



KB1 – Business Financial Reporting

December 2017

Examiner's Comments

Question-wise comments

Question 01

Performance satisfactory.

Common mistakes made by the candidates were:

- Part (a) (i) Many had just stated that there can be no certainty about the probability of future economic benefits (i.e.) they have not given the reason for this; which is the company cannot control an employee as the employee can leave the company at any time. Therefore the candidates could not obtain full marks for the part.
- (ii) Some candidates had stated that this is a contingent asset probably based on the mistaken notion that 'virtually certain' and 'probable' have the same meaning.
- Part (b) Some candidates had not understood the requirements of the question and have elaborated on the functions of the committees concerned instead of explaining their compositions.

Question 02

Performance poor.

Part (a)

- Many had not understood the examiners expectations in terms of the requirements and had proceeded to answer the application parts without first describing the accounting treatments for parts a (i) and (ii) and thereby lost valuable marks. Similarly some had given only a description of the relevant accounting treatment without attempting the application part.
- Some had treated the interest free loan granted and the investment in non-convertible preference shares as financial liabilities.
- Some had not calculated the initial financial cost recognition.
- In calculating the finance income, many had taken the number of months to be 3 instead of 4.

- Some had failed to recognise the amortised cost at the subsequent measurement.

Part (b)

- Some had misunderstood this part of the question and had indicated details regarding the asset impairment.

Question 03

Performance satisfactory.

Common mistakes made by the candidates were;

Part (a)

Many could not explain properly the concept of 'temporary differences'. Some had defined temporary differences as the difference between the accounting profit and taxable profit.

Part (b)

- Working out only temporary differences and deferred tax not calculated.
- Applying a different tax rate instead of 28%.
- Calculating the deferred tax based on either the carrying value or tax base instead of the difference between the two values.
- Inability to identify whether the calculated item is a deferred tax asset or liability.
- Computation of depreciation even after the building has been revalued.
- Applying an incorrect number of years (some taking 5 years, some 1 year)

Question 04

Performance satisfactory.

Common mistakes made by the candidates were;

Part (a)

- Dividend income shown under other comprehensive income.
- Dividends declared by Complex PLC has been identified as dividend payable by Wealth (Pvt) Ltd.
- Showing dividend declared as an expense.
- Writing up journal entries instead of financial statement extracts.
- Some had stated that the dividend declared is a non-adjusting event and accounted only when it is received.
- Showing T accounts instead of financial statement extracts.
- Some showed the AFS investment as a current asset.
- Some had failed to work out the equity and liability components, instead had explained how they are worked out.
- Fair value of the bond taken as Rs. 600,000 without multiplying by 100.
- Taking the discount factor as 8% instead on 10%
- Calculating future values instead of present values.

Question 05

Performance satisfactory.

Part (a)

Some had provided lengthy answers and had given unnecessary details such as suggestions to improve the given ratios. Candidates need to understand the requirements of the question is to assess the performance of Decimal (Pvt) Ltd in comparison with the industry average.

Most answers were restricted to comparison of company performance with that of the industry, lacking an analysis/explanation of the deviations from the industry average.

Question 06

Performance satisfactory

Common mistakes made by the candidates were;

- Many had interpreted 'goods costing Rs. 7.5 million sold by Pan to its customers' as the cost of the goods to Saga and had therefore, worked out the cost of the goods to Pan as $7,500 \times 140\% = 10,500$ and arrived at an unrealised profit of $(12,000 - 10,500) \times \frac{40}{140} = 42.8$
- Many had incorrectly calculated the number of shares transferred as $1,200 \times \frac{2}{3} = 800$ without adjusting for minority holding (20%).
- Incorrect computation of goodwill due to incorrect calculation of the consideration amount, incorrect pre-acquisition profit calculation, not making the fair value adjustment of the plant.
- Cost in transit (Rs. 500) and trade receivable (Rs. 1,500) were both removed from trade and other receivables in the consolidation due to misinterpretation of additional information given in item (iii).
- Incorrect calculation of group share of the retained profit and non-controlling interest (NCI) due to incorrect calculation of the post-acquisition profit/non adjustment of unrealized profit/non adjustment of depreciation due to the change on the carrying value of plant.
- In the calculation of the unrealised profit many had taken $\frac{4,500}{100} \times 40$ instead of $\frac{4,500}{140} \times 40$
- Non elimination of intercompany sales from both sales and cost of sales in the consolidated profit and loss. Instead of adding the unrealised profit and depreciation to the cost of sales some had deducted them.
- Depreciation adjustment for the change in the carrying value of the plant shown under administration expenses instead of cost of sales.
- Some had calculated NCI twice using two different methods and getting two different answers one for the P & L and another for the SOFP.

Question 07

Performance poor. Had the lowest average marks for the paper. Common mistakes made by the candidates were;

Part (a)

- Few had stated that the two convertible bond issues have no impact on the earnings per share possibly due to their ignorance of the two ways of calculating earnings per share (basic and diluted)
- Many had not calculated the EPS separately for each of the two convertible bonds. Instead they have included the incremental earnings from both the bonds and the current earnings and had calculated the diluted EPS, without considering the anti-dilutive effect of the 10% bonds.
- Some had deducted incremental earnings (instead of adding) in their calculation of diluted EPS.

Part (b)

- Some had written only the recognition criteria for an intangible asset and have proceeded to state the costs that are to be capitalised.
- Some had not identified that the website had fulfilled the recognition criteria under development cost, but have identified costs to be capitalized as development costs rather than intangible assets.
- Capitalising the planning website expenses and the expense related to obtaining the domain name charging to the P&L.

Part (c)

- Even though some had identified this as a bill and hold sale, the candidates had stated that revenue cannot be recognised as delivery has not been made.
- Some had answered from the buyer's point of view.
- Some had identified the transaction as a deferred revenue.
- Some had stated that only at the point of delivery the risks and rewards of ownership will be transferred to the buyer.
- Some could not identify the transaction as a bill and hold sales arrangement.

Part (d)

- Some had stated that the revaluation loss is debited to other comprehensive income whereas the revaluation surplus is credited to the P & L.
- Some had set-off the revaluation loss against the revaluation surplus.
- Stating the revaluation of assets as a change in estimate and stating the change in useful life of the asset as a change in accounting policy.



KB2 – Business Management Accounting

December 2017

Examiner's Comments

Question-wise comments

General comments about submission of workings

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

General comment about candidates' handwriting

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

Question 01

General Comments

Question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 1 "Absorption Costing Vs. Activity Based Costing" of the CA Sri Lanka Study Guide.

The average performance for question 01 ranges from **6 marks to 7 marks** out of 10 marks allocated and around 85% of students had scored more than 5 marks out of 10.

The question is straightforward and tests the candidates' knowledge about Activity Based Costing (ABC) and the difference between ABC and Traditional Absorption Costing.

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

Part (i)

Candidates' performance on part (i) was **very satisfactory**. Majority of the candidates (about 90%) had scored **full marks** allocated to the part.

Part (ii)

Performance of candidates was **somewhat satisfactory**. Average marks scored on this part ranges from 2 marks out of 3 marks. A large number of candidates had not correctly understood the word “**Advise**” and most of the students (around 85%) who had correctly computed the maximum discount failed to **advise** the management on the range of discount or maximum discount that can be given.

Some candidates (around 3%) had taken the cost difference and calculated the maximum discount without consideration of profit mark up and price.

Part (iii)

This part tests the theoretical knowledge of ABC and Traditional Absorption Costing and it requires the candidate **to differentiate** between the two techniques. The performance was average. Some candidates had provided lengthy descriptive answers explaining ABC and Absorption Costing techniques and had spent excessive time answering it.

Question 02

Part (a) of Question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 3 “Contemporary Management Accounting” of the CA Sri Lanka Study Guide.

Part (b) of Question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 18 “Working Capital Management” of the CA Sri Lanka Study Guide.

Around 10% of the candidates had not attempted this question and on average the marks scored ranged from 3 to 4 marks out of 10 marks, only around 22% of percent students scored more than 5 marks out of the 10.

Part (a)

This part of the question tested the application of Total Quality Controls techniques. However a majority of the candidates had identified each stage but failed to **outline the application** of TQC at each stage to reduce the defects.

Some candidates had just explained the TQC process without referring the scenario given in the question it showed the candidates’ weakness in the application of knowledge.

Part (b)

(1) Many candidates had just referred to increasing sales based on the general English meaning of over-trading without referring to the capital structure in the “overtrading” situation.

Some had given irrelevant answers like trying to explain the aggressive working capital management.

(2) Some students had just mentioned that the overtrading situation leads to liquidity issues but failed to discuss **how** overtrading could lead to liquidity issues displaying their lack of knowledge on identifying the facts which leads liquidity issues.

Question 03

This Question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 8 “Information for Short-Term Decision Making Decision Making” of the CA Sri Lanka Study Guide.

The average performance for question 03 ranged from **5 marks to 6 marks** out of the 10 marks allocated and around 47% of students had scored more than 5 marks out of 10 marks.

Most of the candidates had made mistakes on the identification of the relevant cost component in Latex and Chemicals. They had taken the value of the existing stocks of Latex as relevant costs without identifying it is a sunk cost and the chemicals were valued at the resalable value instead of the current market value.

A majority of candidates had not understood that both Chemicals and Latex are **regularly** used by the company and whatever the requirement it should be purchased from outside.

Some candidates had valued the pigment incorrectly taking the current market price as the relevant price, this indicated that candidates had not understood the main two points, that:

1. It is not a regular input
2. There is no resale value.

Most of the candidates correctly identified and valued the other cost line items.

This question particularly required the candidates to give the **reasons** as to why the information in the question is **irrelevant** or **relevant** in terms of determining the offer price but a very low number of candidates had provided the reasons.

Question 04

General Comments

This Question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 17 of “Responsibility Centre Accounting “of the CA Sri Lanka Study Guide.

The average performance for question 04 ranged from **3 marks to 4 marks** out of 10 marks allocated and around 23% of students had scored more than 5 marks out of 10 Marks.

Further it was noticed that nearly 19% of students have not attempted the question and around 10% of students had attempted but could not gain any marks.

Part (a)

Most of the candidates had not understood the requirements of the question therefore they had skipped this part and the candidates’ performance on part (a) was **very poor**.

Sales and cost impact on the CA division due to both proposals had been correctly calculated by many candidates but the sales and cost impact on the EE division had not been correctly calculated.

Eg. Units 2,500 reduction of product Y in the EE division was not correctly applied.

Interpretation of final answer (Decision) had not been provided by many candidates.

Part (b)

Performance of the candidates was **very poor**. Average marks scored on this part ranged from **½ a mark to 1 mark out of 3 marks**. The question required the candidates to do the calculation to identify the best course of action from **company’s** point of view but many candidates did calculations for both divisions separately. It indicated that the candidates had not understood that this proposal does not affect current operations of the EE Division.

Interpretation of the final answer was not done by many candidates.

Question 05

This Question had been designed to test the Intended Learning Outcomes (ILO) of Chapter 18 “Working Capital Management” of the CA Sri Lanka Study Guide.

The average performance for question 05 ranged from **3 marks to 4 marks** out of 10 marks allocated and only around 16% of candidates had scored more than 5 marks out of 10 marks. The lowest performance of candidates was seen in this question. Further it was noticed that 16% of the students had not attempted or scored zero marks.

Part (a)

Many candidates had identified the annual ordering cost correctly but the annual demand and annual holding costs were not identified correctly.

The candidates had applied the monthly holding cost of $(1,000 * 1\%)$ as the annual holding cost $(1,000 * 1\% * 12)$.

The candidates had determined the annual material requirement as 12,500 instead of 125,000 (12,500 * 10).

Most of the candidates had applied the correct EOQ formula but had made mistakes in solving the formula.

Part (b)

Part (b) of the question clearly requires the candidates to assess the revised order quantity of Y that will minimize the total cost of inventory, firstly the students needed to calculate the total Cost of Inventory based on the current EOQ (Part a). But many candidates without calculating the current Inventory Cost compared the Inventory cost based on the two discount ranges and compared only those two inventory costs to arrive at a decision. A comparison with the current Inventory costs was not made.

Most of the students had not calculated the EOQ based on the discount offered and had just calculated the Total Cost of Inventory based on the lowest quantity to gain each level of discount. It showed the students' lack of knowledge of the requirement to identify each EOQ within the range of discounts offered before calculating the total inventory cost.

Eg: Students took the order quantity as 4,700 and computed the total cost applying a 10% discount.

Question 06

General comments

This Question was designed to test the Intended Learning Outcomes (ILO) of Chapter 6 "Budgeting for Planning and Control" of the CA Sri Lanka Study Guide.

The average performance for question 06 ranged from **8 marks to 9 marks** out of the 25 marks allocated and around 31% of students had scored more than 12 marks out of 25 Marks. It was further noted that 5% of the candidates had not attempted the question.

Part (a)

Part (a) of the question tests the candidates' knowledge on the preparation of a fixed budget, a flexed budget, and presentation of the profit statement showing a fixed budget, flexed budget and actual performance using a **marginal** costing format.

Many candidates had not understood that the budgeted occupancy rate is 90%.

Eg. Many candidates had presented the fixed budget for a 100% occupancy rate and prepared the flexed budget for a 90% occupancy rate.

Some candidates considered the given costs to be at 90% capacity utilization, although the question states that costs are for 100% capacity utilization.

Most of the students had not understood that they have to calculate and present the contribution and profits under the marginal costing format.

E.g. a. Showing the total costs instead of presenting the variable cost and fixed cost separately
b. Calculating only the profit without calculating the contribution.

Some students had not understood that the requirement was for a quarterly profit statement.

E.g. Preparing the profit statement for a year, for 6 months and for 4 months.

Part (b)

Part (b) of the question tested the knowledge on preparation of profit reconciliation using the relevant variances.

- (1) Very few candidates had understood the Sales Volume Variance correctly valuing it at the contribution per bed day.

$$\begin{aligned}\text{Sales Volume Variance} &= (\text{Flexed Budget Units} - \text{Fixed Budget Units}) * \text{Contribution per unit} \\ \text{Sales Volume Variance} &= (34,200 - 32,400) * 19,437.5\end{aligned}$$

All most all the candidates had calculated the sales volume variance using the bed revenue and together with the variable cost variance reconciled the fixed budget profit and flexed budget profit.

$$\text{Eg. Sales Volume Variance} = (\text{Flexed budget revenue} - \text{Fixed budget Revenue}) - (\text{Flexed Budget V C} - \text{Fixed Budget VC})$$

- (2) Many students had not shown the details of the bed rate variance computation but had taken the variance between the Flexed budget revenue and Actual revenue.

Other variances on Variable cost and Fixed costs have been calculated correctly by most of the candidates.

Part (c)

Many candidates had not attempted this part of the question and those who had attempted the question had failed to correctly explain the reasons.

Question 07

This question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 14 “Long Term Decision Making” of the CA Sri Lanka Study Guide.

The question consisted of four parts, a majority of the candidates scored on part (a), part (b) and part (c) but performance on part (d) was average.

The average performance for question 07 ranged from **11 marks to 12 marks** out of the 25 marks allocated and around 54% of candidates has scored more than 12 marks out of 25 marks.

Part (a)

The question required the students to evaluate the proposal based on the Net Present Value method, most of the students had satisfactorily answered this part of the question but some had not picked up some important information in the question and failed to score marks.

E.g.

1. Some candidates had not correctly identified the contribution increase from 35% to 40% and they have not taken the cash flow as a relevant cash flow in the evaluation.

2. Some candidates had not correctly applied the payment pattern of the tax liability and they had taken a 100% tax payment in the same year the liability was created.

Few candidates had not provided the interpretation of the final answer they had arrived at which is whether the project is viable or not.

Most of the candidates had correctly applied the probability and calculated the expected sales and 40% contribution.

Part (b)

Part b of the question clearly states three benefits of the NPV method when compared to other appraisal methods.

Many candidates had mentioned only the benefits of the NPV approach but not compared with the other methods, however the candidates' performance on this part was satisfactory.

Part (c)

Some candidates had correctly computed the NPV using different discounting factors but failed to correctly apply the IRR formula and compute the IRR.

Part (d)

Performance was poor and lack of good understanding on sensitivity analysis in the NPV project evaluation method.

Many candidates had not attempted this part of the question and candidates made the following common mistakes.

1. Majority of the candidates had not considered the taxation effect on the total present value of contribution and total present value of overheads.
2. Many candidates had computed the total present value based on their cash flows but it had not been correctly applied to compute the sensitivity calculations.

The question required the candidates to evaluate the sensitivity however the candidates had just computed the sensitivity without interpreting the sensitivity analysis.



KB3 – Business Law and Tax

December 2017

Examiner's Comments

Question 01

- (a) Candidates are required to explain when an insurance policy is in the name of the main shareholder of a company and property effected is owned by the company and if the said property is damaged due to natural disaster whether the insurance company is liable to pay the insurance claim made by the said main shareholder. A handful of candidates had misunderstood this position and had tried to misinterpret that Maniq is also the owner of the cinnamon estate “Kurunduwatte” owned by Cinnamon (Pvt) Ltd as he is the main shareholder of the company and therefore, Maniq can claim compensation per damage caused to part of land “Kurunduwatte” by a landslide. Under the insurance policy Maniq had obtained it in his personal name from Always Assurance PLC.

The main requirement of the question is to decide whether Maniq can claim compensation for damages caused by the landslide to part of “Kurunduwatte” which is owned by Cinnamon (Pvt) Ltd under the insurance policy he had obtained it in his own name and not in the name of the company. Instead of giving the decision with reasons and referring to a decided case decision on the said requirement, a very high percentage of candidates had gone on to explain minor details of the Macura vs North Assurance case which was not the expected answer to the question and candidates had wasted time unnecessarily.

Some candidates had even failed to apply the correct principles.

There were numerous instances where candidates had furnished completely irrelevant answers and had dealt with areas like;

- (i) Cinnamon (Pvt) Ltd. is a separate legal person and the company can do any transaction using its own name without using the name of the owners of the company.
- (ii) As the name implies Cinnamon (Pvt) Ltd is a private limited company which was incorporated under the Companies Act No. 07 of 2007.
- (iii) As a private limited company it should have had some characteristics which are different from other types of businesses like;
 - (a) Limited liability
 - (b) Perpetual succession
 - (c) Separate legal personality (ownership is separated from management)

- (iv) Those special characteristics of a (Pvt) Ltd always give several privileges to other entities including the following:-
- Independent and different existence from its members before the eyes of the Law.
 - Has its own seal.
 - Its assets and liabilities are separated and distinct from those who manage them.
 - Capable of owning property incurring debts, borrowing money, employing public, having bank accounts entering into contracts suing and being sued etc.

- (b) The question is clear and the candidates were required to explain the manner in which a director can be removed from office due to the reason of not attending the board meetings on a regular basis as per the provisions laid down in Companies Act No. 07 of 2007. A fair percentage of candidates had failed to understand it in that sense and had interpreted it some other correct ways to give different meeting. Accordingly some had tried to explain grounds under which a director can be removed the office and why Mr. Senadeera should be removed from office under what circumstances a director is treated as vacated from office and explained circumstances such as;

In the following instances under section 202 of the Companies Act No. 07 a director is treated as having vacated from the office of director.

- (a) When he has resigned from his office
- (b) Has been removed from office of director in keeping with the provisions of Companies Act or Articles of the company.
- (c) Has become disqualified to be a director.
- (d) Death or vacated from office of director in pursuant to section 12 of the Act.

Some candidates had failed to understand as to what is expected by the question when the question very clearly states that Mr. Senadheera a director at XY (Pvt) Ltd. has not been attending the board meetings of the company on a regular basis and shareholders of the company intend to remove him from the board of directors of the company and are required to explain the manner in which a director can be removed from office as per the provisions laid down in the Companies Act.

Good side of answers

- (a) There were a good number of candidates who had correctly identified that a limited liability company is separate from its owners i.e. shareholders. Therefore property of the company is owned by the company itself and not by shareholders. Accordingly the cinnamon estate called "Kurunduwatte" belongs to Cinnamon (Pvt) Ltd whilst the insurance policy is in the name of Maniq the sole shareholder of the company. Therefore, Maniq is not entitled to claim damages under his personal insurance policy since the company is a separate legal entity different from its owners.

The candidates had correctly quoted the relevant case of Macura vs Northern Assurance (1929).

- (b) There were some good answers to part (b) of the question and the candidates had explained relevant areas like;

Under section 206 of the Companies Act subject to the provisions contained in the Articles of the Company, a director may be removed by passing a resolution at a meeting where prior notice of such removal has been indicated.

The candidates had correctly explained the rest of the procedure as has been laid down in the Companies Act under section 206 for which they deserve high marks.

Question 02

- (a) The question required the comparison of two types of companies i.e. a company limited by guarantee and a private limited company and to decide as to which meets certain requirements as stated in the question. Many candidates had explained some irrelevant areas such as;
- i. As per section 4 (i) of the Companies Act a company that issues shares to shareholders are liable to contribute to the assets of the company if there are any specified in articles of the company in respect of the share of the company.
 - ii. Companies that issue shares which have unlimited liabilities shareholder are liable to contribute to the assets of the company under its articles.
 - iii. There are 4 types of companies that could be registered under the Companies Act, Namely (a) limited liability companies (b) unlimited companies
(c) companies limited guarantee (d) off-shore company
- Off-shore companies are companies registered in Sri Lanka under the Companies Act, but do carry out business outside Sri Lanka.
- iv. Unlimited companies issue shares but holders of those share have unlimited liabilities to contribute to the assets of the company under the Companies Act.

A handful of candidates had stated that a company that issues shares to the public has limited liability subject to the value of shares they hold specified in the company articles.

Few others had expressed the view that members of companies which do not issue shares do not have any liability in respect of activities of these companies since they do not hold any shares of the company and so on and had wasted time.

Candidates were required to explain whether the indoor management rule can be applied under the given instance i.e. when Asha enters into a construction contract with ABC (pvt) Ltd without pursuing the relevant documents to ensure whether the laid down procedure has been followed by the company. In other words whether an outsider has a duty to check whether the company has followed all the procedures laid down internally such as the articles of the company and so on. However candidates have not properly understood the requirement and as a result they have focused their answers on incorrect or irrelevant points.

When candidates are required to explain whether the indoor management rule is applicable in certain instances given in the question instead of explaining what is asked they have gone and explained various irrelevant areas. Here again they have failed to understand the requirements of the question correctly.

Many had correctly explained the pros and cons of a company limited by guarantee and private company and had come to the conclusion that as far as the required purposes of Benjamin are concerned a private company is better than a company limited by guarantee as the former meets the requirements of Benjamin for which they had earned good marks as they had understood the question correctly.

A fair percentage of candidates had correctly explained as to what is meant by indoor management rule.

Question 03

- (a) Candidates have been provided with some relevant data based on the most recent financial statements of Duruthu (Pvt) Ltd in addition to the information to say that the confirmation from the auditor of the company has been received confirming that the company is able to pay its debts as they become due in the normal course of business and were required to explain whether the company will be able to meet the solvency test as explained by the Companies Act. A fair percentage of candidates had not understood the question correctly and had explained various areas which are not relevant to what is required from them by the question. Therefore the candidates had explained certain irrelevant areas including the following;
- i. In determining whether the company is satisfied with the solvency report the directors must take into account:
 - (a) The most recent financial statements of the company prepared according to Section 151 of the Act.
 - (b) Circumstances that the directors know or should know which will affect the value of the companies assets and liabilities.
 - (c) A fair valuation or other method of assessing the value of assets and liabilities.
 - ii. As per section 57 of the Companies Act a company shall be deemed to have satisfied the solvency test.
 - iii. As per the Act, the solvency test requirements are:
 - (a) Total assets should be equal to total liabilities and assets should exceed the stated capital.

Accordingly the company has satisfied both criteria and it is a solvent company. In other words the company is a going concern.

What could be observed was that the candidates have failed to understand the question or they were not very familiar with the formulae explained in the Companies Act and they had followed some of their own formulas which were incorrect.

- (b) Part (b) of the question is in relation to a major transaction that is going to be entered by Dharman (Pvt) Ltd. As per the information furnished is question this total assets of the company as at 30.12.2017 is 10,000,000 and it plans to acquire a land for Rs. 800,000 on 31.12.2017. Candidates are required to discuss the manner in which the company can enter into this transaction in keeping with the provisions of Companies Act. Some candidates have failed to understand even this easy and straightforward question and had provided some answer which are not relevant to question. They had dealt with some areas like;
- (i) The Companies Act provides provision under its section 185 to enter into a major transaction by a company.
 - (ii) Dharma (Pvt) Ltd acquiring land during the current year is an addition (Rs. 8 million) to the assets of the company therefore it is a major transaction.
 - (iii) The disposition of an agreement to dispose of whether contingent or not whole or more than half by value of the asset of the company.

When the question is clear and required the candidates to explain the manner in which a company can enter into a major transaction they had focused their answers on various incorrect/irrelevant directions and had based their answers covering some areas like;

- (i) Failed to follow the correct formulae to decide whether it is a major transaction or not.
- (ii) Simply stating that the particular transaction is a major transaction but failed to give reasons as to why it is treated as a major transaction.
- (iii) Few others had compared 50% of the value of assets acquired with the total value of existing assets and so on and had wasted time.

A good number of candidates had furnished satisfactory answers and had explained subject areas like:

“for passing the solvency test in accordance with section 57 of the Act it should be established that the company is able to pay its debts as they become due in the normal course of business and the value of assets of the company is greater than the aggregate value of its liabilities and its stated capital.

Further the candidates had stated that although the first condition is satisfied as per the confirmation given by the company auditor it has failed the second condition i.e. total assets are only Rs. 100,000 whilst the total liabilities plus stated capital are Rs. 105,000 i.e. the value of assets is less than the aggregate value of total liabilities plus stated capital. Therefore, the company does not satisfy the second condition and is not able to meet the solvency test for which they have earned very high marks.

Answers to part (b) were fairly satisfactory. The candidates were aware of the procedures that should be followed by a company in entering into a major transaction for which they obtained good marks.

Question 04

Part (a)

- (i) The candidates were asked to summarise the provisions contained in the Companies Act that should be considered or followed in conveying an extra ordinary general meeting (AGM). Some candidates had failed to understand this simple question and had focused their answers completely on irrelevant directions such as;
- (ii) According to section 136 of the Companies Act the procedure that should be considered in calling for an AGM is:-
 - (a) Notice of the meeting is required to be served under the provisions of the model articles.
 - (b) In the case of a private company two shareholders and in the case of other companies three shareholders present in person under the provisions.
 - (c) Any shareholder elected by the shareholders at a meeting may chair the meeting.

There were other irrelevant answers like;

- (a) Meetings are as follows.
General Meetings (GM), Annual General Meetings (AGM), Extra Ordinary General Meetings (EOGM)

For each of the meetings there are some minimum requirements [criteria] that have to be followed in holding the meeting. For instance an EGM cannot be called upon just on a request received from some shareholders.

- (b) EGMs usually mention the purpose of passing a special resolution to take important decisions of the company. For example removal of a director etc.

The question asks to summarise the procedure that should be followed in calling for an EGM as per the provisions contained in the Companies Act, some have gone on to explain the different types of meetings, the purpose of calling for an EGM/other meetings, entitlement of shareholders to vote at a meeting is passing a resolution, why an EGM needs to be called, the procedure that is followed for passing a special resolution etc.

A handful of others had misunderstood the EGM as the AGM of the company as they have not read the question properly. It is essential for them to first understand the question correctly before starting to write their answers.

Also there were a few instances where some candidates had confused an EGM with the General Meetings conducted by a company and so on to waste their time.

Part (b)

It is a direct question where the shareholders of Fingalss (Pvt) Ltd had been informed that the company may be wound up by courts as it is unable to pay its debts and the shareholders of the company wishes to request the courts to appoint Wishwa Pinto the main creditor of the company as its liquidator and requires the candidate to outline instances where a company is deemed unable to pay its debts and to explain whether Wish Pinto can be appointed as the liquidator. Many candidates had not understood the question and had furnished completely irrelevant answer.

Some others had expressed the view that even shareholders wish to appoint Wishwa Pinto as the liquidator and they have no power to do so and only the courts have the powers to appoint a liquidator.

Good side of the answers

- (a) Fair percentage of candidates had furnished satisfactory answers for this easy question and had summarized the relevant sections of the Act. i.e. sections 134, 134 (i), 135 (i) (b) and 135 (3) (b) and explained the procedure that should be followed in calling for an EGM for which they deserved good marks.
- (b) Many had correctly explained the instances where a company is deemed unable to pay its debts as has been detailed under section 271 of the Companies Act to earn a very high percentage of marks.

Large no. of candidates were aware that Whishwa Pinto cannot be appointed as the liquidator of Fingale (Pvt) Ltd since he is the main creditor of that company. They had correctly quoted the contents of section 383 and had stated that a creditor of the company cannot be appointed as the liquidator under section 383 of the Act for which they deserve full marks.

Question 05

Part (a)

Straightforward question and it required the candidates to state five services provided by the Central Depository System. A fair percentage of candidates had failed to understand this question and had focused their answers on some irrelevant points. They had dealt with some areas such as:-

- The central depository system is a deposit system in respect of services traded in the Colombo Stock Exchange and held securities in custody on behalf of the shareholders of the listed companies.
- Providing facilities for post traded fund settlement in respect of equity and debts.
- Facilitates electronic record keeping and automated clearance of shares

Dematerialisation means the process of a listed company's share certificates being converted to electronic form. Investors can give their physical certificates to the CDS and convert it to an electronic format. Re-materialisation is a process in which the electronic format are converted to physical certificates.

The candidates instead of stating 5 services provided by CDS have explained the details on the operations of the Central Depository System including its duties, responsibilities, share market operations and failed to give the required answer. This may be due to their ignorance of the subject or misunderstanding the requirements expected of them.

Part (b)

The question required the candidates to explain the procedure that should be followed on enforcing an arbitral award. A high percentage of candidates had failed to understand to what is required by this straightforward question and had focused their answers in various irrelevant directions and had furnished same answers such as;

Arbitral awards are final and court of law has no jurisdiction to interpret on merits of the awards. A court can only be set aside an award only on the limited grounds which have better set out the Act.

Good side of answers

There were a good number of candidates who had correctly given 5 or even more services provided by CDS earning very high or full marks. There were many others who had provided less than 5 services or partly correct answers earning a reasonable percentage of marks.

There were correct answers for part (b) of the question too. A few candidates obtained full marks. They had correctly explained the procedure that is to be followed in order to enforce an arbitral award. In their answers they had correctly stated that for enforcement of an arbitral award an application has to be made to the high court within 1 year.

It appears that some candidates have furnished their answer to both parts of question no. 05 which were more or less like carbon copies of details contained in the Business Level study text. It can be presumed that they had copied these areas to the Companies Act and taken to the examination hall and copied them again to their answer booklets as their own answers to the question.

General

As usual the grammatical mistakes, writing lengthy sentences with no sense, explaining numerous irrelevant areas, repeating the question were noted. Poor understanding of the articles and so on could be observed.

Tax part

General comments applicable to all questions

1. The subject matter tested was within the syllabus and adequately covered in the study pack published by CA Sri Lanka.
2. The model answers appear to be well planned and structured and can be considered as a reliable guide to the marking examiners.
3. Overall performance in the paper appears to be quite satisfactory since an examination of a sample of the bundle summaries suggests a pass rate of approximately 55% to 65% of the total candidates.

Question wise comments

The paper comprised of two (02) questions and carried 25 marks each.

Question 06

The candidates were required to compute the total income tax liability and the balance tax payable by a member of a group of companies providing freight forwarding services to exporters.

The question included:

- (a) Calculation of statutory income from the following sources:
 - (i) Trade income – this included an adjustment to profits.
 - (ii) Interest income – treasury bills.
 - (iii) Dividend income.
- (b) Deduction under section 32.
- (c) Qualifying payment relief under section 34.
- (d) Tax credits.

Specific comments

Instances where information given in the question was not understood.

- (i) Depreciation allowance - The question clearly indicates that the company's office and warehouse building are under construction as at the end of the year of assessment. However, a good number of candidates claimed depreciation allowance in respect of these buildings. Only qualified buildings constructed and used by the owner are eligible to claim depreciation allowances.
- (ii) Income tax rate – The intention of the examiner was to test section 58 (iii) and the information relating to the company was given accordingly. Such companies are eligible for a concessionary rate of 12% tax under item 22 in the fifth schedule to the Inland Revenue Act. However, a majority of the candidates applied the 28% rate of income tax stating that the company is a member of a group of companies.

Instances where the requirements of the question were not understood by the candidates.

- (i) The question required candidates to compute the income tax liability (that tax on taxable income) of the company.

- (ii) A few candidates attempted to compute deemed dividend tax thereby wasting valuable exam time.

Errors in principle/shortcomings in technical knowledge.

- (i) Business income –

1. Computation of adjusted trade profit-a few candidates computed this commencing with turnover instead of net profit as per accounts.
2. Staff training cost – most candidates treated this as an allowable cost. Section 25 (1) (q) stipulates such cost is allowable only if ‘such training is directly relevant to the duties performed by such employee before the commencement of such training’. Since this stipulation was not met, such training cost is disallowed.
3. General rent – Most candidates correctly treated this expense as disallowable without stating the reason for disallowance, section 25 (1) (x) allows ground rent only if it is paid.
4. Office building and warehouse – some candidates claimed depreciation allowance in respect of this building.

Depreciation allowance can be claimed only in respect of ‘qualified buildings’ which means the buildings must be used in the trade or business. Since the construction is not completed as at the end of the year of assessment, capital allowance cannot be claimed as the building cannot be used in the business.

- (ii) Interest income – some candidates mentioned that this had not formed part of the assessable income since withholding tax (WHT) has been deducted. In the case of companies WHT is an advance payment of income tax and not final tax.
- (iii) Deduction under section 32 – some candidates claimed 35% of the tax loss brought forward.
- (iv) Profits and income eligible for concessionary rate of income tax. Some candidates obtained such profits as the taxable income in proportion to the business income and total statutory income which includes interest income. The method is incorrect since such profits can be ascertained separately.
- (v) Rate of income tax – a good number of candidates applied the 28% tax rate stating that the company is a member of a group of companies.

In the given question, the nature of the business carried on by the company satisfies the conditions laid down by section 58 (iii) in terms of which the profits and income of such company is entitled to concessionary tax rate of 12%.

- (vi) Tax credit – surprisingly, a significant number of candidates claimed the tax losses brought forward from the previous year of assessment. Such losses are deductions under section 32.

Mistakes made in the application of concepts/formulae.

- (i) The capitalization

Some candidates made mistakes in the construction of the formula for determining the maximum interest allowable under section 26 (1) (x).

- (ii) Tax losses brought forward from year of assessment 2015/16 – A few candidates made mistakes in ascertaining the maximum of such loss that can be deductible.

- E.g.
1. 35% of the brought forward loss
 2. 35% of the assessable income

Common mistakes made by the students.

Majority of the candidates failed to identify the correct rate of income tax applicable to the company.

Building/planning of the answer.

Income tax computation – a few number of candidates claimed statutory deductions at improper places.

- E.g.
1. Deducting qualifying payments under section 32.
 2. Deducting tax credits from assessable income or taxable income.

Good side of the answers produced.

1. Majority of the candidates displayed excellent knowledge in the structure, identification of the statutory contents and presentation of a corporate income tax computation.
2. Majority of the candidates displayed sound knowledge of sections 25 and 26 of the Inland Revenue Act relating to allowable and disallowable charges/expenses.

Question 07

The candidates were required to:-

- Part (a) (i) - Assess the divisible profit of a partnership, partnership tax payable and the distribution of divisible profit among the partners.
- (ii) - State the information to be included in a partnership return.
- Part (b) (i) - Calculate the VAT liability of the partnership in respect of a given quarter.
- (ii) - Explain the provisions applicable to filing of VAT return and the payment of such taxes as per the VAT Act.
- (iii) - Recognise whether the partnership is liable to pay NBT, and if it is liable to compute the NBT liability in respect of a given quarter.

Instances where information given in the question is not understood.

- (i) Part (a) (i) The information given in the question clearly identifies Nalani as a non-equity partner. Majority of the candidates recognised this fact but included Nalani in the distribution of divisible profits.
- (ii) Part (b) The question clearly states that all income has been given exclusive of Value Added Tax (VAT). However, a good number of candidates answered on the basis that the income is inclusive of VAT.
E.g. A candidates computed VAT as follows, Rs. 2,500,000 x 100 x 15%.
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- (iii) Part 07 (b) (i) and (iii) – the information for computing VAT and NTB liability for the quarter ended 31 March 2017 is given in the question. However, a good number of candidates used $\frac{1}{4}$ th of the annual turnover for the purpose of computing the VAT and NBT liability for the quarter ended 31 March, 2017.

Instances where the requirements from the candidates are not understood.

- (i) Part 07 (a) (i) the question required candidates to compute only the partnership tax liability. However, some candidates computed, in addition to partnership tax, the tax liability of individual.
- (ii) Part 07 (a) (ii) the question required candidates to state the information required to be included in a partnership return.
 - 1. Some candidates discussed the consequence of not filing a return.
 - 2. Some candidates discussed whether the partnership should furnish a return or not.Item (i) and (ii) mentioned above are instances where candidates wasted valuable examination time earning no extra marks.
- (iii) Part 07 (b) (iii) the question required candidates to recognise whether the partnership is liable to NBT and, if so, to compute the NBT liability.
A good number of candidates either –
 - 1. Computed the NBT liability without recognizing whether the partnership is liable to NBT, or
 - 2. Merely mentioned that the partnership is liable to NBT without identifying the reasons for liability.

Errors in principle/shortcomings in the candidates answers.

- (i) Part 07 (a) (i) divisible profit
 - 1. Working partners share of profits. Majority (over 90%) of the candidates did not know that this is an allowable expense in ascertaining the adjusted trade profits.
 - 2. Computation of divisible profits – a good number of candidates made mistakes.
 - Not recognising that the working partner's share of profits is an allowable expense ascertaining the adjusted trade profits.
 - Identifying adjusted trade profit as divisible profit.
 - Ignorance of section 76 (2) which stipulates the basis of ascertaining the divisible profits of a partnership.
 - 3. Distribution of divisible profits.
 - Majority of the candidates identified Nalani as a working partner and correctly mentioned that the salary paid to her is an allowable expense in ascertaining the adjusted trade profits but included her in the distribution of divisible income which only an equity partner is entitled to.
- (ii) Interest on fixed deposits – some candidates treated this as part of the taxable income.

It should be noted that withholding tax deducted in respect of interest income received by a partnership is a final tax and therefore not liable to further taxation.

Part 07 (b) (i) Computation of Value Added Tax. A significant number of candidates made mistakes in computing the disallowable part of the common input tax.

Mistakes made in the application of concepts/formulae

- (i) Part 07 (b) (i) Majority of the candidates made mistakes in the application of the formulae for computing the disallowable part of the common input tax.

The question states that no expenditure was incurred in respect of designing of a survey plan for a Maldivian hotel. However, candidates overlooked this fact in applying the formula.

- (ii) Part 07 (b) (i) & (iii) – A good number of candidates applied the short cut method for computing VAT and NBT by aggregating taxable supplies/turnover of different nature and applying the VAT/NBT rate.

Candidates should display their knowledge of considering each kind of supply/turnover separately and applying the VAT/NBT rate because the nature of the turnover can influence tax liability.

- E.g.
1. Supplies taxed at standard rate.
 2. Supplies taxed at zero rate.
 3. Supplies which are exempt from tax.

Common mistakes made by the student

- (i) Majority (over 90%) of the candidates did not know that the working partner's share of profits is an allowable expense in ascertaining the statutory income from business.
- (ii) A significant number of candidates did not know that a working partner (non-equity partner) is not entitled to a share of the divisible profits.
- (iii) A good number of candidates made mistakes in computing the divisible profits. Candidates are advised to read section 76 (2) of the Inland Revenue Act for a better understanding of the statutory computation.

Any other comments to be communicated to students:-

- (i) Read the question carefully and understand the contents and the requirements clearly before attempting to answer. Candidates are given 15 minutes extra time to read and plan the answer.

This will help you to save valuable exam time of avoiding irrelevant and/or lengthy answers.

E.g. Question 7 (a) (i) requires only the partnership tax to be computed. However, some candidates computed individual partner's tax liability as well, thereby wasting valuable exam time earning no extra marks.

- (ii) Computation of adjusted trade profits always commence with the 'net profit as per accounts' figure.

Some candidates commenced the computation with the 'annual turnover' figure. This method should be avoided as it is cumbersome and time consuming. Besides, such a method of computation may not be acceptable to revenue authorities.

- (iii) Focus your attention on all relevant information given in the question and display your knowledge to the examiner even if such information does not require an adjustment to the income tax computation.

E.g. In question 7 (a) (i), salary paid to the working partner and rent paid to Vikum (equity partner) are allowable expenses and, therefore, no adjustments are necessary in respect of such items in the computation of adjusted trade profits.

A significant number of candidates know this fact but were silent without displaying their knowledge to the examiner. The examiner cannot assume that the candidates is knowledgeable unless expressly displayed.

(iv) Improve your handwriting and language skills.

The examiner cannot be expected to award marks to an answer which he cannot reach or understand.

(v) Begin each answer on a separate page. This requirement is also mentioned in question paper under 'instructions to candidates'.

It was observed that a few candidates commenced answering a question on the same page in which the previous answer ends.

KB4 – Business Assurance & Ethics

December 2017

Examiner's Comments

General comments

This paper consisted of two sections. Section 1 contained five questions for 10 marks each. Section 2 contained two questions of 25 marks each. As previous examination sessions, to score well in the exam candidates needed to demonstrate good technical knowledge on SLAuSs. Many candidates appeared to have lost focus on the requirements of questions and gave answers which are irrelevant and general, as a result they couldn't gain sufficient marks. It was observed that as the candidates have not followed the action verbs wasted time in writing lengthy answers when required only to state.

Specific Comments

Question no 01

This question was on the code of ethics. It was observed that the candidates have knowledge on the code of ethics, but they failed to understand the question and plan the answer. It reflects that they have not read the question several times in order to understand the question's requirements. If they had practiced the past question papers they could have understood the question well.

Part (a)

It was required to state factors that a professional accountant considers when disclosing internal information to a third party. The examiner expected the candidates to peruse the study text. Even though the general points were also considered, the examiner expected the candidates to give specific factors. Majority of the candidates wrote the following points.

- Disclosure is permitted by law and authorized by the client
- It is a professional duty to disclose

Many candidates have written incomplete, and irrelevant points such as;

- As SLAASMB is a professional body, corporate body
- To resolve a problem of a member
- To maintain a relationship between the company and the stakeholders
- For prospective investors to assess credit worthiness

Part (b)

It was required to discuss the action that Sunil should take in compliance with the code of ethics for professional accountants issued by CA Sri Lanka. The examiner expected the candidates to discuss, which means that they should examine in detail by argument showing different aspects for the purpose of arriving at a conclusion. The candidates were expected to address why the internal information should not be disclosed to a third party, if disclosing it when it should be disclosed and how it should be disclosed. Most of the candidates just wrote that the internal information should be disclosed to SLAASMB as it is required by law. Most of the candidates have produced incomplete and irrelevant answers such as;

- Arrange a meeting with the SLAASMB
- Find other alternatives
- Get legal advice

Part (c)

It was required to state the parties that can be appointed as an auditor of Bluesky (Pvt) Ltd. This part of the question was answered well.

Question no 02

Part (a)

It was required to state the principles set out in the code of Best Practice on Corporate Governance 2013 with regard to the roles and responsibilities of board of directors (BOD). The candidates who had gone through the code and studied the text book have produced satisfactory answers. Many candidates have ignored the code of Best practice on corporate governance and written the general responsibilities of BOD such as;

- They are responsible for the financial statements
- They are responsible for designing implementing and maintaining of internal controls
- Achieve objective of the company
- Responsible to the shareholders for the activities
- To ensure going concern of the company
- Appoint auditors

Although these points are not incorrect, the examiner expected the candidates to refer to the code and produce specific answers.

Part (b)

It was required to summarize functions of the audit committee. Many candidates had written satisfactory answers. There were some incomplete and irrelevant answers such as;

- Provide information to the external auditors
- Discuss significant changes in the business cycle
- Review uncertain areas of the company

Part (c)

It was required to list benefits to the company of establishing an audit committee. This part of the question also was answered well. There were some irrelevant answers such as;

- To create a goodwill as sales will be increased
- To get a unmodified opinion
- To able earn profits and pay dividends
- Can implement Corporate Governance
- Maintain financial reports with quality

Question 03

Part (a)

In this part of the question it was expected to identify control weaknesses of the given scenario. There were some satisfactory answers. Many candidates have identified the weak areas, but they have failed to address what sort of internal controls should be in place in order to control such situations such as;

- At stores the GRN is issued and both copies are filed - this is only the event and the control weakness is that **there is no check of quality** which will affect inventory valuation
- PO is sent to the supplier at the purchase manager's discretion- this is an event, the control weakness is **that no authority for the purchase** which leaves room for frauds
- Stores clerk raises the GRN and also updates the records-this is an event. the control weakness is that there is **no segregation of duties** which leaves room for frauds

(ii) It was required to outline potential implications arising from each control weakness which has been identified. Some candidates have produced satisfactory answers. Many candidates without referring to the scenario have written general implications arising out of control weaknesses such as;

- No segregation of duties-Corruption
- No tender board-frauds

Most of the candidates did not understand the implications and they have written recommendations to minimize the risk such as;

- Establish proper supplier selection process
- Always check the specification and quantity with the purchase order

Part (b)

It was required to recognize important points that should be considered when preparing written communication on internal control matters. Majority of the candidates have demonstrated poor subject knowledge. Some candidates have written irrelevant answers such as;

- Should state that the management is liable for internal control
- The information given in the communication should be in accordance with SLAuS

Question 04

Part (a)

It was required to explain how a risk assessment helps the auditor when performing an audit of financial statements. Many candidates were unable to understand the requirements of the question; it may be due to the poor communication skills. The candidates are advised to read the question several times to understand the requirement. Some have wasted time in discussing the SLAuS and explained how the risk assessment is carried out instead of writing how it helps the audit. There were irrelevant answers such as;

- Assess the internal control procedure
- Conduct SWOT analysis
- Study the industry in business

Part (b)

It was required to assess audit risks in the financial statements of Softek. Many candidates have failed to understand the audit risks. Most of the candidates had written business risks instead of audit risks such as;

- Heavy competition
- Poor after sales service
- Customer dissatisfaction

Part (c)

It was required to outline audit procedures for the risks identified. Many candidates have written general audit procedures such as;

- Perform substantial procedure
- Inquire from management
- Carryout analytical review
- Carryout physical verification of assets

Part (d)

In this part of the question it was asked to demonstrate the most appropriate benchmark for calculating the materiality of the financial statements. Most of the candidates have identified the benchmark but were unable to give reasons for the selection. Some candidates have identified incorrect benchmarks such as the net assets and given reasons as;

- Profits are affected by net assets
- Net assets are reflected in financial statements
- Revenue cannot be taken as it always fluctuate

Question 05

Part a; It was required to differentiate the risk of material misstatement at the financial statement level and the risk of material misstatements at the assertion level. It was disappointing to note that most of the candidates were unable to identify the difference between the financial statement and the assertions. They should be trained to give the specific answer. Most of the answers carried irrelevant points such as;

- Material misstatements at financial statement are identified through test of controls
- Material misstatements are identified through substantial testing as it contains assumptions and estimation.

Part b; It was required to outline two conditions that may indicate the risk of material misstatement at the financial statement level of the given scenario. The examiner expected the candidates to write the audit risks which were not understood by many candidates. It was observed that majority of candidates were not able to identify the events that affect the misstatements at the financial statements. It reflected that they were not aware that there are audit risks due to such events, sometimes if the question was to identify the audit risks they would have answered well. They have written irrelevant answers such as;

- Decrease in sales
- Need 50 m profit after tax to get bonus
- Application of wrong accounting standard
- Damage to the goodwill
- Due to extended credit period increase of trade receivable

Part (c)

It was required to outline risks of material misstatements at the assertion level of UB. Most of the answers demonstrated poor knowledge on assertions. The examiner expected from the candidates to address the following assertions.

- Inventory valuation
- Provision for trade receivable
- Provision for warranty claims

Most of the candidates have written irrelevant answers without identifying the risk such as;

- Replace with cheaper raw materials
- Finance controller has been dismissed
- Unable to service bank borrowings according to repayment schedule
- Fraudulent financial reporting to get bonus
- Manipulate revenue to get bonus
- Risk of high interest payable

Question 06

Part (a)

It was required to state four audit procedures to be performed prior to attending the inventory count. Many candidates have not understood the question requirement and have not planned their answer. They would have started writing without reading the question. Most of the candidates wrote the audit procedures which are performed during the inventory count. Most of them ignored the fact that 30 showrooms are located across the country. Most of the candidates have produced irrelevant answers such as;

- Get signature of the authorizing officer
- Check values and quantities with the GRNs
- Request to computerize inventory records

Part (b)

It was required to summarize the audit procedure to check inventory which should be valued at net realizable value. Many candidates have written audit procedures to verify the NRV of the inventory. If the candidates have read the scenario properly they could have easily answered this part of the question. In the given scenario it was stated that there are high value items and a considerable stock is gathering dust. Many candidates were unable to produce satisfactory answers. They produced irrelevant answers such as;

- Check assumptions used for inventory valuation
- Check the suitability of estimation
- Check barcode
- Get the advice of an expert
- Get a valuation done
- Inquire for the market value
- Obtain written representation

Part (c)

- (i) It was required to discuss the audit issue relating to the inventory as per LKAS 10 (Events *after the reporting period*)

The candidates were expected to discuss the issue as per the LKAS 10. Most of the candidates were not aware of the principle behind the LKAS10, which states that any event after the period end and which give additional information of conditions that existed at the period end should be adjusted. The candidates should have discussed that, it is a condition after the reporting period but the audit report not been issued yet. Many candidates have failed to recognize that NRV adjustment should be made to the inventory which has been sold at a lower price after the Balance Sheet date. Some candidates demonstrated poor technical knowledge and wrote that it should be disclosed in the audit report or modify the opinion as the NRV of the inventory is less than the cost. Some candidates have stated that it is a non-adjusting event. Those who have identified as an adjusting event also did not discuss about the adjustment.

- (ii) It was required to outline the action that the management should take with regard to such an issue. Some have answered this part satisfactorily. Most of the candidates who attempted this part just wrote the issues in the scenario. Some have written that management should take steps to disclose

Part (d)

This part of the question was on the appropriateness of obtaining written representation for the amount receivable as a form of audit evidence. Most of the candidates demonstrated poor technical knowledge. Some candidates were of the view that the most appropriate audit evidence is the written representation. Most of them justified saying that as it is from internal source it is more reliable. Many candidates failed to discuss that it is internal to the organization and will often need to be corroborated to sources of evidence from third party. Most of the candidates have not understood that reliable written representation does not affect the nature or extent of other audit evidence to be obtained by the auditor.

Part (e)

It was required to discuss the action that the audit team should take in response to the refusal of sending confirmation. Some candidates have identified that imposing limitation on receiving

confirmation is a matter to be considered for modifying the opinion but they have not discussed applying their knowledge on other audit procedures. There were irrelevant answers such as;

- Withdraw from the engagement
- Mention in the management letter
- Auditor himself should call for confirmation

Part (f)

It was required to state action that the auditor may take when the management refuses to provide written representation in connection with warranty provision. Some candidates have wasted time in writing lengthy answers ignoring the meaning of the action verb. Some have produced relevant answers but some have produced points which were not the specific answers expected. Following are such points.

- Seek advice from CA Sri Lanka or from a legal firm
- Mention in the management letter
- Carryout audit procedure such as;
 - Calculate warranty provision
 - Reconcile current year provision with last year
 - Check the adequacy of the provision

Question 07

Part (a)

(i) It was required to state the responsibility of the auditor in connection with the opening balances. Most of the candidates identified the responsibility of the auditor with regard to checking of opening balances. The candidates have failed to address the issue that the auditor should check that the appropriate accounting policies have been applied and if any changes have been made to the opening balances and whether it is properly accounted. There were some answers stating that checking the opening balances is not a responsibility of the auditor and the management is responsible for providing accurate opening balances. Some have produced irrelevant answers such as;

- Check the land value with the value given in the deed
- Check the documents for the bank loan to ensure the balance
- Provide security to the warehouses

(ii) It was required to outline the impact on the audit report if the auditor is unable to confirm the opening balances. Most of the candidates wrote that the audit report should be modified but failed to assess the issue and write the particular modification. Some have not understood the word impact and wrote the audit procedures to be carried out in checking the opening balances. Some candidates wrote answers such as if the opening balances are not confirmed it will effect on provision for bad debts which is not the direct impact on the audit report.

Part (b)

It was required to write audit procedures to test the opening balances of land and buildings. Some candidates have produced satisfactory answers. This is a theoretical question, but some candidates wasted time in explaining the issues in the given scenario. Some have written irrelevant answers such as;

- Check the deeds

- Physical verification
- Inquire from management
- Obtain assistance from a valuer

Part (c)

It was required to identify the financial statement line items where the balance for the financial year end are misstated. Most of the candidates produced satisfactory answers. There were some answers giving completely irrelevant answers such as;

- Long standing bank loan and high borrowing costs
- Short term liabilities and long term liabilities are not recognized, which results in misstatements.
- Closing balance of the inventory exceeds the materiality level which has an impact on the financial statements.

Part (d)

It was required to outline the impact on the audit report when the auditor was unable to attend the inventory count. The candidates demonstrated poor technical knowledge in forming audit opinion. Most of the candidates were unable to plan the answer assessing the significant points such as;

- Whether it is a reason for qualification
- What are the steps that the auditor can take to ascertain the accuracy of the balance
- If the auditor was able to obtain sufficient and appropriate audit evidence, and was unable to reconcile what is the impact on the report

Part (e)

It was required to write benefits of documenting the audit work performed. This part of the question was answered well.

Part (f)

It was required to outline the circumstances that could be considered as significant matters under SLAuS 230 audit documentation. Some candidates have produced satisfactory answers. Some have written general answers such as;

- When the government is imposing new regulations
- When there is a change of the public opinion
- When there is litigation
- When they loose a major agency

Some have written irrelevant answers such as;

- When physical verification is not carried out
- When capitalizing the interest
- When computing the borrowing cost

Conclusion

Many candidates have demonstrated poor technical knowledge. They should be aware of with past experience that the questions are within the syllabus and most of them can be answered if the text book is referred.

KB5 – Business Value Creation

December 2017

Examiner's Comments

Question-wise comments

Question 01

General comments

Overall performance of the candidates was good. The question carries 10 marks and requires candidates;

- (a) to assess the interest & power of three main stakeholders in the given scenario and state how ABC should respond to the concerns.
- (b) to demonstrate two types of responsibilities that ABC has towards its stakeholders.

Specific comments

- (a) Some identified 3 stakeholders correctly and explained their level of power and interest and also the response of ABC to their concerns. They concluded that ABC should take the views of the 'People Watch' carefully and decisions taken in this regard need to be informed to the employees of ABC. Some students incorrectly stated that the group with high interest and high power need to be informed about the activities taken by ABC rather than their ideas being taken over by the management of ABC.
- (b) A fair number of students have correctly demonstrated responsibilities like legal, social and economic responsibilities. Some just listed out responsibilities and lost some marks. Some have not identified the category/type of responsibility but they have explained responsibilities, for example ABC needs to reduce the impact to the environment when using plastics.

Question 02

General Comments

Overall performance of the candidates was good. This question carries 10 marks and requires candidates;

- (a) to identify two aspects of logistics and physical distribution that QPL needs to consider in its operations.
- (b) to analyze how a Warehouse Management System (WMS) would enable QPL to improve its operations.

Specific comments

- (a) The examiner expected to identify 'Location of Warehouses, Method of transport and size of transport vehicles' as the answer. Some just listed out these aspects whereas a few identified the aspects under reference providing relevant details like delivery times, costs, different methods of transport. Some incorrectly identified the aspects as inward logistics and outward logistics.
- (b) Some correctly analyzed as to how WMS helps QPL to reduce costs, speed up the delivery process, provide an automated link between order processing and logistics management, to track products using RFID/Bar codes and maximize the use of warehouse space etc. Some could not analyze as to how products are tracked, costs are reduced and the delivery process is sped up.

Question 03

General Comments

Overall performance of the students was good. This question carries 10 marks and requires students;

- (a) to explain 03 main problems with R&D
- (b) to discuss why innovation is important

Specific comments

- (a) Some candidates explained the main problems correctly under 'Organization and Management', 'Financial', 'Evaluation & control' and 'Cultural issues'. Some just mentioned R&D is a costly exercise and were not certain about the return and cash flows. Some stated a lack of resources as a problem with R&D, which earned no marks.
- (b) Some kept on writing in different ways that innovation is important to a Company like Multi Pharma which earned no marks. Only a handful of students stated that due to the rapid pace of technology change and to survive in the competitive market, innovation is required. According to them, innovation provides new ways of manufacturing or delivering a service. According to some, innovation leads to a differentiation strategy which earned no marks. Some students have listed out benefits of innovation like keeping market leadership, keeping good name in the market etc. which is not the way candidates are expected to answer.

Question 04

General Comments

Overall performance of the candidates was satisfactory. This question carries 10 marks and requires candidates;

- (a) to state the difference between batch production and chain manufacturing
- (b) to explain four elements of quality costs and how it could be minimized

Specific comments

- (a) A fair number of students have written correctly that every item in a batch is the same and slight differences could be obvious when batches are taken into consideration. Chain manufacturing method is used to produce a standard item with a high volume and as a result the unit cost of production becomes lower compared to that of batch production. Some incorrectly mentioned the unit cost of batch production is lower compared to that of chain manufacturing.
- (b) Most of the students correctly explained four elements of quality costs, namely prevention costs inspection & testing costs, internal failure costs and external failure costs. Some just listed out the cost categories. Only a few stated how quality cost could be minimized. Inspection costs and correction cost need to be avoided completely and the aim should be to achieve zero defects. Some stated external failure cost needs to be avoided since the image of the Company could be damaged but those students were silent on the cost of internal failure and inspection costs.

Question 05

General Comments

Marks obtained by most of the students were very low. The question carries 10 marks and requires students;

- (a) to explain the prevailing culture at AAL (i.e. name of the Company mentioned in the question.)
- (b) to recommend an appropriate culture to overcome the present issues of the Company

Specific comments

- (a) Only a few explained the prevailing culture and concluded it is a power culture. Some of those who opined a power culture was in existence could not justify same citing facts from the given case. E.g.: they did not state that Arun discouraged others to make their opinions. Some cited certain relevant facts like AAL did not have a formal authority structure to make decisions but could not conclude clearly that the prevailing culture was a power culture. A few concluded the prevailing culture as bureaucratic.
- (b) Most of the students could not recommend the appropriate culture as 'task culture' with justifications. Some just named the culture as 'task'. Some were able to cite relevant facts from the scenario given but did not conclude and recommend 'task culture'. E.g.; they opined that decision making should not be centralized. Some incorrectly recommended 'role culture' as a solution to the existing issues citing the fact that employees could express their views under role culture. A few recommended an innovative culture which earned no marks.

Question 06

General Comments

Average performance of the students was poor. The question carries 25 marks and requires students;

- (a) to analyze the business strategy for expanding the business under option I.

- (b) to analyze Porter's generic business strategies to determine the best strategy in Implementing option 2 to expand the business.
- (c)
 - (i) to differentiate the leadership styles of Ramesh and Suresh
 - (ii) to recommend the most appropriate leadership style
- (d) to recognize two financial and two non-financial KPIs to measure performance under Option 2.

Specific comments

- (a) The Soft drink industry has little opportunity to differentiate and therefore Tasty Cola is unable to differentiate. Option I expands the same production on a large scale aiming at high competition and customers are conscious about the price. Tasty Cola is able to reap economies of scale. Under these circumstances 'no frills strategy' is the most suitable which contains a low price with low perceived product benefits. Most of the students recommended a low price strategy and some managed to get some marks for the analysis directed towards a low price strategy where they stated that the Company could harness economies of scale due to mass production, however when they made a conclusion on price strategy they ignored the fact that a low price strategy offers better value than competitors, information to that effect was not available in the given scenario. Some just concluded a 'Low cost leadership strategy' as an appropriate strategy.
- (b) Most of the students managed to earn some marks, describing the 'cost leadership', 'differentiation' and 'focus' strategies Porter suggested. Nevertheless most of the students could not analyze the information given in the scenario in a way which would lead to a 'focus differentiation strategy'. A fair number of students proposed differentiation for option 2 citing that there are some consumers who now seek soft drinks made out of natural ingredients without sugar.
- (c)
 - (i) A fair number of students have correctly drawn the Managerial Grid. But most of them have not identified one feature of the Leadership Style of Suresh, (i.e. less productivity.) Some students viewed that Ramesh follows a sell leadership strategy whereas Suresh follows participative decision making without Blake Monton Managerial Grid being associated. Ramesh follows a 'Task management-leadership style' whereas a 'Country Club' style is being followed by Suresh as per some students who earned marks.
 - (ii) Some just recommended a 'Team Management' leadership style for Tasty Cola as the most appropriate style but they were unable to provide reasons. Only a few students justified the style citing productivity in a competitive environment needs to be focused while Tasty cola has to retain experienced employees without allowing them to join with competitors. Some incorrectly recommended a 'task management' leadership style as the most appropriate since it leads to an increase in productivity.
- (d) Most of the students have provided an acceptable financial KPIs E.g. '5% increase in net profit margin by 2019'. But a few students provided incomplete financial KPIs. 'Revenue turnover', 'GP margin' etc. Some incorrectly mentioned 'brand name', 'environment pollution', 'number of employees needs', as non-financial KPIs. '10% reduction of number of customer complaints by next year', 'zero defects by next year' are some acceptable non-financial KPIs.

Question 07

General Comments

Overall performance of the students was poor. The question carries 25 marks and requires students;

- (a) (i) to recognize suitable target markets for Airline 1 and Airline 2 based on appropriate demographic segmentation variables
- (a) (ii) to advise CEO on how to position the above two airlines in the market using the positioning map
- (b) to explain the service marketing mix that you recommend for Airline 1
- (c) to explain benefits of using Customer Relationship Management (CRM)

Specific Comments

- (a) (i) Some have correctly identified that Airline I could be targeted for high income earners and low income earners need to be targeted by Airline 2. However they have not adequately cited the facts given in the scenario to validate the basis of segmentation, i.e. Level of income of the passengers.
 - (ii) Some have correctly drawn positioning maps and Airline I has been positioned between High quality and high price whereas Airline 2 was positioned between 'low price and 'low quality'. However most of the students could not adequately justify the positioning under reference. Eg: Airline 2 caters to budget travelers at a lowest cost by providing limited facilities.
- (b) Almost all the candidates have listed out the service marketing mix. But most of the candidates did not explain the marketing mix in relation to Airline I. Place means locations of service touch points and therefore the airport in Singapore and other premium destinations like ticket counters. Some mentioned only 'Airport' as place. Promotion for Airline I means advertising at the media reach to premium customers, online promotion. Some just mentioned 'promotion mix' without explaining it further. Most of the candidates explaining 'people' stated staff of the Airline I should be professionally trained and should have the highest level of skills, but they were unable to highlight the staff as 'front office employees' and 'cabin crew' and they were also unable to mention what is most important is to provide a courteous professional service in order to delight passengers of Airline I.
- (c) Some correctly explained that updating the customer database about customer's future intentions and buying preferences to make selling propositions (e.g.: arranging tour packages for corporates) and to send personalized sales promotions and as a result sales could be increased. Some just mentioned loyalty, intangible benefits, satisfaction of customer needs etc. without explaining as to how sales could be increased using CRM. A few mentioned that by getting to know the customer on individual basis and getting the customer to understand what the Company knows about them and by using the knowledge about the customer to provide greater customer satisfaction, Sunny Travels PLC could increase sales.