

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Accounting Applications and Taxation - March 2012

Accounting Applications

Standard of this paper was similar to papers given in the previous examination sessions. Fair number of candidates had attempted the question number 02 and obtained full marks though none was able to answer question 01 with at least 70% of the level expected. This was mainly due to the calculation of NCI (Non-Controlling Interest) for which none of the candidates had appeared to have prepared well.

Common reasons for failures of the candidates as identified by the marking examiners were poor time management, non-submission of workings, poor or careless presentation of answers coupled with illegible handwriting. It was also evident that a significant number of candidates had not studied the syllabus completely. Still others continue to follow conventional methods even though examiners expect the candidates to work-out their answers according to best practices of financial reporting. For example, many candidates were rather ignorant about the terms such as *Non-controlling Interest* and *Statement of Financial Position* which is the current terminology. Instead, they had used terms such as *minority interest* and *Balance Sheet*.

Question No. 01

The question was for preparation of Consolidated Statement of Financial Position. Except for very few candidates, majority had not being taught that *non-controlling interest* could be valued using current market prices of shares, if available. Overall, candidates appeared to have been confused by the term fair value and fair value method mentioned in the question. However, they would not have faced such a difficulty if they had read and understood the relevant Accounting Standards.

As a result of the above scenario, majority of the candidates was not able to compute the goodwill correctly.

This had a very serious impact on the marks that could be earned through this question. Candidates were more puzzled by payment of dividends out of pre-acquisition profits that is normally recorded according to historical cost rather than fair values of such payments. Candidates had faced some difficulties in fitting this to the fair value model.

It is advisable for the candidates to refrain from preparing conventional memorandum accounts as it complicates adjustments under fair value model. Preparing statements or schedules as given in the recently published books and study guides will save time and minimize errors in the examination hall.

Rest of the question was quite simple and straightforward. However, following deficiencies were found:

1. A fair number of candidates failed to eliminate the inter-company portion of debentures. Many others had shown remaining balance of debentures as part of non-controlling interest. However, no such clues were given in the question. So the balance debentures form an external liability and not a part of the equity.
2. Many candidates failed to identify the amount of cash-in-transit correctly.
3. Some candidates had erroneously apportioned a part of unrealized profit on inventory to non-controlling interest. They had failed to identify where such profits were initially recorded.
4. In adjusting unrealized profit on sale of plant, many candidates failed to account for the proper share of such unrealized profits to non-controlling interest.

5. Many candidates failed to show the post-acquisition revaluation. Many others had treated the same as something not yet recorded in the books of account.
6. There were many candidates who failed to show share of dividend paid during the year under non-controlling interest.
7. Impairment of goodwill had erroneously been adjusted to non-controlling interest. This could be adjusted only to the consolidated profit.

Question No. 02

A reasonable number of candidates had attempted this question successfully. Many of them could earn almost all the marks allocated to the question.

Candidates neglected or failed to identify the impact of a given transaction on multiple items such as sales return on debtors and inventory and revaluation on cost and depreciation. Identification of proper sequence of recording such items is very important as change in value could affect the provision of depreciation or doubtful debts. Candidates very often make the provision before adjusting the value.

Candidates should include a way to link items in Financial Statements to their workings through a suitable method such as a reference number. This is very advantageous for candidates who are not able to do the adjustments correctly. Examiners have found numerous instances where candidates had not linked their workings to the answer for marks to be awarded. Showing adjustments as additions or deductions from the items on the face of Financial Statements is acceptable for examination purposes. Marks will be awarded only if the amount and the sign (plus or minus) are indicated correctly.

Following deficiencies are observed among the candidates who had attempted the question with reasonable level of success.

Statement of Comprehensive Income

- 1) Many failed to compute the value of stocks remaining unsold with agents. (i.e. $\text{Rs. } 160,000/3 = 53,333$)
- 2) Some of them who made the sales adjustment correctly, failed to remove the cost of such items from cost of sales. (i.e. $\text{Rs. } 105,000/3 = 35,000$)
- 3) Many had erroneously calculated interest on Fixed Deposit for three (03) months. Interest had to be accrued only for 02 months.
- 4) Almost all candidates had credited revaluation of buildings to revaluation reserve. They appeared to be unaware of the recommendations of Accounting Standard for Impairment where a reversal of previous impairment loss not in excess of original cost could be credited to the income Statement.
- 5) Many had not adjusted the court order to pay compensation thinking that it is sufficient to disclose the same through a note.
- 6) In calculating bad debts to be written off, many failed to consider the specific provision already made in the accounts. ($340,000 - 255,000(75\%) = 85,000$)
- 7) Many candidates had adjusted penalty charges on Income Tax 20,000 as an administrative expense. Candidates with experience in preparing accounts for compliance with tax law naturally tend to show penalties in that way. Therefore, such candidates were not penalized.
- 8) Candidates need to understand the meaning of the Comprehensive Income Statement. Items that were not treated as income under historical cost model are now shown as an addition to years' income at the foot of the Income Statement under fair value model.

Statement of Financial Position

- 1) Failure to make the corresponding adjustment for unsold goods with agents on inventory and debtors. (Rs. 35,000 and Rs. 53,333)
- 2) Failure to adjust the specific provision of doubtful debts written off in determining the provision for doubtful debts.
- 3) Failure to assess the impact of tax over provision in previous years in determining the tax payable amount at the (Balance Sheet) date.
- 4) Failure to classify items as current or non-current. Many had shown gratuity provision as a current liability.

Statement of Changes in Equity

- 1) Failure to include a column for Revaluation Reserve arising from land (300) and buildings (349).
- 2) Failure to transfer the profit from Comprehensive Income Statement.
- 3)

Statement showing Changes in PPE

- 1) Failure to consider remaining useful life of Revalued Buildings in calculating depreciation. (110)
- 2) Failure to show revalued amounts as movements during the year (649)
- 3) Failure to adjust the opening balance of Computer equipment. (Some candidates had shown this as a movement during the year)

Question No. 03

This included calculation of accounting ratios from the information given. Calculation of ratios was straightforward. One ratio required detailed calculation of amounts for use in calculating the ratio.

Common Errors Found were as follows

- 1) Failure to include both cash and credit sales in calculating the Gross Profit Ratio.
- 2) In calculating ROCE, some candidates had taken only equity.
- 3) Candidates displayed very poor knowledge of Credit control ratios.
- 4) Many failed to calculate ratios for both years given.
- 5) Many Candidates had produced the ratio by using calculators. They had not given workings. This limits the potential for earning marks.

Many candidates had not given a comment on the ratio as required by the question. It appears that the candidates had not read the question properly. Marks for the comment will be awarded if it referred to the results obtained in calculating ratios correctly. Thus there is possibility of earning marks for comments even if there were small errors in the ratio calculation.

The second part of the question was theoretical. It could have been answered even without reading the framework referred to in the question. However, candidates had given a definition of the items referred to in the question rather than the criteria for recognizing the item.

As a general guideline to candidates – All items in the Financial Statements prepared in the exam do not carry marks. More weight is given to adjustments involving Accounting Standards. However, 100% of the marks allocated to the question could be earned only if all items were shown with their correct values. Notes on accounting policies are not required unless specifically indicated in the question.

There were candidates whose performance was very poor. Those candidates should do their studies seriously before sitting the exam.

Tax Part
General Comments

1. The questions were within the syllabus and could have been worked within the allocated time by average candidates.
2. The under mentioned shortcomings are noteworthy.
 - (a) Illegible handwriting – some examiners commented that it was almost impossible to read the handwriting of few candidates.
 - (b) Improper reading of the question.

e.g. (i) in question no. 04, the respective periods worked during the year of assessment in the government sector and private sector are clearly evident from the question. However, a good number of candidates have taken erroneous periods.

e.g. (ii) in question no. 05, a few candidates computed the partnership tax payable although the question did not require such computation.

e.g. (iii) in question no. 07, some candidates wrote the answer relevant to part (2) under part (i).
 - (c) Candidates should realize that workings carry significant marks.
 - (i) e.g. in question no. 04, some candidates merely mentioned the Net Annual Value (NAV) of houses without giving the workings how it was arrived at.
 - (ii) Some candidates enter the final answer in the main answer script without submitting the detailed workings.

Question No. 04

The question tested the computation of the income tax liability of a resident individual having different sources of income.

Short-comings/weaknesses of candidates can be summarized as follows:

1. Presentation of Income Tax computation (i) not identifying properly total statutory income, assessable income and taxable income.
 - (ii) Errors of principle –
 - Deducting expenses, reliefs and claims at wrong places –

e.g.(a) - housing loan interest under qualifying payments

(b) - treating tax-free allowance, housing loan repayment as deductions under section 32.

(c) - tax credit (e.g. PAYE) from taxable income.
2. Employment Income
 - (i) salary & allowances – please refer general comments 2 (b) – improper reading of the question.
 - (ii) PAYE tax – adding this to employment income.
 - (iii) Commuted pension and monthly pension
 - candidates should realize that these are different kinds of income for tax purposes – former being terminal benefit while the latter is regular income. Most of the candidates failed to identify these separately.
 - (iv) A few candidates treated the rent income as employment benefit.
3. Net Annual Value
A good number of candidates failed to realize that the period of exemption in respect of the first house is over.

4. Rent Income –
Very few candidates mentioned that this income is not exempt because the house is not used for residential purposes.
5. Interest income/dividend income/profit on sale of gems –
A good no. of candidates mentioned that the above are exempt since WHT has been deducted. Candidates should realize that exempt and final taxes are different concepts.
6. Computation of income tax payable
 - (i) a few candidates applied old slabs and tax rates.
 - (ii) a few candidates applied future slabs and tax rates (effective from year of assessment 2011/2012)
7. Tax credit -
A good no. of candidates failed to claim tax credit in respect of government employment income.

Question No. 05

The question tested the knowledge of computing the divisible profit of a partnership business and the distribution thereof among the partners.

The standard of the question was very much similar to previous exam though with fewer adjustments. The under mentioned shortcomings/weaknesses are noteworthy.

- (a) Poor reading of the question - A good number of candidates computed the net real income and the partnership tax which were not required in the question.
- (b) Use of wrong terminology - a good number of candidates described divisible profit as taxable profit.
- (c) A good number of candidates disallowed royalty payable forgetting that was an expense incurred in the production of income.
- (d) Rent income – a good number of candidates failed to deduct this in arriving at the divisible income.
- (e) Rates paid and repairs to building – Majority of the candidates failed to disallow that part of the expense attributable to the portion of the building rented out.

Question No. 06

Part (i)

This could be considered as a bonus question. The question tested the basic principle of calculating output and input value added tax (VAT) and the balance VAT payable. Only a very few candidates attempted the question.

Part (ii)

This question tested the meaning of 'supply of service' for the purposes of Value Added Tax.

The answers were extremely poor.

Question No. 07

Part (i)

This question tested the self-assessment scheme under the IRA No. 10 of 2006. A few candidates mentioned the operation of the scheme in general terms without mentioning the frequency (quarterly) and/or the due dates on or before the tax should be paid of the few candidates who attempted the question, a good number of candidates submitted satisfactory answers.

Part (ii)

This part tested how a tax payer can avoid penalty when complying with self-assessment scheme. Majority of the candidates appeared to have not properly understood the question and submitted irrelevant answers.

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Fundamental of Management Accounting and Business Finance - March 2012

Question No. 01

- Part (1) (a) This part was poorly answered. Candidates were required to state three aspects that are looked at when a good investment appraisal criterion is selected. However, many had instead stated the methods of investment appraisal.
- (b) This part was fairly answered. However some had not compared NPV with pay back and ARR methods and instead had given the description of these methods.
- (c) Instead of giving possible reasons for being concerned about ARR, many had attempted to describe ARR methodology.

Part (2) Common mistakes observed were:

- (i) Stating some figures in millions and others in thousands in the cash flow.
- (ii) Lease payment
- Though the question stated that annual rent was Rs. 800,000 and 50% of total lease (lease of 5 years) has to be paid at the time of signing lease agreement, most of the candidates considered the annual rental amount as the total rental payable for 5 years.
 - Some candidates had not considered this as a relevant expense to the project.
- (iii) Market research expenses
- Some candidates considered this as a relevant expense incorrectly
- (iv) Legal fees Rs. 400,000, Plant and machinery Rs. 125M and loss of contribution Rs.2 million a year
- Some candidates considered these are not relevant to the project.
- (v) Cash Inflow from the sale revenue
- Most of the candidates computed the sales correctly.
 - Some candidates have misinterpreted sales price per pack given in rupees as total sales revenue in rupees million .
- (vi) Cash out flow for payment for material
- Most of the candidates quoted figures given in the sum correctly
 - Some candidates have misinterpreted the total payments for materials given in million per annum as unit price per pack. This was deducted from unit sale price and multiplied by number of units to get net cash inflow.
- (vii) Payment for contract labour
- Most of the candidates quoted figures given in the table correctly and have ignored the reference given as Note 01
 - Some candidates considered this as an irrelevant expense as this is a prevailing expense.
- (viii) Working capital requirements
- Most of the candidates quoted figures given in the table under Year 1
 - But some candidates recorded under year 0 ignoring year given in the table
 - Some candidates failed to consider the cash inflow effect of working capital at end of the project.
- (ix) Note 01 incremental cost of Rs. 10.000 effect due to transferring of 5 employees with annual increment of 10% w.e.f. second year of the project
- Some candidates comprehended the facts given in the Sinhalese and English papers correctly and considered the incremental monthly salary and then annual cash out flow with the 10% annual salary increment correctly.

- Some candidates considered the salaries of 5 employees as part of contract labour and eliminated it as irrelevant cost for project.
 - Some candidates considered total salary of Rs. 35,000 with increment as a cash outflow of the project some candidates considered only the current salary of Rs. 25,000.
 - Some misinterpreted the monthly salary of one employee as an annual salary of one employee. (Rs. 35X12=420)
 - Some applied the 10% increment for contract labour also.
- (x) Overhead Rs. 5 m
- Some candidates kept increasing the overhead cost year by year 5, 10, 15...
- (xi) Computation of Payback period
- Some candidates considered the sales contribution for computation of payback period
 - Some candidates considered depreciation also as out flow

Part (3) Explanation for not considering certain cost items into cash flows

- Most of the candidates answered well to this part of question
- Some candidates just noted the items but reasons were not given
- Some candidates considered the research cost as not relevant since it was incurred by a research firm in a foreign country

Advice on Selection of project under given criteria

- Most of the candidates performed well in this part
- Some candidates failed to compare with the criteria given by the management in their recommendations

Generally

- It appeared that some candidates failed to read the question carefully and comprehend before attempting to work out.
- Certain information given in the question has been forgotten completely by the candidates when they answer the latter part of the question.

Question No. 02

Part (1) Only a few candidates had stated the stages of the budgeting process correctly. Some had given answers such as describing various types of budgets and advantages of budgeting in general.

Part (2) Common mistakes made by the candidates were;

- (i) Incorrect calculation of quarterly budgeted sales quantity and selling price.
- (ii) Incorrect calculation of quarterly opening and closing stock of raw material of finished goods.
- (iii) Incorrect calculation of overtime cost.
- (iv) Incorrect calculation of production overhead.

Question No. 03

Though satisfactorily answered by some candidates, many failed to obtain marks due to following common mistakes made by them.

- (i) Incorrect calculation of abnormal loss.
- (ii) Incorrect computation of equivalent units without separating base units, additional material, labour and overheads.
- (iii) Some had attempted to value on weighted average cost basis.
- (iv) Incorrect debit and credit entries in the ledger accounts.

- (v) Attempting to calculate the total cost per equivalent unit instead of the required cost per equivalent base unit.

Question No. 04

This question was poorly answered. Candidates were not able to deal with a situation of having two limitation factors giving conflicting rankings. Candidates could not reduce the three product problem to the two product problem by taking out the most profitable product (A) out of the linear programming problem. A proper analysis of the problem would have resulted in concluding that, having undisputed profitability rank 1 in both limitation factors have to be produced to satisfy the full demand. Many had incorrectly taken skilled labour which is a fixed cost into consideration in determining contribution per limiting factors. Many could not appreciate that two limitation factors giving conflicting rankings require linear programming method to get the optimum solution.

A satisfactory answer to the linear programming part would have a clearly labeled graph indicating all constraints and the feasibility region together with proper evaluation of all the corner points.

Question No. 05

This question was satisfactorily answered. However, some had failed to answer part of the question.

Other shortcomings were:

- (i) Candidates have written down the applicable formulas but had failed to calculate the relevant variance. Candidates are reminded that writing down formulas only will not attract any marks.
- (ii) Some of the candidates could not understand what was tested in the question and had written irrelevant answers. This may be due to not reading the question and understanding it before attempting it.
- (iii) In answering theory parts it was noted that the candidates had often repeated the same point. Candidates are advised that this is a waste of time.
- (iv) Failure to interpret the answers in part 2.
- (v) In answering part 4 of the question some had tended to give an essay type answers that did not address what was required. The question specifically required the candidates to briefly describe 3 matters. A point form description of 3 matters would have yielded better results.

Question No. 06

This question was poorly answered. Many candidates had not selected this (optional) question. It is apparent that this area in the syllabus (Business Finance) has been inadequately covered in their studies.

Common mistakes made by the candidates were:

- (i) Could not differentiate capital from equity.
Many had taken ROCE to be $\frac{\text{PBIT}}{\text{Equity}}$ and others, ROE to be $\frac{\text{PAT}}{\text{Capital}}$ (i.e.) $\frac{120}{800 + 400}$
- (ii) Cost of debt taken without tax adjustment.
- (iii) Many were unaware of the formula $g = rb$.
- (iv) Share value in dividend growth model was incorrect due to application of wrong values e.g. dividend calculated as $240 \times 60\%$ instead of $120 \times 60\%$
Growth factor taken as 8 instead of .08.
- (v) In calculating the free cash flow, some had merely written down a memorized formula without applying it to the current problem.

Question No. 07

- Part (1) The performance of the candidates was around (2.5-3)/5, though the question was straightforward and tested the introductory level knowledge on Activity Based Costing. Many candidates had discussed the merits of ABC and pitfalls of Traditional Costing method without regard to the allocation of overhead in both approaches. Only a very few candidates (about 7%) had mentioned that determination of cost drivers of selected activities for the allocation of overhead is much objective and relevant than using an arbitrary rate which might lead to under-costing or over-costing of products and services.
- Part (2) Average performance was (1 ½ - 2)/5. Handful of candidates (about 5%) had been able to identify shareholder wealth maximization as the correct role of the Finance Manager. None of the candidates had been able to mention that consideration of risk in the process of shareholder wealth enhancement such as undertaking projects with acceptable level of risk to the shareholders. Some candidates (about 15%) had mentioned that maintaining liquidity is the main role of the Finance Manager, and identified profit maximization as a secondary task. They displayed a poor knowledge in relation to this question. A number of candidates (about 50% - 60%) had discussed in point form, the duties of accountant/routine functions of a finance department instead of identifying the role of a finance manager. The question would have been perfectly answered by supporting economist's theory in relation to maximization of profits with taking acceptable level of risk so as to enhance shareholder wealth i.e. value of the firm. A handful of candidates (about 4% - 5%) had discussed the correct task/s under each decision in order to claim full marks allocated to the part. However a very few candidates (about 1% - 2%) had been able to discuss a little about consideration of time value of money (i.e. an element of risk) in maximization of wealth of the shareholders, claiming only a ¼ mark.
- Part (3) In average, 2/5 was scored for this part of the question. A number of candidates repeated facts given in the question without giving justifications with reasons. Almost all the candidates had missed out the important comment that the firm needs to consider the project specific cost of capital which may involve different level of systematic risk (different operating characteristics) and capital structure i.e. gearing level. Majority of the candidates do not appear to have understood the difference between firms overall cost of capital and project specific cost of capital. Large number of candidates (about 50%-60%) discussed various methods of project evaluation and suitability of such methods in details for example IRR, NPV, payback method etc. thus displayed poor skills in reading and understanding the question.
- Part (4) The performance of the candidates was poor i.e. (1 ½ - 2)/5. Large number of candidates had repeated the facts given in the question. None of the candidates had been able to correctly mention that this technique is not valid when the firm is enjoying a tax holiday. Many candidates (about 55% - 60%) had not identified that the reduction in WACC is due to tax savings on cost of debt (i.e. interest cost). Only one candidate had been able to discuss the additional implications that might arise in increasing the proportion of debt in the capital structure for example increase in cost of equity; a premium for financial risk by the ordinary shareholders.

Some candidates had explained WACC by taking extensive calculations as examples which were irrelevant to the expected answer to the question.

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Information Management - March 2012

Question No. 01

Only few candidates had scored more than 15 marks out of 20. Most of candidates were able to answer for parts (i) & (ii) but not part (iii).

In part (i) most of the candidates were identified 'server types' but not given its usefulness. But some of the candidates did not understand this part and given network topologies instead of 'server types'. Some irrelevant answers also were given. If candidates read their study pack it would have been easy to understand 'server types'.

Part (ii) of this question is straight from the study pack. Most of the candidates did not answer correctly. But some of the candidates gave very correct answers as given in the study pack.

Part (iii) only few candidates were attended to this part, from that also very few candidates gave approximately correct answer. This question is also straight from the study pack. However this part may be too technical for this level of students.

Question No. 02

Part (i) majority of the candidates were able to answer part (i) correctly. They clearly presented their answers by giving advantages and disadvantages of COTS & Bespoke approaches separately. Some of them gave table format for this. However some of the candidates had mixed these two approaches and had given mixed up answers.

Part (ii) Answers for this part were very poor. Most of the candidates did not understand the question clearly. Most of them had given problems/matters of 'Project Management Software Package' instead of giving the problems/matters that were addressed by a project management software package.

Part (iii), This part was also from the study pack and most of the candidates did not answer well. However some of candidates were able to draw diagram correctly and described correctly.

If candidates read the study pack, they could have easily answered this kind of question.

Question No. 03

This was very easy theory question straight from the study pack. Most of the candidates gave contents of TOR, and some of them who may not have followed study pack gave completely wrong answers such as 'system life cycle' and some categories of costs etc.

Question No. 04

This was also an easy question from study pack. But majority of the candidates were unable to obtain 50% of the 15 marks. Question was about the objectives and issues related to cost and profit centres. Most of the candidates mixed their answers and gave costs related to IS instead of objectives.

Question No. 05

This was highly technical question from study pack. Majority of the candidates did not attempt to this question. Those who attempted also get very low marks. Some of them mixed up answer (a), (b) and (c) and given answers incorrectly .

Question No. 06

Majority of the candidates gave correct answers for part (a). Part (a) and part (b) are straight theory questions. Only few candidates were able to give correct answers for part (b). For part (b), most of the candidates gave irrelevant answers instead of 'objectives'.

Part (c) was the practical part of the question. Most of the candidates gave common factors such as internet facility and credit card facility. Candidates may not have correctly understood the question.

Question No. 07

This question was about 'Port Implementation Review' which was directly from the study pack. Majority of the candidates did not answer correctly and got very low marks. Most of them had written advantages instead of areas to be considered.

Question No. 08

This question was about Information System Security' which was straight from the study pack. Most of the candidates had 8-10 marks out of 15 marks.

In part (i) and (iii) candidates were able to give correct answers, but answers to part (ii) was very weak. This may be due to the fact that part (ii) was too technical, but it was well defined in the study pack. In general candidates should have read the questions and should have got clear understanding about what the question was about before answering the question.

Candidates should at least have gone through the study pack although it was not enough to get wider knowledge.

Candidates should write their answers clearly. They should improve their handwriting as well.

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Audit and Assurance - March 2012

Question No. 01

The question has tested the candidates on the following:

- Limitations in assurance services.
- Importance of Letter of Engagement and matters to be included therein.
- Identifying of weaknesses in internal controls in a given purchase system and suggestions for improvement to the system.

Almost all the candidates have attempted this question. Except for part (iv) other parts have been answered fairly well by many. Most of them managed to earn 8 – 10 marks out of 20 marks. About 50% of the candidates have obtained 50% or more of the allotted 20 marks.

Following are some of the common weaknesses observed:

Irrelevant answers

Part (i) Limitations

- Assurance is done as per Companies Act.
- Assurance is done as per SLAS.
- Assurance is done as per SLAuS.
- Legal and regulatory matters.
- Existence of material misstatements in the financial statements.
- Code of Ethics as a limitation of assurance.
- Lack of knowledge of the auditor.
- Lack of facilities for the auditor.
- Lack of resources.
- Human errors.

Following points were omitted by many candidates.

- Reliance on the information provided by the responsible party.
- Use of estimates in the subject matter.

Part (ii) - Can give the audit opinion correctly.

- Can standardize and improve the audit opinion.
- Some had confused with agreed upon services.
- Many had failed to state clearly possibility of minimizing disputes between the auditor and clients.
- Some have wasted their time by writing long answers rather than answering to the point.
- Some gave content of the letter of engagement.

Part (iii) - Some candidates had given irrelevant answers such as obtaining the consent of the previous auditor, considering the Professional Ethics, etc.

- Some candidates mentioned to include title, address, signature, date, name of the auditor, date of commencement audit and date of completion of the audit, leaving out the important matters to be included.

- Some candidates have given three headings under which matters to be included rather than the contents e.g. principal contents, matters that auditor may wish to include and matters that include when relevant.

Part (iv) - Majority of the candidates have identified the deficiencies in the internal control system.

However, some candidates though knew how purchasing system should be organized in a typical business entity they could not apply that knowledge to the given situation. As a result they could not identify the weaknesses clearly in the given scenario. Thus, accepting invoice received directly to the site has not been identified as a weakness by many.

- Some candidates noted payment clerk was not supervised by a finance manager and finance manager need to be appointed.
- Some others saw site manager was not supervised by an engineer and suggested to appoint an engineer as a measure of improvement.
- Some candidates suggested having a complete purchasing office rather than improving the present system.
- Very few have mentioned approval from HO to be obtained for purchases and channel through H.O.
- Some mentioned merely no segregation of duties without relating to the given scenario.
- Few candidates identified payment made at the end of the credit period as a deficiency displaying their lack of knowledge.

Question No. 02

The question has tested candidates' knowledge on:

- Auditor's report on financial statements with reference to audit opinion and types of modification with circumstances leading to such modifications (SLAuS 700 and 705).
- Applying audit procedures for land and buildings revaluation by a professional valuer – SLAuS-620)
- Going concern ability when a major customer had become bankrupt (SLAuS 570) using the work of internal auditors (SLAuS 610) and verifying events after reporting period.

Most of the candidates have attempted this question and majority of them obtained 10 marks or more out of 25 marks allotted.

Due to the following shortcomings and mistakes observed many candidates could not earn good marks.

For part (i) most of the candidates have written matters that can be included in the audit report and not identified matters specifically included in the 'opinion' paragraph though it was clearly stated in the question.

- E.g.
- Responsibility of management
 - Scope of audit, name of the auditor, basis of opinion, accounting period audited, date of the audit.
 - Some candidates mentioned regulatory of framework for audit (SLAuS) need to be included, instead of the framework for preparation of financial statements (SLAS).
 - Also some candidates mentioned about giving a qualified opinion, disclaimer of opinion and adverse opinion which were not relevant for this part of the question.

Part (ii) - Most of the candidates have named the types of modifications to opinion correctly but could not correctly say the circumstances in which those opinions were expressed.

- Some candidates though identified the scope limitation and disagreement with management as circumstances leading to disclaimer or adverse opinion they failed to mention the words so material and pervasive.
- Some candidates did not use appropriate terms when explaining modifications, in that they use the words such as important, very material, very important and bigger errors.
- Some candidates mentioned the correct facts but not mentioned the type of opinion, e.g. Auditor can modify opinion when disagreement with management is so material and pervasive.

Part (iii)(a) Some candidates have incorrectly wrote about physical verification of land and buildings, checking title deeds and depreciation . without mentioning audit procedures required to verify the accuracy and reliability of revaluation of land and buildings done by a professional valuer. This displayed their lack of knowledge on the SLAuS dealing with the using the work of an expert.

- Some candidates were able to give only one audit procedure although there were several procedures given in the study text.

(b) High proportion of candidates misunderstood the question and wrote about going concern doubtfulness indicators such as net liability position, net current liability position, adverse key financial ratios, inability to pay creditors on due dates and loss of major customers . without giving the audit procedures such as analysis and discussing cash flow, profit and other relevant forecasts with management, analysis and discussing the entity's latest available interim financial statements, reading minutes of meetings of the board of directors, and important committees . envisaged in SLAuS concerned.

- Some candidates suggested to verify whether bankruptcy is reliable and if so to make a provision for doubtful debt.
- Some candidates have written about various ratios to be calculated, whilst some others simply said financial indications, operating indications and other indications to be considered in audit.

(c) Some candidates have misunderstood this part of the question and wrote about the audit procedures for payroll system in a computerized environment instead of the audit procedures to determine to what extent reliance on the work carried out by the Internal Audit Division, such as whether the work was carried out by internal auditors having adequate technical training and proficiency, and that they exercised due care in performing their work, any exceptions or unusual matters disclosed by them are properly resolved.

- Some candidates mentioned general audit procedures,such as checking EPF, ETF, recoveries, check personal files, letters of appointment which indicate they have not read and understood the question properly.

(d) Majority of the candidates obtained 60% or more out of 4 marks allotted. However, some candidates failed to mention important audit procedures such as inquiring from the entity's legal counsel about possible outcome of the case and inquiring from management about the current status of the case.

- Some candidates simply mentioned discussing with management and inquiring from entity's lawyer but not considered about the current status of the case or outcome of the case. So they could not earn full marks.

- Need to disclose or making provision depending on the legal opinion, was omitted by many.

Question No. 03

The question has tested the knowledge of the candidates on auditor's role in corporate governance and Code of Ethics with special reference to threats to independence of the auditor.

Almost all the candidates attempted this question.

Part (i) dealing with corporate governance was poorly answered. Instead of explaining the role of the auditor many candidates tried to explain what the corporate governance is. Many others attempted to explain the normal duties of the auditor.

Large number of candidates were of the view that auditor was not responsible for frauds.

Very few candidates said that the auditor did not have direct responsibility on corporate governance. Instead of saying auditor has to provide a check on the information provided for governance system, majority had explained checking of various controls established such as non-executive directors, minutes of meeting, audit committees, remuneration committee etc.

Parts (ii) (a) and (b)

A large number of candidates have produced satisfactory answers to these parts. Following are some of common weaknesses observed.

- Some candidates suggested to communicate with previous auditors of the 15 companies to ascertain whether they have any professional objections.
- Some candidates identified audit fee as the issue but unable to say the form of threat involved.
- Instead of self-interest threats some candidates mentioned various other threats such as familiarities threat, intimidation threat, self-review threat etc.
- Most of the candidates considered Kumara as a past employee of the Elite company although the question said he has only assisted. It was only providing a services in advisory capacity. This has resulted wrong conclusion and identifying an inappropriate threat i.e. familiarity threat.
- Some candidates saw this as an advocacy threat rather than a self- review threat.
- Some candidates quoted sections in Companies Act though the question was purely on Code of Ethics of ICASL.
- Some answers were too general in that no reference to independence, Code of Ethic, or threat involved, but simply mentioned this would affect the audit and audit should not be accepted.
- Some have failed to identify the independence issue and the threat to independence in two situations and not stated auditors should be independent to provide assurance services.

Question No. 04

This question dealt with the qualifications and disqualifications of a person to become an auditor of a company and identification of risk in a given scenario and audit procedures to mitigate those risks. Although the question was simple and straightforward, performance of candidates was not very satisfactory.

Large number of candidates had displayed their unfamiliarity with the provisions in the Companies Act to answer part (i) and (ii). Many candidates mentioned only ICASL membership as qualification to be an auditor of a company. They did not earn full marks.

Following are some of the irrelevant answers given some candidates for qualifications.

- Should be an independent person
- Should be an experienced person.
- Person over 18 years of age.
- Should not be a lunatic.
- Person registered with Auditor General.
- Person registered with Inland Revenue Dept.
- Persons having adequate knowledge on SLAuS.
- Persons with professional skills and competence.
- Persons below 60 years of age.
- Persons having good knowledge on SLAS and SLAuS with experience.
- Persons who has completed a course in a professional body.

For disqualifications

- Shareholder of the company.
- Persons who have no professional qualifications.
- Persons who have not appointed by the shareholders.
- Debenture holders of the company.
- Lawyers. Head of departments
- Politicians.
- Persons who have convicted by a court of law

These types of answers clearly reflected their level of knowledge which resulted in obtaining low marks.

Answers to part (iii) (a) and (b) showed that many candidates have not understood the risks arise in the given situation from the perspective of the auditor.

They have considered the possible risks from the management's point of view and had produced various answers which were not relevant.

Many candidates have identified the following as risks.

- Dissatisfaction of customers.
- Company will lose market.
- Effect on the goodwill of the company.
- Stock obsolescence.
- Stock damage
- Working capital issue
- Increase in stock holding cost.
- Displacement of stock items.
- Dissatisfaction of employees.
- Management inefficiency.
- Going concern of the company.

Since the answer to part (iii) (b) depends on the part iii (a) of the question, the candidates who produced wrong answers for part (a) did not score any marks for part (b).

It was noted that some candidates had written procedures which were relevant to the management and not to mitigate the risks faced by the auditor, thus they mentioned the following points.

- Necessity to fulfill the requirement of customers.

- Sell goods at discounted prices to attract customers.
- Possibility of stock becoming obsolete.
- Undertaking a new advertising campaign to increase sales.
- Improving the quality of goods produced.
- Exploring the possibility of producing new products for which there is a demand.

Question No. 05

The question was designed to test candidates on review engagement and agreed upon procedure engagement and basic knowledge on some LKASs, namely LKAS 2, 16, 24 and 10.

Almost all the candidates have attempted and overall performance was not up to the expected level. Average marks were between 5 – 9 marks.

In view of the following deficiencies and errors, the majority of the candidates could not obtain high marks.

Most of them could not state the objective of review engagement and agreed upon procedure engagement correctly.

Some candidates were confused with the nature of assurance of the two assignments.

e.g. No assurance is given in respect of review engagement and moderate or negative assurance is applicable to agreed upon procedure engagement which is not the case.

Many candidates did not mention about factual findings.

Considerable number of candidates had written agreed upon procedure engagement was to verify 100% one or two items in the financial statements and provides 100% assurance.

Many candidates did not know the procedures to be performed in a review engagement and agreed upon procedure engagement which resulted in losing 4 marks.

A good number of candidates were not aware of the level of assurance or nature of opinion given on two engagements. Some incorrectly stated positive opinion for review engagement and negative opinion for agreed upon procedure engagement.

Part (ii)

Almost all candidates had correctly answered parts (ii)(a) and (b) dealing with capitalizing expenses. For part (ii) (c) high proportion of candidates did not know the disclosure requirement in relation to related party transactions.

Some candidates suggested adjusting accounts to reflect correct value of goods transferred to the related company while some others thought this issue as a consolidation matter. Some candidates went on discussing about the issue without giving any conclusion.

Some candidates did not demonstrate the knowledge on LKAS recommendations.

For part (ii) (d) some candidates turned to look at the issue as a going concern without looking at LKAS 10.

Some candidates suggested that duty to be added to the cost of sales instead of inventory cost.

A quite a number of candidates had mentioned verification procedures for inventory, machinery, related party transactions and debtors instead of steps to be taken to resolve the issues associated with the items.

Question No. 06

The question had tested knowledge of the candidates on :

- (i) Letter of representations as an audit evidence.
- (ii) Disadvantages of audit programme.
- (iii) Additional audit procedures need to be performed in given situations.

Around 90% of the candidates have attempted the question. Average marks were between 8 – 10 marks. Common weaknesses were as follows:

Part (i)

- * A large number of candidates correctly described where auditor can't rely on management representation as audit evidence but no examples were given.
- * Although the question requires to state two examples where auditor cannot rely on the management as the only audit evidence. Some candidates gave condition rather than examples for instance such as management's integrity is questionable, incompetent management newly appointed management etc.
- * Some candidates have not understood the question properly and gave answers as follows:
 - * Explained what is a management representation.
 - * Reliability aspect of management representation.
 - * Knowledge of management on accounting.

Part (ii)

Performance in this part is average. Majority of candidates failed to mention three disadvantages of an audit programme. They repeated the same point in different form.

For instance, the work may become mechanical has been stated in following forms.

Programme may be outdated not taking in to account changes in entity, systems and controls.

Programme may not be suitable for every year.

Programme is not updated in line with changes in SLAuS and SLAS.

Thus they could earn only one mark.

Some candidates have given advantages of pre-prepared audit programme while some others have given both advantages and disadvantages.

Some of which were general sort of answers as follows:

- Possibility of having errors.
- All important areas may not be covered.
- If there were errors in pre-planned audit procedures there would be an possibility of repetitions.

It is apparent from the answers that many candidates had not read the study text as the answer is readily available therein.

Part (iii)

- (a) Majority have scored 2 marks allotted by mentioning the need to check with the management and proper disclosure is needed in financial statements.

Some candidates, however, suggested adjusting the accounts instead of disclosure.

- (b) Most candidates described general audit procedures on inventory verification not specific to the given circumstances.

Some candidates mentioned that this is a scope limitation and it will lead to qualification of the audit report which carried no marks.

Performing analytical procedures, test of controls over inventory and confirmation from custodians of inventory have been overlooked by many.

Some answers were incomplete in that they suggested a sample verification at a subsequent date but not mentioned reconciling with records.

- (c) A good number of candidates had answered fairly well and obtained full marks.

Although the question clearly said that auditor should complete the audit within 2 days some suggested to call for confirmation once again.

Some others came up with suggestion like expressing qualified audit opinion, withdraw from audit etc.

Question No. 07

The question has aimed at testing the knowledge of the candidates on EDP environment audit. High proportion of candidates, around 80%, had not attempted this question perhaps due to the availability of choice of question. Many of those who attempted too could not answer parts (ii) and (iii) satisfactorily. Average marks obtained were in the region of 7 – 10 marks.

Many candidates misunderstood part (ii). Although it was clear that steps to be taken in GAS application, some explained the steps to be taken in choosing a GAS.

Common mistakes made were:

- Giving general answers without giving due attention to what was asked for in the question.
- Auditors knowledge about the software.
- Cost of the software, benefits of the software rather than explaining advantages of using GAS application in audit.
- Some candidates described physical access control in details whilst some others dwelt on logical access control in detail.
- Some candidates instead of giving types of general controls, went on the explain different controls coming under one category of controls.

Some candidates had given irrelevant answers for part ii such are as follows:

- Computer know-how.
- Availability of software
- Data collection
- Auditing samples
- Data entry/book-keeping.
- Easy to identify risks
- Complexity of the EDP system.

For part (iii) the following irrelevant answers were given

- Avoid threatening for information about valuable customers.
- Proper guidelines to the audit staff
- Conduct proper audit.
- Obtain audit evidence.
- Assessment of risk in the data

The above examples demonstrate the following

- Candidates write whatever they have studied in EPD systems.
- They have not understood the question properly

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Business English II - March 2012

Question No. 01 : Vocabulary test

A passage from the Central Bank report – 2011 has been given to fill in the blank spaces. Only a few candidates have understood the passage and fared well. The majority of candidates have got poor marks though the passage was quite simple.

Question No. 02 : Testing simple grammar – verb forms. Though the given passage looked quite simple even 5/10 marks. Their knowledge of basic grammar was poor.

Question No. 03 : Writing a business. Ordering of goods under the given guidelines. Most candidates have performed well. They are proficient in writing business letters. It was easy to score here as marks were allocated even for the format. The given guidelines have been followed and about 70% have scored 8/15 marks.

Question No. 04 : **Report writing.** Here also most candidates have scored fairly well as they are quite familiar with the format of report writing. It was observed that their weakness in the construction of grammatically correct sentences led to not being able to follow the guidelines. A few have scored full marks by giving model type answer.

Question No. 05 **Essay writing.** Essay writing has been re-introduced after a short break. The three topics given are all current news. Most candidates had a lot of information but found it difficult to score marks to their weakness in writing the language.

Question No. 06 **Comprehension** (A) The passage was about Chinese economy. The candidates have given their answers in one or two words when they were expected to answer in complete sentences. Most have lost marks due to this fact. Candidates have to be trained to read the given instructions properly and answer accordingly. (B) Writing a short paragraph of about six sentences on ‘Sri Lanka’s ties with China’. Most candidates have not read the instructions properly and have written whole essays and few have misunderstood the word ‘ties’.

In general the paper was of average standard. About 60 – 70% have passed the examination. As usual candidates from the rural areas have not performed well.