

## **KB1 – Business Financial Reporting**

**December 2015**

### **Examiner's Comments**

### **Question-wise comments**

#### **Question 01**

##### **Part (a)**

- Performance on this question was average.
- Some students failed to identify that there was no present obligation to recognise a liability and thereby provided incorrect answers.
- Many students wrote irrelevant answers, describing the qualitative characteristics of financial statements such as relevance, materiality etc., thereby wasting time unnecessarily.

##### **Part (b)**

- Performance on this question was not very good. Whilst the question required students to highlight the management's responsibility for providing information to the Board, many students described the board structures and the role of directors. It appeared that students had not understood this question.
- Quite a number of students had chosen Question 01 as the last question to answer and had run out of time to answer this part. This displayed poor time management skills.
- Most students presented badly drafted, unstructured answers to this question.

#### **Question 02**

- Quite a number of students had not attempted this question.
- Quality of the answers of those students who had attempted this question, was poor.
- It appeared that students were not thorough with the SLFRS for SMEs and the simplifications given in that standard. It appeared that not enough attention was given to studying this standard.
- About 10% - 15% of students scored below 2 marks out of the 10 marks allocated for this question.

### Question 03

- Answers were very poor for the first part of the question where students were required to explain the reason for separately identifying the liability and equity elements of compound financial instruments. Students failed to explain the rationale for this.
- Answers for the second part were fairly good.
- Answers to the third part were yet again poor. Students had to explain whether the presentation of the bond would be changed in the 3<sup>rd</sup> year when it was found that the likelihood of exercising the option is very low. It appeared that students were not familiar with the relevant standard and its concepts and application.

### Question 04

- Performance on this question was very poor. Only a very few students seemed to have understood the question.
- Many students described the benefits of a loyalty programme in increasing sales volume and building loyalty, instead of addressing the question that was asked.
- In answers to part (b), instead of describing the accounting policies that need to be established for a customer loyalty programme, students explained double entry on how to account for the same, giving an example.
- Irrelevant answers, describing loyalty programmes operated through third parties, were explained by many.
- Subject knowledge demonstrated was exceptionally poor.

### Question 05

This question was on the interpretation of ratios. Satisfactory marks were obtained by many students for the first part of the question, which was on assessing profitability and solvency of the company based on given financial results.

However, answers for the second part were poor. Whilst the question was to “advise” Damith (the prospective investor) on limitations of financial statements, students had narrowed down their answer to the information given in the question. E.g. inability to cover some of the ratios as a full balance sheet is not given etc., and therefore lost some marks. It appeared that students had misunderstood the second part of the question.

Overall, about 65% of students scored 6 - 7 marks out of the total of 10 marks.

### Question 06

This question was in two parts, where 20 marks were given for consolidation, and 5 marks for the application of knowledge on LKAS 37 and SLFRS 3 where limited exemptions are provided in recognising and measuring contingent liabilities.

- The consolidation question was an easy one compared to the questions in previous examinations. Therefore a large number of candidates scored more than 75% of the marks allocated for this question.
- However, answers to the second part (contingent liability) were poor and none of the candidates obtained 50% of the marks allocated to that part.
- Overall performance on this question was very good as students scored good marks for the first part.

- It appears that students are good at working out sums but weak in application of theoretical knowledge to practical scenarios.

### **Question 07**

This question was of a very high standard, carrying 25 marks in total.

#### **Part (a)**

This question addressed the identification of investment property in different scenarios. Many students failed to evaluate the land and building of the Dambulla hotel as separate assets and therefore did not score good marks.

- Evaluation of the Negombo land was correctly done by a fair number of students.
- Overall marks for this question were about 2-3 marks out of the total of 6 marks.

#### **Part (b)**

This question related to recognising a non-current asset held for sale. Performance on this question was fairly satisfactory.

- Average marks scored were 3 marks out of the total of 5 marks.

#### **Part (c) (i)**

This question tested students' knowledge on defined benefit plans.

- A considerable number of students had done the calculations correctly and most of the students had understood the question very well.
- Performance was good and about 50% of the students scored the full 5 marks allocated to this question.

#### **Part (c) (ii)**

This question related to capitalisation of borrowing costs.

- A considerable number of students did not score well on this. Many students did not know that salaries of staff directly not involved should not be considered in capitalising borrowing costs.
- A lot of students made mistakes in taking the correct construction period of 4 months.
- Some had done calculations correctly but the presentation was not done and therefore lost some marks.

#### **Part (d)**

This question tested students' knowledge on charging depreciation for a newly constructed asset.

- Most students demonstrated that they had the knowledge on when depreciation should commence (i.e. when the asset is ready for intended use).
- However, they failed to apply this concept correctly to the practical scenario given and therefore lost some marks.
- Overall marks scored for this question were satisfactory.

## **KB2 – Business Management Accounting**

**December 2015**

### **Examiner's Comments**

#### **General comments**

##### ***Handwriting***

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

##### ***Workings***

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

## Question-wise comments

### Question 01

#### General comments

Overall performance varied between 2 ½ marks to 3 marks out of the 10 marks allocated. **None of the candidates** scored full marks for this question. The major weaknesses in the answers included unfamiliarity with basic principles tested in the question and repeating what students knew (what had been memorised) about marginal costing and throughput accounting, rather than the specific requirements in the question.

The question was designed to test the candidates' basic understanding on throughput accounting and their ability to distinguish throughput accounting applications from marginal costing. If the candidates had known the basic distinguishing features of the two concepts, they would have at least secured half of the marks allocated to this question.

Majority of the candidates (about 60%) appeared to not have a basic idea about how throughput accounting and corresponding ratios could be used to improve financial performance i.e. profitability of a firm.

However, it is pleasing to note that there were a few candidates who had structured the answer (especially part (d)) in a very practical manner. Though the number was negligible, it created great enthusiasm for the examiners during marking.

#### Part (a)

The overall performance of candidates was not up to expectation. Many candidates (about 40% – 50%) had failed to understand that there is a bottleneck resource (i.e. drying process time). Thus, ranking the products based on contribution per limiting factor (resource) was not observed. These candidates had ranked products for priority production based on unit contribution, displaying a lack of attention to the requirement of the question.

The average mark obtained by candidates for this question varied between ½ a mark to 1 mark. A negligible amount of candidates (about 3%) had attempted to answer the question by deriving marginal revenue over marginal cost and ended up halfway through. These candidates would have not even walk through the requirements of the question.

Some candidates (about 20% – 30%) appeared to have spent a substantial amount of time converting bottleneck time (on their computation) into hours, where such an alternative method was incorrect in many answers (80% – 90%). A considerable number of candidates (about 30% – 40%) had attempted to construct a detailed production plan including total sales values generated by each product under different options, rather than concentrating on the product mix as required by the examiner.

A very few (about 2% – 3%) candidates had attempted to answer the question by proposing a mix which maximises the total profit by taking a range of units on a trial and error basis, and failed to secure marks for this question.

## **Part (b)**

On average, candidates were able to identify and calculate throughput contribution but failed to rank and decide the priorities based on the contribution per limiting factor. However, some candidates (about 40 – 50%) had identified throughput contribution and ranked the product based on throughput contribution per limiting resource (i.e. processing hours).

A considerable number of candidates (about 60%) had arrived at the profit maximising product mix based on the unit contribution in part (a) of the question (i.e. marginal cost basis).

The average marks obtained by candidates for this question varied from  $\frac{1}{4}$  a mark to  $\frac{3}{4}$  a mark out of the 2 marks allocated.

A very negligible number of candidates (about 1% – 2%) had attempted to prepare budgeted profit and loss statements displaying very poor understanding of the requirement of the question. Some candidates (about 10% – 15%) had calculated the profit maximising product mix for both maximum demand and planned production and sales, without giving any regard to the bottleneck resource.

All minor/other mistakes observed in part (a) of the question were mostly repeated in this part as well.

## **Part (c)**

Overall performance in this question was very poor. The average mark was around  $\frac{1}{2}$  a mark.

Many candidates (about 50%) had displayed a lack of familiarity with the Throughput Accounting Ratio (TAR) and failed to understand what constitutes it. A considerable number of candidates (about 20%) had computed the contributions/sales ratio instead of TAR. A good number of candidates (about 40%) were able to compute the throughput return per hour of bottleneck resource but failed to divide it correctly by total overhead cost per hour of bottleneck resource.

A considerable number of candidates (about 40%) had failed to compute throughput per contribution in total (alternatively) or throughput return per drying process hour, which is needed to calculate TAR. Some candidates (about 30%) had attempted to compute TAR under maximum demand and the planned production and sales, without any regard to the bottleneck resource.

## **Part (d)**

Though the question seemed simple and straightforward, a large number of candidates (50% – 60%) failed to understand the requirement of the question.

Many candidates (about 30% – 40%) had failed to relate their answer to the elements or the line items of TAR and how profitability could be improved by TAR. Rather, they had given indirect factors, for example technology and training of staff, that could be considered in improving TAR and failed to secure the full marks allocated to this part of the question. Some candidates (about 20%) had explained how contributions could be improved rather than profitability through TAR, while some candidates (about 30%) had tried to explain the answer/outcomes of part (a) and (b) here, displaying very poor attention being given to the requirement of the question.

A considerable number of candidates (about 40%) had attempted to define throughput accounting and explain TAR rather than demonstrating how profitability could be improved through TAR.

### ***Suggestions to improve***

*Students are advised to understand the requirements of the question before they start answering it. Also, it is advised to relate concepts studied in the classroom to a practicable situation (in classroom learning) for effective learning rather than memorising the concepts and trying to reproduce them in the exam without aiming at the specific requirements of the question. Students are advised to understand the learning outcomes of each Chapter in the study text before they begin to study.*

### **Question 02**

This question tested the knowledge of candidates in relevant costing in a “make or buy” scenario. Though a number of candidates had performed well, a fair number could not obtain 50% of the marks allocated for this question. Candidates had a difficulty in identifying relevant/irrelevant costs and relevant revenues under each scenario. Therefore, though many had correctly answered part (a) of the question, parts (b) and (c) were not well answered.

Many had totally ignored the relevance of unavoidable fixed costs in a “make or buy” decision. Candidates need to relate manufacturing with the buying order and the extra order, and see which one is more beneficial. This understanding was not properly demonstrated and many could not make a clear recommendation based on their workings. In some cases, candidates had given recommendations, which were not in line with their workings.

### **Question 03**

The question tested candidates’ ability to calculate a divisional performance measure (ROCE) and discuss the likely responses of the divisional manager to the proposed capital asset acquisition/sale and changes in working capital. Candidates were also requested to demonstrate, using a given scenario, how performance measures using ROCE could be detrimental to the overall objective of the company.

Candidates’ performance in this question was poor. It had the lowest average mark in the whole question paper.

Common mistakes made by the candidates were:

- (i) Not calculating ROCE for each transaction separately, one at a time. Instead some had calculated one ROCE taking into consideration all four transactions together. This indicated the candidates had not properly read the question before answering it.
- (ii) Failing to correctly calculate the capital employed under each scenario.
- (iii) Failing to appreciate that net current assets will remain unchanged under scenarios (iii) and (iv).
- (iv) In part (b) of the question, comparing the ROCE calculated in part (a) with the company’s cost of capital, and giving responses based on whether ROCE is greater than or less than the cost of capital.

#### Question 04

The question tested the candidates' knowledge in assessing the financial impact caused by a change in the credit policy. A fair number of candidates had scored high marks for this question. However, more than 50% of the candidates had performed poorly in this question.

Common mistakes made by the candidates were:

- (i) Calculating the outstanding receivable using total sales instead of credit sales.
- (ii) Taking the increase in annual sales as a decrease in sales by 10%.
- (iii) Reducing the discount of 2% from the sales figure without taking it as a cost.
- (iv) Failing to take the contribution on increased sales.
- (v) Failing to calculate or incorrectly calculating the overdraft interest.
- (vi) Incorrectly computing the discount by taking into account the credit period as well.

#### Question 05

##### General comments

Average performance for Question 05 ranged from 2 marks to 3 ½ marks out of the 10 marks allocated.

This question has been designed to test the candidates' understanding about relevant cost for the computation and assessment of economic order quantity (EOQ), and compute the total cost of inventory for management decision-making. In particular, part (b) included adjustments for price discounts to assess whether candidates could take this into account when computing EOQ and the cost of inventory to decide on the least cost option.

The most common mistakes observed included (but not limited to) unfamiliarity with the EOQ formula or even what constitutes EOQ (i.e. the variables needed to compute the EOQ). A large number of candidates (about 60% 70%) appeared to be confused with where to adjust the discount. Weaknesses also included failing to compute the holding cost accurately. The computation of purchase cost inventory was not accurate in many answer scripts (about 60%)

#### Part (a)

It was very disappointing to see that a considerable number of candidates (about 40%) were unfamiliar with relevant factors affecting the computation of EOQ. Majority of the candidates (about 80% – 90%) missed out the fact that the price of material is required to determine the benefit of the discount or incorporate the discount (bulk) that is offered on a specific quantity of orders. Average performance ranged from ½ a mark to ¾ a mark, which was poor.

A number of candidates (40% – 50%) had stated that the assistant's comment is correct (i.e. price is irrelevant) without a single justification, whereas the same proportion of candidates had mentioned that the assistant's comment is incorrect without giving any reasons thereof. These candidates appeared to have played with the stroke of luck and secured no marks for part (a) of the question.

Some candidates (about 40%) had mentioned that it only matters to arrive at the correct ordering cost.



As it can be argued both ways, a handful of candidates (about 20% – 30%) demonstrated that though the material price is not directly relevant for the EOQ computation, if bulk discounts are offered by the supplier on the quantity ordered, material prices come into the EOQ computation.

Another important aspect that was expected from the students is that when the holding cost is estimated in relation to material price or cost (Note: may not readily be applied in practice), the price of material is factored into the EOQ computation.

It was disappointing to see that only about 5% – 8% of the candidates had been able to identify both of the above important aspects, though marks were allocated for either point alone.

Some candidates (about 15% – 20%) had mentioned that material price is only needed to assess ordering cost, displaying very poor understanding of the calculation of the total cost of inventory. A negligible amount of candidates (about 8% – 10%) had mentioned that material price is irrelevant as it is quoted in USD and only conversion of gains and losses matter.

Average performance on this question varied from 3 marks to 4 marks (out of the 8 marks allocated). A considerable amount of candidates (about 40%) had written the EOQ formula but failed to compute the correct figures for the variables needed to compute such.

Many candidates (about 50%) failed to calculate the cost of holding as the import duties and other import expenses were not considered in the total factory cost. Some candidates (about 20%) had applied the discount on the ordering cost of Rs. 10,000, and had used that in the EOQ formula, displaying poor knowledge on EOQ computations.

A large number of candidates (about 95%) failed to calculate the EOQ under the two discount options in order to determine whether the company should order a quantity other than the minimum quantity offered by the supplier if it were to obtain the advantage of discounts. This was missed out by almost all of the candidates.

Though a considerable number of candidates (40% – 50%) had computed the ordering cost correctly in determining the total cost of inventory, the majority failed to compute the holding cost correctly in the total cost of inventory computation.

The computation of purchase cost was incorrect in many answers (about 60%) and a large number of candidates (about 50%) had missed out import duties and other import expenses in the computation. Some candidates (about 10%) multiplied the EOQ computed in the first part by Rs. 135 (i.e. exchange rate) and USD 1,000 (i.e. supplier price in USD), to arrive at the purchase cost of inventory, thus displaying very poor knowledge about the elements of inventory cost.

### ***Suggestions to improve***

*Candidates are advised to practice answering questions relating to EOQ computations under different scenarios (e.g. EOQ under discounts, lead-time etc.), which might help them to cope up with time management in the exam. It was observed that many students (about 40%) appeared to have spent a lot of time understanding the question (particularly part (b)) and were thereby unable to complete the answer.*

## Question 06

### General comments

Answers to this question were varied.

Although some candidates provided good answers, more than half the candidates failed to score 50% of the marks allocated to the question.

The question consisted of five parts and tested the knowledge of variances and the learning curve.

Part (a) required candidates to calculate the sales mix contribution variance and the sales quantity contribution variance.

Part (b) required candidates to analyse the variances calculated in part (a), showing the impact of actual performance on the budgeted outcome in terms of profitability.

In part (c), candidates were required to analyse the total labour variance of Product C by calculating the labour rate and efficiency variances, comment on the results and indicate whether they agree with the statement made by the production manager regarding the labour cost and labour variance of Product C.

In part (d), candidates were required to calculate planning and operating variances after recognising the learning curve effect (where a learning curve scenario applied).

Part (e) tested the candidates' knowledge of factors to be considered when investigating variances.

Considering parts (a), (d) and (e) individually, there were quite a few candidates who obtained full marks for each part. However, although some candidates provided excellent answers to some of the parts, they answered the remaining parts poorly. Some others did not seem to be confident in answered questions that involved calculations, but obtained full marks for part (e). Some candidates only attempted some parts of the question, thereby forfeiting marks.

Overall, although some candidates performed well, the performance of more than half the candidates wasn't satisfactory.

### Part (a)

This was the best answered part of the question.

Although some candidates scored the full marks allocated to this part, some others had used the budgeted sales quantity instead of the actual sales quantity in calculating the sales mix contribution variance and actual sales quantity instead of budgeted sales quantity in calculating sales quantity contribution variance. Some others compared actual and budgeted sales quantities in calculating the sales quantity contribution variance. Some candidates had used the actual contribution/unit on the standard selling price instead of using the standard contribution/unit.

It was evident that some candidates were unable to identify a favourable and adverse variance correctly.

### **Part (b)**

Majority of the candidates failed to mention that (i) Product A (for which the actual sales were much less than budgeted), earns a significantly higher contribution, and that Product B (for which the actual sales were much more than budgeted), earns the lowest contribution and (ii) the fact that due to this sales mix, the profit declined.

### **Part (c)**

Common mistakes made by the candidates were the following:

- Failing to calculate the direct labour rate variance and the direct labour efficiency variance, in order to analyse the total direct labour variance of Product C.
- Failing to comment on the employment of cheaper labour and labour inefficiency in utilising more direct labour hours to produce a unit of Product C.
- Wasting time calculating the direct labour rate and efficiency variances in order to analyse the total direct labour variance of Product C.
- Wasting time calculating the direct labour rate and efficiency variances for products A and B and commenting on these products, which was not required.
- Discussing the learning curve effect and calculating variances using the information provided to be used in part (d).

### **Part (d)**

Most of the candidates had calculated the learning index correctly. However, there were some common mistakes made by candidates.

- Although many candidates calculated the original and revised standard times correctly, some candidates mixed up 'a' and 'x' in the equation (substituting 560 for 'a' and 8 for 'x') and arrived at an incorrect revised standard time.
- There were candidates who had calculated a planning rate variance, although there was no revision of the standard rate.
- Some candidates had calculated the operating efficiency variance using the original standard time instead of the revised standard time.
- Some had used the actual labour rate/hour of Rs. 330 instead of the standard rate of Rs. 300.
- There were some candidates who identified favourable and adverse variances incorrectly.

### **Part (e)**

Some candidates simply listed factors without explaining, although the question required the candidates to "explain" the factors. Some candidates listed many factors (some wrong and some repeated), although the question required the candidates to explain only three factors.

### Question 07

This question was answered satisfactorily by the majority of candidates. It had the highest average marks in the paper.

The question required candidates to draw a network diagram for the given project (part a) and identify its critical path and project duration (part b). Candidates were required to assess whether speeding up some activities will change the critical path (part c) and expediting given activities is beneficial to the company. Part (e) required candidates to state common problems associated with network analysis.

Parts (a) and (b) were answered satisfactorily by majority of the candidates. However, some had failed to correctly indicate the dummy activities and compute the project duration. Failure to indicate or incorrect calculation of the times (EST, LST) had contributed to incorrect identification of the critical path and project duration.

For parts (c) and (d), many candidates could not base their answers by considering the floats of the activities concerned. Some had answered taking all of the activities together and/or drawing a new network diagram.

## **KB3 – Business Law and Tax**

**December 2015**

### **Examiner's Comments**

#### **General comment**

There was a lack of preparation for the question paper and it appeared that candidates did not read the questions properly to understand them. The other main problem faced most candidates was their ability to express ideas correctly due to poor language skills. Not only were there numerous grammatical mistakes, there were also many instances where the candidates had written certain statements that made no sense and the examiner had no way of understanding what they were trying to express. Therefore, it is very important to improve language skills specially in answering the theory questions.

#### **Question 01**

##### **Part (a)**

This was a simple question on identifying the legal personality of an incorporated company from its owners or shareholders.

A fair percentage of candidates were familiar with the principle and had stated that when a limited liability company is incorporated even with a single shareholder, that single owner/shareholder and the company are two different persons and not one and the same person. This is because when a limited liability company is incorporated, a separate legal entity comes into existence, which is different from its owners/the shareholders.

In given scenario, Sandun has sold 5,000 coconuts to Miller (Pvt.) Ltd (MPL) where he is the sole shareholder. He has obtained a fire insurance policy from ABC Insurance PLC covering the coconut stock, but the policy is in his personal name and not in company name. The coconuts were destroyed by a subsequent fire and Sandun intends to claim damages for the loss caused by the fire under the fire policy he has obtained from ABC Insurance PLC. Candidates were expected to discuss whether he will be able to successfully claim damages for loss on fire under the existing fire policy obtained in his personal name.

A few candidates had correctly identified the aforesaid position and explained that Sandun and MPL are not one and the same person but two different persons, although Sandun is the sole shareholder of the company. MPL is an incorporated legal body completely different from the owner/sole shareholder Sandun. The coconut stock is the property of MPL whilst the fire policy is in the personal name of Sandun. Therefore, ABC Insurance PLC does not have a legal obligation to pay compensation for a loss sustained by MPL on a fire policy held by its sole shareholder Sandun, as these are two different persons. The main reason for this is that Sandun has no insurable interest in the assets owned by MPL. Therefore, he cannot claim damages and MPL also cannot claim damages since it does not have an insurance policy.

Some candidates had quoted the relevant case law as well. *Macaura vs Northern Assurance* facts are similar to the case given in the question. Candidates who were able to focus their answers in those directions earned a fair percentage of marks, as they were conversant with the subject area and capable of analysing the situation correctly.

However, the majority of candidates were not competent in this area and had tried to write some answers based on their own assumptions. Many had failed to realise that the coconut stock was not the property of Sandun and was in fact the property of MPL (although Sandun is the sole shareholder of MPL). Since Sandun is the sole owner of MPL, candidates incorrectly assumed that he is also the sole owner of the property that belonged to MPL.

Some candidates had tried to explain various areas that were not relevant to the situation such as:

- i. When the company is incorporated, it will automatically become a juristic person; it will have its own name, separate legal personality, common seal, separate management and so on.
- ii. An incorporated company can enter into agreements, purchase property and can be sued in the name of the company.
- iii. When a company is incorporated it is treated as a separate person from those who created, own and manage it. Therefore the company is treated as a person capable of doing all of its activities on its own. The company is personally liable for its own activities/liabilities and the directors, shareholders, employees or anyone else.
- iv. When a company is incorporated, it is a separate legal entity and activities relating to the company should be performed using the company name since the law has created a legal personality by incorporating it as a separate body. The relevant legal case is *Solomon vs. Soloman*. Also, a veil of incorporation means that the company is separate from its shareholders and the shareholders cannot use the assets of the company for personal use, cannot act as an agent of the company and cannot claim anything that they wish to claim on behalf of the company.
- v. Sandun can claim from the insurance policy because he has obtained the policy in his personal name and capacity and not in the name of the company.
- vi. Before making a claim under the fire policy from ABC Insurance PLC for the loss sustained by Sandun, he should know as to what the veil of incorporation is.

Under these circumstances it was clear that candidates didn't even know the correct meaning of the veil of incorporation. In addition, they had provided the above irrelevant answers as they had failed to understand what was expected by the question.

## **Part (b)**

This was another easy question on the current position of a Company Secretary after the landmark decision given in *Panorama Developments Ltd. vs Fidelis Furnishing Fabrics Ltd* in 1971. This case is very important for accounting students since the ruling given has brought the position of the

Company Secretary to a higher level. It is now well known to any average accountancy student as the ruling given directly affects the position of the Company Secretary.

A fair percentage of candidates had some knowledge on the subject area and had provided some satisfactory answers. They were capable of realising the position of a Company Secretary before the ruling given in the Panorama case, and had explained that the Company Secretary was just similar to a clerk of the company and he/she had no authority to take important decisions on behalf of the company.

Some candidates were familiar with the view held by Lord Denning in delivering the decision of the Panorama case and had explained that the Company Secretary is no longer a mere clerk of the company but an officer with extensive duties and responsibilities. Therefore, he/she regularly makes representations on behalf of the company and has authority to enter into contracts relating to the day-to-day administrative matters of the company's business. Accordingly, he/she may be regarded as an officer with authority to do such matters on behalf of the company indicating that the Company Secretary has the ostensible or apparent authority to enter into an agreement on behalf of the company with third parties for which the company is responsible. Candidates who had provided answers based on these points obtained a reasonable percentage of marks for this easy question.

A similar or higher percentage of candidates were not very competent in building their answers based on the correct points and had focused their answers on various irrelevant/incorrect directions. They had wasted their time due to not understanding the question properly. Some irrelevant areas including were the following:

- i. According to the Panorama case, the Company Secretary was held liable due to misleading Fidelis Furnishing Fabrics Ltd. on the negotiable instrument drawn.
- ii. Per Section, 222, the Company Secretary of every company, which has turnover or stated capital exceeding the amount prescribed by the Act, shall have such qualifications as prescribed with regard to the nature of duties called upon to be discharged by him/her.
- iii. A Company Secretary deals with legal documents. Therefore, he/she should be a qualified and capable individual, and as per Section 222 (1) of the Companies Act every company should have a Company Secretary.
- iv. The first secretary of the company is appointed at the time the company is incorporated and he/she can act until he/she ceases to hold office under any provisions contained in the Articles of the company or till he/she is removed by the directors. The Articles of the company can include a rule as to how a secretary is appointed/removed.
- v. The Company Secretary manages the relationship between the board of directors and the owners/shareholders, and the directors take the latest successful decisions made by the Company Secretary. Therefore the Company Secretary helps the successful running of the company.
- vi. In terms of the provisions of the Companies Act, all the companies should appoint a Company Secretary and he/she must be one of the following:
  - (a) A citizen and ordinary resident of Sri Lanka.
  - (b) Any registered lawyer of supreme court/member of CA Sri Lanka.
  - (c) Member of the Institute of Chartered Secretaries & Administrators of Sri Lanka/Members of CIMA.
  - (d) Even a company or partnership can be appointed as a Company Secretary and there should at least be one director or partner complying with the above requirements.
- vii. A Company Secretary should have qualifications such as Attorney-at-Law/Member of CA Sri Lanka/ICMA (SL) or he/she should be a person who has undergone a course of administration and legal practice approved by the Minister, or a person who holds experience in the relevant field the Minister thinks is fit for the purpose. Directors do not require this many qualifications

in order to be a director of a company. This indicates the importance of the role of a Company Secretary. However there are exceptions and such Company Secretaries are not allowed to make contracts on behalf of the company.

The Company Secretary does not have apparent authority for the following:

- Borrow money on behalf of the company;
- Delete a name from the share register of the company.
- Call an AGM on his/her own authority..

## **Question 02**

This was a direct question on analysing the different types of companies that could be incorporated under Section 3 of the Companies Act No 7 of 2007. If the candidates explained the various types of companies that are permitted to be incorporated in Sri Lanka under the Companies Act along with their main features, they could have easily earned high marks by simply quoting the contents of Section 3 of the Act.

A minor percentage of candidates had discussed limited companies, unlimited companies, companies limited by guarantee, offshore companies etc., with their sub-divisions like private limited companies and public limited companies. The main features of unlimited companies and companies limited by guarantee and so on were laid down in the Act.

A handful of candidates had also discussed offshore companies along with their features. Out of these candidates, some had concluded that the most suitable company, which meets the expectations of Ajith and Sujith as per the scenario is a private limited company. Many others had expressed the view that a company limited by guarantee can be the most suitable type of company that will meet the requirements of Ajith and Sujith, but they failed to support their view with acceptable grounds.

Since it was an open book examination, candidates were able to provide satisfactory answers by referring to the Companies Act, which deserved reasonable marks. However, they must pay more attention to how they can follow the relevant sections of the Act (and collect appropriate details from it) with the help of the contents listed at the beginning of the Act.

Further, a large number of candidates had simply copied or repeated the question in different wordings/ways. They had also explained some irrelevant areas such as:

- i. Ajith and Sujith have to incorporate the company under the Companies Act No. 7 of 2007. The shareholders' main intention is to safeguard their personal assets by placing some limits on the amounts they are liable to the company in the event of future liquidation. This type of characteristics can be found in a company limited by guarantee. Any two or more persons are required to incorporate a company limited by guarantee. Therefore, the most suitable type of company for the purpose of Ajith and Sujith is a company limited by guarantee.

According to Section 32 of the Companies Act, two or more persons can apply to form a company limited by guarantee by making an application to the Registrar of Companies in the prescribed form signed by each of them. The Articles of Association, consent of initial directors and the consent of the initial secretary should be attached to the application.

- ii. When analysing the information given in the question, it seems that Ajith and Sujith are not willing to give ownership of the company to others and they intend to safeguard their personal assets by placing a limit on the amount they are going to invest. Their liabilities will



be limited to the amounts of the guarantee that they are going to include in the Articles of the company. Therefore, this may be the best company they can form for their purpose.

- iii. Another matter is that under Section 33 1(b), it is clearly mentioned that a company limited by guarantee shall have an Articles of Association that sets out the amount each shareholder of the company undertakes to contribute to the assets of the company in the event of it being put into liquidation. Eventually as per the information provided, the most suitable option is a company limited by guarantee when considering the features of it. Therefore, Ajith and Sujith should incorporate a company limited by guarantee.
- iv. The most suitable company for their purpose is a company limited by guarantee since it can be incorporated with two shareholders as per Section 32 of the Act. Also, the UK buyer only wanted Ajith and Sujith to be the shareholders. Further, under Section 40 of the Act, it will be better for promoting commerce as they are extending to promote exports and that can be included in the Articles, as the main object of the company.

Further, incorporating a company limited by guarantee will help them to limit their liabilities as per their wishes and also allow them to determine and agree on the amounts that they are willing to contribute when the company goes into liquidation as stated under Section 33 (b).

- v. A private limited company is the most suitable company for this purpose and publishing of financial statements is not compulsory. Further, there are no complex legal requirements like in public limited companies. In addition, if there is a unanimous agreement, they need not maintain an interests register.
- vi. Ajith and Sujith export t-shirts abroad and they are carrying on a partnership. However, their buyer will only deal with a company in Sri Lanka. They intend to safeguard their personal assets. Therefore they should register as an offshore company. An offshore company refers to a company registered in Sri Lanka that does its business outside Sri Lanka. Therefore, it is suitable for the purpose.
- vii. When a company is incorporated they can enjoy benefits such as:
  - Legal partnership (easy to raise capital)
  - Limited liability/limited share issues
  - Surmount existence
  - Separate management from the owners and separate name.
  - Future liquidation and so on

Candidates had wasted their time explaining the above areas as they had not properly understood the question and/or because they were not competent to produce acceptable answers for a question of this nature.

### Question 03

#### Part (a)

This part expected candidates to discuss the provisions laid down under Section 108 of the Companies Act relating to redemption of redeemable shares of a company at the option of shareholders. A fair percentage of candidates who were familiar with, or capable of referring to Sections 68 (1) (a) (b) and (c), had provided satisfactory answers. They had correctly stated that as per the Articles of Silvia (Pvt) Ltd., redeemable shareholders who held 10% of the stated capital had given prior notice to the company requesting to redeem their shares in keeping with the company Articles. Therefore the redemption of redeemable shares will take place on 31 December 2015 as specified in the notice given by the shareholders and as laid down under Section 68 (1) (a) of the Companies Act.

Further, they had identified that the shares, which are to be redeemed, have to be cancelled on 31 December 2015 since they are redeemed on that date, in keeping with provisions of Section 68 (1) (b) of the Act. Also they had dealt with the provisions of Section 68 (1) (c) of the Act (i.e. those shareholders whose shares are redeemed will be ranked as unsecured creditors of the company for the amounts payable to them until 31 January 2016 since only on that date will their dues be settled).

Candidates who had focused their answers on those aspects earned high marks or even the full marks allocated. However, other candidates were not familiar with the provisions of Section 68 or even competent to follow the Act. Even under an open book examination, candidates had completely failed to provide satisfactory answers for this easy/direct question. They had wasted their time trying to explain completely irrelevant areas such as:

- i. Redeemable shares should be redeemed at the option of those shareholders and the company is liable to redeem them. Details of such redemption should be notified to the Registrar of Companies 10 days after redemption of capital by way of Form No. 08.
- ii. Redemption of shares can be identified as one of the major type of share dealings in a company. There are 3 types of redemption of shares:
  - Redemption of shares at the option of the company
  - Redemption of shares at the option of shareholders
  - Redemption of shares on a fixed dateSilvia (Pvt) Ltd has identified two types of redemption of shares (i.e. the first two types).
- iii. The redemption of shares will result in a reduction of capital. Therefore, the company should perform this task by passing a special resolution (i.e. with more than 75% of votes for the reduction of capital).
- iv. Where the amount of any financial assistance approved under Section 70(8) together with the amount of any other financial assistance given by the company that is still outstanding exceeds 10% of the company's stated capital, the company shall not give any further financial assistance unless it first obtains a certificate from its auditor (or if it does not have an auditor, from a person qualified to act as the auditor). He has to inquire into matters that affected the company before issuing the certificate.
- v. Under Section 59 of the Companies Act, the board of directors are empowered to obtain a certificate of solvency from the auditor of the company. If the company has sufficient profits, it is not required. Therefore, a reduction of 60% of capital at the option of shareholders can be implemented.
- vi. This is a redemption at the option of the company because they wanted to redeem the shares before the fixed date (31 January 2016). The redemption can be done if the board had previously determined that the redemption is in the interest of the company.

- vii. Since the redemption is done by giving prior notice to the shareholders on a specific date, this can be considered the most suitable method of redemption out of the methods of options available for redemption of shares by shareholders. Further, if the company wants to reduce the redemption of shares amounting to 10%, the company must approve it by passing a normal resolution (general resolution). Redemption of shares will decrease the stated capital but earnings per share will increase since the total number of shares decreased.

It appears that candidates had failed to understand as to what was expected from the question.

## **Part (b)**

This part expected the candidates to discuss the procedure that should be followed by a company in reducing its stated capital as laid down in the Companies Act. A large number of candidates were aware of the contents of sub-sections 59 (1), (2), (3), (4) (a) (c) and (5) of the Companies Act, which contained provisions to be followed in the reduction of stated capital of a company. They had dealt with all or some of the following provisions in relation to reducing the stated capital of a company.

Section 59 (1) - A special resolution has to be passed for the purpose.

Section 59 (2) - Giving public notice to ensure that the persons dealing with company are aware of such decision of the company to reduce its stated capital at least sixty (60) days prior to passing the special resolution for the purpose.

Section 59 (3) - Under this sub-section the company is required to enter into agreements with all its creditors agreeing to obtain their consent prior to reducing the stated capital, otherwise the resolution passed for the purpose will not be valid and will be of no effect. In the given scenario, this requirement has already been fulfilled.

Section 59 (4) (c) - The board of directors should obtain a certificate of solvency from its auditors and then pass a board resolution to reduce the stated capital of the company by the amount by which the company would fail to satisfy the solvency test.

Section 59 (5) - the details of the reduction in stated capital (i.e. the amount of reduction and the amount of reduced stated capital) must be communicated to the Registrar of Companies using Form No.08 within ten(10) working days of such reduction.

Candidates who had satisfactory knowledge in stated capital reduction or those who had carefully referred to the Companies Act provided some satisfactory answers, which deserved good marks.

However, there were many others with a lack of knowledge on the subject area and/or not capable of following the relevant sections in the Companies Act. They had provided various irrelevant or incorrect answers such as:

- i. For redemption of the further 15% of stated capital, the company should take the following steps:
  - The board should resolve that the redemption of shares would be in the interest of the company and it would satisfy the solvency test after redemption.
  - The board should call a meeting of the shareholders by giving 15 working days' notice. The shareholders should approve the redemption of shares.
- ii. The redemption will be done on a pro-rata or non-pro-rata basis. If it is a non-pro-rata basis, the company should make sure that it will not affect shareholders whose shares were redeemed and well as those whose share were not.

- iii. The proposed redemption of shares amounting to 15% of the stated capital relates to ordinary shareholders. Therefore, the board of directors should inform the shareholders about this situation. After receiving written consent of the shareholders, the company can retain the shares by paying money for them. Also, the board of directors should inform at a general meeting (before deciding to reduce the share capital) that they have received approval from the company's auditors. If the company fails to fulfill this requirement, it will be guilty of an offence and be liable on conviction to pay a fine not exceeding Rs. 50,000, and every officer of the company who is in default shall be guilty of an offence and be liable for a fine not exceeding Rs. 50,000.
- iv. The company can exercise an option to redeem shares, which are redeemable at the option of the company, had the board previously resolved the redemption is in the interest of the company.
- v. A company may agree to purchase or otherwise acquire its own shares if the Articles of the company has provided for it with approval of the board. Before the company offers or agrees to purchase its own shares the board of directors of the company shall resolve that the company has followed the procedure that should be followed under the Companies Act to reduce the stated capital by a further 15%.
- vi. The company can reduce 10% of redeemable shares. However, if the company further decreases 15% of its stated capital, the total capital reduction that affects the value of cost of capital will increase, and the dividend per share will increase too as shareholders' income is now at more risk.

Some candidates had given the answer for part (a), which was applicable to part (b), and vice versa. A few others had repeated the question without producing an answer to the question or had explained unnecessary details regarding passing of special resolutions (the process followed is passing a special resolution at an extraordinary general meeting etc.). A handful of others who were not capable of distinguishing or identifying the differences between "redemption of redeemable shares" and "reduction of stated capital" had provided answers under the incorrect part of the question.

## **Question 04**

### **Part (a)**

This part of the question expected candidates to discuss the provisions laid down under Section 144 of the Companies Act relating to passing of a resolution by shareholders in writing known as a 'circular resolution'. As Section 144 had clearly laid down the procedure to be followed in passing a circular resolution, this was a simple and straightforward question, which could have been answered with no difficulties under an open book examination by referring to the Act.

A small percentage of candidates had correctly explained that if a resolution is in writing, signed by at least 85% of the shareholders entitled to vote at a meeting of the shareholders, and who together hold at least 85% of the votes entitled to vote on such a resolution, then it is treated as a validly passed resolution under the Act as laid down under Section 144. Also they had realised that if the resolution referred in the given scenario could be put in writing and signed by at least 85% of the shareholders (since they have equal voting rights), then the said resolution could be treated as a validly passed one even though no meeting of the shareholders was held by giving prior notice for the resolution. When 85% of the shareholders are considered, it would be all 5 shareholders as 85% of 5 shareholders will come to 4.25 shareholders.

Section 144 (5) of the Act gives the power to a company to pass a circular resolution of the shareholders with no prior notice as required to pass a special resolution. Candidates who were competent to focus their answer in those directions provided acceptable answers.

However, the candidates who were not able to focus their answers in correct directions failed to provide acceptable answers even by referring to the relevant section of the Act. They had explained or discussed various irrelevant areas instead of discussing the provision given under Section 144 of the Act. The areas covered by their answers included the following:

- i. A company may wind up voluntarily when the period fixed for the duration of the company (if any) by its Articles has expired. When the company passes a resolution for voluntarily winding up, it shall within 14 days from the date of passing the resolution give public notice by publishing in the gazette.
- ii. Section 319 of the Act states that if the company at a general meeting has passed a resolution for voluntarily winding up the company, it will be a valid winding up.
- iii. The resolution passed by Harrison (Pvt) Ltd is known as a "Resolution passed at an adjourned meeting." When a company has passed a resolution at an adjourned meeting, it will be treated as a resolution passed on the date on which it was in fact passed, and not as a resolution passed on an earlier date.
- iv. If a company is to wind up when its fixed period of duration (if any) has expired, the company has to pass an ordinary or special resolution at a general meeting and appoint a liquidator to carry on the affairs of the company. However, Harrison Pvt. Ltd states that they do not have sufficient time for that. As they have not passed a resolution they are liable to pay a fine. Further they have to take the following steps:
  - Call an extraordinary general meeting and pass the special resolution with majority of 75% of shareholders.
  - Appoint a liquidator after passing the resolution.
- v. In terms of Section 267 (1) of the Companies Act, it cannot wind up voluntarily. Section 325 has described the provisions relating to a shareholders voluntarily winding up and Section 326 details the powers given to a company to appoint and fix remuneration of the liquidator.
- vi. The company should have passed a resolution for voluntarily winding up, and within 14 days from passing the resolution it should wind up the company. Otherwise the company is liable to a fine. To avoid this situation under Section 320 (3) of the Act, the liquidator of the company shall be deemed to be an officer of the company.
- vii. Any voluntarily winding up shall be deemed to be communicated at the time of passing of the resolution for voluntarily winding up. Since there is no time, a special resolution can be passed by the majority of 75% of those shareholders entitled to vote for the special resolution referred to in the question. Therefore, Harrison (Pvt.) Ltd. should pass the special resolution for voluntarily winding up of the company.

## **Part (b)**

This part of the question required candidates to discuss the powers vested by a liquidator in relation to the sale of immovable property of the company, which is under liquidation. This too was a simple and direct question and if the candidates had referred to Section 292 of the Act, they could have easily provided acceptable answers since it is all explained in the Act.

Some candidates were on the correct direction and discussed the relevant provisions laid down in the Act. In those answers, they had explained that the liquidator has the power to sell immovable property after taking custody of the property to his hand. Further, the liquidator can transfer the ownership of the property to any person or company who is the buyer. The liquidator has the authority to execute the deed of transfer when the sale is effected and to place the common seal of the company on such deeds on behalf of the company under liquidation. In addition, he is empowered to accept the payment in any form on behalf of the company, to distribute the proceeds collected as applicable and to accept shares etc. offered by the buyer in consideration for the sale effected by him on behalf of the company, which is under liquidation.

Candidates who were capable of focusing their answers on those directions earned a fair percentage of marks as they had disclosed their knowledge in the subject area tested. However, there were many others who had not correctly understood the question or had not properly read the question. Therefore they had focused their answers in various irrelevant directions despite the fact that they had the ability to go through the Act while answering the question and produce correct answers under this open book examination. Those answers had dealt with some areas such as:

- i. Dimuthu is the liquidator of the company and he has the power to bring or initiate any action or to follow other legal proceedings in the name and on behalf of the company for:
  - Carrying on the business of the company. So far, as may be necessary for the winding up of the company.
  - To appoint an Attorney-at-Law to assist in performing his duties as the liquidator
  - To pay any class of creditors in full
  - To make a compromise or arrangement with creditors
- ii. According to the situation, Dimuthu was appointed as the liquidator of the company and he plans to sell the company land in Angoda. Therefore, he has to appoint an Attorney-at-Law to assist him in the sale of the land since there are legal activities involved in the sale of the land.
- iii. Under the given situation it can be assumed that the liquidator is qualified, and in a winding up by court he shall have powers including the power to sell assets of the company on the option of it by public auction or on private contract, and the power to transfer the whole or part thereof to any person or company or to sell a part of it.
- iv. Dimuthu can be appointed as the liquidator only by passing a resolution and since the liquidator has been appointed by the director, he has the power to do anything that is relevant to winding up of the company (Section 292). Also, he can exercise his own power empowering the liquidator to sell the movable and immovable property in a future auction or on private contract. Therefore he has 100% power given by the Companies Act to sell the company land and since it is not a major transaction there is no need to have an AGM and obtain the consent of 75% of the shareholders.
- v. In case where the liquidator is not appointed by court, the official receiver shall be the liquidator of the company.
- vi. As per Section 288, in winding up of a company by court, a person other than the official receiver is appointed as the liquidator and that person:
  - (a) shall not be capable of acting as the liquidator until he has been notified of such appointment.
  - (b) shall give the official receiver such information and such powers of access to forcibly inspect the relevant documents of the company in general and such other acts as may be required to carry out his duties under the Act.
- vii. Dimuthu can act as the liquidator as he is not a person below the age of 18 years and not a creditor or shareholder of the company (Section 383).

## Question 05

### Part (a)

This part required candidates to explain the dematerialisation of securities in the CDS and the difference between the two terms “Intra Account Transfer” and “Inter Account Transfer” in CDS.

These were straightforward questions from the study text. Candidates who had studied the study text had provided some satisfactory answers, which deserved good marks. In those answers, they had explained that when an account holder at the CDS changes his/her participant or the broker it is called as an “Intra Account Transfer” whilst if an account holder transfers the securities held by him/her at the CDS to another party or person outside the trading procedure it is called “Inter Account Transfer”.

Only a minor percentage of candidates were able to focus their answers on those correct directions. Many had provided irrelevant answers covering areas such as:

- Central depositing system is the system, which is available to the investors of the stock exchange and it is a part of Colombo Stock Exchange (CSE). Through the central depository system, investors will be able to do transactions immediately. The investor will not get a certificate but the transaction would be recorded in the CDS. Transfers, purchase of shares, and allied transactions can be done efficiently, quickly and easily.
- The following steps will be involved in decentralising the process:
  - Participant would deliver securities to the CDS for transfer sale and so on.
  - CDS makes an electronic record of the share transaction.
- Depositing of securities in the CDS may not require the creation of an account in the CDS.
- CDS is the depository system for all the securities listed in the CSE.
- CDS facilitates the post-trade settlement in respect of equity debt transactions.
- The same board of directors of the CSE serve as the directors of CDS (Pvt) Ltd.
- 21 member firms of the CSE are licensed by the Securities and Exchange Commission. The balance 15 members are not licensed.
- A private company wholly owned by the CSE is responsible for all securities listed under the CSE and it is registered as a market intermediary.

An intra account transfer is where the account holder of an investment who can be a stock broker or stock dealer of the shareholder will be transferred as per the CSE guidance of the Securities and Exchange Commission.

An inter account transfer is where the account holder/trader can be charged according to the rules and regulations of the SEC, but it will be outside the CSE.

An intra account transfer is a transfer within the same account and a CDS inter account transfer is a transaction transferring with internal accounts in the CDS.

Certain statements included in some answers made no sense and were simply wordings without a reasoning. Candidates had wasted time as they were not competent to provide satisfactory answers for this question.

## Part (b)

This was another easy question directly from study text covering the Mediation Board Act No. 72 of 1988 (explain four general characteristics of mediation).

A few candidates had some idea on the general characteristics of mediation as they had studied the subject area. Accordingly, they had stated that mediation is a process where the parties of the dispute get the assistance of a neutral third party, to act as the mediator or the facilitating intermediary. Mediation is a non-binding mechanism of dispute resolution without involving the court system, and no party is legally binding on the decision given by the mediator, as he has no authority to make such legally binding decisions. In dispute resolution, the mediator uses various procedures, techniques and skills to help the party in settling the dispute, negotiating an agreement with no adjudication.

Further, the mediation calls upon the parties themselves to provide a non-binding evaluation of the merits of the dispute, but that too will be a non-binding decision. The mediator can explain to the parties the probable outcome of the failure to mediate and if litigation or arbitration is to follow.

The mediator is appointed by the parties, and the procedure or process to be followed is usually at the discretion of the mediator and the parties themselves. Usual practice dictates the parties to forward to each other and to the mediator a summary of the key facts and issues on which the dispute resolves and thereafter the parties meet with the mediator to resolve the dispute. Some candidates had based their answers on the above lines to discuss the general characteristics of mediation disclosing their knowledge on the subject area and earned a fair amount of marks.

However, the majority of candidates had no knowledge in the area tested or failed to understand the question properly. They had focused their answers in various incorrect/irrelevant directions and provided some answers such as:

- i.
  - A mediation board consists of three members who are specialised in the relevant field.
  - A settlement reached by the mediation board is not enforceable in a court of law unless it was referred to the mediation board by court.
  - A statement of non-settlement will be declared by the mediation board if parties do not reach a settlement or if one party does not abide by the procedure of mediation.
  - A minimum of 3 months is given by court to the mediation board in order to reach a settlement for the dispute referred by the court.
  - The main object is not to give a decision but to resolve the dispute through co-operation.
- ii. A mediator is a third party to consult or obtain advice from regarding any disputes between two parties without going to court. It is a civil dispute resolution method.
- iii. Characteristics of mediation are:
  - Promote wider acceptance of mediation and settlement of commercial disputes.
  - Encourage parties to resolve commercial disputes through mediation.
  - To conduct a facilitating process for settlement of commercial disputes.

Candidates had wasted their time trying to explain these irrelevant areas, as they were not familiar with the general characteristics of mediation.

## Question 06

Most of the candidates made a good attempt at the question and the overall performance was satisfactory. The majority scored over 50% of the allocated marks. There were some excellent answers and a few candidates obtained 20 or more marks out of the allocated 25 marks.



Most candidates displayed good application skills in constructing the structure of the answer and in identifying the contents of:

- the income tax computation of a corporate entity, and
- the computation of distributable dividend

Majority of the candidates demonstrated sound subject knowledge in the application of tax law in relation to:

- sections 25 and 26 of the Inland Revenue Act – allowable and disallowable expenses and charges.
- computing the statutory income from the trade of a company.
- computing the distributable dividend statement.

Where mistakes were made, they generally related to:

### **Improper reading of the question**

- new computers were purchased before selling old ones. A good number of candidates treated this as a replacement.
- it is clearly stated that the key money paid on the rented building is Rs. 600,000. A few candidates had taken the monthly rent (Rs. 60,000) as the key money.

### **Lack of subject knowledge**

#### **Part (a)**

A good majority appeared to be ignorant of the provisions of Section 106 (ii). They gave different general answers like maintaining separate accounts will facilitate ascertainment of profit from exports and local sales separately.

#### **Part (b)**

#### Trade income

- The question clearly stated that new computers were purchased before selling the old ones. However, a good number of candidates treated this as a replacement.
- Insurance claim received – a few candidates mentioned this as a capital receipt and therefore assumed it was not liable to tax.
- Foreign travel – a good number of candidates limited the deductibility to a maximum of 2% of statutory income of the previous year, ignoring the fact that such expenditure is wholly deductible if incurred in connection with export promotions of any article.
- Expenditure in providing housing benefits to employees – only a few candidates provided fully correct answers. Others appeared to be confused and made mistakes at various stages in the computation. E.g. deducting the employee's benefit from gross rent paid without first selecting the higher of gross rent paid and rental value of the house.
- Interest received from treasury bills – a few candidates mentioned that this is not liable since withholding tax has been deducted.

### Tax liability

- a few candidates applied the 28% tax rate for the entire profit, ignoring concessionary rates applicable to exports and s.59B undertakings.
- majority of candidates failed to include tax on dividend declared.

### Tax credits

A few candidates claimed the PAYE tax paid.

### **Part (c)**

Minimum distributable dividends:

- a few candidates deducted the depreciation allowance claimed in the tax computation.
- a good number of candidates included tax payable on all dividend declared in the computation.

### **Question 07**

The question tested four (04) areas of taxation in relation to a trade association, namely:

- (a) Income tax liability
- (b) Value Added Tax (VAT) and Nation Building Tax (NBT)
- (c) Provisions regarding the filing of VAT and NBT returns and the payment of such taxes as per the respective statutes, and
- (d) Consequences of not filing the tax return on or before the due dates

Majority of the candidates scored over 40% of the allocated marks. However, only a very few (about 2%) scored over 20 marks for the allocated 25 marks. Subject knowledge in relation to VAT and NBT was very inadequate.

### **Part (a)**

The overall performance was quite satisfactory. Most candidates made a good attempt at the question and scored over 50% of the allocated marks. There were some excellent answers and a few candidates scored over 10 marks out of the allocated 11 marks.

Majority of the candidates displayed sound subject knowledge in relation to taxation of a trade association.

Where mistakes were made, these generally related to:

### **Lack of subject matter**

- A few candidates, though they correctly identified that the association was carrying on a business, were confused as to the basis of taxation. Some mentioned that the association was liable to tax on both business and other income whereas some mentioned that it was liable only on other income.

- A few candidates commenced the computation of trade income with turnover and thereafter deducted allowable expenses. This approach, although cannot be rejected, is tedious and a waste of valuable time at the examination.
- Business income – a good number of candidates claimed the depreciation on the van assuming that it is used for business travelling.
- Rent income – a few candidates computed this on the cash basis instead of the accrual basis.
- Dividend and interest income – a good number of candidates failed to mention that these are not taxable further since the final tax has been paid.
- Qualifying payment – a good number of candidates claimed the actual expenditure instead of restricting the claim to the maximum claimable.
- A good number of candidates claimed the tax-free allowance, which is available only to individuals and charitable institutions.

### **Part (b)**

- Majority of the candidates demonstrated sound knowledge in the basic concepts of the VAT computation.
- A good number of candidates computed output VAT for 12 months instead of for a quarter. This is a prime example of poor reading of the question.

### **Part (c)**

This question required candidates to explain the provisions regarding the filing of VAT and NBT returns and the payment of such taxes. A good number of candidates answered taking VAT and NBT together instead of dealing with each tax individually since different provisions are apparently applicable to each tax but both were dealt with together..

## **KB4 – Business Assurance Ethics & Audit**

**December 2015**

### **Examiner's Comments**

#### **General comments**

This paper consisted of seven compulsory questions, based on the study text. There were two parts; Section 1 containing five questions (carrying 10 marks each) and Section 2 containing two questions (carrying 25 marks each).

Majority of the candidates attempted all the questions. However, there was some evidence of time pressure where some parts were left unanswered. This appeared to be due to a lack of knowledge or poor examination techniques as opposed to actual time pressure.

The following weaknesses were observed:

- Writing too little for the marks available
- Not managing time effectively
- Wasting time writing lengthy answers
- Identifying issues but not explaining them as required
- Lack of analytical skills
- Illegible hand writing
- Not following action verbs
- Not planning the answer and as a result failing to answer the actual requirement (which resulted in irrelevant answers).

The average performance was very poor. Only 15% of the candidates were successful at the examination. If the candidates had studied the study text, they could have easily secured the pass mark.

## Question-wise comments

### Question 01

The candidates were expected to explain threats to independence and objectivity of the members, based on the given scenario. Majority had written correct answers, but some had explained the issues in the scenario without identifying the exact threat.

#### Part (a)

Some candidates had referred to the intimidation threat and the advocacy threat. There were some answers carrying all possible threats without identifying the exact threats. There were some other answers that overlooked the familiarity threat created by Saman who has been a team member for the last five years, and referred to the familiarity threat with regard to the finance manager who was the audit manager last year.

#### Part (b)

This part was answered well but there were some irrelevant answers such as:

- Change the partner
- Prohibit Saman from joining the bank
- Give up the audit

### Question 02

This question was aimed at testing the knowledge of candidates on internal control procedures. The candidates should have known the internal control procedures at a compromising control environment, control activity, and procedures adopted by the directors/management in order to achieve objectives, efficient conduct of business including adherence to internal policies, safeguard of assets, declaration of frauds and errors, accuracy and completeness of accounting records in a timely and reliable manner. Candidates were expected to recommend the internal control procedure for fixed assets and petty cash of the company, which is in the construction business.

#### Fixed asset management

It was disappointing to note that candidates did not have knowledge about the fixed assets register. Almost everyone did not have knowledge on the commissioning of fixed assets. The internal control procedures were expected, not the audit checks. Most candidates had misunderstood the question requirement and written irrelevant answers such as:

- Check the lease agreement
- Check depreciation calculations
- Check valuation methods
- Check approval for purchase

#### Petty cash management

The internal control procedure with regard to petty cash management should be to prevent frauds or thefts. The answers were not satisfactory. It reflected that candidates had no idea about petty cash. Most of them were clueless about IOUs, had written the audit tests to be carried out and had ignored the scenario. There were irrelevant answers such as:

- Maintain a petty cash book (without mentioning the petty cash imprest, which is the most important internal procedure in petty cash management)
- Deposit daily receipts with the bank
- Prepare bank reconciliation

### **Question 03**

The aim of this question was to test the knowledge of audit reporting. It was based on Chapter 18 in the study text.

#### **Part (a)**

Candidates were expected to outline factors that an auditor should consider when incorporating an emphasis of matter paragraph. The auditor has to form an opinion in accordance with the applicable reporting framework.

Candidates should know as to why the auditor incorporates an emphasis of matter paragraph. Most of them had not understood the question. They had written irrelevant answers such as:

- Assess the materiality of the destroyed factory
- Estimate the loss to the company
- Assess the going concern issue
- Collect sufficient evidence with regard to the destroyed factory
- Check related party transactions

#### **Part (b)**

Candidates were required to differentiate between an emphasis of matter paragraph and an other matter paragraph. Many had not understood the question and as a result the answers were very poor. It implied that the candidates had not studied the study text. Most were unable to differentiate the two paragraphs. They have written irrelevant answers such as:

- the emphasis of matter paragraph is with regard to huge matters in the financial statements
- the other matter paragraph is for non-financial matters.

#### **Part (c)**

Candidates were expected to discuss the impact of the incidents in the scenario on the audit report. Most were unable to identify the impact of the destroyed factory. They should have been able to understand the gravity of it as it is a major catastrophe, and users of the financial statements should know about the damage. If that had been disclosed in the financial statement the audit report should contain an emphasis of matter paragraph. If not, the report should be qualified. Candidates had instead written;

- Loss of the inventory and plant and machinery should be estimated and adjusted in the financial statements
- Estimate the insurance claim
- Obtain evidence with regard to the destroyed factory

## **Question 04**

### **Part (a)**

This question attempted to test the knowledge of candidates on audit procedures. It asked to identify audit procedures used in the given scenario in order to gather audit evidence. This question was based on Chapter 10 in the study text. As per SLAuS 500, the auditor must design and perform audit procedures to obtain sufficient and appropriate audit evidence. Some candidates had written general audit procedures without referring to the scenario. Some had written irrelevant answers such as:

- check internal control procedures to gather evidence
- compare sales orders with receipts in order to gather audit evidence

The answers reflected that candidates were unaware of the methods of inquiries, recalculation, re-performance, obtaining confirmation, and analytical procedure to obtain audit evidence.

### **Part (b)**

Candidates were required to outline the concerns that the audit senior would raise during the review procedure. Answers were expected to be based on the scenario. The audit senior is expected to prepare a complete set of working papers, detailing the tests carried out and the evidence obtained. Candidates were unable to demonstrate good knowledge in reviewing the working papers.

## **Question 05**

### **Part (a)**

Candidates were required to outline the internal controls implemented at the client's office and their control objectives. The scenario was expected to be referred to in the answer. If the candidates had studied Chapter 6 in the study text, they could have easily answered this question. They could have simply picked the answers from the question itself if they knew the internal controls. Most of the candidates failed to identify the relevant internal controls for the given scenario.

### **Part (b)**

Candidates were required to outline test of controls to check the design and operating effectiveness of the internal controls. Test of controls are audit procedures designed to evaluate the operating effectiveness of controls in preventing, directing, correcting material misstatements at the assertion level. Candidates could have referred those to the scenario. Most of the candidates were unable to produce satisfactory answers. There were common irrelevant answers such as:

- Check sales orders with the cash book
- Observe internal control procedures
- Inquire from staff

## Question 06

Performance on this question was very poor. Only about 20% of the candidates obtained about 10 marks out of the 25 marks allocated.

### Part (a)

Candidates were asked to prepare an analytical review of the given draft financial statements. Although it was easy to calculate the variance on the question paper itself, they had wasted time in rewriting the figures and calculating the variances. Although most had understood the question, they had not done a comprehensive variance analysis, which resulted in poor marks. As the question was on risk assessment, a comparison between the years was expected and the candidates should have anticipated this when two years' performance was given. Some candidates had prepared a ratio analysis including gross profit ratio, current ratio and gearing ratio. This implied that they had come to a conclusion without planning the answer.

### Part (b)

Candidates were required to assess the possible risk areas. This type of question had been there almost every year. It was disappointing to note that the candidates' knowledge in audit risk is very poor. Some have written business risks instead of audit risks. Although the candidates were able to identify the risk area in the given scenario, they were unable to link that with the audit risk. It reflected that they lacked the theoretical knowledge, or the ability to apply what they had studied. Most had written irrelevant answers such as:

- Increase in distribution expenses does not have an impact on sales
- Production of low quality products results in sales reduction
- Loss of key customers affects the debtors balance
- Loss of key personnel affects fraudulent sales

### Part (c)

Candidates were required to outline possible audit responses for the assessed risks. They should have had the knowledge gained from studying the study text or SLAuS 330. Common answers were:

- Check inventory valuation
- Check board minutes
- Check the disclosures in financial statements
- Check accuracy of ageing customers
- Call for confirmation

Majority of the candidates had not written the audit responses against the audit risks. They could have coupled both answers and saved time, if they had planned the answer.



## Question 07

This question consisted of six parts and it was based on the scenario. The purpose of this question was to assess the acquired knowledge in a practical situation. Most of the candidates had understood the question, but they had not presented the answers in accordance with the given scenario. Most candidates had also not followed the action verbs.

### Part (a)

Candidates were required to demonstrate the advantages of CAAT software. Examples were expected to prove the points. Candidates demonstrated a good knowledge in CAAT software. However, it was disappointing to see that they were unable to prove their points with examples.

### Part (b)

This part attempted to test the knowledge on audit procedures in order to reduce the risk arising from related party transactions. Candidates were unable to demonstrate good knowledge on audit procedures. Only 10% of the candidates understood the question and wrote that the auditor should check the joint venture agreement, which is the most important document to check related party transactions. Common answers were:

- Check board minutes
- Inquire from management

Candidates did not demonstrate good knowledge in related parties. Some had written, as an audit procedure, that the auditor should check a sample of invoices to identify any favorable rates applied to any customer in order to reduce the risk. It was disappointing to see such basic answers at a business level examination. Candidates should plan their answers using a broad aspect. They should know that different rates can be applied not only for related parties; it could also be due to so many other reasons.

### Part (c)

(i) Candidates were required to discuss the auditor's responsibility with regard to the lawsuit filed by the Pradeshia Sabha. The question aimed to test the knowledge of candidates on the auditor's responsibility in a practical situation that was related to subsequent events. It appeared that candidates did not understand the question's requirement.

(ii) Candidates were expected to outline audit procedures the auditor could perform for subsequent events. Some have written, "request the management to comply with the regulations, if not qualify the audit report". They were unable to recognise the issue as a subsequent event.

Although these two parts were related to one issue, candidates were expected to look at them in different angles. Majority had answered both together. Common answers were:

- Discuss with the management
- Make inquiries
- Read board minutes

### **Part (d)**

Candidates were required to list financial and non-financial indicators that cast doubt on the going concern of the company. There were satisfactory answers. However, there were some irrelevant answers as well such as:

#### Financial

- Unable to pay loans
- Assets will be seized by the bank
- Joint venture income

#### Non-financial

- Key management person left the company
- IT system is not compatible
- Loss of major markets
- Government rules
- No proper management

### **Part (e)**

This part was also in relation to the going concern issue. It required candidates to write the audit procedures to evaluate the validity of the going concern in relation to the indicators identified. Most of the candidates had answered this question in isolation, without referring to the financial and non-financial indicators. They could have saved time if they had coupled both. There were common answers such as:

- Forecast future cash flows
- Carry out a solvency test to ensure assets are sufficient to pay the liabilities
- Obtain a comfort letter from the parent company

There were some irrelevant answers such as:

- Identify indicators relevant to the going concern issue
- Check current ratio
- Check the joint venture agreement to assess how the profits are distributed

### **Part (f)**

Candidates were expected to outline factors to be considered when evaluating the reliability of data. This question was based on the study text. 80% of the candidates had answered well, but some had not understood the question and wrote irrelevant answers such as:

- Whether the given data consists of all the information
- How, from whom, from where the data is generated?
- Check the estimates used
- Check the integrity of management
- The company is struggling to breakeven, but both the GP ratio and net profit ratio have increased. This implies that there is something wrong with the information.

## **KB5 – Business Value Creation**

**December 2015**

### **Examiner's Comments**

#### **Question 01**

##### **General comments**

The overall performance on this question was satisfactory.

Part (a) – Required candidates to differentiate threshold competencies from core competencies.

Part(b) – Required candidates to apply the VRIN framework to the given scenario to assess each of the competencies.

#### **Part (a)**

Some candidates correctly identified threshold competencies (TC) as activities/processes needed to meet minimum requirements of an organisation to compete and survive in the market. Core competencies (CC) on the other hand are activities that a competitor finds difficult to imitate, which will result in developing a competitive advantage. Five employees being trained in software development and winning international awards for software development are examples for TC and CC respectively. A few candidates got confused and meant CC for TC and vice versa. Anura's strong leadership style was incorrectly identified as a TC, instead of a CC.

#### **Part (b)**

Value, Rarity, Inimitability and Non-substitutability are descriptions of the acronym VRIN. A few candidates were unable to provide the correct word for each letter in the acronym. Some incorrectly identified "Spacious building and facilities" as a "rare" resource. According to some candidates, the leadership style of Anura could be imitated, which did not earn marks.

## Question 02

### General comments

The overall performance on this question was satisfactory.

The question required candidates to demonstrate possible methods for improving the supply chain activities of RSL.

Some candidates correctly provided acceptable solutions to the issues identified. Negotiations with existing suppliers for reduced prices, implementing a JIT system, implementing an EDI system and online sales were some of the solutions provided. Some candidates simply mentioned answers like “develop technology, communications, online transactions” without elaborating, and as a result, they were unable to earn adequate marks.

## Question 03

### General comments

The overall performance on this question was not that satisfactory.

Part (a) – Required candidates to assess quality costs, giving examples from the garment industry.

Part (b) – Required candidates to discuss the applicability of the two concepts in TQM in relation to the given scenario.

### Part (a)

Prevention costs, inspections and testing costs, and internal and external failure costs were identified by some candidates correctly with examples. A few candidates were unable to mention what each type of cost meant and a few incorrectly identified raw material cost, employees cost, distribution cost etc. as quality costs.

### Part (b)

Zero defects and “Get it right the first time” are the two concepts in TQM. Some incorrectly stated Reliability and Relationship as the two concepts in TQM. Only a few mentioned the fact that Marks Garment (Pvt) Ltd may face difficulties in applying the zero defects concept since it is a labour-intensive business.

#### Question 04

##### General comments

The overall performance on this question was not that satisfactory.

Part (a) – Required candidates to discuss the problems when undertaking the new product development given in the scenario.

Part (b) – Required candidates to outline the stages that customers would pass through as per the innovation diffusion model.

##### Part (a)

Only a few candidates correctly identified the potential problems in “Organisation and management”, “Finances”, “Evaluation and control” and “Cultural issues”. Out of those who had identified the issues, only a few had appropriately discussed the problems. For example, under “Organisation and management”, trivial matters like the R&D department should be headed by an experienced person in the relevant field, rather than the need for proper coordination between sales, marketing and manufacturing departments being highlighted.

##### Part (b)

Only a few candidates outlined the five stages, namely “Awareness, Interest, Evaluation, Trial and Adoption”. Some described the stages of the product life cycle (i.e. introduction, growth, maturity and decline), which earned no marks.

#### Question 05

##### General comments

The overall performance on this question was not that satisfactory.

Part (a) – Required candidates to contrast the two cultures before and after the arrival of the new CEO.

Part (b) – Required candidates to discuss the application of Lewin’s Three Stage Model for the proposed changing process.

##### Part (a)

Before the arrival of the new CEO, role culture was in existence where jobs and responsibilities were clearly defined. After the new CEO’s arrival, a person culture existed where he believed he was superior to the organisation and his expertise will drive the organisation. He also ignored others in the organisation. However, most candidates incorrectly stated that the new CEO exercised duties under the power culture. A fair number of candidates were of the view that both person culture and power culture meant the same meaning.

## Part (b)

A fair number of candidates were able to identify the three stages as Unfreeze, Movement and Re-freeze. However, they were not able to explain the stages as expected. For example, the unfreeze stage is the process of finding a way to get people to end their resistance to change. However, some candidates just mentioned that Awareness programmes need to be conducted in the unfreeze stage without the resistance aspect being addressed, which earned only a few marks. Some candidates just named the three stages as the answer.

## Question 06

### General comments

The overall performance on this question was not satisfactory.

Part (a) – Required candidates to explain how “Berry Story”, the company given in the case, can position the brand in the European and Sri Lankan markets.

Part (b) – Required candidates to discuss the importance of brand equity and how it is protected.

Part (c) – Required candidates to analyse distribution channels and management options available to Berry Story.

Part (d) – Required candidates to analyse different promotional methods.

## Part (a)

Berry Story could use “fair trade” and organic labels to show the product is environmentally friendly. Compliance with ISO 14001 and ISO 9001 standards could further add to the market positioning favorably as mentioned by some candidates who obtained the full marks allocated. A few stated that since Sri Lankans are concerned about price, Berry Story could position the product by charging a low price without mentioning the need for/concerns over environmental standards, which earned no marks.

## Part (b)

Selling the product better, successful extension of the product line including selling in overseas markets, successful implementation of marketing programmes such as CSR projects were some of the advantages (importance) of brand equity mentioned by some candidates who scored the full marks allocated. They further stated that by maintaining quality standards and by taking legal action for imitating the brand, Berry Story could protect the brand. Some did not mention this fact.

## Part (c)

Only a few explained that selective distribution, exclusive distribution and direct distribution could be used by Berry Story, and that an extensive distribution channel is not recommended. Some candidates just listed out options available without explaining them and this did not earn them full marks. Some argued that it will be an additional cost once distribution channels are established.

These candidates had not understood the question. Even though some identified “direct distribution” as a channel, they did not relate it to online sales using the internet.

### **Part (d)**

According to some candidates, design of packaging, public relations, point of sale displays and advertising could be important promotional methods available to Berry Story. Some did not analyse important promotional methods, but described free issues, discounts etc. which earned only a few marks. Some candidates simply listed out promotional methods without analysing them.

### **Question 07**

#### **General comments**

The overall performance in this question was not satisfactory.

Part (a) – Required candidates to evaluate the leadership style of Nuwan using the four ‘Is’ of transformational leaders.

Part (b) – Required candidates to recommend the appropriate strategy using Bowman’s Strategy Clock to overcome the current situation.

Part (c) – Required candidates to recommend the appropriate KPIs to monitor strategic performance.

### **Part (a)**

Some candidates had evaluated the leadership style using Idealised influence, Inspirational motivation, Individualised consideration and Intellectual stimulation. Some had just named the four styles, which earned only a few marks. Most of the candidates did not mention quality empathy of Nuwan under idealised influence. Some simply cited qualities of Nuwan without identifying the four elements.

### **Part(b)**

A few candidates made acceptable recommendations, in that, only the differentiation strategy was the appropriate strategy. Strategic positions 1 and 2 would worsen the profits due to the low price being charged, and strategic position 5 (focused differentiation) would worsen the profit due to the income level of customers where high value products at a higher price are sold. Some recommended several strategies displaying a lack of understanding over Porter’s competitive strategy and the given case. Some candidates incorrectly suggested a low cost strategy since customers are not able to spend much.

### **Part (c)**

Some candidates recommended sales volume per customer, customer retention ratio, number of lost customers for the customer value aspect of the BSC; average waiting time in the queues for bill settlement and labour productivity growth for the operational aspect; average training cost per employee and expenses on research and innovation for the learning aspect; and profitability, sales volume and sales growth for the financial aspect.

Some had just mentioned customer satisfaction as a KPI without a measure being identified. Some incorrectly identified the quality management system, re-structuring of cost etc. as KPIs under the operational perspective.

### **Overall comment**

All the questions in the paper could have been successfully attempted if candidates had read and understood the study material provided by CA Sri Lanka. Suggested answers have indicated the learning outcomes for each question in this paper.