

## KC1 – Corporate Financial Reporting

June 2019

### Examiner's Comments

#### Overall performance

Overall, the question paper was not as demanding as the previous examinations. Question 1 was, on average, at the same standard. However, Question 2 on SLFRS 15 was very demanding, and most candidates did not perform well in this. Question 3, which was based on the pre-seen, was comparatively easier than in the previous two examinations. However, many shortcomings were noted in relation to the candidates' performance, and thus the overall results were disappointing.

The majority of candidates who were successful in obtaining a pass scored very marginal marks. Only a handful scored above 53 marks, and the highest mark was 67. Only five candidates scored above 60 marks.

Unlike in previous examinations most parts of the questions were not too open-ended and therefore the need for considering many alternative answers was less this time around. However, variations were considered in some areas of ambiguities and marks were reallocated to pass on the benefit to the candidates in some instances.

Some candidates missed the opportunity to score easy marks due to not reading the question properly and not understanding the requirement of the examiner. In certain questions the technical knowledge demonstrated was not up to the expected level of a corporate level candidate. Poor time management skills, poor planning of the answer, writing irrelevant answers at length, not building up a proper answer, and lack of knowledge in interpreting and evaluating ratios were also issues evident in some of the answers.

#### Question 01

- (b) In this part, the examiner tested knowledge on LKAS 24, in particular the government-related entity exemption. Some candidates applied LKAS 24 in general and disclosures were made per the main standard. As a result they were unable to score some easy marks. For example, some candidates applied the group/subsidiary relationship and mentioned that as intercompany transactions and balances are omitted in consolidated financial statements, only transactions with KMP and the government guarantees given need to be disclosed.

Further, candidates were required to **prepare** the note (related party disclosures) to be included in the financial statements per LKAS 24. The majority of candidates advised on what should be disclosed, instead of *preparing* the note. Thus they failed to gain the full marks allocated for this part.

## Question 02

- (a) In this part, the examiner tested the application of LKAS 38, where the requirement was to assess a management decision to write-off in the current year a research cost which was capitalised over the past two years.

Some candidates argued that the write-off of Rs. 120 million in the current year income statement was not in accordance with LKAS 1, as faithful representation of the financial statements would then not be achieved.

Some others developed their answer by referring to LKAS 8 (correction of error).

A few others developed their answer by referring to this as either an accounting policy change or a change in estimates. Such poor technical knowledge was quite unexpected from corporate level candidates.

Quite a number of candidates also listed out the criteria for identification of development costs, and mentioned that the research cost should not be capitalised since all six criteria were not satisfied. These candidates were unable to recognise that the knowledge gathering phase expense is a research cost. And regardless of whether the development phase has been met, this cost needs to be expensed.

## Question 03

- (a) In this part, candidates were not required to prepare consolidated financial statements. However, a considerable number of candidates did do that. Certain candidates concluded that the asset acquisition gives effect to a significant influence, and thus identified this transaction as an associate. Accordingly, they applied the equity method.
- (b) In this part, the measurement period adjustment was tested. The knowledge demonstrated by candidates on this topic was very poor. Most candidates did not have any knowledge on how to treat the independent valuation of the brand name, based on the valuation report received within 12 months from the date of the acquisition.
- (c) In this part, candidates were required to evaluate (for 15 marks) the impact on the gearing and liquidity positions before and after the acquisition of Juizie. However, some candidates evaluated the 2019 position vs. the 2018 position, instead of what was required.
- (e) In this part, candidates were required to advise on measures to overcome the ethical issue faced by the finance director. However, candidates instead explained in detail the application of the accounting standard (LKAS 38) relevant to the issue and the ethical principles involved. They did not advise on all the possible safeguards and thus lost majority of the marks allocated for this part of the question.



## KC2 – Corporate Finance and Risk Management

June 2019

### Examiner's Comments

This paper carried two 25-mark questions and one 50-mark question that was based on the common pre-seen. All the questions were within the syllabus. Candidates who had the knowledge and competency in the subject earned high marks. However it appeared that most candidates had sat for the exam without any preparation at all. About 9% of the candidates earned a total of less than 20 marks for this paper, and 3% did not even attempt Question 02.

Common mistakes and errors observed in the answers are detailed below.

#### Question 01

Basic knowledge on asset-based business valuation, earning-based valuation, share splits, profit forecasting, systematic and unsystematic risks were tested in this question. Some candidates earned high marks whilst some performed poorly. The average mark earned was 14 out of 25 marks.

(a)

- (i) Candidates were required to write a memo determining the selling price for a 50% equity stake, assuming an enterprise valuation of price to EBITDA multiple of 10 times less debt, or an equity valuation of price to book value of 2 times; whichever is higher.

Some candidates did not understand what the debt value for this valuation was (e.g. a fair number of candidates had not considered the 10% short term loan). A few candidates did not exclude depreciation from administrative expenses to arrive at EBITDA. Some calculated the value of the company using the EPS formula rather than applying the method given in the question.

- (ii) The memo above also had to address the proposing of a share split of 1 for 1 to the existing shareholders (prior to the sale), and its rationale.

Some candidates wrote advantages of a share split without showing the calculations. Some were unable to answer this part due to a lack of knowledge over the term "share split".

- (iii) In this part, candidates were required to compute the amount of USD that needs to be remitted by the foreign investor to his share investment account. Even though this calculation should have been based on the answer to part (i), some candidates took different amounts for the calculation. Most candidates also overlooked the bank commission in their calculations.

- (iv) In this part, candidates were required to draw up the shareholding structure of MEL/SMEL pre and post investment, reflecting the number of shares, shareholding % and the stated capital in rupees. Most candidates did not consider the impact of the share split when calculating the post capital structure. The joint shareholder investment was also not calculated correctly by the majority of candidates.
- (v) In this part, candidates were required to compute the return on investment for the foreign investor, and explain how the balance sheet restructuring has improved the financial stability of SMEL, and the impact it has had on the gearing ratio, along with non-financial factors.

Most candidates did not consider the bank commission of 0.25% when computing the new investment value. Current year profit was also not considered for the equity calculations. Instead of the foreign investor's ROI, some candidates calculated the company's ROI. A considerable number of candidates also wasted time preparing a balance sheet, which was not relevant.

- (b) In this part, candidates were required to explain what was meant by unsystematic and systematic risks when investing in a share portfolio by plotting a graph, along with two (02) examples for each risk.

Most candidates did not explain systematic and unsystematic risks correctly. Some mixed up the two meanings whilst others gave wrong examples. Some candidates did not plot the graph whilst some did so albeit incorrectly. Only a few candidates obtained full marks for this part.

## Question 02

This question tested candidates' knowledge on the hedging of foreign exchange exposures and the importance of stakeholder value maximisation. Some candidates earned high marks, whilst some got low marks for this question. 3% of the candidates did not even try to answer it.

- (a) In this part, candidates were required to evaluate and select one order from the orders received from the French and Rwandan customers.

In general, most of this part was understood by the candidates, except for a few areas mentioned below.

The order received from the Rwandan customer for EUR 250,000 to settle in their home currency was one of the options available for evaluation. However, most candidates did not consider this option due to a misunderstanding in the instructions presented in the question. Therefore the marking examiners did not penalise the candidates for this.

Most candidates miscalculated the currency conversion from one currency to another. If they used their general knowledge to identify the strong and weak currencies separately, they would not have made this mistake.

Misunderstandings also occurred when it came to the reporting currency. In the question it is clear that orders are accepted by the UK company and its reporting currency is GBP. But some candidates evaluated using either USD or EUR.

Some candidates also took the credit period as 60 days instead of 90 days (for the Rwandan order to be settled in USD).

- (b) In this part, candidates were required to explain the areas where the group could gain from a currency swap and interest rate swap, using the given information. However some candidates simply repeated the question itself and wrote general benefits of hedging without exactly identifying the ways this group could have used.
- (c) In this part, candidates were required to discuss shareholder value maximisation and the stakeholders' perspective. Most candidates did not understand this part properly. Only a very few discussed stakeholders. Further, even though the requirement was to discuss the chairman's viewpoint, most candidates gave conclusions rather than discussing the viewpoint.

### **Question 03**

This question tested candidates' knowledge on cash flow business valuation, share buy backs, CAPM, WACC, debt financing, international investments, capital investment appraisals and exit strategy under amalgamations and restructures.

This question was properly planned and presented, which made it easy for candidates to understand it. Despite this, many candidates did not understand the question properly. The average mark scored for this question was 10 – 20 marks.

- (a) In this part, the examiner directly asked two questions from the candidates: to recommend a price range to be offered for the share buy back and to comment on the finance director's opinion on financing the share buy back. The majority of candidates correctly answered the first part but they failed to comment on the finance director's opinion. Instead of commenting on the finance director's opinion by comparing the existing internal financing sources with price ranges, candidates wrote the consequences of debt financing (e.g. impact on the gearing level, impact on finance cost).

The average mark scored was 10 out of 16 marks. Common errors observed in the calculations are noted below.

#### **Asset-based valuation**

Most candidates properly calculated the company value by using the asset-based valuation method. However some did mistakes in eliminating the 8% overstatement of total assets (e.g. the 8% overstatement was calculated based on net assets instead of total assets).

#### **Free cash flow method**

Most candidates made an attempt to calculate the company value based on this method; and they did it properly. However the following mistakes were seen in some answers.

- Erroneously taking the finance cost for the calculation of free cash flow of the company.
- Instead of adding the depreciation to profit, deducting it.
- Inflationary impact being considered for capital expenditure and changes in working capital requirements.
- Incorrectly taking changes in working capital (netting off against the previous year).
- Ignoring/calculating incorrectly the terminal value.
- Considering the firm's value as the equity holders' value (failing to deduct short term and long term borrowing values).
- Ignoring the 50% adjustment of the firm value in deriving the equity holders' value.

## **Calculation of WACC**

- Incorrectly taking the debt value for the WACC calculation.
- Incorrectly taking the debt-to-equity ratio.
- Incorrectly calculating the company beta factor (re-gearing the beta factor to match the company's gearing ratio).

## **David Scott's stake in the company**

The majority of candidates correctly calculated the ownership stake of David Scott (36%).

## **Price range to be offered**

Although some candidates correctly calculated the value of the company based on the two methods, they failed to give the price range. This showed that candidates failed to plan their answers properly.

- (b) Most candidates failed to understand this part properly and were unable to relate it to the given situation of the company. They wrote general answers for this part. The average mark obtained was 4 out of 9 marks.

Most candidates did not mention "not to purchase the shares" when in a situation where the share value is overstated.

## **Debt financing for share buy back**

Most candidates mentioned the impact on the company's gearing level. However other consequences were not addressed such as impact on the cash flow position of the company, tax benefit of debt financing and the impact on WACC.

## **Share options to key executive employees**

The majority of candidates made general comments on the impact of giving share options to executive employees, without relating them to the given situation (e.g. employee motivation, cash saving on giving shares instead of giving cash as compensation, general impact on the existing shareholders' stake in the company).

Candidates did not focus on the fact that manipulated information could be forwarded to the board of directors, as a result of which they would expect an increase in the share price in the near future which would then lead to them earning capital gains by the disposing shares.

This part used the word "as a method of compensation." Some candidates understood this as a VRS scheme compensation and wrote their answers accordingly.

## **High priority given to share buy backs (over profitable projects)**

Most candidates mentioned the company should not forego positive NPV projects. However, they were silent on the opportunity cost and risks involved.

- (c) Candidates were unable to answer this part properly, and an average mark of only 6 out of 17 marks was obtained. Marks were low due to the fact that candidates only explained the qualitative factors and did not do any calculations. However there were a few candidates who did answer this part well.

- (i) Most candidates did not recalculate the NPV of the project. Some calculated the NPV but made mistakes such as:
- Not considering the 40% stake of CBC for calculations.
  - Calculating the terminal value by applying the 5% growth to the Maldivian rufiyaa value instead of the LKR value.
  - Not considering the loans granted and the re-payments.
  - Not considering the remittance tax payment.

Some candidates made general comments on the weaknesses/limitations of an NPV calculation instead of commenting on the assistant accountant's calculation (e.g. challenges in calculating the discount factor, difficulties in estimating accurate cash flows of the company and applicability of the growth rate).

Candidates were also required to mention three (03) qualitative factors and most answered this fairly.

- (ii) In this part, candidates were required to evaluate the current exit strategies available for the Maldivian operation. However, candidates gave possible exit strategies that were not applicable to the Maldivian operation.

The majority of candidates did not compare the NPV of the two options when arriving at the final decision.

- (d) This part was attempted by the majority of candidates. However, most did not provide facts sufficient for 8 marks. Instead of stating the factors mentioned below to be considered when deciding the dividend policy of the company, candidates mentioned various theories available in relation to dividend policy such as traditional dividend theory and M & M Theory, which were irrelevant for the answer.

- Growth stage of the company
- Shareholders' profile
- Dividend policy of similar companies
- Company objective of shareholder wealth maximisation
- Not compulsory to maintain a high dividend payout ratio as a practice.



## KC3 – Corporate Taxation

June 2019

### Examiner's Comments

#### General comments

The majority of candidates were unsuccessful in applying a methodical approach to questions, and were thereby unable to produce reasonably focused, relevant answers addressing the principal and core components of each requirement.

Candidates should be able to compile a comprehensive tax computation. They should also be able to undertake tax planning, understand methodologies on minimising tax expenses and mitigating risks, and carry out effective communication with tax authorities, clients, management etc. Therefore, displaying mere technical knowledge is not adequate at this level.

Being an open book examination, the candidates' level of presenting answers in line with the required standard (in terms of technical and legal aspects) was not satisfactory at all. Answers were especially not in line with the new Inland Revenue Act.

Candidates should pay close attention to the structure of the paper where the three (03) questions are based on practical scenarios. Their answers should be related to the contents of those practical scenarios. Furthermore, candidates should be able to display their willingness to address the action verbs, expected learning outcome/s, knowledge process, knowledge dimension etc. when producing meaningful answers.

The following reasons may have adversely influenced candidates' performance.

- Lack of pre-study in relation to the pre-seen material.
- Lack of understanding of the requirements of the questions.
- Producing irrelevant facts and thereby creating a time constraint.
- Not being familiar with the new Inland Revenue Act No. 24 of 2017 and the latest changes compared with the previous Inland Revenue Act.
- Lack of communication and presentation skills.



## Question 01

The overall performance on this question was poor and below the satisfactory level. Candidates who scored well had carefully read and interpreted what the question was asking for, and made their points clearly and concisely.

The majority of candidates were not able to submit a complete answer, and were able to score only 40% or less of the marks allocated for this question.

Some candidates spent a significant amount of time writing a lot of details about a subject based on their knowledge, which if not relevant to the question and the scenario outlined, did not score any marks. Commonly observed weaknesses of candidates were:

- Lack of knowledge in the chargeability of income tax on non-resident persons.
- Inability to support answer by giving facts.
- Poor reference to the relevant sections of the Inland Revenue Act and building answers accordingly.
- Misunderstandings and careless mistakes in calculations.
- Not interpreting and connecting the relevant articles of DTA-India.

- (a) Many candidates were unsuccessful in applying theoretical knowledge to practical aspects in relation to the given scenario. However, those who displayed their knowledge to analyse, refer and describe the applicable sections etc. failed to connect such facts to the given scenario in order to score additional marks thereon.

In some cases candidates wasted time explaining further reasons for the criteria to be considered by a non-resident person, which was not necessary.

- (b) Many candidates overlooked the requirement of this part and attempted to calculate the adjusted business profit (by adjusting income and expenditure), which was readily given in the question, thereby wasting their time unnecessarily.

A considerable number of candidates misunderstood the fact that gains on the sale of QPC shares are exempt only for the purpose of income tax and not for remittance tax. Thereby many of them incorrectly took the taxable income after deducting the income tax payment for the purpose of calculating remittance tax.

- (c) Many candidates did not understand this part and gave answers that were not relevant.

It is noted with regret that the majority of candidates failed to refer to the provisions of the respective articles of the double tax treaty agreement readily given in the question paper.

As a result of this many candidates were unable to make a correct decision based on the information given.

- (d) Answers to this part were varied. A very high proportion of candidates were unable to give the exact answer that was expected by the examiner. Although this part required evaluating whether income tax is payable in Sri Lanka on employment income and profit on the sale of machinery, many candidates computed such tax liabilities instead of explaining or evaluating the matter. As a result they spent time unproductively and earned less marks.

## Question 02

On the whole this question seemed to be very well received by most candidates, who attempted all the parts of it. The overall performance on this question was within the satisfactory level.

- (a) Many candidates successfully computed the VAT liability correctly, identifying the applicable taxable supplies and input credits. They were comfortable with issues such as calculating the disallowance portion of input credit and deciding the allowable input tax when zero-rated/SVAT supplies were being dealt with.

Whilst no specific indication was given in the question, a few candidates incorrectly calculated the VAT using the tax fraction (5/115), assuming the sales are inclusive of VAT.

A surprising number of candidates ignored the fact that the total invoice value of rent income is liable to VAT. Many of them mixed-up the accounting treatment and incorrectly took three (03) months' rent instead.

Although many candidates knew that the income on the disposal of fixed assets is liable to VAT, they either struggled or were unsuccessful in finding the sale proceeds on such disposal. Some candidates failed to identify the upfront VAT payment of Rs. 18,708 as an input credit on imports, and incorrectly treated it as a tax credit.

- (b) There were a lot of excellent answers to this part, and most candidates displayed a good understanding of the consequences such as time bar provisions and penalties arising from late filing of income tax returns.

However, some candidates overloaded the requirement of this part and incorrectly addressed the penalty procedure on non-payment of self-assessment payment, and thereby lost easy marks.

The majority of candidates failed to describe that Section 135 deals with time bar provisions to make an assessment or additional assessments.

- (c) This part was highly topical and candidates scored fairly good marks as anticipated. However, a considerable number of candidates failed to highlight the circumstances under Section 139(8) where taxpayers may request a CGIR review after 30 days of receiving an assessment.

There was a general failure in referring to the three (03) required conditions, which are to be fulfilled when appealing to the Tax Appeal Commission and to the Court of Appeal.

A handful of candidates who were able to refer to the three (03) conditions limited their answers only to one appeal procedure.

### Question 03

Overall there was a noticeable drop in the marks scored when it came to this question. Candidates generally performed poorly in parts (b), (c) and (d). Part (a) was answered fairly in line the examiner's expectation, but it did not exceed it. It is highly advisable to keep up to date with the new legislations and current issues in taxation.

- (a) Although this computation part was generally answered well by a considerable number of candidates, those who did not score well had the following shortcomings in their answers.

Many candidates did not know that the field visit vehicle used for private travelling has to be considered for PAYE tax at Rs. 25 per km, and such expenditure is deductible from business income. Although many identified the fact that private travelling is a domestic expense, they failed to quantify the amount.

Candidates missed the fact that offshore business units are exempt under Section 13 of the previous Inland Revenue Act. Therefore the brought forward trade losses cannot be claimed. Nevertheless many candidates knew that the current year's trade loss from the offshore businesses could be claimed since the predominant rule applies for export sales.

A very few candidates knew that capital gains are liable to tax at the rate of 10%. However, they did not identify that the realised gain from the foregone lease rights is a capital gain, and incorrectly taxed it at the 28% rate.

Many candidates found it difficult to determine the deductible amount of finance cost in accordance to Section 18 of the Inland Revenue Act.

Knowledge displayed by candidates in this part proved that some vital provisions under the new Inland Revenue Act are not yet formalised as anticipated. Thereby candidates did not notice the provision under Section 6(g), which referred to the phrase "effectively connected with the business". As a result many candidates incorrectly categorised the lorry hire income as investment income.

Almost all the candidates failed to refer to the information of the actuarial gain of Rs. 18,562 given in pre-seen. As such they did not consider it when the actual gratuity payment was ascertained.

A good number of candidates applied the incorrect WHT rate of 10%, not knowing that the prevailing WHT rate of 5% is applicable to any kind of interest. Moreover these candidates claimed the same incorrect WHT amounts as tax credits. Thereby they lost easy marks allocated to these adjustments.

A considerable number of candidates mixed-up the provisions of the previous Inland Revenue Act related to notional tax credits on treasury bill (TB) interest, and used the same application assuming that it prevails under the new Inland Revenue Act as well. Thereby many candidates computed the notional credit on TB interest, grossed up the interest income and gave the tax credit thereon.

Almost all the candidates knew that the donation to the government institution by way of cash or kind is a 100% deductible qualifying payment. However a very few candidates mixed-up the relief with a donation made to an approved charitable institution, which is restricted to  $\frac{1}{5}$  of taxable income or Rs. 500,000; whichever is less.

(b)

- (i) Overall, candidates displayed reasonable knowledge of the areas tested in this part such as exempt, zero-rated and input tax. Some candidates did not read this part properly and mixed up the requirement with the 5 points given in the question itself. They were thus not able to evaluate the points given and present a methodical answer.
- (ii) Although the VAT return for the quarter ended 31 December 2015 was submitted within the period (i.e. before 30 January 2016), many candidates misunderstood this fact and incorrectly stated that the return could have been filed on or before 20 January, which is the payment due date.

The majority of candidates had the same confusion on the exact date on which the time bar provision applies: whether on the date of payment or the date of return submission. Only a very few candidates identified that expiration of three (03) years from the end of the taxable period is considered the time bar only when the return is submitted on the due date.

(c)

- (i) Although many candidates mentioned relevant quotes from Section 15, they were unable to analyse them by referring to the facts already given in the pre-seen. They did not come up with proper advice related to tax benefits/tax exposure as expected by the examiner.
- (ii) This part was generally well answered. However the common problem was that some candidates did not know that dividends are considered based on the difference between fair value less cost.
- (iii) This part too was answered fairly well. However many candidates were unable to present suitable advice since they were not aware of the impact of this particular case under transitional provisions.

(d)

- (i) A good number of candidates understood that under Section 5(2) of the Inland Revenue Act there are a few selection criteria, which should be considered when treating an individual's gains and profits from employment.

Accordingly many candidates successfully identified that the special payment received by David Scott should be treated as part of his employment income. However, almost all the candidates failed to refer to decided cases related to similar incidents.

Furthermore, a very few candidates incorrectly discussed the tax implications from the company's side, thereby ignoring the requirement of the question. Others treated it as an investment income without knowing the provisions under Section 59(2).

- (ii) Despite many candidates recognising the applicable sections of the Inland Revenue Act, they were unsuccessful in presenting their final decision on whether the expenditure was deductible or not. The main problem was the failure to pay close attention to the information readily given in the question.

Only a handful of candidates identified that the particular machinery was purchased before 1 April 2018, and hence fully depreciated for tax purposes. Thereby provisions related to repair and improvements will not be applicable to this particular case.

Surprisingly none of the candidates were able to support their answers with a decided case.



# KC4 – Corporate Governance, Assurance and Ethics

## June 2019

### Examiner's Comments

#### General comments

This paper consisted of two sections. Section 1 contained two questions carrying 25 marks each, and Section 2 contained one question (based on the common pre-seen) carrying 50 marks.

The overall performance in this sitting was disappointing. Candidates must ensure they devote sufficient time for preparing for the exam. This examination seemed to be more time pressured for candidates than previous ones. It was noted that they spent more time answering Question 03 and consequently spent less time answering Question 02. Candidates are reminded of the need to allocate their time appropriately. Attempting two questions only makes it more likely that they will fail.

Common issues that contributed towards poor answers were:

- Reproducing the points from the question with little development and not following the action verbs.
- Using vague phrases such as “perform analytical procedures”, “check the relevant documents” and “per the code”.
- Losing focus of the requirement or failing to explain in detail.
- Not knowing the exact standard (SLAuS and SLSRS)
- Poor planning of answers and poor time management.

Candidates preparing for this exam must focus on tailoring the number of points written to the marks available, and take note of areas that are not essential. They are also advised to read the question and plan their answer without being hasty to write.

## SECTION 1

### Question 01

- (a)(i) For 9 marks candidates were required to evaluate key risks the management of CML should consider as part of its risk management framework. The examiner expected candidates to determine the significance of the risks that the management has to face in a risk-based system of controls designed to provide reasonable assurance of achieving business objectives (in other words to categorise business risks into broad areas).

This part was well attempted and candidates answered very well drawing on the details given in the scenario to evaluate the risks in relation to compliance and regulations, and their implications on business operations.

Weaker answers simply repeated the facts given in the scenario with little improvement. There were some candidates who did not read the question properly and wrote all the possible business risks without relating them to the scenario. Some candidates did not understand the question requirement and identified certain points as key risks, which were completely irrelevant to the given scenario. These included:

- Natural disasters like floods and fire
- The Maldives is a country that will be covered by the sea in few years' time.
- The government has increased fuel prices and emission tax
- The climatic condition is not conducive for the bicycle industry

The examiner did not expect such general risks. Candidates had to ensure that the risks are specific to the scenario rather than simply listing business risks as political, compliance, fraud etc.

Some candidates did not understand the concept of risks in the risk management framework and wrote the risk areas without writing the impact on business objectives. Some wasted time writing lengthy answers explaining the concept of risk. Some candidates, without understanding the question requirement, recognised audit risks such as revenue recognition, going concern, and management override as business risks.

- (ii) For 6 marks candidates were required to propose risk mitigating measures for the identified risks. Some candidates answered this part well. However, there were others who did not understand the requirement and wrote responses to the audit risks with audit procedures without writing the mitigating measures for the business risks.

Some candidates wrote general answers such as comply with regulations and sign an agreement as mitigating measures, without explaining how it will mitigate the risk. Candidates are advised to be mindful of the action verb, which here was "propose".

- (b)(i) For 6 marks candidates were required to advise on "what could go wrong"/risk questions that should be included in a detailed system studies working paper in respect of the revenue and financial reporting cycles of QFPL. The examiner expected candidates to relate the risks in order to assess the risk of material misstatements in respect of the revenue and financial reporting cycles. This part was generally well attempted with most candidates working through the information given in the scenario to identify and advise on what could go wrong. There were some candidates who without understanding the question requirement wrote the answer in question form such as:

- whether the customers will pay the balance amount?
- how much was returned?

Some problems noted in the answers were a lack of knowledge and poor exam technique. It is vital with these types of questions to spend some time reading the information provided and think how the information gives rise to the risk of material misstatements.

- (b)(ii) For 4 marks candidates were required to develop an audit programme including key audit procedures. The examiner tried to test candidates' knowledge on audit procedures, taking into account of relevant controls when the risk is higher and there is a likelihood of misstatements at the assertion level. Many candidates addressed the given issues and wrote relevant audit procedures. Some candidates answered parts (i) and (ii) in tabular form and scored good marks.

A significant number of candidates wrote general audit procedures such as inquire from the management and examine board minutes, without specifying the relevant procedure. Some candidates who did not understand the question requirement wrote controls to be implemented as audit procedures. Some candidates misunderstood the given information (which stated that differences were noted between the subsidiary ledger and the general ledger) as differences between books of the parent company and the subsidiary company. Candidates are advised to read the question and the scenario properly.

## Question 02

- (a) For 6 marks candidates were required to advise, using theoretical knowledge of SLSQC, on matters that K&J should consider before accepting its client to provide the required services.

The examiner expected to test candidates' knowledge on auditor's considerations when accepting the client. Many candidates misunderstood client acceptance as engagement acceptance and wrote irrelevant answers.

There were some candidates who misunderstood the question requirement and thought it was an engagement for a completion audit and thus referred to SLAuS 800 and wasted time explaining the standard.

Some candidates understood the question requirement, but demonstrated poor knowledge in analysing the issues given in the scenario. The examiner expected candidates to apply theoretical knowledge of the acceptance of a client according to SLSQC and evaluate the scenario accordingly.

Some candidates explained the issues in the scenario without applying ethical considerations. Some who lacked the technical knowledge wrote the elements of an assurance engagement such as three-party relationship, appropriate subject matter, suitable criteria, and sufficient appropriate evidence, which were not relevant to the question. Some answers also tended to be too brief, whilst some were a little more than a list of bullet points.

- (b) For 5 marks candidates were required to propose the appropriate reporting framework K&J should apply in reporting on the completion audit of the financial statements of Ringtel for three months. The examiner expected candidates to understand that financial statements should be prepared to determine the final consideration for the acquisition.

A fair number of candidates identified the relevant reporting framework but failed to analyse why it was suitable for the purpose. Some candidates failed to identify the correct framework and referred to SLAuS 805 (which is on single financial statements or specific items), SLSRE 2400 on review engagements, and due diligence assignments. Some candidates who did not read the question properly (where it was specifically stated that it is for a specific use), considered it for general purposes.

- (c) For 4 marks candidates were required to analyse the elements of the quality control system of K&J that were affected. Many candidates failed to analyse correctly referring to the scenario how individually each element of the quality control system was affected such as:
- SLAASMB finding a number of errors in the recently issued financial statements (which carried a qualified opinion).
  - Staff working long hours due to staff shortages.

- Working papers not providing sufficient audit evidence.
- Monitoring not taking place pertaining to complying with policies.

Many candidates ignored the action verb and just copied the elements of a quality control system without referring to the scenario. Some candidates explained the deficiencies in the client's system without referring to the elements of quality control.

- (d) This part for 4 marks required candidates to propose an action for each of the affected elements in the quality control system in order to strengthen it. The majority of candidates failed to match the relevant issues in the scenario to the elements of the quality control system. They identified monitoring as an element but stated irrelevant actions such as reviewing the working papers. Some identified leadership as the element but stated irrelevant actions such as following policies and procedures with regard to independence.

Some candidates wrote all the possible matters pertaining to the quality control system without considering the applicability to the scenario. Some who did not comprehend the question properly wrote about the training of staff, which was not an issue in the given scenario. The performance on this part was average.

- (e) This part for 6 marks required candidates to evaluate whether K&J had complied with ethical requirements when carrying out their activities. The examiner expected to test candidates' knowledge on the marketing of professional services in accordance with Section 250 of the Code of Ethics issued by CA Sri Lanka. Although almost all the candidates attempted this part of the question, only a few were able to obtain satisfactory marks.

The majority of candidates failed to evaluate the given scenario and simply copied the relevant section of the Code. Most of them failed to address how advertising affects professional ethics. Although the Code does not indicate that advertising is prohibited most candidates who lacked subject knowledge mentioned that advertising should not be done as it is a violation of ethics. Some candidates without referring to the scenario and the question requirement wrote the principles of the Code such as integrity, objectivity, professional competence and due care, professional behaviour and confidentiality.

## SECTION 2

### Question 03

Question 03 was a 50-mark case study style question based on the common pre-seen. The client was a large beverage and confectionery company.

- (a) This part for 9 marks was based on the Code of Best Practice on Corporate Governance 2017. Candidates were required to comment on the effectiveness of the role of the chairman of CBC.

The majority of candidates ignored the question requirement and simply copied the role of the chairman from the Code. Candidates are advised that although this was an open book exam they should not just copy the facts given in the Code; but rather relate them to the role of the chairman in the given scenario and address the question requirement which was the *effectiveness* of the role of the chairman.

- (b) This part for 4 marks required candidates to recommend audit procedures to be performed to address the possible audit risks related to the chairman's plan. The examiner expected candidates to assess the chairman's plan and consider the risks associated with politically



exposed persons. Many candidates understood the question requirement but failed to provide relevant audit procedures, which should be based on the examination of compliance with policies, review of documents and minutes, and examination of internal audit reports. The majority of candidates wrote irrelevant answers such as:

- Check the quality of the product as they could be contaminated
- Check the procurement procedure as bribes could have been offered
- Check the accounts of the minister known to the chairman

- (c) This part for 7 marks required candidates to evaluate the issues in accepting the professional service, which was a due diligence engagement, and address the safeguards that could be put in place. The majority of candidates understood the professional service as a special assignment but failed to understand the question requirement, which was on ethical behaviour.

Most candidates explained the theory of due diligence engagements. Some candidates discussed various aspects of review engagements such as scope of review, level of assurance, terms of engagement, planning procedures and obtaining evidence. Many candidates produced descriptive answers that were either not required or irrelevant.

- (d) This part for 12 marks required candidates to evaluate eight (08) risks of material misstatements, which have a material impact on the financial statement numbers and disclosures of CBC. In a question of this nature it should be easy for most candidates to apply their accumulated knowledge. Disappointingly many candidates were not able to provide sufficient detail and analysis in relation to the risks identified. Many candidates focused on issues that were not material to the given scenario (e.g. borrowing costs, foreign exchange losses, valuation of investments). Candidates are reminded that the requirement was for risks of material misstatements. If any balance in the given accounts is immaterial it is unlikely that it can result in a material misstatement in the financial statements.

- (e) This part for 6 marks required candidates to propose two (02) audit procedures each to address four (04) complex audit areas. The examiner expected candidates to address complex areas relating to financial reporting issues such as audit of fair value measurements and estimates of derivatives and the use of the work of an expert. The majority of candidates failed to identify complex audit areas, and as a result they wrote audit procedures for all the risks identified in part (d).

- (f) This part for 6 marks required candidates to evaluate the auditor's role in making conclusions on the given uncorrected misstatements. Factual and judgmental uncorrected misstatements were given. Some candidates who lacked technical knowledge failed to differentiate factual misstatements (which included the effect of uncorrected misstatements identified during the audit of the previous period if they affected the current period financial statements) from judgemental misstatements. Candidates demonstrated poor technical knowledge on judgemental misstatements relating to accounting policies and estimates (which affected the misstatements in the financial statements of the given scenario) in making conclusions. The examiner expected candidates to address the following steps before making the conclusion.
- Identify the differences in the balances that are above the set materiality.
  - Discuss with the management on the adjustment of identified differences.
  - Give priority to factual misstatements.
  - Request the client to revisit judgemental differences.
  - Maintain a summary of all the adjustments.
  - Assess adjustments individually and in aggregate, and ascertain whether there is a material impact on the financial statements.

There were some answers analysing each step. The majority of candidates wrote general answers and wrote only the opinion, which was also stated as adverse and not appropriate to the given scenario.

- (g)(i) In this part candidates were required to comment on the audit opinion given in the last year's report. Some candidates demonstrated poor knowledge on the types of audit opinion that the auditor can formulate. Also, they were not sure when an emphasis of matter paragraph should be included in the auditor's report. There were hardly any answers demonstrating the fact that the emphasis of matter paragraph does not constitute a qualification of the audit report.
- (g)(ii) In this part candidates were required to discuss their role in relation to uncorrected misstatements on inventory provision and impairment of machinery in the current year audit, and also the type of audit opinion to be issued. Some candidates who lacked subject knowledge and did not understand the question said to correct the last year's opinion to be adverse. Only a small number of candidates discussed the steps that the auditor should have carried out. Most of them wrote irrelevant and incorrect conclusions such as "if the management refuses to correct the misstatements, one should report an adverse opinion".

### **Conclusion**

A question paper could test any part of the syllabus; therefore candidates should study the whole syllabus. Selective study will definitely limit the number of questions that candidates can attempt.

Candidates are requested to apply the principles and rules from their previous studies to more complex scenarios, and demonstrate their ability to handle the different issues in the common pre-seen. They should keep abreast of current developments in the economy in order to understand the issues easily.

Candidates are expected to have broad technical knowledge and be able to link it to appropriate audit issues in a practical situation. They are also advised to practice past exam papers and review the model answers given together