

## **KB1 – Business Financial Reporting**

**December 2019**

### **Examiner's Comments**

#### **Question 1 (10 Marks)**

Conceptual framework of Financial Reporting revised in 2018 and Corporate Governance in relation to the Board of Directors were tested.

Most candidates answered this question and were found to be at a satisfactory level.

Part (a)

The criteria to determine an asset were not properly explained by some of the students.

Part (b)

Some students had given a List of Duties of Directors instead of describing the role of Corporate Governance, by Directors.

Overall performance was at an acceptable level.

#### **Question 2 - 10 Marks**

Students were expected to know the LKAS 8 in this question.

The answer was expected to identify the error in Grant Accounting and present Extracts of Financial Statements together with Disclosures. Some students had not prepared the Extracts and had shown "T" accounts. Though the question itself indicated the need for accuracy of depreciation accounting, most students had re-calculated depreciation, displaying a lack of understanding of the question. The examiner's expectation with regard to the action verb "prepare", was not met by most of the students, who had copied the Disclosure Note directly from the Reference Books instead of describing its application.

Other observations – Amortization of Grant had been shown as an expense instead of as deferred income. Grant balance was shown under Revenue Reserve instead of identifying it as Non-Current Liabilities. Restated amounts had not been shown for 2017 under Extract of Statement of Income. Prior period error correction of Grant Amortization had been computed for one year instead of for 9 months.

#### **Question 3 - 10 marks**

This question was to test students' knowledge in computing Impairment Provision in relation to Trade Debtors as per SLFRS 9.

A majority of students may not have had sufficient knowledge to apply the related standard or were unaware of the contents of the standard.

A fair number of students had used either PD or LGD and multiplied the gross carrying value without showing the multiplication of both figures to arrive at the provision. Even students who had some knowledge had ignored the Rs. 2 mn balance of the 'bankrupt debtor' and simply applied the collective impairment factor to the total balance of Rs. 50 Mn.

Overall performance was very poor and a few students with some technical knowledge managed to secure some marks.

Only a few students had attempted and secured full marks. Many students had not attempted the question.

#### **Question 04 - 10 marks**

Part (a) the computation of basic profitability ratios and liquidity ratios was expected by the examiner.

Part (b) the ratios calculated as above had to be interpreted and discussed, to establish the accuracy of the CEO's statement.

Part (a) – Most students earned full marks. Some students however, failed to apply correct formulae in a straight forward calculation. Others had added the inventory value to current assets demonstrating that they were not aware that inventory is a part of current assets.

Part (b) – A considerable number of students had not understood the purpose of discussing the CEO's statement. As a result they had not given conclusions about the CEO's statement. Some students had given detailed analysis and computations, without linking them to the CEO's statement.

#### **Question 05 - 10 marks**

Part (a) Knowledge re Cash flow - to identify relevant activity of a transaction had been tested under indirect method.

- (i) Share issue to related parties, no impact on cash flow. This was not properly understood and incorrect answers were given by many candidates.
- (iii) Investment in very short term maturities is equivalent to cash but most candidates' answers identified this as an investment activity.

Lack of knowledge of concepts in relation to cash flow was evident in such incorrect treatment.

Part (b) Accounting treatment in relation to leases –SLFRS 16 had been tested.

In calculating depreciation on right to use assets, many did not know the asset should be depreciated on a straight line basis over the shorter of its estimated useful life or the lease term.

Students failed to elaborate on Recognition of lease and non-lease components & charging to revenue.

Students failed to compute the interest portion in the installment and the lease liability accurately.

Overall performance was not at an acceptable level while part (b) was not attempted by most of the students.

### Question 06 -25 marks

This question was designed to test application of knowledge of consolidated accounts with an Associate company.

A majority of the students scored more than 50% of the total marks allocated.

However, a large number of candidates had not understood the adjustment for unrealized profit on intercompany sales and incorrectly adjusted inventory. Further students had trouble distinguishing between markup and margin.

Some students had incorrectly consolidated the Associate company, considering it as a subsidiary.

Further some students had failed to eliminate intercompany receivables and payables.

Impairment in an Associate company should have been adjusted from 'investment in Associate' whereas students had made adjustments to the 'goodwill account'.

The interim dividend paid was already adjusted against retained earnings of the Associate but some of the students have re adjusted to retained earnings.

Deferred Consideration and Interest on Deferred Consideration had not been correctly computed by some, and Interest Cost on Deferred Consideration and Excess Depreciation on Building had not been correctly taken for a 11 month period.

Most students failed to arrive at correct Deferred Tax amounts and in some instances, Deferred Assets and Liabilities had erroneously been adjusted to the Goodwill computation. Some had even computed Deferred Tax on additional Depreciation which was not an item for which Deferred Tax was required to be calculated.

Cash in Transit was ignored in consolidation by some students.

Post-acquisition Profit in the subsidiary had been incorrectly calculated by some.

Overall performance was at an acceptable level.

### Question 07 – 25 marks

This question was mainly framed to test the practical application of some accounting standards.

Part (a) – Accounting for different patterns of consumption, and economic benefits of component wise PPE were tested. In relation to the same machine components, impairment was tested under a practical situation, banning machine usage. In this question, events after the 'end of reporting period' and 'relevance for reporting of adjusting events or non-adjusting events' were also tested.

Except for the answer to part (a) (i) of the question, students had made many 'errors of principle' and displayed a lack of technical knowledge of related standards. In part (a) (i), too, though they had calculated the required outcome such as depreciation or maintenance cost, they had not indicated the accounting treatment (eg. depreciation to be charged to the cost of sales).

- (a) (ii) Even though students had calculated value in use (Rs. 4 Mn) and FV less cost to sale (Rs. 3.61 Mn) correctly, they had compared net carrying value with FV less cost to sale (Rs. 3.61 Mn) which was an erroneous calculation of impairment.

Further due to an erroneous calculation of value in use (less than Rs. 3.61 Mn) they had recommended the machine be sold for Rs. 3.61 Mn, which was incorrect treatment, as scrapping of the machine was effective only in 1 April 2023, even though it was announced on 30 June 2019.

Incorrect determination of impairment loss had arisen mainly as a result of incorrect calculation of value in use. In arriving at the value in use, many had failed to recognise the discounting of maintenance cost for three years. They had merely deducted Rs. 2.5 Mn from future cash flows of Rs. 5.93 Mn (without discounting). Due to this error, net value in use stood at Rs. 3.43Mn, which was less than the net disposal proceeds of Rs. 3.61mn.

Even though value of future cash inflows Rs. 5.93 mn was clearly stated in the sum as being at present value, a fair number of students disregarded this information, and discounted this present value again, using the discounting factor of 12% for three years.

iii) Since the information regarding scrapping the machine came before publishing financial statements, a majority concluded that it was an adjusting event.

They failed to state that there was no indicative result with regard to this as at 31 March 2019. Even though some of them did identify this as a non-adjusting event, they failed to indicate the requirement for disclosure.

Part (b): This part was to test performance obligations as per SLFRS 15 – Revenue from Contracts with Customers.

Most students had considered the discount (for both corporate and domestic customers) for all 3 services, this being inapplicable to domestic customers.

Rather than providing the discount calculation, some had mentioned the 5 step model in standards, which resulted in wasted time, due to not scoring any marks.

Most students ignored the action verb and had done only calculations related to the question. A majority of the students had shown vary poor performance in answering this question.

## **KB2 – Business Management Accounting**

**December 2019**

### **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 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 other subsequent steps, which would 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.

##### **Overall Performance of the candidates**

Question paper was a well-balanced paper and a very fair paper, from a students' point of view. The average pass rate was around 29% and average marks scored by students was around 44.

##### **Question 01**

###### **General Comments**

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

The average performance for the question was **6 marks** out of 10 marks allocated and almost all candidates had attempted this question.

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

###### **Part (a)**

Candidates had scored 4 marks on average for this section and many candidates had made a mistake in applying the discount awarded to the supermarket. Many had applied 25% instead of a 30% special discount offered.

###### **Part (b)**

Some candidates had scored the allocated marks for this section but candidates who had made the above mistake in part (a) could not perform this part well and hence lost marks.

### Part (c)

Candidates had not performed well in this part, as they had just provided the actions that can be taken to increase profitability in general, whereas the question clearly asked for initiatives that the management of HPL could take, to improve the profitability of the company, based on Customer Profitability Analysis (CPA) prepared for part a. This showed that candidates had not clearly understood the question. The reason may be that the candidates had not practiced building up the answers to such questions, in a particular way, as related to the scenario given in the question, which was expected from Business Level Students.

### Question 02

94% of candidates had attempted this question, yet overall performance in this question was not at an acceptable level. The average mark scored for this question was around 2.5.

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

#### Part a

The first part of the question was a very straight forward theory question and the answer was readily available in page 97 of the Study Text, but many candidates had not provided the correct answer. In the second part, some candidates had just mentioned the features of one of the two costing methods. But the question asks for the differences, and candidates were expected to identify the features, and explain difference between two costing methods.

#### Part b

Some candidates had explained the process of TQM but had failed to also explain how its principles would impact the profitability of the company. A few candidates had just mentioned principles but they had not related to the profitability impact.

### Question 03

This Question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 10 “Further Processing Decisions”.

The average marks obtained by the candidates is **4.5 marks** out of 10 marks allocated and around 21% of candidates had not attempted the question with 10% of candidates scoring “0” marks.

Many candidates had scored full marks for part (a) of the question.

However some candidates had not understood the requirement of the question and had presented irrelevant answers. One common mistake made by candidates was that they had taken the individual sales prices instead of the total sales value, to split the Joint cost.

They had then ended-up with incorrect answers as follows:

	NH	CL
Sales Price	5,000	7,500
Cost Allocation (M)	$\frac{5,000}{12,500} \times 40$ = 16	$\frac{7,500}{12,500} \times 40$ = 24

Candidates performance in part (b) was poor when compared to part (a) and they had not scored reasonable marks. Many candidates had incorrectly computed the minimum price of CL as follows

Minimum Price = (Opportunity cost + Incremental cost) / Number of units

$$\begin{aligned} &= (7500 \times 3200 + 8,000,000) / 3,200 \\ &= (24,000,000 + 8,000,000) / 3,200 \\ &= (32,000,000) / 3,200 \\ &= 10,000/- \end{aligned}$$

#### Question 04

##### General Comments

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

The average performance for question 04 ranges from **3.5 to 4 marks** out of 10 marks allocated. Around 7% of the candidates had not attempted the question.

##### Part (a)

Many candidates had provided acceptable answers and scored reasonable marks for this part of the question.

##### Part (b)

Most candidates had not understood the question. They had provided examples for responsibilities, instead of criteria to determine a responsibility center.

##### Part (c)

Many candidates had argued that the Seetawaka factory was a Profit center rather than a revenue center and some candidates had totally rejected the FDs suggestion and argued that it is as an Investment center, which is not the case here.

It showed candidates did not have adequate knowledge to identify the type of responsibility center based on the activities carried out by the center.

##### Part (d)

Many candidates had not understood the requirement in the question and had explained the importance of cost control, which would help to increase performance and profitability of the responsibility center.

#### Question 05

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

The average marks for question 05 ranges from **1.5 marks to 2 marks**, out of the 10 marks allocated. Around 5% of the candidates had not attempted the question and 25% of the candidates scored “0” marks.

##### Part (a)

Many candidates had knowledge re computing the EOQ but had failed to apply that theory in the practical scenario, where a discount was offered. They had just computed EOQ at the price of 1,600 and failed to construct the answer beyond that level, whilst some candidates had computed the EOQ for all 3 prices, but failed to assess the total cost, and evaluate the most economical order quantity.

It showed that candidates did not have adequate knowledge to apply the EOQ theory in practical scenarios.

**Part (b)**

Many candidates had not understood what was required in the question and had failed to provide the correct answer. The answers to this question, were the poorest.

**Question 06****General comments**

This Question had been designed to test the Intended Learning Outcomes (ILO) of Chapter 4 “Standard Costing As a Planning and Control Technique” and Chapter 6 “Budgeting for Planning and Control” of the CA Sri Lanka Study Guide.

Answers to question 06 averaged scores ranging between **13 to 15 marks** out of a total 25 marks allocated. Only 1% of candidates had not attempted the question, whilst 2% of the candidates had scored “0” marks.

Most candidates who had completed the paper had scored more than 15 marks for this question since part (c) of this question was relatively easier, enabling them score 12 marks.

**Part (a)**

Candidates had not performed well in this part of the question, and most candidates had focused only on the production budget and given the answer.

**Part (b)**

Most candidates had performed well in this part. Some candidates however, had taken the actual sales price when computing the flexed budget column.

**Part (c)**

Most candidates had performed very well and scored marks in this part, as it is a very straightforward question, based on the information provided in the question.

**Part (d)**

Many students had performed well in this part of the question based on the answers arrived at in part (c).

**Part (e)**

Some candidates had not really understood the question and had provided irrelevant answers, whilst others had performed well.

**Question 07**

This question has been designed to test the Intended Learning Outcomes (ILO) of Chapter 16 “Risk and Uncertainty in Decision Making” of CA Sri Lanka Study Guide.

The average performance for question 07 ranged between **10 to 12 marks** out of 25 marks allocated and approximately. 7% of candidates had not attempted the question.

**Part (a)**

In this section the examiner was testing the application of knowledge, in Problem Solving using a Decision Tree Diagram.

**Sub Part (ii)**

Most candidates had drawn the requested Decision Tree Diagram and scored full marks.



**Sub part (ii)**

Many candidates had done the evaluation and were able to score approximately. 5 marks, out of 12 marks.

The following common mistakes were made by the candidates.

1. The Scrap Value of the project had not been considered in the evaluation.
2. The Time Value of the Cash Inflow / Outflow had not been considered, and as such, they had not computed Present Value .
3. Candidates had computed the outcome of each and every branch, without considering the probabilities accurately. They had just applied the probability to a particular branch and not combined two probabilities and applied same to the branch.
4. Some candidates had just applied the NPV technique to resolve the problem, without applying the Decision Tree Technique

**Sub Part (iii)**

Many candidates had not considered the initial investment (Rs. 200 million) and opportunity cost (Land - market price Rs. 450 million ) when computing Expected Net Present Value (ENPV).

A majority of the candidates had not evaluated the total project. They had merely recommended whether to upgrade the fleet.

**Part b**

The question clearly requested the best option–route-wise, but many candidates had given the answers based on the grades. Many candidates however, scored two marks for this part of the question.

## **KB3 – Business Taxation and Law**

**December 2019**

### **Examiner's Comments**

#### **Question-wise comments**

##### **SECTION 1**

##### **BUSINESS LAW**

###### **Question 01**

- (a) The question was whether Mudiyanse can incorporate a company in the manner mentioned in the question. It was therefore not necessary to mention details of methodology of incorporating a company. Candidates were expected to make reference to section 4 (2) and section 201 regarding single shareholder, sole director scenarios, of the Companies Act No. 07 of 2007.
- (b) The question was whether 'Sama' could be reappointed as MPL's auditor and the manner of making this re-appointment. Mentioning that another auditor cannot be appointed was irrelevant.

Candidates were expected to mention rights of Sama as an auditor, as laid down under section 164 and 165 of the Companies Act No. 07 of 2007, and not their duties.

###### **Question 02**

This question was direct and there were no ambiguities to create confusion in the minds of candidates. The Examiner expected candidates to mention implied warranties, when a person entered into a pre incorporation contract deemed as given under section 24 of the Companies Act No. 07 of 2007.

The Onus was on the Company to ratify the contract. Regardless of whether the Company ratified the contract or not, the Company was still liable to 'S' on this contract.

###### **Question 03**

This was an easy question provided candidates were prepared. The examiner was testing about minority buy out right, in section (a).

The relevant points expected by the examiner were;

1. Minority shareholders who voted against a resolution relating to a major transaction are entitled to minority buy out right.
2. They can request the company to purchase their shares.
3. The shareholders who wish to exercise this right must give prior written notice to the company of their intention to do so, within 10 days of passing the special resolution.

Part (b) required an analysis to prove that the two shareholders were eligible to file this application in court (section 224)

This application can only be made during the last six months, by shareholders, constituted of not less than 5% of the total number of shareholders, or the sum of the shares held, carried not less than 5% of the voting rights at a general meeting of the company.

The two shareholders had 20% of the voting rights of the company. This is more than the stipulated 5% of the voting rights.

Further the two shareholders together constituted 20% of the total number of shareholders of the company which is more than the stipulated minimum 5%.

Also they have been holding these shares for more than 6 months.

Therefore these two shareholders are eligible to file an application in court, for oppression.

#### Question 04

- (a) The question requires candidates to explain with reasons whether the statements made by Sajith, Ajith and Rajith are fully accurate, partly accurate or not accurate.

Accordingly candidates were expected to mention if each statement was fully accurate, partly accurate or not accurate, in their answers.

Section 135 is the relevant section.

- (b) (ii) Candidates were expected to state two modes of winding up available to a company. Therefore, no detail explaining is required.

#### Question 05

- (a) Study material provided by the CA covered the subject area adequately.

Candidates were required to state three objectives of regulating the securities market. Objectives of the section, is not the answer expected. The term 'insider trading' was used to mean unfair trade of securities, by an insider.

- (b) This is a straightforward question and adequately covered in the study material provided by the CA.  
The most important point was that candidates should understand that no arbitral award was made by the arbitrators. Therefore, there is no arbitral award for the High Court to enforce. Hence 'M' will not succeed in his application.

## **SECTION 2**

### **BUSINESS TAXATION**

#### **Requirement of the Question**

The question required the candidates to assess gross income tax liability, tax credits and balance tax payable or refund due by a private limited liability Company engaged in developing software. The question covered the areas such as calculation of assessable income from business & investment, Section 52 deductions & Tax Credits under Section 2(3) (c).

#### **General**

Overall, candidates performed well in this question, with quite a few scoring full marks.

Generally many were able to score just 50% or less, of marks allocated for this question.

#### **Specific Comments**

A small number of candidates computed the Income Tax liability applying the provisions of the previous IRD Act No. 10 of 2006. Students should understand that the current statute is IRD Act No. 24 of 2017 and that it was effective from 01<sup>st</sup> April 2018.

Many students struggled to select the correct income tax rates due to an oversight or not having noticed the information given in the question, or not reading properly. As the Company was predominantly engaged in developing Software, the applicability of the 14% rate could have easily been understood.

Some candidates had applied the current rate of 14%, reasoning that the Company was in the category - small and medium sized (SME) entity, forgetting SME rate concessions are not applicable to Associate Companies.

**There were noticeable gaps in the candidates knowledge, in some of the key areas described, as follows;**

- Almost all candidates did not know that the Company was entitled to an additional 35% deduction on Software Engineers Salaries as per the provisions in the 6<sup>th</sup> Schedule to the Act, since the entity was predominantly engaged in providing information technology services.
- Although many students disallowed the training expenses made on employees children, they failed to give the reason i.e. that it was because the Company had not deducted PAYE on such benefits.
- Candidates made many errors in Research & Development Expenditure Adjustment. A considerable number of them did not recognize that this particular Research & Development expenditure had not been incurred to improve the business and therefore was not entitled to any deduction, even under general deductions. Most misunderstood and treated it as R & D expenses and had erroneously allowed a further 100% deduction. In some cases, they had incorrectly allowed 200% & 300% as well.

Students appeared unfamiliar with some vital provisions in the IRD Act. Many of them had not identified that the Rent Income is part of Business income, since it is effectively connected to the business - (Ref Section 6(2) g) deciding on sources of income based on the theme "Effectively connected with the Business".

- Many students had missed the fact that the Gratuity Provision included in Administrative Expenses was not disallowed, when calculating business income – thus losing easy marks.
- A majority of the candidates were unsuccessful in applying section 18 provisions related to deduction of financial cost. Most failed to apply applicable provisional requirements to practical aspects, in relation to the given information, in the question.

Some candidates had not considered the lease facility as a part of borrowings and had only considered Bank Loans as total borrowings, which resulted in their not scoring marks, as anticipated.

A few candidates had incorrectly applied 3 times for the formula, imagining that this could be classified as a manufacturing entity, which was totally wrong.

Only a very few recognized that the amount of disallowed finance cost could be carried forward and claimable within the next six years.

- A majority of the candidates had not identified that the gains on disposal of listed Company shares were exempted. It was noted that students had wrongly considered both private & listed company disposals together, and calculated gains on disposal thereon.

Some students displayed a lack of knowledge of the requirement re taking the Market Value as at 30/09/2017 as the cost, and had incorrectly considered the actual cost in their calculations.

- Many candidates had decided that donations made to a temple could be classified as a qualifying payment, as prescribed in 5<sup>th</sup> schedule to the Act. They therefore treated the said donation as a qualifying payment and lost easy marks. In some cases those who had not treated it as a qualifying payment just indicated a dash, but remained silent as to the reason why it should not be a qualifying payment.
- A considerable number of students had not known that gains from realization of investment assets shall be taxed at the rate of 10%.

On the other hand many of them did not know that the relevant tax on Capital Gains was to be paid within one month, and that such tax would become a tax credit.

It was surprising to see that such gains had also been included under business income, and erroneously taxed at the 14% rate.

- Some students were confused about the information of ESC given in the question and had not identified that the ESC was a Tax Credit. Some had set off the ESC of 2017/18 against ESC payments made in 2018/19, a clear indication that they did not know that brought forward ESC was a tax Credit.
- A few candidates were confused about the application of WHT Credit on Rent, and had erroneously claimed WHT paid on Rent expenditure, instead of claiming WHT on Rent Income.

## Question 07

### General

The overall performance on this question was 'average' i.e. did not exceed 'satisfactory' level.

A majority of the candidates were unable to submit a complete answer, and were able to score only 50% or less of the marks, allocated to the question.

### Part (a)

The question required the candidates to,

- Assess WHT payable by partnership on allocation of partnership divisible profits.
- Calculate share of profit & other income Assessable to each partner.

The candidates were successful in scoring approx. 60% of allocated marks for computations. Those who did not score well had the following shortcomings in their answers;

- i. Having clearly given the information about partners' monthly salaries, many students had just taken one month's salary into the calculation.
- ii. Salary paid to spouse  
Almost all candidates knew that the salary paid to the spouse of a partner was not an 'allowed expenditure' when partnership income allocation is concerned. However many of them had not known that the salary paid to the wife would become part of the assessable income of the respective partner.
- iii. Interest Income on Investment  
Majority of candidates not recognized that the net interest income which should not include in adjusted partnership income for allocation. Very few candidates only were mentioned that such net interest income will be directly allocated to partners.  
Handful of candidates only knew that net interests in the hands of partners will not taxable since final WHT payments are already made.
- iv. Profit allocation to each partner  
A considerable number of candidates wrongly allocated share of profits and other income, displaying a lack of knowledge, re a methodical approach to profit allocation.  
Without considering salaries, service fee & salary of spouse, most students had merely divided the whole adjusted profit for purposes of allocation among partners.

### Part (b)

This part of the question required candidates to calculate VAT liability for the quarter ended 31<sup>st</sup> March 2019.

The candidates generally answered well but did not exceed the examiners expectations. A considerable number of them scored a maximum of 50% - 55% to the allocated marks.

The following are the shortcomings observed in their answers;

- i. Despite knowing that the applicable VAT rate is 15%, many of them had confused liable suppliers with exemptions. Many had erroneously considered the Sale of computers as liable and in some cases Income from AC installation had been treated as exempt.
- ii. Only a very few candidates had known that Input Taxes on Common Expenses are to be proportionately allowed, as claims against output VAT.

Those who knew that the Sale of Computers was exempt supply, sadly missed the fact that Input Tax pertaining to Computers was not eligible for input tax credit. Most candidates had incorrectly considered the entire input tax in arriving at the disallowable proportion, displaying a lack of knowledge of the required learning outcome.

**Part (c)**

This question was surprisingly poorly answered. It was a direct question that could have been answered well, had the students studied the relevant provisions.

Almost all candidates made mention of members who were Chartered Accountants but had not explained whether KP Associates could accept the assignment. Many candidates' lost easy marks whilst a very few candidates were able to score full marks.

**Part (d)**

Many candidates had misunderstood that what was required in the question was to identify to whom the stamp duty would be payable. Almost everyone had erroneously stated that the transferee is liable to pay the stamp duty, and had not specified that the stamp duty was payable to the Provincial Council.

Of those who had calculated applicable stamp duty, some had also inadvertently considered it as just a transfer, and ignored the fact that it was by way of deed of gift.

**Other comments to be communicated to candidates.**

It appears that candidates had ignored the instructions issued by ICA Sri Lanka to all students related to the examination paper.

The under mentioned reasons could have an adverse effect on student performances;

- Ignoring carefully reading the instructions given in the question paper before attempting to answer any of questions.
- Students had not paid attention when reading each question carefully to understand the information given and what is required in the question - before attempting to answer. It may be necessary for candidates to read the question more than once, to ensure the information given and the requirement of the question are clearly understood. This will help students to save valuable examination time, by avoiding irrelevant and / or lengthy answers. If candidates use the 15 minutes extra time which is given to read & plan, answers can be focused and relevant.
- Poor handwriting and communication (Language) skills.  
If the examiner can't read or understand ones' writing easily, they will find it really hard to mark your answer, possibly resulting in lower marks for such answers.

## **KB4 – Business Assurance, Ethics and Audit**

### **December 2019**

#### **Examiner's Comments**

##### **General Comments**

This examination consisted of two sections. Section 1 contained five compulsory questions carrying 10 marks each, and section 2 two compulsory questions carrying 25 marks each.

In this exam, well prepared candidates demonstrated an ability to use their subject knowledge and experience, to relate their answers to the question requirement. Weaker answers demonstrated poor subject knowledge. Candidates are advised to study the text book to have subject knowledge. Generally, candidates were able to demonstrate good time management and address the required number of questions.

##### **Specific comments**

##### **Section 1**

##### **Question 1**

##### **Part (a)**

The requirement was to outline three safeguards that P&S should implement to ensure that the conflict of interest is properly managed. As per the action verb they were required to make a summary of significant features. Some candidates did this correctly, determining that the conflict of interest would arise, and had recommended appropriate safeguards. However, many candidates failed to identify the potential issues successfully, such as confidentiality of clients' information. Some candidates just mentioned the use of a Chinese wall, without addressing the issues.

Some had tried to comment on every one of the ethical principles, some of which were not relevant. Candidates should have used the exam techniques to focus on the relevant technical points, without trying to cover all points, especially when the question carries only 5 marks.

##### **Part (b)**

In this part of the question the examiner expected the candidates to discuss two procedures that P&S should carry out, before accepting nomination to carry out the audit. The question specified it was 'before accepting the nomination'. Some candidates answered well. Others, without comprehending the question requirement, wrote the procedure that an auditor should follow, after nomination, such as;

- Ensure outgoing auditors' removal has been properly concluded.
- Ensure new audit appointment is valid



## Question 2

### Part (a)

In this part of the question the examiner expected the candidates to discuss three benefits to EPLC of forming an audit committee. The candidates who had studied the text book had given relevant answers.

Some candidates without comprehending the question requirement wrote;

- solutions for the issues in the given scenario
- requirement of having an audit committee without addressing how it will benefit the client

Some candidates without having the subject knowledge wrote;

- Will prepare annual accounts
- Will design and implement internal control

Many candidates seemed to forget that they were to discuss benefits to the company, and failed to point out that a stronger control environment would benefit the company, which an audit committee would help to create.

### Part (b)

Students were required to identify two weaknesses in the proposed audit committee. Most of the candidates furnished satisfactory answers.

## Question 3

### Part (a)

Candidates were required to discuss three deficiencies in IT general controls that can be identified in the given scenario, where

- maintenance agreement was not signed
- a weak backup procedure exists
- a weak password control exists

Most of the candidates had identified the deficiencies, but ignored the action verb and not explained in detail, the different aspects of the conclusion, to decide on deficiencies, and the effect on the client.

### Part (b)

Students were required to make four recommendations to remedy the deficiencies. Most of the candidates had misunderstood the issue of having backup data for one calendar year. The examiner expected the candidates to address the need for having frequent backups. As the candidates lacked knowledge of ERP solutions, it was suggested that data be preserved for five years, demonstrating they were unaware that in ERP solutions, backup is maintained annually, year wise.

Some candidates wrote IT general controls as approval for changes, job scheduling, segregation of duties, protection of equipment etc which are not relevant to the given issues.

Some candidates had written that vendors had access to confidential data and could misuse it and suggested concluding a vendor agreement, This was not an issue in the given scenario.

On average, performance was satisfactory.

## Question 4

This part of the question was on audit risks.

### **Part (a)**

Candidates were required to outline four audit risks in the audit of HL. Some answers were not specific, and provided general answers. Candidates demonstrated poor theoretical knowledge when answering this part. A considerable number of candidates had attempted this part of the question, but most answers were not satisfactory.

Some candidates who lacked the technical knowledge, reproduced the areas given in the scenario without addressing how such issues will result in audit risks. Audit risks are risks that the auditor highlights in his audit opinion, particularly, when financial statements are materially misstated. The examiner expected candidates to analyze transactions which could lead to misstatements in the financial statements and decide on areas to be tested.

Some candidates identified an increase in Gross Profit as an area for audit consideration, but they failed to address how it would affect misstatements in financial statements.

There were a few candidates who had the technical knowledge, who considered the increase in PPE as possibly being due to repair cost being included in noncurrent assets. Most candidates were able to identify introducing a new accounting system as an audit risk and explained how that will cause misstatements in financial statements.

### **Part (b)**

Students were required to outline one response each, to address highlighted risks. As the risks identified by many were incorrect, the responses were also not relevant. Some candidates wrote answers such as

- Carry out analytical procedure
- Substantive test
- Test of controls

without aligning the responses to each audit risk.

### **Question 5**

Candidates were required to recognize five key areas that the auditor should consider when planning the audit. It was expected that candidates would discuss the issues arising from a risk based approach, which uses auditing techniques that are responsive to risk factors. This approach would ensure that the audit effort is directed at the areas in which the financial statements are most likely to be misstated. Candidates were expected to use the technical knowledge in order to recognize the key areas of focus, mainly following LKAS s as;

- Applying LKAS 41 treat mango trees as biological assets and account at fair value and
- account PPE following LKAS 16

The examiner expected candidates to analyze the given information on specific issues arising during the year, in order to assess the risks. Most candidates had reproduced the information given in the scenario without identifying how such issues would affect misstatement in financial statements. The main reason candidates lost marks was that they did not actually understand what audit risks relate to. Audit risk is a key element of the syllabus and candidates must understand audit risks. Many candidates performed inadequately in this part of the question.

Many candidates without considering the question requirement, wrote irrelevant answers such as;

- Mango trees should be treated as an inventory and valued at cost or net realizable value - without identifying the issue
- treating mango trees as PPE is a classification error - without identifying the incorrect valuation
- new experts should be appointed to carry out the valuation

## Question 6

Part (a) Students were required to discuss three risks of material misstatements at the assertion level for the year ending 31<sup>st</sup> Dec. 2019. They were expected to address the significance of the account balances and their disclosure. They should have discussed how assertions such as disclosure, completeness and valuation will affect the potential risk in material misstatements in financial statements. Some candidates did particularly well, and spent sufficient time in discussing the disclosure of related party transactions. Weaker candidates wrote principal accounting issues as related party transactions and stated the steps to be taken to ensure transactions are at arm's length without any reference to assertions. Most candidates failed to discuss adequately how the particular assertions would affect the material misstatements.

Some candidates discussed the disclosure of related party transactions and valuation of land and gained considerable marks. There were only a few candidates who addressed the compliance of regularity requirement.

Most candidates failed to relate risks at the assertion level, as per SLAuS 315 that the auditor should use assertions to consider the different types of potential misstatements that may occur. Some candidates paid attention to accounting issues as related party transactions, and non-current assets held for sale, without linking to assertions.

### Part (b)(1)

They were also required to state two assertions that would affect the material misstatements. They were only expected to state the assertions. A majority of the candidates understood the question requirement and answered well, but some had wasted time in writing lengthy answers, when the part carried only 2 marks.

### Part (b) (11)

Students were required to explain how each of the assertions stated in part (b) 1) could have an impact, using the facts given in the scenario. This part carried only 4 marks, so the examiner expected a short explanation. Most of the candidates had understood the question requirement and furnished relevant answers, but most were limited to valuation of land and disclosure of related party transactions.

There were some candidates who wrote general audit procedures without any relevance to the question requirement. Students were expected to apply the theoretical knowledge to a practical situation. Some candidates had just copied the facts given in the scenario ignoring the question requirement.

### Part (c)

Candidates were required to write three substantive audit procedures each, that could be performed to address the misstatements at the assertion level. Most candidates furnished relevant answers, but some candidates, due to lack of knowledge, wrote irrelevant answers, such as;

- Call for confirmation from related parties
- Report about the valuation in the annual report

Part (d). They were also required to discuss the importance of performing audit procedures on other information disclosed in the annual report in relation to related parties. There were only a few candidates who understood the question requirement. Most candidates just explained the importance of disclosing related party transactions, without addressing the disclosure in annual report.

## Question 7

This question also carried 25 marks and consisted of 5 parts.

### Part (a)

It was required to differentiate the responsibilities of the management and the auditor of HL in relation to errors in payment of excise duty, referring to SLAuS 250. Most candidates furnished general answers differentiating between responsibilities of Management from those of auditors', without focusing on errors in payment of excise duty. Most answers were about the responsibilities in preparation of financial statements and introducing systems and controls. The examiner expected the candidates to focus on compliance of regularity requirements.

### Part (b)

Candidates were required to state four audit procedures that could be performed in addition to obtaining written management representation, in respect of Gain on Revaluation of Land. Some candidates who misunderstood the question explained the benefits of obtaining written representation. Some candidates, whilst they had understood what was required in the question, wrote audit procedures which were not practicable, due to lack of subject knowledge such as;

- Get an another professional valuer
- Recruit a technical expert and recalculate
- Assess qualification of the valuer

### Part (c)

This part required a discussion on 'appropriateness of written representations as a form of audit evidence, in respect of the Gain on Revaluation. Most candidates did not comprehend what was required in the question, and wrote irrelevant answers such as;

- It is written
- It will help to reduce audit risk
- Can be used in courts
- More reliable as issued by management

### Part (d)(1)

Students were required to discuss whether the financial statements for the year ended 30<sup>th</sup> Sept required amendments. This part carried 3 marks. Some candidates ignored the action verb and wrote yes or no, but it was expected that students would give a brief note as to why they said yes or no. Some candidates wrote lengthy answers without considering that the question carried only 3 marks.

### Part (d) (11)

They were also required to list two appropriate audit procedures that should be performed, in order to identify required amendments. Almost all candidates wrote 'read board minutes', or 'check details from the lawyer'.

### Part (e)

Candidates had to assess the impact on the audit report of HL. A majority of the candidates failed to understand the concept of materiality, and how it affects financial statements, or to discuss issues and decide how an opinion should be formed. Most candidates came to the conclusion that the audit report should be modified. Candidates should note that when presenting audit opinions, it is not sufficient to say the opinion would be modified. Simply writing qualified would not attract full marks. Some candidates who had ignored the action verb which was to 'assess'. They failed to analyze the steps that an auditor has to follow, before coming to the conclusion that the opinion must be qualified.

## Conclusion

Although the average performance was satisfactory, there were only a few excellent answers. A large number of candidates had a narrow focus on the topics that they were studying and were not keeping up with the relevant SLASs and SLAuSs. Candidates are required to learn the basics of auditing, corporate governance, the application and proper use of audit opinions. They are also encouraged to practice past exam papers.



## KB5 – Business Value Creation

**December 2019**

### Examiner's Comments

#### Question 01 - General comments

Overall performance for this question was good. The question carried 10 marks and required candidates to;

- (a) Explain four primary activities of the Value Chain in relation to the given scenario i.e. Milkycoo. (MC)
- (b) Explain how Milkycoo could use procurement and Human Resource Management (HRM) to add value to its customers.

#### Question 01 -Specific comments

- (a) Inbound logistics, operations, outbound logistics, marketing and sales & service are primary activities through which Milkycoo expects to add value. Under Inbound Logistics, milk is collected, stored as per health and safety standards and issued to production as and when requested. Milk and other ingredients are converted into Yoghurts, following quality control labeling and packaging, before it is delivered to the customers under "operations". Most of the candidates explained the primary activities in relation to the given scenario thereby earned allocated marks. Some stated that main operation of the MC is manufacturing yoghurt and transport into nearby super markets for which full marks was not awarded.
- (b) To add value HRM needs to ensure MC has suitably trained and skilled people to carry out operations, and must gear recruitment, training and rewards to achieve set goals. Inputs (Milk) are to be obtained at economical prices, without delay, ensuring high quality milk-is processed. Some had provided irrelevant details like threshold resources, unique resources etc. under HRM, without such details being related to value addition. Some have described procurement procedures and activities, like raising Purchase Requisitions, Purchase Orders (PO), checking once goods are received with the PO and invoice, etc. for which marks were not awarded.

### Question.02 - General comments

Overall performance of the candidates for this question was good. The question carried 10 marks and required candidates to

- (a) Outline 2 reasons why inventory management would be beneficial to “Rainydays’ (RD) the company provided in the question.
- (b) Discuss how a warehouse management system (WMS) could help RD to improve its warehouse operations.

### Question 02 - Specific comments

- (a) An Inventory Management System will keep the inventory costs to a minimum, prevent the accumulation of excess inventory, without unacceptable delays, by recording and monitoring inventory levels. Some had just outlined that RD could avoid non-moving Stocks and the holding of unnecessary stocks, delays in production and bad warehousing when an Inventory Management System (IMS) is adopted without the specific features of the IMS being quoted.
- (b) WMS helps RD to reduce costs by minimizing the amount of unnecessary inventory and by arranging physical storage facilities in such a way that finished goods could be separately stored and picked up easily and shipped to customers. WMS could provide data to management with analysis of data, since RFID or bar coding could be used in WMS. WMS will ensure proper maintenance of records, which helps in monitoring inventory levels. Some just discussed WMS will help RD to improve warehouse operations, without having a discussion as to how WMS would help to improve the operation.

### Question 03 - General comments

Overall performance for this question was satisfactory. The question carried 10 marks and the candidate was required to

- (a) Explain four elements of quality cost giving examples in relation to the given case i.e. “Navesta Pharmaceuticals” (NP).
- (b) Outline two key features of the six sigma approach as a ‘quality enhancing program’.

### Question 03 - Specific comments

- (a) Prevention costs, Inspection and testing costs, internal failure costs and External failure costs are the 4 elements of quality costs. Some wrongly worded “Prevention Costs” as “Elimination costs”. Some identified “supervision, quality raw materials, warehousing” as quality costs and explained that the company should hire qualified and experienced people to supervise the process under “supervision” in order to avoid defective items. A few marks were awarded for this response. Some could not explain, as was expected, the types of quality costs, with at least one example being provided for each type of cost.
- (b) Avoiding waste & inefficiency and delivery of what is expected by the customer, establishing quality standards and project teams are some of the key features of a six sigma approach. A fair number of students outlined only the reduction of waste as the key feature of the six sigma. Some had listed process improvement and process design with six sigma as key features, for which no marks were allocated.

#### **Question 04 - General comments**

Overall performance in this question was good. The question carried 10 marks and required candidates to

- (a) Analyze two possible B2C models for e-commerce, for the given scenario i.e. "Knowledge Hub" (KH).
- (b) Explain 3 issues to consider when starting an e-commerce operation in relation to the "Knowledge Hub".

#### **Question 04 - Specific comments**

- (a) Subscription Model, Advertising Model and Merchant Model are possible B2C models of e-commerce for "Knowledge Hub". Some could not analyze the models and just named them, for which full marks were not awarded. A few analyzed the models without the model name being properly mentioned. E.g. Merchant model and Subscription model were analyzed correctly under E-Fairs and E-Groups respectively, for which some marks were awarded.
- (b) When starting an e-commerce operation, issues could be explained under "Value proposition", 'Revenue', 'Market opportunity', 'competitive environment', competitive advantage Management Team, Market strategy and organization of operation. A few explained issues somewhat, without any caption being cited, as mentioned above. E.g. they had explained "whether the customer feels value addition by reading a journal through internet" for which marks were awarded.

#### **Question 05 - General Comments**

Overall performance in this question was not bad. The question carried 10 marks and required candidates to

- (a) State two advantages each for internal and external recruitment.
- (b) Explain 3 stages of the socialization process to ensure new employees are familiar with the organization.

#### **Question 05 - Specific comments**

- (a) Internal promotions can improve motivation and provide career development opportunities to existing employees. It will be a less expensive method of recruitment and the performance record of existing employees will help to reduce the risk of sub-standard performance in comparison with external recruitments. On the other hand, External Recruitment may introduce fresh thinking and new ideas into the organization. Additionally, existing employees may not have the skills required for the job. Most candidates managed to obtain more than 50% of the allocated marks for this part. A few mentioned that external recruitment would help new persons to be recruited to positions - for which marks were not allocated. Some had just stated that internal recruitment would save costs, without specifying which costs.

- (b) Before joining the organization, On first joining, and Familiarization, were the 3 stages in the socialization process, expected by the examiner. A few just mentioned these 3 stages without explaining each stage. Some omitted to mention that the 'Familiarization' stage should be started, after the employee joined the organization.

### **Question 06 - General comments**

This question had been answered poorly by quite a number of students. The question had 4 parts, carried 25 marks, and required candidates to

- (a) Analyze how the marketing mix for the new herbal shampoo (given scenario) could be designed, based on the stage of the Product Life Cycle (PLC).
- (b) Explain why the product generates negative cash flows and make losses, at this stage.
- (c) Explain 4 key requirements for successful brand positioning, of the Akbamaru brand.
- (d) Outline 3 key decisions that ALP (given scenario) should consider, in relation to its channel management.

### **Question 06 - Specific Comments**

- (a) Marketing mix i.e., product, price, place and promotion need to be analyzed in relation to the new herbal shampoo, which product was at the introduction stage of the PLC. Some just described the marketing mix without commenting on the related scenario. To make potential customers aware of the new product, advertising & promotion cost would be high as stated by some students, who managed to score the allocated marks. Some incorrectly mentioned that penetration pricing was more suitable.
- (b) Most candidates correctly cited 3 reasons for the losses and negative cash flows, i.e., low output, low sales & low growth, high expenditure including costly sales promotions. A fair number of students had omitted to mention low sales growth as one reason for the losses.
- (c) Relevance, clarity, coherence and patience are 4 key requirements for successful brand positioning, as was stated by some students who scored the allocated marks. Some just stated these 4 key requirements, but had not explained them. Some kept explaining about brand positioning, without the key requirements expected, being mentioned.
- (d) The key decisions in channel management are price policy, terms and conditions of sales, Territorial rights and definition of responsibilities. These were correctly stated by some, as expected by the examiner, and were awarded marks. Some stated that size of production, warehouse location, social responsibilities etc. were the key decisions to be taken. A fair number of candidates had earned only 2 marks out of 6, for this part of the question.

### **Question 07 - General comments**

Most candidates scored around 10 marks for this question. The question carried 25 marks and required candidates to,

- (a) Conduct a SWOT analysis for MTT i.e. given scenario
- (b) Evaluate the proposed business strategy for launching Satellite TV services by MTT based on the 3 generic strategies.
- (c) Analyze how the Kubler-Rose model can be used to understand and manage major changes.



### Question 07 - Specific comments

- (a) Availability of technical expertise and required equipment were strengths. Non availability of an HR Department and lack of working experience of the founding partners were weaknesses of MTT. Most of the students who obtained the allocated marks provided these responses. The presence of a 50% illegal market for TV services, and price conscious consumers, were some opportunities, according to a fair number of candidates, who managed to score the marks allocated. A few mentioned, SWOT and its elements, which earned no marks.
- (b) Most students had given a brief description about Porter's generic competitive strategy namely Cost leadership ,Differentiation and Focus, as a part of their evaluation of the proposed business strategy, for which some marks were awarded. A fair number of students recommended correctly, that focus should be on a cost leadership strategy. But only a few of these justified the strategy, citing that more net benefits would accrue to the customer, in comparison to the marker leader.
- (c) The five stages of Kublar-Ross (KR) model namely Denial, Anger, Bargaining, Depression and Acceptance, were described only by a few students, as a part of their analysis. Some just named the stages. Only a few stated in their analysis that some of the stages under reference were not experienced by all individuals.