EXAMINERS’ COMMENTS

Part II of the
Qualifying Examination-
Financial Management
November 2007
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 2007. 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)

Analysis of first time and repeat candidates over the period 2004 – 2007:

<table>
<thead>
<tr>
<th>Year</th>
<th>FAIL</th>
<th>PASS</th>
<th>TOTAL</th>
<th>% PASS</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First timers</td>
<td>28</td>
<td>48</td>
<td>76</td>
<td>63.2%</td>
</tr>
<tr>
<td>Repeats</td>
<td>41</td>
<td>29</td>
<td>70</td>
<td>41.4%</td>
</tr>
<tr>
<td>Overall 2007</td>
<td>69</td>
<td>77</td>
<td>146</td>
<td>52.7%</td>
</tr>
<tr>
<td>2006</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First timers</td>
<td>38</td>
<td>39</td>
<td>77</td>
<td>50.6%</td>
</tr>
<tr>
<td>Repeats</td>
<td>35</td>
<td>12</td>
<td>47</td>
<td>25.5%</td>
</tr>
<tr>
<td>Overall 2006</td>
<td>73</td>
<td>51</td>
<td>124</td>
<td>41.1%</td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First timers</td>
<td>39</td>
<td>60</td>
<td>99</td>
<td>60.6%</td>
</tr>
<tr>
<td>Repeats</td>
<td>16</td>
<td>8</td>
<td>24</td>
<td>33.3%</td>
</tr>
<tr>
<td>Overall 2005</td>
<td>55</td>
<td>68</td>
<td>123</td>
<td>55.3%</td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First timers</td>
<td>25</td>
<td>51</td>
<td>76</td>
<td>67.1%</td>
</tr>
<tr>
<td>Repeats</td>
<td>4</td>
<td>7</td>
<td>11</td>
<td>63.6%</td>
</tr>
<tr>
<td>Overall 2004</td>
<td>29</td>
<td>58</td>
<td>87</td>
<td>66.7%</td>
</tr>
</tbody>
</table>

Average marks per question:

<table>
<thead>
<tr>
<th></th>
<th>Question 1</th>
<th>Question 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total marks</td>
<td>100</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Average marks</td>
<td>44</td>
<td>56</td>
<td>100</td>
</tr>
</tbody>
</table>
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 2007 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 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.

2.4 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.

2.5 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.

2.6 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 format of the examination changed this year. Previously, candidates wrote the entire paper in one sitting. The exam was divided into two separate questions with each question allowing an additional 20 minutes reading time over and above the normal 2 and ½ hours writing allocated. This should have allowed candidates to read and absorb the facts of the question before committing their answers to paper. In addition, it should have prevented the overrunning of time between the two questions.

The paper was challenging overall and dealt with practical issues. It is clear from the analysis of the results that candidates found question 1 to be more difficult than question 2. This is not surprising as question 1 included financial analysis (a topic that has been poorly answered historically) and required significant application of knowledge by candidates.

Generally the exam technique displayed by most candidates was disappointing. This would include:

- not reading the required carefully;
- 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. A number of 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.

Detailed analyses of the questions are set out for each question later in this report. But in general it is clear that candidates struggled with sections that required application of knowledge and/or original thought.

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.

**University comments**

We received commentary from University of Johannesburg, Wits, UCT and Rhodes. Universities commented favourably on question 1 indicating that this was of acceptable standard in the Part II examination. Question 2, however, was heavily criticized. Most respondents felt that the question favoured TOPP candidates completing training contracts in banking and financial services sectors and discriminated against other TOPP candidates. Particular issues raised regarding Question 2 included:

- Part (a)’s wording was vague and unhelpful, and the mark plan included arbitrary and casual observations;
- Part (b) required candidates to calculate pro forma income statements, balance sheets and cash flow statements for 3 years. Universities felt that this could have been examined for 1 year as opposed to 3 years, and there was wasteful repetition;
- Part (d), which required commentary on local versus foreign debt facilities, unfairly favoured TOPP candidates who had trained in financial services; and
- Part (f) required section was not well articulated.

With hindsight, part (a) and (d) were well answered and we do not believe these sections unduly favoured particular candidates. Part (b) was deliberately expanded to include many calculations to achieve a balance in the paper as a whole. We acknowledge that candidates could have been adequately tested in part (b) by asking them to prepare financial statements for one of the 3 years as opposed to all three years. Part (f) required application and original thinking, and hence was challenging.

The mark team reviewed the detailed university comments and amended the mark plan where appropriate.

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!!

*Mandi Olivier  
**Project Director: Education**
Question 1

Number of scripts marked: 146

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50%</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>44</td>
<td>31%</td>
</tr>
<tr>
<td>Highest mark</td>
<td>Lowest mark</td>
<td>Marks &lt; 50%</td>
</tr>
<tr>
<td>65</td>
<td>23</td>
<td>69%</td>
</tr>
</tbody>
</table>

Level of difficulty: Average

The scenario was a supplier of office automation products, mainly through renting equipment as opposed to selling products.

Specific comments made by the examiners:

- In part (a) candidates were required to comment on Arete’s trading and financial performance in the 2007 financial year. Unlike in prior years, candidates performed adequately in this section. Candidates could, however, have performed better in this part if they analysed the “required section” properly. Even though this was not asked, many candidates compared the 2007 actual results with 2008 budgeted results, this being a typical requirement in most similar questions.

- Part (b) required candidates to discuss whether they agreed with a divisional manager’s views on the profitability of the Consumables division. This required a comprehensive understanding of the information provided in the question. The majority of candidates struggled to intelligently discuss the issues arising.

- Most candidates failed to express an opinion on whether Susan DeMille’s instructions would achieve a turnaround of the business and instead merely commented on the feasibility of implementing her plans. This displayed poor exam technique in that candidates should have discussed each instruction and shared their views on what impact (if any) this could have on profitability.

- Candidates performed adequately in parts (d) and (e) which was a pleasant surprise. Historically, candidates have struggled to comment on valuations as opposed to performing these. A small amount of planning before attempting an answer combined with the proper analysis of the “required section” could, once again, have improved the candidates’ performance. In part (d) many candidates did not formulate new actions; instead they expanded on the actions already proposed in the question.

- Part (f) was poorly answered in general. The majority of candidates listed issues to consider but failed to provide insightful comments on the financial attractiveness of the investment opportunity. This section required a high level of application from candidates in order for them to formulate their own views.

- Performance in part (g) was disappointing in that this presented an opportunity for candidates to score relatively easy marks. Too many candidates focused on financial risks facing the company as opposed to the wider business risks.
Part (h) was surprisingly well answered, a pleasing change from prior years where candidates have struggled with questions dealing with ethics.
Question 2

Number of scripts marked: 146

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50%</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>56</td>
<td>68%</td>
</tr>
<tr>
<td>Highest mark</td>
<td>Lowest mark</td>
<td>Marks &lt; 50%</td>
</tr>
<tr>
<td>87</td>
<td>34</td>
<td>32%</td>
</tr>
</tbody>
</table>

Level of difficulty: Average

The scenario in question 2 was a listed company in the manufacturing sector, which was the target of a proposed buyout.

Specific comments made by the examiners:

- In part (a) candidates were required to discuss the nature and role of private equity in South Africa. The marking of this section was very lenient and candidates generally obtained high marks for the discussion of the potential negative consequences of private equity deals. From the question, the high gearing was obvious – most candidates did note and comment on the financial risk attached to private equity transactions. However, in general, it was apparent that candidates are not reading Accountancy SA or newspapers on a regular basis. As part of their CPD, candidates should already be updating their knowledge continuously.

- In part (b), candidates were asked to calculate and review whether or not Newco would meet its loan repayment and financial covenant obligations. Candidates were guided to prepare pro-forma income statements, balance sheets and cash flow statements for 3 years in support of their answers. Many candidates struggled to produce simple financial statements. Typical problems with answers included:
  - Candidates were told that working capital ratios would remain intact, yet many candidates ignored this and made illogical assumptions e.g. no change in working capital amounts at all over 3 years;
  - Goodwill was ignored;
  - Candidates included the same tax charge that they calculated for the income statement, in both the balance sheet as the outstanding amount at year-end, and as the cash tax payment in the cash flow statement. This illustrates a basic lack of understanding of a cash flow statement;
  - Most candidates used a single percentage to calculate the cost of sales for the three projected years. The rates differed between the SA and export markets, and should have been calculated separately;
  - Quite a number of candidates considered a shareholder’s loan to be an asset of the company;
  - Most candidates failed to show their calculations for interest cover and debt equity ratios;
Many candidates did not remember that retained earnings is a cumulative figure. The income statement figure was taken as the retained earnings at the end of the year in the balance sheet;

Some candidates drew up both income statements and balance sheets – but failed to produce cash flow statements. Cash in the balance sheet was calculated in a rudimentary fashion without consideration of the impact of working capital, taxation, EBITDA etc; and

Many candidates prepared the required financial statements but failed to comment on whether the terms of the loan repayments or financial obligations would be met. This was the crux of the question, yet many candidates overlooked this.

In part (c) candidates were required to calculate implicit annual interest rates on 3 individual loan components, and the total facility. Candidates either scored 3 out of 4 or zero on this part. Many candidates calculated the effective interest rates for the different loans, but not the overall rate as was also required by the question.

Part (d), in which candidates were asked to compare terms of the foreign loan versus the South African loan and highlight key differences, was the section in which the highest pass rate was achieved. Candidates simply had to re-write what was given in the question. Despite having to copy the information, a couple of candidates still struggled. The candidates who obtained poor marks mostly did not compare the foreign and local loans. They simply re-wrote what was given in the question, without mentioning where the agreements were the same and where they differed. This indicates a lack of exam technique or reading skills.

The results for part (e) were dismal. This question required candidates to discuss and evaluate the offer price. The question required candidates to review existing valuation figures and assume or calculate other information, which would have allowed them to prepare a rudimentary valuation. Candidates struggled to apply their theory to the information provided. Only 15 candidates passed this section of the paper illustrating that most candidates prefer to perform a valuation rather than intelligently comment thereon.

In part (f), candidates were asked to identify and describe the merits, disadvantages and risks of the reinvestment option for shareholders. A few candidates did not use their reading time optimally, as they assumed that the re-investment option was in fact the company’s future expansion plans. Layout was poor with candidates failing to address all three requirements and listing points in a bullet fashion instead.

In part (g) candidates were required to identify and explain any potential conflicts of interest executive directors may have. This section was poorly answered and candidates failed to understand the real and potential ethical conflicts. Many inappropriately pointed to the lack of ability to work with a new management and personality clashes as an ethical conflict. Candidate’s level of understanding of this section was extremely poor.