



Qualification Programme Examination Panelists' Report

Final Examination (December 2017 Session) Paper II

(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 candidates' performance was unsatisfactory. In general, most candidates showed insufficient comprehension of the case facts and understanding of the question requirements. Candidates did not answer in the context of the case facts and candidates did not respond specifically or apply the case information properly. As a future professional CPA, it is important to have appropriate and in-depth discussions in order to devise proper and specific responses.

Specific Comments

Question 1(a) – 5 marks

The question required candidates to analyse and advise as to the financial impact and disclosure requirement if the waiver letter for strict compliance of financial covenants was obtained on 10 April 2017 instead of 30 March 2017.

The candidates' performance was less than satisfactory. Most students were clear about the question requirement and could comment that the breach led to the reclassification of the bank loan to current. However, many candidates wrongly considered the waiver was an adjusting event. Many candidates copied the general disclosure requirement instead of the specified disclosure requirement based on the fact pattern.

Question 1(b)(i) – 3 marks

The question required candidates to explain whether the management should consider financial distress in determining the capital structure.

The candidates' performance was less than satisfactory. Most candidates stated the definition of Modigliani and Miller's theory and failed to relate their answers to the question being tested and candidates were unable to relate their answers to the reality that the firm would worry about financial distress.



Question 1(b)(ii) – 3 marks

The question required candidates to explain whether it was possible for the company to reach the optimal amount of debt in the capital structure.

The candidates' performance was unsatisfactory. Most candidates stated the definition of Trade-off theory and failed to relate the answers to the question being tested and most candidates could not elaborate with regard to the dynamics between the increasing amount of debt against the cost of debt.

Question 2 – 6 marks

The question required candidates to explain the reasons that corporate management often undertake rights issues instead of seasoned offerings (cash offers) to raise capital.

The candidates' performance was fair. In general, candidates were able to apply appropriate technical knowledge. However, candidates could not elaborate and present their answers from the company's perspective.

Question 3 – 6 marks

The question required candidates to explain the impact of the rights issue granted after the year end on the financial statements and calculate the basic and diluted earnings per share.

The candidates' performance was less than satisfactory. Only a few candidates could identify the "bonus element" in the rights issue. Most candidates demonstrated a lack of understanding regarding the impact of the rights issue on earnings per share, including time apportioning the rights issue. Some candidates even stated that the rights issue was a non-adjusting event and hence had no impact on earnings per share.

Question 4 – 9 marks

The question required candidates to explain the accounting treatment of the acquisition-related costs in the consolidated financial statements for the year ended 31 March 2017 and the impact after receiving the finalised PPA report on the consolidated financial statements for the year ending 31 March 2018.

The candidates' performance was fair. Most candidates could properly conclude that the acquisition-related costs should be expensed off. However, the answers were too general and without proper explanations.



Question 5 – 5 marks

The question required candidates to define the terms “specified financial statements” and “non-statutory accounts” under the Hong Kong Companies Ordinance and explain the requirements that apply when making “specified financial statements” and “non-statutory accounts” available to others.

The candidates’ performance was unsatisfactory. Around half of the candidates did not attempt the question and for those candidates who answered the question, they provided irrelevant points. This demonstrated their understanding on this topic was weak.

Question 6 – 4 marks

The question required candidates to evaluate whether the target that allows for each of the younger staff to receive an annual withdrawal amount of HK\$350,000 with a 25-year withdrawal period after 30 years could be achieved.

The candidates’ performance was unsatisfactory. Most candidates did not attempt the question or did so with irrelevant calculations. Most candidates showed a weak understanding and application of the technical knowledge to the facts provided in the question and candidates were not familiar with an annuity calculation, especially a Future Value Annuity.

Question 7(a) – 5 marks

The question required candidates to explain whether the parties involved could earn excess if they made trades based on the information provided.

The candidates’ performance was fair. In general, candidates understood and applied their technical knowledge appropriately to the facts provided.

Question 7(b) – 4 marks

The question required candidates to advise as to the ethical issues involved in accordance with the Code of Ethics for Professional Accountants.

The candidates’ performance was fair. Candidates demonstrated that they had the fundamental understanding of the technical knowledge tested. However, some candidates focused on the legal implication of the cases involved instead of the Code of Ethics for Professional Accountants.

Question 8(a) – 9 marks

The question required candidates to state, with reference to the relevant standard, four matters that AAA & Co have to address before accepting the engagement to become the auditor of the Group. Candidates also had to identify any concerns raised



related to these four matters and provide one suggestion as to how AAA & Co should respond to each of the concerns identified.

The candidates' performance was fair. Some candidates did not read the question carefully and only provided suggestions for each of the related matters. Some candidates' discussions were too generic and without linkage to the case.

Question 8(b) – 12 marks

The question required candidates to identify four specific areas that should be focused on in order to address the risks from the overall financial statement's perspective. For each of the specific areas identified, candidates had to list two items that they had to remind the engagement team of regarding how that area should be addressed. Detailed audit procedures were not required to be set out for the purpose of answering this question.

The candidates' performance was unsatisfactory. Some candidates did not read the question carefully and copied the same responses from question 8(a) and discussed the integrity, ethical issue and competence. The question clearly stated to focus from the overall financial statement's perspective. Candidates should be aware that it was unlikely the same question was asked again and the same responses could be applied in two different questions. Candidates were also weak in the application of technical knowledge to the facts provided in the case. Many candidates only listed out a number of items to remind the engagement team without specifically matching them with the specific risks identified as stated in the question. Some candidates only copied the standards related to the risk of material misstatement from the learning pack without applying the case information. Many candidates were not able to identify that "first year audit" and "laws and regulations" were specific areas that should be focused.

Question 8(c) – 4 marks

The question required candidates to state how the disclosures in the notes to the financial statements would impact the audit opinion. Also, with reference to the relevant standard, candidates had to state how the going concern issue should be reflected in the auditor's report.

The candidates' performance was less than satisfactory. Candidates were not familiar with HKSA 701(Revised) *Communicating Key Audit Matters* and were not aware that a matter related to going concern by nature is a key audit matter but it has to be covered in either the basis of qualified (adverse) opinion, or in the material uncertainty related to going concern section.

(II) Section B – Essay Questions

General Comments

Most candidates were not familiar with the latest tax developments and the tax principles of some important tax cases. In addition, Hong Kong has entered into a lot of Double Taxation Agreements (“DTA”) with other countries and has actively participated in the Base Erosion and Profit Shifting (BEPS) Action Plan. It is therefore important for candidates to understand how Hong Kong DTAs operate from an international tax perspective.

Specific Comments

Question 9 – 10 marks

The question required candidates to analyse the different circumstances under which income from employment may be taxable.

The candidates’ performance was fair. However, many candidates were unable to differentiate the tax treatments applicable to mandatory and voluntary contributions as well as the principle that “income from employment comprises income for past and future services”.

Question 10 – 15 marks

The question required candidates to recommend measures to mitigate both the taxes in mainland China and Hong Kong under a specific business model.

The candidates’ performance on Hong Kong tax part was fair. However, knowledge of the application of DTA was still insufficient. For the China tax part, most candidates focused on discussing on the permanent establishment (“PE”) based on the “services PE” but only a few candidates considered other aspects, such as “agency PE” and “fixed place of business”. Many candidates were not aware of the important tax development that Value Added Tax has replaced Business Tax in mainland China.

(III) Conclusion and Recommendation

Same as Paper I, candidates had difficulties in questions relating to practical situations or in-depth analyses. They are recommended to expose themselves more to practice in addition to their revision of the study materials and past examination papers.

Candidates should be aware that success in the CPA professional examinations requires hard work to become familiar with the examinable topics. They should familiarize themselves with different aspects and different practical scenarios of the topics during their studies.