



# KB1 – Business Financial Reporting

## June 2019

### Examiner's Comments

## SECTION 1

### Question 01

The conceptual framework & its Regulatory framework have been tested.

Most students had not properly answered Part B – Regulatory framework provisions.

Part (a) Though the intended users of financial statements had been identified, the decisions such users might take based on the financial statements had not been identified.

Part (b) Most students were not aware of the provisions of Sri Lanka Accounting and Auditing Standard Act No. 15 of 1995. Students had not properly stated the three criteria relevant to the question, to assess the Managing Director's opinion, when submitting accounts to the SLAASMB. Some students had identified the relevant provisions, but the Managing Director's opinion was inaccurate.

### Question 02

Students were expected to know how to apply the principles of LKAS 2 – Inventories

Part (a) Some students had not correctly calculated the inventory value, as they had ignored the raw materials which were meant to produce tanks. They had therefore considered the net realizable value of the raw material in computing the closing inventory value, instead of the purchase price.

Some students considered estimated selling cost, as part of the finished goods value.

Part (b) Action verb "Criticize" had been ignored by the majority, who had stated the facts given in the question, without justification.

Most of the students just compared two valuation methods (FIFO & WAC) given in the question, without highlighting the impact on performance and cash flow separately.

### Question 03

This question was intended to test students' knowledge of the classification & measurement basis of SLFRS 9 & LKAS 39 on financial instruments and its application.

Part (a) Action verb "Differentiate" was not properly considered, and most students had copied contents from the standards related to financial instruments, including irrelevant sections.

Part (b) Even though the fair value of the bond was given in the question, most students tried to compute the fair value by using different rates given in the question, and arrived at incorrect answers.

Lack of knowledge of accounting treatment for fair value gain and fair value changes due to market fluctuations was also observed.

#### **Question 04**

Part (a) capitalization of borrowing cost tested in this section

- (i) Most students considered Rs. 4 mn as having been paid to the contractor as utilized loan amount, and had included this in the borrowing cost to be capitalized whereas the utilized amount for the project is Rs. 5 Mn, which had been specifically obtained for the power plant.
- (ii) Whilst students were required to compute the weighted average interest rate to capitalize the borrowing cost, some students had used the simple average of the two interest rates given.

Rs. 4 Mn was not borrowed specifically for the construction of the power plant, although Rs.1.5 mn had been utilized for the plant. Some students had calculated interest on Rs.4 mn instead of on Rs. 1.5 mn. Further it was observed that some students had taken the full years' interest, instead of six months.

Part (b) section 9 of SLFRS for SME with regard to consolidation is tested in this section.

Though the action verb is "discuss", most students had not analyzed, or discussed, the facts given. Instead they had copied and presented a part of the Standard.

Although the 3<sup>rd</sup> subsidiary was acquired to be disposed of within one year, some students had suggested consolidating same.

#### **Question 05**

Students were required to calculate and discuss profitability, liquidity, gearing and efficiency ratios.

Part (a) Most students answered well. When preparing net profit margin most of them had taken earnings available to equity holders, without calculating profit after tax, using the given tax rate.

Overall performance is at an acceptable level.

#### **Question 06**

To test application of knowledge of consolidated accounts.

A majority of the students were not familiar with the deferred tax application for consolidated accounts, and had not attempted any adjustments in deferred tax computation, for revaluation of land, and devaluation of building, in the goodwill computation.

Deferred tax on reversal of depreciation of building was not done, due to lack of knowledge. Additional information (iii) & (iv) indicated that the deferred tax implication on inventory, brand name and contingent liability, were to be ignored, but some students who were conversant with deferred tax, had overlooked the contents of the question.

Some students failed to eliminate intercompany receivables and payables.

Lack of knowledge was also displayed when consolidated accounts were prepared including the balances of the joint venture, which was an investment.

Present value computation on deferred consideration paid after one year, had not been considered for goodwill calculation and related interest cost.

Some students had wasted their time in providing unnecessary journal entries with workings, which was considered duplication.

Overall performance of this part is at acceptable level.

### **Question 07**

This question was mainly framed to test practical application of accounting standards under different specific areas.

#### **Part (a) – LKAS 16 –Property Plant & Equipment**

In relation to transport cost, even though students had identified transport cost as a directly attributable expense, most had failed to capitalize proportionately, among the components.

Most students had not stated the depreciation related to the components.

Further, students stated the theory part of the standard - without proper application.

#### **Part (b) – LKAS 24 – Related Party Disclosures**

Students were expected to identify related parties of Aaron PLC with proper justification.

Most students had mentioned related parties of Aaron PLC without justification, and indicated all related parties of the Group rather than relating to Aaron PLC. Further students had written definitions of related parties copied from the standard, which was not relevant.

#### **Part (c) – SLFRS 15 – Revenue from Contracts with Customers**

The Question asked students to evaluate whether the control of goods had passed or not, but most students had attempted to explain the five steps model in SLFRS 15, which is relevant to revenue recognition. Most students had copied the standard, without linking answers to the question.

#### **Part (d) – Calculate Basic EPS & Diluted EPS**

Most students had attempted to calculate diluted EPS for convertible bond and share option separately, whereas the question expected students to compute total diluted EPS.

Some students had not even calculated basic earnings per share.

#### **Part (e) – Advise on accounting treatment for initial recognition of convertible bond.**

Students had not 'advised' as required, and had merely computed liability and equity component of the bond. They were required to advise on the convertible bond needing to be split into liability and equity components, at the initial recognition, and that the liability component should be calculated at present value of future cash flows, discounted at 15%. To calculate present value of the future cash flows, many students had used 12% convertible bond rate instead of the rate of return of 15%



## KB2 – Business Management Accounting

June 2019

### Examiner's Comments

### Question-wise comments

#### General comments about submission of workings

There were a number of instances where marking examiners could not award marks due to the failure of the candidates to submit workings. When a candidate had made a mistake, and the particular workings were not shown, it would not be possible for the examiner to award marks for the correct steps in the particular workings, 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 for the illegible section.

#### Question 01

##### General comments

Questions had been designed to test the Intended Learning Outcomes (ILO) of Chapter 2 "Marginal Costing Vs Throughput Accounting" of CA Sri Lanka Study Guide.

The average performance for the question was **4 marks** out of 10 marks allocated with around 5% of the candidates not attempting the question, and 3% of the candidates scoring "0" marks.

The question tests the knowledge about the application of bottleneck resources identification and optimal product mix.

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

##### Part (a)

Most candidates had scored the full 3 marks for this section identifying the bottleneck resource (machine).

##### Part (b)

Many candidates had scored the allocated marks in this section also, but some candidates had not considered the minimum production requirement of IP that is 450 units.

### Part (c)

Candidates had not performed well in this part and the following mistakes had been made, in common.

- Conversion cost per cutting machine minute had not been computed correctly.
- Fixed cost had not been considered in computing the conversion cost.
- Throughput contribution per minute had not been computed, correctly.

### Question 02

98% candidates had attempted this question and many had performed well in part (a) of the question but not in (b), obtaining an average mark of 4.5. This is the question with the highest performance, in the entire paper.

Part (a) and Part (b) of the Question had been designed to test the Intended Learning Outcomes (ILO) of Chapter 1 “Absorption Costing Vs Activity Based Costing “of CA Sri Lanka Study Guide.

#### Part (a)

Most of the students had successfully completed this part and scored the full 4 Marks. Some candidates however, had applied inappropriate cost drivers mistakenly to allocate the pool cost.

#### Part (b)

Candidates failed to answer this part adequately, and although many had mentioned ‘activity based management’ but they had failed to relate it to APL and Competitive environment.

#### Part (c)

Many candidates had answered this question explaining how proper working capital management could improve the profitability of a general company, but had not related their answers to a “company such as APL” which was required by the examiner.

### Question 03

This question had been designed to test the Intended Learning Outcomes (ILO) of Chapter 08 “Information for Short – Term Decision Making”.

The average marks obtained by the candidates was **4 marks** out of 10 marks allocated approximately 16% of candidates had not attempted the question and 7% of candidates scored “0” marks.

Many candidates had not identified the correct approach, to assess the best option, but they had computed some relevant parts of the cost, and scored some marks.

Some candidates had computed the incremental cost for one option and the total cost for one option, and then compared the costs - which was not acceptable. To make a decision the same approach should be taken when comparing the cost of all 3 options.

It shows that most candidates did not have sufficient subject knowledge to assess options and identify the best option.

## Question 04

### General comments

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

The average performance for question 04 ranges from *1.5 to 2 marks* out of 10 marks allocated with around 16% of the candidates not attempting the question and around 8% of the candidates scoring “0” marks. This is the poorest performance of all the questions in the paper.

Many candidates had correctly computed the mark-up, variable cost and fixed cost, but some students had failed to identify these cost elements correctly, which was not acceptable, at business level.

Most of the candidates who had attempted to compute the January transfer price, just ignored the opportunity cost and arrived at a transfer price considering only Market price. The examiner clearly requested that the candidates should **discuss** the appropriate transfer prices. Candidates should therefore have assessed the transfer price using both methods.

Some candidates had added the additional cost of packaging and arrived at a transfer price.

$$TP = 5,000 + 500$$

Most of the students failed to compute the appropriate transfer price, for the months of February and March.

The above facts show that candidates did not have sufficient knowledge on transfer pricing computations.

## Question 05

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

The average performance for question 05 ranges from **2 marks to 3 marks** out of 10 marks allocated. Around 15% of candidates had not attempted the question and 8% of candidates had scored “0” marks.

Part (a)

Many candidates had assessed the options A, B and C, but they had assessed the current policy. Some candidates had considered sales value instead of cost when computing the average receivables at cost.

Part (b)

Most of the candidates had not understood the key components of the credit policy, as stated by the finance manager, and failed to explain the two matters to be considered, in each component.

Answers to this question had the second poorest performance - next to question 4, out of all ten questions.

## Question 06

### General comments

This question had been designed to test the Intended Learning Outcomes (ILO) of Chapter 4 “Standard Costing As a Planning and control Technique” and Chapter 7 “Contemporary Planning and Control” of C A Sri Lanka Study Guide.

The average performance for question 06 ranges from **8 marks to 10 marks** out of 25 marks allocated. Approximately 6% of the candidates had not attempted the question, and approximately 3% of the candidates had scored “0” marks.

#### Part (a)

Part (a) of the question tests the knowledge on computation of the labour variances.

Most of the candidates had misunderstood the information given on the standard cost of labour per batch, and they had mistakenly taken Rs. 600 as the standard labour rate per hour, and computed the variances.

Some candidates had not considered the information given, that the 15% labour utilisation increased because the recipe had changed.

#### Part (b)

Most of the candidates had not performed well in this part. It shows that candidates had not understood the requirements in the question. It also shows that candidates do not have sufficient understanding of theory, to apply, which is what is required at this level.

#### Part (c)

Most candidates had failed to understand how to tailor the answers to meet the criteria required in the question, and some students had just computed the material mix and yield variances, without assessing the production manager’s performance. Again it shows that the candidates ability to use their knowledge, and apply the theory to a particular situation, is poor.

#### Part (d)

Most candidates had merely mentioned what benchmarking was but had failed to explain it, in relation to Yorks Product (Pvt) Ltd.

## Question 07

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

The average performance for question 07 ranges from **9 marks to 11 marks** out of 25 marks allocated, although approximately 2% of candidates had not attempted the question.

#### Part (a)

In this section the examiner was testing the application of knowledge related to project evaluation, based on Net Present Value (NPV). Many students had attempted this part and scored reasonable marks. However, the following common mistakes had been made by several candidates.

Many candidates had also applied the real cost of capital, without computing Cost of Capital using ‘Fisher’s formula’.

The adjustment for inflation should have been considered from Year 1, but many candidates had adjusted it from Year 2 onwards.

Some candidates had not computed the expected value, and directly applied the highest value or lowest value, to compute year one contribution.

Some candidates had not correctly understood the tax payment pattern and considered 100% as being paid in the same year.

### **Part (b)**

Many candidates had not correctly understood the requirement stated in the question, and had not provided the correct answer. It showed weakness in understanding the language, and the information given.

Even though the question required the candidates to explain the substance of NPV and IRR to Non-financial managers, some students had provided the advantages and disadvantages, of using both techniques.

### **Part (c)**

None of the candidates had performed this part well. Many had just commented about the time value of money, but not identified and explained the three elements of time value of money.



## KB3 – Business Taxation and Law

June 2019

### Examiner's Comments

### Question-wise comments

#### SECTION 1

#### BUSINESS LAW

##### Question 01

- (a) The question was about the legal concept of separate legal personality of a Limited Liability company.

Accordingly, in the given scenario, GPL was a separate legal person in the eyes of the Law whilst 'G' was another legal person.

The question required candidates to establish whom Ralph should file legal action against to recover the loss he suffered due to spoilt coconuts. For this it was necessary to establish the owner of the coconuts. As per the given scenario, the land belonged to 'G' and the coconut trees belong to 'GPL'. Since the trees belonged to 'GPL', this implies that the fruits of the trees too would belong to 'GPL'. Therefore, it can be concluded that the spoilt coconuts would belong to 'GPL' and that Ralph should file action against 'GPL'.

Discussion regarding the 'Veil of Incorporation' was not relevant to this scenario. The relevant cases were;

1. Saloman vs Saloman Co. Ltd
2. Macaura vs Northern assurance

- (b) This was a fairly easy question. It was straightforward and without any ambiguities.

The study text provided by the CA and section 206 of the Companies Act No. 07 of 2007 covered this subject area.

Circumstances under which directors vacate office, is not relevant to the question.

##### Question 02

- (a) This was a fairly easy question. The study text provided by the CA and the Companies Act No. 07 of 2007 adequately covered the subject area.

It is important to touch on 'name approval', as this was the first step in obtaining the approval of The Registrar of Companies, for the proposed name of the company.

It is also important to touch on 'public notice of incorporation' in addition to mentioning documents required for Incorporation, and Certificate of Incorporation.

- (b) The examiner was testing the candidates' knowledge regarding conditions applicable to issue of a copy of Articles of Association.

This was a simple question. Section 18 of the Companies Act No. 07 of 2007 deals with this subject area.

It was important to have read and understood the question, before answering. This would have helped candidates to avoid giving incorrect/irrelevant answers such as;

1. Question was whether the company could decline to give a copy of the AOA to Amara. Some candidates had mentioned that she could get a copy from the Registrar of Companies and therefore the company could decline to issue a copy to Amara.
2. Some candidates had misunderstood the question – i.e. that the Company had lost the AOA.

Candidates should plan their answers in a logical manner to arrive at the correct conclusion.

### Question 03

- (a) Part (i) required candidates to explain what was meant by a prospectus and give instances where a prospectus was not required.

This subject matter is amply dealt with in the study text provided by the CA and the section 37 of the Companies Act No. 07 of 2007.

Despite this, some candidates had failed to give important points – i.e. that the prospectus should give important information regarding the company, which would help prospective subscribers to make investment decisions.

"Dating of the prospectus" (S.36) is not the answer expected.

Similarly consent of experts, i.e. banks, attorney at law, auditor, - for inclusion of names in prospectus (S.38 & S.39), did not fall within the framework of the expected answer.

Part (ii) was also straightforward. Section 37 (3) of the Companies Act No. 07 of 2007 lists these instances.

- (b) (i) & (ii)

The study text provided by the CA and section 57 of the Companies Act No. 07 of 2007 deals with the subject area adequately.

However, there were instances where candidates deviated from the expected answer and discussed in detail, the procedure for valuing assets, techniques of valuation, responsibilities of directors in carrying out proper valuation of assets etc. Candidates did not get marks for these irrelevant points.

Candidates were expected to explain whether GL is in a position to declare a dividend in accordance with the Companies Act No. 07 of 2007. Candidates should have presented the answer in a logical sequence and concluded that the company could declare the dividend.

#### Question 04

- (a) This is a very easy question and the study text issued by the CA covers this subject area adequately.

The question required candidates to limit items of the agenda, to the given information. However candidates had included other items also, e.g. welcome speech.

“Notice of Meeting” and “Agenda” are separate items and candidates were expected to answer accordingly.

The Company Secretary should have issued the Agenda by the authority of the Board. Therefore, mentioning ‘by order of the Board’ was important.

There is an accepted format for preparing the Notice of Meeting and the Agenda. Some candidates had prepared this in essay form.

- (b) (i) This is adequately dealt with in the study text as well as the Companies Act No. 07 of 2007. The question was on ‘declaration of solvency’ and not on the solvency test.

How a ‘declaration of solvency’ becomes effective was also an important part of the question, which should have been answered.

- (ii) The Examiner was expecting candidates to explain whether the statements made by Saman were accurate or not. Merely stating ‘accurate’ or ‘not accurate’ was not the expected answer. Justification was required. Merely copying section 324 of Companies Act did not constitute a satisfactory answer. Salient points relevant to the question should have been highlighted.

#### Question 05

- (a) The question required candidates to discuss whether ‘M’ who was a director of ‘ABC’, a public listed company, could purchase 10,000 shares of ABC without violating ‘SEC’ Regulations.

This subject is dealt with in the study pack issued by the CA.

According to the SEC Act, a director of a company is ‘connected with’ the company. Mahen being a director of ABC PLC, should have been treated as a person connected with the company ABC PLC.

Therefore, ‘M’ is an ‘insider’ in relation to the proposed transaction. Insider trading commonly refers to the unfair trade of securities by a connected person who has access to non-public information.

Therefore, if ‘M’ purchased any listed shares of ABC PLC, he would have been violating the regulations pertaining to ‘insider trading’, according to the SEC Act.

Sections 187 (1), 187 (2), 180 are not relevant to the question.

Candidates were required to discuss and conclude whether ‘M’ could purchase listed shares without violating SEC regulations.

- (b) This is a simple and straightforward question. No ambiguities.

The Study Pack adequately covers this area.

However, some candidates had incorrectly touched on other 'dispute resolution' methods. The examiner required candidates to list 5 advantages of resolving disputes through ADR method.

## **SECTION 2 BUSINESS TAXATION**

This section of the paper is comprised of two (02) questions in taxation each carrying 25 marks.

### **Question 06**

Requirement of the question

The question required the candidates to assess the income tax liability, tax credits and balance tax payable by a subsidiary company, engaged in operating a hotel business, approved by the Ceylon Tourist Board.

The question included

- (a) Calculation of the total assessable income from the following sources (i) Business – this included on adjustment to book profits, (ii) Investment income – this included calculation of interest income from treasury bills, dividend income and rent income.
- (b) Deduction under section 52.
- (c) Tax credits under section 2 (3) (c).

Specific comments:

Instances where information given in the question were not understood by students

- (i) 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 was repealed effective from 1<sup>st</sup> April 2018.
- (ii) The information given in the question was to test candidates knowledge of item 4 (2)(f) of the first schedule to the Act, i.e. taxation of a company predominantly engaged in an undertaking promoting tourism. However, a few candidates mentioned that Stella Beach Hotel (Pvt) Ltd. (SBH) is not a small and medium sized (SME) enterprise and therefore not eligible to concessionary rates of income tax. It should be noted that SBH satisfies the requirement of item 4(2)(f) for eligibility to concessionary rates of income tax (4%) even though SBH is not a SME, as required under item 4 (2) (a) of the first schedule.

Errors in principle/shortcomings in technical knowledge:

1. Business income

Some candidates had applied the provisions of the old Act (No. 10 of 2006) in computing the business income, for the under-mentioned adjustments.

- (i) Rent income from sub-letting part of the hotel premises temporarily – in terms of the new Act, such income is effectively connected to the business and should therefore have been included in business income [Sec. 6 (2) (g)]
  - (ii) A cash prize received for recognition as ‘best hospitality service provider’ – in terms of the new Act, such income is effectively connected to the business and therefore should have been treated as business income [section 6 (2) (f)].
  - (iii) Management fee – in terms of the new Act this expense is deductible in full, without any limitation [section 11 (i)].
  - (iv) Director’s fees – in terms of section 10 (2) of the new Act, a deductible payment shall not be allowed, until the tax which has to be deducted, has been paid to the Commissioner General of Inland Revenue.
  - (v) The tax loss brought forward from the previous Y/A – in terms of section 19 (1) (b) of the new Act, is a loss that can be deducted in calculating the business income.
2. Qualifying payment relief – a donation in money or otherwise is claimable in full without limitation. However, a few candidates had imposed a limitation to the claim.
  3. Taxation – a good number of candidates mentioned that the company is eligible for concessional rate of income tax because the hotel is approved by the Ceylon Tourist Board. It should be noted that the company is eligible for concessional rates of taxation not merely because the hotel is approved by the Ceylon Tourist Board but because it also satisfies the conditions laid down in items (2)(f) and (3)(ii)(a) of the first schedule for eligibility.
  4. Tax credits – a few candidates deducted these from taxable income. This is an error of principle and is serious in nature.

### Question 07

Requirement of the question: The question required the candidates to:-

- (a)
  - (i) Define the term “partnership” per the Inland Revenue Act No. 24 of 2017.
  - (iii) Assess the Withholding Tax payable by the partnership on each partners’ share.
- (b)
  - (i) Calculate the balance VAT payable/(refund due) by the partnership, in respect of a particular quarter.
  - (ii) Calculate the Economic Service Charge for a particular quarter.
- (c)
  - (i) Compute the WHT to be deducted if any, on a cash distribution of dividend and on a bonus share issue by capitalizing part of the profits.
  - (ii) State the due dates for the payment of WHT to the Department of Inland Revenue.

### Specific comments

Instances where information given in the question was not understood.

- (i) Part (a) (ii) - the definition of a partnership is given under section 195. However, a good number of candidates mentioned the taxation of a partnership under section 53.
- (ii) Part (c) (i) - Some candidates deducted the value of the bonus issue from the value of the cash distribution and computed the WHT on the net balance, stating that the bonus issue of shares was exempted from WHT. It should be noted that there is such provision in the Act permitting such deduction.

Example of an answer:	Interim dividend	Rs. 3,000,000
	Les: Bonus share issue	Rs. <u>2,000,000</u>
	WHT @ 14% on	Rs. <u>1,000,000</u>

- (iii) Part (b) (i) – the question clearly stated that the supplies are exclusive of VAT. However, some candidates computed output VAT on the basis that the supplies were inclusive of VAT.

Instances where the requirements of the question were not understood:

- (i) Part (b) (i) & (ii) – Action verbs – Some candidates merely wrote the amount of Value Added Tax, or Economic Service Charge payable, ignoring the definition of action verb ‘calculate’. These definitions are given at the end of question paper.

Errors in principle/shortcomings in technical knowledge:

Part (a) (ii)

Some candidates answered this part of the question applying the provisions of the old Act (No. 10 of 2006) which ceased to be effective from 1<sup>st</sup> April 2018.

E.g. (1) - Some had computed divisible profits of the partnership, claiming tax free allowance and computing tax payable by the partnership. It should be noted that under the new Act, a partnership is not liable to income tax on its taxable income – section 53 (1).

E.g. (2) - Allowing the interest paid to a partner on a loan made to the partnership, as a deductible expense in ascertaining the profits of the partnership, should not have been recognized, according to section 53 (7) (a).

Part (b) (i)

- (i) The question clearly stated that input tax was paid by the company on imports and local purchases and on other expenses. However, some candidates applied the VAT rate to the given input taxes, before claiming the input tax credit.

- (ii) Some candidates computed VAT liability on the wrong basis.

E.g. Taxable supply ..... xx  
Less: input tax ..... ~~xx~~  
VAT payable 15% ..... ~~xx~~

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

Mistakes made in the application of concepts formula.

Part (b) (i)

- (1) A good number of candidates made mistakes in the formula for claiming the allowable part of input tax paid on common expenses.

- (2) A majority of the candidates failed to apply the limitation of 100% of the output tax before claiming input tax deduction.

Common mistakes made by the candidates:

Part (b) (i)

A majority of the candidates failed to apply the limitation of 100% of the output tax before claiming input tax deduction.

**Other comments to be communicated to candidates:**

- (1) Candidates should read the instructions given in the question paper before attempting to answer any question. The instructions clearly required candidates 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 candidates simply wrote the capital allowance claimed without giving the computation.

- (2) Candidates should read each question carefully, understand the information given and the requirements of the question clearly, before attempting to answer. It may be necessary to read the question more than once, to ensure that the information given and the requirements, are clearly understood. This will help save valuable exam time by avoiding irrelevant and/or lengthy answers.

Candidates are given 15 minutes extra time to read and plan the answers.

- (3) Improve handwriting and communication (language) skills. An examiner cannot award marks to an answer which he cannot read or understand.



## KB4 – Business Assurance, Ethics and Audit

### June 2019

#### Examiner's Comments

#### General Comments

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

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

#### Specific comments

#### Section 1

#### Question 01

Part (a) The requirement was to demonstrate audit procedures that the auditor could perform to identify whether there was non-compliance with relevant regulations. The best answers provided well explained procedures, that clearly set out how the test would be performed, and where appropriate the required documents that would be used. Weaker answers contained vague or very brief lists such as examine, inquire, inspect etc. - without any relevance to the scenario, and as such, were not clear enough to gain marks.

Part (b) In this part of the question the examiner expected candidates to list steps that an auditor in charge would take, to report the matter, if non-compliance with regulations was detected. This requirement was generally well answered. Some candidates merely stated that one should qualify the audit report, without analyzing whether the non-compliance had a material effect on the financial statements. Candidates are advised to be specific when answering questions.

Part (c) Candidates were required to assess whether the audit firm would be violating any principles of Code of Ethics of CA Sri Lanka, if the firm reported the noncompliance to a regularity and enforcement authority. In this part of the question the examiner expected the candidates to address the most relevant principle which is 'confidentiality'. Some candidates had identified the principle and written relevant answers, but some had failed to understand what was required in the question, and analyzed each and every principle of the Code of Ethics.

## Question 02

Part (a) In this part of the question, the examiner expected the candidates to identify 'fraud red flags' which indicated fraudulent activities taking place at ADP. Many candidates failed to understand that 'fraud red flags' meant that the area required further investigations. Only a small number of candidates were successful in identifying the 'fraud red flags' from the given issues.

Part (b) Candidates were required to identify possible fraud risk factors from the given scenario together with the conditions/factors in the fraud triangle for each fraud risk factor. Many candidates were able to recognize the fraud risk factors, but failed to link them to the relevant fraud triangle. The candidates who had studied the text book had given relevant answers.

## Question 03

This question was on the Sales and Receivables Process.

Part (a) Candidates were required to identify significant weaknesses in the Sales and Receivables system. Many candidates were able to identify the significant weaknesses. Some had reproduced the facts given in the scenario. Some had not read the question properly and incorrectly highlighted the fact that the sales clerk prepared the dispatch note and the invoice. Some had identified insignificant weaknesses in the system, i.e. that there were no transport facilities for use by the company.

Part (b) Candidates were also required to outline improvements to address each of the weaknesses identified. Some had written vague answers such as 'take steps to have controls to avoid such weaknesses'. Some had written the improvements in tabular form, when identifying the weaknesses, and gained satisfactory marks.

## Question 04

This part of the question was on corporate governance.

Part (a) Candidates were required to pick one of the suggested good governance principles to facilitate the communication between the audit committee and the auditor. This part was a theoretical question. Some answers were not specific, but were general answers. Candidates demonstrated poor theoretical knowledge when answering this part. A considerable number of candidates had not attempted this part of the question.

Part (b) They were also required to identify weaknesses in BP in respect of corporate governance taking into account the requirements for listed companies, and to apply this theoretical knowledge to a practical situation. Most candidates were able to identify weaknesses in the given scenario.

Part (c) However, the examiner expected the candidates to discuss recommendations for each of the weaknesses. There were two issues. One was the going concern issue and the other was that the 2018 audit was done by another auditor, and had been given an unqualified opinion. Many candidates managed to identify appropriate recommendations for the going concern issue, but a majority of the candidates had not addressed the second issue.

## Question 05

Part (a) Candidates were required to list audit procedures which should have been undertaken to address the financial statement assertion occurrence, for audit of revenue at SP. Most of the candidates had written 'inspection of documents', but had failed to list the relevant analytical procedures.

Some candidates who lacked the technical knowledge had stated -check cut off procedure, accuracy, classification etc. - which are also audit assertions. Many candidates, who did not understand the requirements in the question, wrote irrelevant audit procedures, such as review board minutes, check loan agreement, check share certificates etc.

Part (b) The question required candidates to discuss the auditors response, 'if the finance director refuses permission for the audit team to send confirmation requests to customers'. Some candidates who had ignored the action verb, which was 'to discuss', answered 'to qualify the audit report'. They failed to analyze the steps that the auditor had to follow before coming to the conclusion, that they should qualify the opinion. Most candidates failed to discuss that there were alternative procedures, due to poor technical knowledge.

Part (c) Candidates were required to analyze the impact on the audit report, of SP for the year ended 31 March 2019, based on the information available in the given scenario. Many candidates had not understood what was required in the question, and had written irrelevant answers such as;

- impact on audit opinion would be influenced by economic decisions of users
- the related party transactions were not adequately disclosed and therefore report should be qualified

## Question 06

This question carried 25 marks and consisted of 4 parts. This part was about a going concern issue.

Part (a) The analysis of potential indicators would have showed that ZL was not a going concern. Most candidates were of the view that selling off a major asset to settle a loan would be an indicator, that the company was not a going concern. They had misunderstood the SLAuS where it was mentioned as a mitigating factor. A majority of candidates secured full marks.

Part (b) Candidates were required to outline audit procedures to be performed to assess whether ZL was a going concern. Most candidates wrote satisfactory answers. There were some candidates who just copied the facts given in the scenario. There were other candidates who wrote general audit procedures without any relevance to the scenario.

Part (c) This part required candidates to identify 4 improvements to the audit working papers given. Most of the candidates furnished relevant answers but there were some who misunderstood the word 'improvement' and made suggestions to add certain additional points. Some candidates, who did not have knowledge in preparing working papers, wrote that the reviewer's name and date should be included. They failed to understand that the review is carried out after the initial audit.

Part (d) Candidates were also required to analyze the audit work carried out in respect of Accounts Payable Balances. Most candidates answered giving general audit procedures in relation to accounts payable, without referring to the issues in the given scenario. This part was not answered well by many candidates.

Part (e) Candidates were required to outline further audit procedures, to ensure Accounts Payable was fairly stated in the financial statements. The average performance in this part was satisfactory. Some candidates, without following the requirements in the question, had written irrelevant answers such as;

- Cut-off procedure to identify unrecorded liabilities
- Analyze cash flow statement to check the ability to service the loan

Part (f) The requirement was - to state 2 follow-up procedures that the audit team should perform in instances where the auditor has not received a response to an accounts receivable confirmation.

The performance in this section, was poor. The common answer was - 'to send a reminder'.

### Question 07

This question also carried 25 marks and consisted of 7 parts.

Part (a) Candidates were required to assess four key audit risks that should be considered, when planning the audit. The examiner expected candidates to analyze the given information on specific issues that had arisen during the year, in order to assess the risks. Most candidates had not considered the information given in the scenario. Many candidates performed inadequately in this part of the question. Audit Risk is a key element of the syllabus and candidates must demonstrate a good understanding of audit risks. The main reason candidates lost marks was that they did not actually understand what 'audit risks' relate to. Hence they reproduced the facts given in the scenario, which were not audit risks - for example;

- Previous auditor did not apply for re-election
- D&P was appointed after the stock count
- Auditor expressed a qualified opinion

Part (b) This part required students to explain three procedures that the auditor should carry out to confirm the opening balances of the new audit engagement. Most of the candidates demonstrated poor technical knowledge, merely stating - 'obtain management representation'. Some candidates, ignoring the requirement in the question, had written procedures which were relevant to the stock balance. i.e.

- review closing stock balance
- do a stock count
- check stock sheets

Some candidates demonstrated poor subject knowledge - writing irrelevant answers, such as - 'check invoices with the ledger'.

Part (c) Candidates were asked to outline the impact on the audit report, when the opening inventory balance contained misstatements. The examiner expected candidates to address different audit opinions analyzing the material effect on the financial statements, considering the consistency of application of accounting policies, and the qualified opinion given by the previous auditor. A majority of the candidates failed to discuss the issues and came to the conclusion that the audit report should be modified. Candidates should have noted that - when presenting audit opinions, it is not sufficient to say 'the opinion would be modified' as this could refer to several possible implications. Candidates should state the type of modification proposed e.g. 'qualified on the basis of material misstatements, as the auditor was unable to obtain sufficient and appropriate audit evidence'. Simply stating 'should be qualified', will not attract full marks.

Part (d) Candidates were required to analyze the impact on the audit report, if the auditor was not able to attend the inventory count. A majority of the candidates failed to assess that attendance at a stock count, is not a valid reason to modify the opinion. They failed to analyze the steps to be taken, to verify the stock balance, when the auditor can collect sufficient audit evidence from alternative procedures. Most failed to apply theoretical knowledge to the given scenario.

Part (e) This part required students to identify 4 procedures that the auditor may carry out, to verify the inventory balance, that appeared in the financial statements of KL for the year ended 31<sup>st</sup> March 2019. Some candidates had written relevant satisfactory answers. It was noted that some candidates had produced lengthy answers explaining cut-off testing, without using the technical term.

### **Conclusion**

Although the average performance was satisfactory, there were only a few answers that could be classified 'excellent'. A large number of candidates had a narrow focus, on the topics that they were studying, and not keeping up with the relevant SLASs and SLAuSs.

Candidates should learn the basics of auditing, corporate governance, the application and proper use of audit opinions and are also encouraged to practice past exam papers.



## KB5 – Business Value Creation

June 2019

### Examiner's Comments

#### Question 01

##### General comments

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

- Apply their knowledge of stakeholder mapping to differentiate the stakeholder groups of the given scenario, i.e., A&M Enterprises.
- State how A&M manage these stakeholder groups in their decision making process.

##### Specific comments

- A fair number of candidates had drawn stakeholder mapping correctly as depicted below and differentiated stakeholder groups into four.

		<u>Level of interest</u>	
		Low	High
<u>Level of Power</u>	Low	A	B
	High	C	D

A few had not drawn the map at all, whereas some had drawn it incorrectly, in that, the level of interest and the "power" and level thereof i.e. low or high were not identified. The owners, major suppliers and senior management fall into "D" category i.e. High level of interest and High level of power. Nevertheless some candidates identified "trade unions" and government as stakeholders coming under group "D", without giving an acceptable argument for same. Some identified correctly that people living away from the immediate community fall into group "A" where both the power and the interest level are low. But some incorrectly identified local residents as stakeholders under group "A".

- (b) Some candidates were correct in stating that views of the group “D” need to be taken very seriously when decisions are made, whereas some wrongly stated that the stakeholders coming under the purview of group “D” could merely be informed of the decisions taken. A fair number of students correctly stated that the views of stakeholders coming under group “A” may not be considered in making decisions. Stakeholders coming under group “C” and “B” had to be treated with care and had to be informed of the decisions taken, respectively.

## **Question 02**

### General comments

Overall performance of the candidates was not that satisfactory. The question carried 10 marks and required candidates to;

- (a) Analyze how Lak Sahana (LS) can use its intranet to improve its Supply Chain Process.  
(b) Explain four advantages of E-procurement to Lak Sahana, the company in the given scenario.

### Specific comments

- (a) According to some candidates who scored full marks allocated, - the Intranet could be used by all outlets to place orders. The outlets which did not have products requested could direct the customers to visit nearby outlets, which had the requested items. The intranet could also be used as a ‘knowledge sharing platform’, i.e. information being disseminated among everyone in the outlets, within a few seconds. Some candidates gave answers which the examiner considered as general answers - pointing out that their intranet could be used to reduce cost of operations, increase the effectiveness and efficiency of operation etc. As stated by some students – by using the intranet, decisions could be taken quickly. This answer earned only few marks.
- (b) Some students just mentioned cost reduction, reduced inventory levels, wider choice of suppliers, and quicker ordering - as benefits of e-procurement, without further explanation. Some incorrectly concluded that there is no need for warehouses, in an e-procurement situation. Some could not explain, as expected by the Examiner, as to how cost reduction would be a benefit by adopting e-procurement. They merely stated that ‘cost will be reduced compared to the cost under a manual procurement system’. Only a few gave acceptable explanations, like reduction of purchasing overhead, cost reduction due to process efficiencies etc.

## **Question 03**

### General comments

Performance of the candidates for this question was satisfactory. The question carried 10 marks and required candidates to,

- (a) Outline four responsibilities of a Project Manager.  
(b) Explain how to deal with the problem of not achieving the targets of the project.

### Specific comments

- (a) Outline planning, detailed planning, obtaining necessary resources, team building, communicating, coordinating project activities, monitoring and controlling, problem resolving, quality controlling are all responsibilities of a Project Manager. Some candidates managed to obtain the full marks allocated.
- (b) Some correctly explained the need to get the approval of the Project Committee, for additional time to complete the project, obtaining extra resources or reducing the scope of the project, outsourcing some of the works to another 3<sup>rd</sup> party, working overtime and reducing non-value added items. A few proposed stopping the project as a solution to the problem of not achieving the project target, which did not earn any marks. Some stated that root-cause analysis needs to be done, before solutions could be suggested for the problems encountered.

#### **Question 04**

##### General comments

Overall performance of the candidates was good and the question carries 10 marks and requires candidates to,

- (a) Explain the validity of using subscription B2C model for e-commerce in the given scenario.
- (b) Outline four main issues when starting the e-commerce operation.

##### Specific comments

- (a) The subscription B2C model allows users to pay for access to Danuma website which contains high added value customized content targeting A/Ls, Universities and Professional examinations. Some argued that subscription B2C model is not valid to the given scenario since opening cost is more than the traditional education and also students would be lazy to use the online website for which marks were not allocated. A few justified the use subscription B2C model since the initial cost of the model will reduce as customer base increases.
- (b) Some outlined correctly the below mentioned matters. Areas that need to be considered when starting e-commerce operation i.e. value proposition revenue, Market, opportunity, competitive environment, competitive advantage, market strategy, organization of operations and management team. Some identified establishing an e-commerce site is not easy, providing learning materials but not wrote about the cost involved. Some others outlined the need to take banking facilities, difficulty in deciding the content of e-learning materials for which marks were not allocated.

#### **Question 05**

##### General comments

Overall performance for this question was not good. The question carried 10 marks and required candidates to

- (a) Analyze Saman's management style using the Ashridge Management College model
- (b) State the difference between Transactional and Transformational Leaders.

##### Specific comments

- (a) Out of four different management styles namely Tells, Sells, Consults and Joins. Saman's Management style more closely relates to "Consults" since the given scenario gives evidence that Saman takes into consideration, the views of his subordinates. But he has the final say in decision making. The candidates who scored full marks for this part of the question analyzed the "Consults" style, differentiating from qualities of other categories of Leaders. Some candidates stated that the relevant management styles are directive, delegating, supportive and persuasive - for which marks were not allocated. Some concluded Saman's management style was democratic and independent, for which no marks were given either.
- (b) Some students correctly answered that Transformational Leaders lead the organization through change, whereas Transactional Leaders deal with operational and transactional problems in the business, - scoring full marks for their answer. Some provided incomplete answers, stating that transactional leaders were followers, showing concern for tasks, whilst transformational leaders were innovators, showing concern for people. These answers were not awarded any marks.

## Question 06

### General comments

Overall performance of candidates was good. The question carried 25 marks and required students to:

- (a) Discuss extended marketing mix of ASP (relating to the company and the given scenario) and how it can promote its new 'car sharing service' to its customers.
- (b) Identify the key requirements ASP should consider when developing and mapping a Successful Customer Relationships Management (CRM) strategy
- (c) Analyze pricing strategies for the purpose of recommending the most appropriate pricing strategy for the ASP car sharing service.

### Specific comments

- (a) Some had just listed out seven P's, namely product, price, place, promotion, people, process and physical evidence. Of those who had discussed the seven P's, most described what the product means in relation to the given scenario i.e. Car sharing service, where the company provides the core benefits of convenient transportation for customers, with supplementary services, when needed information is provided for order taking, billing or providing consultancy. Some did not mention the supplementary services offered, with the product. Under "place" some stated only the fact that the car sharing system had to be simple and easy. They did not discuss the time taken to move the car from one location to another, the process of reserving a car and obtaining it, payment methods, services etc.
- (b) The key requirements for successful CRM are: getting to know the customer, getting the customers to understand that the company is focused on their needs, and appreciate their business and the developing customer interest in and loyalty to the company. A few mentioned that in order to gain competitive advantage CRM needs to be developed. Some stated that arrangements are to be made to wish customer for their birthdays and to offer discounts. Those candidates did not state why the company needs to do these activities. This part of the question was poorly answered by most of the candidates.
- (c) Some students included 'demand based strategies, competitor based pricing, cost plus pricing, price discrimination and product mix pricing' as pricing strategies, and scored marks. Some were unable to analyze the strategies and merely listed out the pricing strategies. The price skimming strategy was recommended by some candidates correctly – but without justification being produced. The application of a price skimming strategy could have been justified, given that the concept was new to the market, it targeted 'high end customers' who were Tech savvy, and useful due to shortage of supply. A fair number of students justified the strategy only by stating the fact that the service had been newly introduced. Other reasons were not highlighted. Some came out with inappropriate terminology in naming the price strategies example: lower price strategy, higher price strategy.

## Question 07

### General comments

Overall Performance in this question was not satisfactory. The question carried 25 marks and required candidates to,

- (a) Recommend appropriate strategy for Veerya based on three generic strategies proposed by Michael Porter, giving valid reasons.
- (b) Evaluate the recommended strategy using the Suitability, Feasibility and Acceptability Model
- (c) Explain the process of Performance Management that Happy House (HH) should adopt for the staff of Veerya.

- (d) Outline two main issues HH should consider when measuring ROI of the Training Programs scheduled for Veerya staff.

Specific comments

- (a) Cost Leadership, differentiation and focus are the three generic strategies to gain competitive advantage. A fair number of students recommended a differentiation strategy, but only some of them provided valid reasons for same e.g. "it is expected to enhance the quality of the product, and differentiate their product from others, and to use heavy advertising".

It is difficult for Veerya to follow a cost leadership strategy since it is new to grain based products. Some very correctly mentioned that cost leadership is not appropriate for Veerya, because the market leader Seera, produces on a large scale and enjoy economies of scale. A few candidates incorrectly cited Porters Five Forces Model in place of Generic Strategies, whilst some others wrongly recommended 'focus' and achieving differentiation in a particular targeted segment or niche of the market.

- (b) Some had correctly evaluated the 'suitability' citing that strategy should fit with the organizations' objectives, resources, competencies and SWOT. Some however, stated that suitability meant that the new product needed to be suitable to the needs and wants of the customer, which answer was not awarded marks. Some students stated that suitability meant that the strategy should be suitable to fulfill the company goals, but did not mention other factors like resources, SWOT etc.

Other acceptable answers included: Acceptability is related to the expectations of the stakeholders e.g. "the strategy is not acceptable if it is opposed strongly by influential stakeholders" or "how much the strategy selected affected the share price and profitability of the company. Some students however did not earn marks because they gave incorrect answers e.g. "Because of the expected advertisement there will be more demand, which means the product is acceptable".

Some stated that feasibility meant an evaluation of whether the company had enough cash/resources/time in comparison to its competitors, when implementing the strategy, and were awarded with the relevant marks. Some however, stated that the ability to achieve quality was the feasibility - which did not earn marks.

Identification of requirements and competencies, performance agreements, performance and development plan, managing performance continually throughout the year, annual performance appraisals are the steps to be adopted by Veerya to implement a performance management system, according to the candidates, who were awarded the allocated marks.

- (c) Some had just identified the process under reference, as the comparison of actual performance vs. the targeted performance. Some stated only the need for training for employees, as performance management system.
- (d) Identification of the type of data required, principles of collecting data and analyzing the data, process of collecting data measurements and timing of the evaluations are the main issues involved in measuring ROI of the training program.

This part of the question had been poorly answered by most candidates:

- Some stated that the costs and the benefits of the performance management system (PMS) needed to be identified - for which answer - marks were not given.
- Some candidates were doubtful about the ability to measure the benefits to the organization after training was provided.
- Some had outlined PMS under a normal situation rather than measuring performance on training provided. E.g. "There must be comparison of the output of employees with the cost of employees like salaries and other perks".