

## KB1 – Business Financial Reporting

December 2018

### Examiner's Comments

#### SECTION 1

##### Question 01

The Conceptual Framework for Financial Reporting and the regulatory framework were tested here.

Most of the candidates did not properly answer this question by taking into account the action verb “explain”.

- (a) (i) Candidates displayed poor knowledge of the direct intended users of financial statements. Most failed to identify the direct users and other users who should be considered as ‘useful’.
- (ii) It appeared that most candidates did not understand the word ‘recourse’, and thus did not answer this part.
- (b) Most candidates did not properly explain and refer to the act that relates to the regulatory framework. Some had written full SLFRS are required even though the company is **not** a listed entity. They were unaware of the option available to apply SLFRS for SMEs. Further, most candidates did not indicate the threshold of Rs. 500 million.

**(Total: 10 marks)**

##### Question 02

Candidates were expected to know the deferred tax liability computation under various scenarios.

Some candidates did not calculate the temporary difference, and many did not indicate the nature of the difference; whether it was a deferred tax asset or liability. Since the question asked for the deferred tax liability, some candidates ignored the assets.

Many candidates also did not consider the PPE revaluation for the deferred tax computation.

The applicable tax rate was not properly taken for the computation by most of the candidates.

**(Total: 10 marks)**

### Question 03

This question tested candidates' knowledge of the finance cost of bond issues.

Candidates yet again did not pay attention to the action verbs given.

- (a) This part tested the knowledge to identify the components of finance cost with figures. Some candidates did a NPV calculation, which was the wrong approach. However a few did identify the cost components such as interest, issuing cost, premium and discounts in the correct manner.
- (b) Candidates were confused answering parts (a) and (b). For example, the relevant answer for part (a) was given under part (b), and vice versa. Also, candidates were failed in selecting the correct interest rate. The effective interest rate was the one to be applied.

The cost associated with issuing the bond was not considered as a finance cost by some candidates; and thus it was not deducted in arriving at the proceeds of the bond. This led to arriving at the incorrect opening balance of the bond account.

- (c) The benefits and characteristics of effective interest rates were given instead of explaining the reasons why the effective interest rate method is superior to other methods.

**(Total: 10 marks)**

### Question 04

- (a) Employee share options, and the related share value computations and accounting, were tested here.

Candidates were required to "explain." However, the majority only did a calculation and did not do any explaining. Some copied paragraphs at length from the book. Many were not aware of the treatment of the two vesting conditions: market condition and service condition. Most candidates also failed to take the fair value of the share price, and instead took the share price on 31<sup>st</sup> March 2018 for calculation purposes (i.e. considered the share price as Rs. 80 instead of Rs. 100). The service condition given in the question required the employees to remain in service for three years. Only two directors fulfilled this service condition. Some candidates worked it out for three directors instead of two directors. Some others recognised the service received as an expense, but failed to recognise the corresponding increase as equity (they instead considered it as a liability).

- (b) Knowledge of fair value accounting arising from impairment adjustments was tested here.

There was no ambiguity in the question. However, candidates did not have a thorough knowledge on how to account for an impairment. Many only showed the calculations and completely ignored the action verb "advise" in answering the question. Some even copied irrelevant paragraphs from the accounting standards.

Most of the candidates failed to adjust for the Rs. 15 million (Rs. 45 million – Rs. 30 million) deduction from goodwill, and they considered both the disposal loss of Rs. 30 million from vehicles, and the Rs. 15 million impairment loss against the vehicles cost. Therefore the value of vehicles as at 1<sup>st</sup> February 2018 was shown as Rs. 75 million. A few candidates arrived at the impairment loss of Rs. 30 million from 1<sup>st</sup> February 2018 to 1<sup>st</sup> March 2018 and made proper adjustments to goodwill.

Most candidates answered either part (a) or part (b), and only a few answered both parts.

**(Total: 10 marks)**

### Question 05

This question required candidates to calculate and explain profitability, liquidity, gearing and efficiency levels derived from the financial statement details given for two years. Most candidates just calculated the financial ratios, and did not explain how the company had strengthened its financial position and performance.

Some candidates had calculated the return on equity (ROE) instead of the return on capital employed (ROCE). It was further noticed that the gearing ratio was calculated instead of the debt ratio.

The overall performance on this question was acceptable.

**(Total: 10 marks)**

## SECTION 2

### Question 06

- (a) This question tested the application knowledge of consolidated accounts.

Majority of the candidates either did not understand, or misinterpreted the adjustment for deferred tax on fair value of land and building, and inventory, for goodwill. Thus this adjustment was ignored.

- (b) Candidates were expected to explain the accounting treatment to be applied in the partial disposal of a subsidiary.

Most candidates did not attempt this part. The few that did attempt were also not familiar enough to explain the accounting treatment for the partial disposal of a subsidiary or the computation to be applied in the consolidated financial statements.

**(Total: 25 marks)**

### Question 07

This question was mainly framed to test the practical application of accounting standards in different areas.

- (a) *LKAS 16 Property, Plant and Equipment*

- Cost of roof removal (Rs. 3 million) – most candidates wrongly considered this as an expense and charged it to the income statement, whereas it should have been capitalised.
- Repair of car park – this was correctly answered by most candidates by identifying it as an income statement charge.
- Improvement to hotel rooms – this was correctly answered by most candidates who identified it as a capital item.
- Painting the existing wall – almost all the candidates correctly answered this by identifying it as an income statement charge.
- Cost of promoting hotel after repair – this was correctly answered by almost all the candidates who identified it as an income statement charge.

(b) LKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Candidates were expected to identify the provision required for the expected restructuring cost.

Most candidates correctly indicated the provision required for the direct restructuring cost of Rs. 30 million and the compensation to affected employees of Rs. 7 million. For the non-cancelable lease contract of 3 years, the annual lease rental was Rs. 1 million. Therefore the provision required for this was Rs. 3 million. However, most candidates only provided for Rs. 1 million.

(c) SLRFS 9 *Financial Instruments*

Portfolio investment in treasury bonds – some candidates did not indicate the business model of “collecting contractual cash flows (interest and principal) and selling them”, but provided the rest of the expected answer.

Investment in listed investment shares – this part was also answered as above without indicating the business model.

Receivables portfolio – this part was answered without indicating the business model “to hold”.

(d) *Changes in Accounting Policy for Investment Properties*

Most candidates correctly wrote that the change in accounting policy should be applied retrospectively, but they did not know how to apply it. Instead of adjusting for the fair value in 2016 and thereafter comparing the fair value each year, some candidates compared the carrying value of the investment property with the same year fair value.

**(Total: 25 marks)**

**General comment** – candidates seem to simply extract paragraphs from the given material and fail to relate them to the given scenario or provide proper justification for their conclusion. Candidates should not directly copy paragraphs from the reference material given. Practical application should be justified by emphasising the principles given in standards or other reading material.

## KB2 – Business Management Accounting

December 2018

### Examiner's Comments

#### ***General comment about submission of workings***

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

#### ***General comment about candidates' handwriting***

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

## SECTION 1

### **Question 01**

This question was designed to test the Intended Learning Outcomes (ILO) of Chapter 1 "Absorption Costing vs Activity-Based Costing" of the study text.

The average performance on this question ranged from 2 marks to 4 marks (out of the 10 marks allocated). Only around 10% of the candidates scored more than 5 marks.

The question tested the application knowledge of Activity-Based Costing (ABC).

- (a) Most candidates failed to correctly identify the features that existed in the given scenario that would encourage the application of ABC.
- (b) Many candidates did not identify the features that may obstruct the application of ABC. The performance on this part was very poor.

**(Total: 10 marks)**

### **Question 02**

Around 5% of the candidates did not attempt this question. The average performance on this question ranged from 3 marks to 5 marks (out of the 10 marks allocated). Only around 38% of the candidates scored more than 5 marks.

- (a) This part was designed to test the Intended Learning Outcomes (ILO) of Chapter 2 "Marginal Costing vs Throughput Accounting" of the study text.

It tested the theory knowledge on throughput accounting, and many candidates scored some marks on this part.

- (b) It tested the ability to identify cash management techniques that can be applied to the given scenario.

Some candidates did not understand the question and tried to do some calculations using the information given in the table.

**(Total: 10 marks)**

### **Question 03**

This question was designed to test the Intended Learning Outcomes (ILO) of Chapter 11 "Pricing" of the study text.

The average performance on this question ranged from 7 marks to 8 marks (out of the 10 marks allocated). Around 60% of the candidates scored more than 5 marks. This was the highest performing question in the paper.

- (a) Most candidates made mistakes in identifying the working capital of Rs. 16 million as part of the investment.
- (b) Many candidates completed this part correctly and scored the allocated marks.
- (c) Many candidates performed well and scored good marks for this part.

**(Total: 10 marks)**

### **Question 04**

This question was designed to test the Intended Learning Outcomes (ILO) of Chapter 17 "Responsibility Centre Accounting" of the study text.

The average performance on this question ranged from 3 marks to 4 marks (out of the 10 marks allocated). Only around 15% of the candidates scored more than 5 marks.

- (a) Many candidates did not understand the advantages and disadvantages of the apportionment of head office costs. They had described the process of absorption of fixed overheads amongst the two automobile centers.
- (b) Many candidates performed well on this part and scored the allocated marks.
- (c) Candidates failed to provide successful answers for this part. This showed that many of them did not have sufficient knowledge to relate ROCE to the evaluation of performance.
- (d) Many candidates did not perform well on this part. This showed that they did not have sufficient knowledge to relate RI and ROCE to the evaluation of a bonus scheme.

**(Total: 10 marks)**

### **Question 05**

This question was designed to test the Intended Learning Outcomes (ILO) of Chapter 18 "Working Capital Management" of the study text.

The average performance on this question ranged from 6 marks to 7 marks (out of the 10 marks allocated). Around 45% of the candidates scored more than 5 marks.

- (a) Many candidates scored well on this part.

- (b) Many candidates failed to compute the effective rate of interest and just applied the 15% rate. However, they scored more marks from the rest of the computation.

Some candidates failed to pick the correct maximum and minimum inventory levels from the information given in the question.

**(Total: 10 marks)**

## SECTION 2

### Question 06

This question was designed to test the Intended Learning Outcomes (ILO) of Chapter 5 “The Learning Curve” and Chapter 6 “Budgeting for Planning and Control” of the study text.

The average performance on this question ranged from 11 marks to 14 marks (out of the 25 marks allocated). Around 40% of the candidates scored more than 14 marks.

- (a) This part tested the knowledge on the computation of the learning curve effect on labour efficiency.

Most candidates failed to apply the learning curve effect on calculating the first 3,000 units and 5,000 units.

This showed that candidates had knowledge on the learning index value for the 90% learning curve; but many failed to apply the value correctly to the calculation of unit cost.

- (b) Most candidates did not perform well on this part. This showed that they had not understood the requirement of the question. Some had even concluded that the production manager would be happy about the labour utilisation due to the average labour time for the first 5,000 units being lower than the average labour time for the first 3,000 units. However, this was not the expected way of evaluation.

- (c) Many candidates performed well on this part, but some calculated the variances instead of preparing a budgetary control statement including flexed and actual results.

- (d) (i) Many candidates provided successful answers for this part, but they failed to give examples. This showed they had not clearly read and understood the question.

- (ii) Most candidates scored well on this part (average of 2 marks).

- (iii) Performance on this part was poor and many candidates answered in way of ZBB being applicable for a new line item of the budget (not available in previous years).

**(Total: 25 marks)**

### Question 07

This question was designed to test the Intended Learning Outcomes (ILO) of Chapter 13 “Network Analysis” and Chapter 16 “Risk and Uncertainty in Decision Making” of the study text.

It consisted of four parts. Candidates scored good marks only for parts (a), (b) and (c) (network analysis). The performance on part (d) (decision making) was very poor.

The average performance on this question ranged from 10 marks to 12 marks (out of the 25 marks allocated). Only around 38% of the candidates scored more than 12 marks.

- (a) This part required candidates to draw a network diagram for the given project. Many drew the diagram correctly, but some candidates failed to correctly draw activities E and G. Many candidates did not consider the fact that activities E and G could not be carried out simultaneously.
- (b) Many candidates did not correctly understand the requirement of this part and did not provide the correct answer. This showed their weakness in understanding the language and information given.

Some candidates considered the nature of the activity and tried to line up the activities without considering the timing factors and resource limitation.

- (c) Many candidates performed well on this part and scored the marks allocated for it.
- (d) Many candidates failed to identify the information given, and even provided some marketing-related facts as their answers. Performance on this part was poor.

**(Total: 25 marks)**



## KB3 – Business Taxation and Law

December 2018

### Examiner's Comments

#### SECTION 1

#### BUSINESS LAW

##### Question 01

This question was straightforward, and no ambiguities were observed.

- (a) This part required candidates to explain six (06) general characteristics of a company.

Most candidates understood the question and provided good answers. However, there were a few candidates who did not fare well, probably due to a lack of preparation.

Some candidates gave incorrect answers such as articles of association, certificate of incorporation, and company registration number etc., which did not fall under the general characteristics of a company.

- (b) Candidates were required to explain the difference between executive directors and non-executive directors. Most answered this part well. The study text adequately covers this subject area.

**(Total: 10 marks)**

##### Question 02

- (a) This part required candidates to explain the duties breached by Palitha, as the promoter, in the given scenario.

Merely writing about a promoter does not answer the question. Candidates were expected to briefly explain the duties that were breached by Palitha, as the promoter.

Candidates should establish the fact that Palitha made a secret profit and he has a duty **not** to make this secret profit. This is a breach of his duty. As a promoter Palitha should make a full disclosure of all the relevant facts relating to the transaction. He did not do this, and that constitutes a breach of his duties.

- (b) (i) Candidates were required to state the orders that a court may make when a pre-incorporation contract is not ratified by the company.

This area is covered by Section 25 of the Companies Act No. 07 of 2007.

- (ii) Candidates were required to state the implied warranties in a pre-incorporation contract. This was a straightforward question and the subject area is covered in Section 24 of the Companies Act No. 07 of 2007, as well as in the study text.

**(Total: 10 marks)**

**Question 03**

- (a) Candidates were required to outline the procedure that SPL should follow under the Companies Act No. 07 of 2007 in order to reduce its stated capital.

Section 59 of the Companies Act lays down the procedure.

Giving lengthy details relating to the solvency test was not required.

- (b) Candidates were required to analyse the given scenario in relation to Section 226 of the Companies Act, and state whether S can file action in a court for oppression or mismanagement under the Act. Stating what constitutes oppression or mismanagement is irrelevant.

The analysis should lead towards finding out whether S is eligible under the Companies Act to file an application to courts for oppression or mismanagement.

Although S does not hold the required 5% of voting rights, he constitutes 25% of the total number of shareholders.

S has held the shares for the last one year, and thus has satisfied the second requirement as well.

Accordingly it is clear that it is possible for S to file action in courts for oppression or mismanagement under the Companies Act.

**(Total: 10 marks)**

**Question 04**

- (a) This was a straightforward and easy question. The study text gives a format for the minutes of annual general meetings.

Minutes should cover important points of matter transpired at the AGM and the resolutions made.

The information given contained all the matters considered and resolutions made. Candidates were required to prepare the minutes based on these.

It is important to mention the type of meeting, place and time of the meeting.

The chairman should sign the minutes, confirming them as correct.

- (b) Section 291 of the Companies Act No. 07 of 2007 deals with vesting of property of a company in liquidator.

This is was a straightforward question. The examiner was not asking candidates to mention the powers of the liquidator. Candidates should understand the question before starting to answer.

**(Total: 10 marks)**

### Question 05

- (a) (i) Candidates were required to explain the time at which ownership of the 400 shares will get transferred to Malik's wife.

Ownership will get transferred only upon Malik's death.

Many candidates failed to produce the required answer.

- (ii) The procedure to be followed at the CDS to gift 100 shares to the son was also not explained well.

Answers to both parts are given in the study text.

- (b) Candidates were required to state five (05) components of an arbitration clause. They were not expected to give arbitration procedures, which were irrelevant.

The study text adequately covers this subject area.

## SECTION 2

### BUSINESS TAXATION

- *The subject matter tested was within the syllabus.*
- *The questions were specific and did not contain any ambiguities.*
- *The model answers were well planned and structured, and can be considered a reliable guide to marking examiners.*
- *Overall performance was excellent and there was a pass rate of approximately 63% (of the total number of candidates). This was a significant increase compared to the preceding examination.*

#### General comments applicable to all questions

1. Candidates must read the instructions given in the question paper before attempting to answer any questions. The instructions clearly state that candidates are required to submit all workings. Workings (where relevant) carry marks. It was observed that some candidates merely wrote the final answer without submitting the workings to support their answers (e.g. in Question 06, some simply stated the balancing allowance/assessable charge on the disposed asset).
2. Candidates must read each question carefully and understand the information given and the requirements of the questions clearly, before attempting to answer them. It may be necessary for the candidates to read the questions more than once to ensure that the information given and the requirements are clearly understood. This will help them to save valuable time at the exam by avoiding irrelevant and/or lengthy answers.  
  
Candidates are given 15 minutes of extra time to read and plan the answer.
3. Candidates must improve their handwriting and communication (language) skills. An examiner cannot award marks to an answer that he cannot read or understand.

## Question 06

- (a) Candidates were required to assess the tax payable on the taxable income, tax credits and balance tax payable by a company engaged in the business of manufacturing tyres for both local and foreign markets.

The information given in the question related to the year of assessment 2018/19, and the applicable statute was the Inland Revenue Act No. 24 of 2017. However, some candidates computed the income tax liability applying the provisions of the old Act (No. 10 of 2006), which ceased to be effective from 1 April 2018.

The information given in the question was to test candidates' knowledge of item 4 (2) (b) of the first schedule to the Act, that is taxation of a company predominately conducting the business of exporting goods. However, a few candidates erroneously treated Ride & Race (Pvt) Ltd as a small and medium-sized enterprise.

The information given in the question related to taxation of a company. However, a few candidates claimed tax-free allowances and applied progressive rates of taxation.

### Business income

- Staff training cost – a good number of candidates mentioned that this expense was allowable since PAYE is deducted. This is a business expense allowable for tax purposes, and the question of PAYE does not arise here.
- Balancing allowance on disposal of machinery – no capital allowance can be claimed in respect of assets purchased and sold during the year since the asset is non-existent as at the end of the year of assessment. However, a good number of candidates claimed capital allowances in computing the profit/loss on disposal.
- Research expenses – majority of the candidates only mentioned that the expense was allowable. Item 8 of the sixth schedule to the Act allows an additional deduction of 100% of research and development expenses for three years of assessment from the commencement of the Act.
- Capital allowances – the land and factory buildings under construction at the end of the year of assessment (work-in-progress) are not eligible for capital allowances. However, a few candidates claimed capital allowances in respect of these assets.

Qualifying payment – a donation made in money or otherwise to the government is deductible in full without limitation. However, a few candidates applied a limitation to the claim.

Taxation – a few candidates applied two rates of tax, namely 14% on the gains and profits attributable to export turnover, and 28% on gains and profits attributable to local turnover and on investment income. Per 4(2)(b) of the first schedule to the Act, the entire taxable income of a company predominantly conducting a business of exporting goods and services shall be taxed at the single rate of 14%.

Deduction of tax credits from taxable income – this is an error of principle, and therefore serious in nature.

Qualifying payment – the donation of tyres to the government of Sri Lanka is claimable in full without restrictions. However, a few candidates claimed the relief subject to the restriction.

The lowest of actual donation  $1/5^{\text{th}}$  of taxable income and Rs. 500,000.

With regard to the balancing allowance/assessable charge in respect of machinery purchased and sold during the year of assessment, a good number of candidates claimed capital allowances for the year of assessment. It should be noted that no capital allowance can be claimed in respect of such an asset since the company does not own the asset at the end of the year of assessment.

In deciding whether the company is eligible to be taxed at the concessionary rate of tax under item 4(2)(b) of the first schedule to the Act, a significant number of candidates calculated the percentage of exports of total turnover (which is 82%), and concluded that the company is predominantly conducting a business of exports. Such a conclusion is incorrect without defining the term “predominant”.

Income tax computation – a few candidates claimed statutory deductions in inappropriate places (e.g. deducting tax credits from assessable income or taxable income).

However, it was encouraging to note that a majority of candidates displayed excellent knowledge in the construction of the structure, identification of the statutory contents and presentation of a corporate income tax computation that was compliant with the new Inland Revenue Act No. 24 of 2017.

- (b) This part required candidates to compute the WHT to be deducted on a planned distribution of dividends, and state the due date for payment of this tax.

Some candidates misunderstood the requirement of the question and attempted to compute the deemed dividend tax. Further the new Act (No. 24 of 2017) makes no provision for the imposition of deemed dividend tax.

**(Total: 25 marks)**

#### **Question 07**

The question required candidates in relation to a company engaged in providing management consultancy services to both local and overseas clients to:

- (a)
- (i) Calculate VAT liability for a given quarter.
  - (ii) State the due dates for VAT instalments payments for a given quarter.
  - (i) Identify the statutory time limits to claim on unclaimed allowable input tax invoice.
  - (ii) Calculate the NBT liability for a given quarter.
  - (iii) Calculate the capital gain tax on the sale of a bare land held as an investment asset.
  - (iv) State the due date for payment of capital gain tax.
  - (v) State whether the land sale is liable for stamp duty and if so, at what rate.
- (b)
- (i) Define the term ‘person’ per the Inland Revenue Act No. 24 of 2017.
  - (i) State the responsibilities of the precedent partner in respect of the payment of taxes over the ‘partners’ share of profits.
- (a) The question states that the supplies made during the given quarter are *exclusive* of VAT. However, some candidates computed output VAT on the basis that the supplies were inclusive of VAT.

The question clearly states that it is input tax paid by the company on purchases and expenses. However, some candidates applied the VAT rate to the given input taxes before claiming the input tax credit.

Part (a) (ii) required candidates to state the due dates for the VAT instalment payments of ISL for the quarter ended 30 September 2018. This is a specific question. However, the majority of candidates gave general answers like:

- VAT is payable every two weeks.
- VAT is payable from the 1<sup>st</sup> to the 15<sup>th</sup> of the month on or before the end of the month.

Some candidates computed VAT on the wrong basis.

E.g.	Taxable supply	=	xx
	<u>Less</u> input tax	=	<u>xx</u>
			<u>xxx</u>
	VAT payable 15% of		<u>xxx</u>

A good number of candidates wrongly claimed the input tax brought forward from the previous taxable period as a tax credit against the VAT payable.

Some candidates computed output VAT on the total supply without identifying the different classes of supply (exports, SVAT supplies, non-SVAT supplies etc.)

The majority of candidates made mistakes in the application of the formula for claiming input tax without restriction and input tax claimable subject to 100% of output VAT.

Some candidates applied a short cut method for computing VAT by aggregating taxable supplies of different classes and applying a common VAT rate. Candidates should display their knowledge by considering each class of supply separately and applying the appropriate VAT rate, since the nature of supply can influence the tax liability. For example:

- Direct exports taxed at zero rate
- Supplies taxed at standard rate

It was noticed however that the majority of candidates correctly computed the capital gain arising on the sale of land and the capital gains tax payable thereon.

- (b) This part required candidates to define the term “person” and state the responsibilities of the precedent partner in respect of payment of taxes over partners’ share of profits.

The intention of the examiner was to test candidates’ knowledge of Section 53 (9) and Section 84 (1) (ii) of the Act. However, some candidates mentioned the definitions (Section 195) of a precedent partner while some candidates mentioned the responsibilities other than what was required by the examiner.

**(Total: 25 marks)**

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

**December 2018**

### **Examiner's Comments**

#### **General comments**

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

In this exam well-prepared candidates demonstrated the ability to use their knowledge and experience to relate their answers to the question requirement. Those who were unsuccessful demonstrated poor subject knowledge, and should have studied the study text in order to have this knowledge. In general, candidates were able to demonstrate good time management and address all the questions.

### **SECTION 1**

#### **Question 01**

- (a) The requirement was to explain whether a new engagement letter was needed for the audit of the financial statements in 2018. Many candidates answered this part well. The examiner expected candidates to have an understanding of the issues of the entity in the given scenario, where the ownership changed, and a new board of directors was appointed.

There was a fair amount of candidates who analysed the issues and wrote appropriate answers. However, there were some who did not understand the question requirement and answered that a new engagement letter was not required.

Some candidates wasted time explaining the contents of the engagement letter, which was not required. These candidates demonstrated good knowledge on engagement letters, but lacked the knowledge to apply this knowledge to an appropriate situation.

- (b)(i) This part of the question was on the importance of audit documentation. Many candidates demonstrated poor knowledge on documentation. Most of them wrote that documentation was required for future investigations, inquiries and litigation matters. These were the general answers discussed. Candidates must know the basics of auditing and read the study text, as it is a good guide.
- (ii) In this part of the question candidates were required to explain the difference between the permanent audit file and the current audit file. Although some candidates provided satisfactory answers, the majority demonstrated poor subject knowledge. It was evident that candidates had not studied the study text or the SLAuSs. Weak answers carried irrelevant and incomplete answers, such as:

- The permanent audit file will contain the asset register, share register etc.
- The permanent audit file will contain permanent documents (*but failed to mention the documents*)
- The current audit file will contain current documents.

Other than a few candidates, most were unable to address the difference between the two audit files.

**(Total: 10 marks)**

## Question 02

- (a) In this part of the question the examiner tried to test the knowledge of candidates on the difference between the business risk approach and the audit risk approach.

Most candidates were able to explain business risks and audit risks, but some ignored the question requirement, which was the business risk *approach* and the audit risk *approach*. They should know that the audit risk approach is the approach to auditing followed by the auditors. The business risk approach is also an approach followed by the auditors, as the financial statements are often misstated due to the business risks of the company.

Most candidates failed to explain the difference between the two approaches. Some candidates without understanding the question requirement wrote that the audit risk approach is to give an opinion and the business risk approach is the study of internal controls.

- (b) This part required candidates to recognise key business risks in the given scenario and their implications. Some candidates simply reproduced the facts given in the scenario. Most were able to recognise key risk areas but failed to identify the impact on business operations.

There were some answers that mentioned general risks without any reference to the scenario, such as:

- Due to court case
- Due to competition

Some candidates wrote irrelevant implications, such as:

- With a bonus scheme employees can get a good bonus package
- Due to legal action the cost will be more and there will be less profits

**(Total: 10 marks)**

## Question 03

This question was on corporate governance. The majority of candidates secured full marks for this question.

- (a) Candidates were required to identify corporate governance weaknesses from the given scenario. Most demonstrated good knowledge. However, there were some candidates who lacked subject knowledge, misunderstood the question requirement and wrote irrelevant answers that included:
- Writing the definition of the remuneration committee, audit committee, and risk committee
  - Just writing, without identifying the weakness in relation to the code of corporate governance, the appointment of external auditors, EDs' remuneration, audit committee etc.



- (b) Candidates were required to discuss recommendations for each weakness. There were good answers that scored full marks. However, some candidates, who did not have proper subject knowledge, misunderstood the question requirement and wrote irrelevant answers, such as:
- The chairman is independent and non-executive, and can be appointed to the audit committee.
  - Remuneration to executive directors should be approved by non-executive directors or at the AGM.
  - Appointment of the external auditor should be done by the remuneration committee.
  - The board chairman should have the same qualifications as the audit committee chairman.

**(Total: 10 marks)**

#### **Question 04**

- (a) This part of the question was on the implementation of formal internal controls. Candidates were required to explain the reasons why it is difficult to implement internal controls in small businesses.

Some candidates demonstrated good subject knowledge and wrote the limitations of internal controls such as costs not outweighing the benefits, potential human error, controls being bypassed by the management, collusion etc. However, they failed to apply theory into a practical situation.

A common irrelevant point noted was that controls cannot be implemented as small businesses do not have the required knowledge and people. Candidates who wrote this point failed to explain why the segregation of duties cannot be implemented.

Although many candidates addressed the issue of cost in implementing internal controls, they failed to address it in comparison to the benefits.

It was also observed that candidates did not use technical words, which was a requirement (e.g. costs outweighing benefits, segregation of duties).

- (b) Candidates were required to identify weaknesses in the cash collection process in the given scenario. Most were unable to identify weaknesses in the process perhaps due to their poor knowledge in the application of internal controls. A lot of candidates reproduced the facts given in the question without addressing the weakness in the cash collection process.
- (c) The examiner expected candidates to outline three improvements to be implemented to overcome such weaknesses. Many candidates demonstrated poor knowledge in the cash control process, and as a result they failed to outline appropriate recommendations.

**(Total: 10 marks)**

#### **Question 05**

- (a) Candidates were required to summarise matters where the audit manager could obtain a letter of representation in connection with the given information.

Some candidates understood the question requirement and wrote appropriate answers.

Candidates who demonstrated poor subject knowledge wrote that it should include a letter from an expert, a letter from the central environment authority, details of the modification to the water plant, details of the funds to pay the penalty and include all documents for the audit.

- (b) This part was related to a going concern issue and candidates were required to outline the impact on the audit opinion. The examiner expected candidates to analyse the issue in line with SLAuS 705 and SLAuS 570 and decide on the relevant opinion.

Some candidates understood the issue and analysed the impact on the audit opinion satisfactorily.

However, some candidates who did not have proper technical knowledge, failed to decide on what opinion should be based and just wrote a modification was necessary.

Some candidates just copied the facts given in the question, such as “the going concern assumption is appropriate, but a material uncertainty exists”.

A few candidates misunderstood the question requirement and wrote audit procedures relating to going concern.

**(Total: 10 marks)**

## SECTION 2

### Question 06

This question carried 25 marks and consisted of four parts.

- (a)(i) Candidates were required to assess whether the given events needed adjustments in the financial statements as at 31 March 2018. The examiner wished to test the knowledge of LKAS 10, LKAS 37, SLAuS 501 and SLAuS 560.

There were some satisfactory answers assessing the issues, applying relevant SLAuSs and deciding the impact on the financial statements.

However, some candidates just wrote the need for adjustment of the first two issues and not the adjustment of the third issue, without actually assessing the issues. Some others assessed incorrectly and gave irrelevant answers.

- (ii) Candidates were required to outline the auditor’s responsibilities and additional procedures that should be undertaken. Some candidates, who ignored the action verb “outline”, only wrote “review board minutes and check subsequent events” as audit procedures.
- (b) Candidates were required to discuss possible threats to independence and objectivity when carrying out the audit of FSP. The examiner expected them to assess the information given in the scenario in order to identify the possible threats. Most candidates wrote satisfactory answers explaining the threats adequately. However, there were some candidates who just listed out the threats to independence without any explanation.
- (c) Candidates were required to outline safeguards that should be implemented to mitigate the identified threats. Many candidates performed well on this part.
- (d)(i) Candidates were required to identify potential related party transactions in the given scenario. The majority of candidates provided appropriate answers.
- (ii) Candidates were required to state two audit procedures in respect of the related party transactions. Most candidates had inadequate technical knowledge and wrote only to inquire from management. Some candidates even wrote to inquire from the audit committee, which was not relevant.

**(Total: 25 marks)**

## Question 07

This question carried 25 marks and consisted of seven parts.

- (a) Candidates were required to state two steps that the auditor may perform when identifying and assessing the risk of material misstatements at the financial statement level and at the assertion level. The requirement was to state the steps in identifying and assessing risks.

Those who studied the study text wrote relevant answers.

There were some candidates who misunderstood the question requirement and wrote analytical review, inquire, recalculate, observe etc., which were the audit procedures for the assessed risks. If candidates did past exam papers they would have known the difference between taking steps, and carrying out audit procedures.

- (b) Candidates were required to assess the difference between risk of material misstatements at the financial statement level and the risk of material misstatements at the assertion level. This part was answered well.
- (c) Candidates were required to assess two risks of material misstatements at the assertion level of the given scenario. They were expected to have an understanding of the given information. The majority of candidates failed to assess the risks of material misstatements.

Most candidates wrote that long-term loans were a material misstatement at the assertion level, which did not carry details in the scenario. Some candidates identified the correct risks and listed (without any assessment) them as inventory and depreciation, ignoring the question requirement.

- (d) Candidates were required to outline two substantive procedures to address the risks that were assessed. There were some satisfactory answers, but some candidates ignored the question requirement and explained the theory of substantive procedures. Some wrote incomplete answers without addressing the risks, such as:
- Review the list of receivables
  - Check opening balances
  - Obtain confirmation
- (e) Candidates were required to discuss further action that the audit team should take in respect of the chairman's message in the annual report. There were some satisfactory answers, but some candidates misunderstood the question and wrote that substantive procedures had to be carried out.
- (f) Candidates were required to identify accounting estimates contained in the financial statements of GC. Many candidates wrote satisfactory answers for this part.
- (g) Candidates were required to summarise three other audit procedures per SLAuS 540. Many demonstrated poor technical knowledge and wrote general audit procedures and vague answers, such as:
- Perform recalculation
  - Physical inspection
  - Inspect documents

**(Total: 25 marks)**

## **Conclusion**

Although the average performance was satisfactory, there were only a few excellent answers. A large number of candidates had a narrow focus on the topics that they studied, and were not keeping up with the relevant SLASs and SLAuSs. Candidates are required to learn the basics of auditing, independence, ethics, audit risks and application, proper use of the audit opinion, and are encouraged to go through past papers.

## KB5 – Business Value Creation

December 2018

### Examiner's Comments

#### Question 01

This question carried 10 marks and the overall performance of candidates was good.

- (a) (i) Dynamic capabilities (DCs) refer to the capacity of an organisation to purposefully create, extend and modify its resource base enabling it to survive in dynamic environments. Redundant capabilities (RCs) are resources and competencies that an organisation has built up that are no longer needed and no longer help to create value.

A fair number of candidates just mentioned that DCs will add value to the organisation and RCs will not. This earned only a few marks. Some stated that DCs will gain a competitive advantage to the organisation and RCs will not help it survive in dynamic environments. This also earned only some marks. A few mentioned that DCs are new business opportunities and RCs generate negative cash flow.

Around 2% of the candidates did not attempt this part at all.

- (ii) Dynamic capabilities (DCs) would enable a firm to recognise strategic opportunities and threats present in the market, and thereby help it seize the strategic opportunities. Procedures and systems referred to in the given scenario are becoming redundant and the firm needs to build new capabilities in order to survive in the future.

Some candidates inadequately explained that DCs will help the firm lower costs, which could result in lower prices. Some stated DCs are important to create value for the firm, but they did not mention that DCs will recognise strategic opportunities and threats. Thereby they did not earn any marks.

A few stated that DCs will provide a competitive advantage.

- (b) The provision of information to the management, management of IT systems, supporting management decisions, and managing finances and cash flows of the organisation are some important functions of accountants. A few candidates stated that accountants are engaged in asset management and assist in the preparation of annual reports, which were not main functions to earn marks.

**(Total: 10 marks)**

## Question 02

The question carried 10 marks and most candidates managed to obtain only around 45% of the marks allocated.

- (a) Responsiveness can be ensured by making available all the products required by the customers, adequately and quickly. It can also be ensured by maintaining sufficient inputs (fruits) in the warehouse, or by GL quickly getting them from suppliers.

Reliability can be ensured only when the right amount of goods, of the right quality, can be obtained at the time expected by the customers of the GL. GL also needs to predict the requested demand from customers and the ingredients needed from suppliers, in a timely manner.

Most candidates only mentioned the fact that suppliers of GL should ensure inputs are provided at the right time in order to ensure responsiveness. A few stated that to ensure responsiveness, fruits and vegetables should be fresh; rather than mentioning this fact under reliability.

Some just mentioned that inputs and materials need to be bought from reliable suppliers.

However, a fair number of candidates correctly advised that reliability could be ensured when GL sells products of the right quality, in the right quantity at the expected price and locations.

- (b) GL can improve its supply chain by reducing the number of suppliers and customers, and by coordinating production, warehousing, sales and marketing. It can also do this by getting suppliers involved in product development and design.

Some candidates explained that the supply chain could be improved by making suppliers satisfied and locating the factories of GL close to the main supplier. Some incorrectly explained that the Internet, intranet and EDI could improve the supply chain of GL.

**(Total: 10 marks)**

## Question 03

Performance of candidates on this question was poor. The average mark was around 40% of the allocated 10 marks.

- (a) Per Juran, quality means 'fitness for use', which includes two elements: quality of design and quality of conformance. Some candidates just stated the two elements correctly without discussing them. Some argued that Juran introduced the Total Quality Management system where zero defects, quality in supply chain and reduction of quality costs etc. need to be ensured. A few candidates stated the facts given in the question and concluded that Glory should ensure quality in all its activities. This earned no marks.
- (b) Most candidates correctly mentioned that Kaizen means 'continuous improvement'. However, they were unable to explain the possible applications of Kaizen (i.e. by making major changes to the production processes and methods). A few stated correctly that the management of Glory should be concerned about the views of the workers and encouraged them to find solutions to the problems encountered. Some candidates also explained the 5S concept instead of Kaizen.

**(Total: 10 marks)**

## Question 04

This question carried 10 marks and the performance of candidates on this question was good.

- (a) Since SMP is a family-owned business, ideas for change from employees are normally not accommodated. In this type of hierarchical organisation, even if the leaders want to do changes, it is very difficult to persuade the layers of managers to agree on the need for change. This results in taking a long time for the change. Also it is not possible to avoid resistance to change under these circumstances.

Most candidates outlined only the resistance for change due to the bureaucratic structure of SMP. This earned only a few marks. Some put forward arguments for resistance for change (e.g. due to the fact that employees are attached to SMP for a long period). Some cited in their answers almost all the facts given in the scenario.

Only a few candidates outlined legal barriers and environmental factors as difficulties in implementing changes.

- (b) Some candidates stated the three stages (unfreeze, movement and re-freeze) and described what they meant. This earned some marks. However, they were unable to explain citing facts from the given case. Some incorrectly stated the terms of the stages (for example, de-freeze instead of refreeze, change instead of movement, refreeze instead of unfreeze). A few displayed in their answers that they were not aware of Lewin's model and just mentioned that the management of SMP needs to discuss with employees before launching the change intended.

**(Total: 10 marks)**

### Question 05

The overall performance on this question was satisfactory. Most candidates managed to get around 45% of the allocated marks (i.e. 4½ marks out of 10 marks).

- (a) Certainty, consistency, clarity, capacity and commitment were the conditions under reference. A fair number of candidates named the conditions correctly, but could not provide the explanation required by the examiner. Some stated that the decision making power should not be given to employees as one condition. This did not earn any marks. A few explained that job enrichment and job enlargement were the conditions under reference.
- (b) Job evaluation, fairness, negotiated pay scales, market rates and individual performance on the job were methods of deciding the pay of an individual or a job, according to some candidates. However, only around 50% of them were able to explain each method as expected.

Some candidates completely misunderstood this part of the question. They explained pension schemes, provision of facilities, and basic payments as methods of deciding pay. Some others explained methods of deciding pay such as seniority, time basis and output basis.

**(Total: 10 marks)**

## SECTION 2

### Question 06

This question carried 25 marks and the overall performance of candidates was satisfactory.

- (a) Some candidates correctly mentioned that Krispy crackers fall into the category of convenience goods, since consumers buy them in convenient locations, on a regular basis at a low price, and it has close substitutes sold under different brand names. However, a few incorrectly identified Krispy crackers as a fast-moving consumer good (FMCG). Some candidates, who identified Krispy crackers as a convenience good, were unable to provide justifications.

A few candidates even indicated Krispy crackers was a specialty good.

- (b) Most candidates stated promotional mix tools such as advertising, point of sale (POS) displays, design of packaging, direct marketing, sponsorship, public relations, consumer-based promotions and personal selling. However, some who identified personal selling as a tool did not mention the fact that personal selling is not very applicable to Krispy crackers since they are intensively distributed, and Unico has established links with other related products. Most of those who identified direct marketing as a tool could not state the limited application of direct marketing for products like Krispy crackers.
- (c) A few candidates appeared to be confused with the two terms push and pull. They stated that a pull marketing policy is concerned with transferring goods to wholesalers and retailers, and a push policy is concerned with influencing final consumer attitudes. Some did not display knowledge that both pull and push policies could be combined in the case of selling Krispy crackers. A few candidates concluded that the only applicable policy for Krispy crackers is a push policy.

Some candidates explained push and pull systems in relation to ordering and production systems.

- (d) A fair number of candidates identified Krispy crackers to be at the introduction stage of the product life cycle (PLC).

Under “product”, some candidates correctly explained that it was very difficult to meet customer needs when the product is newly developed. But most did not mention the fact that the possibility of significant changes to product features cannot be ruled out, since producers may not get the product features right the first time.

Some could not argue that Unico can select either a price skimming strategy or a penetration pricing strategy. According to most candidates, the ideal strategy for Unico was penetration pricing.

Some candidates just mentioned that the cost of promotion was high in the introduction stage of the product life cycle, and could not further analyse the need for such high advertising and promotion costs (i.e. to make potential customers aware of the existence of the product, to create interest, and persuade them to buy the product).

**(Total: 25 marks)**

### **Question 07**

This question carried 25 marks and the performance of candidates was satisfactory.

- (a) Some candidates wasted time describing what each element of the SWOT meant. However, most were able to develop the SWOT analysis for EAP correctly.

A few candidates made some mistakes. For example, high taxes were identified as an opportunity instead of a threat, good suppliers were identified as an opportunity, the insufficient customer base was identified as a weakness, investment in technology was identified as a strength, and the high manufacturing cost was identified as a weakness.

- (b) Most candidates could not mention whether the elements in the 7S model would be suitably aligned and consistent. If there were any inconsistencies these needed to be identified and then resolved for successful implementation of the strategy.



A fair number of candidates just described the 7S elements i.e. strategy, structure, systems, staff, style, skills and shared values without making any reference to the given scenario (e.g. under 'staff' some wrote that staff means availability of appropriate staff to implement the strategy). Instead, these candidates should have mentioned the fact that an assessment needs to be made over the capabilities of the staff to produce and market organic products.

- (c) Some candidates just described the value chain (VC) elements: inbound logistics, operations, outbound logistics, marketing and sales, service, procurement, technology development, human resource management and firm infrastructure. They did not explain how IT could improve each element.

Some candidates mentioned the value chain could be improved by reducing costs, increasing efficiency, increasing R&D etc. However, they did not indicate *how* the value chain could be improved using IT. Some candidates correctly explained the use of material requirements planning (MRP) and enterprise resource planning (ERP) under inbound logistics, computer-aided manufacturing (CAM) under operations, RFID under outbound logistics, and links to a supplier with EDI under procurement.

**(Total: 25 marks)**