

KE1 – Financial Accounting & Reporting Fundamentals

March 2017

Examiner's comments

Question-wise comments

General : The performance of the candidates was at a very satisfactory level. However a majority of candidates failed to answer the questions on accounting standards, classification of capital/revenue expenditure, and regulatory aspects. Many had not attempted the optional question on accounting ratios.

Failure to present answers in a professional style by giving a proper reference to the workings was a common weakness among the candidates.

Question 01

Multiple Choice - 10 questions – Compulsory – 20 Marks

Candidates performed well earning more than 50% of the allocated marks. However, a majority of the candidates failed to select the correct answer to questions 1 through 5. Candidates have to learn concepts such as *matching* more carefully as they are becoming deprecated due to developments in financial reporting standards. Many had a poor knowledge of the role played by the institute.

Question 02

10 Parts – Answer expected from a given scenario – Compulsory – 30 Marks

This question contained 10 sub questions. The style of the questions varied from one to another. Thus candidates had to face difficulty in selecting the proper style for their answers. e.g. determining whether to provide a very short answer or an somewhat explanatory answer.

- 2.1 Many candidates had a difficulty in selecting the proper accounting entity to record the transaction in relation to the given scenario. Some candidates looked from the supplier's side while others tried to explain the same from the receiving end.

There were many possible answers to part (a).

For many candidates the answer to part (b) did not match the reason given in part (a). Marks were awarded for the correct answers in part (b) irrespective of reasons given in part (a).

- 2.2 The answers to this part were of varying length. A large number of candidates had provided detailed explanations while a few others had provided a single term as "accrual basis" which cannot be ruled out as **incorrect**. Accordingly the performance of candidates on this question was very satisfactory.
- 2.3 The answers to this question were satisfactory except for a few candidates who had recorded the entries in the wrong side of the account.
- 2.4 This question was somewhat difficult for candidates. Answers expected was for **closing** the bond transaction. Therefore the issue of amortization does not arise. The premium was just accidental and had to be written off immediately. Some candidates were ignorant in selecting the time period for calculating interest. Except for those matters, the answer was straight forward. The candidates were able to earn reasonable marks for this question.
- 2.5 The answers to this part (a) were not up to the expected level as the candidates had displayed poor knowledge of why consolidated financial statements are needed. Instead many had attempted to explain how the consolidation is being carried out. However, for part (b) there was a plethora of limitations. Marks earned on this question were less than 50% of the allocated marks.
- 2.6 The candidates had good knowledge on the types of leases. Therefore performance was very satisfactory although there was some confusion between the **criteria** for identifying the lease as a finance lease and **characteristics** of the finance lease itself.
- 2.7 The performance on this part was below the expected level as candidates had attempted to assign values to both the tax base and temporary differences simultaneously. There were answers showing a deferred tax asset or liability. Candidates who had not studied this subject before the exam had made reference to income tax law.
- 2.8 Many candidates had not attempted this part of the question and were skeptical about whether the benefits related to the period of employment or post employment. There were a few good answers as well. The marks earned ranged below the 40% level.
- 2.9 This question had to be read carefully. Answer expected was the accounting treatment **after initial recognition**. Part (c) was a financial instrument which was not designated as **FVTPL**. Parts (a) and (c) was for a specified term while (b) was for an indefinite time period. The answer depended on students having a good grasp of the principles. Only a few candidates were able to answer this part correctly.
- 2.10 It appeared that candidates had not studied this aspect of the syllabus. Candidates had attempted this part of the question on trial and error basis. The performance of candidates on this part was poor.

Question 03

Bank Reconciliation - Optional – 10 Marks

Candidates performed well. Many earned all 10 marks.

Weaknesses observed are as follows:

- Showing items such as bank charges, direct deposit, standing orders in the bank reconciliation statement rather than adjusting them in the cash book.
- Treating the balance resulting in the bank reconciliation statement as the opening balance of the cash book.

Candidates had a doubt as to whether the realized/unrealized deposits had be added or deducted from the bank statement balance.

Candidates named the accounts as "standing order" and "returned cheques" whereas the actual accounts they relate to, such as rent or debtor was given in the question.

Returned cheques were entered on the wrong side of the cash book.

Question 04

Partnerships - Optional – 10 Marks

Candidates performed well. Many earned all 10 marks.

Weaknesses observed are as follows:

Monthly salaries were taken as full year annual salaries

Partners' drawings were shown in the appropriation account

Interest on capital was shown in the Profit and Loss and not in the appropriation account.

Few candidates had appropriated the draft profit given in the question without adjusting the same.

Question 05

Preparing Financial Statements from Incomplete Records - Optional – 10 Marks

This was a poorly answered question. Candidates had tried to present the answer in sparse form without giving due consideration to matters such as dates in selecting the opening and closing balances. In calculating expenses such as electricity, the accrual concept has not been taken into consideration. Workings had not been submitted thereby losing marks allocated for calculations where the resulting amount was incorrect. This adversely affected the candidates who arrived at the capital as a balancing figure. According to the allocation of marks to items in the answer, the candidates were able to earn a healthy score.

Other Weaknesses observed are as follows:

Treating the prepaid rental as a liability.

Entering drawings to profit & loss as an expense

Treating receipts from debtors and payments to creditors as cash sales and cash purchases respectively.

Adjusting Rs. 2,000/- to the closing inventory.

Including the purchase of a motor cycle in profit & loss and calculating depreciation for 02 years.

Question 06

Accounting Ratios and Cash Flow - Optional – 10 Marks

This was the least attempted question. For those who attempted, in many instances, the values used for the denominator in the ratio equation was not correct.

For ratios like Inventory turnover period and collection period, many candidates had calculated a ratio (index) and not the number of days.

For ratios like ROCE – there are two methods widely in use – profit before tax and interest compared with equity plus borrowings and profit before tax compared with equity. Many candidates had mixed the components of the two methods.

Many candidates had shown the formula for the ratio but failed to do the actual calculation by assigning values.

Those who attempted the cash flow section performed well. However candidates had started the cash flow with varying profit amounts such as profit before tax, profit after tax and profit before interest and tax. Still others had deducted items which should have been added and vice versa.

Question 07

Preparation of Financial Statements for Publication - Compulsory – 30 Marks

This question included calculations requiring judgment such as capital/revenue expenditure classification and tax expense with payment of arrears. Many failed to tackle those aspects correctly.

There were a few candidates who were not aware of the changes that had taken place in financial reporting over the years. Movement in property, plant and equipment had been shown within the body of the balance sheet even though the question required it to be presented as a separate part of the answer.

The candidates had difficulties in understanding and presenting amounts which are rounded to the nearest thousand. The amounts resulting from detailed calculations were inserted without rounding it off. A few candidates had wasted time attempting to add zeros to rounded off amounts.

Examiners observed instances where the figures inserted in the body of the financial statements were not correct even though the calculations were correct in workings shown.

A possible reason for this might be that the candidates carry out the calculations first and insert the amounts to the body of the financial statements as a second step. This type of error could have been avoided if the figures were inserted as and when the calculations were completed.

Common errors observed are as follows:

Interest had been accrued for the whole year and not for the relevant period.

Many failed to do the income tax expense calculation correctly.

Current portion of the bank loan was not identified.

Adjustment regarding revenue recognition had not been correctly adjusted for debtors. Instead it had been adjusted as a liability or in some cases shown as an expense.

A few candidates had valued inventory at net realizable value even though cost was less.

Training cost has been capitalized with the cost of machinery but failed to include other costs such as installation.

Depreciation amount was incorrect for many candidates because they were not able to calculate the cost of machinery correctly.

Depreciation had been calculated on the reducing balance method instead of straight line method.

Depreciation had been calculated for both land and buildings.

Machinery depreciation was included under administration cost and not under cost of sales.

Other classification errors such as showing bad debts under finance cost and interest under administration cost.

KE2 – Management Accounting Information

March 2017

Examiner's comments

Question-wise comments

General points about candidates' handwriting

There were number of instances where marking examiners found it extremely difficult to read the candidates' handwriting. Therefore, no marks were allowed for the illegible parts of the answers.

The following may be helpful in enhancing the performance level of the candidates.

1. Read the question several times and answer only what is required by the question.
2. Candidates should carefully understand the theories/concepts applicable to the given scenario of the question. They should evaluate the given information and link them with the applicable theories /concepts carefully to derive the answer.
3. Be extra vigilant in extracting the correct details/figures to the answer script and avoid arithmetical errors.
4. Focus on the Action Verb given in the question to provide the exact and appropriate answer.
5. By studying the theory properly and answering past question papers and practice questions you can improve the subject knowledge as well as the ability to write answers well.
6. Plan your answer properly and manage the time efficiently at the examination.
7. Submit all workings. This will enable the examiners to award marks for the correct steps in an incorrect answer.

Question 01

Consists of ten multiple-choice questions each carrying two marks. The performance of the candidates was satisfactory with 52 % of candidates scoring half or more marks.

Performance of the candidates in each individual question is given in the table below.

Percentage of the candidates selecting the answers A, B, C, D as correct.

Question No.	A%	B%	C%	D%	NA
1.1	8	14	44	34	-
1.2	26	14	49	11	-
1.3	27	38	13	21	1
1.4	7	80	5	8	-
1.5	42	7	28	22	1
1.6	14	25	16	42	3
1.7	20	13	30	36	1
1.8	5	19	60	15	1
1.9	20	18	46	15	1
1.10	17	69	6	8	-

Note: Correct answers are circled.

Question 02

- 2.1 The question has been designed to test the ability of the candidates to identify some useful concepts in management accounting. The overall performance of the candidates **was on average**. Statement (b) and (c) **had not been correctly identified** by many candidates (about 40%) whereas some candidates (about 20%) had just written the **EOQ formula without identifying whether the statement is false or true**. A considerable number of candidates (about 50%) had failed to demonstrate the fact that the economic batch quantity is used when the **supply is gradual**, displaying their unfamiliarity with the application of the model. Surprisingly, many candidates (50%) had identified the **three critical levels of inventory** and had scored the full marks allocated to this part of the question. A handful of candidates (about 15%) had **mixed up LIFO with cumulative weighted average pricing formula**, thus failed to answer part (f) correctly. However, part (e) had been answered correctly by many candidates (about 40%). Some candidates (about 10%) appeared to have spent a **substantial amount of time, unnecessarily on each statement**, discussing each statement at length. Students are advised to **practice time management** in answering the questions prior to the exam. This could be easily achieved by answering past paper questions under time constraints.

The average marks scored by candidates range from 1 ½ to 2 marks.

- 2.2 The question is very **simple and straightforward**. The question tests the ability of the candidates to compute **first the mean weight and the second the standard deviation of a variable** (i.e. promotional pack in this particular question). However, many candidates had computed the **mean again on weighted value**. Only about 1 to 5 candidates had been able to compute the **standard deviation correctly, taking squares of the given standard deviation of each product, multiplying them by the relevant weights before the square root of the value could be taken**. Many candidates (about 95%) had computed the standard deviation of the standard deviation figures given in the question. These students appeared to have been confused with the requirement of the question. A negligible amount of candidates had computed the **standard deviation of each product using weighted sample variance (or standard deviation) formula** but failed to finish the job by completing the answer correctly.

Overall performance of the candidates for this part **was not satisfactory**. On average, candidates had scored 1 – 1 ½ marks out of 3 marks allocated to the part.

- 2.3 The question tests the candidates' ability to compute the **standard error of the mean shelf life** and determine the **range of shelf life at a 95% confidence level**. The candidates had failed to identify that the question requires to identify the **'shelf life'** (i.e. raw variable) and not the **'mean of the shelf life'**, in part (b) of the question. Hence, the Z score formula should only include the **standard deviation instead of the standard error**. Only about 5% of the candidates had been able to identify this, although the marking examiners were keen to award full marks for both methods. A handful of candidates (about 3% -5%) **had not read the Z score value applicable to the 95% confidence level correctly**, hence failed to proceed with the balance steps to arrive at the final answer.

A handful of candidates had **misunderstood the requirement of the question** as they appeared to have misinterpreted the word "range" and applied the confidence interval for a **population range**.

The marks range from 1 ½ marks to 2 marks allocated to the part of the question.

- 2.4 Overall performance of the candidates **was somewhat satisfactory**. A number of candidates (about 60%) had **earned about 2 marks** allocated to this part of the question. Out of those who had attempted the question, **about 90% of the candidates had not computed the per unit cost**, although they had computed the total cost of the product DD correctly.

However, some candidates (about 10%) had failed to apply the **indirect cost of each activity to the product DD based on the applicable cost driver** whereas some had **multiplied the total cost driver quantity** and the **applicable quantity** for product DD, instead of dividing the **total cost of each activity by the total cost driver quantity** and multiplying the **amount by the amount applicable to the product DD**.

Average marks scored by the candidates varied from 2 – 2 ½ marks

- 2.5 Although the question seemed simple, overall performance of the **candidates was not satisfactory**. A large amount of candidates (60%) had provided **very general and some irrelevant answers**. These include general comments such as easy to understand and compute, budgeting is time consuming etc. The expectation of the examiner was to test the ability of the candidates to **identify three (03) important differences between budgets and standards** not **budgeting and standard costing**. A considerable amount of candidates (about 20% - 30%) had discussed the differences between **budgeting and standard costing** and some candidates (about 20%) had attempted to **define** budgeting and standard costing. Some candidates had mentioned that a **budget is an appraisal of the future state** of the business, **without linking it to standards** for a useful discussion.

A decent amount of candidates had pointed out that budgets are **prepared for a specific period** and are **explained in monetary** terms as opposed to standards and had scored good marks. Valuable points such as **standards are used in the preparation of budgets, preparation of budgets is for all functions** (or functional/business units) of an organization whereas the standards can be prepared (or set) for each line item in the operational processes of a business, have been missed out by many (about 75%) in the answers scripts.

The average marks range from 1 – 1 ½ marks out of 3 marks allocated for the part of the question.

- 2.6 The average performance of this part was **poor**. A majority of the candidates (about 60%) had **scored about 1 ½ to 2 marks** allocated to the part of the question. However, a handful of candidates (about 15%) had correctly computed the **sales volume variance and applied standard profit per unit on it to arrive at the sales volume profit variance** of the product for February 2016. Some answers (about 30%) had carried **simple but meaningless solutions** such as **multiplying budgeted sales volume by actual selling price**. These answer scripts were given **lower marks**.

A large number of candidates (about 80%) had not been able to compute the **standard profit per unit** which is needed to compute the **sales volume profit variance**. A number of candidates (about 75%) had **applied the profit margin of 30% on the actual selling price instead of the budgeted selling price to arrive at the profit margin per unit**. Many candidates (about 20%) had failed to identify whether the **variance is favorable or adverse** to the Company.

Average marks scored by the candidates varied from 1 to 1 ½ marks.

- 2.7 The question had been designed to test the candidates' ability understand the **demand and supply relationship in functional form**. A majority of the candidates (60%) had been able to specify the equation correctly whereas as some candidates did not appear to have understood the **basic principles** such as the **usual (i.e. negative) relationship between demand and supply**. These candidates are advised not to sit the exams until they have comprehended the basic principles in the management accounting discipline.

Some candidates (about 20%) had computed the **demand coefficient incorrectly** taking the figures given in the question. These candidates had taken the **percentage of drop in demand and the percentage of increase in price to compute the coefficient**. A negligible amount of candidates (5%-10%) had computed **elasticity of demand** instead of computing the **demand coefficient** to be used to specify the demand function. These candidates had displayed a **very poor performance in the subsequent sections**. Intercept term had not been computed by many (about 50% of those who attempted) However, some candidates had scored full **marks maintaining the discipline throughout the answer** to this part of the question.

Overall performance **was however somewhat satisfactory**. Average marks scored on this part of the question varied from 1 ½ to 2 marks.

- 2.8 Overall performance **was very poor**. A considerable amount of candidates (about 40%) had failed to derive and compute the total revenue. In particular, these candidates had **multiplied the X (i.e. $X = 120 - 2P$) by X itself** to arrive at the total revenue displaying **very poor knowledge** about basic mathematics. A handful of candidates (about 15%) had rearranged the formula above, captioning P and **multiplied it by the minimum capacity, 20** to arrive at the total revenue, hence scored no marks. A number of candidates (about 20%) had **substituted 20 (the minimum capacity) into the above equation, as X and computed the price accordingly** to be used for the rest of the calculations. Surprisingly, a handful of candidates had computed a **breakeven point, dividing fixed cost by their (i.e. students' estimate) estimate of unit contribution**, displaying a lack of understanding of the **requirement** of the question.

A majority of the candidates (about 55%) from those who had attempted the question had been able to **specify the cost function including the fixed cost correctly**. A large amount of candidates (about 80%) had displayed their **unfamiliarity with solving the problem by quadratic equation**, which could have been done easily with a few steps. Only about 2%-4% of those who had attempted this question **had been able to solve the problem correctly**.

Overall, average marks obtained for the part ranged from 1 ½ - 2 marks.

- 2.9 The overall performance of the candidates **was somewhat satisfactory**. The average mark scored by candidates varies from **1 ½ to 2 marks**.

A considerable amount of candidates (about 50%-60%) had failed to **derive the total revenue function by integrals and many did not appear to have known that the total revenue is a function of integrals, of which the given function is the derivative, (i.e. which yields that function when differentiated)**.

However, some candidates (about 30%) had been able to **arrive at the unit at which the profit is maximized** but **failed to compute the maximum profit** as requested by the examiner. A number of candidates (about 40%) had failed to **compute the total revenue correctly** as they had multiplied the **profit maximizing unit by variable cost** (i.e. Rs. 60) instead of the **price computed** (i.e. Rs. 80). Some candidates (about 10%) had considered Rs. 100 – Rs. 60 as the unit price displaying a very poor understanding and comprehension.

Almost all the candidates, those who **proceeded up to computation of profit** (i.e. final stage) had been able to **specify the total cost function correctly in which the fixed cost was considered by all candidates**.

- 2.10** Average marks obtained for this part of question varied from **1 to 1 ½ marks** out of 3 marks allocated to the question. Many candidates (about 50%) had not **correctly treated the opening and closing stocks of unpacked tea**. The opening stock of tea packets at the finished goods stores and the expected closing inventory of tea packets had been **treated incorrectly**. Many of these candidates had followed an **accounting approach** (i.e. adding opening stock/s to and subtracting closing stock/s from the total budgeted sales, **in arriving at the total purchase requirement** of unpacked tea, which did not produce the correct answer in this question.

Some candidates (about 40%) had mixed up **grams and kilograms** and failed to compute the **total purchase requirement in one unit of measurement**. A number of candidates (about 30%) had ignored the fact that **one tea case contains 24 tea packets** when treating the number of **tea packets in inventory** in the computation.

The performance of the candidates is not up to the expectation.

Question 03

This is a two-part question testing the candidates' knowledge on the probability and statistics section of the syllabus. Many candidates had not attempted the question and the performance of those who had attempted the question is very poor. The question has the lowest average marks score for the paper, indicating the general weakness in mathematics and statistics among the Executive level student population.

Specific comments

- Part (a) Requires the candidates to prepare a table or diagram showing all possible outcomes, their profit, associated probabilities of the outcomes and the expected value of profit. Many could not identify all the possible outcomes, while some others who had identified correctly all the possible outcomes failed to calculate the profits of each outcome. Many had attempted to calculate the expected profit by calculating the expected number of units x expected contribution per unit minus expected fixed cost for each outcome without realizing that by doing so the expected fixed cost at each outcome is incorrectly calculated due to their failure to take the joint probabilities into consideration.
- Part (b) Due to the failure of the candidates to calculate the joint probabilities in part (a) many could not successfully attempt the part (b) of the question.

Question 04

General comments

This is a four-part question testing the candidate's knowledge on marginal and absorption costing. The performance of the candidates was satisfactory with the question having the highest average marks scored by the candidates.

Specific comments

Common mistakes made by the candidates were:

- (i) Value of the closing stocks calculated based on the value of the opening stocks (e.g. under marginal costing $606,000/125 \times 100$, under absorption costing $643,000/125 \times 100$).
- (ii) Using the absorption costing methodology for marginal costing and vice versa. Some were unaware of the difference between the two methods.
- (iii) Incorrect calculation of overhead absorption rate.
e.g. $OAR = \frac{\text{Budgeted FOH}}{\text{Actual units}} \quad \frac{\text{Actual FOH}}{\text{Actual units}}$
- (iv) When calculating overhead over/under absorption, candidates have used budgeted fixed production overhead to be Rs. 300,000 without flexing to $1,275 \times 250 = 318,750$.
- (v) Overhead over absorption not added to the profit, instead it was deducted. Also over absorption stated as under absorption.
- (vi) Profit statements worked out only up to the gross profit.
- (vii) In answering part (d) of the question, many could not state precisely the reason for the profit difference. Some had merely stated it as due to stock value difference or under absorption costing, the fixed overhead is part of the production costs.
- (viii) Some candidates took over/under absorption as the difference between the closing value of inventory under absorption method and the marginal costing method.
- (ix) In calculating the closing stock units some had taken budgeted production instead of actual production.
- (x) Closing inventory units calculation. Some had computed two different numbers of units under the two methods;
Marginal costing : $1,275 + 125 - 1,300 = 100$
Absorption costing : $1,200 + 125 - 1,300 = 25$

Question 05

General comments

Question tests the candidates' knowledge on payback period, ARR, NPV and IRR under simple project cash flow. Performance of candidates was satisfactory with the question having the second highest average marks.

Specific comments

Common mistakes made by the candidates were:

- (i) Many had not taken the revenue and residual values annually multiplied by the number of coaches. This may be due to not reading the question carefully.
- (ii) Adding back depreciation in the calculation of NPV when the question says that the total direct cost is excluding depreciation.
- (iii) Taking the fixed cost from other departments as relevant costs in the NPV calculation.
- (iv) Cash inflows and outflows have not been correctly applied as plus and minus respectively.
- (v) Taking the NPV in the calculation of ARR as the average profit.
- (vi) Average investment in the calculations of ARR taken incorrectly. Some had divided the amount by 5 (instead of 2) whereas some had not considered the residual value correctly in arriving at the average investment.
e.g. $\frac{80}{5}$, $\frac{80 - 40}{5}$, $\frac{80 - 40}{2}$, $\frac{80 - 4}{5}$, $\frac{80 - 4}{2}$
- (vii) Many had not deducted depreciation in ascertaining the average profit in their calculation of ARR.
- (viii) Revenue increased by 10% each year not accounted correctly. Direct cost not computed correctly. Other expenses taken only on monthly basis (not multiplied by 12).
- (ix) Only revenue had been taken into consideration in the calculation of the payback period.
- (x) ARR formulae had not been applied correctly with the required adjustments for depreciation and fixed costs.
- (xi) Discounting factors other than 15% per annum have been applied in calculating NPV.
- (xii) NPV vs IRR. Many had stated IRR does not consider the time value of money. Some had compared NPV to ARR.

Question 06

General comments

Three part question on budgeting using the time series forecasting method. Performance was poor with 49% of the candidates not attempting the question indicating a general lack of preference to/ weakness in mathematically based questions.

Specific comments

Common mistakes made by the candidates were:

- (i) Incorrect adjustment for seasonal variations, e.g. for seasonal index 110, some adding (110) some deducting (110) some multiplying by 110 instead of multiplying by 1.10.
- (ii) Value of x (x = 1, 2, 3, 4) needed to work out the sales trend y in the formula $y = 20,000 + 4,000x$ was not properly understood.
- (iii) Sales quantity worked out without considering the effect of the seasonal index.
- (iv) Calculating (a) and (b) in the equation, $y = a + bx$, using an incorrect formulae
- (v) Many had not taken into account the price increase of 10% in quarter 04.
- (vi) Even though the statistical data for $\sum x$ and $\sum x^2$ is given separately, some had taken $\sum x^2$ as 306^2
- (vii) Fixed overhead cost (a) considered as Rs. 4,000 instead of Rs. 4 million.
- (viii) Some had used n = 4 instead of n = 6.
- (ix) When calculating the production overhead in the formulae $y = a + bx$, some had given x values 1,2,3,4 to calculate the value of production overhead for the respective quarter.

Question 07

General comments

The answers to the question varied. Many candidates had performed satisfactorily scoring 50% or more of the marks allocated to the question. Some candidates had scored high marks whereas some others had performed poorly. The question consisted of five parts, which tested the candidates' knowledge of process costing, job costing and service costing.

Part (a) (i) required the candidates to calculate the normal loss and abnormal loss in units for the relevant process for the month for 2 marks. In part (a) (ii), where the mark allocation was 8, the candidates were required to prepare a statement of equivalent units showing the equivalent units produced during the month and the cost per unit of materials, labour and overheads using the weighted average cost method (AVCO). Part (a) (iii) required the candidates to assess the value of completed production, closing work in progress and accounting loss in the abnormal loss account for the month for 3 marks. Part (a) (iv) which had a mark allocation of 3, required the candidates to explain two distinguishing features of process costing in comparison with job costing. The requirement of part (b) was to calculate an estimated fare per kilometer at a 50% profit mark-up that AT, a business unit of the group operating a transport service, could charge for its transport services. The mark allocation for the part was 04.

Specific comments

Answers to part (a) (i) were generally not satisfactory. Many candidates had calculated the normal loss as 4,100, which was 10% of the units transferred from process 1. Only a few candidates had calculated the normal loss accurately as 3,900.

Many candidates had provided good answers to part (a) (ii). However, many candidates had calculated the scrap value of normal loss incorrectly. Some candidates took Rs. 2.52 million as the scrap value of normal loss. Some had taken the scrap value of each unit of normal loss to be Rs. 2.52. Some candidates had taken 2,400 equivalent units in respect of opening work in progress for labour and overheads according to the FIFO method, although the question requires the candidates to use the weighted average cost method (AVCO).

Part (a) (iii) was generally well answered. Many candidates hadn't set off the scrap value of abnormal loss against the cost of abnormal loss, in arriving at the accounting loss in the abnormal loss account. Some candidates had valued closing work in progress taking 8,000 units for labour and overhead as well, although they had correctly taken 4,000 units for labour and overhead in the statement of equivalent units.

Answers to part (a)(iv) were generally not satisfactory. Many candidates had explained only the features of process costing without making a comparison with job costing, although the question required a comparison with job costing. Some candidates seemed to lack knowledge of the features of process costing and job costing, as some hadn't attempted this part, whereas some candidates had provided good answers.

Part (b) was generally well answered, common mistakes made were some candidates calculating the fuel cost using 21,600 km instead of 24,000 km, considering the chargeable distance as 24,000 km instead of 21,600 km (90% of 24,000 km), omitting depreciation from the calculation and calculating depreciation for a year instead of a month

KE3 (A) – Fundamentals of Taxation

March 2017

Examiner's Comments

Question-wise comments

General comments applicable to all questions

- 1. The paper comprised of three (03) questions.**

Question 01

- (a) There were five (05) multiple choice questions covering the following areas of taxation:
- 1.1. Principles of taxation.
 - 1.2. Rent income received by a company (s.217).
 - 1.3. Executive officer for the purpose of taxation.
 - 1.4. Winnings from lottery.
 - 1.5. Deemed dividend tax.
- (b)
- 1.6 Computation of taxable rent income received by an individual.
 - 1.7 Gross income tax payable and balance tax payable by a company.
 - 1.8 Applicable penalties for failure to comply with statutory requirements to make self- assessment payments on or before the due dates.
 - 1.9 Difference between exempted supplies and zero-rated supplies with reference to Value Add Tax (VAT).
 - 1.10 Computation of NBT payable by a manufacturer.

Question 02

Computation of gross income tax liability and balance tax payable by a company which is a subsidiary of another company.

Question 03

Computation of gross income tax liability and balance tax payable by an individual who is employed in a private company and also carries on the business of developing software for the local market.

2. Subject matter tested in all questions was within the syllabus and adequately covered in the study pack published by CA Sri Lanka.

Overall performance in the question paper can be considered as satisfactory with around 50% of the candidates scoring 50% or more of the total allocated marks.

Specific comments

1. (a) Instances where information given in the question is not understood.

Question 03

- (i) The business carried by Pasindu was software development for the local market. A good number of candidates did not know that the profits and income of such businesses is taxable at a concessionary rate of 10%.
- (ii) Question 1 (b) part 1.7. A good number of candidates applied the 12% rate of tax assuming sha-sha ((POR) Ltd. is a small and medium company (section 59B). The business carried on by the company is buying and selling shoes for the local market. The concessionary rate (12%) of tax is available only to undertakings carrying on the business of manufacturing and the provision of services.

- (b) Instances where the requirements were not understood by the candidates.

Part 1.8. Majority of the students have misunderstood the question and mentioned recovery procedures, legal action, impounding passport, etc. Some candidates mentioned Rs. 50,000 which is the penalty for not furnishing income tax returns. The question clearly requires the candidates to state the applicable penalties.

2. Shortcomings/mistakes in candidates answers

- (a) Errors of principle/shortcomings in technical knowledge.

- (i) Part (b) 1.6

In computing the taxable rent income most candidates merely computed the net rent income but failed to compare it with the Net Annual Value (NAV).

- (ii) Part (b) 1.7

A few candidates applied the tax rate on sales to calculate, the tax liability.

- (iii) Part (b) 1.10

- (i) A good number of candidates calculated NBT on 50% of the sales.
- (ii) A good number of candidates claimed tax credit for NBT paid on services.

Questions 01 part (b) 1.7, 02 and 03

A number of candidates claimed tax credit from taxable income

Question 01 part 1 (b) 1.7 and 02

- (i) A good number of candidates applied a progressive rate of taxation in calculating the tax liability of a company.
- (ii) A few candidates claimed tax free allowances in respect of the company.

Question 03

- (i) A number of students claimed capital allowances in respect of fixed assets acquired from the lease.
- (ii) A few candidates claimed a Rs. 100,000 qualifying payments relief in respect of employment income.

(b) Mistakes made in the application of knowledge

Some students displayed knowledge in their written notes but failed to apply such knowledge.

E.g. Question 02 – one candidate mentioned in his notes that a donation to the Pradeshiya Sabha is not allowable but did not disallow the expense in the tax computation.

(c) Common mistakes made by the students

(i) **Question 01 (a)**

A majority of the students gave incorrect answers (options) to the following parts of the question.

- | | | |
|----------|---|-----------------------------------|
| Part 1.2 | - | Rent income received by a company |
| Part 1.5 | - | Deemed dividend tax |

(ii) Part 1.6

In ascertaining taxable rent income a significant number of candidates failed to compute the Net Annual Value (NAV) of the property for the purpose of comparison. The higher of Net Rent and Net Annual Value is the taxable rent income.

(iii) Part 1.10

A good number of candidates claimed NBT paid on services as a deduction from NBT payable.

Question 01 part 1.7 and 02

A significant number of candidates applied a progressive rate of taxation in calculating the tax liability of a company.

(d) Building/planning of the answer

Question 01 parts 1.7 and 1.10

A few candidates merely entered the answers without showing the computations of the answers.

E.g. 01: Gross tax liability is Rs. 1,999, 2000 without showing the computation as follows:
28% of Rs. 7,140,000.

Questions 02 and 03

Most students made mistakes in the tax computation.

- E.g.
- (i) Claiming qualifying payment relief under section 32.
 - (ii) Claiming interest paid on housing loan as a qualifying payment.

3. Good answers produced

- (i) A majority of the candidates displayed sound knowledge in the construction and presentation of the income tax computation in respect of both the company and individual.
- (ii) Over 50% of the candidates scored 50% or more of the total allocated marks.

Any other comments to be communicated to the students.

- (i) Question 1 (a) - multiple choice questions. Students should answer the multiple choice questions in the specially formatted answer sheet. It was observed that many students entered their answer in the normal paper.
- (ii) Display your knowledge.

E.g. 01 (Q.No.02) legal expenses incurred to recover bad debts is an allowed expense and therefore, no adjustment is necessary in the computation of adjusted trade profit. Students should mention this fact in their answer.

E.g. 02 Q.No.03) Computers acquired by finance lease are not eligible for capital allowances this should have been stated by the candidate.

Silence does not amount to an answer and the marking examiner cannot assume that the student is knowledgeable unless expressly displayed.

KE3 (B) – Fundamentals of Law

March 2017

Examiner's Comments

Question-wise comments

Originally the KE03 (Fundamentals of taxation & Law) question paper consisted of 2 sections i.e. Fundamentals of Taxation (40%) and Fundamentals of Law (60%). From March 2017 these 2 sections were separated and were made two separate papers (50% each) and the original 60% in Law was reduced to 50% and the balance 50% in Taxation. Out of the 50 marks in Fundamentals of Law, 20 marks (40% of the paper) was allocated for 10 MCQs and a candidate has to earn only 25 marks to pass the subject. If a candidate has earned 20 marks (100% for Q.No.01) he/she needs to score only 5 more marks out of the balance 30 marks allocated for the balance 3 questions i.e. Q. No. 02 (5 short answers), 03 and 04 (two mini scenario questions). It was observed that all 10 parts of question no. 01 were not difficult and the correct answers can be guessed by an average candidate who has a general knowledge in the subject area.

Accordingly it could be noted that a good number of candidates had scored 25 marks in the following manner. 20 marks for Q. No. 01 (10 MCQ) and the balance 5 marks from the rest of the questions i.e. $\frac{1}{2}$ or 1 $\frac{1}{2}$, 2, 2 $\frac{1}{2}$ or 3 marks for the other questions.

This clearly indicates that a candidate with no proper standard of knowledge in law could pass the subject since there are 20 marks for the 10 MCQ answers, which could be guessed and another 5 marks could be scored by obtaining $\frac{1}{2}$ or 01 mark per question from the rest of the other questions provided he/she has some general knowledge.

Question 01 – 10 MCQs

Almost all the 10 parts of the question are very easy any average candidate at Executive level can select the correct answers. Out of the 4 points given under each part, it could be noted that a very high percentage of candidates had scored 12 to 18 marks whilst a good number of candidates had scored 20 out of 20 marks.

Question 02 – 5 short answer questions

The five parts of question no. 02 are also easy and an average candidate can furnish short answers for them without any difficulties. Almost all those questions too are based on subject areas which can be answered with the general knowledge of an average Executive level candidate.

But many candidates were not very familiar with the areas tested or have failed to understand the question properly and were not competent to furnish acceptable answers. A majority had failed to understand parts 2.4 & 2.5 of the question and had dealt with the following areas instead of stating the requirements/conditions which should be fulfilled by an employer before terminating employment as per the Termination of Employment of Workmen (special provisions) Act No. 45 of 1971 (2.4) and explaining 2 defenses for the offences of theft (2.5)

- 2.4.
 - i. payments that should be made to a workman when he/she leaves the particular employment.
 - ii. Employees who are entitled for gratuity payments
 - iii. Employers who are liable to pay gratuity.
 - iv. Documents that should be returned or issued to employees by the employer.
 - v. Resignation letters given by employees and so on.
- 2.5
 - i. Differing the term theft.
 - ii. Punishment generally given for the offence of theft.
 - iii. Parties who initiate action against theft and so on.

Question 03

- (a) A good percentage of candidates were aware of differences between conditions and warranties and the effect if broken. There were others who had confused the two terms.
- (b) Many had expressed the view that delaying the payment of one monthly instalment is not material or a big issue and it is a breach of warranty and not a breach of condition. A few others had expressed the view that Movi had not refused to make the payment but just delayed the payment by 10 days and that Suvi can recover the installment with interest therefore cannot repudiate the contract since it is only a breach of warranty.

However, a minor percentage of candidates had correctly understood the scenario and what is expected from them and had furnished acceptable answers. Only a handful of candidates are familiar with the relevant case law and had quoted Lombard North Central PLC vs. Buttersworth in support of their answers.

Question 04

- (a) A majority of the candidates did not identify when the property of goods passed from the seller to the buyer or in other words they were not very familiar with the law relating to the sale of unascertained goods and liabilities of the seller and buyer in different stages. A high percentage of candidates stated that since the 15 bags of sugar were stolen when they were in the stores of Gilbert, he is liable to refund the price paid for them by Pandu. They have totally failed to realise that on the 3rd of January when Gilbert sent the delivery order to Pandu and informed that 125 bags can be collected from the location and the balance 15 bags from Gilbert's shop he (Gilbert) has appropriated all 140 bags of sugar and Pandu has indicated his

consent for this appropriation by his conduct i.e. he had not objected to such appropriation. Therefore, the property of all 140 sugar bags has passed from the seller (Gilbert) to the buyer (Pandu), hence answers that stated that Gilbert is liable to refund the price paid for the 15 bags and that it is the duty of Gilbert to safeguard the goods he sold to Pandu until the buyer collects them from him is incorrect.

Only a handful of candidates had correctly understood the question that when Gilbert appropriated the goods on the 3rd of January the property of the sugar bags had passed from the seller to the buyer, and when 15 bags were stolen the owner of those bags is Pandu (buyer) although they were in the shop owned by Gilbert and Pandu will not be successful in claiming the price paid for those bags from Gilbert. A few candidates quoted the correct case law *Pignataro vs Gilroy* in support of their answers.

(b) This question was based on a famous case *Panorama Developments vs. Fidelis Furnishing Fabrics*. The question was not correctly understood by a very high percentage of candidates. It appears that they were not familiar with the *Panaroma* case and had focused their answers on the directors. A few discussion points made by the candidates are given below;

- i. Aloma the secretary of ABC (Pvt) Ltd had not been given any authority by the company to enter into contracts on behalf of the company, therefore, the agreement by Aloma with the furniture hiring company is not a legally formed contract.
- ii. Aloma has not informed ABC (Pvt) Ltd that she is hiring furniture from a furniture hiring company, therefore, the company is not liable to pay for hiring the furniture.
- iii. She should not have hired expensive furniture without the prior approval of ABC (Pvt) Ltd.
- iv. Aloma has made a fraudulent misrepresentation to the furniture hiring company in hiring expensive furniture for her personal use, and the company is not liable to pay for the furniture since they were hired for the personal use of Aloma.

A majority of the candidates do not know that the secretary of a company can act as an agent of the company and has ostensible or apparent authority to enter into contracts on behalf the company and the company is liable for those contracts entered into by the secretary on behalf the company.

KE4 – Processes, Assurance and Ethics

March 2017

Examiner's Comments

Question-wise comments

General Comments

In this exam the candidate is expected to have knowledge on business processes, nature of internal controls surrounding them, concepts of assurance, and principles of values and ethics. In this exam good time management was generally well evidenced by the candidates. Many candidates have understood the requirements of the questions and displayed a sound technical knowledge by answering the questions with clarity. The common reasons for poor marks in this exam is due to;

- Not reading the question properly before answering
- When required to state, lengthy answers were written
- When asked to explain answers were written in point form
- The correct answer is written then it is cut and an irrelevant answer is written
- Time is wasted in answering all questions when there is an option- this was noted in good answer scripts. They could have used that time to improve the written answers

Question 01

This question carried 20 marks and tested almost all the areas in the syllabus. The overall performance was satisfactory other than for the following.

- 1.2. About 60% of candidates failed to identify the correct risk
- 1.8. About 70% of candidates were unable to understand why an accountant should behave ethically when dealing with money.
- 1.10. About 70% of candidates were unable to identify the activity that helps the auditor to determine the key areas more susceptible to material misstatements. It reflects that their technical knowledge on risk assessment is not satisfactory. The following deficiencies were noted in the answers to question no 01.
 - Marked two answers when asked to mark the most appropriate answer
 - Marked the answer on the top sheet where the marks are to be entered
 - Answered in numerical form when asked to use alphabetical letters

Question 02

This question consisted of 10 short questions carrying 3 marks each, almost all candidates have attempted this question and a fair number of candidates obtained satisfactory marks.

- 2.1. It was required to identify the core processes of the given scenario. Although the candidates could have picked up the answer from the question itself; a few candidates gave irrelevant answers such as;

- Place an order
- Receive an invoice
- Check the receipt of the goods
- Make payment

80% of the candidates have identified the core processes correctly.

- 2.2 The candidates were asked to define the negative risk and to give an example of a negative risk. Many candidates mixed up the negative risk with the strategic risk and wrote that possible outcomes may be either better or worse than expected, a few gave irrelevant examples such as;

- Loss of market
- Trade union action
- Bankruptcy of debtors

- 2.3 It was required to identify the type of operational risk for each event in the given scenario. Operational risks are risks of losses resulting from failures in internal processes and operations. Some candidates who did not have proper technical knowledge tried to address this risk by giving irrelevant answers such as;

- Breakdown in machinery-internal risk, going concern
- Employees fail to work according to procedures - personal risk, internal risk
- Selling products of poor quality - purchase risk, negative risk, competitive risk

Many candidates produced relevant answers for the third part.

- 2.4 It was required to identify the document given and state the purpose of it. Many candidates furnished relevant answers but a few have demonstrated poor technical knowledge and wrote irrelevant answers such as;

- Delivery note
- Bin card

- 2.5 It was required to explain the consideration to be taken into account when deciding the quantity of audit evidence. The expected answer was that the quantity is affected by the level of risk in the area being audited. Many have misunderstood the question and wrote irrelevant answers such as;

- Checking original documents
- Quantity depends on the nature of the entity and on the business operation
- Consider compliance with SLAuS

- 2.6 It was required to explain components of the COSO Internal control system. Many have produced satisfactory answers. Some have written irrelevant answers such as;
- Experience of the control staff
 - Professional competence
 - Questionnaires, flow charts
 - Documentation
- 2.7 It was required to list procedures that should be included in a process to be implemented in relation to employees leaving an entity. Some have written satisfactory answers but some have misunderstood the question and wasted time in explaining the procedures. There were irrelevant answers such;
- Pay EPF, ETF and gratuity
 - Make steps to fill the vacancy
- 2.8 It was required explain the difference between laws and morality. Many candidates produced satisfactory answers.
- 2.9 It was required to explain the two types of assurance engagements. Majority of candidates produced satisfactory answers. A few candidates demonstrated poor technical knowledge by giving irrelevant answers such as;
- Limited assurance-give a true and fair opinion
 - Reasonable assurance- does not give an opinion as insufficient evidence is obtained
- 2.10 It was required to identify two types of tests in an audit procedure for sales and state examples.
- Many candidates answered the first part and a few candidates were unable to produce relevant examples.

Question 03

- (a) It was required to identify specific deficiencies in the operational effectiveness of internal controls in the given scenario. Many candidates understood the deficiencies but failed to explain the impact of the deficiencies. There were completely irrelevant answers such as;
- As the reconciliation of the debtors balance of the control account with the ledger is done manually human errors will arise
 - Upgrading the debtors module will be subject to IT failures
 - Communication gap
- (b) It was required to define the term mitigating controls. This part was poorly answered due to failure to understand that the mitigating control is a control that is designed to discover the failures in controls. A few irrelevant answers were noted such as;
- Regularize or introduce controls in order to reduce the effect of system failures
 - Introduce segregation of duties as power is centered
 - Design controls to reduce cost
 - System to automate controls

- (c) It was required to identify mitigating controls to overcome the identified deficiency. As the candidates did not have knowledge on mitigating controls they produced irrelevant answers such as;
- Reduce human intervention
 - Introduce a new software for the debtors control account reconciliation
- (d) It was required to list inherent limitations affecting the operating effectiveness of the internal control. Many students wrote relevant answers but some were unable to understand that the internal controls may be ineffective in operation due to the reasons given in the answer. Many have written irrelevant answers such as;
- Poor design
 - Operational failures
 - Operational risk
 - No risk assessment
 - No access control
 - High cost

Question 04

This question was based on professional ethics

- (a) The candidate was required to identify the obligations imposed on a professional accountant under the principle of confidentiality. The average performance was satisfactory, but a few candidates failed to understand the requirements of the question. A few candidates produced irrelevant answers such as;

Confidentiality means

- not to do wrong things
- not to criticize client

- (b) In this part of the question the candidate was required to state the exception to the rule of confidentiality. Although the average performance was good there were irrelevant answers such as;

- When officers do corruption
- When the company deals with illegal practices
- When a survey is carried out by a professional body

- (c) In this part it was required to state the areas of an audit where professional judgment is required. Some candidates understood the question and wrote good answers. Many candidates however misunderstood and wrote answers such as;

- When there is self interest
- Areas of advocacy
- Areas of familiarity

There were candidates who demonstrated the knowledge but did not apply it properly and such answers were;

- When collecting the evidence
- When evidence is contractively
- When deciding the sample

Question 05

This question was on internal controls which are implemented to reduce the risks that have been identified.

- (a) It was required to identify the important internal controls missing in the process given in the scenario. The candidates should have known that there are internal controls in the entity but it was not adequate. Many candidates were unable to understand the requirements of the question. A few candidates wrote the weaknesses in the process and a few wrote the steps in the stock taking process. Some candidates wrote that the deficiency is that the stock levels are not maintained.

The following irrelevant answers were noted:

- As no stock movements are allowed during the stock count it will affect the production
 - The count sheets should be given to the auditor
 - Check the value
 - Arrange the stock sheets before the count
 - Agree stock balances with the ledger
- (b) In this part it was required to identify controls to reduce risks in the issues in the given scenario.
- (i) In this part it was expected to recognize the controls on the issue that payments are made to non-existing employees. Many candidates misunderstood the question. They were unable to identify the risk that the salaries payment will be incorrect. Some have written tests of controls instead of controls such as;
- Check attendance records
 - Observe segregation of duties
 - Check authorization process
 - Update the payroll
- (ii) In this part it was required to address the issue that all deductions and benefits may not be computed correctly. In order to reduce the risk of salaries being overpaid or under paid there should be controls and checks by the payroll staff. Many have misunderstood the requirements of the question and obtained poor marks. A few examples of such tests to be carried out by the auditors:
- Review reconciliation
 - Recalculate
 - Check management decisions
- (iii) In this part the issue was that payroll transactions may not be recorded properly. Many candidates have not understood the requirements of the question and wrote the audit tests to be carried out. They were unable to understand the risk in order to identify the controls that should be in place. Some candidates have written irrelevant answers such as;
- Maintain an information system
 - Introduce IT general controls

- (iv) In this part it was expected to identify the controls that should be in place in order to avoid payroll transactions not being recorded in the correct accounting period. Many candidates wrote irrelevant answers such as;
- Carry out an audit
 - Computerize the process
 - Assign the task to the finance manager

Question 06

This question was on audit evidence.

- (a) In this part it was required to identify sources from which the auditor can obtain audit evidence other than from accounting records. Many were unable to write relevant answers. Many have written answers such as;
- Checking source documents
 - Graphs flow charts
 - Examine vouchers
 - Examine bank statements
- (b) It was required to explain the meaning of relevant and reliable audit evidence. The candidates demonstrated poor technical knowledge and were unable to give the exact definition, and written such as;
- Relevant - for the purpose of the audit
- to agree with the objective
- Reliable - correct quantities
- correct information
 - acceptable

Many candidate wrote correct examples but it was disappointing that they were unable to explain the meaning of reliable and relevant audit evidence.

- (c) It was required to identify financial statement assertions for the transactions given. Although many candidates knew about the assertions, they were unable to identify the correct assertions related to the statement of comprehensive income and the statement of financial position. There were many answers such as;
- Direct confirmation-occurrence
 - Physical verification-measurement
 - Recalculation of samples-valuation
 - Reconciliation of sales ledger –presentation and disclosure

Many answers consisted of all possible assertions. Some candidates wrote irrelevant answers such as;

- Debtors control account
- Audit procedures
- General procedures

Question 07

This question carried 20 marks and consisted of 4 parts.

(a) It was required to identify the important missing fields in the receipt and the counterfoil given in the scenario. Many candidates ignored the fact that the company which operates vehicle parks need to account for the income of parking fees from the counterfoil. Many wrote irrelevant answers assuming that the person who parks the vehicle will have to get a reimbursement from their employer. Such answers were;

- Customers' signature
- Cashiers signature
- Name of the company and address
- Name of the director

(b)

(i) It was required to assess the business risks in the payment of salaries in the given scenario. Many have misunderstood the word payment and the information given in the scenario which mentioned that salaries are paid in cash. The candidates who had a sound technical knowledge easily identified the business risks. Many candidates wrote irrelevant answers such as;

- There can be frauds as the payment is made in cash
- As OT is paid the company will have a high cost
- As acknowledgement is not taken fraudulent persons can collect cash
- Money in the safe can be subject to theft

Some candidates identified the risk of underpayment or overpayment but linked to the issue that salaries are paid in cash.

(ii) It was required to explain the controls to be implemented to minimize the risks identified. As the identification of the risk was incorrect, most of the candidates wrote irrelevant answers such as;

- insure cash in transit
- pay through the bank or by cheque
- introduce swipe cards

(iii) It was required to explain the use of biometric devices and swipe cards. Many candidates furnished satisfactory answers

KE5 – Commercial Insight for Management

March 2017

Examiner's Comments

Question-wise comments

Question 01

General Comments

The overall performance of the candidates was good. The MCQ which carries 20 marks, was based on product attributes, balanced scorecard unity of command, economic resources, production possibility curve, porter's five forces model, external economies of scale, market positioning, control of inflation and law of diminishing returns.

Specific comments

Most of the students could not choose the correct answer for Q. no. 1.6 & 1.8. A fair number of students chose the correct answer for Q. no. 1.1, 1.3, 1.5, 1.7 & 1.9.

Question 02

General Comments

Overall the performance of the candidates was good. The question carried 30 marks and requires,

- 2.1 to state main characteristics of job production and batch-production.
- 2.2 to define efficiency and to state how it differs from productivity and effectiveness.
- 2.3 to explain the free-rider problem and to state ways to overcome the problem.
- 2.4 to explain consumer rationality.
- 2.5 to state 03 advantages of having a single supply sourcing strategy.
- 2.6 to explain relationship between GDP, GNP & NNP.
- 2.7 to state actions taken by any government to create jobs.
- 2.8 to state 03 factors that would trigger the need for an Organization to change or develop.
- 2.9 to explain core functions of a business Organization.
- 2.10 to explain the reasons for the behavior of the long run average cost curve.

Specific comments

- 2.1 Job products are made to customer orders and therefore they are non-standard. Batch products are standard and produced in certain volumes. A few candidates incorrectly stated that batch production is processed based on customer orders. Some were of the view that job production is made based on the customer needs and wants whereas batch production considers needs of a group of customers.
- 2.2 Efficiency means doing things right. Productivity is the rate of production overtime. Effectiveness is doing the right thing. A few candidates incorrectly stated that efficiency means doing right things and effectiveness means doing things right. According to some, productivity means obtaining the maximum output from a unit of input which earned only a few marks.
- 2.3 Anyone can get the benefit from public goods without a price being paid. This is the free rider problem. Most of the students have written the correct answer with examples. Around 5% of the students had not answered. Provision of the public services directly and introducing compulsory payments for the use of roads and highways are some of the ways to overcome the free rider problem. Some incorrectly stated that the government needs to do more investments on public goods to overcome the free rider problem.
- 2.4 When a consumer attempts to maximize the total utility attainable with a limited income and when the consumer decides to buy one unit of a good the marginal utility of which exceeds that of another alternative good, the consumer is said to have acted rationally. Some incorrectly described ordinal utility and cardinal utility. Some students have mentioned that when benefits from a good/service is more than the price paid, it is called rational behavior.
- 2.5 Stronger relationship with the supplier, facilitating better communication, economies of scale, facilitating confidentiality are some of the advantages of having a single supply sourcing strategy. Some students stated that 'convenience', 'time saving' as advantages without being elaborated. Some have repeated same point. E.g.; economies of scale, ability to obtain discounts etc.
- 2.6 GDP means total value of income/production from economic activities within Sri Lanka. GNP is arrived at after adjusting the net property income from Abroad to the GDP. Depreciation is deducted from GNP to arrive at NNP. Some candidates incorrectly stated that the difference between exports and imports is adjusted to GDP to arrive at GNP. A few stated incorrectly that NNP is arrived at after deducting GDP from GNP.
- 2.7 Encouraging growth in the private sector, encouraging training on job skills & offering assistance to employers are some action to be taken to create more jobs. A few candidates stated that by introducing new technology, job opportunities could be enhanced without being elaborated. A few stated that by launching large scale projects, jobs could be created.
- 2.8 Changes in the environment, technology, organizational structure and in the products the organization makes are some of the changes to be considered by an organization for the sake of sustainability.
- A few candidates stated that in order to expand the business and to increase the profit, changes need to be made, which earned no marks. Some stated that due to factors like technological, geographical & economical, changes need to be done by the Organizations without elaborating it further.

- 2.9 Core functions of a business are operations, marketing & sales and product & service development. Certain candidates explained that production activities, marketing activities and financial activities are core functions of a business. A few candidates explained the 'Input → Production process → Output' as main functions of a business, which earned no marks.
- 2.10 Increasing returns to scale, constant returns to scale and decreasing returns to scale are the 3 stages in the 'U' shaped long run average cost curve. The unit cost of production continues to fall as the volume of output rises" in the increasing returns to scale stage. In the constant returns to scale, output increases in the same proportion' as inputs. Output increases less proportionally to inputs in the decreasing returns to scale stage. A few candidates stated that due to economies of scale and diseconomies of scale, the long run average cost curve takes a U shape which earned some marks. However those candidates did not comment on the constant returns to scale.

Question 03

General Comments

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

- (a) List four determinants of the exchange rate
- (b) State two advantages and two disadvantages
- (c) Explain the impact of depreciation on the SL rupee

Specific comments

- (a) The rate of inflation and interest rate, the balance of payment with other countries, government policy of intervention to influence the exchange rates are the main determinants of an exchange rate of a country. Most of the candidates just stated the interest rate and inflation rate as determinants which earned only a few marks. Certain candidates incorrectly stated that the wage rate is also a determinant.
- (b) Advantages expected by the examiner are; Government does not have to hold foreign resources, balance of payments deficits or surpluses automatically corrected, it encourages an efficient allocation of resources. Disadvantages are; if the exchange rate appreciates too much under a floating exchange rate system international competitiveness may be reduced, uncertainty over the exchange rate could adversely affect trade and when the exchange rate of a country falls excessively, the import prices will go up and in turn, inflation will rise. A few candidates just mentioned that imports and exports will be encouraged under a floating rate. A few candidates stated that there will be issues/disadvantages under floating rate without the issues being elaborated.
- (c) Export goods will be cheaper resulting in greater benefits to export Companies and imported goods will be expensive which will lead to an increase in demand for locally produced goods. Most importantly, price elasticity of demand for exports and imports will be the deciding factor regarding the outcomes mentioned above. Only a few explained the result of elasticity of exports and import prices. Certain candidates stated that the prices of export goods will be high without explaining as to how it happens.

Question 04

General Comments

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

- (a) List two disadvantages of a tall Organizational structure.
- (b)
 - i) –Define the term ‘de-layering’
 - ii) –State three reasons that have led to de-layering Organizational structures.
- (c) State four benefits of delegation of authority.

Specific comments

- (a) The main disadvantages are an increase in administrative cost, slow decision making and responses and rigid supervision which will block initiatives. A few candidates stated that there will be a responsible person for each task which they did not explain as to how it becomes a disadvantage.
- (b)
 - I) De-layering is the reduction of the number of management layers from bottom to top which most of the students answered correctly. A few stated de-layering is a reduction of a layer. Approximately 2% of the candidates incorrectly mentioned that de-layering is the Management of an Organization by only a few members.
 - II) Information Technology, need for reduction of costs and empowerment are the main reasons which lead to de-layering Organizational structures. Some just stated that due to excess labour, de-layering is required. Some pointed out that in order to enhance efficiency and effectiveness, de-layering needs to be done.
- (c) Job satisfaction and development of lower level employees, managers are allowed to concentrate on higher level tasks such as Strategic Planning and Managerial and Technical specialization are some benefits of delegation of authority. A few candidates just stated that delegation will reduce the responsibilities and enhance efficiency without elaborating it further. A few candidates stated that delegation will lead to close supervision which earned no marks.

Question 05

General Comments

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

- (a) Explain two reasons as to why human resource management is important
- (b) Identify two strategies for managing staffing shortages and staffing surpluses.
- (c) Discuss the possible effects of implementing a policy of minimum wage using a diagram.

Specific comments

- (a) Increased productivity, reduced staff turnover and encouragement of initiative are the main reasons why HRM is important. Some candidates have just listed out these points without elaborating it. Some stated that HRM will enhance the efficiency without explaining it. A few candidates stated that HRM will enhance the production which is not sufficiently elaborative to earn marks.

- (b) Internal transfers, promotions, training, external recruitment and overtime are the main strategies to be adopted in dealing with a shortage of staff. To deal with a surplus, strategies like allowing voluntary retirement (VRS), restructuring recruitment and compulsory retirement as a last resort could be adopted. Almost all candidates wrote acceptable answers. A few stated that division of labour is a strategy to deal with a surplus. Around 2% of the students stated that departmentalization will give an answer to the surplus or shortage of staff, which earned no marks.
- (c) Immediate results would be an excess supply of labour leading to unemployment. However unemployment will not happen when an industry has been paying low wages which had already become unattractive. A graph showing the wage rate and number of workers is required to be drawn and the equilibrium wage needs to be shown and above which the minimum wage rate is to be displayed. Most of the students have correctly drawn the graph and indicated the possibility of unemployment as a consequence. However the candidates have ignored the circumstances where a lower wage rate compared to the standard rate was being paid. Some candidates have not understood the question and stated that efficiency and effectiveness would be reduced due to the imposition of minimum wages which earned no marks. They having misinterpreted the question stating that there would be protests staged by the employees against the reduction of wages.

Question 06

General Comments

Overall performance of the candidates was not satisfactory. The question carries 10 marks and requires to:

- (a) Explain three key features of monopolistic competition.
- (b) Explain why perfect competition is considered to be the most desirable market structure.
- (c) Discuss why firms in the breakfast cereal industry incur a wastage of resources.

Specific comments

- (a) Key features of monopolistic competition is the differentiation of products, no barriers to entry and a large number of firms in the industry. In most instances the questions were answered well. However a few stated either the features of a monopoly like one firm in the market or features of perfect competition i.e. price taker, a large number of firms which produce/sell homogeneous goods.
- (b) A graph showing $MR=MC=AC=AR=P$ at equilibrium quantity was required to be drawn. Some candidates have drawn the graph as expected. However most of the candidates could not prove that perfect competition is the most desirable market structure by pointing out the productive efficiency i.e. the lowest average cost and the allocative efficiency i.e. $P=MC$.
- (c) The breakfast cereal industry operates under monopolistic competition, in which the firms are both productive inefficient and allocative inefficient. Therefore wastage of resources could be evident in the breakfast cereal industry when differentiated versions of the same product exists. 'Advertising used to differentiate the products becomes wastage'. This part has been poorly answered by most of the students. Those who have attempted this part have not cited the waste on differentiation under advertising.

Question 07

General Comments

The overall performance of the candidates was satisfactory. The question carries 20 marks and requires students to,

- (a) Calculate the equilibrium price and quantity on the given demand and supply functions
- (b) Discuss how the prevailing conditions will impact the market for natural rubber using a suitable diagram.
- (c) Identify the nature of the likely cross elasticity of demand between
 - i) natural rubber and synthetic rubber
 - ii) automobiles and tyres
- (d) i) discuss the economic and social consequences of introducing a new subsidy
 - ii) discuss the consequences of a policy decision taken by the government to introduce a minimum price for rubber
- (d) Explain how the political environment could influence the industries in Sri Lanka

Specific comments

- (a) Most of the students managed to compute the equilibrium price at Rs. 500/- and the equilibrium quantity as 30,000 MT. A few candidates had made calculation errors and ended up with incorrect answers. Certain candidates were unable to indicate the unit of measurement i.e. Rupees and Metric tons.
- (b) Demand for natural rubber will increase due to increase in the demand for automobiles, synthetic rubber price- fluctuations in relation to world oil prices and due to speculative demand for natural rubber. On the other hand the supply of rubber will decrease due to poor weather conditions. Hence the demand curve will shift to the right and the supply curve will shift to the left resulting in an increase in price. Some have concluded incorrectly that the demand for natural rubber will go down. A few candidates identified the correct directions the supply and demand curve would move but had not stated the impact of it on the price.
- (c) Gross elasticity of demand between natural rubber and synthetic rubber is positive and automobiles and tyres is negative. A few candidates correctly identified the relevant gross elasticity, however some candidates incorrectly concluded that the gross elasticity of demand between natural rubber and synthetic rubber is negative.
- (d) i) The payment of a subsidy moves the supply curve downwards which results in a lower equilibrium price. Some candidates have correctly drawn the graph showing the equilibrium price and quantities before and after the subsidy is given. The candidates also discussed the possibility of the standard of living being enhanced. Some have correctly shown using the diagram the benefits both to the producer and consumer. A few candidates stated that social welfare would be reduced due to the provision of a subsidy.

Some candidates had drawn the graph showing only the reduction of the equilibrium price. They further pointed out that as a consequence of the subsidy being provided, there would be an increase in the rubber production and more foreign exchange could be earned.

- ii) The minimum price needs to be above the existing equilibrium price which results in an excess supply. Some mentioned that the excess supply could be exported but only a few stated that the export market would be dependent on elasticity of demand. Some argued that there would be a wastage of resources due to the minimum price being imposed without elaborating as to how it happens.
- (e) Government influence on taxation, tax relief, subsidies, regulations, controls, policies on different industries were correctly identified by some of the candidates who earned the full marks allocated. A few candidates explained that due to the short-sighted policies of the government, some industries were badly affected, which is not the proper answer to the question raised.