

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Examiner's Comments – Strategic Level II – June 2012

Advanced Financial Reporting

Only a few numbers of candidates had sat for this paper. Comments are based on their performance and may not be treated as representative for making general conclusions.

Question No. 01

Part (a)

The subject matter covered in this part of the question is discussed only in discussions in Advanced Accounting. So the candidates had to study them. However, except for very few candidates, others were not aware of existence of SICs. SICs like IFRICs cover matters not included in the body of the standard. So the marks earned by candidates for the part (a) were very poor.

Part (b)

This part of the question was somewhat easy compared to previous examinations. Candidates had attempted this with considerable level of success. But there were candidates who had done their workings and Statement of Financial Position according to the old fashioned letter "T" type formats. Candidates have to keep in mind that most of the subject matter covered in the Accounting Standard for Business Combinations had been presented in schedule format. It may not be prudent to work the same back to conventional methods.

In addition to that following deficiencies were found among the answers.

Goodwill Calculation

1. Failure to identify the value appreciation of the previously acquired portion of 30% and credit the same to the Income Statement.
2. Inappropriate treatment of already acquired goodwill of Rs. 1.3 million. This item is treated as an asset that cannot be identified. However, the goodwill arrived at the final consolidation will remain the same. But the fair value adjustment, additional depreciation could vary according to the treatment of this item.
3. The compensation to the CEO could have been paid by now. Many candidates had treated the same as still outstanding.
4. Many candidates failed to remove the proper amount of unrealized profits on inventory.
5. Candidates face difficulties in carrying out impairment tests based on cash generating units.
6. Many failed to properly account for changes in equity (in a schedule format).

Only very few candidates were able to earn reasonable marks for this question.

Question No. 02

This question carried 25 marks for six parts applicable to different accounting standards. It appeared that candidates were not prepared to discuss the issues into the same depth as expected by the examiner.

Part (a)

Candidates had identified cows as biological assets, but failed to indicate the measurement criteria and accounting treatment . Therefore the marks earned were very poor.

Part (b)

This part was answered satisfactorily. But the candidates failed to identify foreign exchange transactions that are normally reported under Other Comprehensive Income.

Part (c)

Computations had been carried out well. But the amount to be recognized as income for the period was not indicated correctly. Thus the candidates failed to secure reasonable marks.

Part (d)

Candidates knew how to account for share based payments. But many failed to show the calculations and accounting entries as required by the question. Only one aspect had been presented. This caused marks earned from this part to be somewhat lower.

Part (e)

This part of the question was directly related to the items in the accounting standard. But the candidates had been commenting generally. So most of the answers were unclear and marks earned were very poor.

Part (f)

This part was a straightforward question. But the candidates had not paid much attention to answer this question properly. So the marks earned were at a moderate level.

Question No. 03

This question tested the candidate's knowledge on interpretation of Financial Statements. Question was similar to previous examinations in length and the level of difficulty.

Many candidates were not able to calculate ratios correctly. Many had not indicated the formula correctly. So awarding marks also was a difficult task for the examiner. Candidates should take extra care in using calculators. Accidental omission of a single digit could cause severe problems. Hence care should be taken to indicate the formula and amounts applied in order to earn a healthy score.

For interpretation of ratios, candidates had only compared the two ratios. They failed to hint on possible causes or trends as required for making sense of ratio interpretation.

Question No. 04

This question covered the general topics. But the candidates were not able to answer this part satisfactorily. It appears that the candidates did not tend to study beyond the standard text or classroom tutorials. Detailed discussion of those topics could easily be downloaded from the internet.

This was a poorly attempted question.

Question No. 05

Part (a)

Although many candidates failed to define Bench Marking correctly, they could have indicated the benefits gained through bench marking. None had indicated the disadvantages.

Hence the marks earned to this part remained somewhat lower.

Part (b)

This part of the question was answered by many candidates satisfactorily.

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Strategic Financial Management – June 2012

Question No. 01

- 1 a . Tested the ability of candidates to express an opinion about the statement of a group's finance director regarding the opportunity available to CFOs in formulating the organization's business strategy when back office functions of the group's finance and accounting activities are taken over by a shared service unit, and to discuss the role of a CFO in the context of modern business management.

Weaknesses observed in the answers

- a. Most of the Candidates failed to provide a good answer. Some answers were vague e.g. more or less agreeable, partly disagreeable, it is difficult to agree with the statement straightly, It is difficult to say agree or not, agreed and (but) on the other hand not agreed.
- b. Most of the answers were not consisted the specific function of CFO which cannot be alienated from the CFO to a shared service unit.
- c. There were lengthy answers without proper substance but repeating routine roles of CFO using different phrases and sentences.
- d. Most of the answers did not reflect the role of a CFO in the context of modern business management.

- b (i) Tested the knowledge in project evaluations using discounted cash flow method

Most of the candidates answered this part of question satisfactorily. However following fundamental mistakes were observed.

Weaknesses observed in the answers were

- a. Incorrect computation of capacity utilization compared to facts given in the question
- b. Failure to annualize Administration Overheads of Rs. 3 million p.m. in computation of cash outflow
- c. Failure to identify direct costs as a cash outflow in the computation
- d. Disregarding three year tax holiday benefit by project in computation of cash out flow and taking into consideration of tax payment during tax holiday period
- e. Taking of monthly loan repayment installments and interest as cash out flow, resulting incorrect net cash inflows
- f. Consideration of depreciation as a cash out flow item.
- g. Computation of capital allowance exceeding the assets value eg. 125% or 5 year capital allowances at 25% p.a. for furniture
- h. Inability to indicate EBIDTA in the table
- i. Taking different rates as discounting factor other than 10% given in the question
- j. Computation of NPV incorrectly restricting to 5 years cash flow disregarding the perpetuity of life span of the project. (failure to compute terminal value)
- k. Failure to show workings where necessary to substantiate the answers.

Note: One candidate had calculated depreciation for the land and treated it as cash outflow

- ii Tested knowledge about steps to be taken to improve cash inflow to shorten discounted payback period to meet three year criteria.

Weaknesses observed in the answers

- a. Some candidates had suggested to reduce the discounting rate of 10% to a lower rate in order to increase the discounted net cash inflow and to bring discounted payback period less than three years.

- iii. Tested the ability of computation of accounting profit and ascertaining dividend to be allocated under different funding strategy

Weaknesses observed in the answers

- a. Some candidates had failed to consider depreciation and interest cost to ascertain accounting profits correctly.
- b. Some candidates had charged tax on accounting profit in year one which fallen in to tax holiday period.
- c. Some candidates had not calculated the dividend payable to employees which was tested in the question.

- iv. Tested the knowledge about the significance of option analysis in shared services projects and the difference between shared services and centralized services

- a. Some candidates had stated the general options available in selecting a project such as drop option and growth option .
- b. Most of the candidates were not aware of the meaning of shared service unit and had not attempted this part

2. Standard of the question
Average

3. (ii) As a guide to candidates

Candidates should learn the entirety of the subject matter without confining to a limited area and improve the basics as well.

Question No. 02

- a tested the knowledge about the shape of term structure of interest

Answers were not satisfactory.

Observations and comments

- a. The majority of the candidates scored low marks due to their inability to understand the question properly.
 - b. Some of the candidates had misinterpreted the word “term” as the “condition” relating to loans given by a financial institute.
 - c. Some of the candidates had described what interest means, composition of interest rate, (repeating what is given in the question i.e. Inflation, risk), type of interest i.e. fixed interest, floating interest, determining interest of a company ,based on capital structure, frequency of interest payment i.e monthly quarterly and yearly.
 - d. Some candidates had stated that long term loans need securities and short-term loans need personal guarantees
 - e. Candidates had not mentioned the financial instruments i.e. government securities and corporate bonds, that determine bench mark interest rates except Loans
- b. tested the ability of computation of expected one and two year inflation rate after giving formula. This was the easiest part of the question and 4 marks awarded was like “bonus marks” if the candidates had been able to comprehend the facts given in the question. However, the performance of the candidates was average.

Observations and comments

- a. Some candidates had attempted to solve this question using the complicated Fisher formula disregarding easy formula given in the question and had lost marks due to using the Fisher formula incorrectly or incorrect application of data.
 - b. In computation of expected two years inflation rate some candidates “divided the correct rate by two” unnecessarily.
- c Test the ability of computation of interest Rate Swap, potential gain and benefit to company by swap

Observations and comments

- a. The majority of the candidates were well aware of the subject area
 - b. Some candidates had indicated target rate incorrectly in the computation.
as $PLR - 1.5\% = 13.5\% = 20 - 1.5\% = 13.5\%$
 - c. Most of the candidates failed to recognize the differences $PLR - PLR + 1$ and have added fixed rate as $(4+1) = 5$ instead of $(4 - 1) = 3$
 - d. Some candidates had failed to split 3% equally between HR & LR and to arrive at the correct target rates.
- d Tested the ability of computing financial benefits of refinancing (retiring and reissuing) the existing bonds using the given data, comparing the financial benefits and skills of decision making on refinancing based on financial benefits.

This is a text book type question but performance of the most of candidates was not satisfactory

Observations and comments

- a. Most of the candidates calculated only the cost of retiring and cost of reissuing of bond I.e. cost of call premium and transaction cost.
- b. Some candidates failed to compute the tax effect on transaction cost thus failing to arrive at the correct total cost of refunding.
- c. Most of the candidates failed to compute annual benefit $[\text{Rs. } 75 \text{ mn} \times (6.5\% - 4.5\%) \times (1-t)]$ related to refunding.
- d. Most of the candidates failed, to compute relevant Annuity PV factors related to refunding and to determine PV of the benefits correctly. Thus many candidates had failed to compute NPV of benefits
- e. Some candidates had attempted to use the project evaluation type format to solve the problem but failed after just plug in some figures.
- f. Most of the candidates did not consider the fact that retiring and reissuing has occurred simultaneously.

Question No. 03

- a. tested the knowledge about the negative synergy effect in mergers.
 - a. There were quite a number of reasons that caused negative synergy impact in mergers but the points of answers of candidates were confined to three or four points indicating lack of knowledge in depth of the subject matter.
 - b. Most of the candidates had repeated few points in different wordings and phrases.
- b. (i) Tested the ability of computation of Net current assets of two companies as at 30 June 2012
 - a. Most of the candidates had calculated **net assets** (NA) instead of **net current assets** (NCA) failing to comprehend that question was to compute **net current assets**
 - b. Incorrect postulation made by candidates assuming the wording of question “NCA” was a mistake of the examiner (Few candidates had mentioned this). This may be due to fact that the price in mergers are determined on **NA** basis and preconditioned mentality of candidates indicating that calculation of NA is prerequisite of merger thus computation of NCA is irrelevant.
 - c. Few candidates demonstrated their inability or lack of knowledge to calculate NCA using the adjustments relating to three months operations re: NCA of the last balance sheet figures. They had calculated NCA with the given information adjusting the equity and liability of last balance sheet.
 - d. Some candidates had considered PPE as part of NCA. This is not commensurate with knowledge expected at strategic level of examination.
 - e. Some candidates had failed to add the three months profit and deduct the dividend paid in computing NCA.
- (ii) Tested skills in calculation of Purchase Consideration of P Ltd, Value per share of G Ltd., Number of shares to be issued against purchase consideration of P Ltd, Estimated (theoretical) earnings of G Ltd, Total no. of shares of G Ltd after acquisition, and EPS before and after acquisition.

Compared to other parts of the question the candidates had performed well in this part.

- a. Few candidates had calculated the NA value of P Ltd incorrectly.
 - b. Some candidates had not calculated NA value of G Ltd on the date of merger. Some of them had taken NA value as at 31.03.2012 Instead of 30.06.2012.
 - c. The majority of the candidates had taken the par value of G Ltd as the NAV per share at the date of merger. Hence the number of shares to be issued had not been calculated correctly.
 - d. In computation of estimated (theoretical) earnings of G Ltd after acquisition, the first quarter profits of P Ltd already included in purchase consideration was also added by some candidates.
 - e. Some candidates used the net profits after dividends in calculating the EPS.
 - f. Some candidates had calculated EPS per quarter without annualizing the profit and had failed to express the opinion whether dilution of EPS is expected or not.
 - g. Some candidates had just mentioned the dilution of EPS without calculation to substantiate the statement.
- (iii) Tested the ability of preparation of a Merged Balance Sheet
- a. Some Candidates had failed to add revaluation reserve and deduct depreciation of the last three months since the last balance sheet date in calculating WDV of PPE as at date of merger
 - b. Some Candidates had failed to calculate current assets correctly adding the trading result adjusting for dividend paid and none cash items of depreciation of first quarter for the merged balance sheet.
 - c. Stated capital determined was also not correct due to the computational mistakes of the candidates in part (ii) of the question.
 - d. Some candidates had added "P" Ltd's reserve to the Balance sheet after the merger that was already included in purchase consideration.
 - e. Some candidates had considered the purchase consideration as an investment in balance sheet and prepared two Balance Sheets indicating the poor theoretical knowledge of candidates regarding the mergers and acquisitions.
- (iv) Tested the knowledge in identifying the possible implications of settlement of purchase consideration by shares in mergers as against cash (not just settling consideration by share)
- a. Most of the candidates confined to indicate implication of settling the purchase consideration by shares and failed to compare with implication of settlement by cash as focused in the questions
 - b. Answers of the majority of the candidates were based on dilution of EPS and controlling power only.
 - c. Most of the candidates failed to mention about the negative impact to cash outflow when purchase consideration is settled in cash
- (v) Tested the ability of logical thinking in considering the given information i.e. merging a company having market share in Europe and USA for consumable goods, by a company having market share in Australia for consumable goods and the evaluation of synergistic effects in consequence of merger based on the given information specifically.

The performance of the candidates was very poor

- a. The majority of the candidates had failed to assimilate facts given in the question properly.
- b. The majority of the candidates indicated the positive and general synergetic effects of a merger i.e. expansion of market, advantageous of combined resources, disregarding the specific information given in the question about market of P Ltd.

- c. The majority of the candidates had failed to understand P limited market was in western countries and the USA and Europe were experiencing financial crisis affecting the market.
- d. The majority of the candidates failed to recognize the nature of the consumable goods supplied by P Ltd., nature of elasticity of demand and difficulty in expansion of market of such items under a crisis situation.

(vi) Testing knowledge in Forex Management – mitigating foreign exchange risks though Forward contract, preference to options vs forward contract in forex risk management

The performance of the candidates was satisfactory

Question No. 04

Most of the candidates performed well in all the parts of the question and earned satisfactory marks.

- a. Tested the ability to discuss about credit rating based on the quoted statement on rating, specially downbeat aspects of financial distress.
 - a. Few candidates had mentioned about what to look into a company in deciding a rating and what reflect in different ratings.
 - b. Most of the candidates had mentioned about the advantages and disadvantages of having good and bad rates for a firm in obtaining financial credit facilities.
 - c. Very few candidates had mentioned about the impact of future outlook of the firm in rating.
 - d. No candidate had discussed about weaknesses in credit rating or possibility of erroneous rating and its impact.
 - e. A number of candidates reflected their ignorance about credit rating.
- b. i. tested the ability in computation of EBITDA and Debt value using given data immediately prior to a rights issue
 - a. some candidates had computed the Debt value /EBITDA instead of EBITDA/ Debt value without reading the question carefully
- ii tested the ability of computation of total value of rights proceeds using given data
 - a. A number of candidates interpreted 2 : 1 rights issue as 1:2 rights issue and computed differently
- iii tested the ability of computation of Debt/equity (Market Value) levels of the company after the rights issue.
- iv tested the ability of computation of net investment made in right issue by the company after divesting a part of its rights entitlement.
 - a. Performance of the candidates was satisfactory.
 - b. A few candidates had failed to compute the gain on divested part of rights entitlement at Rs. 1 per share correctly. Or ignored it.
- c. tested the skill of evaluating the improvement of risk bearing capacity of company after right issue.
 - a. Performance of the candidates was not satisfactory as the most of the answers were not focused e.g. the situation had changed after right issue and not relevant to evaluate risk bearing capacity of the company, but the general statements of financial status.

- d
 - i tested the ability in drawing up the capital employed structure both before (pre) and after (post) the rights issue.
 - a. Most of the candidates indicated market value of the capital and debts instead of book value for “capital employed structure” .
 - b. The word “structure” appeared to have misguided the candidates to compute market value.
 - ii tested the ability of rating attributable to Dow Agro Seeds Lanka PLC after the rights issue and settlement of debts.

Performance of the candidates was satisfactory.

Question No. 05

1. What is tested in the question, observations and comments

Tested the knowledge in strategic finance, analytical skills in ratio analysis and skills using an appropriate format, structure and presentation of the report

- a. Some candidates have used an appropriate format while describing the issue, building up the answer with a closing paragraph and signature.
 - b. About 50% of the candidates had not used report writing format and proper structure in the answer
 - c. The candidate who had written the answer with the report form/format had shown their inadequate knowledge on writing internal memorandums (without using opening or closing paragraph placing their signature, etc.).
 - d. The candidates had shown inadequate knowledge on interpretation of the ratios. They had given lengthy answers which are not relevant showing their vague knowledge or not having a clear understanding about the subject.
- a. Tested the knowledge about Importance of linking capital budgeting process with Corporate Strategy.
- Performance of candidates was satisfactory
- a. Some candidates had given irrelevant answers with repetitions “in a different way”
- b. Market Value Addition
- a. Most of the candidates have not written the MVA formula. However, most of them have worked out the mathematical part correctly
 - b. Some candidates had not attempted this part
 - c. Few candidates had misunderstood the Market Value Addition (MVA) as “Book value - Market value”.
- c. Economic Value Addition of the company
- a. Most of the candidates have not written the EVA formula but they have worked out the mathematical part correctly.
 - b. Most of the candidates had answered satisfactorily. However, some candidates have given essay type answers without showing calculations.
 - c. Market value of the capital has taken for the EVA calculation instead of taking capital employed.

- d. In computing EVA some candidates had used CoC instead of WACC.
 - e. Book value of debt and equity had been taken instead of taking market value to calculate WACC
 - f. Even though the company was a geared one, most of the candidates have treated it as an un-geared company, and calculated cost of equity instead of calculating WACC.
 - g. Some candidates have treated EAIT as NOPAT instead of arriving NOPAT using EBIT $(1 - t)$ formula.
 - h. Some candidates ignored the effective tax rate of (kd) in computation of WACC
 - i. Almost all the candidates had not calculated the charge for cost of capital of Rs. 183.60 correctly or have not attempted to calculate it.
 - j. Knowledge of some candidates seem weak as indicated in the calculation of WACC by using both MV of capital and book value of capital giving two alternative answers using both methods.
- d tested knowledge regarding impact of financial ratios on operating decisions, financing decisions and taxation on Return on Equity
- a. A number of candidates had not attempted this part.
 - b. Interpretations of ratios were very weak .
 - c. Some candidates had calculated irrelevant ratios or ratios incorrectly.
 - d. Most of the candidates had shown inadequate knowledge about calculating ratios and interpretation of results.
 - e. Most of the candidates had not used the correct formula.
- e Comparison of Sales Growth Rate with Sustainable Growth rate
- a. Most of the candidates had calculated growth in sales and sustainable growth rate correctly.
 - b. Most of the candidates had not explained the impact of these ratios to the organization.
 - c. Only a few candidates had interpreted the financial status of the company.
- f tested the knowledge about return spread and ability to create value of a company
- a. Performance was very poor as the most of the candidates were not aware of what “Return Spread” means.
 - b. Most of the candidates had not answered this part. Less than 1% of the candidates had correctly approached the question.
 - c. Few candidates had calculated ROE instead of ROIC and had compared with WACC
- g tested the knowledge about other important factors that should be considered in achieving company’s “sustainable growth”
- a. Performance was satisfactory

General comments

- It appears that the quotations given in the Question no. 1, 3 and 4 had not lead the minds of candidates to the focal area of the questions as expected.
- It is apparent that candidates were unable to grasp various facts given in the question paper and answers expected from them for the given situations
- Most of the candidates did not have an in depth knowledge and analytical ability required to produce quality answers to the questions in this SFM paper
- It appears that the poor standard of the English in answer scripts had further weakened the ability of candidates to demonstrate the subject knowledge that they may have acquired in the process of successfully completing of previous stages of exams. The hand writing of some candidates was “illegible”. Grammatical mistakes and syntax errors were also observed in a large number of answer scripts.
- Answers for theory part of the question were very poor and candidates earned marks mostly in computation of problems.
- Applications of knowledge to the facts given in questions in answering questions was also very poor.

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Business Strategy and Knowledge Management – June 2012

Question No. 01

1. The diagram given in the suggested answer was not drawn by the candidates whereas they have listed generic forces. (Listing awarded full marks)
2. 50% of the candidates have answered the 5 competitive forces for the parts (a) and (b) and they did not gain any single marks on that.
3. The above theory explained (comment 2) in details by the most of the candidates and wasting their time for the part (a) and (b).
4. Candidates have discussed about strategic clock and marks were given for the relevant points.
5. Some candidates have compared the cost structure of mobile phone companies and discussed about the sharing of telecom/mobile towers (part (c) of the question)
6. Candidates have not accessed to the additional reading prescribed book for this level.
7. As in the suggested answer, candidates have not discussed the answer for part (c) and most of them discussed only few points such as economy of scale and other cost reduction ways.
8. Point (a) & (b)- candidates have not discussed the best cost provider strategy as given in the suggested answer.
9. Maximum marks 8½ was given those who shown fair knowledge of the question.
10. Some of the remarks given by the candidates in answer script is as follows:
 - This question is confused because 4 generic strategies and question asked about 5 generic competitive strategies.
 - According to Porter there are only 3 strategies and not five
 - Question asked generic competitive strategies. There are 3 such generic strategies, question says 5
11. Some candidates have explained the same points for part (b) as discussed for the part (a).

Question No. 02

1. Part (a) of the question was purely based on study materials given to the students and the candidates have answered it fairly and they did not discuss/apply it practically to the business environment.
2. As given in the suggested answer for the part (a), candidates have not answered that level and they have not read the additional reading for this part (a).

Part (b) of the question was based on additional reading books and candidates were hardly given correct answers.

3. Some of irrelevant answers are:
 - Company is in business from long time
 - Export oriented company.
 - Import the good/traditional items.
 - Cost to introduce new product to the market.
4. Part (c) was based on additional reading and it was very poor performance shown by the most of the candidates.
5. Most of the candidates had not attended part (c) of the question at all.

Question No. 03

1. Part (b) of the question was attended by the some of the candidates satisfactorily and obtained 2 ½ marks out of 3 marks allocated for the question.
2. Candidates had shown fair knowledge about TQM but some candidates had written irrelevant answers.
3. Part (a) and (b)- some of the irrelevant answers were;
 - Top management/middle management
 - Prepare annual budgets/provide help desk.
 - Vision/mission, goals/objectives.
 - SWOT / to identify the critical success factors.
 - Organization functions.
 - Commitment of employees/build strong culture focus of external research/finance review.
4. Candidates should have read all prescribed additional reading for this level.

Question No. 04

- (a)
 1. The way question appearing and relevant to the case study, candidates had explained in detail only multi form structure and thereby they gained maximum 2 marks.
 2. Candidates had not discussed other structures and internal control in M Form structure whereby they lost 4 marks.
 3. Some candidates attempted part (a) and shown fair knowledge about the structure and internal control of the M Form structure.
 4. Marks were given for all relevant structures discussed by the candidates and some of them discussed only structures without internal control of the M Form structure. (lost 2 marks)
 5. Candidates got confused about the business structures are only relevant to the question or all other structures (marks given for all cases)
 6. Internal controls Application of internal controls in M Form structure were not identified by the candidates properly and they had discussed about audit committee, business strategy, strategy operation, organizational strategy etc.

7. Considering the fact that most of the candidates work at audit firms, it is noted that practical experience regarding business environment was lacking. Institute lecturers should conduct seminars based on the practical situations.
- (b) (i) Candidates had fair knowledge about the merits and demerits of the M Form structure and obtained up to 2 ½ marks out of 3.
- (ii) The practical application of M Form structure relevant to the case was not attended properly by around 90% of the candidates.
- (iii) Some of the candidates answered following irrelevant points.
- a. Men, money, machines, management, method, market.
 - b. Discussed the merits and demerits of the marketing.
 - c. By discussing merits and demerits only, candidates lost 3 marks from the part (b) of the question.
- (c) (i) Most of the candidates explained strategic leadership in general.
- (ii) The key capabilities of strategic leader were not discussed as given in the suggested answer. Full marks were given for all the points they discussed relevant to the strategic leadership.
- (iii) Most of the candidates, around 60% had identified only the importance of strategic leadership in motivating employees but other capabilities were not highlighted.
- (d) i. Candidates could have obtained certain marks by just attempting this question.
- ii. Developing human capital for the success of organization – Candidates answered fairly reasonable way.
- iii. This part was not discussed in detail by the candidates as expected by the suggested answer. Fair explanation given by the candidates was considered for awarding marks
- iv. Poor performance and not attempting part (d) also was noted.
- (e) 1. Very few candidates obtained reasonable marks for the part (e) of the question.
2. Under this part fair number of the candidates described knowledge orientation.
- What we actually know.
 - What we think to know.
 - What we need to know.
 - What we don't need to know.
 - What would be useful to know.

Some of the wrong explanations given by the candidates were as follows.

- SWOT analysis/Critical success factors
 - Culture of the firm / core competency.
 - Discussed the activities of the HR division.
 - Key dimension degrees of satisfaction levels and loyalty levels of employees.
5. Only few candidates attempted part “e” of the question.

General

1. Candidates should pay due attention for the additional reading materials prescribed by the CA Sri Lanka for this level.
2. Need to read question carefully and attempt all parts of the question.
3. Out of the candidates 90% obtained less than 10 marks for the question 4 due to poor preparation and lack of knowledge related to additional reading materials.
4. There were candidates who obtained zero marks and for the question 4. Some had not attempted the question.
5. Illegible handwriting was a frequent phenomenon.

Question No. 05

Majority of the candidates did not fare well and were able to get 9 to 1 marks out of 20.

The main issues was most of candidate did not clearly understand the case. Candidates should carefully read the case and they should get clear idea about case before answering.

In part (i) of question majority of the candidates were given correct answer by giving detail explanation on benefits.

But in part (ii) most of candidates misunderstood the ‘application areas and relevant organisations’. Most of them were given processes such as knowledge generation, knowledge authorization, knowledge validation, knowledge sharing and knowledge updating . instead of application areas. None of them had given very good answers with appropriate knowledge organization and justification.

In part (iii) most of candidates did not answer well, did not understand the required structure and its necessity.

In part (iv) most of candidates well understood and given very good answers. Majority of them identified CICO portion and other knowledge management experts.

Question No. 06

Majority of the candidates explained knowledge management chain by giving correct answers for part (i). Most of the candidates correctly identified the knowledge acquisition phase. But some of the candidates identified mostly affected phase as a knowledge application which was incorrect.

In part (ii), candidates explained intranet and extranet. But they did not properly answer for question asked. They did not give correct examples and in general answers in this part was not up to the standard. In part (iii) almost all the candidates clearly explained Anthony Hierarchy with pyramid diagram. Most of the candidates obtained full marks for this part.

In part (iv) most of candidates listed out four important aspects that need to be checked to ensure the quality of information. But their explanations on importance were not correctly done.

Question No. 07

Majority of the candidates were able to get 8 – 9 marks out of 10 marks. Most of them clearly understood the all parts of this question.

In part (i) most of the candidates were clearly driven by the relationship between ‘time taken to learn’ and experience gathered with graphical representation of learning curve.

Impact of cost of production also was discussed in annually by most of candidates with graphical explanation of experience curve.

In part (ii) impact of social networking on knowledge management also was clearly explained with good examples by the candidates.

Therefore answering in this question was in very good level.

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Advanced Audit and Assurance – June 2012

Question No. 01

The question has tested candidates' knowledge on assessing control environment of a company which is a subsidiary and ability to identify matters which warrant a special attention in an audit planning phase based on given scenario. Also the question has attempted to test candidates on some accounting issues relating to those matters by requiring explaining why special attention should be paid. Related areas were LKAS dealing with revenue recognition, related party disclosures, events occurring after reporting period, PPE revaluation and depreciation of intangible assets, accounting for changes in foreign exchange rates and accounting for investment in associates.

Majority of the candidates have obtained 40% or more out of 37 marks allotted for the question.

Standard answer to this question is more specific and therefore weaker candidates tended to score badly. There were some candidates who have written lengthy answers on matters such as corporate governance, SEC requirements, Companies Act requirements, group audit, work of component, and auditors global economy which were not directly relevant to the question .

Invariably this would have resulted in time constrain for them to answer the other questions.

Part (a)- This part of the question was answered satisfactorily by majority of the candidates and obtained 3 marks or more out of 5 marks.

- Some candidates however mentioned about corporate governance requirements, such as composition, balance, performance appraisal of the Board Audit Committees, Chairman's role, Compliance and Risk Management Committee . which were not directly related to the given scenario and did not earn any marks.
- Many candidates failed to identify the fact that CEO's role was dominant and as a results there could have been pressure on the management to show a desired target.
- Not having independence for the internal audit as all required reports are sent to CEO by the outsourced firm is missed by many.
- Some candidates however, stated that control environment in the given situation is strong which in fact is not correct.

Part (b)- Majority of the candidates have obtained 40% or more out of the 32 marks allotted for this part.

Many candidates were able to correctly identify revenue recognition, related party transactions. ERP system (intangible assets), revaluation of buildings, investment properly valuation, unusual fluctuation in assets, liabilities, expenses, and income appearing in the financial statements, and accounting for investment in associate. However they could not explain in sufficient depth, thus could not earn full marks.

Some candidates failed to mention the following significant matters.

- Assets and liabilities denominated in foreign currencies to be translated at closing rate (year and rate) and the exchange gain or loss to be included in the profit and loss instead of revaluation reserve – LKAS 21.
- Significant exchange variation experienced during the post t balance sheet period resulting material non-adjusting event which warranted disclosure (LKAS – 10).
- Building depreciation over 25 years instead of say 40 to 60 years which was an unusual practice.
- Not having frequent revaluation. The land revaluation was done over 6 years ago.
- Carrying value of derecognised assets to be charged to PPL instead of revaluation reserve (LKAS – 16)
- Not identified the gap of the year end of the associate of the company should be 3 months and as the gap is 6 months the requirement of draft accounts as at 31 March 2012 for the purpose of calculating equity method of accounting.
- Not identified the fact that investment property of the associate was carried at valuation and that of OMG PLC was at cost.

Some candidates did not interpret the standards properly and wrote irrelevant answers as follows:

- Treatment of recognizing exchange loss/gain in the reserve in the reserve account is correct.
- Significant exchange rate movements which are material (post balance sheet) should be adjusted instead of disclosure.
- Charging the carrying value of derecognized assets to revaluation reserve is correct.

Question No. 02

The question has tested knowledge of the candidates on theory and application of SLAuS 510 – Initial Engagement – Opening Balance and SLAuS 705 – Modification to opinion and 706 Emphasis of matter paragraph.

This question also had been attempted by most of the candidates and about 30% of them have obtained more than 9 marks. Only part (b) had been answered satisfactorily.

Part A

Many candidates displayed their lack of knowledge on the SLAuS 510 dealing with opening balance when the financial statements are audited for the first time or when financial statements for the prior period were audited by another auditor.

Some candidates have stated incorrectly that new auditor need not worry about 2010 audit. The other irrelevant answers observed were as follows:

- Check the date of the audit report.
- Discuss with the previous auditor.
- Evaluate the audit opinion.

In the case of 2011 balance the irrelevant answers observed were;

- Checking comparative figures.
- 44% increase in inventory compared to 2011 balances.
- Debtors too decreased by 41% compared to 2011.
- Discuss with the management as to why they have not reappointed the previous auditor.
- Issue a qualified opinion.
- Verification of debtors – calling for confirmation.
- Verification of land – physical verification.
- Long term loan – checking subsequent payment.

These answers show that many candidates had not studied the relevant auditing standard.

Only few candidates mentioned about the need for reviewing the predecessor auditor's working papers for 2010 balances.

A good number of candidates have listed normal audit procedures for verification of balances given in question which carried no marks.

Part B

This part of the question was reasonably attempted by most candidates. However, there were some candidates who had not understood the question properly and given irrelevant answers. For example,

- Some candidates wrote the content of the auditor's report while some others reworded the opinion in a different form to express a qualified opinion.
- Some candidates thought leaving out of inventory from previous production order was an oversight and could be utilised them in a subsequent production orders. Hence this did not affect audit opinion.
- Some candidates suggested a disclaimer of opinion as there was a scope limitation arising from these two issues.
- Some candidates had no clear idea about emphasis of matter paragraph and the circumstances under which such a paragraph is added.
- Some stated that liability arising on the law suit filed against the company needs to be provided although it was mentioned in the question that the case was at the preliminary stage and company filed a counter action.

Question No. 03

The question has tested the following.

- (a) Merits and demerits of rotation of auditors.
- (b) Matters to be considered prior to an acceptance of an audit.
- (c) How a fraud detected would affect audit work and audit report.

The majority of the candidates were able to answer part (a) and (b) fairly well. However, answers to part (c) were not up to expectation.

Common errors were as follows.

part (a)

- some candidates stated that this was in compliance with SEC Regulations which was a merit of audit for rotation.
- Some had confused the merits of auditor rotation with demerits of auditor rotation.
- It may be difficult to rotate the auditor for a small firm and this was a demerit..
- Few candidates were not aware the meaning of the words merits and demerits and have given irrelevant answers.
- Some candidates had explained the same point over and over again sometimes in different way.

Part (b)

- Some candidates wrote about the procedure for appointment of auditors as per Companies Act which was not required.
- Some have elaborated more about communication with outgoing auditor.
- Some others have written about terms of engagement and content therein.
- A good number of candidates mentioned about the necessity to discuss with management regarding the nature, environment, and internal controls of the business which were not relevant as the engagement was not yet accepted.

Part (c)

- Some candidates mentioned responsibilities of the management for prevention and detection of fraud.
- A quite number of candidates concluded that this fraud was material and suggested to qualify the audit report.
- Hardly any candidates referred to the corresponding figures and their relevance.
- The fact that discovery of the fraud would result in placing less reliance on internal controls and the necessity to increase substantive audit procedures was omitted by many.
- Even though some candidates determined Rs. 80,000 was not material, they forgot to say whether it warrant a qualification either in the last year or this year's financial statements.
- Although the question required to discuss the effect of fraud on three areas, namely effect on financial statements, audit work and audit report, some candidates had not done so. They wrote more on effect on audit report, such as qualified opinion, disclaimer, adverse opinion and emphasis of matter giving lesser attention to other areas.

Question No. 04

The question has tested certain aspect of professional conduct and ethics applicable to members in public practice. Almost all the candidates attempted this question. Overall performance of the candidates was not up to the expectation. Only a handful of candidates scored over 10 marks or more.

Most of the candidates were able to identify the ethical issues and threats arising out of the situation but could not say how to deal with those ethical issues.

Some candidates however, did not identify ethical issues correctly and fully. They displayed their lack of knowledge on section of Code of Ethics of CA Sri Lanka dealing with second opinions, referred fee or commission and custody of client assets.

Following common weaknesses were observed.

Part (a)

- Some candidates did not identify issues correctly. A large number of candidates had failed to identify the facts that second opinion may compromise the opinion of the existing auditor and that client may be opinion shopping which may indicate lack of management integrity.
- Many candidates stated that the auditor should decline the engagement since it violated the Code of Ethics.
- Some candidates merely stated that to discuss with the previous auditor but did not mention that permission should have been obtained from the client. Also they did not mention about the action to be taken if the client would have not permitted said communication.

Part (b)

- Some candidates mentioned about advocacy threat instead of self- interest threat to objectivity and professional competence and due care.
- Some have not identified the threat and safeguards but simply discussed fundamental principles such as integrity, objectivity, professional competence and due care, professional behavior..etc.

Part (c)

Many candidates thought that preparing accounting records (payroll) aroused the self- review threat although the question clearly stated the Firm did not provide any other services to the client concerned.

Nothing has been said about holding of client assets.

Few candidates mentioned about the necessity to examine sources of funds to prevent money laundering.

Question No. 05

The question was aimed at testing the candidates knowledge on fundamentals of Sri Lanka standard on quality control (SLSQ) 1 which was not difficult as the answer was readily available in the study text.

Although many candidates answered fairly well and earned high marks for part (a) and (b) they earned very low marks for part (c). Apparently, candidates who have studied SLSQ – 1 scored more than average marks. Most of the others have answered the question based on SLAuS 220, quality control for an audit of financial statements and thus could not demonstrate their knowledge on SLSQ 1.

Some candidates had given unnecessary lengthy answers specially for part (b) mentioning whatever they studied about quality control policies and procedures followed in an audit firm.

Following are some of irrelevant answers observed.

Part (a)

- Delegation of work to be done according to audit plan, and the work should be carried out under proper direction and supervision.
- The firm should have a policy to consult with others to resolve complex issues.
- To achieve, the right purpose of the client retention in future.
- Improving understandability of the users.
- Improve the accuracy.
- Auditor should apply the following standards as applicable.
 - o SLAuS, SLPSs
 - o SLS on Review Engagement
 - o SLS on Assurance Engagements
 - o SLS on Related Services.

Part (a) (ii)

Described about cold/hot review in detail.

- The purpose/objective of the assignment.
- Professional competence required for the assignment
- Whether it is reasonable assurance engagement or limited assurance engagement.

Part (b)

Some candidates discussed about the elements of quality control instead of procedures to be performed, such as;

- Leadership responsibilities for quality.
- Human resources, monitoring, acceptance and continuance of relationship with the clients.
- Some have suggested to preparing inspection plan for quality control review at firm level control and engagement level control, and supervise accordingly whilst some others discussed about the composition of the firm.

