

KC1 - Corporate Financial Reporting

December 2016

Examiner's Comments

General Comments

The question paper consisted of two sections. Section 1 contain two questions of 25 marks each and section two contain one question with 50 marks which is based on the common pre seen. Questions at this final level requires the candidates to display knowledge on accounting standards in depth, as well as new developments in the accounting standards and to keep up to date on current issues and developments in the subject area.

A well-structured complete answer should therefore contain a display of the knowledge in identifying the accounting issue in a given scenario, explanation of the relevant accounting treatment referring to applicable accounting standards/ conceptual framework, commenting on the appropriateness of the manner in which the scenario has been treated and then performing calculations where necessary and setting out implications/ or advice on correct accounting and disclosure requirements. As often seen in many answer scripts, performing only the computations or straightaway going to application of accounting treatment without any explanation is grossly inadequate to collect satisfactory marks, and will result in the candidate scoring only a nominal/ marginal score for the question.

Overall, the performance of the candidates at this exam was not satisfactory. Although the structure of questions 1 and 2 are similar, very poor performance was noted on question one compared to question two and a majority did not reach a score of 50% of the allocated marks for question 1. However, performance on question two was better and those who scored well on the pre seen question was thus able to reach the overall pass mark of 50.

Question-wise comments

Specific comments

Question 1

Performance of the question was not satisfactory. Average marks scored was between 5-8 out of a total of 25 marks. Less than 10% of the candidates scored a pass mark of 50% on this question.

In part a) with 20 marks examiner tested the ability of the candidates to explain requirements from several accounting standards and validate the accounting adjustments given under each scenario and to propose required corrections if any. The scenarios given included the following.

- 1 Basic EPS and Diluted EPS in a scenario where there were convertible bonds at any time up to maturity with a contract to settle in ordinary shares or cash (LKAS 33)
- 2 Recognition of revenue where there is a principal, agent relationship (LKAS 18)
- 3 Disclosures given in relation to the credit risk of the financial assets of the company (SLFRS 7)

In part b) with 5 marks the examiner tested the knowledge on new accounting standards by requiring the candidates to advise whether the answer in (2) would change when SLFRS 15 is applied.

Reasons for bad performance

- Irrelevant answers and not reading the information given in the question
- Background knowledge written at length without focusing on the facts/ scenario in the question.
- Lack of knowledge on new accounting standards
- Lack of practice in building up an answer
- Many candidates simply deal with only the numeric aspects without the necessary explanations.

- Eg:
1. For part a) Quite a number of candidates wasted time unnecessarily computing the liability and equity component of the bond instrument though question specifically says that these two have been checked and found to be correct.
 2. Answers were incomplete. Some Candidates do computations only but without any explanations. When the action verb used is explain rational should be explained and applied to the information given in the scenario.
 3. Some candidates explained the requirement of the standard- how to compute basic EPS and DEPS with formulas, but did not relate to the information given to validate the figures in the question. Wherever the figures are given, necessary computations should be made and commented to earn full marks
 4. For part b) many did not identify the principal agent relationship in the scenario. Instead provided general answers on criteria to be satisfied in order to recognize revenue. Some others mentioned that only the commission should be accounted as revenue as Luxury Motors is the agent- No explanations given.
 5. Some candidates provided answers only for the items/ values that has to be adjusted. E.g: In part a) basic EPS given was correct and in part c) some of the risk disclosures were made but candidates failed to mention this and therefore lost some of the easy marks. This shows that due attention is not given to the action verb in the question.
 6. Knowledge on SLFRS 15 was very poor. Majority did not answer this part which carried 5 marks although questions testing this standard has been in previous papers as well.

Question 2

This was also a 25 marks question. Performance on this question was generally better than the question one. Average marks were between 10 – 12 out of 25. About 30%- 35% of the candidates scored 50% of the total marks allocated to this question.

Questions on part (a) carrying 10 marks was based on two different accounting scenarios of a given Company. First scenario gave information that indicated a decline in FV of a AFS investment over several years which the candidates should have recognized as a significant and prolonged decline and thus an impairment. The question required to **advise** the finance manager on the accounting treatment necessary at year end.

The second scenario described some of the accounting practices of the company in relation to accounting for deferred tax and in relation to valuation of equity investments. The candidates were required to prepare notes to be included on accounting judgements and assumptions relating to (i) recognition of DTA where the company has a tax loss and (ii) FV of equity investment derived using valuation techniques.

It was observed that a majority of candidates have not read and understood the question as to what is required by them. There were many irrelevant and unfocussed answers and therefore performance was not satisfactory.

In part (b) examiner tested the accounting implications of a compound financial instrument. Although this was a very easy direct question carrying 5 marks, considerable number of candidates failed to recognize that the preference shares described in the question represented a compound financial instrument. This was very much disappointing as the information was very clearly given under two bullet points. Performance on this part displayed the lack of knowledge of relevant accounting standards. Candidates who correctly identified the preference share as a compound instrument did not build up a complete answer and therefore lost some easy marks.

Part (C) of the question with fairly easy 10 marks was on related party transactions. Different scenarios were given and it was required to advise the finance manager in determining relevant related party disclosures. This part was well attempted by a majority of the candidates. As a result of the good performance on this part, it was seen that majority scored a pass in the overall question.

Reasons for bad performance:

Not understanding what is required from the students

- In part a) what was required was to advise the FM on the accounting treatment of a AFS investment that has been impaired. Firstly, the candidates should have analysed the information and shown that the investment is impaired and thereafter proceeded to explain the accounting treatment for impairment as at 31.03.2016. Instead of this, many candidates went on explaining the standard- initial and subsequent measurement of AFS investment and accounting treatment. Some others computed the decline in

value for each financial year and showed double entries recording it in AFS reserve.

Lack of technical knowledge- Poor technical knowledge demonstrated by the candidates in part (A) & (B) was a concern. The following points highlight some of the areas of poor technical knowledge.

In part A),

- Candidates were not able to identify the impairment indicators and justify that the investment was impaired.
- Some candidates did not know that when the investment is impaired, the previously recorded losses in OCI should be transferred to P& L. Instead they continued to explain that the decline in value as at 31.03.2016 also to be recorded in AFS reserve and shown under OCI.
- The ability to draft notes to financial statements explaining the accounting judgements was very poor. Quite a number of candidates only reproduced the information given in the question.

In part B),

- Lack of knowledge of the standard- very poor knowledge was demonstrated on this standard. Majority wrote that since the holder has the right to redemption after 5 years the instrument has debt characteristics than equity and therefore to be recognized as a financial liability. Some others said as it will be redeemed only after 5 years for a fixed amount the HL (Pvt) Ltd does not have a constructive obligation and therefore not a financial liability.

Other common mistakes made by the candidates

- Writing irrelevant answers wasting time that can be utilized for another question.
- General answers describing accounting treatment of an AFS investment does not attract any marks. Candidates are advised to relate the knowledge of the standard to the given scenario in order to score marks.
- Candidates who correctly identified the preference share in part B as a compound financial instrument failed to build a complete answer. Whilst they explained it requires split accounting and did not go any further. Some others explained the initial recognition but failed to describe the subsequent measurement.

Question 3

This question carried 50 marks and was based on the pre seen. This question requires the students to demonstrate their analytical thinking, report writing skills and ability to arrive at a conclusion by giving a rational using knowledge on accounting standards. Performance of this question was not satisfactory. Average marks were between 16 -22 and only about 18% - 20% of the candidates scored a pass for this question.

Part (a) of the question tested the candidate's ability to assess whether an investment in a particular entity results in 'control' and application of the principle of SLFRS 10 to identify that an investor controls an investee and therefore the need for consolidation. It was required for the candidate to display this knowledge through comprehensive explanation by way of a memorandum and thereafter to conclude the treatment on the classification of the investment and the financial accounting and reporting impact arising as a result of the investment. For a successful answer, it was required to carry out a step by step analysis based on the information provided in the pre seen and the unseen and linking such information in building the report. In addition, ability to write a report was also required to properly present the answer. This part carried 22 marks out of the total 50 marks. It was noted that performance on this part was not satisfactory.

In the previous exam papers, this part carried considerable portion of marks for computations and workings in preparation of a Consolidation Financial Statement, whereas in this paper it was more on justifying the need for consolidation. Candidates who practiced only on computations therefore performed very badly in this.

Part (b) tested the candidate's knowledge on application of new accounting standards, namely on leasing (SLFRS 16), and required to evaluate whether there will be changes to the accounting treatment of a lease of a land as a result of the application of new standard. Lack of knowledge on new developments was evident by the poor performance of candidates.

Part (c) tested the knowledge on corporate governance, and requested the candidates to criticize the practices prevalent in Ceylon Sugar. This was a very easy 6 marks question as the question was totally based on the pre seen and was answered fairly well by majority candidates.

Part (d) was a question on ethics where it was required to evaluate how excessive ministerial intervention impair the ability of making sound decisions referring to business conduct and ethics. Although an easy 4 marks question, candidates failed to secure the easy marks. This was because some of them failed to identify and link to the issue from the scenario (mainly conflict of interest) and commented on all ethical principles in general.

Part (e) required the candidates to assess the liquidity position of Ceylon Sugar considering the financial re structure that took place immediately after acquisition.

Reasons for bad performance:

Not understanding what is required from the students- It was noted that some candidates had not understood what the examiner required them to do. Examples given below.

- For part a) Instead of building an answer testing the three main criteria required to have control, some candidates attempted to prepare Consolidated FS which was not required, and also information for such preparation was not available in the question. Thus these candidates spent time unnecessarily trying to build an answer for a question not tested by the examiner.

- In part (d), many commented on all the ethical principles without properly relating to the issue in the scenario. Some others went on to list down and define ethics in general as in a theory question.
- In part e) where it was required to assess the 'liquidity position', some candidates wrote about profitability and gearing.

Lack of technical knowledge- Poor technical knowledge demonstrated by the candidates in part (a) & (b) was a concern. The following points highlight some of the areas of poor technical knowledge.

- Many candidates did not demonstrate sufficient technical knowledge on 'requirements to be satisfied to have control'. Most of them evaluated only on power to govern policies and then directly identified the investment as subsidiary. Only a few candidates evaluated on exposure/ right to variable return and link between power and return. The scenario gave clear information to cover all 3 aspects and therefore those who did not cover all three criteria failed to gain the full marks allocated for this part.
- Instead of evaluating the information given in the question in assessing whether Alpha has control or not, some candidates just assumed less than 50% holding results in significant influence rather than control. Some others attempted to establish the significant influence using the power over decision making on key activities.
- Quite a number did not identify whether the investment results in a control or significant influence. Instead produced answers to both sides for which no marks could be given. What was expected by the candidates to make a judgement by giving the rational and therefore this type of answers without any conclusion (instead build up on "if" condition) does not attract any marks for the candidates. As a result, time spent becomes a total waste without gaining any marks.
- Some others identified the investment as an "Associate" however computed goodwill as in a business combination. This is because of poor knowledge of accounting standards and marks could not be awarded.
- Few candidates considered carried forward tax losses as an asset in computing net assets rather than considering the deferred tax impact on the tax loss. Further some candidates were unable to justify the recognition of deferred tax asset using the information given in the question (need to evaluate the availability of future tax profits). Due to this, they have not linked the future cash flow forecasts given in the pre seen in building the answer and lost some of the marks.
- Significant number of candidates did not know how to treat issue cost of debentures. They have deducted this from the purchase consideration instead of deducting from the liability. (LKAS 39)

- Some have not understood that all assets and liabilities to be recorded at FV at the acquisition date and commented that inventory should be measured at lower of cost and NRV referring to LKAS 2. Therefore, lost some of the marks.

Other common mistakes made by the candidates- In addition to the points covered under lack of technical knowledge, following are some other common mistakes made by the candidates, by which they lost the opportunity to gain some easy marks.

- Quite a number of candidates missed out to explain the financial reporting treatment of the investment in the separate financial statements of Alpha (Pvt) Ltd. i.e. it should be reflected at cost or as per LKAS 39 (i.e. at fair value)
- Without noting that the negative net asset value candidates did the computation and said the investment was made at a bargain purchase whereas it resulted in a goodwill.
- Not explaining the accounting treatment for debenture issue cost and intangible asset from favourable lease terms.
- Inaccuracies in deferred tax computation (not identifying whether each item is a DTA or DTL). There were some candidates who totally missed out to recognize the deferred tax impact of the fair value changes.
- Most of the candidates were not familiar about the new standard on leasing (SLFRS 16). Many answers referred to “type A and type B” classification which was in an earlier exposure draft.
- In part e) - impact on liquidity as a result of the restructure was not properly addressed by many. There were three main changes in re structure immediately after acquisition specifically given in the question (unseen). These were listed under bullet points just above the question. However, a considerable number of candidates had not addressed the impact on these. Instead they have commented at length on efficiency ratios.

Other General Comments

- Some candidates directly started computing good will without assessing whether control exists or not and without understanding the requirement of the question. Due to this they duplicated the same work in different places of the answer wasting valuable time which could have been utilised for other parts/ questions. Further, this reflected poor planning and building up of the answers. Therefore, it is advised that students practice a step by step approach in building up the answer.
- There were quite a number of candidates who did not follow a proper format or structure of compiling a memo.
- Some candidates spent too much time on writing more than what is required. This showed a weakness in planning an answer and managing time wisely. For e.g.: for a 4 marks question on ethics, some candidates wrote about 2-3 pages

whereas for the part (e) ratios (to assess liquidity) only a half-page one paragraph answer written for 15 marks.

- In the corporate governance question some candidates just listed down the issues addressed in the pre seen and did not discuss the impacts arising from such issues. Therefore, lost the opportunity to gain some easy marks.
- It is advised that students pay attention to the quantum of marks allocated to a question before planning the answer. Also being familiar with the action verb used in the question is important to understand what is required to do and also to manage the time properly.

Good side of the answers - Although lot of weaknesses were observed as given above, following comments can be given as good side of the answers produced.

- Considerable number of the candidates have identified that the acquisition results a subsidiary, although the shortcomings mentioned above prevailed them from collecting good marks.
- Goodwill computation was accurate except for the errors in deferred tax adjustment and issue cost
- Corporate governance part was well answered by many.

KC2 - Corporate Finance and Risk Management

December 2016

Examiner's Comments

Question-wise comments

Question 01

In Part (a) most of the students answered quoting theories like dividend relevant theory, dividend irrelevant theory etc. which were not the expected answer.

In Part (b) most of the students had not adequately described the theory tested. Many had written vague answers showing their inadequate knowledge. Dividend irrelevant theory had been defined as dividend relevant theory by some students.

Part (c) some students did not know how to calculate dividend cover, EPS & PE ratios. E.g. profit after dividend was used to calculate EPS ratio. Most of the students have done only the calculations, without providing any explanations. Interpretations on each calculation were not up to standard.

In part (d) other than the new project news, other important reasons for increase in share price had not been identified by many students.

In part (e) only a few students have presented their answers in a methodical way. Others have not either presented the calculations relevant to the answer or interpreted the results correctly.

Question 02

Part (a) of the question requires the analysis of risk factors pertaining to “**investing in the Maldives**”. About 95% of the answers were on the proposed investment in Maldives.

Part (b) of the question has been misinterpreted by the students.

In part (c) of the question, most of the students did not consider the waiver of USD 5 million. They have also not taken into consideration the mortgage value of USD 10 m.

In part (d) some students forget to double the room rate. A few of the students overlooked the number of 'villas'. Finance cost was calculated on net purchase price.

In part (e) most of the students used profit after tax (PAT) to work out payback period. Amortization cost and management fees and tax implications were not considered. Some considered net purchase consideration as the cost of investment. Some were unable to calculate payback period.

Question 03

- (a) Some students have not identified the correct risks of the given business. Some have written about sugar prices, health risk, strategic risk etc. Some have explained many points under one type of risk. e.g. under political risk.
- (b) Most of the students had no idea about "serious loss of capital" with reference to the Companies Act. Therefore, many misinterpretations were given by the students.
- (c) Some students have given incorrect points without understanding the question. E.g. liquidation, merger, acquisition etc.
- (d) The correct formula for the WACC was not used by some students. Wrong debt equity ratio was taken by majority of the students. E.g. (D/E) ratio of 30% interpreted as debt 30 and equity 70. Unlevered company, Beta calculation was wrong. Some have not done the calculation. Total debt amount of CSL has not been identified correctly. For the second part of the question their view had not been discussed or wrong reasons were given.
- (e) When answering part (ii) students were unable to get the correct EBIT after tax. They were also unable to use the correct discounting factor for CSL e.g. majority used 14%. Majority have not deducted debt amount from NPV to arrive at the stake in CSL. Further they were unable to calculate terminal value for year 5 onwards. Some have given the answer which is relevant to part (f).
- (f) Majority have not identified management fees and S&D expenses as an income source. Some have made mistakes in the calculation of these two items while some have ignored the calculation. Many failed to identify the accurate WACC rate.
- (g) Majority of students have not computed the relevant IRR, but compared corporate bonds with bank loan. Majority of students who did the calculation, have ignored the tax implication of interest. Some were unable to do the IRR calculation. Calculations required to compare the two financial options were not known to some students.

KC3 - Corporate Taxation

December 2016

Examiner's Comments

General

Overall performance of the candidates was not satisfactory compared to previous examination.

Majority of candidates were unsuccessful in adopting a methodical approach to questions and thereby were not able to produce reasonably focused, relevant answers addressing the principal and core components of each requirement.

It appears that the candidates have continuously ignored the key attributes related to the corporate level curriculum which requires the display of their ability to understand industry and business circumstances, making decisions based on various information collected and analysis as well as skill in reporting and communicating etc.

Students should be able to prepare comprehensive tax computations. They should also be able to carry out tax planning, make decisions on minimizing tax expenses and mitigating risks as well as have effective communication with tax authorities, clients and the management etc. Therefore, displaying mere technical knowledge is not adequate. Being an open book examination students' level of presenting their answers in line with required standard in terms of technical & legal aspects are not satisfactory at all.

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

The under mentioned reasons could have an adverse influence on student performances;

- Lack of pre study connected with the Pre Seen case study materials.
- Lack of understanding of the requirements of the questions
- Producing irrelevant facts and thereby creating time constraint
- Lack of communication and presentation skills.

Question-wise comments

Question 01

General Comment: Overall performance was very poor and below satisfactory level.

The commonly observed weaknesses of candidates were;

- Lack of knowledge of liability to income tax of non-resident persons.
- Inability to support the answer by giving facts of relevant case law.
- Poor references to relevant sections of Inland Revenue Act and building the answer accordingly.
- Misunderstandings & careless mistakes in calculations.

Part-(a)

Although many candidates knew that a non-resident person is assessable for income tax purposes in Sri-Lanka, they were not successful in supporting their answer citing relevant case law, statutory provisions or related articles of the double tax treaty between Sri-Lanka & UK.

Many of them had no idea about the law in respect of an agent of a non-resident.

Part-(b)

Majority of candidates had not properly calculated and computed taxable income and tax thereon as required.

The main loss of marks on this question was due to most candidates being unaware that "PEL" the company operating in UK is liable to income tax in Sri-Lanka on Profits & Income derived through the operations of the company operating in Sri-Lanka on their behalf. Thereby some candidates have failed to even attempt to compute the relevant tax liability of PEL-UK. Only a handful of candidates knew that online transactions are not liable to income tax in Sri-Lanka.

A very high proportion of candidates were unable to identify the applicable income tax rates on the company operating in Sri Lanka as well as the UK Company.

Almost all candidates were unsuccessful in calculating the required Cost of Sales figure despite, having stated clearly that 100% markup is on total cost excluding commission. Those who have done the adjustment too have incorrectly taken it as inclusive of commission.

Some candidates have not identified that the online sales are not liable to income tax in Sri-Lanka.

One of the biggest weaknesses noted in planning the answer is calculating tax liability on both companies taken as one company which is unrealistic.

Part-(c)

It is quite surprising that students had not referred the applicable sections of the Inland Revenue Act as reference with regard to remittances is quite straightforward.

Most candidates displayed their lack of knowledge in calculating taxable income in respect of remittance tax. None of them were able to calculate the accurate tax liability on results of both companies.

Instead of calculating profit available for remittance, many have incorrectly just applied the remittance tax rate on the total amount of Rs.90 million remitted to PEL.

However a fairly good number of candidates were able to describe how “remittances” are defined in the Inland Revenue Act.

Part-(d)

A handful of candidates were able to identify a few steps of procedure to be taken up with Tax Appeal Commission upon the receipt of determination. No complete answer was seen and it is evident that the procedure is not known to almost all the candidates.

Some candidates have incorrectly described Appeal Procedure or referred to Board of Review instead of what is required.

Question 02

General Comment: Overall performance was very poor and below satisfactory level.

The commonly observed weaknesses of candidates were;

- Lack of knowledge on difference between Zero Rated Supplies & Excluded Supplies.
- Inability to identify Allowable and Disallowable Input Tax and limitations of Input Tax claims.
- Not knowing the treatment for Suspended VAT.
- Misunderstandings & mistakes in calculations.

Part-(a)

This part of the question was well attempted but students did not score reasonable marks. Following errors were noted as reasons for the low marks.

Not familiar with the proper method of calculating VAT.

Some of candidates have applied VAT rate as 12% or 15% which is incorrect.

Candidates failed to identify Maldives project as excluded supplies. Students were confused and applied zero rated adjustments on excluded supplies.

Some have identified suspended supplies as zero rated supplies.

Not recognising input tax, which is claimable without any restriction.

Mistakenly applying 11% again on input tax.

Disallowed input tax on excluded supplies has not been identified by many students.

Incorrectly considered Suspended supplies when identifying claimable input tax subject to 100% restriction.

SVAT credit Vouchers incorrectly categorized under Input Tax and not claimed as Input Credit.

Part-(b)

This part of the question was on claimable input tax. A very high proportion did not know that input tax is deductible only on expenditure attributable to taxable supplies. Many did not know that supply of residential accommodation is exempt from VAT.

Part-(c)

Majority of candidates have referred to section 79 and section 2 of the Inland Revenue Act in their answers. However, the main weakness was ignorance of the provisions of the double tax treaty.

Part-(d)

Most candidates were not able to give correct answers indicating consequences related to income tax liability. They have ignored impact on tax rates under section 59B and Part B of the second schedule to the Act.

Some students have mentioned the impact on losses, but were not able to link it to tax consequences or explain in a proper manner.

Question 03

General

The students are strongly advised to understand the importance of “Pre seen” as the aim of the examination is to test a wide range of syllabus areas. It is regrettable to observe that candidates are ignoring the fact that they should be familiarise themselves with the pre-seen case study material prior to the examination.

Part (a)

In this question, tax computation of a limited liability company was given and the candidates were required to assess the income tax liability for the Year of Assessment 2015/16.

The overall performance was not satisfactory. The candidates seemed to struggle to identify three different business sectors such as Agriculture, Production & Seeds separately. Surprisingly some candidates have not applied columnar format as well. Thereby many of them were unable to form a methodical answer.

Those who have identified Seeds operations as exempt from income tax too have not identified that Agriculture & Production should be separately taken into consideration.

The common mistakes that were observed are as follows:

- Many candidates were unsuccessful in figuring out how to start with applicable segregation on “Net Profit before Tax” as per accounts for each business sector.
- Most of the candidates were ignorant about applicable exemption available on the sugarcane seeds breeding sector under Section 16B of the Act.
- Many candidates had displayed their unawareness of recent Amendments to the Inland Revenue Act in respect of Sections 45 and 46 on the income tax rate applicable to undertakings for manufacture of sugar being 12%. Instead many of them have incorrectly applied the tax rate as 28%.
- A handful of candidates knew that agriculture is liable at the rate of 10% under Section 48A.
- Students sadly missed scoring ‘easy’ marks allocated for disallowable expenses due to non-identification of the applicable business sector.
- Although many candidates knew that specific provision for doubtful debts are allowed for tax purposes they had not known such bad debts are allowed only on Trade Debts. They ignored the fact that the given specific debt is on loans that are given to suppliers (farmers).
- Depreciation
Many students had missed the fact that the Water Distribution Line is entitled to 6 2/3% capital allowances. Some have erroneously calculated at the 10% rate which is applicable only to buildings constructed.

Candidates have overlooked sighted and not considered the applicable depreciation allowances brought forward from previous year and thereby lost ‘easy’ marks.

- Amortization of land lease
Very few candidates displayed their knowledge in adjusting the allowed and disallowed figures using the information given for ground rent. However, those who knew the adjustment too have not considered the proportion applicable to each business sector.

- Government grant
Many neither identified that the government grant is applicable to Seeds sector nor that it is not taxable.
- Research & Development expenses on agriculture
Majority of candidates have ignored the fact that the amount already charged to income statement is to be considered when 300% deduction is claimed. Common error of this adjustment was that candidates have overlooked to adjust capital expenditure in this regard. It resulted in erroneously adding back the total research expense including capital expense which is clearly mentioned in the question paper as already capitalised under property, plant and equipment.

Some students have claimed 200% instead of 300% due to their lack of awareness of Amendments to the Inland Revenue Act.

- B/F Trade Loss adjustment
None of the candidates knew that the brought forward exempt trade loss should be set off against adjusted exempt profit for the year on seeds and any balance is to be carried forward as trade loss for the seeds operations.

Part (b)

- (i) Market research expenses
Some candidates have not identified that market research expenses cannot be allowed as expenses for tax purposes and thereby lost 'easy' marks.

Construction of sheds

Most of candidates have not attempted this part of the question. A few candidates successfully mentioned the correct treatment.

However, many candidates failed to present possible action to be taken by the company, though they gave the tax treatment.

- (ii) Most of candidates have not attempted this part of the question.

Part (c)

None of the candidates understood the question properly and were not able to provide a suitable answer. Candidates had not read the question properly and some of them have incorrectly mentioned about shareholdings in respect of ownership change.

The most common omission from the answers by many candidates is that they have not taken into consideration losses incurred on exempted business.

Had they referred section 32 (5) (b) they could have earned 'easy' marks.

Part (d)

This question was not answered as well as anticipated. No one has identified that supply of sugar is exempt from VAT and thereby the company is not required to register for VAT.

Some candidates simply stated in their answers that such input tax can be capitalized if not claimable etc.

Part (e)

Most of candidates have correctly mentioned the ESC provisions.

**KC4 - Corporate Governance, Assurance
and Ethics
December 2016**

General comments

This paper consisted of two sections. Sec 1 carried two questions for 25 marks each and sec 2 carried one question with 50 marks which is based on a pre seen. Overall performance is not up to standard. A number of common issues arose in the answers that contributed to the disappointing pass rate;

- Poor time management
- Lack of application skills
- Not delivering the question requirement
- Using vague phrases such as
 - Perform analytical procedure
 - Check relevant documents
 - Give appropriate opinion
- Writing lengthy answers when asked to outline
- When asked for four points writing all possible points

Question-wise comments

Specific comments

Question 01

(a) (i) It was required to evaluate matters that W&P needs to consider in establishing the overall audit strategy for the group audit. Many candidates have ignored the fact that the question requirement is for a group. Many candidates have referred to SLAuS300 and written general matters as given in the appendix. They have not referred to the scenario; as a result they obtained less marks. Some misunderstood the question and wrote about steps in planning the audit. The question called for only four matters given in the standard. There were satisfactory answers referring to SLAuS600 and the scenario which scored good marks.

(a) (ii) It was required to evaluate audit risks that should be considered for the group audit, and recommend appropriate audit procedure. Some candidates have not referred to the scenario and listed all possible audit risks such as

- Management override
- Fraud risk
- Impairment assessment of goodwill
- Risk of going concern assumption
- Related party transactions

There were some answers which referred to weaknesses in the given scenario, instead of audit risks. However an improvement in answers was demonstrated on the audit risks when compared with the answers in previous years.

(b) The candidates were required to propose audit procedure on the matters given in the scenario.

(b) (1) Debtors confirmation

Answers reflected that many candidates have not read the question properly; as a result they produced irrelevant answers such as;

- Obtain an age analysis
- Obtain a management representation
- Carryout the impairment test

(b) (2) Value in use calculated on pretax rate- most of the candidates have identified the issue and produced satisfactory answers

Cash flows included 3rd year new capital expenditure- most of the candidates wrote inquiries should be made from the management and secured marks.

Growth rate- satisfactory answers.

Cash flow –satisfactory answers.

The average performance in this part was satisfactory.

Question 02

Part a It was required to explain appropriate type of assurance engagement in connection with the proposed interim review. Many candidates have not understood the question requirement which is on a review of interim financial statements. SLSRE 2410 applies to interim reviews and SLSRE 2400 applies to reviews. Many candidates have not understood the difference. Candidates at the corporate level are expected to know the difference between limited assurance and the reasonable assurance. Most of the answers were incomplete, and did not address the following;

Assurance engagement- limited

Level of assurance – moderate

Expression of conclusion-negative

Part b The candidates were required to recommend procedures when performing an interim review. The satisfactory answers demonstrated knowledge of SLSRE 2400& 2410.

Part c The candidates were required to evaluate the significant areas of concern based on the given information. The most common relevant answer was compliance with loan covenants. Majority have produced irrelevant answers such as;

- using the bank loan for working capital requirement
- dividend policy
- profit of 27 million earned during six months
- liquidity problems
- negative operating cash flow

Part d The candidates were required to propose the conclusion paragraph and the basis for a modified opinion. Most of the candidates have based their conclusion on the assumption that the company is a valid going concern as all the current liabilities have been settled and the loan will be treated a long-term liability. It reflects that they have not read the question properly where it

stated the candidate should assume that the going concern assumption is not valid. They were unable to score marks as they have not read the question to propose a suitable conclusion. There were some satisfactory answers where the candidates have referred to SLAuS 570, where it is stated that when the going concern assumption is not valid the opinion should be an adverse opinion. There were irrelevant conclusions such as;

- Except for
- Include emphasis of matter paragraph
- Qualified opinion

Although many candidates have identified that in an interim review a conclusion has to be provided but an opinion is not given some have included an opinion.

Question 03

This question is based on the pre-seen and the unseen. It was observed that many candidates have not gone through the pre-seen although it had been sent in advance.

(a) (i) It was required to outline 5 factors that determine the effective internal environment of an entity. This is a theoretical question which could have been answered satisfactorily by referring to the SLAuS 315. Some candidates have referred to circumstances for risk assessment process and wrote irrelevant answers such as;

- Change in reporting environment
- New personnel
- Change in operating environment

Some candidates who have not prepared wrote irrelevant answers such as;

- Sound financial control
- Sufficient risk management procedure
- Independent committees
- Strategy setting
- Event identification
- Risk response

(a) (ii) In this part the candidates were required to use the information given in the pre-seen and unseen and evaluate the factors given in part 1. This part carried 15 marks for the following;

- Identification of the factors and
- How those affected the entity

Most of the candidates have identified the factors in the pre-seen but failed to evaluate them. Some have identified all weak areas in the pre-seen and unseen but failed to link them to an internal control environment. It is expected at this level that candidates are able to apply their technical

knowledge into a practical situation. The poor marks were obtained due to following reasons;

- Explaining the factors referring to the theory
- Writing about general weaknesses without linking to the factors
- Unable to identify the factors

(a) (iii) It was required to assess the effectiveness of the internal control environment based on the evaluation. In this part the examiner expected to test the ability of the candidates to summarize their findings. Many have not summarized; they have stated due to the reasons given in part (a) (ii) there is no efficient control environment; as a result they obtained less marks.

(b) (i) It was required to analyze operational risks. Many candidates have confused the operational risk which is a process risk with the business risk which arises during operation. Most of the candidates have listed all possible weak areas in the pre-seen such as;

- Market risk
- Not sufficient sugar cane because of labour issues
- Underutilisation of factory
- Sourcing land

(b) (ii) the candidates were required to recommend risk management strategies in order to address the risks identified in the pre-seen using a likelihood consequence matrix. Almost all candidates have attempted this part. Many were not able to write correct strategies using the likelihood/ consequence matrix. There were irrelevant likelihoods and consequences such as;

Likelihood

- Almost certain
- Likely
- Possible
- Unlike

Consequence

- Severe
- Major-moderate
- Minor
- Insignificant

Part (1) It was required to discuss the importance of assessing a self-review threat to the auditor prior to accepting a service other than an assurance service. It was disappointing to note that only a small number of candidates wrote that providing a non-audit service to the audit client will;

- Create a mutuality of interest
- Find the auditor himself in the role of advocate for the client
- Amount to participation in decision making

Most of the candidates wrote the steps to eliminate the threat.

Part (2) It was required to advise whether to accept the assignment to perform the valuation. Majority have answered satisfactorily. Some candidates without analyzing the materiality of the issue had written the valuation assignment can be accepted subject to applying safeguards.

Conclusion

The overall impression is that the majority was not prepared for the exam. As this is an open book exam, some had written irrelevant points straight from the pages of the SLAuS. They had not put any effort into reading the pre-seen which was sent before the exam. The scripts which carried poor marks reflected the poor technical knowledge of candidates. They would not have read the study text at all. The candidates should spend more time to practise past papers in order to grasp what the examiner expects from them in a professional exam.