



## **Qualification Programme Examination Panelists' Report**

### **Final Examination (December 2013 Session) Paper I**

*(The main purpose of the following report is to summarise candidates' common weaknesses and make recommendations to help future candidates improve their examination performance.)*

#### **(I) Section A – Case Questions**

##### **General Comments**

The case was a rather short and straightforward one and candidates had a 30-minute reading time to read the case. However, a lot of candidates were unable to comprehend properly the case facts in order to extract the relevant information for their answers. This may be because candidates were too nervous to concentrate in the examination centre or felt too rushed to answer the questions within the time constraints.

Also, quite a lot of candidates did not answer in the context of the case facts and answered only in general terms. A significant number of the candidates just copied and pasted their answers from the Learning Pack ("LP") without proper elaboration/logical argumentation based on the case facts. Candidates should pay special attention to master the skills needed to apply the case facts in their answers.

As a future professional CPA, it is important to master the skills required to obtain a clear understanding of the business issues encountered. It is even more important to have an appropriate discussion and that all proposals are relevant and specific. The candidates' performance in these aspects requires particular attention.

##### **Specific Comments**

##### **Question 1(a) – 11 Marks**

This question required candidates to draft the cash flow projection to appraise Project Ebook by using the payback period and the net present value ("NPV") approach.

The purpose of the question was to examine candidates' understanding of the concept and application of cashflow in project evaluation. Unfortunately, a significant number of candidates failed to produce a cashflow table with the relevant cashflow items and their correct timing. Candidates were also unable to properly adjust for the non-cashflow items in their workings. Some candidates seemed not to understand the concept of sunk cost. As a result, most candidates could not arrive at the correct NPV answer.



In short, a significant number of candidates failed to demonstrate their understanding of the concept and application of cashflow and yet this is the very fundamental requirement in cashflow based evaluation.

With regard to the payback period, many candidates were unable to prorate in their computation the last cashflow period/year where the condition of total cash inflows equal to cash outflows occurred. Some candidates with a poor understanding of investment decisions even used the present value of cashflow items in their payback period calculation.

#### **Question 1(b) – 4 Marks**

This question required candidates to decide whether Project Ebook should be accepted with the sales team deployed.

The question was designed to examine candidates' understanding of opportunity cost. A lot of candidates failed to make the proper adjustment for the profit forgone. Some even adjusted for the tax effect despite the fact that net profit after tax was used in their workings. It was a worrying indication of candidates' competence in this topic and their carelessness in the examination.

#### **Question 1(c) – 6 Marks**

This question required candidates to compute the revised NPV and decide on what investment decision should have been made if the project was appraised at the beginning of 2013. This question also required candidates to decide whether DXG should continue with Project Ebook, if DXG re-appraises Project Ebook at the beginning of 2015.

The question was designed to examine candidates' understanding of what cashflow items were relevant. A lot of candidates still took into account past cashflow items, i.e. incurred before the investment decision reference point. This indicated that they did not fully understand that only future or forecast cashflow items would be relevant.

#### **Question 1(d) – 4 Marks**

This question required candidates to discuss the benefits of conducting a post-completion audit and to recommend who should be responsible for conducting it.

Most candidates performed well in this question as the suggested answers could be found in the Learning Pack. However, there were still a small number of candidates who did not know that a completion audit should be conducted by personnel independent of the original project team.



**Question 2(a) – 13 Marks**

This question required candidates to explain and analyse whether DXG should consolidate the financial information of GFM and its subsidiaries in its consolidated financial statements for each of the scenarios listed. This question also required candidates to explain whether DXG was required to adjust the comparative information and to what extent in its 2013 consolidated financial statements.

For scenario (i), the candidates' performance was satisfactory. Most candidates were able to determine that DXG had power over GFM through de facto control and the financial information of GFM and its subsidiaries should be consolidated in DXG's consolidated financial statements for the year ended 31 December 2013. However, some candidates forgot to answer as to whether comparatives should or should not be restated retrospectively.

For scenario (ii), the candidates' performance was satisfactory. Most candidates were able to determine that DXG did not have the power to control GFM and that no consolidation of financial information of GFM and its subsidiaries was required for the year ended 31 December 2013.

For scenario (iii), the candidates' performance was not satisfactory. Most candidates were not able to discuss or evaluate whether DXG had the power to control GFM and consequently whether consolidation was required for the year ended 31 December 2013.

The majority of the candidates were not able to specify that the assessment of control should be performed on a continuous basis under HKFRS 10. The reassessment should also be performed when changes occur which affect one or more of the elements of control.

**Question 2(b) – 4 Marks**

This question required candidates to recommend and explain the accounting treatment of the share-based payment transactions in the separate financial statements of GFM's subsidiaries.

The candidates' performance was not satisfactory. Some candidates were able to determine that this was an equity-settled share-based payment transaction if the subsidiary had no obligation to provide its parent's shares to its employees.

In respect of accounting treatments, most candidates were not able to specify under which accounts caption in profit or loss such expenses should be recognized.



### **Question 2(c) – 8 Marks**

This question required candidates to explain why the company's statement of financial position (balance sheet) is always presented in the consolidated financial statements in the group accounts of a Hong Kong incorporated parent company. This question also required candidates to discuss the true and fair view financial statements presentation requirement in the Hong Kong Companies Ordinance and the Hong Kong Financial Reporting Standards.

The candidates' performance was not satisfactory. They were not familiar with the Hong Kong Companies Ordinance requirements governing the preparation of financial statements. Good candidates were able to discuss the requirements under HKAS 1, *Presentation of financial statements*, in respect of true and fair view and compliance with HKFRSs.

### **Question 3(a) – 8 Marks**

This question required candidates to explain what inherent risk and control risk are. This question also required candidates to discuss, based on the case facts, the factors affecting the auditor's assessment of the risk of material misstatement, covering inherent risk affecting the entity as a whole and affecting particular account balances or transactions, and control risk relating to the entity.

Most candidates were able to define inherent risk and control risk and explained the factors affecting the entity as a whole in relation to the auditor's assessment of inherent risk and those factors in relation to the auditor's assessment of control risk. However, only some candidates were able to elaborate how the facts in the case affect particular account balances or transactions. Some candidates only discussed in general the factors affecting inherent risk and control risks without specific reference to the case facts, despite this explicit question requirement. Their scoring was thus unsatisfactory.

### **Question 3(b) – 8 Marks**

This question required candidates to explain what detection risk is and its relationship with inherent risk and control risk. This question also required candidates to explain, based on the case facts, how the external auditors might manage detection risk by varying their work.

Most candidates were able to define detection risk and explain its relationship with inherent risk and control risk.

However, the second part of the question was not answered satisfactorily as a lot of candidates misunderstood the question requirements and listed out only the audit procedures for three selected account balances or transactions and did not explain how the auditors managed the detection risk by varying their work or procedures in the aspects around the nature, timing and extent of testing or audit.



### **Question 4 – 9 Marks**

This question required candidates to explain why the external auditor would generally assess the internal audit department and its work. This question also required candidates to explain how the external auditors would assess the internal audit department and specifically what additional procedures the external auditors should perform before placing reliance on the work of the internal audit.

Only a few candidates were able to point out that the auditor's assessment of internal audit work could be related to the assessment of the internal control environment of an entity or as a pre-requisite for placing direct reliance on the work of the internal audit.

Most candidates were able to name the factors to be considered in assessing the internal audit department and the additional work to be performed before placing reliance on the work of the internal audit. However, some candidates did not refer to the case facts at all, although this was an explicit question requirement.

## **(II) Section B – Essay Questions**

### **General Comments**

In general, candidates performed well in those questions in which the answers could be directly copied from the Learning Pack. However, the candidates should not just copy straight from the Learning Pack, past year papers or textbook materials without also properly linking such information to the facts and scenarios given in the case and questions.

Also, candidates should have enough examination preparation so that their answers are not too short or too general. It is difficult to get marks if the answers are not relevant and do not elaborate on issues in depth.

Furthermore, candidates should read the questions thoroughly in order to fully understand the exact question requirements. For example, in the question related to the change of accounting year-end date, although the question stated that it was a “new” business from the tax perspective, some candidates still stated that it was an “old business (pre-1974)” and drew the incorrect conclusion.

### **Specific Comments**

#### **Question 5(a) – 5 Marks**

This question required candidates to advise on how to properly report in the Employers' Return (BIR56B) the income received by the relevant staff of GFM who had entered into employment contracts with GFM's Hong Kong and Macau subsidiaries in order to fulfill the requirement of the IRD and to advise whether these staff were entitled to lodge a partial exemption (explain bases) for Hong Kong Salaries



Tax in their Individual Tax Return (BIR60), if they had paid certain tax for the income derived from their Macau employment.

The candidates did not perform well in this question as most of the candidates just explained the factors that constituted a Hong Kong employment and non-Hong Kong employment, without going into the details of how to fulfill the IRD's reporting requirements.

**Question 5(b) – 7 Marks**

This question required candidates to advise when and on what basis Peter's share option benefit was assessable. This question also required candidates to advise on how to minimize Peter's salaries tax liabilities in the case if Peter elected to have the share options benefits assessed notionally.

The candidates performed well in this question and most of the candidates could state the detailed requirements under DIPN 38.

**Question 6(a)(i) – 4 marks**

This question required candidates to advise as to the Hong Kong Profits Tax treatment of the recharge of share option expenses.

The candidates performed well in this question.

**Question 6(a)(ii) – 6 marks**

This question required candidates to advise on the necessary documentation required to justify the recharge of share option expenses for IRD's scrutiny in a prudent manner.

Candidates answered this question unsatisfactorily even though this question was open-ended and any answers based on reasonable commercial substance or rationale would have been accepted. Most of the candidates used the "audit approach" to answer this taxation question and listed out the audit procedures and audit documentation requirement as answers to the necessary documentation for share option expenses. Again, these candidates had misunderstood the question requirements.

**Question 6(b) – 3 marks**

This question required candidates to discuss whether the potential change of accounting year-end date would trigger any adverse tax implication for GFM and how such a change could be applied in the forthcoming profits tax return filing.

It was disappointing to note that many candidates answered this question unsatisfactorily despite the fact that this was quite a straightforward question.