



SAICA

THE SOUTH AFRICAN INSTITUTE
OF CHARTERED ACCOUNTANTS

MARKERS' AND UMPIRES' COMMENTS INITIAL TEST OF COMPETENCE (PREVIOUSLY KNOWN AS PART I OF THE QUALIFYING EXAMINATION) JANUARY 2013

OBJECTIVES OF THIS REPORT

This report has been compiled from the analysis of examiners on candidates' performance in the Initial Test of Competence (ITC) – previously known as Part I of the Qualifying Examination, which was written in January 2013. Its objectives are to –

- assist unsuccessful candidates in identifying those areas in which they lost marks and need to improve their knowledge and/or presentation; and
- assist future exam candidates, by providing a commentary for them to use when working through past papers.

To accomplish these objectives, the report provides background information on how the examination questions are chosen, marked and adjudicated, comments on general shortcomings in answers and specific comments on each question of the two examination papers.

The purpose of the ITC is to test the integrated application of technical competence, preferably as soon as possible after the prescribed academic requirements have been met.

The remainder of this report is discussed under the following headings:

- Statistics for ITC 2013
- Background information on the setting, marking and adjudication of SAICA examinations
- General comments on ITC 2013
- Detailed comments by question
 - Professional paper 1
 - Professional paper 2
 - Professional paper 3
 - Professional paper 4

STATISTICS FOR ITC 2013

| | % Pass | Passed | Failed | Total |
|-----------------------|---------------|---------------|---------------|--------------|
| First attempt | 86% | 1 884 | 314 | 2 189 |
| Repeat candidates | 42% | 388 | 531 | 919 |
| All candidates | 73% | 2 272 | 845 | 3 117 |

Average marks per question

| | Question 1 | Question 2 | Total |
|--------------------|-------------------|-------------------|--------------|
| Paper 1 | | | |
| Total marks | 75 | 25 | 100 |
| Average marks | 35.72 | 16.83 | 52.55 |
| Paper 2 | | | |
| Total marks | 55 | 45 | 100 |
| Average marks | 27.65 | 24.67 | 52.32 |
| Paper 3 | | | |
| Total marks | 50 | 50 | 100 |
| Average marks | 23.31 | 27.49 | 50.80 |
| Paper 4 | | | |
| Total marks | 100 | | 100 |
| Average marks | 53.84 | | 53.84 |

More detailed statistics can be found on the SAICA website at www.saica.co.za.

BACKGROUND INFORMATION ON THE SETTING, MARKING AND ADJUDICATION OF SAICA EXAMINATIONS

The Examinations Committee (Examco) constantly strives to improve its ability to determine whether candidates demonstrate a readiness to continue with their accounting education and training. This is done by means of an ongoing process of evaluation and improvement of the way in which it selects questions for inclusion in the examination and decides on the final mark plans.

1 Source of the questions

Examco is a sub-committee of the SAICA Initial Professional Development Committee (IPD Committee), and takes overall responsibility for the setting of the examination paper. Examination questions are drawn from different sources:

- Questions may be submitted by practitioners, accountants in commerce and industry, as well as academics. These questions are added to a question pool that has been built up over the years and from which questions may be selected; or
- Questions on a particular subject may be commissioned from persons in commerce and industry or public practice or from academics.

Academics or former academics are also involved in reviewing exam questions in each of the core subject areas. Academics who have any involvement whatsoever in the presentation or otherwise of Board courses may NOT act as reviewers. These academics or former academics are appointed by core subject area and their role is to –

- review questions for conceptual problems and consistency in use of terminology;
- give an indication as to whether the relevant examination questions are set at an appropriate level;
- provide comments on whether the number of marks and time limit are appropriate; and
- provide comments on the validity and reliability of such assessment.

In addition, two external examination sitters, who are independent of the exam setting process, are appointed to review the entire set of questions after the review by the academics has been completed. The examination sitters provide independent comments on the examination paper, suggestion solutions or mark plans which are reported to the Examco.

SAICA would like to acknowledge and thank all the people involved in the examination setting process. An alphabetical list of all the people involved in various roles, including members of the Examinations Committee, question composers, subject specific reviewers and external examination sitters, is as follows:

Greg Beech
Graeme Berry
Helen Bimbassis
Alex Brettenny
Carol Cairney
Glynnis Carthy
Karien Coates
Fed de Hart
Reghardt Dippenaar
Cobus Grove
Andre Hamel
Thinus Hamman
Muneer Hassan
Beverley Jackson

Goolam Modack
Ferdinand Mokete
Terry Moore
Veryl Mulder
Piet Nel
Renshia van Noordwyk
Mandi Olivier
Greg Plant
Jo-Ann Pohl
Karen Stark
Kobus Swanepoel
Amanda Singleton
Dirk Steyn
Sandy van der Walt

Dana Josset
Tracy Krauss
Francois Liebenberg
Zwelo Mabhoza

Nico van der Merwe
Pieter von Wielligh
Craig Wallington

2 Security and confidentiality of examination papers

The examination papers for each year are compiled, printed and sent to each examination centre under very stringent conditions of security. The only persons who know the contents of a particular paper are the members of the Examco. They are all selected with great care regarding their integrity and professional standing and are sworn to secrecy.

3 The marking process

The Examco devotes a great deal of time to the review and refinement of mark plans to ensure that the plans are consistent with its expectations for each question.

Before marking of the scripts commences, copies of the examination papers and suggested solutions are forwarded to all participating universities for comment. The markers and umpires decide on a suggested solution and mark plan once all these comments have been considered and a test batch of scripts has been marked. The suggested solutions, mark plans and test batch results are then reviewed by the Examco, which authorises the final suggested solutions and the mark plans that will be used in the marking process.

Marking is undertaken by teams, with each team consisting of a number of markers (comprising academics, practitioners and representatives from commerce and industry) and an umpire, who are on the whole fully bilingual and equally capable of marking both English and Afrikaans scripts. Markers and umpires are assigned to specific questions based on their fields of expertise.

All markers and umpires have to sign a declaration of secrecy regarding the handling of scripts, questions, solutions and mark plans. SAICA holds the copyright of the solutions and mark plans.

Marking of ITC 2013 again took place at a central mark centre. An administration hub was set up, from which administrative personnel controlled which scripts were signed out, to whom and when the marked scripts were returned. All marking took place at the central mark centre. Each script was marked independently by two different persons who recorded their marks on separate mark sheets. Only once the double blind marking of each batch of scripts was completed did the markers confer and jointly decide on the final mark to be awarded (i.e. during the marking process). Thereafter each marker's mark, as well as the final mark, was noted down on the cover of the script. In the event of the markers being unable to agree upon the number of marks to be awarded for a particular answer, the script was referred to the umpire, who then awarded the final mark. SAICA secretariat was responsible for capturing and final checking of the marks of all candidates.

Consistency marking was introduced in 2012, in which a pack of ten scripts (consisting of six scripts selected from first timers and four from repeat candidates) are selected on a random basis by SAICA's Examinations Unit, and the exam numbers removed. These scripts are then numbered from 1 – 10 and photocopied. Every person on the mark team has to mark the question to which they have been assigned in the batch of ten scripts. This takes place on the first two days of the main marking process and the umpire, together with his/her mark team, then discuss how the individual markers award the marks point by point for each question. The aim of this process is to identify any concerns, differences and discrepancies in interpretation that the marker(s) may have in awarding of marks as per the final mark plan before final marking commences. The main

objective is to achieve consistency in the way the different markers within a mark team award marks.

In view of the above stringent marking process no request for re-marks will be entertained.

4 Adjudication

Adjudication is a process during which the IPD Committee considers all relevant evidence, including the following, to determine the final marks to be awarded for each question:

- Whether there were any time constraints encountered by candidates;
- The level of difficulty for each question;
- Possible ambiguity in the wording or translation; and
- Any other problems that may have been encountered relating to the examination.

The members of the Committee do not know the candidate details at the time the adjudication process takes place.

Adjudication is done by the full IPD Committee as soon as possible after the marking process has been finalised and checked by the SAICA secretariat.

It is important to note that no person from the academe who is a member of SAICA's IPD Committee is allowed to serve on the Examco, and that candidates' anonymity is preserved until the final adjudication has been completed.

In order to ensure that the whole marking and adjudication process remain anonymous, the instructions to candidates clearly state that their names should not appear anywhere on their scripts.

GENERAL COMMENTS ON ITC 2013

1 Objective

In view of the primary objective of ITC, namely to test the integrated application of technical competence, candidates are tested on their ability to –

- apply the knowledge specified in the subject areas set out in the prescribed syllabus;
- identify, define and rank problems and issues;
- analyse information;
- address problems in an integrative manner;
- exercise professional judgement;
- evaluate alternatives and propose practical solutions that respond to the users' needs; and
- communicate clearly and effectively.

2 Overall comments on the papers

Overall comments received from universities indicated that the papers were of an appropriate standard for ITC.

- The **accounting and external reporting question's** level of difficulty was generally described as "moderate" or fair" and of a good standard, as can be expected for this part of the examination. The question was solely an external financial reporting question. The questions required candidates to have a good knowledge of and solid foundation regarding the basic principles underlying the topics. Topics examined were relevant and of importance both in practice and in the academic syllabus.

However, a few areas relating to general exam technique need to be highlighted, and may be of use to candidates for purposes of future examinations:

- Many candidates were unable to demonstrate a clear grasp of the principles relating to changes in the degree of ownership, even though they exhibited a good understanding of the basic principles.
 - Many candidates struggled to articulate the application of principles before arriving to the conclusion. This was most evident in discussion type questions.
 - Candidates did not provide any or all journal narrations.
- The **tax question** was set at an appropriate level of difficulty. The question was well balanced with an increased focus on the application of principles rather than the calculation based approach. However, candidates did not perform as well as expected this showed a lack of ability to answer discursive questions.
 - The **strategy, risk management and governance** questions were set at a moderate level of difficulty overall for the two questions. In Paper 2 Part B various principles of King III and companies act sections were combined and tested but overall candidates struggled to understand the composition of the board, and battled in exhibiting integration of knowledge..
 - The **management decision making and control** question assessed the candidate's ability to apply competencies in a typical business context. The question was well balanced and covered a range of topics. The majority of the answers provided by the candidates indicated a level of difficulty experienced in responding to the standard costing question and the analysis and discussion of a business line
 - The **audit** question was relatively straightforward, testing for the most past basic principles of external auditing. The question was reasonably well answered by candidates however as

highlighted in prior years examination technique was again, a problem. Many candidates did not read and consider the information of the question carefully or apply this in answering the question. This often resulted in generic or mind dump type of answers.

- The **financial management** question exposed the candidates to a “real world flavour” in considering the trucking industry, especially in today’s economic environment where fuel prices are increasing rapidly and transport companies are seeking different methods to save costs. The question tested technical competence in financial analysis and corporate finance. Important strategic issues relating to outsourcing decisions needed to be dealt with and required candidates to calculate the NPV and IRR of the planned reinvestment in the trucks. Candidates in some instances fell short as they were unable to display the depth of knowledge regarding ROI as a performance measure and merely touched on key issues. Candidates also found it difficult to distinguish between the driver’s revenue and that earned by TTT.
- **Pervasive skills** were also assessed more extensively in this exam with communication skills being given additional prominence by the requirement being specifically set out where required for each section of the relevant questions.

3 Specific comments

From a review of candidates’ answers to the seven questions for the January 2013 examination, the general deficiencies set out below were identified. These problems affected the overall performance of candidates, and it is a matter of concern that candidates make the same mistakes year after year. Although these aspects seem like common sense, candidates who pay attention to them are likely to obtain better marks, and it may even turn a low mark into a pass.

3.1 *Application of knowledge*

A serious problem experienced throughout the examination was that candidates were unable to **apply** their knowledge to the scenarios described in the questions. Many responses by candidates were a ‘shopping list’ of items – this being a pure regurgitation of what candidates may have learnt about the theory at university, but of no real relevance to the question in hand. Candidates also do not appear to be able to identify the correct issues in the scenario provided.

This is a major concern, because by the time candidates qualify for entry to these examinations, one would expect them to have assimilated the knowledge, at least to the extent of being able to apply it to simplified facts as set out in an examination question. Obviously, candidates who are unable to identify the correct issues did not do well in the examination.

3.2 *Workings*

It is essential that candidates show their workings and supply detailed computations to support the figures in their answers. Marks are reserved for methodology, but can only be awarded for what is shown. **Workings should, like the rest of the paper, be done in blue or black ink to ensure legibility.** In many instances workings were performed by candidates but not cross-referenced to the final solution. Once again, markers could not award marks as they were unable to follow which working related to which part of the final solution. Candidates must ensure they show their workings and that these are properly and neatly cross-referenced to the final solution.

3.3 Communication

Candidates fared better in questions requiring calculations than in discursive questions. It is important that candidates bear in mind that written answers are a large component of the Qualifying Examination, because written communication is a key competency required in the workplace. Candidates should learn to answer discursive questions properly. This can be done by practicing exam-type answers under exam conditions in preparation for the examination.

In addition markers found that candidates used their own abbreviations (sms messaging style) in their answers. Marks could not be awarded here as it is not up to the markers to interpret abbreviations that are not commonly used. The increased use of an sms style of writing in a professional examination it is a major concern. **Candidates should pay specific attention to the way in which they write their answers, and bear in mind that this is a professional examination for which communication and presentation marks are awarded.**

3.4 Journal entries

A fundamental part of financial accounting is an understanding of debits and credits. A means of assessing whether a candidate understands the fundamental principles is to require the candidate to prepare the relevant journal entries. Candidates increasingly do not understand what journal entries they need to process. In many instances basic journal entries were processed the wrong way around. In addition, account descriptions were poor and abbreviations were used.

This is inexcusable and candidates must ensure that they understand what impact transactions would have on specific account balances, by showing that they know which account in the income statement or balance sheet has to be debited or credited. It is not sufficient for a candidate with Accounts IV to be a technocrat – understanding of the fundamental principles of accounting is critical to the success of a candidate at the ITC level.

3.5 Time management

Candidates are advised to use their time wisely and budget time for each question. The marks allocated to each question are an indication of the relevant importance the examiners attach to that question and thus the time that should be spent on it. Candidates should beware of the tendency to spend too much time on the first question attempted and too little time on the last. They should never overrun on time on any question, but rather return to it after attempting all other questions.

3.6 Layout and presentation

Candidates should allocate time to planning the layout and presentation of their answers before committing thought to paper. Very often, candidates start to write without having read the question properly, which invariably leads to, for example, parts of the same question being answered in several places or restatement of facts in different parts. Marks are awarded for appropriate presentation and candidates should answer questions in the required format, that is, in the form of a letter, memorandum or a report, if this is what is required.

The quality of handwriting is also an ongoing problem and was of particular concern in this year's examination. **The onus is on the candidate to produce legible answers.**

Separate books are used to answer each question of the ITC. Each book is clearly marked and colour coded. Candidates are given explicit instructions to write the correct answer in the correct book. Despite this some candidates did not write the correct answer in the correct book, the secretariat did ensure that candidates who wrote answers in the incorrect book were marked by the correct mark team.

3.7 Irrelevancy

Marks are awarded for quality, not quantity. Verbosity is no substitute for clear, concise, logical thinking and good presentation. Candidates should bear in mind that a display of irrelevant knowledge, however sound, will gain no marks.

3.8 Recommendations / interpretations

Responses to these requirements are generally poor, either because candidates are unable to explain principles that they can apply numerically or because they are reluctant to commit themselves to one course of action. It is essential to make a recommendation when a question calls for it, and to support it with reasons. Not only the direction of the recommendation (i.e. to do or not to do something) is important, but particularly the quality of the arguments – in other words, whether they are relevant to the actual case and whether the final recommendation is consistent with those arguments. Unnecessary time is wasted by stating all the alternatives.

3.9 Examination technique

Examination technique remains the key distinguishing feature between candidates who pass and those that fail. Many candidates did not address what was required by the questions and, for example, provided a discussion where calculations were required or presented financial statements where a **discussion** of the appropriate disclosure was required.

3.10 Open-book examination

Candidates are reminded that they **MUST** familiarise themselves with SAICA's open book policy and be aware that this may differ from that of their CTA university. Candidates are also reminded that only SAICA has the authority to interpret its own open book policy. To this end candidates are advised of the following:

- **No loose pages** (of any kind) may be brought into the exam. This includes index pages which were seen by some candidates in this year's exam not to 'supplement texts' and therefore considered acceptable; and
- Writing on flags – As per section 4.4 of the SAICA examination regulations: *'Candidates are only be allowed to highlight, underline, sideline and flag in the permitted texts. Writing on flags is permitted for reference and cross-referencing purposes only, that is, writing may only refer to the name or number of the relevant discipline, standard, statement or section in the legislation'*.

Any contravention of regulation 4 will be considered to be misconduct.

- Candidates are advised to familiarise themselves with SAICA's exam rules prior to writing the examination.

Another problem relating to the open-book examination was that candidates did not state the relevant theory and/or definitions in their answers. One cannot build a logical argument without using the theory as a base and starting point. Reference to theory and definitions is essential to create the perspective from which the question is answered and is required to enable markers to follow the argument. However, since candidates have this information at hand, marks are not awarded for stating detailed definitions only. This type of examination does affect the answer that is expected and *application* and demonstration of insight into the use of the definition have gained in importance.

Candidates should also remember that one has to be very well prepared for an open-book examination. There is not enough time in the examination to look up *all* information from the texts. With regard to certain aspects one would be expected to offer an immediate response based on embedded knowledge. Complex information needs to be fully understood before the examination. Candidates who enter the examination hoping to look up data that they have not processed in advance will be at a disadvantage as they are unlikely to finish the papers.

In conclusion, a message to those who were unfortunately not successful in the examination:

Please start preparing for next years' examination in good time. Don't give up - sufficient preparation and a review of the basics will stand you in good stead for next year's exam!

Best of luck!!

PROFESSIONAL PAPER 1

Paper 1 consisted of two questions that dealt with the following aspects:

Question 1

This question was a taxation question, counting 75 marks in total. The question examined the following topics:

- Section 11(a) read with section 23(g) of the Income Tax Act
- Output tax levied in terms of the VAT Act
- Input tax claimed in terms of the VAT Act as well as capital allowances that can be claimed.
- Income and estate duty implications of an individual
- The application of section 42 and section 24B in a share for asset transaction
- Vat implications of the acquisition of a office block
- The accounting implications of a office block acquired in the financial statements of a listed company

Question 2

This question was an auditing question, counting 25 marks in total. It dealt with the following aspects:

- Audit and Assurance ISA 200
- ISA 700
- ISRE 2400
- Companies Act and Regulations

Presentation marks were available for both questions. These marks were clearly and separately stated in the 'required' sections of each question.

QUESTION 1

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 75 | 36 | 1 256 | 1 861 |

Level of difficulty

The question was straight forward and easy to moderate. This section was answered below average to average.

General comments

Candidates generally performed well in the question. The markers were, however, still disappointed at the mistakes candidates made which resulted in easy marks being lost.

Areas the candidates handled well

- Candidates attempted to list all the requirements of the 'general deduction formula' or s 11(a).
- Candidates wrote a conclusion, even if it was on the wrong principles.

Areas the candidates handled poorly

- Many candidates neglected to discuss the trade aspect of s 11(a) of the Income Tax Act, nor the prohibition in terms of s 23(g) of the Income Tax Act that forms part of the so called "general deduction formula".
- Majority of the candidates also neglected to discuss the 'onus of proof' - s 82 of the Income Tax Act.
- Candidates also got confused between "In the production of Income" and "Carrying on of a trade"
- Most candidates applied the capital arguments for income – rather than a discussion on whether the expenditure created an enduring benefit/income-earning structure or whether the expenditure formed part of income earning operations/activities.
- Only a handful of candidates were able to apply more than two applicable cases.
- Candidates did not structure their answer – their thoughts did not follow a logical manner and it appeared as if candidates lack an understanding of basic principles.
- Candidates wasted time listing the whole of s 11(a) and also discussing requirements of s 11(a) that were clearly met rather than only the identified 'issues'.
- Most candidates discussed "in the production of income" requirement but did not link it to the question (did not apply it to the scenario at hand) or came to a conclusion.
- In the capital versus revenue discussion, candidates applied used case law to identify if the amount is 'gross income' of a capital nature or not. This is a fundamental error in applying case law principles.
- Majority of the candidates simply dumped court cases without applying them and this is a clear indication of candidates memorising names without any understanding of the detail or principles of the case/cases.
- Candidates did not answer the discussion coherently and used sms/text language.

Specific comments on sections of the question

Part a

It was surprising that candidates could not build a good, strong argument based on case law as the 2012 QE1 also included a case law study. In scripts moderated by the umpire it was observed that the candidates did not spend a lot of time on discussing the provided scenario while on the other hand a few candidates wrote at least 10 pages.

Part b

In the past, candidates usually have no problem in applying VAT principles. They should not have been unsettled by the fact that it was assessed in a different format.

Part c

The lack of critical thinking cost the candidates at least 3 of the 5 marks as it was observed that they did not read the provided section 12N thoroughly or did not understand the implications. This led to a pure re-iteration of section 13sex instead of concluding that the capital allowances could not be applied.

Part d

Candidates could not integrate the asset and income flow at the death of individual. The basic principle that the estate of a deceased person is a 'person' for tax purposes was completely lacking. Candidates did not apply the basic principle that an s 8C gain is included in gross income not taxable income. The principles of par 40 of the Eighth Schedule were not applied.

Part e

Surprisingly, candidates who attempted this part did well.

Part f

Most candidates did not apply section 8(25) of the VAT Act.

Part g

Candidates could provide the calculation of deferred tax but did not substantiate it with reasons.

QUESTION 2

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 25 | 17 | 2 266 | 851 |

Level of difficulty

The question was a moderate to easy audit and assurance question for 25 marks, including three communication skills marks, which covered the following:

- Audit and assurance, ISA 200, ISA 700, ISRE 2400 and
- Companies Act and its Regulations

General comments

Most candidates performed well in the question, which was in line with expectations. The candidates who did not perform well appeared to have not been familiar with the topic that was examined.

Areas the candidates handled well

The majority of candidates handled requirement (i) and (ii) very well.

Areas the candidates handled poorly

The requirement (b) was poorly handled. Some of the candidates who attempted this part of the requirement did not read the requirement properly in order to provide the correct answer. This however, was the easiest part of the requirement.

Specific comments on sections of the question

Part a (i)

This part of the requirement was answered very well overall by the candidates. Candidates understood the difference between an audit and a review engagement. There was however some candidates who incorrectly stated that an independent review consists of agreed upon procedures.

Part a (ii)

Most candidates understood overall the legislative requirements applicable to the determination of audit and a review.

The following are areas where some candidates lost obvious marks and demonstrated inadequate knowledge on the topic examined:

- Candidates simply stated the legislation requirements without applying to the scenario.
- Candidates were not even aware that they had to calculate the public interest score.
- Candidates allocated incorrect points on the public interest score base, such as including deferred tax liability when determining the third parties liabilities.
- Candidates struggled with the difference between independently compiled verses internally compiled financial statements.
- Candidates incorrectly thought of a public company and a listed company being the same thing.
- Candidates mistook the fact that Mr Smith is compiling the financials independently, as to mean that he is performing the review independently.

Part (b)

While this was a very easy part of the requirement many candidates did not attempt this part of the requirement.

The following are areas where candidates who have attempted this part of the requirement lost obvious marks and demonstrated inadequate knowledge on the topic examined:

- Candidates confused the reportable irregularity per Regulation 29 with that of the Auditing Professions Act.
- Candidates misinterpreted the requirement by including in their answers the auditor's responsibility with regards to the audit opinion.
- Students missed critically important aspects related to the reporting of the matter, such as the fact that the independent reviewer needs to report the reportable irregularity "without delay" or that the days that should elapse between the different stages of reporting should be "business days" and not just any days.
- Candidates specifically failed to apply the fact that adequate steps have already been taken by management with regards to the irregularity.
- Candidates incorrectly also identified the tax issue as a reportable irregularity.

Candidates who concluded that there is no reportable irregularity taking place since those charged with governance have correctly dealt with the matter were awarded marks accordingly. These candidates were able to obtain the maximum available marks for this part of the requirement as they addressed the reportable irregularity requirements prior to their conclusion.

PROFESSIONAL PAPER 2

Paper 2 consisted of two questions that dealt with the following aspects:

Question 1 Part A

This question was a management and decision making and control question, counting 55 marks in total. It dealt with the following aspects:

- Standard Costing
- Breakeven Analysis
- Analysis and discussion (strategic discussion)
- Hedging techniques
- Business Risks .

Question 1 Part B

This question examined strategy, risk management and governance counting 45 marks in total. It dealt with the following aspects:

- King III Corporate Governance
- Companies Act and Regulations
- Professional Code of Conduct
- ISQC1

Presentation marks were available for both questions. These marks were clearly and separately stated in the 'required' sections of each question.

QUESTION 1 Part A

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 55 | 28 | 1 559 | 1 558 |

Level of difficulty

The question was moderate to difficult.

Main subjects / topics examined in the question

- Part (a) Standard costing
- Part (b) Breakeven analysis
- Part (c) Analysis and discussion (strategic discussion)
- Part (d) Hedging techniques
- Part (e) Business Risks

General comments

None

Areas the candidates handled well

- Financial Accounting (Part D), which required candidates to explain how AA could hedge against the jet fuel price increases.
- Breakeven Analysis calculations (Part B).

Areas the candidates handled poorly

- Standard costing (Part A) and
- The analysis and discussion of a business line (Part C).

Specific comments on sections of the question

Part (a)

Candidates were required to calculate certain variances. This section was of a complex nature and required a detailed understanding of standard costing calculations. Furthermore, candidates generally expect the usual manufacturing environment, as opposed to an airline (service industry)

Candidates could generally answer the easier variances namely: sales price variance, sales margin mix variance and sales margin quantity variance. However, in certain instances it was clear that candidates did not know their basic standard costing formulas i.e.: $AQ (AP - SP)$.

Very few candidates were able to calculate the jet fuel consumption and the jet fuel price variance. This was expected, given the comments received from the universities.

Part (b)

Candidates were required to calculate the breakeven number of economy and business class passengers. These calculations were easy to perform, straightforward and principally based.

Therefore, candidates performed well in Part (b), but could have performed even better. The following problem areas are highlighted:

- Many candidates don't know how to calculate the weighted average number of passengers (using a sales mix which was given: business class passengers to economy class passengers).
- The majority of candidates also struggled with the differentiation of fixed and variable costs in this industry. No calculation was required, candidates merely had to categorise these costs correctly to score the marks.

Part (c)

Candidates were expected to analyse and discuss the importance of business class passengers. This required some insight from candidates, using the figures in the previous section.

Even though this question was principally marked, it was identified that candidates who were uncertain of their answers in Part (b), struggled with the analysis and discussion. Furthermore, in some instances candidates only discussed the importance of the business line, and lost out on a potential 6 marks for the easier analysis calculations which were based on Part (b).

Part (d)

Part (d) required candidates to explain how the company could hedge against jet fuel price increases. Even though Part (d) was in the context of the airline industry, candidates' previous answers did not impact this section, and thus candidates performed well in this section. Moreover, this part allowed the integration of candidates' financial accounting knowledge.

The mark team adopted a relatively strict approach though. Candidates for the first mark were expected to identify the hedge and for the second mark, how it could be applied in the context of the question.

Part (e)

In Part (e), markers also adopted a relatively strict approach. Candidates were expected to identify and describe four major risks. The first mark was awarded for identifying the risk and the second mark for describing the risk.

Candidates fared well in this section. However, it must be emphasized that candidates should be able to distinguish between a 'major risk' and a 'risk'.

QUESTION 1 Part B

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 45 | 25 | 2 122 | 995 |

Level of difficulty

Moderate to difficult – the question required depth and breadth from the candidates on the topic of Governance – having to integrate King III, the Companies Act, the APA and SAICA CPC into their solutions. Given the manner in which the “required” was phrased as well as the number of marks allocated to the question, many candidates were challenged by the question.

General comments

The mark team was impressed in some cases by the depth and breadth which certain candidates do appear to have. The main critique overall in the way the candidates answered the question is the “dumping” of King III principles, Companies Act requirements etc without placing them into the context created by the scenario.

Secondly, candidates going forward will need to address answering questions such as this one by correctly referring to the sources – even though one would not necessarily expect a candidate to quote a principle from King III and cite the correct principle number, candidates do need to state the source they are referring. They need to clearly identify the requirements per King III vs Companies Act vs Audit Professions Act vs SAICA Code of Professional Conduct.

In terms of the pervasive skills, candidates need to be able to integrate their knowledge – in this question is meant referring to all the sources above and identifying issues in the scenario which contravened any of the above. Some candidates did battle with the integration. Another issue is the reading of the scenario – candidates need to engross themselves in the scenario before attempting to answer the question.

Areas the candidates handled poorly

- Candidates battled to understand the composition of the Board – many did not know that the CEO, COO and CFO serve on the Board of directors. As a result they did not address the lack of a balance of power correctly.
- Many candidates stated that information was not provided to determine the independence of the non-executive directors – they should however considered issues such as share options being received by non-executive directors, the fact that the aircraft technician could have been an employee of AA and that the travel agent could have been a material customer of AA – all impact on the independence issue.
- Many candidates discussed at length the fact the Mr Jacobs had been the engagement partner and that his wife being a director of AA could have posed an independence threat. Problem = he has resigned and left United Inc and is now the CEO of AA – how does this create concerns? This is what needed to be addressed not issues relating to the past.
- Many candidates did not question the fact that Mr Brooney may not exercise the majority of voting rights given that he only owns 40% of the shares.
- Another issue lacking in many answers was that candidates did not see the fact that the directors three-year contracts all terminating at the same time posed a risk to AA and that succession planning needed to be questioned.
- Candidates did not clearly indicate that the issue that is of concern regarding the outsourcing of the internal audit function to the same firm that performs the external audit engagement is that AA is listed – it is the latter which creates the problem.

- Many candidates were not aware that both the Companies Act and King III determine that the Audit Committee is required to nominate the external auditors to be appointed and determine the terms of the engagement.
- Many candidates did not pick up on the cooling off period required given that Mr Jacobs is now CEO and United Inc have not yet signed off on the audit.
- Many candidates did not pick up on the issue of transparent and effective communication at AA given the way in which Alexia's resignation was dealt with and the reasons for resigning which she cited.
- Many candidates did pick up on the existence of a reportable irregularity and discussed the latter accordingly.

Given the nature of this question, it was difficult not to not award the mark for logical argumentation. The mark team did however penalise the candidates for clarity of presentation. It is a pity that no marks had been allocated for layout – the manner in which some candidates set out their answers was appalling by just listing a number of facts.

PROFESSIONAL PAPER 3

Paper 3 consisted of two questions that dealt with the following aspects:

Question 1

The questions focus was auditing and assurance, counting, 50 marks. It dealt with the following aspects:

- Pre-engagement Activities
- Audit procedures on accounts receivable
- Audit reporting

Question 2

The question was an integrated strategy, risk management and governance and financial management question, counting 50 marks. It dealt with the following aspects:

- Calculation and discussion of ROI as a performance measure
- Calculation of NPV and IRR
- Strategic analysis and proposed implementation of suggested scheme

Presentation marks were available for both questions. These marks were clearly and separately stated in the 'required' sections of each question.

QUESTION 1

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 50 | 23 | 1 243 | 1 874 |

Level of difficulty

The question was well set, with adequate topic coverage of the syllabus. The aspects examined were also of importance and relevant, integrating engagement and planning, procedures and reporting. This view is also supported by the various university comments

Main subjects / topics examined in the question

The question counted 50 marks covering engagement considerations, planning materiality and risk at the financial statement level, audit procedures of trade accounts receivables and reporting considerations.

General comments

The question was well balanced and contained a mix of easier and more difficult marks. The question also tested discussion and calculations. The question was reasonably well answered by the candidates who attempted it and applied themselves to the information of the question and the requirements thereof. It was however disappointing to see that, as in previous years, some candidates neglected the auditing and did not put in an assertive effort in the answering thereof and accordingly recorded very low marks.

Examination technique was again, as in previous years a problem. Many candidates did not read and consider the information of the question carefully, and applied this in answering of the question. This was evident for example in section cii) and ciii) dealing with trade accounts receivable and section d) dealing with inventory, where the students did not often made the distinction and dealt with the wrong account.

Many candidates also often did a generic or mid dump answer of standard theory and did not apply the information of the scenario to their answers.

It was also clear that candidates are still battling with the pervasive skills requirement as per the Competency Framework, as aspects were often only listed instead of discussed or critically evaluated.

Areas the candidates handled well

The section on planning materiality and risks candidates handled reasonably well. Regarding the risks, these were not always discussed, but the facts of the question merely listed. Thus the aspects were not linked to the risk of going concern or fraudulent financial reporting that could result in material misstatement.

Areas the candidates handled poorly

Candidates handled the sections on engagement (a) and procedures (cii) rather poorly. Many candidates answered the section very theoretical, doing a mind dump of standard procedures, rather than applying these principles to the information of the question.

The sections on reporting ciii) and d) were also often answered without linking the principles of the ISA's to the information set

Specific comments on sections of the question

Part (a)

Part (a) of the question counted 11 marks (10 marks on engagement and 1 mark for communication skills) and required candidates to discuss the factors the auditor should consider before accepting the appointment as external auditor.

This section was poorly answered, as candidates often listed theory without applying the principles to the scenario of the question.

Candidates would also mention there was an independence issue due to the family relationship but they did not take it a step further and consider the type of threat(s) or the significance or how it could be mitigated. Not many candidates picked up on the bookkeeping services risk (Companies Act).

Part (b)

Part (b) of the question counted 5 marks and required candidates to critically evaluate the planning materiality. Although reasonably well answered candidates often did not pick up on the fact that a loss cannot be used as a basis for calculating materiality and did not often relate the entity risk identified in the scenario to the adjustment of materiality.

Part (c)(i)

Part (c)(i) of the question counted 5 marks and required of candidates to discuss the risk of material misstatement at the financial statement level. As stated this section was reasonably well answered. Candidates however often made the mistake of merely listing the facts instead of discussing the risk. Also the aspects were not linked to the risk of going concern or fraudulent financial reporting that could result in material misstatement.

Candidates also often identified risks at the assertion level, whilst risk at overall financial statement level was asked. Candidates did not always limit their answer to the risk of material misstatement, but also discussed detection risk.

This again stresses the importance of sound examination technique applied by candidates.

Part (c)(ii)

Part (c)(ii) of the question counted 18 marks and required of candidates to formulate the substantive procedures to audit the opening balance of trade accounts receivable. Many candidates answered the section very theoretical, doing a mind dump of standard procedures, rather than applying these principles to the information of the question.

Some candidates also wrote substantive procedures relating to Inventory when the question clearly asked for Trade Accounts Receivable. Candidates also often did not write full sentences based on WHAT, HOW and WHY (e.g. Obtain a management representation letter; perform cut-off procedures). Only a handful of candidates identified the roll-back alternative approach. A number of candidates did a “memory dump” of “generic” substantive procedures, without making it relevant to the information as contained in the scenario.

As stated above, this again stresses the importance of sound examination technique applied by candidates and a sound understanding of the pervasive skills of the Competency Framework.

Part (c)(iii)

Part (c)(iii) of the question counted 3 marks and required of candidates to describe the steps to be taken if reliance cannot be placed on the opening balances of trade accounts receivable.

Candidates often did not apply their mind to the scenario at hand and merely did a theory dump. Candidates also did not always discuss the two outcomes, namely that management makes the corrections or they don't.

Part (c) Communication skill marks

This counted 2 marks and was awarded for layout and clarity of expression. Poor presentation of answers, and illogical or SMS styled language often resulted in candidates losing these marks.

Part (d)

Part (d) of the question counted 6 marks (5 marks on reporting and 1 mark for communication skills) and required of candidates to discuss the impact on the audit report of the prior year qualification relating to inventory.

Candidates did not always identify the limitation of scope and linked this to the materiality and/or pervasiveness of the issue when discussing the types of audit opinions that could be appropriate. Not many candidates identified the need for a basis of qualification paragraph or an Other Matter paragraph. A number of candidates wrote theory (e.g. if pervasive then disclaim, if not pervasive then qualify) without coming to a definite conclusion which general approach did not earn any marks.

QUESTION 2

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 50 | 27 | 2 206 | 911 |

Level of difficulty

The question was fair and set at an appropriate level of difficulty for ITC.

General areas covered by the question

- Parts (a) required candidates to calculate annual return on investment ('ROI') and average ROI's over a 5 year period. Candidates generally performed well in this section.
- Part (b) asked for the merits and pitfalls of ROI as a performance measure. Candidates could answer the question generically or use the information in the question and the results of their calculations in part (a) to address the required.
- Part (c) required candidates to calculate the NPV and IRR of the planned reinvestment in trucks
- Part (d) asked for a strategic analysis of the proposed implementation of an owner driver scheme and
- Part (e) for financial analysis thereof. Refer to the end of this report for detailed commentary on candidates' performance in each section.

Specific comments on sections of the question

Part (a)

The mark plan was lenient and permitted 3 alternatives with regards to the calculation of the net book values of trucks. We did, however, note that many candidates used the original acquisition cost of trucks in each of the 5 years as the net book value for ROI calculations. This is not appropriate as the trucks would depreciate in value over time. Many candidates also added back depreciation in calculating ROI which is not correct.

Part (b)

Candidates generally acquitted themselves well in part (b). However, many candidates were unable to display a depth of knowledge about ROI as a performance measure and merely touched on key issues. Future candidates should note that inferring that management could manipulate accounting results and act in an unethical manner is beyond the scope of the question. There was nothing in the information given that inferred any unethical behaviour by the management team. The suggested solution could provide a useful reference for future students re the positives and negatives of using ROI as a management evaluation tool.

Part (c)

Despite candidates performing adequately in this part, we noted numerous technical errors and omissions made by candidates:

- Including lease payments in the capital budget is incorrect as the financing decision should be ignored for the purposes of determining the financial viability of the project. Similarly, finance costs implicit in the lease agreement should have been ignored for the purposes of the NPV and IRR calculations
- Many candidates calculated income tax payable by the company over the 5 year period. Normally this would have been appropriate however, the question clearly stated that a pre tax WACC is used to evaluate projects. Candidates who did include taxation in the project

analysis did not receive a mark for the NPV calculation as the WACC used was a pre tax hurdle rate

- The majority of candidates failed to identify and discuss the implications of including inter divisional profits (servicing and maintenance division) in the capital budget
- Too many candidates recalculated operating profit starting from revenue and deducting relevant operating costs. This wasted time as using operating profit and simply adjusting for depreciation, finance costs and servicing & maintenance costs would have achieved the same result in half the time

Part (d)

This part required candidates to consider the strategic considerations relating to the company (TTT) implementing the owner driver scheme. Numerous candidates failed to distinguish between the company's perspective and that of the drivers. Therefore mentioning that the drivers may abuse the trucks or use them for private purposes is irrelevant from TTT's perspective. The trucks would be owned by the drivers post the introduction of the scheme and their responsibility.

Answers generally lacked depth in part (d).

Part (e)

This section required candidates to analyse the potential financial impact of the owner driver scheme from the perspective of the drivers and not TTT. It was concerning to note the number of candidates who included irrelevant costs in the analysis such as TTT's corporate allocated overheads and other insurance costs. Some candidates failed to distinguish between driver's revenue and that earned by TTT.

The question only required candidates to assess the financial impact in 2015. Unfortunately, many candidates misread the required and calculated the financial implications in 2014 or for all 5 years (wasting invaluable time).

PROFESSIONAL PAPER 4

Paper 4 consisted of one question that dealt with the following aspects:

Question

This question was an integrated financial accounting and auditing question, counting 100 marks in total. It dealt with the following aspects:

- Business Combinations and property, plant and equipment
- Changes in ownership (IFRS 10)
- Investment in Associates
- Control and joint control
- Business combinations – step acquisitions
- Consolidated Cash flow statements

Presentation marks were available for the question. These marks were clearly and separately stated in the 'required' sections of each question.

QUESTION 1

| Maximum mark | Average mark | Marks > 50% | Marks < 50% |
|--------------|--------------|-------------|-------------|
| 100 | 54 | 2 137 | 980 |

Level of difficulty

The level of difficulty was generally described as “moderate” or “fair”. Section (d) was found to be more difficult as the number of marks allocated to the section required an extensive discussion with an advanced application of the information in the question.

Main subjects / topics examined in the question

This question was solely an external financial reporting question counting 100 marks in total. The question dealt with:

- Part (a) – calculation of the carrying amount of an item of PPE in the consolidated financial statements;
- Part (b) – pro forma consolidation journal entries (including of a change in ownership in a subsidiary);
- Part (c) – calculation of the carrying amount of an investment in a joint venture in accordance with the equity method;
- Part (d) – drafting of a memorandum to the group financial accountant (using communication skills) in which it is discussed:
 - whether another entity is controlled by the reporting entity (IFRS 10) (part (d)(i)); and
 - the appropriate recognition and measurement of an interest in a joint operation (IFRS 11) (part (d)(ii));
- Part (e)(i) – calculation of the goodwill or gain on bargain purchase on a business combination in the form of a step acquisition;
- Part (e)(ii) – calculation of the amounts that will be reflected in the consolidated profit or loss of the group as a direct consequence of the above (refer part (e)(i)); and
- Part (f) – preparation of relevant extracts of the consolidated statement of cash flows and the notes thereto (including the appropriate presentation thereof) to reflect a sale of a controlling interest in a subsidiary.

In total 5 marks were awarded for communication skills (included above).

General comments

The question required a demonstration of both technical knowledge as well as pervasive skills (such as critically analysing information and applying principles in an integrated manner to different settings).

Areas the candidates handled well

- Candidates generally attempted all subsections (although the layout of part (f) was somewhat messy at times).
- Candidates demonstrated knowledge of basic group principles throughout most sections.
- The majority of candidates presented their memorandum (part (d)) using communication skills appropriate at this level.

Areas the candidates handled poorly

A few areas should however be highlighted, which may be of use to candidates for future examination purposes:

- Although candidates knew their basic group principles well, some were unable to demonstrate a clear grasp of the principles relating to changes in the degree of ownership.
- In respect of part (d), candidates did not articulate their application of the principles well, i.e. candidates knew the final answer but did not write enough before arriving at their conclusion.
- Candidates did not provide any or all journal narrations in part (b).

Specific comments on sections of the question

Part (a)

In this section, candidates were required to calculate the carrying amount of a factory building in the consolidated financial statements of the entity. The building had previously been sold by one of the parent's subsidiaries to another of its subsidiaries. The fundamental principle tested was therefore that the intercompany sale must effectively be ignored from a group perspective, i.e. the original cost for the seller must be used as the cost for the group (alternatively the cost for the buyer may have been used with an adjustment for the elimination of unrealised profit).

Candidates who demonstrated a grasp of the principle described above performed well. Candidates who did not, performed poorly in this section.

Part (b)

In this section, candidates were required to provide pro forma consolidation journal entries, including of a change in ownership where the interest in a subsidiary decreased from 80% to 60% as a result of a share issue by the subsidiary solely to the non-controlling interest (NCI).

Where candidates performed poorly in this section the reasons were either one or a combination of the following:

- Answers were incomplete (e.g. candidates attempted the journal entries in respect of the change in ownership but left out basic journal entries like the 'at acquisition' elimination entry or the attribution of reserves to the NCI).
- The changes in ownership journal entries were incorrect (e.g. the effects were recognised in profit or loss, instead of being reflected as an equity transaction or investment was debited with R200m instead of ordinary capital).
- The calculation of the amount recognised in equity (R85.6m) as a result of the reduction of the interest in the subsidiary was calculated incorrectly.

As stated earlier, candidates also did not provide journal narrations.

Part (c)

In this section, candidates were required to calculate the carrying amount of an investment in a joint venture in accordance with the equity method.

The following problem areas are highlighted:

- Candidates used the starting point in their application of the equity method as the cost of the investment without testing or calculating whether a gain on bargain purchase arose on initial recognition of the interest in the joint venture. Where candidates did calculate the gain on bargain purchase loosely (for example in an analysis), they did not use it

appropriately (i.e. add to the investment or demonstrate a starting point of the fair net asset value).

- Candidates did not multiply any or all of the amounts with the 40% shareholding.
- The unrealised profit in closing inventory was inaccurately calculated by candidates (e.g. using sales for the year instead of the closing inventory balance, or using the incorrect mark-up, i.e. 25% instead of 28%).
- One of the main problem areas related to incorrect signs. The investment had to be increased with reversing of the excess depreciation on the overvalued plant. Some candidates also added dividends received instead of reducing the investment.

Part (d)(i)

In this section, candidates were required to write a memorandum to discuss whether the reporting entity controls another entity where voting rights were relevant in determining control. This section tested many of the more subjective principles in IFRS 10 relating to de facto power (practical ability to control) as the entity did not hold enough voting rights to have legal control.

The required was very specific and the vast majority of candidates stated and applied the most basic principles in IFRS 10. The main reason for not achieving better marks related to incomplete answers, i.e. candidates considered some of the facts that indicated control, but did not address the others. There was also evidence of a lack of planning and clear articulation of the application of the principles (the question required extensive discussion indicated by the number of marks allocated to this section, thereby assessing a pervasive professional communication skill in conveying arguments thoroughly before arriving at a conclusion).

Part (d)(ii)

In this section, candidates had to continue the memorandum with a discussion on the appropriate recognition and measurement of an interest in a joint operation. This part inherently required candidates to identify that the given arrangement may be a joint arrangement, i.e. the question did not specify that a joint arrangement existed.

Candidates generally answered this section fairly well and only a relatively small number did not correctly identify the issue. Some candidates did however, arrive at the incorrect classification (joint venture instead of joint operation) based on what appeared to be a lack of understanding of the guidance given in IFRS 11.

Part (e)(i)

In this section, candidates were required to calculate goodwill or a gain on bargain purchase relating to the acquisition of control over the entity referred to in part (d)(i). Candidates performed well in this section. The marks that were not earned related to:

- Other components of NCI: The preference shares in this case had to be measured at fair value. Candidates regarded the preference share capital as part of net assets acquired or simply ignored the preference share capital.
- Fair value of previously held interest: This was a step acquisition and therefore the interest previously held should be measured at fair value. Candidates simply used the original consideration at cost.

Part (e)(ii)

In this section, candidates were required to calculate the effect on consolidated profit or loss as a result of acquiring control over the subsidiary. This section was generally answered incompletely with candidates only considering either the transaction costs or the fair value adjustment on the

interest previously held and ignoring the reclassification of the foreign currency translation reserve. Some candidates reclassified the mark-to-market reserve which is not consistent with IFRS 9.

Candidates did not consider the tax effect of their adjustments (throughout the question). The question implied a tax consideration as post-tax information was provided and therefore considering the tax consequences was pervasive to answering the question.

Part (f)

In this section, candidates were required to prepare relevant extracts from the consolidated statement of cash flows and notes thereto relating to the disposal of a controlling interest in a subsidiary.

Performance in this section was fair. Where candidates performed poorly in this section the reasons were either one or a combination of the following:

- The cash flow on losing control of the subsidiary was incorrectly classified as financing activities. This should be classified as operating activities as per IAS 7.
- The amount of cash received (R50m) was not reported net of the cash (R2.8m) disposed of.
- The total consideration received (the deferred component) was calculated incorrectly.