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 June 2016. 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 June 2016;
- Background information on the setting, marking and adjudication of SAICA examinations;
- General comments on the ITC June 2016; and
- Detailed comments by question in each of the professional papers (1–4).
### STATISTICS FOR ITC JUNE 2016

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<th>% Pass</th>
<th>Passed</th>
<th>Failed</th>
<th>Total</th>
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<tbody>
<tr>
<td>All candidates</td>
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#### Average marks per question (all candidates)

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<th>Question 1</th>
<th>Question 2</th>
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<td>Part I</td>
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<tr>
<td>Paper 1</td>
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<tr>
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More detailed statistics can be found on the SAICA website at www.saica.co.za.
BACKGROUND INFORMATION ON THE SETTING, MARKING AND ADJUDICATION OF SAICA EXAMINATIONS

The ITC 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**

The ITC 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, suggested solutions or mark plans, and are reported to the ITC 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 ITC Examco, question composers, subject specific reviewers and external examination sitters, is as follows:

<table>
<thead>
<tr>
<th>Amanda Singleton</th>
<th>Kobus Swanepoel</th>
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<tbody>
<tr>
<td>Anton du Toit</td>
<td>Lelanie Bredenhann</td>
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<td>Anuradha Pandya</td>
<td>Lisa Vidulich</td>
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<tr>
<td>Carmen Westermeyer</td>
<td>Lyndsay Maseko</td>
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<td>Cobus Rosssouw</td>
<td>Mandi Oliver</td>
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<td>Elhorere Wesigye</td>
<td>Mariaan van Staden</td>
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<tr>
<td>Ferdinand Mokete</td>
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<td>Francois Liebenberg</td>
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<td>Francois van den Berg</td>
<td>Piet Nel</td>
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<td>Frans Prinsloo</td>
<td>Pieter Landsdell</td>
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<td>Gideon Petrus</td>
<td>Pieter van der Zwan</td>
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</table>
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 ITC Examco. They are all selected with great care regarding their integrity and professional standing and are sworn to secrecy.

3. The marking process

The ITC 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 ITC 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 the ITC June 2016 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 discuss how the
individual markers award the marks point by point for each question. The aim of this process is to identify any concerns, differences and discrepancies in interpretation that the marker(s) may have in awarding of marks as per the final mark plan before 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 IPD 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 ITC 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 detailed statistics for the examination are prepared. Candidates who are selected for the borderline review are not awarded the secretaries mark (1 mark 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 the ITC in this regard).*
GENERAL COMMENTS ON THE ITC JUNE 2016

1. Objective

In view of the primary objective of the 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

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<td>100 – 120 marks</td>
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<td>25 – 30%</td>
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<td>0 – 5%</td>
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<th>Audit &amp; Assurance</th>
<th>Tax</th>
<th>Financial Management</th>
<th>Management Decision Making &amp; Control</th>
<th>Ethics</th>
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<td>P1 Q2</td>
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<td>16%</td>
<td>13%</td>
<td>11%</td>
<td>3%</td>
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3. Overall comments on the papers

The June 2016 ITC examination was considered overall challenging, yet fair and at appropriate level for the ITC.

From result statistics, it was evident that candidates found paper 4 easier and paper 2 the hardest amongst all 4 papers.

The examination covered a broad range of issues and was a fair test of candidates’ ability to apply knowledge to specific scenarios. It was evident that candidates struggled to apply their answers to some scenarios and the information at hand. Insight into understanding the context of the scenario, which required an application of knowledge and/or original thought, was problematic. Candidates often disregarded the context of the scenario and addressed aspects in their answers which were outside the scope of the scenario.

Paper 1 Question 1 consisted of two parts, which were considered to be moderate to challenging. The question integrated financial accounting and management accounting topics with finance and also integrated these with ethics and taxation (dividends tax, capital gains tax and related income tax). It tested candidates’ ability to think comprehensively about financial decisions in the form of the consequences of performance incentives on decision making. The question examined share buybacks and the effect on a company’s ROE, EPS and management remuneration. It explored possible conflicts of interest and ethical dimensions of such decision making and the conflict between returning cash to its shareholders and the need to finance expansion. It examined the real-life trend to increase ROE and fundamentally change a company’s capital structure by engaging in share buybacks, which is tied to management remuneration. Overall, there was a good balance between the written and calculation sections of the question.

Paper 1 Question 2 required a critical discussion of the recognition and measurement of an internally generated intangible asset as well as correcting journal entries. It was considered to be easy to moderate, with some challenges arising because of the blend between accounting and external reporting.

Paper 2 Question 1 achieved a strong intra-disciplinary integration in the auditing and assurance competency area, together with limited inter-disciplinary integration (with external reporting and strategy, risk management and governance). Part I was considered to be moderate, with an interesting scenario covering auditing aspects as well as taxation and accounting. It integrated changes to revenue standard into the scenario, with strong intra-disciplinary integration in the auditing and assurance competency area, covering the core areas of audit planning, internal controls, and substantive procedures. There was also inter-disciplinary integration with external reporting and strategy, risk management and governance. The non-standard scenario tested the ability of the candidate to apply real world and relevant controls to ensure integrity of financial information recorded. Requirement (d) was more complex, as it focused on only one assertion, the valuation assertion which forced candidates to think outside the box.

Paper 2 Question 1 Part II dealt with strategy and risk management, with the discussion on the new IFRS 15 being relatively straight forward, although approaches to answering the question differed greatly because candidates were still grappling with the principles of the standard – this was catered for in the mark allocation. Candidates had to think outside of the box and incorporate an array of elements regarding strategy to ensure that they identified key factors affecting the strategy of the company. The question tested imported analytical skills, specifically evaluating and considering different factors in a decision.

Paper 3 Question 1 Part I was considered to be moderate to difficult, with management of the amount of information included in the scenario on various financial accounting topics and pulling these together in the solution one of the greatest challenges faced by the candidates in writing this question. The question provided good coverage of a number of group and other IFRS matters, as it integrated many different aspects of IAS 7, IFRS 2, IFRS 3, IFRS 5 and IFRS 10 into a cash flow question. The level of difficulty was increased by the variety of issues that needed to be considered,
including share-based payments, impairments and deferred tax. Candidates therefore needed to plan their solutions properly.

Paper 3 Question 1 Part II was of moderate difficulty, and dealt with strategy, risk management and governance. However, the identification of key business risks was fairly challenging to candidates due to the unstructured nature of the scenario. This was an open-ended type of question that brought strategic planning and risk management to the fore. It forced candidates to critically analyse the scenario and apply their minds to mitigate risks. The overall inclusion of IFRS was well spread and topical.

Paper 4 Question 1 contained good syllabus coverage of taxation topics and was set in a rich, convincing scenario. There was a good balance between corporate income tax, personal income tax, VAT, dividends tax and donations tax and trusts. More marks were allocated to discussion than to calculation and it required attention to detail on the specific sections.

Paper 4 Question 2 tested management decision making and control, dealing with critical management issues and basic costing concepts and awarding marks for application of knowledge to the scenario instead of basic number crunching. The scenario is relevant to the current business environment, in which numerous mergers and acquisitions are taking place. It accordingly tested basic knowledge and logical thinking and covered a few quite complicated areas, resulting in a spread in difficulty with easier and more difficult aspects. It tested candidates' integrated knowledge of transfer pricing, relevant costing and performance management implications. There was a good mix between calculations and discussions. The breakdown of the required sections served to navigate candidates to the crux of the management issues contained in the scenario.

4. Specific comments

From a review of candidates’ answers to the nine required sections for the ITC June 2016 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 are given to these important skills. It is important that candidates bear in mind that written answers are a large component of the Qualifying Examinations, 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. By not managing time appropriately it was evident that candidates left out many marks, often easier marks, whilst the difficult sections were attempted and clearly taken more time to address, but resulted in no marks.

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, but this adds to the marking time).

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.

Candidates should communicate reasons for calculations, if required. A discussion of a case study should always have a conclusion. Or if it requires a decision, a conclusion alone is not sufficient, discussion beforehand is required.

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 Examination Regulations 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.'

We have been in the position, in the past, where we unfortunately had to fail a candidate because that candidate did not achieve the 40% subminimum in two of the 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 three sections, that dealt with the following aspects:

Question 1 Part I

(a) An estimate of the amount of economic value added that has been created or destroyed by the relevant company (performance evaluation).
(b) An estimate of the total bonus amount due to senior management (performance evaluation) in terms of a management incentive scheme, on the assumption that a share buyback programme is either implemented or not.
(c) A critical discussion of a management incentive scheme implemented from the perspective of the company.
(d) A discussion of the potential merits and pitfalls of the proposed share buyback programme from the perspective of the company and its shareholders.

Question 1 Part II

(e) A discussion of a primary ethical dilemma, including related governance and statutory implications, inherent in the share buyback proposal tabled by two senior managers and description of the appropriate action(s) that should have been taken.
(f) A discussion, supported by calculations, of the tax implications in terms of the Income Tax Act should one company sell part of its total shareholding to another company as part of a share buyback programme.

Question 2

The critical discussion of the recognition and measurement relating to the development of a new intangible asset, with correcting journal entries.

Five presentation marks were available for this paper. These marks were clearly and separately stated in the 'required' sections of each question.

QUESTION 1 PART I

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (pass)</th>
<th>Marks &lt; 50% (fail)</th>
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<tbody>
<tr>
<td>53</td>
<td>22.77</td>
<td>174 (24%)</td>
<td>550 (76%)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

The question begins with an economic value added calculation, followed by the calculation of management incentive bonus using a given formula. The question then examines share buybacks and the effect on a company’s ROE, EPS and management remuneration. It explores possible conflicts of interest and ethical dimensions of such decision making and the conflict between returning cash to its shareholders (dividend policy) and the need to finance expansion. The question focused on the practical impacts on management remuneration and the forecasts of ROE and EPS. The considerations between returning capital via a share buyback or a dividend were also considered.

Specific sections from the competency-based framework that were addressed are performance evaluation, economic value added, dividend policy, share buybacks and ratio analysis.
The question had both difficult and easier sections. Although the topics are part of the competency-based framework and thus examinable, candidates struggled because these were not topics commonly examined in the ITC and they may have had less exposure to them. While the question was rated as moderate by the universities, this was not borne out by the results.

2. In what respect candidates’ answers are considered to fall short of requirements

There was clear evidence of candidates being unprepared for the EVA, performance evaluation, dividends and share buyback topics, these not being common topics examined in the ITC, and therefore they may have had less exposure in the form of previous questions in their preparation. The topics are however included in the competency-based framework and are examinable.

There was also evidence that candidates did not interpret the required properly, and answered what they knew, rather than what was being asked. An example was in required (d), which required the discussion of the incentive scheme, where candidates provided comments on the governance of the scheme, and not the merits thereof.

3. Common mistakes made by candidates

Exam technique was generally adequate from a structural perspective, but there were often irrelevant comments in the theory sections. It appeared that candidates had exhausted their knowledge on what was asked for, which resulted in an irrelevant theory dump.

Candidates therefore often provided solutions at a basic level, rather than at an intermediate / advanced level as was required. This was evidenced in answers which stated a point, but not the context or consequence thereof; a level of insight is required to earn marks.

There was often also evidence of candidates stating the same point multiple times with different wording, instead of broadening their discussion.

4. Areas that the candidates handled well

The candidates performed well in applying the given formula in parts (b) and (c).

5. Specific comments on sections of the question

- Many candidates appeared to have little idea of how to calculate EVA, perhaps evidence of insufficient preparation due to the topic being unexpected, as it has not been examined recently. Candidates should ensure that they are prepared on all aspects of the competency-based framework.
- This section required candidates to use a given formula, therefore a mechanical exercise not requiring preparation or application. Although many candidates missed the dividend and bonus provision addbacks, this was generally handled well.
- This section again required the application of the given formula, but in an altered environment, following a share buyback. The application within the formula was again handled well, but many candidates did not understand the share buyback, and made simple technical errors, including not addressing the buyback, interest and dividend adjustment marks.
- In this required candidates had to critically evaluate the incentive programme. Candidates did not appear to understand the formula, or its purpose. There was also a lack of knowledge with respect to share buybacks. Some candidates suggested that a share buyback would increase EPS, which is not correct, as the standard requires this to be adjusted. Some candidates went into governance issues which were not required. Some treated the share buyback as a share issue. There were many generic comments on manipulating accounting principles, and a general lack of application.
There was a distinct lack of knowledge on share buybacks and dividend theory. Many candidates discussed regulatory requirements, which were not asked for. There was also much evidence of making statements rather than providing input. This was again evidence of insufficient preparation for unexpected examination topics where candidates had not prepared for the entire competency-based framework syllabus.

**QUESTION 1 PART II**

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (pass)</th>
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<tbody>
<tr>
<td>26</td>
<td>10.23</td>
<td>338 (47%)</td>
<td>386 (53%)</td>
</tr>
</tbody>
</table>

1. **What general areas the question covered**

The question covered various ethical, statutory and governance areas and the tax consequences (normal tax, capital gains tax and dividends tax) of a share buyback from the perspective of the holder of the shares.

In part (f) candidates had to discuss the primary ethical dilemma, including related governance and statutory implications, of a share buyback proposal, as well as the appropriate actions the CEO (also a CA(SA)) of the company should have taken. Two senior managers of the company proposed that the company implement a share buyback. In answering this question, candidates had to identify that a decrease in the number of shares would impact on the bonus that would be received by management since the management incentive scheme was based on earnings per share (this was provided in the scenario).

Candidates were required to address the application of the Code of Professional Conduct as it relates to the CEO as a CA(SA), and also to discuss the statutory and governance issues inherent to the share buyback proposal in terms of the Companies Act and King III.

In part (g) candidates had to discuss, with supporting calculations, the tax implications for a shareholder of the company on the sale of 7.68% of its shareholding in terms of the share buyback programme. It therefore required candidates to discuss whether the share buyback would be a ‘dividend’ as defined and then deal with the resulting capital gains tax and dividends tax consequences that would follow.

Part (f) was considered to be fair to moderate and part (g) moderate to difficult.

2. **In what respect candidates’ answers are considered to fall short of requirements**

In part (f) many candidates failed to identify that a share buyback would have an effect on the management incentives scheme and that, as a member of management, the CEO’s bonus would also increase. They therefore failed to identify the consequential primary ethical dilemma of a conflict of interest from which various ethical, statutory and related governance issues flowed.

Candidates displayed poor communications skills, exam technique and layout in terms of the ethical dilemma and the actions that the CEO should have taken.

With regard to part (g) many candidates failed to identify the impact of whether the share buyback was a dividend or not, and whether there was a return of CTC or not. Candidates often contradicted themselves in their discussion and many candidates attempted to answer the question using and mixing both alternatives. Many also did not address all the tax consequences (normal tax, capital gains tax and dividends tax) and also displayed poor exam technique and layout in terms of the three distinct tax consequences.
3. Common mistakes made by candidates

Part (f)

- Applying the Code of Professional Conduct to the two senior managers, even though the question did not mention whether they are CAs.
- Discussing the Companies Act requirements pertaining to the repurchase of shares, the solvency and liquidity tests and the requirements regarding special resolutions. The scenario clearly stated that ‘The board of directors obtain the necessary approvals in terms of the Companies Act and the Johannesburg Stock Exchange Listing Requirements prior to the share buyback programme being implemented’. Such requirements have therefore been adhered to and this meant that valuable time was wasted on addressing such irrelevant points, which resulted in limited time available to address more pertinent issues.
- Candidates failed to identify that the CEO was a CA(SA) and thus that the Code of Professional Conduct would apply to him. Where a candidate did identify that the Code would apply, very few correctly articulated the thought and logic process of the Code and the actions the CEO would have had to take.
- Candidates failed to address the fiduciary responsibilities of directors in terms of sections 75 and 76 of the Companies Act.
- Many candidates merely stated various sections of the Companies Act with limited to no application to the facts given.
- Many candidates did not distinguish between the Companies Act and King III.
- Candidates focused on addressing the legislation in respect of a share buyback instead of the conflict of interest threats.
- Many candidates indicated that the CEO had an obligation to report a ‘reportable irregularity’ in terms of section 45 of the Auditing Profession Act. However, the CEO was not a registered auditor (and did not act in the capacity of a registered auditor) and therefore had no obligation to report this to the IRBA.

Part (g)

- A number of candidates stated that because the one company was an investment holding company, the shares were held for speculative purposes. An investment holding company would hold shares for capital appreciation. If an entity holds an asset (share) to generate income (dividends) and where the shares are not held for sale in the ordinary course of business (no scheme of profit making), such shares are capital assets.
- Some candidates treated the sale of the shares as capital in nature in terms of section 9C as the shares were held for more than three years. While they therefore got the resulting capital gains consequences correct, they failed to discuss the share buyback implications in terms of dividend definition.
- Some candidates incorrectly calculated the shares sold and the amount received by the company for the shares sold.
- Candidates displayed a very limited understanding of the principles of the dividend definition in section 1 of the Income Tax Act. Where a candidate did discuss whether the amount was a dividend, the discussion was often limited to quoting from the legislation with limited to no application to the facts given.
- When candidates attempted to answer the question as both a dividend and a return of capital it was difficult to award and carry forward principle marks.
- Not clearly addressing all the separate tax consequences, i.e. dividends tax, normal tax and capital gains tax. Layout and structure was often poor.
- A number of candidates applied the annual exclusion of R30 000 and used the inclusion rate of 33.3% despite the fact that it was a company and not a natural person.
- Where a candidate identified that the share buyback was a return of capital: Often candidates stated that the distribution net of contributed tax capital was a dividend, but then also stated that this same distribution (net of the contributed tax capital amount) was the proceeds for the purpose of capital gains tax.
- Many candidates reduced the base cost of the shares by the contributed tax capital instead of using the contributed tax capital amount as proceeds.
• Candidates often contradicted themselves in their discussions and many candidates attempted to answer the question using and mixing both alternatives. For example: they started off explaining that it is a dividend and then continued to state that it is not a dividend (basically giving two solutions). Candidates were unsure what the correct treatment was for a share buyback.

4. **Areas that the candidates handled well**

**Part (f)**
- Identification that the Code of Professional Conduct would apply to the scenario.
- Understanding of the Companies Act.

**Part (g)**
- That dividends would be exempt from normal tax.
- That there would be no dividends tax on a dividend paid to a resident company.
- That a share buyback would be a disposal of an asset for capital gains tax purposes.
- The capital gains tax calculation.
- Answers were supported with the necessary calculations.

5. **Specific comments on sections of the question**

Candidates failed to reference their workings and often writing was illegible, making their scripts very difficult to mark. It would appear that many candidates had not read the whole scenario and what was required with comprehension before attempting to answer this question. Candidates’ solutions were often contradictory and this also indicates a lack of planning.

Some candidates did not manage their time and therefore did not finish the question. Often candidates scored high marks for part (f) and no marks for part (g) (or the other way around).

**QUESTION 2**

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (pass)</th>
<th>Marks &lt; 50% (fail)</th>
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<td>21</td>
<td>12.21</td>
<td>470 (65%)</td>
<td>254 (35%)</td>
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</table>

1. **What general areas the question covered**

The question required a critical discussion of the recognition and measurement of an internally generated intangible asset as well as correcting journal entries.

The question was considered to be easy to moderate. Candidates displayed a good theoretical knowledge but struggled with the practical application.

2. **In what respect candidates’ answers are considered to fall short of requirements**

Candidates generally displayed a good theoretical knowledge of IAS 38, but poor application of the theory to the case study. Candidates’ discussions focussed mainly on the recognition of the intangible asset (i.e. definition and recognition requirements), with insufficient consideration of measurement, specifically subsequent measurement (i.e. amortisation method, useful life, impairment, etc.).
The question was considered easy to moderate. Candidates displayed a good theoretical knowledge but struggled with the practical application.

### 3. Common mistakes made by candidates

Many candidates accepted management’s conclusion that the requirements of par. 57 of IAS 38 had been met on a certain date and therefore did not consider the par. 57 requirements in detail. Since the question required candidates to critically discuss the recognition and measurement of the intangible asset, it cannot simply be accepted that management’s conclusion in this regard was correct, but rather should have been considered critically.

Many candidates did not correctly interpret the information that was given in the case study regarding journal entries that had already been processed in the current and previous years, resulting in mostly incorrect correcting journal entries. Prior-year expenses were correctly expensed during the prior years and those expenses were only capitalised in the current year. It is therefore incorrect to adjust retained earnings at the beginning of the current year for this error.

### 4. Areas that the candidates handled well

Candidates generally structured their answers well by including relevant theory to support their arguments and they mostly followed an appropriate exam technique for the question.

Candidates generally did well in sticking to the required, i.e. only considering recognition and measurement of the intangible asset and including correcting journal entries.

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**PROFESSIONAL PAPER 2**

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Paper 2 consisted of a single question with two required sections that dealt with the following aspects:

**Question 1 Part I**

(a) Identification and discussion of the risks of material misstatement at the overall financial statement level.
(b) Description of specific overall audit responses to risks.
(c) Design of additional key controls to mitigate risks of material misstatement related to revenue.
(d) Description of substantive audit procedures applicable to the valuation of a rental car fleet.

**Question 1 Part II**

(e) Identification of the key factors the company should consider from a business and strategic perspective prior to entering into an agreement with another company.
(f) Identification and discussion of performance obligations included in a service level agreement, including how the performance obligations should be recognised and measured, in terms of IFRS 15.

Six presentation marks were available for this paper. These marks were clearly and separately stated in the ‘required’ sections of each question.
QUESTION 1 PART I

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
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<tbody>
<tr>
<td>70</td>
<td>35.84</td>
<td>441 (61%)</td>
<td>283 (39%)</td>
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</table>

1. What general areas the question covered

The auditing aspects of 70 marks formed part of an integrated 100 mark question, with taxation and accounting and covered the risk of material misstatement at the overall financial statement level and specific overall audit responses to these risks, additional key controls to mitigate the risk of material misstatement for revenue and substantive procedures applicable to the valuation of stock.

The question was considered to be moderate to easy, with the exception of part (c), which was considered to be difficult.

2. In what respect candidates’ answers are considered to fall short of requirements

Candidates could have done better in parts (c) and (d) of the question if they focused on the given of the scenario and then planned their audit responses accordingly. In this regard they often disregarded the context of the scenario and addressed aspects that were outside the scope of the scenario or not applicable to the given system. They also often only focused on certain aspects of the scenario and did not consider the broader scope of aspects to address. In addition, in part (c) the candidates would test or mention controls already provided in the scenario.

3. Common mistakes made by candidates

As stated above, candidates did not always apply the information of the question in the answering of the required or consider what was actually required. This specifically related to section (c) where additional key controls to mitigate the risk of material misstatement for revenue should have been given. Candidates provided test of controls, instead of controls; often memory dumping, not making it applicable to the scenario and/or listed controls to address business risks instead of risk of material misstatement (RoMM) for revenue. This is also indicative of generally poor examination technique.

Some candidates spent too much time on parts (a) and (b) and performed well (obtaining maximum marks), but then clearly ran out of time for parts (c) and (d), which they then answered very poorly.

4. Areas that the candidates handled well

Section (a) on risks at the financial statement level was well answered as well as the response thereto (b). Candidates tend to do better with the parts (a) and (b) where theory could be applied.

5. Specific comment on sections of the question

Part (a) on the identification and discussion of the risks of material misstatement at the overall financial statement level was well answered. Candidates clearly understand the concept of risk at the financial statement level, and dealt with it appropriately. Some candidates had poor exam technique and described the risk indicator (e.g. JSE listed, could lose listing) and did not explain why it was a risk or a risk of material misstatement (e.g. incentive to manipulate results to maintain listing).
Some candidates listed the detection risk and not the risk of material misstatement. Most candidates did not address or identify the non-compliance with the Companies Act and other legislation. Many candidates were unable to differentiate between Companies Act and King III risks.

With regard to part (b), on the description of specific overall audit responses to the risks identified in part (a), candidates showed an understanding of the auditing concepts of how to respond to the identified risks. In some cases responses were however given of a mere general nature, and not a response to the specific risks as identified.

Some candidates answered (a) and (b) in columns, leading to them repeating the same audit response for some risks, which wasted their own time, as it was only rewarded once. Many candidates listed 4–5 specific procedures to be done on accounts and transactions, neglecting to indicate the overall audit response (which would affect procedures for all accounts and transactions).

Candidates did not demonstrate an understanding of what is meant by a combined or substantive approach. Despite indicating the substantive approach, they nevertheless still mentioned aspects of test of control procedures.

On part (c) relating to the design of additional key controls to mitigate the risks of material misstatement related to the company's revenue, candidate generally struggled and performed poorly. The scenario, namely of a paperless system, and the controls and information flow in existence in it were often ignored. Controls should have been provided that in addition to the existing controls would mitigate the risks.

Candidates often failed to provide controls that complemented the existing controls. This would be the case if they did not consider the given system and controls currently in place to mitigate the risk of material misstatement and the further areas of risks for which controls should be provided.

A few candidates gave the test of controls, instead of describing the control. Many candidates focussed on password controls, which were not specific or key to the company’s revenue, but rather IT general controls.

Candidates fared reasonably well in part (d), which required the description of the substantive procedures applicable to the valuation of a rental car fleet. However, a number of candidates still ignored the scenario and the nature of the assets (rental car fleet) that needed to be audited. This resulted in the provision of audit procedures that were not relevant to the scenario and not applicable.

Candidates were also asked to provide substantive procedures to audit the valuation assertion only, but many failed to restrict their answers to this. Poorly worded substantive procedures were provided in many instances. Some candidates addressed procedures on opening balances, despite the fact that it was expressly excluded.

It was evident in the responses that candidates did not follow a logical response to their answer, and randomly responded to procedures to be performed, almost like dumping procedures relating to valuation of inventory/fixed assets.

**QUESTION 1 PART II**

<table>
<thead>
<tr>
<th></th>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>30</td>
<td>14.55</td>
<td>289 (40%)</td>
<td>435 (60%)</td>
</tr>
</tbody>
</table>

1. **What general areas the question covered**

The question required a discussion of the key considerations from a business and strategic perspective to determine the acceptance of a contract with another company.
The second required covered a discussion of performance obligations in terms of IFRS 15, and the recognition and measurement of the revenue.

2. **In what respect candidates’ answers are considered to fall short of requirements**

If candidates applied their minds to the question and required, they could do very well; however, there was limited application by candidates, given the required and the amount of marks allocated to each.

In part (e) candidates discussed basic considerations and factors to consider, but not enough for the 20 marks. The straight-forward and logical points were there, but candidates did have to think a bit ‘outside the box’ and many of these marks were not discussed.

In part (f) candidates did relatively well if they attempted the question with proper application. However, in many cases only a theory dump was given with little to no application, or not all the sections of the required were addressed. A few candidates also did not read the required properly and discussed revenue from the rental business and not the advertising revenue from an agreement with another company. Candidates also should have been guided by mark allocation. In this section (for only 8 marks), the discussion sometimes stretched over three pages, with more than half of the discussion being an IFRS 15 theory dump.

3. **Common mistakes made by candidates**

- Candidates did not always let the mark allocation guide them. Part (e) was a 22 mark question compared to part (f) which counted 8 marks. However, in some cases discussions of almost similar length (and in a few cases even more for the 8 mark question than the 22 mark question) were provided. The mark allocation should always be a guide as to the amount that should be discussed.
- In the IFRS 15 section, many of the attempts contained theory dumping with limited application.
- The IFRS 15 section required a recognition and measurement discussion, but the measurement part was often not discussed.

4. **Areas that the candidates handled well**

- Basic strategic and business factors were well identified and discussed well.
- Discussion applicable to the current economic environment, competitors, taxi violence, etc., was well done and the markers were impressed with the incorporation of current affairs into the strategic discussions.
- If the IFRS 15 question were approached correctly, candidates performed very well in the application of the steps.
- Generally the performance obligations were correctly identified. Because of the large number of marks available, candidates performed well if they just discussed this section properly.
- The majority of the candidates obtained most communication skills marks and the layout of their solutions was generally good and in accordance with what was required.

5. **Specific comments on sections of the question**

**Part (e)**

- Performance on this section was average to good. Candidates considered many relevant points and often included current economic affairs and news in their answers. The considerations were also described clearly and understandably.
- A suggestion would be to place discussions under relevant headings.
- A further suggestion is that the mark allocation should always be a guide to determine how many points should be discussed.
Part (f)
- In this section candidates did relatively well if they attempted the question with proper application. Many candidates obtained the maximum 8 marks.
- However, in certain cases only a theory dump of IFRS 15 was given with little to no application, or not all the sections of the required were addressed.
- The question required the recognition and measurement of revenue, but in most instances measurement was not discussed. The measurement section did not add many marks, but candidates should be prepared to properly analyse the required and address all sections that was required.

PROFESSIONAL PAPER 3

<table>
<thead>
<tr>
<th>Paper 3 consisted of two questions that dealt with the following aspects:</th>
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<tbody>
<tr>
<td><strong>Question 1 Part I</strong></td>
</tr>
<tr>
<td>(a) A calculation of the goodwill or bargain purchase gain recognised on an acquisition.</td>
</tr>
<tr>
<td>(b) The preparation of a consolidated statement of cash flows.</td>
</tr>
<tr>
<td><strong>Question 1 Part II</strong></td>
</tr>
<tr>
<td>(c)(i) Identification and explanation of the key business risks faced by the group that should be disclosed in the FY2016 integrated report.</td>
</tr>
<tr>
<td>(c)(ii) A possible measure to appropriately respond to each of the key business risks identified.</td>
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</tbody>
</table>

Three presentation marks were available for this paper. These marks were clearly and separately stated in the ‘required’ sections of each question.

**QUESTION 1 PART I**

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<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
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<td>77</td>
<td>34.08</td>
<td>180 (25%)</td>
<td>544 (75%)</td>
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</table>

1. What general areas the question covered

This question covered the calculation of goodwill at acquisition and a complete consolidated statement of cash flow, which totalled 77 marks. Part (a) of the question dealt with the calculation of at acquisition goodwill. Candidates were required to calculate the goodwill acquired in a 100% interest acquisition of a subsidiary during the current financial year. The candidates had to apply IFRS 3 *Business Combinations* to determine the consideration transferred as well as the fair value of net assets acquired, with changes in deferred tax due to changes in fair value as well as a change in the manner of recovery on a non-current asset held for sale. In part (b) candidates were required to prepare a complete consolidated statement of cash flow.

The question was considered to be of moderate difficulty.
2. In what respect candidates’ answers are considered to fall short of requirements

- Some candidates did not adjust deferred tax at acquisition due to the changes in fair value of the acquired assets in part (a).
- Some candidates ignored the effect of the share-based payment (SBP) transaction with the employees at acquisition in part (a). Very few candidates classified the transaction as non-controlling interest.
- Some candidates used the direct method to calculate cash generated from operations although the information clearly indicated that the indirect method should be used to present cash generated from operations.
- Some candidates started their calculation of cash generated from operations with the line item profit for the year instead of with the operating profit line item, as instructed. This incorrect starting point cost them valuable time, because they had to reverse many more items than were required.
- Some candidates did not provide a step-by-step and logical layout of their calculations. This resulted in calculations not being used or not used in context. This was especially evident in the calculation of the cash movement required for the consolidated statement of cash flow.

3. Common mistakes made by candidates

- Candidates did not plan their approaches well enough which filtered through to the exam technique used in preparing the consolidated statement of cash flow.
- Some candidates presented cash inflow from dividend income and interest income as part of investing activities and cash outflow from dividends paid and interest paid as part of financing activities, although the information clearly stated that these items should be treated as cash in/outflows from operating activities.

4. Areas that the candidates handled well

- Candidates were able to identify most of the relevant changes in fair value at acquisition of the subsidiary.
- Candidates generally provided well-structured answers showing their calculations clearly.
- Candidates generally performed well in preparing the consolidated statement of cash flows.

5. Specific comments on sections of the question

**Part (a)**

Candidates who performed well in this sub-section were those who used good exam technique to perform the necessary calculations and disclosures to earn marks in a reasonable time. These candidates were able to structure their answers logically and clearly addressed the required. Candidates who identified the changes in fair value of the assets and liabilities acquired as well as the resulting change in deferred tax performed reasonably well.

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

- Candidates did not present a logical, well-structured answer. In these cases, it was clear that sufficient planning of the question was lacking and therefore resulted in important calculations not being performed.
- Candidates who failed to calculate changes in fair value at acquisition did not earn the relatively easy marks that were allocated for calculating these differences.
- Some candidates did not account for the settlement gain correctly, while others did not account for the favourable lease terms of the acquiree correctly as is required by IFRS 3 *Business Combinations*.
- Candidates ignored or incorrectly accounted for the tax effect of the fair value adjustments and recognition of identifiable assets and liabilities in the business combination. Generally, in an equity acquisition, the carrying amount of assets and liabilities change without a corresponding change in the tax base, which gives rise to temporary differences. Care needs to be exercised as to the correct tax rate to be applied to these temporary differences. In the case of assets, this depends on whether the carrying amount is recovered through use or
sale or a combination thereof. In the case of liabilities, this depends on the deduction available for the liabilities upon settlement thereof.

**Part (b)**

In this section, on the consolidated statement of cash flows of a company, candidates who performed well were able to use the information provided in the scenario and apply it in calculating the relevant cash flows for each of the line items and including it in the consolidated statement of cash flows. These candidates also classified the line items in the correct categories of cash flow as instructed, which showed good exam technique.

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

- Candidates did not start the calculation of cash generated from operations with the line item operating profit as was instructed; this cost them valuable time because they had to eliminate many more items due to the incorrect starting point.
- Some candidates presented cash inflow from dividend income and interest income as part of investing activities and cash outflow from dividends paid and interest paid as part of financing activities although the information clearly stated that these items should be treated as part of cash flows from operating activities.
- Candidates did not include the bank overdraft as part of the cash and cash equivalent balances at the beginning and end of the period, although the information stated that it was managed as part of cash and cash equivalents.
- Some candidates incorrectly calculated the net impairment loss on the property, plant and equipment as R1 million. This reflects the net loss in the company’s separate financial statements and not the group’s net loss of R3 million.
- Most candidates understood how to account for the acquisition of the subsidiary in the consolidated financial statements. These candidates identified the cash consideration correctly and also deducted the take-on cash balances correctly. However, some candidates did not understand that the assets and liabilities taken on at fair value should be removed in each affected asset or liability calculation to determine the required cash amount.
- Candidates did not calculate the dividends paid and received to be reflected in the consolidated statement of cash flow correctly. Dividends paid comprise cash outflows from the group, i.e. the parent’s dividend paid and dividends paid to the non-controlling interest.
- Candidates made adjustments for intercompany transactions. This is incorrect, as the starting point in preparing the consolidated statement of cash flow is the consolidated financial statements, which means intercompany transactions have already been eliminated.
- Some candidates did not complete the consolidated statement of cash flows due to poor exam technique. This generally involved doing unnecessary calculations and workings or not adopting a logical approach to answering the question. Unnecessary calculations also included calculating a profit or loss on the additional shareholding acquired in a subsidiary, when this was not required.

**QUESTION 1 PART II**

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>14.05</td>
<td>537 (74%)</td>
<td>187 (26%)</td>
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</table>

1. **What general areas the question covered**

This part of the question integrated business risk within a financial accounting scenario. Candidates were required to identify and discuss business risks that would be disclosed in the integrated report and provide a response as to how these risks could be managed.
The question was moderate to difficult, with the difficulty being increased by the open ended and unstructured required.

2. In what respect candidates’ answers are considered to fall short of requirements

Many candidates did not understand the difference between audit and business risks.

3. Common mistakes made by candidates

Many candidates inappropriately identified and discussed audit risks rather than business risks. Candidates also struggled to differentiate risks that would warrant disclosure in an integrated report from other less significant business risks. Weaker candidates tended to provide a generic laundry list of risks and did not apply their discussion to the scenario.

4. Areas that the candidates handled well

Generally candidates who had identified appropriate business risks were also able to provide appropriate responses for these risks.

PROFESSIONAL PAPER 4

Paper 4 consisted of two questions that dealt with the following aspects:

Question 1

(a) A calculation of the taxable income of an individual.
(b) A critical discussion of a taxpayer’s decision to transfer assets to a trust for no consideration.
(c) Discussion of the tax consequences of a payment made to a trustee by the company.
(d) A discussion, with reasons, of the normal income tax and VAT consequences of a barter transaction where the value of a service rendered did not match the value of a right received in return for the service.

Question 2

(a) The identification of variable costs from a set of financial results.
(b) Impact on group operating profits re a shift from internal transfers to external purchases.
(c) Factors the group should consider in setting a fair transfer price between divisions.
(d) A critical analysis of support division costs allocated to production divisions, i.e. cost assignment.
(e) An outline of the pitfalls of an incentivisation scheme for production divisional managers.

Four presentation marks were available for this paper. These marks were clearly and separately stated in the ‘required’ sections of each question.
QUESTION 1

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<th>Marks &lt; 50% (Fail)</th>
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<tr>
<td>54</td>
<td>22.0</td>
<td>169 (23%)</td>
<td>555 (77%)</td>
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</table>

1. **What general areas the question covered**

Part (a) required the calculation of a natural person’s taxable income. The calculation had to be started with an estimated taxable income to which adjustments had to be made. The calculation mainly covered income received from a family trust of which the person was also a beneficiary. Because the natural person donated assets to the trust, the attribution rules contained in section 7 of the Income Tax Act were applicable. The donation also resulted in donations tax implications that had to be added to the base cost of the asset in terms of par. 22 of the Eighth Schedule.

Part (b) required a critical discussion of a taxpayer's decision to transfer assets to a trust for no consideration. Candidates had to consider and discuss alternative tax planning actions that could have been taken by the taxpayer and to indicate the tax consequences thereof.

In part (c) candidates had to discuss the tax consequences where the trustees of a trust directs a private company (of which one of the trustees is the sole shareholder) to pay a trust expense on behalf of the trust without requiring the trust to repay the amount to the private company.

Part (d) required a discussion of the normal income tax the value-added tax consequences of a barter transaction where the value a service rendered did not match the value of a right received in return for the service.

2. **In what respect candidates’ answers are considered to fall short of requirements**

**Part (a)**

Some candidates did not identify that donations tax has to be calculated and added to the base cost of the asset disposed of. Candidates also used old legislation. Some candidates referred to 33% or 33.4% as the inclusion rate instead of 33.3%. Some candidates first used the assessed capital loss and then the yearly exclusion of R30 000 and lost valuable marks.

Most candidates passed this part of the question based on the capital gains tax section of the calculation. Candidates who attempted the trust calculation usually had a good idea of what to do in terms of the income tax calculation, but they did not always carry these amounts through to the final taxable income calculation.

The attributions and distributions of income and expenditure between the trust and natural person was poorly done.

**Part (b)**

This section was not answered well and showed a lack of critical thinking. Candidates struggled to critically assess a specific transaction and to apply alternative actions that could have been taken by the taxpayer.

Candidates only discussed the tax consequences of the transaction at hand (i.e. the transfer of assets to a trust for no consideration) without considering alternative actions (or planning) that could have been taken place to place the taxpayer in a more beneficial tax position than his original action taken as indicated in part (a) of the question.
Part (c)

In this section the majority of candidates did discuss the deduction of the amount in terms of section 11(a) read with section 23 (g). However, only a limited number of candidates identified that the amount meets the definition of a dividend. Those candidates who did identify the dividend did not indicate that the date when the dividend tax should be paid (30 November) and that the liability for the dividend tax is with the company.

Part (d)(i)

A large number of candidates only discussed either the income side or the expense side of the transaction. Candidates did not go back to the basics of the definition and application of gross income or deductions. Court cases were dumped in the answer without the correct principle of the court case, thus not earning a mark at all.

Part (d)(ii)

Candidates did not consider the basics of VAT (supply, time of supply, consideration). Furthermore the candidates did not discuss the issue of a valid tax invoice. Candidates tended to only deal with either output or input tax instead of dealing with both. Candidates did not know the VAT rules applicable to barter transactions, where a tax invoice was not issued.

3. Common mistakes made by candidates

Part (a)

Few candidates deducted the trustee remuneration from the trust’s income in the calculation the income of the trust that should be attributable to the donor in terms of section 7(5). A number of candidates were not sure how to treat the trust income and expenses.

Some candidates did not take into account the donations tax exemption of R100 000. It is worrisome that a few candidates even applied section 18A.

The following mistakes were commonly made by candidates who attempted the capital gains tax calculation:

- Candidates first deducted the assessed capital loss brought forward from the previous year of assessment before the annual exclusion for the current year of assessment was deducted.
- Candidates applied incorrect capital gain tax inclusion rates such as 33%, 33,33%, 33,4%, 66,6% and 28%, instead of the correct inclusion rate of 33,3%.
- Some candidates deducted the R30 000 annual exclusion from an assessed capital loss position, instead of adding it.
- Candidates who incorrectly calculated an assessed capital loss did not clearly indicate that it should be carried forward to the following year of assessment.

Part (b)

As most candidates did not provide alternative trust planning measures, mistakes were limited to the incorrect application of exemptions for capital gains tax and donations tax.

Some candidates focused on ethics instead of tax matters.

Candidates need to be aware of the meaning of the instruction words. To ‘critically assess’ is to ‘make a judgement based on careful consideration for and against something’ and ‘discuss’ is to ‘explain; present both sides of an issue; take a position; explore implications’.
Part (c)

Candidates generally incorrectly indicated that the transaction constituted a donation which triggered a donations tax liability. Very few candidates correctly identified the controlling relationship between the trust and the sole shareholder of the company in order to conclude that the payment made on behalf of the trust constituted a dividend *in specie*, resulting in a dividends tax liability for the company.

Part (d)(i)

Candidates incorrectly referred to an inclusion to be made in taxable income rather than gross income. The correct normal income tax terminology in terms of income tax legislation should be used.

Although bonus marks were added for references to the correct court case, candidates applied the incorrect tax principles, thus not attaining a mark for the court case.

Candidates also did not identify that it was a barter transaction nor discussed it as such.

A large number of candidates discussed impermissible tax avoidance arrangements in terms of section 80. Some candidates focused their discussion on section 19, debt reduction.

Part (d)(ii)

Candidates indicated the time of supply for VAT purposes as the earlier of the date of invoice issued or services rendered, instead of the date of invoice issued and payment made/received.

Candidates indicated that VAT would be applicable as services are rendered or provided instead of supplied. The correct VAT terminology in terms of Value-Added Tax Act should be used (i.e. the supply of service is made).

Candidates indicated that due to the invoice not being issued there was no value on the supply. Very few candidates identified that the open market value of R50 000 should be used.

Use of income tax terminology is not acceptable in a VAT discussion.

4. Areas that the candidates handled well

Generally part (a) of the required dealing with the calculation of natural person’s taxable income was answered fairly well by candidates, specifically the donations tax and capital gains tax calculation.

Some candidates performed fairly well in the discussion of the normal income tax implications of the barter transaction under part (d)(i) of the required, addressing both the income and the expenditure sides of the transaction.

5. Specific comments on sections of the question

In general it seems as if candidates need to improve their exam technique in respect of critical discussion type of questions. Candidates should be able to identify the problem and apply the basics. They also need to have the ability to think critically and to explain and make suggestions on alternative actions that could be taken by a taxpayer that could result in an overall lower tax liability.

Candidates did not take the mark allocation of the different sections into account. Some wrote the same number of pages for 5 marks as they did for 15 marks.
QUESTION 2

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<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
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<tr>
<td>46</td>
<td>18.92</td>
<td>133 (18%)</td>
<td>591 (82%)</td>
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1. **What general areas the question covered**

Management accounting principles and skills were tested through an integration of cost behaviour, decision making, transfer pricing, cost allocation and performance management topics.

2. **In what respect candidates’ answers are considered to fall short of requirements**

In part (a) the required addressed the variable cost of a product produced and sold. Too many candidates merely calculated the product cost, ignoring the commission incurred on sales.

In part (b) the required examined the impact on profits after the consideration of a bonus based on results provided in the scenario before the consideration of bonuses. Too many candidates missed this distinction in the information provided and the information required in the question. Candidates would also be well advised to follow the longer approach in these situations, especially given the marks and time allocated to do it.

In part (c) candidates failed to link factors specific to the company in the determination of a fair transfer price. Consequently candidates simply provided the theory behind the determination of a fair transfer price, without for example identifying the specific opportunity costs in the company. This theory could be applied to any company and candidates failed to identify factors particular to the specific company. This lack of application skills was substantiated by the number of candidates who attempted the discussion questions prior to the calculation questions. It is inconceivable how candidates can consider factors particular to a company before attempting the calculations, as an analysis of the financial data contained in the scenario was obtained by answering parts (a) and (b). This financial information enhances the picture one forms of the company to be managed in the question, i.e. parts (c) to (e).

In part (d) candidates demonstrated poor technique in critically analysing the allocation of support costs to the respective divisions. Generic responses such as ‘ABC is better’ were provided. Candidates failed to look at the nature of the costs in the support division to separate them between costs within their control or not, as well as failed to identify which of these costs should not be allocated at all as they did not represent indirect costs.

In part (e) candidates displayed poor ability as to problems (pitfalls) specific to the system implemented by the company and as per the part (c) were too generic in their responses.

Overall the candidates performed poorly, despite the fact that all universities regarded the paper as moderate.

3. **Common mistakes made by candidates**

In part (a) the cost of 1 kg of yarn (made up of equal amounts mohair and wool) was required. Far too many candidates doubled the cost of yarn by adding the cost of 1 kg of mohair and the cost of 1 kg of wool, i.e. the total cost incurred for 2 kg for the cost of 1 kg of yarn.

As in part (a), candidates failed to see that the impact on profits was the measurement of two different line items in the statement of comprehensive income in part (b). They furthermore failed to recognise that a change in sales affected the change in allocated support costs (as the allocation was based on sales value).
In part (c) candidates failed to link factors specific to the company in the determination of a fair transfer price. Consequently candidates simply provided the theory behind the determination of a fair transfer price, without for example identifying the specific opportunity costs relevant to the company in the scenario. This theory could be applied to any company and candidates failed to manage the company by identifying factors particular to it.

In part (d) candidates showed poor technique in critically analysing the allocation of support costs to the respective divisions and provided generic responses. Candidates failed to look at the nature of the costs in the support division to distinguish between cost within their control and not and also to identify which of these costs should not be allocated at all as they did not represent indirect costs.

In part (e) candidates displayed poor ability as to pitfalls specific to the system implemented by the company and as per the part (c) were too generic in their responses.

4. Areas that the candidates handled well

The areas that candidates handled well included the nature of costs (fixed v variable) and their behaviour for changes in volume and avoiding unit cost calculations in part (b). Most candidates also attempted all parts of the question paper.