implied agreement or by operation of law.
  - (b) In the given scenario the private transport company has breached its duty by not performing the duties for which it has been appointed.
  - (c) The agency relationship exists when the agent agrees to enter into a contract with 3<sup>rd</sup> parties on behalf of the principal for a consideration called commission. There are some duties of principal towards the agent and vice versa.
- (b) Simple question in dissolution of a partnership without a court order. A fair percentage had displayed their satisfactory knowledge on the subject area and had furnished their answers covering the following points.

A partnership can be dissolved without obtaining a court order under the following circumstances.

- (a) On expiration of term for which partnership was formed subject to the partnership agreement, i.e. the two partners Nimal and Nimalee can dissolve the partnership when any of the following take place.
  - (i) If the partnership has been entered into for a fixed term on expiration of that term.
  - (ii) If it was formed for a single adventure/business by completing such adventure/business.
  - (iii) If it has been entered into for an indefinite time by any partner giving notice of dissolution to other partners.
- (b) If one partner suffers his/her share to be charged for his separate debts, then the others may dissolve it.
- (c) If the business of the partnership becomes unlawful then the partnership has to be dissolved since it is illegal to carry on an unlawful business.

Candidates who were capable of focusing their answers on these lines had furnished some satisfactory answers which deserved a fair percentage of marks as they have an acceptable standard of knowledge on the subject area.

However a similar percentage or higher percentage of candidates did not have the expected knowledge and had furnished some answers based on various irrelevant/incorrect matters and had dealt with areas/facts such as;

- (a) If the partnership is unable to continue because of financial issues.
- (b) If one of the partners wishes to leave the partnership/if any of the partners acts inappropriately or breaches the agreement.
- (c) When the partnership agreement needs to be changed by both partners.
- (d) When there is a Tsunami, flood or any other national disaster/when there is frustration and so on.

### Question 09

(a) A general question on fire insurance and candidates were expected to discuss the instances where a fire policy holder can claim damages on items insured even when the fire took place due to ignorance of the insured. This position has been tested in a decided case Harris vs Holland. Handful of candidates were competent to furnish satisfactory answers as they are familiar with the subject area and the case law. Also they had identified that Kanchana has not deliberately set fire with intention of destroying her jewellery and claiming damages from the insurance company. They knew even though the loss was caused by a fire that took place due to negligence of the insured that type of loss is covered under the policy and damages can be claimed under the insurance from insuree. Tintan Insurance Company (Pvt) Ltd since it is liable to pay damages. Also many had quoted the said case law i.e. Harris vs. Holland displaying their knowledge in the subject area and earned reasonable marks. But the majority was not capable of furnishing some satisfactory answers based on those lines and had furnished various irrelevant answers as they do not have the expected knowledge or are not prepared for the examination. In their answers they had dealt with some areas like;

- (a) In an insurance policy there should be elements to claim damages i.e. insurable interest, utmost good faith, proximate cause, subrogation contribution and indemnity. Proximate cause is the nearest cause for the damage caused to the property. If proximate cause is not insured under the policy then no damages will be paid. Any fraudulent activity carried out in order to claim damages will result in no claim being paid and negligence will also result in non-payment of damages.

In the given case the jewellery got damaged due to a fire which is at the insured's risk. But jewellery got damaged due to the negligence of Kanchana and not due to a fire caused naturally. Therefore Kanchana cannot claim any damages from the insurance company.

- (b) The fire which damaged the jewellery is not a natural fire, but it is a deliberately caused fire. The jewellery box was burned due to her negligence or specifically caused fire and it was her fault. So she cannot claim damages from the insurance company. But if she had specifically mentioned at the time of agreement the insurance company might let her claim the damages. Since this is not a natural fire and she initiated the fire herself even though it was not done intentionally to burn the jewellery it is difficult for her to claim damages. So Kanchana cannot recover damages from the insurance company.

- (c) and so on and wasted time.
- (b) Easy question on gratuity payment which can even be answered with the general practical knowledge of an average accountancy student. There were some candidates who were well conversant with relevant provisions of the Payment of Gratuity Act No. 12 of 1983 on gratuity entitlement of the employee. They had correctly explained the criterion that should be fulfilled by an employee to be entitled for gratuity after leaving employment.

In their answers they had dealt with following points.

- (e) The employer of the applicant for gratuity has to have 15 or more workmen or should have employed 15 or more workmen on any day during the period of 12 months immediately preceding the termination of service of the workman.
- (ii) The applicant should have completed not less than 5 years of service under that particular employer.  
The formula of calculation of gratuity for a workman who is a monthly salaried employee is  $\frac{1}{2} \times (\text{salary drawn for last month of employment}) \times \text{No. of years completed in service}$  i.e.  $\frac{1}{2} \times 20,000 \times 6 = \text{Rs. } 90,000$ .

The candidates who were capable of focusing their answers on those lines deserved very high marks as they had displayed their satisfactory knowledge in the subject area. But the majority was not capable of furnishing their answers in these directions as they were not familiar with the provisions of the Gratuity Act and had dealt with various irrelevant areas or points such as;

- (a) Any employee who claims gratuity should have satisfied the following :
- He/she should not have committed any offence or fraud in the company.
  - He/she should not owe any money to the company.
  - He/she should have rendered a reliable service to the company.
  - Should not be an employee working for a government owned organization who receives the benefit of pension.
- (b) Some others had tried to calculate the gratuity payable to Jam's under other categories i.e. workmen who are not paid monthly salaries but on other bases like daily wages etc.  
 $14 \text{ days} \times (\text{salary/wages drawn for the last month of employment}) \times \text{No. of years in service}$ .
- (c) A few others had confused gratuity payments with withdrawals of balance in EPF account and instances where an employee can withdraw the EPF balance before reaching the retiring age.

Many others had not attempted this optional question.

### General

There were numerous instances where candidates had repeated the questions in different ways. Also there were some others specially English medium candidates who had tried to present their answers under 3 stages like:

Facts: Discuss the question in a different way.

Issues: Explain incidents involved in the question which have to be considered.

Law: Applicable law for the problems.

It appears the first 2 parts are hardly relevant and not required in answering the question.

## **KE4 – Process Assurance and Ethics**

**March 2016**

### **Examiner's comments**

### **Question-wise comments**

#### **General comments**

This examination consisted of three sections.

#### **Section 1-**

Question 1 multiple choice question

Question 2 short answer question

#### **Section 2-**

Four questions carrying 10 marks each and three questions were to be answered.

**Section 3** One compulsory question carrying 20 marks

As this paper is on processes assurance and ethics, a knowledge of business processes, nature of internal controls surrounding them, concept of assurance, principles of values and ethics is expected. In general candidates managed their time within the set limit with the majority of submitted scripts being complete or substantially complete. Time management and presentation were generally well evidenced. Many have understood the question requirement and displayed a sound technical knowledge to answer with clarity. Though there were some excellent answers to certain questions the performance as a whole has not improved. A number of common issues arose in the candidates answers that contributed to the disappointing pass rate. Common reasons for poor marks in this exam are;

- Lack of knowledge of certain fundamental syllabus areas
- Failing to understand the question requirement which results in irrelevant answers
- Illegible handwriting

## Specific Comments

### Question 01

This question carried 20 marks and tested almost all the areas in the syllabus. There were irrelevant answers common to many answer scripts which obtained low marks. Such as;

- 1.2 d
- 1.3 c
- 1.6 a
- 1.8 b
- 1.9 b
- 1.10 c

### Question 02

This question carried 10 short questions carrying 3 marks each. Candidates were required to follow the action verbs given in the study text. Candidates showed a marked improvement over previous sittings.

2.1 This part tested the knowledge of the candidates about the risk management framework. Almost all candidates attempted the question and a fair number of candidates obtained satisfactory marks. The question was on business risks; some have misunderstood and wrote audit risks, inherent risk, control risk, and detection risk. Some have written only about the risk assessment and evaluation ignoring that the question was on the risk framework. Some have written about the ways to deal with risks. Some have written the business risks such as financial risks, compliance risk, and operational risks. There had been a similar question in March 2015. In spite of that there were highly irrelevant answers such as;

- Design internal environment
- Segregation of duties
- Delegation of authority
- Identification of events
- Analytical procedure

2.2 It was expected to test the knowledge of candidates on the inherent limitation of a system of internal control. Majority have understood the question requirement and answered well. Some candidates have written the correct inherent limitation but were unable to explain the limitations. Some have mixed up with the reasons for design ineffectiveness. There had been a similar question in March 2015 and in the pilot paper in the same year. It was disappointing to note that some have given highly irrelevant answers such as;

- Objectives of internal control
- Audit risks such as control risks and detection risks
- Professional ethics
- Business environment
- Segregation of duties
- Controls not fully automated

2.3. In this part the candidates were required to give two business risks referring to the given scenario. It was expected to identify the business risk in the payroll process when there is high turnover of employees, and payment of overtime and attendance allowance. Only a very few candidates have answered well. There had been a similar question in March 2015. In spite of that some have written irrelevant answers such as;

- No proper system of recording the attendance
- The number of employees is 300 and difficult to manage
- The cost is high
- Procedure for payroll process

2.4. In this part of the question candidates were expected to be aware of business documentation. It was asked to identify the essential fields missed out from the given specimen of the stores ledger. Majority of the candidates have attempted the question and some have scored full marks. It was observed that some do not have a knowledge about the stores ledger; some have mixed up with the bankcard and material requisition, and given irrelevant answers such as;

- No name of the supplier
- No authorization
- Storekeeper's signature
- Type of stock
- Person requesting
- Approval

2.5. In this part the candidates were expected to explain the business risks associated with the PPE Management process. Majority has attempted the question but only a few have given correct answers. It was expected the candidates would study the text book so that they can plan the answer focusing on the purchase, disposal, physical control and accounting. Some have not understood the question and written irrelevant answers such as;

- Risk for transfer of items.
- Large amount of money involved
- There will be frauds in purchasing and management will go for commission
- Not sufficient space to install

2.6. It attempted to examine the control deficiency in the given information. Many have identified the main control deficiency though they were unable to assess that. Some candidates have wasted time in explaining the process. The candidates should be aware of the requirements of the question. Some were unable to identify the deficiency and had written irrelevant answers such as;

- Not checking the goods in stock
- Not checking the purchase order
- Selecting supplier without calling for quotations
- No physical verification
- Issue of invoice without inspecting the goods

2.7. It was expected to summarize two reasons for design ineffectiveness of internal controls. Many have mixed up with the inherent limitations. It reflected that the candidates have not planned the answer to suit the question. Some have written irrelevant answers such as;

- Change of management decisions
- No proper segregation of duties
- Less experienced management staff
- Complexity of business activities
- No proper communication of the internal control
- Internal controls are not functioning as planned
- Change of technology

2.8. The candidates were expected to explain the threats to ethical behavior of an accountant. It was noted that a fair number of candidates have answered well. There were some candidates who have written one or two threats only and also without any explanation. It is disappointing to note that there were irrelevant answers such as;

- Legal threat
- Management override
- Political influence not to disclose important information
- No professional competence
- Insufficient education
- Compliance with rules and regulations
- Natural disaster

2.9 It was required to identify the parties involved in an assurance engagement. This is a very important question and every candidate who studies auditing should know the parties involved. About 40% have answered well, but it is disappointing to note that many have written irrelevant answers and were unable to mention the parties. This question was tested in March 2015; if the candidates have gone through and practised answering past papers and pilot papers, they could have answered well. Some have written irrelevant answers such as managing director internal auditor

2.10. In this part the candidates were asked to list the procedures by which the audit evidence can be obtained. In 2015 March a similar question was tested. It is noted that almost all have answered well .However there had been irrelevant answers such as;

- Annual reports
- Flow charts
- Bank statements

### **Question 03**

This was the most popular choice of the optional questions and was answered by a significant number of candidates

Part a; The candidates were required to identify the ways of responding to risks faced by the business organization referring to the small scenario given. It was expected to recognize and illustrate

the business risks. Candidates are encouraged to follow the action verbs in order to understand the question requirement. Most of the candidates knew the way to respond to risks but some were not able to refer to the scenario and illustrate the way to respond to risks as a result they got less marks. Some have written risk framework instead of risk response. There were some irrelevant answers such as;

- Maintain sound financial control
- Maintain confidence among the staff
- Analyze the risk response by having a proper internal control

Part b; In the given scenario the issue was on the implementation of the internal control, and candidates were expected to indicate the responsibilities for the internal control. It was disappointing that the knowledge of the candidates were poor on the responsibilities of the board of directors and the internal auditor, It was expected the candidates would study chapter 3 of the study text. They wrote irrelevant answers such as;

Board of directors

- Responsible to staff
- Maintain sound financial position
- Avoid frauds and errors
- Abide by law
- Not to override controls
- Comply with ethics

Internal auditor

- Express an opinion
- Provide necessary information for the audit
- Avoid frauds
- Certify accounts

#### **Question 04**

Part (a) of the question was based on ethics. It was disappointing to note that in spite of it being a major part of the syllabus the performance was poor. The candidates were expected to write the points on compliance with laws, protect the reputation upholding the standards, protect public interest and to know that if they do not behave in an ethical manner they can be faced with disciplinary action. About 90% of the candidates have written that the professional accountants should behave in an ethical manner in order to protect the reputation. It was evident that they have not studied at least the first three pages of chapter 10 of the study text. The candidates have failed to understand the question and plan the answer. Most of their answers carried irrelevant answers such as;

- To protect the interests of the employees
- To enable sound business practice free from frauds
- Follow principles such as integrity, confidentiality and competence
- To pay taxes
- To obtain loans
- To have a good image of the business

Part (ii) of section (a). It was expected to identify the need for ethical behavior when dealing with money and payments. This was poorly answered. Most of the answers carried general points such as;

- Objectivity
- Confidentiality
- To maintain accuracy of financial statements

There were only a few answers which identified the risk separately and explained the need for the ethical behaviour.

Part (b) It was required to identify and explain the purpose of the procurement documents given. It is disappointing to note that although they could have guessed from the words; “our order ref”, “please deliver”, that they relate to a purchase order some candidates failed to do so. The other document indicated “received in good condition”, so they could have guessed that it is a goods received note. The candidates who have identified correctly managed to score marks. Some candidates have identified correctly but mixed up the terms and wrote in Sinhala goods delivery note. Some candidates have written invoice instead of purchase order. The candidates are advised to study the process and use the correct term.

### **Question 05**

Part (a) It was required to discuss the difference between a statutory audit and a review engagement. It was disappointing to note that most of the candidates have not attempted this question. Some have given vague answers such as reasonable or limited assurance, express positive or negative opinion. The few candidates who answered wrote good answers for part (a). There were some irrelevant answers such as; statutory audit will be carried out by the internal auditor. In respect of the review engagement they have written irrelevant answers such as;

- Standards are not necessary to be followed
- Directors carry out the engagement
- Three parties are not involved
- No opinion

Part (b) It was requested to explain the need for conducting a financial audit in accordance with Sri Lanka Auditing Standards. Most of the candidates have mixed this up with the financial audit assignment carried out by the internal audit. The candidates should spend a little time to understand the question, when it indicates in accordance with SLAuS and they should be able to plan the answer accordingly.

### **Question 06**

Candidates were expected to write and explain about general and application IT Controls. There had been a small number of candidates who have attempted this question. There were only a very few good answer scripts, rest have written irrelevant and incomplete answers. As the background information of the question states that many business organizations today use IT Systems to carryout processes and controls, entities develop their own IT Systems and others purchase off the shelf. Some candidates have written the benefits of the developed IT Systems rather than purchasing off the shelf.

## General Controls

Many candidates have not identified that general IT Controls consist of different policies and procedures to support effective functioning of application. They have written irrelevant answers such as;

1. Controls are common ones
2. Must educate the staff
3. Controls are present during the process
4. Only authorized persons should be involved, virus attacks should be detected and all changes documented.
5. These are established in order to control IT Systems as a whole

## Application IT Controls

Most of the candidates were unable to provide a complete and correct answer. They have written that application controls can be used when the IT System is functioning. Many were unable to differentiate the general controls from application controls. Therefore most of them have written common answers such as;

- Password protection
- Access control
- Obtain backup copies

## Question 07

This question carried 20 marks and it was mainly on business risks. There were two parts. The first part carried 11 marks and the second part carried 9 marks. About 50% wrote good answers. The good answers were well planned and applied the subject knowledge. Many were unable to grasp the situation given in the scenario, it may be due to insufficient practical exposure.

Part (a) (i) Candidates were expected to write about business risks faced in relation to cash management in the given scenario where the business is washing vehicles and different are charged for different types of vehicles. Many candidates have written that there is a risk of frauds and embezzlement of cash; they should be able identify the risk, without stating that there is a risk, there will be frauds, and embezzlement. The candidates should read and understand the issue before writing the answer. The candidates are advised not to use general terms such as fraud and misappropriation. There had been irrelevant and incomplete answers such as;

- As there are no records receipts can be misplaced
- Cashiers function should be segregated
- Record can be less than actual
- All duties are done by the cashier, due to that there is a risk
- Collection should not be deposited as there would not be cash to pay for expenses
- Services should be provided on credit

Part (a) (ii) Many have written without proper understanding of the cashier's function that receipt of cash, issue of receipts, and deposit at the bank should be segregated. As that scenario indicated that the payments are made by cheques, candidates have written about writing crossed cheques having two signatories. The candidates should be able to identify the important issue in the given scenario. Candidates were expected to write about the controls

to be introduced for better cash management and control. Many candidates have mixed up with the financial risks and written about the use automated receipts, preprinted receipts, introduction credit cards, and debit cards. Most have written that a cash book should be introduced, ignoring the fact it is the main issue and the management has already decided to do so. The following irrelevant answers were noted;

- Deposit all cash at once
- Appoint three cashiers
- Issue the receipt by the washing staff; confused the receipt with the debit note, or the invoice.
- Provide a full time security guard

Part (a) (iii). It was required to identify the purpose of the cash book. Many candidates have written correct answers. There were some candidates who have written;

- Cash book can be used to avoid frauds
- To update records
- As a confirmation for the cash balance

Part (b) (i). It was required to explain the importance of having an approved purchase requisition. Most of the candidates have not properly captured the gravity of the ordering process, in the procurement process. Some have confused up with the purchase order. There had been irrelevant answers such as;

- Can be used to order goods
- Can maintain reorder level
- As a document for audit purposes
- Payments can be made in advance
- Helps to determine the cost of finished goods
- Frauds can be avoided

Part (b) (2)(1) It was required to discuss the risks in delivery of ordered products. Only a few candidates have given correct answers. Many have written irrelevant answers such as;

- Pilferage during transit
- It helps to take legal action to recover any claim
- Head office does not check the goods

Many candidates have written the safeguards as the question was on physical safeguard. It appears that the candidates do not read the question and plan the answer, which resulted in irrelevant answers such as;

- Fix fire alarms
- Avoid breakdown of delivery vehicle
- Avoid damage due to carelessness

Part (b) (2)(2) It was required to discuss the risk in physical safeguard of inventories.. Most of the candidates have mixed this up with physical safeguard during delivery of goods. There were many irrelevant answers such as;

- Low quality of goods
- Damage during transit
- No proper storage

Candidates have wasted time in writing the steps to safeguard the inventory such as;

- Provide a security guard

- Get an insurance cover
- Fix CCTV cameras

## **Conclusion**

Candidates are encouraged to study the text book as always questions are set within the syllabus. Candidates should practise answering past exam papers and carefully review the model answers, together with the examiners reports this task is important to gauge the style of questions that regularly appear in this paper. It was noted that some candidates have answered correctly had second thoughts and cut that answer and written incorrect answers. The candidates are advised even if they have second thoughts write the answer without cutting the previous answer.

## **KE5 – Commercial Insight for Management**

**March 2016**

**Examiner's comments**

### **Question-wise comments**

#### **Question 01**

1 (a) General comments

Overall performance of the candidates was very good. This question i.e. 10 MCQs carry 20 marks.

– Students were required to choose the most appropriate answer.

Specific comments

– Most of the students could not choose the correct answers for 1.6 and 1.10 i.e. Consequence of inflation and resistance to change.

– A fair amount of students have chosen correct answers for other MCQs.

#### **Question 02**

General Comments

Overall performance of the candidates was satisfactory. The 10 nos. short-answer questions carry 30 marks.

- 2.1 Requires to explain any three elements in a Mission Statement.
- 2.2 Requires to discuss the inter-relationship between scarcity, choice and opportunity cost.
- 2.3 Requires to identify the difference between Cardinal utility and Ordinal utility.
- 2.4 Requires to explain the impact of govt. intervention on a competitive market.
- 2.5 Requires to identify two measures to reduce current a/c deficits.
- 2.6 Requires to state 03 factors which influence demand and supply of foreign exchange.
- 2.7 Requires to identify 03 hygiene factors and 03 motivation factors as per Herzberg's Two-Factor theory.

- 2.8 Requires to define main production methods.
- 2.9 Requires to explain why the long-run AC behavior would be different from that of the short-run.
- 2.10 Requires to list 03 benefits of effective Human Resource Management.

#### Specific comments

- 2.1 Some just stated 03 elements namely purpose, strategy and values, without any explanation.
- 2.2 Most of the students answered well, but a few were unable to state “next best alternative” in explaining opportunity cost.
- 2.3 Some identified that consumers are able to measure absolutely the satisfaction as per the Cardinal utility theory, but they could not identify that consumers could rank different commodities rather than measuring the satisfaction, under Ordinal utility theory.
- 2.4 Some could not explain eventualities like black market, rationing scheme, extra administrative cost etc. as a result of govt. intervention.
- 2.5 Some just mentioned “restriction of imports” without specific measures being cited.  
*E.g.;* increasing/imposing tariffs or imposing import quotas or exchange control regulations.
- 2.6 Some just stated rate of inflation and interest rate as factors affecting demand and supply of foreign currencies. They did not relate the rates of other countries to highlight the comparison.
- 2.7 Some incorrectly identified performance-related pay, group working etc. as motivator factors.
- 2.8 Most of the students defined job production as end product of a job which is a single item made for a specific purpose. Nevertheless a few had stated that job production is production of items for market without any customer being focused.
- 2.9 Some just mentioned that in the long-run all the costs are variable, but in the short-run, variable costs and fixed costs could be separately identified without the shapes of the AC curve and MC curve being stated and without the reasons therefor being elaborated.
- 2.10 Most of the students just identified that HRM will increase the effectiveness and efficiency of the Organization without the main functions being identified i.e. HRM helps to have human resources of the right quantity and quality to meet the current requirements.

### Question 03

#### General Comments

Overall performance was satisfactory.

- (a) Requires to explain 04 main functions to be carried out to achieve the set goals of a company.
- (b) Requires to state 03 levels of Management and their main responsibilities.
- (c) Requires to state 02 Management skills of a General Manager to perform efficiently and effectively.

#### Specific comments

- (a) Most of the candidates explained correctly Planning, Organizing, Leading and Controlling as main tasks. But a few mentioned “Directing” in place of “Leading”.
- (b) Senior Management, Middle Management and Junior Management are 03 levels of Management as per most of the students. But a few could not state that Senior (top level) Management is responsible for overseeing the entire Organization.

- (c) Some incorrectly stated knowledge skills as one of the 03 skills i.e. Technical, Human and Conceptual.

#### **Question 04**

##### General Comments

- (a) Requires to define monetary policy and fiscal policy.  
(b) Requires to explain how government can achieve economic growth using these policies.

##### Specific comments

- (a) Some have repeated the question in defining monetary policy and fiscal policy. Some were unable to mention that money supply and interest rates are involved in monetary policy. A few identified monetary policy as fiscal policy and vice versa.  
(b) Some explained correct expansionary fiscal policies and monetary policies that are required to achieve economic growth. A few were unable to mention measures like reduction of taxes, increasing govt. expenditure, reduction of interest rates and expansion of money supply.

#### **Question 05**

##### General Comments

Overall performance was not satisfactory.

- (a) Requires to discuss merits and demerits of a functional structure and a geographic departmentation structure.  
(b) Requires to explain 04 benefits of delegation of authority.

##### Specific comments

- (a) Some were of the view that functional structure paves the way for effective decision making. They have ignored the fact that sub-optimization could creep in due to functional structure being adopted. Only a few stated that geographical Departmentation could result in loss of economies of scale.  
(b) Some stated incorrectly that delegation of authority leads to taking straightforward decision. Most of the students mentioned correctly that delegated authority contributes to job satisfaction.

#### **Question 06**

##### General Comments

Overall performance was satisfactory.

- (a) Requires to calculate Average Product (AP) & Marginal Product (MP) per worker.  
(b) Requires to explain the law of diminishing marginal returns.  
(c) Requires to identify point at which the law of diminishing returns begins to operate.  
(d) Requires to explain the typical relationship between AP and MP curves.

### Specific comments

- (a) Most of the candidates arrived at correct answers. But a few indicated MP against number of workers, starting at 12 nos. of MP against 01<sup>st</sup> worker, which is not acceptable.
- (b) When equal units of a variable factor are added in succession to a fixed factor, then beyond a point the return to that factor will begin to diminish. But some stated that the point where Marginal Product and Average Product become lowest, diminishing returns starts which is not a clear explanation.
- (c) Most of the candidates mentioned correctly that after 03<sup>rd</sup> worker is employed, diminishing returns set in. But a few miscalculated it as “after 04<sup>th</sup> worker is employed”.
- (d) Marginal Product (MP) will be less when Average Product (AP) is falling and MP will be more when AP is rising. When the two curves intersect, maximum output is arrived at. Most of the students gave correct explanation except regarding the point maximum output is decided on.

### **Question 07**

#### General Comments

Overall performance of the candidates were not that satisfactory.

- (a) Requires to discuss the nature of market structure of mobile telecommunication.
- (b)(i) Requires to define “Barriers to entry”.
  - (ii) Requires to identify 03 barriers to entry in the Sri Lankan Mobile Telecommunication industry.
- (c)(i) Requires to identify the difference between price competition and non-price competition.
  - (ii) Requires to state 03 non-price competitive strategies.
- (d) Requires to explain Porter’s five forces model.

#### Specific Comments

- (a) Some concluded correctly that mobile telecommunication industry belongs to oligopoly market structure, providing justifications under categories like number of firms, nature of the product, price etc. Some identified the industry as monopolistic competition which earned no marks.
- (b) (i) Anything that prevents new firms entering an industry is a barrier to entry. Most of the students correctly answered this part. But a few stated that there are difficulties to start businesses, which earned only a few marks.
- (b) (ii) Some identified correctly 03 barriers namely legal, economic and technological barriers. A few mentioned examples of barriers like government permission, huge investment etc. which were considered in giving some marks.
- (c) (i) Price is the basis for competition in price competition and other factors than price will be the basis for non-price competition, which most of the students correctly identified. A few mentioned that in price competition prices will change and in non-price competition prices will remain the same.

- (c) (ii) Most of the students stated strategies like differentiation, heavy advertising, creating brand loyalty etc. for which allocated marks were awarded. Nevertheless a few mentioned with strategies like provision of free of charge services, giving away gifts etc. which earned a few marks.
- (d) Some explained the 05 forces well namely, threat of new entity, threat of substitutes, bargaining power of customers, bargaining power of suppliers & rivalry among current competitors. However some others just named the 05 forces without a brief explanation being provided. A few did not state what is meant by each force but gave some other explanations. E.g.: Bargaining power of suppliers means suppliers can exert pressure for higher prices. Nevertheless some stated that if the bargaining power is low, it is good for the company under reference.