EXAMINERS’ COMMENTS

Part II of the
Qualifying Examination
Financial Management
November 2006
This report has been compiled from the analysis of examiners on candidates’ performance in Part II of the Qualifying Examination (Financial Management), which was written in November 2006. 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;
- tutors in preparing candidates for the Qualifying Examination; and
- future 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 examination paper.

The purpose of Part II of the Qualifying Examination is to test the integrated application of practical knowledge gained in commerce and industry.

STATISTICS FOR PART II QUALIFYING EXAMINATION (FINANCIAL MANAGEMENT)

In 2006 51 candidates passed Part II of the Qualifying Examination (Financial Management), compared to 68 in 2005.

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<tr>
<th></th>
<th>% Pass</th>
<th>Passed</th>
<th>Failed</th>
<th>Total</th>
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<tbody>
<tr>
<td>First attempt</td>
<td>51%</td>
<td>39</td>
<td>38</td>
<td>77</td>
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<tr>
<td>All candidates</td>
<td>41%</td>
<td>51</td>
<td>73</td>
<td>124</td>
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Average marks per question:

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<tr>
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<th>Question 1</th>
<th>Question 2</th>
<th>Total</th>
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<tr>
<td>Total marks</td>
<td>110</td>
<td>90</td>
<td>200</td>
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<tr>
<td>Average marks</td>
<td>51</td>
<td>45</td>
<td>96</td>
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BACKGROUND

The Examinations Committee constantly strives to improve its ability to determine whether candidates demonstrate the educational ability to qualify as Chartered Accountants. This is done by means of an ongoing process of evaluation and improvement in the way in which it selects questions for inclusion in the examination and decides on the final mark plans.

1 Source of the questions

The examination questions are drawn from three sources:

- Questions (the majority) are set specifically for a particular examination by the members of the Examinations Committee (a subcommittee of the Education Committee), who are all specialists in a particular subject area;
- Questions on a particular subject may be commissioned from persons in commerce and industry as well as in public practice by the Project Director: Education; and
- Questions submitted by practitioners, accountants in commerce and industry, and academics are added to a question pool that has been built up over the years and are also used in the examination papers.

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 Examinations Committee. They are all selected with great care regarding their integrity and professional standing and are sworn to secrecy.

2.1 Marking of the scripts

The Education Committee 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 after 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 Education Committee, who authorises the final suggested solutions and the mark plans that are used in the marking process.

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, and they are returned to SAICA together with the mark lists once the marking has been completed.

Each marking team consists of at least two individuals (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.

Each script is marked by independently by two different persons who record their marks on separate mark sheets that they retain. Once marking has been completed the both markers marks are entered on the front cover and where there are more than two marks different the markers confer and jointly decide on the final mark to be awarded. The final mark is then noted 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 is referred to the umpire, who then awards the final mark.
In view of the above stringent marking process no request for re-marks will be entertained.

2.2 **Adjudication**

Adjudication is done by the Education Committee as soon as possible after the Project Director: Education has received the mark list from the umpire.

The members of the Committee receive lists of candidates – who are identified only by a ranking number based on marks obtained for the examination – together with the marks awarded to every candidate for every question. The members of the Education Committee base their decisions of which candidates passed with honours, which candidates passed, and which did not pass, on the marks as set out in these lists.

During the adjudication process, the Education Committee considers all relevant evidence, including the following:

- The Education Committee’s expectations for each question;
- The level of difficulty for each question;
- Comments from universities, markers and umpires with regard to any marking difficulties which were encountered or candidate time constraints which were noticed;
- Possible ambiguity in the wording or translation; and
- Any other problems that may have been encountered relating to the examination.

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

**GENERAL COMMENTS ON RESPONSES**

1 **Objective**

In view of the primary objective of Part II of the Qualifying Examination (Financial Management), namely to test the integrated application of practical knowledge, 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 **Comments**

From a review of candidates’ answers to the two examination questions for the November 2006 examination the following basic deficiencies were identified. These problems affected the overall performance of candidates, and it is a matter of concern that candidates annually make the same mistakes. 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.
2.1 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, such as a letter, memorandum or report.

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.

2.2 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.

2.3 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 answer 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.

2.4 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.

2.5 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.

2.6 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 answers in the form of statements while calculations were required or presented financial statements where a discussion of the appropriate disclosure was required.

2.7 Basic numeracy skills

It was disappointing to note that many candidates did not display basic numeracy skills. We expect at this level that candidates are able to apply basic numeracy skills, particularly as they have already successfully
completed Part I of the Qualifying Examination. Basic numeracy skills are important both in this exam and in practice and it is important that candidates have a good grasp of these basic skills.

3 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. This is a major concern, because by the time candidates qualify for entrance 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. After all, in a work situation no accountant can expect to deal with textbook type clients and situations, neatly set out in logical format!

4 General comments by the umpires

The paper was challenging overall and dealt with practical issues. Generally the exam technique displayed by most candidates was disappointing. This would include –

- reading the required carefully;
- never dumping information in the hope that the examiner will award marks for something (this only irritates markers and the candidate wastes valuable time);
- time management;
- a legible handwriting and setting out answers in a manner that is easy to read; and
- clarity of expression.

In addition candidates did not apply themselves properly in this exam. It is a concern that candidates did not do better in this exam both with regard to application as well as exam technique. Seven percent of the available marks were for presentation and candidates should easily have scored full marks for this, but few made use of the opportunity.

Overall, the standard of the examination was in line with that of prior years. Several topics, although they did form part of the syllabus, were examined for the first time in the examination. While this may have unnerved some candidates they are expected, as Part II (the final part of the Qualifying Exam) candidates, to be able to deal with this.

The detailed analyses are set out in the comments on the results of each question later in this report. But in general it is clear that candidates struggled with financial analysis, financial accounting and merger and acquisition issues.

The paper required a significant amount of discussion, and marks allocated to calculations were limited, and a number of candidates were unable to cope with this. This could lead to the 2006 examination being construed as being more difficult than in prior years, particularly in conjunction with the level of interpretation of information and original thought that was required to achieve marks. Again, candidates for an exam at this level are expected to have moved beyond the purely calculation stage and demonstrate insight into specific, and fairly complex, situations.

The following issues were considered in the adjudication of the paper:

- The extent to which financial analysis was examined in the paper – 20% of total marks. This is an area that candidates have struggled with in prior years.
- The poor performance in the accounting section.
- The number of repeat candidates and their pass percentages versus those of first-time candidates.
The paper covered a broad range of issues and was a fair test of candidates’ ability to apply knowledge to specific scenarios. However, it was clear that most candidates are still not comfortable attempting “case study” type questions.

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

Please start preparing for next years’ examination in good time.

Opera singer Beverly Sills once observed: “There are no shortcuts to any place worth going” and John C. Maxwell said: “A person who has a dream knows what he is willing to give up in order to go up.”

Best of luck!!
The scenario in the question 1 dealt with a manufacturer of generator sets and a broad range of issues were examined.

Specific comments made by the examiners:

- In part (a) candidates were required to analyse and compare the gross profit margins achieved by the company up to September 2006 with that achieved in the year ended December 2005, and identify possible reasons for the change and issues that needed to be investigated further. Many candidates wasted valuable time discussing issues beyond the scope of the question or failed to absorb information contained in the question, of which the following are examples:
  - A number of candidates discussed revenue growth when only an analysis and discussion of gross profit margins were required.
  - Many candidates wasted time recalculating annualised results for September 2006 when the question clearly indicated that an analysis of the gross profit percentage for nine months versus the previous financial year was required.
  - Numerous candidates stated that the gross margin percentage had deteriorated because of foreign exchange fluctuations, despite the fact that it was clear in the question that forward cover was obtained for all imports, the company adopted a cost-plus pricing policy and all FEC costs were passed on to customers! Marks were available to candidates who showed insight, and queried or discussed whether Azania had passed on FEC costs, the effectiveness of their hedging strategies and whether all imports were covered by FECs.

- In part (b) candidates were required to identify possible weaknesses in the costing system and make recommendations for improvement. There were 25 available marks and the average mark of 6.6 out of 14 was disappointing. There were numerous weaknesses in the system that candidates should have been able to deduce from the information in the question.

- Parts (c) and (d) were generally well answered by candidates. In these sections candidates were required to list factors that had to be considered prior to accepting a special order from a customer and to review the proposed costing of this order.

- The performance in part (e) was very disappointing. The requirement was that a list of factors be considered in the pricing of the special order and that a pricing range be suggested. Most candidates failed to recognise that in the pricing of the order, they had to take into account the potential future orders from the client (pricing now would set precedent for future orders) and the fact that the company was operating a full capacity (and that hence, an incremental costing approach was not appropriate).

- In part (f) candidates were required to list the issues to be considered prior to outsourcing production of the product (generator sets) to a foreign (Chinese) supplier. This was generally well answered.
Part (g) dealt with an ethical issue, namely that the production manager of the firm had accepted a fully paid holiday from a potential Chinese supplier. Most candidates obtained satisfactory marks in this section, particularly in comparison to marks obtained for questions on ethics in prior years.

In part (h) candidates were required to review critically and comment on the draft budget of a proposed new maintenance division. The average mark for this section was a bit disappointing, given that 20 marks were available, as was the maximum of 11 that was obtained.

Part (i), in which candidates were required to list the key business risks facing the company, was generally well answered.

The results for part (j) were dismal. Candidates were asked to discuss the recognition, measurement and presentation implications of FECs taken out by the company to hedge foreign currency movements of imports. It is apparent that most candidates had not reviewed IAS 39 (revised in January 2006). The level of knowledge displayed by candidates with regard to accounting for foreign currency transactions was very poor, as is reflected in the 8% pass rate for this section of the question.

Financial analysis is an area that candidates have struggled with in the Part 1 and Part 2 examinations over the past couple of years. We have not previously examined pricing decisions in Part 2, and this may explain some of the poor results for this section of the question. The results in part (j) would seem to indicate that most candidates did not bother to review accounting statements that had been issued after they had completed their undergraduate studies.
**Question 2**

**Number of scripts marked:** 124

<table>
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<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50%</th>
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<tr>
<td>90</td>
<td>41</td>
<td>32%</td>
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<table>
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<tr>
<th>Highest mark</th>
<th>Lowest mark</th>
<th>Marks &lt; 50%</th>
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<tbody>
<tr>
<td>64</td>
<td>24</td>
<td>68%</td>
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**Level of difficulty:** Average

The scenario in question 2 was a service based organisation, in which a local subsidiary of a multi-national group had three different consulting divisions. The results obtained for this question were also considered to be poor.

**Specific comments made by the examiners:**

- In part (a) candidates were required to comment critically on the allocation of overhead expenditure to operating divisions. Although candidates generally performed adequately in this part, they apparently failed to understand what was required of them. Most candidates interpreted the terminology “…critically comment…” to mean that they should only address incorrect overhead allocation bases. Approximately half of the available marks were for comments on bases that were appropriate. While some candidates may have found the wording “critical” to have been somewhat misleading, the reasonable assumption would have been to comment on all bases and not just those that were blatantly incorrect. Furthermore, the Candidate’s Guide (available to all candidates in published format and also available on the SAICA website) contain a list of terms frequently used in examinations, amongst which are the following definitions:
  - “critically” – state the shortcomings/advantages
  - “discuss” – explain the different arguments.

- In part (b), candidates were asked to review and discuss the revenue performance of each operating division. Only 8% of candidates managed to pass this section. Again, it would seem that candidates struggle to answer financial analysis questions. The following are some of the typical problems that candidates displayed:
  - Calculation of irrelevant ratios;
  - Repetition of results of ratio analysis in words, for example: “The strategic division had the highest revenue per employee of all divisions”. It is difficult to award marks for self-evident comments.

- In part (c) candidates were required to calculate and discuss profitability ratios for each operating division. Many candidates were flummoxed and could not distinguish between the requirements of parts (b) and (c). On reflection, the distinction between “revenue performance” and “profitability” should be obvious to candidates at this level.

- Part (d), in which candidates were asked to list the key issues to be considered in closing down a particular division, was generally well answered.

- The results for part (e) were dismal. The South African subsidiary had received a proposal from a BEE consortium to acquire a strategic minority interest in the company and details of this offer were summarised in the question. Candidates were required to comment critically on the proposal and guidance was given regarding particular issues that should be addressed in answers. The average mark of 32% reflected the general inability to absorb and apply information provided in the question, as well as poor planning in general. Many candidates wrote comments in illogical order indicating
limited or no planning of answers to the question. There were 50 available marks for part (e) yet the average attempt yielded only 8.4 marks! Common mistakes or issues included:

- Questioning whether Mr Sibanda had sufficient cash to acquire an interest in the South African subsidiary, despite the fact that the question stated explicitly that he had recently sold shares in another company for R100 million;
- Repeating information provided without offering any interpretation of such information;
- Little consideration of the implications of the proposed sale from the perspective of the holding company, even though comments on this aspect were expressly asked for in the required section;
- Reference to the “tax implications” of the proposed transaction, but no specific statements or explanation on which category of taxation (CGT, income tax, STC) was relevant here.

Candidates were asked to comment on the suggested valuation of the South African subsidiary by the head office in part (f). Most candidates struggled to comment on a valuation, from which the examiners could only deduce that this way of testing valuations was foreign to them. They proceeded to perform their own valuations of the South Africa subsidiary, instead of commenting on the opinion of the global Vice President of mergers and acquisitions. Furthermore, many candidates apparently did not know (or understand) the difference between a PE multiple and an EBIT multiple.

In part (g) candidates were required to identify and list ways in which the South African subsidiary could improve profitability. Unfortunately, many candidates made generic comments without applying their minds to the specific facts and circumstances of the South African subsidiary for example, the recommendation that “…IGL SA should increase capacity…” was an inappropriate suggestion given that certain divisions were operating well below available capacity.