



# 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 2014**

### **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 2014. 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 four 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 the ITC January 2014;
- Background information on the setting, marking and adjudication of SAICA examinations;
- General comments on the ITC January 2014; and
- Detailed comments by question in each of the professional papers (1–4).

## STATISTICS FOR ITC JANUARY 2014

|                       | <b>% Pass</b> | <b>Passed</b> | <b>Failed</b> | <b>Total</b> |
|-----------------------|---------------|---------------|---------------|--------------|
| First attempt         | 81%           | 1786          | 408           | 2194         |
| Repeat candidates     | 38%           | 162           | 262           | 424          |
| <b>All candidates</b> | <b>74%</b>    | <b>1948</b>   | <b>670</b>    | <b>2618</b>  |

### Average marks per question (all candidates)

|                            | <b>Question 1</b> | <b>Question 2</b> | <b>Total</b> |
|----------------------------|-------------------|-------------------|--------------|
| <b>Paper 1</b>             |                   |                   |              |
| <b>Total marks</b>         | <b>65</b>         | <b>35</b>         | <b>100</b>   |
| Average marks              | 34.37             | 13.94             | 48.31        |
| <b>Paper 2 (two parts)</b> |                   |                   |              |
| <b>Total marks</b>         | <b>80</b>         | <b>20</b>         | <b>100</b>   |
| Average marks              | 50.29             | 9.99              | 60.28        |
| <b>Paper 3</b>             |                   |                   |              |
| <b>Total marks</b>         | <b>100</b>        |                   | <b>100</b>   |
| Average marks              | 56.22             |                   | 56.22        |
| <b>Paper 4</b>             |                   |                   |              |
| <b>Total marks</b>         | <b>80</b>         | <b>20</b>         | <b>100</b>   |
| Average marks              | 37.70             | 10.51             | 48.21        |

More detailed statistics can be found on the SAICA website at [www.saica.co.za](http://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 papers. 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. 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  
Karien Coates  
Johnathan Dillon  
Neville Dipalle  
Reghardt Dippenaar\  
Anton du Toit  
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Jo-Ann Pohl  
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Amanda Singleton  
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Johan Steyn  
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Pieter Landsell  
Francois Liebenberg  
Zweli Mabhoza  
Ben Marx  
Ahmed Mohammedali- Haji

Nico van der Merwe  
Johanna van Staden  
Craig Wallington  
Alex van der Watt  
Carmen Westermeyer  
Pieter van der Zwan

## **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 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 January 2014 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. Each script was marked independently by two persons who recorded their marks on separate mark sheets. Only once the double blind marking of each batch of scripts had been completed did the markers confer and jointly decide on the final raw mark to be awarded for a particular answer. Thereafter each marker's mark, as well as the final mark, was noted down on the cover of the script. If the markers were 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. The SAICA secretariat was responsible for capturing and final checking of the marks of all candidates.

Consistency marking was introduced in 2012, which entails that a pack of ten scripts (consisting of six scripts selected from first-timer 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 discusses 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 actual marking commences. The main objective is to achieve consistency in the way the different markers within a mark team award marks.

#### **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 candidates encountered any time constraints;
- 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 (including the raw pass mark) 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.

#### **5 Borderline review**

In 2013 SAICA introduced a further process to ensure that individual candidates who just fail the exam are not prejudiced in any way. Once the adjudication is finished, candidates who just failed (based on a range determined by the IPD Committee) are selected and a third and final review is undertaken on such candidates scripts. This review is undertaken by the umpire or assistant umpire being the most senior and experienced members of the mark team. The marks during this process may either go up or down and is again done on a question by question basis so the final result is not contrived. A sub-committee of the IPD Committee then meets to discuss the outcome of the borderline review and thereafter the pass percentages and other details statistics for the examination are prepared. Candidates who are selected for the borderline review are not awarded the secretaries mark (1 per paper) because they have had the benefit of a further and more detailed review of their papers.

***In view of the above stringent marking process no request for re-marks will be entertained (also refer to our examination regulations for ITC in this regard).***

## 4 GENERAL COMMENTS ON ITC JANUARY 2014

### 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 Analysis of topics – January 2014

|   | Accounting & External reporting | Strategy, risk management & Governance | Audit & Assurance | Tax           | Fin Man       | Management decision making & control | Ethics       | Comms         |
|---|---------------------------------|--|-------------------|---------------|---------------|--------------------------------------|--------------|---------------|
| Required ranges in terms of the SAICA guidelines (2013 onwards) | 100 – 120 marks                 | 40 – 60 marks                          | 60 – 80 marks     | 60 – 80 marks | 40 – 60 marks | 40 – 60 marks                        | 0 – 20 marks | 20 – 40 marks |
|   | 25 – 30%                        | 10 – 15%                               | 15 – 20%          | 15 – 20%      | 10 – 15%      | 10 – 15%                             | 0 – 5%       | 5 – 10%       |

|              | Accounting & External reporting | Strategy, risk management & Governance | Audit & Assurance | Tax       | Fin Man   | Management decision making & control | Ethics   | Comm      | Total      |
|--------------|---------------------------------|--|-------------------|-----------|-----------|--------------------------------------|----------|-----------|------------|
| P1 Q1        |                                 |  |                   | 61        |           |                                      |          | 4         | 65         |
| P1 Q2        |                                 |  |                   |           | 28        | 5                                    |          | 2         | 35         |
| P2 Part A    | 76                              |  |                   |           |           |                                      |          | 4         | 80         |
| P2 Part B    |                                 | 19                                     |                   |           |           |                                      |          | 1         | 20         |
| P3           | 8                               | 5                                      | 75                |           |           |                                      | 5        | 7         | 20         |
| P4 Q1        |                                 | 23                                     |                   |           | 16        | 39                                   |          | 2         | 80         |
| P4 Q2        | 19                              |  |                   |           |           |                                      |          | 1         | 20         |
| <b>TOTAL</b> | <b>103</b>                      | <b>47</b>                              | <b>75</b>         | <b>61</b> | <b>44</b> | <b>44</b>                            | <b>0</b> | <b>28</b> | <b>400</b> |
| % of TOTAL   | 26%                             | 12%                                    | 19%               | 15%       | 11%       | 11%                                  | 1%       | 5%        |            |

### 3 Overall comments on the papers

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

- The **accounting and external reporting question's** level of difficulty was generally described as 'moderate' or 'fair' and of a good standard. The questions (there were two accounting and external reporting questions) required a demonstration of technical knowledge, but also the competencies of critically analysing information and applying principles in an integrated manner to different settings. On the whole, both questions were relatively well answered.
- The **tax question** was a moderate to difficult discussion question. The question was well balanced with an increased focus on the application of principles rather than being a purely a calculation-based approach. Many candidates identified and discussed most of the key issues.
- The **strategy, risk management and governance** questions were moderate to difficult. The one question dealt with to labour unrest and the impact of increasing costs, a weak exchange rate, decreasing demand for the end product and decreasing selling prices. In identifying strategies to address these issues, candidates were required to draw on their financial management knowledge (such as hedging, financing and working capital management) as well as management decision making (such as costing, decision-making and performance management). The question tested the candidates' depth and breadth of knowledge and their ability to integrate these various topics in developing a solution for the company concerned.
- The **financial management** question (which included a few marks of **financial management**) was an easy to moderate question which was limited to management accounting principles and required little to no integration with other subject areas. Despite this candidates performed extremely poorly in this question. The question included identification of business risks, ratio calculation and meaningful interpretations of the company's performance and testing critical thinking and calculations to separate the management accounts into fixed and variable components and determine the break-even point.
- The **management decision making and control** question (which included some **financial management and strategy risk management and governance** marks) was difficult and candidates in some instances fell short as they were unable to display the depth of knowledge needed to assess risks and decision making regarding the attractiveness of the market. Neither did they apply the calculations to come to a conclusion on whether a subsidiary should be discontinued at the beginning or the end of the year. Candidates could have made up marks with the relatively easy fixed overhead absorption rate calculation, but also came up short here.
- The **audit** question was relatively straightforward, testing basic principles of external auditing. The question was reasonably well answered by candidates, but as in prior years' examinations, we highlight again that exam technique remains problematic. Many candidates did not read and consider the information of the question carefully, or apply this in answering of the question. This was evident in one of the sections in which candidates were asked to discuss the control risk for each of the assertions of occurrence, accuracy and completeness of the sale of cement. Many candidates totally ignored the information given in the scenario,

as well as the specifics of the required and did not apply the information of the scenario to the required and their answers either, and merely gave a generic answer or mind dump of standard theory. It was also clear that candidates are still battling with the pervasive skills requirement as per the Competency Framework, as aspects were often only identified or listed instead of discussed or described.

- **Pervasive skills** were also assessed extensively in this exam, and marks for communication skills were given additional prominence in that such marks were awarded for specific skills, and in specific sections of the required of questions, where relevant.

#### **4 Specific comments**

From a review of candidates' answers to the six questions (seven required sections) for the ITC January 2014 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.

##### **4.1 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 in the form of a pure regurgitation of what candidates may have learnt about the theory at university, but with 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.

##### **4.2 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. 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.

##### **4.3 Communication**

Candidates fared better in questions requiring calculations than in discursive questions. This is a disturbing trend as the ITC is a stepping stone in the qualification process where the final assessment of professional competence (APC) requires that significantly more focus and attention is given to these important skills. 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. **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.**

#### **4.4 Journal entries**

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

#### **4.5 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 relative 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.

#### **4.6 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.

#### **4.7 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.

#### **4.8 Drilling down**

Responses, particularly in the Financial Management, Management Decision Making and Control and the Strategy, Risk Management and Governance areas are often provided by simply repeating the information given in the question. Candidates are unable to drill down to assess what the underlying problem areas are and do not put any effort into going beyond what is stated in the question. Candidates need to draw on their entire knowledge base in order to provide more deep and meaningful insight, particularly in analysis type questions.

#### **4.9 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.

#### **4.10 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.

#### **4.11 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.; 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.

#### **4.12 Paying equal attention to all the competency areas**

It is disappointing to note that candidates still appear to be most prepared to respond to accounting and external report questions and do considerably poorer in some of the other disciplines – most notably Financial Management and Management Decision making and Control. Candidates are reminded that the accountancy discipline is a broad one and the other disciplines are equally important. We draw your attention to the following regulation:

“4.2 A minimum of 200 marks (thus 50%) are required to pass the ITC.

4.3 Candidates need to demonstrate an appropriate level of competence in ALL areas and disciplines, and therefore the overall pass mark of 50% shall be subject to the candidate achieving a sub-minimum of 40% in at least three of the four professional papers.”

For the first time this year we were in a position where we unfortunately had to fail a candidate because they did not achieve the 40% subminimum in two of their four papers. This is really unfortunate and candidates are advised to pay equal attention to all the competency areas in order to obtain an overall pass in the ITC.

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

***Please start preparing for the next examination in good time.*** Don't give up - sufficient preparation and a review of the basics will stand you in good stead for you next 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 65 marks in total. The question examined the following topics:

- Gross income 'unconditionally entitled to', section 11(a) deduction of trading stock with section 23F.
- Gross income – advance payment with section 24C
- Sale of a machine and containers at a unquantified amount (section 24M), section 11(o) scrapping allowance, capital gains tax and recoupment
- S11(c) legal expense deduction with section 23H
- VAT: R400 000 advance payment
- VAT on the sale of a mixed use building
- Calculation of sale of property: tax allowances and capital gains tax
- Discussion of the tax consequences of an interest-free loan to a shareholder.

### Question 2

This question was a management accounting question, counting 35 marks in total. It dealt with the following aspects:

- Performance ratios and interpretation (based on management accounts – income statement only)
- Break-even calculation
- Identification and description of business risk.

**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% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 65           | 34.37        | 59.7% (1564)       | 40.3% (1054)       |

### Level of difficulty

The question was moderate to difficult.

### General comments

Overall, candidates structured their answers well, with an awareness of communication skills when providing conclusions and reasons. The majority of candidates attempted the question and identified most of the key issues which required discussion.

### Specific comments on sections of the question

#### Part (a)(i)

##### Areas the candidates handled well

Trading stock implications were dealt with quite well although candidates often discussed the implications independently of how they had dealt with the sale.

##### Areas the candidates handled poorly

- Many candidates did not commence their discussion with the definition of gross income and the identification of which requirement was problematic.
- Candidates applied and discussed accounting theory (IAS 18) to determine if it should be included in 'gross income' in terms of tax legislation.
- Candidates unnecessarily discussed VAT implications where the 'required' referred to normal tax implications.
- Candidates often did not structure their answer first, which led to them to contradicting themselves. It was important to first decide how the gross income would be dealt with and then to consider the effect on trading stock.
- Many candidates discussed either the sale or the trading stock implications but not both.

Most candidates became confused as to what impact the recognition of gross income has on the closing stock and whether a section 11(a) deduction can be claimed or not.

#### Part (a)(ii)

##### Areas the candidates handled well

If identified, section 24C requirements.

##### Areas the candidates handled poorly

- There were no section 24C discussions or a section 24C discussion without first concluding that the amount would indeed be considered gross income.
- Candidates did not apply 'received by' of the gross income definition to the amount and did not discuss the concept of a 'deposit'.

- Some candidates did not identify the issue – to discuss WHEN the amount should be included in gross Income, or identified the issue but did not address it in their conclusion.
- Too many candidates discussed ‘unconditional entitlement’ instead of discussing a receipt.
- Fewer than expected candidates identified the applicability of section 24C.
- Candidates tend to ‘dump’ court case references without making them applicable to the scenario or mentioned incorrect court cases.

### **Part (a)(iii)**

#### **Areas the candidates handled well**

The current year’s capital allowance was worked out correctly, in most instances, for the shipping containers.

Most candidates realised that the packaging machine had a nil tax value

#### **Areas the candidates handled poorly**

- Candidates did not show an understanding of basic principles of wear and tear and its integration with capital gains tax.
- Many candidates did not realise that the sales price would not have been known during the 2013 year of assessment and did the calculation in the 2013 year as though the scrap price of metal was known.
- Candidates did not realise that section 24M and par. 39A of the Eighth Schedule was applicable.
- In many instances candidates calculated the recoupment and capital gains tax (CGT) for only one type of asset and nor for both types.
- Also quite often they stopped their calculation at the recoupment, and did not proceed to the CGT calculations.
- Candidates became confused and it is unclear whether they are performing recoupment / scrapping allowance calculations or CGT calculations (for e.g. tax value v base cost).
- Many candidates stated (which is quite worrying) indicating that there would be no CGT consequences since proceeds were lower than base cost.
- Candidates did not realise that the sale accrued in the 2014 year of assessment.
- Candidates confused wear and tear calculations with capital gains tax calculations.
- Candidates incorrectly applied the annual exclusion to the CGT calculations, even though Dizzy is a company.

### **Part (a)(iv)**

#### **Areas the candidates handled well**

Where candidates discussed section 11(c) they handled the discussion well.

#### **Areas the candidates handled poorly**

- Candidates applied section 11(a) instead of section 11(c).
- Candidates who discussed section 23H did not apply it to the question, they only gave the theory.
- Many did not realise that s24M and par39A of the Eighth Schedule was applicable.

## **Part (b)(i)**

### **Areas the candidates handled well**

Calculation of output tax to be charged.

### **Areas the candidates handled poorly**

- Alarmingly, many candidates refer to the 'gross income' principle of earlier of receipt or accrual, instead of the invoice basis for VAT purposes in terms of section 9(1).
- Candidates did not follow the logical process of the time and value rules of a supply.
- Candidates did not always know whether to apply the tax fraction or multiply with 14%.
- Some candidates do not know when input tax will be CLAIMED and output tax LEVIED.
- Few of the candidates knew that a deposit is not considered as a consideration. Very few discussed the fact that the deposit would only be considered to be a consideration when applied.
- Timing of supply was not discussed.

## **Part (b)(ii)**

### **Areas the candidates handled well**

All candidates knew that the supply of residential accommodation was exempt from VAT.

### **Areas the candidates handled poorly**

- Candidates did not know that output tax is not apportioned.
- In general the candidates did not discuss the timing of the supply.
- Candidates did not know that the SALE of residential accommodation is NOT exempt from VAT for a property dealer.
- In many instances the candidates made no mention of the VAT consequences on the shares issued.
- The same time rules were applied for both the seller and the buyer.
- Timing was not discussed at all.
- Output VAT was apportioned.

## **Part (c)**

### **Areas the candidates handled well**

When attempted, section 13sex was applied well.

### **Areas the candidates handled poorly**

- Candidates did not take their VAT consequences from the previous section into account.
- It appears that candidates do not have confidence in their answers. They had to indicate the VAT implications of the seller in part (b)(ii), but then used a different amount (not consistent with their answer in (b)(ii)) to calculate the normal tax for the seller in this part.
- Many candidates treated the sale of the building as a capital asset rather than trading stock.
- Candidates treated the sale of the building as the sale of a second-hand asset.
- Candidates incorrectly applied section 42.
- Some candidates incorrectly applied section 13sept.
- Application of section 42.

- The sale of the building was treated as CGT rather than gross income.
- Candidates applied more than one section 13 allowance to the same building.
- Though many candidates identified low cost residential units, they did not apply 55% to the acquisition price as it had been acquired (this also applied where they calculated section 13quin income tax consequences).
- The candidates who identified section 40CA in respect of the property for Dizzy, did not reduce the market value with input tax.

## **Part (d)**

### **Areas the candidates handled well**

Calculation of the deemed dividend and the withholding tax on the deemed dividend was done well in the case of candidates who realised that section 64(4)(a) was applicable.

### **Areas the candidates handled poorly**

- Many candidates did not realise that they were dealing with a shareholder and not an employee.
- Many candidates discussed donations tax in detail, but did not consider deemed dividend.
- Many did not know who would be liable for the dividends tax.
- Candidates did not discuss the timing of the deemed dividend.

## QUESTION 2

| Maximum mark | Average mark | Marks > 50% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 35           | 13.94        | 13.1 (344)         | 86.9% (2274)       |

### Level of difficulty

The level of difficulty was easy to moderate.

### General comments

The question was limited to management accounting principles and required little to no integration with other subject areas. The individual sections can be broken down as follows:

**Part (a):** There were sufficient available marks and almost half of the required marks were obtainable by virtue of general and typical calculations to measure performance. Further to this a fair portion of the required marks were available through meaningful interpretation of the calculated ratios. The balance of the section required insightful interpretations of the company's performance. The section represented a good balance between generic ratio analysis and interpretation thereof and competencies of critical thinking.

**Part (b):** The available marks matched the required marks and all marks involved calculations to separate the management accounts into their fixed and variable components and perform a break-even calculation. A fair question which also provided an element of acute knowledge of cost behaviour.

**Part (c):** There were sufficient available marks and ample scope for candidates to merely expand on the information provided in the two page scenario to identify and describe the business risks facing the company. An easy section, merely requiring candidates to expand on the data provided in the question.

### Areas the candidates handled well

- All sections, with a minor exception for part (b), were attempted suggesting that time allocated to the question was appropriate. Candidates did not demonstrate any non-familiarity of the topics examined.
- Only part (c) on average was passed by candidates.
- Candidates showed sufficient communication and clarity of expression skills.

### Areas the candidates handled poorly

- Candidates showed a lack of performing meaningful calculations; for example, they calculated changes in the annual depreciation charge or the increase in audit fees but did not calculate the change in the exchange rate (the key determinant of the change in company revenue).
- Candidates showed a lack in translating the numbers, such as the percentages obtained from the calculations, into a meaningful interpretation. Generally, the size of the percentages obtained seemed to be irrelevant to the interpretation thereof.
- Candidates made too many financially unsound comments such as the large cash balances indicated good management (despite only earning 4% p.a.) while the cash should have been

applied to eliminate the huge foreign exchange losses incurred (a consequence of holding onto the cash) and far outweighed the interest earned.

- Too many candidates made fundamental errors such as not identifying that the company's revenue was 20% of prices charged by resorts and not the full price charged by resorts (this is resort income), incorrect definitions of the break-even formula, etc.
- Candidates demonstrated a weakness for specific critical thinking in the discussion type sections and provided generic and non-specific factors that were vague and indistinguishable, e.g. merely stating fluctuating exchange rates as a risk without defining how the direction of change would affect operations.

### **Specific comments on sections of the question**

#### **Part (a)**

In this section candidates were required to perform relevant ratios and interpret the performance of management.

Candidates who performed better were more selective in the type of ratios performed, i.e. limited their ratios to the controllable elements of the management accounts. Candidates who applied their minds and provided a deeper insight for the results obtained scored better marks.

The following represents the common errors made by most candidates:

- Ratios were calculated that added no insight or further information. They needed to think about which ratios were key, thus which could the company influence, rather than performing a simple line by line comparison or year on year comparison.
- Too many ratios were expressed as percentages of total income rather than commission revenue. Commission revenue was the company's key source of revenue while the other income was passive or insignificant
- Interpretation of ratios represented a 'dumping of information' applicable to any set of results without incorporating the issues particular to company in the scenario.
- Many candidates provided advice (not required) on how to improve performance – the requirement was to comment on the results only.
- Many candidates simply incorporated comments directly out of the scenario, without converting it into information. These items were often risk-related issues which should have been included in part (c).

#### **Part (b)**

In this section candidates were required to calculate a break-even volume.

Candidates who performed better were able to, with some thought, separate the management accounts into their fixed and variable components and determine the break-even point. Far too few candidates treated the foreign exchange loss and other income correctly.

The following represents the common errors made by most candidates:

- Provision of meaningless answers, such as a one-room night to break even or more than 4 000 room nights (the profit in the accounts was based on 4 000 room nights), without applying a reasonability test to determine if they needed to re-perform their calculations.
- Many based their calculation on the selling price of the resort, and not the company's percentage commission on the resort's selling price, i.e. they had not understood what constituted the company's revenue stream.

- Candidates incorrectly treated the other income and forex losses as variable to room nights.
- Many limited the company's variable cost to a single item – the commission paid to travel agents.
- It was also worrying to see how many candidates simply did not know how to calculate break-even.

### **Part (c)**

In this section the candidates were required to identify and describe the business risks which the company faced. Many of the risks were virtually stated in the scenario. Generally candidates performed the best in this part. Candidates who rephrased the risks provided more meaningfully and demonstrated exactly how the particular risk was a threat to the company performed fairly well in this section.

The following represents the common errors made by most candidates:

- Age-old dumping of information given without any application / insight.
- Not stating that issues were a risk.
- Candidates did not indicate how / why a statement they made was a risk and what its impact would be.
- Candidates were generally vague and indecisive about what they were saying, e.g. stating that foreign exchange was a risk without indicating the direction and impact thereof.

## **PROFESSIONAL PAPER 2**

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

### **Question 1 Part A**

This question concerned financial reporting, counting 80 marks in total. It dealt with the following aspects:

- Discussion on employee benefits
- Discussion of onerous contracts
- Financial instruments, impairment, provision and cash generating unit impairment calculation
- Deferred tax calculation.

### **Question 1 Part B**

This question examined strategy, risk management and governance for a total of 20 marks. It dealt with the following aspects:

- Labour unrest and impact on increasing costs
- Weak exchange rate
- Decreasing demand for the end product
- Decreasing selling prices.

**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% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 80           | 50.29        | 87.7% (2295)       | 12.3% (323)        |

### Level of difficulty

The question was moderate.

### General comments

The question did not only require a demonstration of technical knowledge, but also the competencies of critically analysing information and applying principles in an integrated manner to different settings, amongst others.

### Areas the candidates handled well

- Candidates generally attempted all subsections, which indicates that the time allocated to the question was appropriate.
- The majority of candidates made effective use of the Conceptual Framework definition of a liability, and relevant definitions and recognition criteria from a variety of IFRSs when addressing the appropriate classification, recognition and measurement of employee benefits in subsection (a).
- Candidates effectively combined discussion relating to appropriate accounting treatment with supporting calculations in both subsection (a) and (b).
- The majority of candidates were able to correctly calculate and journalise the impact of the revision of the estimate relating to the provision for environmental rehabilitation in subsection (c)(ii).

### Areas the candidates handled poorly

A few areas stand out, which may be of use to candidates for future examination purposes:

- In respect of the discursive subsections of parts (a) and (b), candidates lost marks due to the lack of clear articulation of the step-by-step application of principles, i.e. candidates knew the final answer but did not provide sufficient depth and analysis before arriving at their conclusion. Alternatively there were candidates who discussed the relevant classification, recognition and measurement requirements in the light of the scenario presented, yet a conclusion as to the appropriate accounting treatment was either not clearly stated, or the conclusion reached was not supported by the arguments presented.
- Candidates did not correctly account for the transaction costs incurred in the purchase of a financial asset subsequently measured at amortised cost in subsection (c)(i), and as a result did not calculate an appropriate effective interest rate, which was a necessary input for calculating the impairment loss.
- Candidates did not carry forward calculations already performed and the journal entries already provided in subsection (c)(i) and (ii) when determining the carrying amount of the cash-generating unit in subsection (c)(iii).
- Similarly, in section (d), candidates did not take into account the calculations already performed and the journal entries already provided in subsection (c) when calculating the deferred tax arising from each individual asset and liability at year end.

## Specific comments on sections of the question

### Part (a)

In this section, candidates were required to discuss the appropriate classification, recognition and measurement of employee benefits arising from certain decisions taken regarding the staffing of various divisions. Marks were awarded for the use of a logical argument.

Candidates who performed well in this subsection were able to present a logical, structured argument in which the aspects of classification, recognition and measurement were addressed, and in which the definitions and requirements of the appropriate IFRSs were applied. Furthermore, such candidates demonstrated an ability to apply accounting principles and concepts to the specific scenario.

Candidates who did not perform well commonly made the following errors or omissions:

- Candidates did not discuss the essential elements of the retrenchment plan, as required by IAS 19, *Employee Benefits*. Furthermore, information from the scenario was not used and appropriately applied when considering whether the contents of the retrenchment plan were appropriate.
- Candidates did not provide a clear conclusion as to the appropriate accounting treatment.
- Candidates provided a conclusion which was in contradiction to the argument presented.

### Part (b)

In this section, candidates were required to discuss the correct recognition and measurement of an onerous contract. Marks were awarded for logical argument.

Candidates who performed well were those who were able to provide a discussion, which represented a combination of the application of principles to the presented and supporting calculations.

Candidates who did not perform well made the following errors or omissions:

- Candidates limited the discussion to whether a lease existed and the nature of the lease.
- Candidates concluded incorrectly that the lease was a finance lease, and therefore did not discuss the recognition of an onerous contract.
- Candidates did not provide supporting calculations.
- Candidates provided notably incorrect supporting calculations, and merely calculated a present value of the lease payments in their entirety.

### Part (c)(i)

In this section candidates were required to prepare journal entries recording the impairment of an investment in debentures, which was subsequently measured at amortised cost.

Candidates who performed very well were those who identified that it was necessary to calculate a new effective interest rate as a result of the recognition of the transaction costs. Furthermore, such candidates were aware that this same effective interest rate was to be used in conjunction with the adjusted cash flows, when calculating the impairment of the financial asset.

The following are examples of mistakes made by candidates in this subsection:

- The transaction costs were not capitalised to the present value of the financial asset, but rather deducted or simply not accounted for.
- A new effective interest rate was not calculated.
- Candidates made unnecessary calculation errors when performing a present value calculation by using an incorrect number of periods.

### **Part (c)(ii)**

In this section candidates were required to prepare the journal entry to record the revision of the estimate of a provision for environmental rehabilitation.

Candidates who performed well were those who were able to correctly calculate the revised present value of the provision, compare it to the carrying amount of the provision and determine an appropriate adjustment. Furthermore, such candidates correctly journalised the increase in the provision as a simultaneous increase in the carrying amount of the factory building.

The following are examples of mistakes made by candidates in this subsection:

- Candidates made unnecessary calculation errors when performing a present value calculation by using an incorrect number of periods.
- Candidates provided a journal entry which recognised the increase in the provision as an expense in the statement of profit or loss and other comprehensive income.

### **Part (c)(iii)**

In this section candidates were required to prepare journal entries recording the impairment of a cash-generating unit. It was necessary to allocate the impairment to the assets within the cash-generating unit that were within the scope of IAS 36, *Impairment of Assets*.

Candidates who performed well were those who correctly identified the non-current assets to which the impairment was to be allocated, and appropriately recognised the impairment in their journal entries. Furthermore such candidates brought forward the calculations already performed in subsection (c)(i) and (ii) in determining the carrying amount of the cash-generating unit.

The following are examples of mistakes made by candidates in this subsection:

- The calculations performed in subsections (c)(i) and (ii) were not taken into account when determining the carrying amount of the cash-generating unit.
- Candidates used the lower of fair value less costs to sell and value in use, as opposed to the higher of the two, when determining the recoverable amount.
- The impairment was not allocated to the underlying assets.
- The impairment was incorrectly allocated to all of the underlying assets, including those excluded from the scope of IAS 36.
- The fact that a portion of the administrative buildings impairment should have been recognised through other comprehensive income was not noted and therefore not calculated.
- A journal entry narration(s) was not provided.

### **Part (d)**

In this section candidates were required to calculate the closing balance of the division's deferred tax at year end. There were two methods available to candidates in answering this subsection. The balance method entailed the use of a table in which the carrying amount of each asset / liability was compared to the item's tax base, the temporary difference calculated and the appropriate tax

rate applied. The movement method entailed the reconciliation of the deferred tax balance, prior to the adjustments processed in subsection (c) to the closing deferred tax balance. The appropriate tax rate was in this instance applied to the movement of each asset / liability.

Candidates who performed well were those who demonstrated an understanding of the future tax consequence upon the recovery or settlement of the carrying amount of each asset / liability. Furthermore such candidates brought forward the calculations already performed in subsection (c)(i) and (ii), and the impairment calculated in subsection (c)(iii) in determining the carrying amount of the individual assets and liabilities.

The following are examples of mistakes made by candidates in this subsection:

- Candidates made use of incorrect tax consequences and exemptions when determining the deferred tax arising from each asset / liability.
- The calculations performed in subsection (c) were not taken into account when determining the carrying amount of the individual assets and liabilities.

## QUESTION 1 Part B

| Maximum mark | Average mark | Marks > 50% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 20           | 9.99         | 57.4% (1502)       | 42.6% (1116)       |

### Level of difficulty

The level of difficulty was moderate to difficult.

### General comments

The mark plan was essentially divided into two parts – (1) labour unrest and (2) increasing costs, decreasing demand and decreasing selling prices.

The first part was on the whole poorly answered. It did however require candidates to possess a certain depth of knowledge relating to labour unrest and the processes used to resolve them (collective bargaining, etc.). The second part was a little more generic, with candidates being able to formulate strategies to reduce costs, hedge currency risk, liquidity risk and financing issues.

Candidates once again did not formulate their answers effectively – markers at times needed to read between the lines in ascertaining what candidates are trying to say. In terms of pervasive skills, some candidates still tend to dump their answers with little attention to layout. Some candidates prepared a list of questions instead of identifying the issues or considerations as required by the question.

### Areas the candidates handled well

Candidates seemed to be able to identify and address issues relating to margin pressures and how to address these more effectively than the labour related issues.

### Areas the candidates handled poorly

Candidates appeared to lack the practical exposure to labour related processes such a collective bargaining agreements and their impact, negotiation processes, retrenchment processes, etc.

## PROFESSIONAL PAPER 3

**Paper 3** consisted of one question that dealt with the following aspects:

### Question 1

The questions focus was auditing and assurance, counting 100 marks. It dealt with the following aspects:

- Risk of material misstatement at overall financial statement level
- Audit strategy to respond to the risk at overall financial statement level
- Companies act and ethical conduct
- Risk of material misstatement at the assertion level for property, plant and equipment
- Substantive procedures to be performed on the valuation of inventory
- Discussion of control risk for each assertion of occurrence, accuracy and completeness of sales
- Substantive procedures to audit the going concern assumption
- Discussion of the accounting treatment of settlement with the Competition Commission for price fixing.

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

| Maximum mark | Average mark | Marks > 50% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 100          | 56.22        | 75.6% (1978)       | 24.4% (640)        |

### 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 was also supported by the various universities in their comments.

### General comments

It was encouraging to see that candidates are starting to realise the importance of auditing and are beginning to devote appropriate effort to it in the ITC.

The question was reasonably well answered by the candidates who 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 still neglect auditing and do not put a concerted effort in answering audit questions. Such candidates received very low marks.

Examination technique was, as in previous years, a problem. Many candidates did not read and consider the information of the question carefully, or applied this in answering the question. This was evident for example in part (d) where candidates were asked to discuss control risk for each of the assertions of occurrence, accuracy and completeness of the sale of cement. Many candidates totally ignored the information in the scenario, as well as the specifics of the required and provided merely a generic answer or mind dump of standard theory.

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

### **Areas the candidates handled well**

**Part (a)(i) and (a)(ii)** on the risk of material misstatement at the financial statement level and the audit strategy to respond to it was extremely well answered. Candidates should however guard against merely listing risk indicators and not describing the risk.

**Part (b)** dealing with companies act and ethical issues were also well handled. Candidates should however guard against reading aspects into the scenario which are not there, for example stating that no Social and Ethics committee exist (no indication was given that this was the case).

**Part (c)(i) and (c)(ii)** on the risk of material misstatement for property, plant and equipment, as well the audit of the valuation of inventory was reasonably well answered. Candidates should however again guard against not going outside the information of the scenario, but focus on basing their answers on what is given of the question.

Answers on **part (e)**, requiring substantive procedures on the going concern assumption, ranged from very well to poor. Part (d) on control risk for the assertions of occurrence, accuracy and completeness was poorly answered

**Part (f)** on the treatment of the payment to the competition commission fine was reasonably well answered. Again, candidates who applied themselves to the information of the question and scenario did well, as opposed to those who merely gave a generic answer or mind dump of standard accounting theory.

### **Areas the candidates handled poorly**

Part (d) dealing with control risk for the assertions of occurrence, accuracy and completeness was poorly answered. Candidates often did not address the control aspects specifically required, and accordingly forfeited their marks for the section. Candidates also often totally ignored the information in the scenario or apply the information of the scenario to the required and their answers, and merely did a generic answer or mind dump of standard theory and did not.

### **Specific comments on sections of the question**

No specific comments.

## **PROFESSIONAL PAPER 4**

**Paper 4** consisted of two questions.

### **Question 1**

This question focused on Management Accounting and Finance, counting 80 marks in total. It dealt with the following aspects:

- Fixed overhead absorption rate calculation
- Break-even sales volume calculation
- Calculation and determination of the appropriate time to discontinue a subsidiary
- Evaluation of the purchase offer for the subsidiary
- Strategy: Identification of opportunities, threats and the attractiveness of the market for the company in question.

### **Question 2**

This question focused on Financial Accounting, counting 20 marks in total. It dealt with the following aspects:

- IAS 33
- IFRS 9.

**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% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 80           | 37.70        | 37.1% (972)        | 62.9% (1646)       |

### Level of difficulty

The level of difficulty was generally described as 'moderate' or 'fair' by the universities although overall we believe this to be quite a difficult question, although still appropriate for ITC. Part (d) was found to be more difficult as the number of marks allocated to this section required an extensive discussion with an advanced application of the information in the question.

### General comments

#### Part (a)

- Many candidates did not know how to calculate the number of units manufactured (sold units + closing stock – opening inventories). Instead they used the units manufactured in the prior year or units sold.
- Many candidates either ignored the over-absorption of the fixed overheads, or added the over-recovery instead of deducting the figure, showing a complete lack of understanding as to what over-recovered means.
- Too many candidates deducted the R2 variable cost from total manufacturing overheads before multiplying their answer by 94,329%. This gives a slightly different answer to multiplying the total manufacturing overheads by 94,329% and only then deducting the R2. A lack of mathematical skills and reasoning were evident.

#### Part (b)

- Most candidates ignored the special order when they calculated the break-even volume.
- Many candidates failed to distinguish between variable and fixed costs, a fundamental premise of determining break-even sales volumes.
- Too many candidates simply assumed cost of sales were variable in nature. The question had sufficient information for them to determine manufacturing costs and then to split these into variable and fixed components. We would have thought that removing the impact of inventory movements to determine actual manufacturing costs would be second nature for ITC candidates.
- The conclusions based on calculations were, however, pleasing. Most candidates correctly reached appropriate conclusions. However, some failed to apply any logic – when their calculations indicated that the break-even number of units was lower than actual sales, they missed the fact that this could not be true! The company was operating at a loss!

#### Part (c)

Part (c) flummoxed most candidates. The question required candidates to assess, with supporting calculations, whether the subsidiary should be discontinued at the beginning or end of the financial year. This would imply that they needed to analyse the cash flow impact of these alternatives and impact on profits. The errors made by candidates included –

- adopting both the total and incremental approaches
- ignoring the special once-off order
- confusing profit and cash flow effects
- failing to identify that depreciation was an irrelevant cost (company had a tax loss and hence, tax impact was also irrelevant); and
- not recognising the time value of money element – discontinuing in a year's time is not equivalent to today's money.

It was clear that some candidates failed to plan their approach to the question and then implement it, and they performed very poorly.

The second part required candidates to discuss the factors to consider in reaching a decision about the timing of the closure of the subsidiary. Many discussed whether the subsidiary should be closed at all, clearly beyond the scope of the required! The mark plan was generous and those who applied themselves diligently scored well.

#### **Part (d)**

- Although the question did not specifically ask for the performance of a FCF valuation, the offered price could not be evaluated without some attempt at how the company had arrived at their valuation
- Too many candidates did not use the results of their calculations in part (c) to assess the offer price
- It was disturbing to note how many candidates combined the FCF and NAV approaches, for example by calculating a terminal value for the NAV or adding cost savings to NAV
- Most ignored the special order in their deliberations
- Many candidates used the incorrect discount rate to present value the terminal value
- Too many candidates simply added the gross value of the tax loss instead of using 28% of the expected future benefit to the acquirer.

It was apparent that valuations are not a strength of most ITC candidates.

#### **Part (e)**

In this part there was generally an insufficient depth to candidates' answers. They could for example identify a valid issue such as sourcing materials required for manufacture from local suppliers but could not explain why this was a good thing (potentially shorter order lead times, no foreign currency exposure, etc.).

Some suggestions for future candidates when answering a strategy type question:

- Refer to generic issues affecting businesses in South Africa at the time, such as labour unrest, electricity price increases, expansion into Africa, etc. This would provide some easy marks.
- Never repeat points, it just irritates markers.
- Let the number of marks lead you when answering questions - two pages of double-spaced writing is insufficient when answering a 24 mark question!

## QUESTION 2

| Maximum mark | Average mark | Marks > 50% (Pass) | Marks < 50% (Fail) |
|--------------|--------------|--------------------|--------------------|
| 20           | 10.51        | 64.9% (1698)       | 35.1% (920)        |

### Level of difficulty

The question was moderate and overall considered to be fair.

### Areas the candidates handled well

- Candidates generally recognised the issue and addressed the required portion. The discussions were not far off from what was required, although some of the technicalities in the discussion were not completely accurately addressed.
- In general, a good distinction was made between 'profit or loss' and 'other comprehensive income'.
- Candidates knew what to discuss when liabilities are measured at fair value through profit or loss and also often brought in some discussions regarding IFRS 13.
- The general approach to the calculation of diluted earnings per share was correct and in accordance with IAS 33. Calculations were performed on the debentures and options, a ranking determined and the calculation was performed. However, specifically more technical calculations of the debentures in terms of IFRS 9 were not calculated accurately.

### Areas the candidates handled poorly

- The discussion part of the question consisted of two aspects, namely the impact on the valuation AND the measurement and presentation thereof. Many candidates only addressed one part of these parts.
- Candidates confused 'presentation' with 'disclosure' and discussed IFRS 7 disclosure requirements, rather than presentation issues.
- Many candidate did not calculate any fair value in part (b) of the question, and hence did not take any fair value adjustment into account in the calculation of the adjustment to the earnings related to the conversion of the debentures for diluted earnings per share. This calculation accounts for six marks in the question.
- The calculation of the dilutive effect of the options on the number of shares was generally done incorrectly. It is believed that the fact that there was an option premium could have confused the candidates somewhat.
- Very few candidates used an effective interest rate to determine the impact on earnings when debentures were converted and only used the coupon payment.
- Many calculations were done manually, where a financial calculator could have been used to save time.

### Specific comments on sections of the question

Part (a) required a discussion of the impact of changes in own credit risk on the valuation of a convertible debenture and the accounting measurement and presentation thereof.

This required a two-fold answer and although candidates had a general idea what to discuss, they mostly answered only one part of the required. Generally, they identified correctly that changes in own credit risk will be accounted for in other comprehensive income (if there is no accounting mismatch), and that other fair value changes will be accounted for in profit or loss.

Part (b) required a calculation of diluted earnings per share, where adjustments had to be made for two instruments, namely options and convertible debentures. Although the general approach in the calculation of diluted earnings per share pre IAS 33 was correct, some of the interest and fair value calculations in terms of IFRS 9 were performed poorly.

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