Examiners' Comments

Corporate Level Examination – June 2015

Corporate Financial Reporting (KCI)

Question 01

All scripts marked contained very unsatisfactory answers. There was not a single candidate who gave a satisfactory answer. This level of performance cannot be accepted from the final level examination candidates. Either the candidates have not studied the Financial Instruments or the lecturers had not covered this topic sufficiently. Chapter 12 of the BPP Study Pack had covered all the parts of the question and provided a worked example which is identical to the instrument II of the question.

The errors and discrepancies that appeared in almost all the answer scripts are as follows.

Part (a)

A large number of candidates had only two classifications (EVTPL and HTM) and not the classification of L7R or AFS. Though the question requires a discussion of the options available for quoted debentures, only a very few explained the same.

Part (b)

Not a single candidate developed Financial Statement Extracts for all four classifications. The candidates were confused about Ask and Bid interest rates. Some incorrectly worked out the simple average of the two interest rates for interest income. Simple interest rate was used by a large number of candidates for the second year in working the PV. No candidate had the correct answer for the FV of the debentures for 2013 & 2014. Hence no candidate had the correct answer for fair value gain or loss at the end of each year.

Part (c)

The answers were satisfactory. Only a few candidates stated that the re-classification should not be carried out as the market has changed.

Part (d)

A large number of candidates had correct answers and very few had not attempted.

Instrument II

Part (e)

A large number candidate had incorrect answers. Most of the candidates were not familiar with the interest rate swap arrangement as a derivative. They have not explained the features. No one had stated that it will have no initial net investment and the settlement occurs at a future date. A few candidates only have stated that its value will have an impact on the change in SLIBO.

Part (f)

The fair value of the derivatives as at 31.12.2013 and 31.12.2014 were incorrectly calculated though it was stated in the question (SWAP). Hence the journal entries were incorrect. The net income too was incorrect. The said problem was identical to the worked example in the BPP study pack.

Question 02

Examiner mainly focused on whether candidates were capable enough regarding:

1. Identification of valuation approaches.
2. Identification and classification of fixed assets.
3. Calculation of net book value of the properties under cost method and fair value method.
4. Identification of fair value adjustment.
5. Adjustment of fair value changes in comprehensive income statement and other comprehensive income statement as appropriate.
6. Deferred tax implication on fair value gain/losses.
7. Analysis and application of accounting standards relating to practical scenarios.

Candidates' competency

Part (a)

Identification of valuation approaches – Majority of candidates were able to identify three valuation approaches.

Part (b)

1. Classification of Assets – Majority were able to classify assets except Assets "D" (PPE to IP) and assets "E" (Operating Lease):
2. Candidates showed their incompetency in calculating NBV after fair valuation.
3. Majority of candidates were not able to calculate depreciation with regard to the assets "C" (IP).
4. Some candidates revalued Operating Lease assets.
5. Majority made mistakes in adjusting fair value gain/loss in comprehensive income and other comprehensive income.
6. Very few were able to calculate DT with regard to the fair value gain.
7. Presentation of the CI and OCI statements was very poor.

Part (c)

1. Majority of the candidates mentioned that the valuation should be done by a qualified valuer and some have interpreted that a diploma holder is also a qualified valuer.

2. Majority of the candidates successfully answered part ii of the question ''C" and earned full marks.

Summary

1. Standard of the question was good. However majority of the candidates' answers were not up to expectation, and not what is expected from the corporate level candidates.
2. Average number of marks earned was below 10 out of 25 marks.

Question 3

(a) **The first part of the question** tested the knowledge of students on SLFRS 10 Consolidated Financial Statements. In this question the candidates were required to discuss and apply to the given scenario the concepts relating to the situations where an investor **controls** an investee.

Answers were poor, main problem being the incorrect assessment of the factors affecting control.

Students mentioned the factors affecting control, but failed to apply the principles correctly to the information in the case study.

Lack of detailed knowledge on the application of the standard was evident.

Common mistakes made by students

Some students mentioned that since LFPL does not have 51% equity stake in NFPL, it does not have control.

Some others said as LFPL has 3 directors out of 5, it has majority voting power.

Majority of the students did not comment on the protective rights of Mr. Charles. Out of the few who commented, most interpreted as Charlie having control (and not LFPL) because of his authority over distribution. Only a handful of students applied the principle correctly. In the given scenario as control over the distributable profits is applicable only in situation where the distribution is over 70% of current year's profits and therefore is contingent on a **specific event** and hence it is clear that Charlie has only protective rights.

A considerable number of students concluded that LFPL has only significant influence over NFPL.

(b) **In the second part of the question**, students' knowledge on the preparation of consolidated financial statements was tested.

Identifying the group structure (whether LFPL has control over NFPL) in the first part of the question was not dealt with properly by many students. As a result , students who failed to correctly identify that LFPL has control, lost considerable marks in this section as some of the consolidation adjustments were not done by them.

This section carried 22 marks out of the 50 marks allocated for the question. Hence students who failed to gather a considerable portion of the marks were in difficulty in reaching the required pass mark.

Common mistakes made and the performance of the students in this section are given below.

Goodwill Computation-

Usually, considerable amount of marks are allocated to computation of goodwill, which could not be scored by the students.

<u>In computing the consideration-</u>

Majority of the students computed the cash consideration correctly. However the following errors were noted in the computation of contingent consideration.

SLFRS 3 requires the acquisition date fair value of the contingent consideration to be recognized as part of the consideration of the acquisition. The requirements of LKAS 37 do not apply in this instance. However, some students mentioned that deferred consideration is a contingent liability and shall be recognized as per LKAS 37 and hence did not take this in computing goodwill.

Some students failed to discount the deferred consideration. Part of the consideration that will be paid on a future date (contingent consideration of Rs 100 mn) should be discounted to its present value using the cost of capital of LFPL which was given in the question as 10%. It is noteworthy to mention that a similar adjustment had been discussed in the pilot paper as well, although students made mistakes in this adjustment.

<u>In computing the fair value of net assets acquired-</u>

Common mistake made by the candidates were in computing the deferred tax arising on the fair value of assets. Majority who did this adjustment, identified the deferred tax asset arising due to the tax loss, but did not compute the deferred tax on fair valuation of the assets.
In arriving at the fair value of the net assets acquired, students omitted to take the inventory and trade receivable balances into consideration. Some students took the tax loss also in to this calculation.

As a result of the above mistakes, none of the students claimed the total marks allocated to computing the goodwill arising on acquisition.

Impairment of the plant and the Impairment loss on Trade receivables-

Majority of the students had done the workings for these two adjustments and did the correct computations.

Fair value gain on investment-

This is another adjustment where majority of students made mistakes. Most students discounted for 3years instead of 2 years, without considering that already one year is over. Another common mistake was using the incorrect rate (9%, instead of 10%).

Other mistakes-

Without considering the date of acquisition (which was the last day of the financial year), about 1/3rd of the students went on to amortize the goodwill. Further provision for depreciation was calculated on the assets as well. The assets were fair valued, and it was at the end of the year, hence no adjustments are necessary.

Presentation of the Statement of Financial Position-

Since this is the final level, the students are expected to demonstrate very well their ability to draw up the financial statements in the correct format. However, it was disappointing to note that many students were not competent in this regard. Very untidy presentations and incorrect classifications were produced by many students.

Students showed the deferred tax asset on the tax loss and the deferred tax liability separately without netting off.

Another mistake was to show the deferred consideration under current liabilities.

Students who computed some value as goodwill failed to show it in the Statement of Financial Position. A similar mistake was seen in not taking the value of the Brand (intangible asset). Overall performance on this section was disappointing considering the principles tested with all the adjustments in this question were quite basic and fundamental.

(c) **The third part of the question** was a general knowledge question on Sustainability. Many students scored considerable marks. However, some students reproduced several paragraphs from the corporate governance code which was available with them (as part of the open book documents permitted). At this stage of the exam, students should bear in mind that marks are awarded for knowledge and application and hence they will not get any marks for merely reproducing sections from the book in hand.

(d) **The fourth and final part of the question** was on evaluating the performance of the company- calculation of specified ratios and a comparative analysis of financial performance they revealed. The question required the students to develop a report and hence students should structure their answer in the form of a report with proper title and headings. This was not done by some students and as a result lost some of the marks.

Calculation of some of the ratios was disappointing. Many students made errors in computing Gearing and interest cover ratios. Further students made errors in calculating ROCE and ROE. These two ratios were not understood properly by many students.

Except for the above, other ratios were computed correctly by majority.

However, there were very few good answers on the analysis, using the effects of the scenarios of the business given in pre seen and connecting them in the interpretations.

Many answers reiterated in words the change in the calculated ratios as an increase or decrease only without any analysis of the possible reasons as to why and not commenting where the company stood in relation to the competitor. This is not an interpretation in any meaningful sense. Even when the ratios computation was incorrect, marks were awarded for the analysis based on those incorrect computation, however lack of good interpretation led to students being unable to score well.

There was a complication in that there were adjustments to the company figures arising as a result of impairment of debtors etc. Very few students had done the computations with these adjustments and commented on the effects of same.

Although this was a section where students could have scored very well, the average marks was about 8 out of a total of 13.

Corporate Finance and Risk Management (KC2)

Question 1

General comment

It is observed that students had difficulties in answering the question within the time allocated. They demonstrated their ability to identify and carry out the numeric calculations. However, they were unable to "**advise**" and "**explain**" as required by the examiner.

Observations made during the marking process, are listed below.

a. The question is to **advise** on two investment options.
Common mistakes made on option 1:
- Used wrong cost of capital rate to discount cash flows. Most of the candidates used guaranteed return of 16% as cost of capital.
- Some candidates made mistakes on discounting factor. e.g. instead of 3.889 used 4.331 as cumulative discounting factor.

Common mistakes made on option 2:
- Some candidates were unable to identify correct number of units for each year. E.g. Considered only the incremental quantities.
- Although selling price and variable cost is fixed for all six years, some candidates spent unnecessary time to calculate sales and variable cost separately for each year and then arrived at the contribution.
- Mistakes were observed on computation of exchange rates and inflation adjustment. Since inflation rate and exchange rate both need to be adjusted students seemed to be confused
- Royalty cost and royalty income not adjusted for inflation.
- Wrong computation of cost of capital rates on local and foreign operations.
- Sri Lanka and Malaysia Income tax rates of 28% and 25% respectively not properly applied.
- Tax is payable one year in arrears. Therefore it should have been taken in to accounts in 3rd year. But most of candidates considered it from 2nd year.
- Purchase consideration of USD 2.6 m not adjusted for inflation.
- Only a few candidates were able to convert MYR cash flow in to Sri Lankan rupees.
- Only a few candidates were able to calculate the incremental working capital.
- Some candidates charged the capital allowance to the cash flow, instead of 25% tax saving on capital allowance.
- Administration expenses, not considered at current prices. E.g. not adjusted for inflation.

b. Most of the candidates were unable to **explain** the benefits of a post completion audit in capital budgeting, giving due reference to above investment.

Question 2

General comment

This is not a difficult question for the corporate level. However it is observed that the candidates were unable to understand it properly and as a result performance was poor.

Observations made during the marking process are listed below.

a. Candidates were unable to **differentiate** redeemable debentures from the zero coupon bonds as expected by the examiner.
b. Most of the candidates were able to **design** the ownership structure but were unable to **compile** the refund scheme. They completely forget the fact that there is no physical refund (i.e. cash movement) in bank guarantees
c. Most of the candidates misunderstood this question and **calculated** only yield to maturity (YTM).
d. Candidates are required to **advise** whether bond holder should go for conversion option based on conversion premium/ discount. Most of the candidates used NPV calculations, which is not relevant. Some candidates misunderstood the question.
e. Candidates are required to **discuss** the views of an investor, who feels investing in one year fixed deposit is better than investing in 5 year debentures. Most of the answers were limited to risk and interest only. In the question candidates need to discuss the use of Value at Risk (VaR) as a tool of risk assessment. However this was totally ignored by the candidates.

Question 3

General comments

It is observed that students had some difficulties in answering the question within the time allocated. They demonstrated their ability to solve questions with calculations. However answered poorly in the areas tested under terms such as **analyse**, **evaluate**, **advise**, **recommend** and **explain**.

Observations made during the marking process are listed blow.

a. (i) Common mistakes made on **analysis** of DOL, DFL, DCL are as follows.
   - Using incorrect formulae.
   - Mixing up of numerator and denominator.
   - Using absolute numbers, instead of percentages.
   - Including sales proceed received from disposal of lands to arrive at EBIT.

   (ii) Majority of the candidates were unable to **evaluate** the finance director's concern, but just mentioned the reasons that appeared in the question.

b. Candidates were required to **advise** on Sri Lankan regularity framework on non-resident s becoming major shareholders by giving due reference to exchange control provisions. Except very few candidates, others were unable to answer this question.

c. (i) The candidates were required to **criticize** on the current discount rate. Fairly satisfactory answers were observed.

   (ii) The candidates were required to **calculate** asset beta, equity beta and discounting rate. Majority have answered well. But some have confused and used beta 1.3 for CAPM model. Also some have no clear idea about the area tested even though relevant formulae was given with the question paper.

(iii) In this part the candidates were required to **recommend** an appropriate WACC. They were able to recommend as expected by the examiner.

d. (i) **Advise** on reasons for difference between the values placed by Sureka and adjusted net book value of the business, were done well. However basic approaches of valuation methods and their relative advantages and disadvantages were not properly explained.

(ii) Many candidates **explained** in favor and against P's view but were unable to justify with reasons.

(iii) A fair number of candidates were able to **recommend** minimum and maximum values to place on shares, satisfactorily. However, following careless mistakes were observed.

- After arriving at the net asset values, full value considered as LPFL shares.
- Some failed to deduct the total liabilities of Rs. 1251m from the total assets, to arrive at value of LPFL shares. Some deducted only current liabilities from the total assets.
- There were candidates, who deducted Rs. 464m of total non -current liabilities in addition to the Rs 1251m.
- Deducting bad debt provision of Rs 114m to arrive at the historical basis and replacement basis of valuation. Deduction of Rs114m is applicable only to realizable basis of valuation.

The candidates were required to **advise** on best option out of "settling in cash", "share swap" and "combination of cash and share-swap". Very poor answers were observed on this question. All most all candidates, who answered indicated only the advantages and disadvantages of the above options. They were unable to provide any appropriate value calculation

Corporate Taxation - (KC3)

General

The paper was set on core topics of the subject. Overall performance of the candidates was not satisfactory.

Most of the candidates were unable to approach the tasks methodically and had not produced well focused, relevant answers addressing the principal and core components of each requirement.
It appears that the candidates have not addressed the structure of the curriculum for 2015 and the key attributes related to corporate level. Ability to understand industry and business circumstances, skill in analyzing, making decisions based on various information collected and analysis made, skill in reporting and communicating etc. were very poor though the corporate level students are expected have those skills as future corporate leaders.

Students should be able to compile comprehensive tax computations. They also should be able to carry out tax planning, decision making on minimizing tax expenses and mitigating risks and effective communication with tax authorities, clients and the management etc. Therefore displaying only their knowledge is not adequate. Though the exam is open book driven, level of answers was not up the standard in technical and legal aspects.

It is advisable to note that students should address the structure of the paper since three questions are based on scenarios. Therefore the answers should be the outcome of that practical situation. In line with that expectation it is recommended to pay attention to action verbs, expected learning outcome, knowledge process, knowledge dimension etc.

Those who could not perform well mainly suffered in respect of the following:

- Lack of pre study and preparation for the syllabus change.
- Lack of understanding of the requirements of the questions.
- Producing irrelevant facts and thereby wasting time.
- Lack of communication and presentation skills.

<u>Question-wise comments</u>

Question 1

<u>General</u>

Performance is marginally below satisfactory level.
The commonly observed error was candidates have confused the two scenarios in respect of two different intimation letters received and consequences under different provisions of the Act.

Part (a)

This was an easy and straightforward question which required evaluating the validity of an assessment referring to a decided case law in taxation. Most of the candidates were able to answer correctly in the light of Section 163(3) of the Inland Revenue Act.

Part (b)

This too was an easy and straightforward question which tested statutory provisions under sub sections 8 & 9 of Section 106 of the Inland Revenue Act. Majority of students were successfully able to give facts to the question but were unable to emphasise the vital fact that **if returns were submitted on time then on subsequent submission of additional details required within 30 days' time, the provisions to deem that "not to have furnished the return" does not apply.**

Some candidates emphasised that it is a must to appeal on the matter forgetting about possible resubmission of the required Assets/liabilities schedule to make the Return a duly furnished Return of Income.

Part (c)

This part of the question required obligations to be fulfilled by a person who is registered for Value Added Tax & NBT. Although majority of the students seemed to be familiar with the relevant provisions, they lost some marks because of the following errors;

- Some candidates have confused with NBT provisions and treated Transport Income as exempt Income for VAT purposes which is incorrect.
- Due to the above incorrect treatment of Transport Income, some candidates did seem to have any idea of apportionment of input tax and adjusted the entire amount of local input tax between taxable and exempt supplies and thereby wasted time.
- Many students had not stated the amount of unabsorbed Input tax C/F balance and thereby lost marks allocated.
- Some students applied the incorrect VAT rate of 12% irrespective of latest change of VAT rate to 11%
- Many candidates did not have clear understanding of the rule that limits the input tax claim to 100% of output tax.

However majority of candidates were successful in answering the NBT part of the calculation.

Part (d)

The requirement of this question was to advise on an effective tax plan. The overall performance was good as most of the candidates seemed familiar with tax planning. However many of them have considered only on Partnership business and not focused on Private Limited Liability Companies or any other business entity.

Part (e)

This part was generally well attempted. Almost all candidates were able to give successful answers to the part.

Question 2

The requirement of this question was to understand the basis and structures of international taxes and how they are applied, understand the role of both tax and non-tax factors that affect tax planning, identify and analyze different international tax issues in a range of cross-border transactions and review a methodology for tax planning and develop students own tax planning approach.

However it is noted with regret that the, majority of the candidates showed a lack of detailed understanding of the areas being examined.

Most of the students were not familiar with the various sources of Income which are liable to tax under different conditions.

A handful of candidates knew that the income of providing Technical Consultancy is liable to Income Tax, VAT and NBT in Sri-Lanka but had not known that the Interest Income received is only liable to Income tax.

None of the candidates knew essential facts on double tax treaty agreement between India and Sri Lanka, especially when employees of the Indian Company present in Sri Lanka for more than 90 days become liable on their Income derived in Sri-Lanka. Almost all candidates identified it as per the general rule which requires 183 days instead of 90 days.

On the other hand surprisingly almost all students have not mentioned or identified the concept of permanent establishment which is a basic and fundamental rule that governs tax treaties and to determine tax jurisdiction of the source country.

Very few candidates have identified that when the interest is payable to a nonresident person on a loan obtained from such person and the interest on such loan is borne directly or indirectly by a person resident in Sri Lanka or by a non-resident person where the amount of such loan or part thereof has been brought to or used in Sri Lanka such interest is deemed to be profits and income arising in Sri Lanka.

Those students who knew that the applicable loan granted prior to 1/4/2012 to any undertaking and approved by the Minister as being essential for the economic progress of Sri Lanka is exempt from Income Tax had sadly not known that the interest accruing to any company on a loan granted after 1/4/2012 to any undertaking is generally exempt from income tax. The fact that the above was not known resulted in a bad effect on tax planning tested in the following part of the question.

It is advisable that students should understand that international tax planning is an art and there are no perfect answers at all times. The answer depends on the facts and circumstances, the tax rules and practices in the concerned jurisdictions, and the business or commercial objective and the risk-taking capacity of the tax payer.

Question 3

General

The students should understand the importance of "Pre seen" as the aim of the examination was to test a wide range of syllabus areas. Candidates are strongly reminded that they must familiarize themselves with the pre-seen material prior to the examination. There may be situations where the examination questions do not directly examine the pre-seen material. However the unseen material does build upon the pre-seen information and it usually does help candidates to gain a better understanding of the overall theme of the unseen material and to get ready for the examination.

Part (a)

In this question, tax computation of a limited liability Company was given and the candidates were required to compute the gross income tax liability for the Year of Assessment 2014/15 and prepare Statement of minimum distribution to be made thereon.

The overall performance was below the expected level. However some candidates seemed familiar with some tax treatments whereas others were not.

The mistakes that were generally observed are as follows:

- Only a handful of students demonstrated their ability to approach the computation of adjusted Profit from Trade and to identify the separate segments of Trade Income.
- Very few candidates had identified that the income from quoted long term bonds is exempt for income tax purposes.
- Almost all the candidates were ignorant of the different Income Tax Rates applicable to qualified export profits, agricultural income, general tax rate for bigger companies & applicable rate on interest income, profit on disposal of assets etc. This could not be accepted where “Pre Seen case studies” are concerned.
- Handful of candidate knew that advertisements outside Sri-Lanka and foreign travel on trade fairs are 100% allowed where export income is concerned.
- Almost all the candidates were not successful in computing the tax adjustment on provision for retirement benefit. Most of them have not identified that there is no need to adjust the actuarial gain on benefit.
- Very few candidates knew the cost of planting trees is an allowed and admissible expense for tax purposes.
- Few candidates had incorrectly applied 50% rate on capital allowances on machinery stating that export income is more than 50%, forgetting the fact that it should be more than 60% as per the provisions of the Act.
- Some candidates have allowed 200% for Research & Development Expense instead of the admissible 300%

Part (b)

The purpose of this question was to test the awareness and application of the knowledge on recent changes in financial reporting and impact on taxation. Majority of students were successfully convinced that the gains arising on fair value adjustments are not liable for income tax. However identifying the relevant legal provision was not satisfactory.

Part (c)

The purpose of this question was to test knowledge on providing Tax advice.
Majority of students were unsuccessful in answering the question.

Part (d)

The purpose of this question was to test knowledge on Statutory Provisions.
Majority of the candidates showed a lack of detailed understanding on the area being examined.

Part (e)

This was an easy and straightforward question which required understanding of Simplified VAT Scheme. The overall performance was good as most of the candidates seemed familiar with the Simplified VAT scheme.

However the poor presentation of the answer badly affected the scoring of allocated marks.

Corporate Governance, Assurance and Ethics (KC4)

General Comments

The performance of the candidates was poor and did not demonstrate the necessary knowledge understanding and application skills to be successful at this challenging exam. The overall pass rate was disappointing. As this is the first exam of the new syllabus the candidates wouldn't have been trained for a paper of this nature, but they should have studied the text. The good answers reflected their knowledge.

This paper consists of three areas, but more weight was given to two areas, which are corporate governance and assurance. The area of ethics was covered on a small scale. The second part of the question was based on a pre seen case study which was provided prior to the exam. A number of common issues arose in the answers that contributed to the disappointing pass rate which are:

- Wasting time in explaining certain areas without focusing on the question
- Illegible hand writing
- Not following the action verbs
- Not applying the theoretical knowledge to practical situation

Specific comments

Question 1

This question is comprised of two sections.

Part A;1

QEP Plc is a public listed company and is a subsidiary of a large conglomerate. QEP imports industrial and household items and sells locally. During the recent past QEP has become significant to the parent company. The reporting deadline of both companies is on the same date. The materiality levels used by the group are;

- Overall materiality Rs. 105 m
- Performance materiality Rs. 80 m

It was requested to propose the materiality levels which should be applied to QEP. Many candidates have misunderstood the question and calculated all possible materiality levels, without identifying the most relevant materiality level. Most of them have not referred to the scenario given.
Most of them have not assessed the following areas;

- Since QEP is a Plc the materiality level should be based on profits.
- The group materiality cannot be applied as it is high.
- The auditors of QEP have to issue a separate audit report on financial statements.
- They have to use a low materiality level, in order to assess the risk of material misstatement and determine the extent of further audit procedures. The audit work would not be sufficient if the group materiality level is used.
- The materiality level should be communicated to Tally and Company.

Further they have ignored the action verbs, and as a result most of the answers were incomplete.

Part A 11

It was expected to develop the audit procedure that the audit team may perform in response to the risks communicated by the parent auditor.

Management override

Majority has written fairly good answers. Some have written in a broad sense without the specific audit procedure, test of details, and test of controls. There were irrelevant answers such as;

- Examine board structure
- Review internal audit report
- Establish directors' independence

Some were able to understand and write the following;

- Check the assumptions and estimates
- Check Board minutes

They have-not given details as to why such tests are to be carried out, and why it affects the accuracy of financial statements.

Valuation of finished goods

Majority have given relevant answers but some have written analytical test should be carried out. Overall performance was good.

Related party transactions

This part was well attempted and relevant answers written.

Part B

This part was based on a scenario. Fast Food Trading Ltd. recorded a net profit of Rs. 150 m. The materiality levels are;

- Overall materiality Rs. 16 m
- Performance materiality Rs. 12 m
- Trivial materiality Rs. 8m
-

It was expected to advise the audit team on further audit evidence.

Sales cut off

By selecting a sample of invoices raised on 30th and 31st March 2015 where the goods were dispatched on 2rd and 3rd April 2015.Total of such invoices amounts to Rs 0.7m. The team has calculated the misstatement below the materiality level. Most of the candidates have written that the sample should be extended. There were irrelevant answers such as;

- Get inventory aging and check whether the same items are there as at that date
- Check serial numbers of inventory
- Check subsequent settlements

Xtra Super

Xtra Super represent 20% of sales of FTPL. The amount due from Xtra Super as at 31st March 2015 was Rs. 32 m due to a drop in sales during Feb and March 2015. FTPL is confident of receiving this amount. The common answers were check subsequent payments and do impairment test. The question was on evidence. The candidates were unable to link the evidence to the audit procedure.

Investment in a property Company

FTPL owns25% of the capital of the property company. Mr Fernando who is a director of FTPL is also a director of this property company. The financial statements of the property company have not been audited as yet. It was expected to advise the audit team regarding audit evidence, as no evidence is available in the file. Most of the candidates have identified the issue and answered well. Majority wrote only about the related party transaction being disclosed. They were unable to write about the impairment and impact on equity method and what sort of evidence should be obtained. Some have written about the audit evidence with regard to investment in property. It reflects that they have not read the question.

B 11 It was expected to analyse the implications for the audit report.

Sales cut off

Some candidates have written that the materiality of that to the financial statement has to be identified, and whether any adjustments are to be made should be checked.
Some have written that an adverse opinion has to be issued. Such answers are disappointing at the corporate level and also because it is an open book exam.

Xtra Super

There were good answers, some have written that if subsequent realisation is doubtful it should be ensured that an impairment charge on debtors be made, and if it is not done suggest a modification to the report. Many candidates have written that there is a going concern issue and an emphasis of matter paragraph should be included.

Investment in Property Company

Most of the candidates have identified the scope limitation and related party transaction but they were unable to state that the equity method should be applied in accounting for investments. Most of the candidates have mentioned that a qualification is required as audited financial statements are not available. There were some irrelevant answers such as disclaimer.

Question 02

This question consists of four parts. This was based on Enterprise Risk Management framework. In the given case study City Hotel Ltd caters to local and business travellers. They had been successful for the past 20 years. During the recent past they were faced with legal charges due to food poisoning. As a result there had been a significant drop in their business.

A .1 It was expected to explain the concept of ERM and the way it would mitigate such risks. Most of the candidates were able to explain the concept. But some have written irrelevant answers such as;

- Designed to implement controls
- Helps good governance

A 2 The answers in relation to risk mitigation were not satisfactory. There were irrelevant answers such as;

- Analyse internal and external risks which relate to the industry
- Implement controls for purchase of material

Most of the candidates have failed to apply mitigation to the given scenario such as;

- Hotel management should assess the risk probability
- Management should take steps to avoid such risks

B It was expected to advise whether ERM is applicable to small scale entities such as City Hotel. Most of the candidates have written yes and that the cost should be considered. They were unable to assess that;

- It does not guarantee the success of the business
- It does not transfer poor management skills to better management skills
- The basic concept of ERM is same for small or large entities
- Methodology is likely to be less formal and less structured in small entities than in larger ones.

It reflected that the candidates have not practised answering questions following action verbs. The question was on advice. Then the answer would be more comprehensive.

C .1 It was expected to convince the board of directors that ERM will enhance the contribution of internal audit function. Most of the candidates were unable to write that internal auditor may use the ERM framework to assess risks and incorporate that into risk assessment and audit planning process. Most of the candidates have written that;

- ERM will give assurance on risk management
- Evaluate risks

The candidates have demonstrated that they lack the ability to think out of the box and apply the theoretical knowledge to a practical situation.

C 2 It was expected to discuss two areas in which an internal auditor should not get involved in his role as an internal auditor in an ERM implementing process. Although many candidates have written correct points they have not given the reason that if he does it independence will be impaired and hence they should not get involved.

Question 03

This is based on pre-seen case study. In addition to the pre-seen case study additional information has been provided at the exam. As per the pre-seen in Aug 2014 PSP a plc agreed to invest Rs 500 m in Aug 2015. The value of machinery is part of the investment. They decided to go for listing in 2015 or 2016.

Other information provided;

- Biological assets are valued at fair value
- Investments are classified as available for sale
- The financial statements as at 31/ 12 /14 carries a qualification on impairment of trade and other receivables
- Disagreement over the rate of tax
-

The information given at the exam was;

- PSP investment- internal valuation Rs 350 m
-

Conditions

- Advance of Rs 50m
- Two board seats to PSP-medical doctor and an architect

Sarath chairman, Sureka executive director

Acquisition of Northern foods

AB Associates – Auditor cum Adviser

A. It was required to evaluate risks of proposed board structure

The good answers made full use of the information provided and referred to the code of best practice on corporate governance. Most of the candidates have mentioned the risk of there being no independent members. It is disappointing that they have not referred to the preseen and the code of best practices which was available at the exam. They were unable to pick from the case and state that Sarath and Sureka would not be able to ensure all stakeholders interests being the father and daughter but only mentioned that they are not independent. Further they did not write that there should be a board balance in order to ensure that no individual can dominate the board decisions. Some have written that one director is a doctor and one is an architect but did not give the reason why it will be a risk. They were unable to link that with the code and state that the board should possess skills experience and knowledge to implement strategies. Some have identified that two directors are foreigners but were unable to link with the code and state that as directors they should dedicate adequate time and effort to matters of the entity. Some have written irrelevant answers such as;

- Non availability of remuneration committee
- Non availability of senior executive directors

B. It was expected to advise Sureka on duties of the audit committee. Almost all the candidates were able to score marks.

C. It was expected to evaluate the ethical issues faced by the firm. Most have written only self-review as a threat, but they were unable to give the reason as to how it will be a threat. Only a few candidates mentioned familiarity threat as an ethical issue. Some have written irrelevant answers such as advocacy, and self-interest. Some have written about all threats.

D. It was expected to advise Sureka on three procedures for embedding risk awareness regarding Lanka Foods. Most have written the following;

- Understand the strength of control environment
- Risk awareness and communication
- Training and involvement
- Performance appraisal and measurement
- Changing risk attitudes

The question indicated that Sureka wanted to increase the risk awareness within LFPL. The candidates were unable to structure the answer accordingly. There were some irrelevant answers also such as;

- Strategic risk
- financial risk
- establish integrated financial risk management
- due diligence
- SWOT Analysis

E1. It was expected to test the ability of candidates to apply knowledge about various types of engagements such as assurance assignments. The candidates at corporate level should be more conscious about the requests of clients. The auditor should use his knowledge to understand what sort of service he should provide. In this case the statutory audit for the year ended 31/03/2014 has been already done and the client wants a report for the three months period also. The client has asked for a special audit in order to value his investment. The candidates were provided with background information and they should find the objective of the client. Now the client is PSP who is planning to invest in Lanka Foods in which you were the auditor and the adviser. Candidates have not understood the question. They have written irrelevant answers such as;

Audit of financial statements prepared for special purposes.

They were unable to assess the difference between agreed upon procedure based on due diligence and the audit for special purposes.

E 11. It was requested to evaluate financial and non-financial information for audit focus. This carried 12 marks. The candidates could have picked the answer from the case study such as;
31/11/2014

- Biological assets at fv
- AFS valuation
- Debtors impairment
- Value of plants based on internal valuation
- Retirement benefits
- Post balance sheet period not sufficient
- Tax assessment
- Related party transaction

31/03/2015

- Northern Foods acquisition
- Debtors' settlement
- Layoff – contingent liabilities

Candidates could have referred to the case study and answered but they have written irrelevant answers and obtained less marks. Most of the answers were irrelevant such as;

- General audit procedure
- Financial risks
- Fraud risk
- Liquidity risk
- Quality control for food purchases
- Foreign currency hedging
- Internal control weaknesses

F It was expected to advise the audit team on significant areas which should be communicated to those charged with governance. This was based on SLAuS 260 and candidates were expected to refer to the scenario. This was poorly answered. They have written the points from the SLAuS 260.