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 2017. 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 2017;
- Background information on the setting, marking and adjudication of SAICA examinations;
- General comments on the ITC June 2017; and
- Detailed comments by question on each of the professional papers (1–4).
## Statistics for ITC June 2017

<table>
<thead>
<tr>
<th></th>
<th>% Pass</th>
<th>Passed</th>
<th>Failed</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td>All candidates</td>
<td>64%</td>
<td>583</td>
<td>330</td>
<td>913</td>
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### Average marks per question (all candidates)

<table>
<thead>
<tr>
<th>Paper</th>
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<th>Question 2</th>
<th>Total</th>
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<tbody>
<tr>
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<td>Average marks</td>
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<td>Paper 3</td>
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<tr>
<td>Average marks</td>
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<td>Paper 4</td>
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<tr>
<td>Average marks</td>
<td>23.09</td>
<td>25.94</td>
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More detailed statistics can be found on the SAICA website at [www.saica.co.za](http://www.saica.co.za)
BACKGROUND INFORMATION ON THE SETTING, MARKING AND ADJUDICATION OF SAICA EXAMINATIONS

The 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:

- Alex van der Watt
- Ben Marx
- Carmen Westermeyer
- Carol Cairney
- Cobus Rossouw
- Craig Wallington
- Elhorere Wesigye
- Elton Pullen
- Francois Liebenberg
- Francois van den Berg
- Frans Prinsloo
- Giel Pieterse
- Goolam Modack
- Greg Beech
- Greg Plant
- Jack Jonck
- Jackie Viljoen
- Janine Claassens
- Linda van Schalkwyk
- Lisa Vidulich
- Mandi Olivier
- Marielienne Janeke
- Neville Dipale
- Paula van de Wouw
- Piet Nel
- Pieter van der Zwan
- Rebecca Coombe
- Reghardt Dippenaar
- Riley Carpenter
- Ross Peasey
- Shaun Parsons
- Shelly Nelson
- Stéfani Coetzee
- Zahir Mayet
- Zwelodumo Mabhoza

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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 2017 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 by means of an electronic marking (CE) tool. 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. A reconciliation process was undertaken by the original two markers, using the CE tool, on scripts that did not comply with the business rules. 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 also extracted reports from the CE tool to perform a final verification of the marks. This was the first time SAICA used an electronic tool to assist with the marking process and this has added great value to the marking process including the elimination of relying on markers to manually add up marks on the mark plan, further eliminating human error in the marking process.

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 awarded 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.

During the adjudication process, four secretaries’ marks (one for each of the four papers) are added to compensate for the possibility that candidates did not have a fair opportunity to demonstrate their knowledge and skills due to inaccuracies in the marking process that cannot be compensated for through the already rigorous controls in the marking process.

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 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 2017

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

<table>
<thead>
<tr>
<th>Accounting &amp; External Reporting</th>
<th>Strategy, Risk Management &amp; Governance</th>
<th>Audit &amp; Assurance</th>
<th>Tax</th>
<th>Financial Management</th>
<th>Management Decision Making &amp; Control</th>
<th>Ethics</th>
<th>Comms</th>
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<td>40 – 60 marks</td>
<td>60 – 80 marks</td>
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<td>40 – 60 marks</td>
<td>0 – 20 marks</td>
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<tr>
<td>25 – 30%</td>
<td>10 – 15%</td>
<td>15 – 20%</td>
<td>15 – 20%</td>
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<td>0 – 5%</td>
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<table>
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<tr>
<th>Accounting &amp; External Reporting</th>
<th>Strategy, Risk Management &amp; Governance</th>
<th>Audit &amp; Assurance</th>
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<td></td>
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<td></td>
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<td>P1 Q2</td>
<td></td>
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<tr>
<td>P2 Q1 (part I and II)</td>
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<td>12</td>
<td>7</td>
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<tr>
<td>P3 Q1 (part I and II)</td>
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<td>P4 Q1</td>
<td></td>
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<tr>
<td>% of TOTAL</td>
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<td>15%</td>
<td>15%</td>
<td>12%</td>
<td>10%</td>
<td>3%</td>
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3. Overall comments on the papers

The June 2017 ITC examination was considered overall challenging, yet fair and at an appropriate level for the ITC.

From result statistics, it was evident that candidates found paper 3, part II and paper 4, question 1 the most difficult and coped best with paper 1, questions 1 and 2 and paper 3, part I.

The examination covered a broad range of topics 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 questions. Question 1 was considered to be easy and fair to moderate. The question assessed accounting and external reporting in a relevant and well-set scenario of a company that manufactures and sells standard heavy-duty business printers. It dealt with basic IAS 2 matters and provided a good coverage of a range of issues governed by IFRS 15 by means of journal entries, calculations and discussion. However, candidates struggled to display a proper understanding of the principles relating to the recognition and measurement of revenue in terms of IFRS 15, and to apply theory to the facts in the scenario. Question 2 dealt with financial management and was balanced between easy to obtain marks, with some challenging sections. The scenario was technically on the more challenging side, and demanded clear, logical thinking and a good understanding of the topics that were a fair mix of acquisition, financing, cost of capital and financial analysis topics. The discussion questions allowed for practical application of the considerations and focused on specific application to the scenario rather than generic points. There was an open-ended question that tested a broader application of knowledge. Candidates performed well in the calculation sections, but poorly in the discursive sections, struggling to apply the theory to the scenario and to display critical thinking.

Paper 2 was a single, 100-mark scenario that integrated audit and assurance with tax and accounting and external reporting, and also contained some ethics. The scenario was relevant to current economic conditions and events in South Africa, but the details and large number of required sections stretched candidates’ abilities. Part I was considered to be easy to moderate, and contained a good spread of audit topics, ranging from the risk of material misstatement and the effect of a misstatement of revenue to substantive procedures, including a going concern assessment. Part II dealt with potential tax avoidance and the related ethical considerations and tested candidates’ ability to synthesise information provided and apply the principles of the Professional Code of Conduct to the case, as well as basic IAS 36 and IAS 37 contingent asset, contingent liability and impairment principles. Despite the assessment of the level of difficulty being moderate to easy, candidates on the whole fared poorly, mainly because of the poor structure of their arguments and a lack of knowledge of the topics examined.

Paper 3 was an integrated question that covered accounting and external reporting and strategy, risk management and governance topics and was considered to be difficult. The owner-driver scheme was an interesting scenario, which was appropriate, relevant and topical. However, it contained quite complex information (for example on a service level agreement that tested IFRIC 4), that required critical analysis from candidates. Part I offered a fresh approach to assessing groups, which required a fairly detailed knowledge of IFRS 10. Some candidates also provided tax journals, even though the question clearly stated that tax should be ignored. Part II tested the skill of identifying risks and actions so as to address risks on a very high level and candidates had to consider the owner-driver scheme from the perspective of both the company and the drivers. This was a practical question that tested the current challenges faced by companies nowadays and candidates were required to apply their knowledge of ethics, governance and the legislation. One section dealt with the relevant issue of carbon emissions and would have encouraged candidates to come up with creative solutions and candidates did in fact fare well in this section. The question provided a good integration with risks, sustainability and governance.
Question 1 of paper 4 dealt with taxation, and tested a number of elements from the examinable pronouncements and integrated company, natural person and VAT issues. It assessed normal tax and VAT consequences from the perspective of both the employee and employer. It was considered to be fair to moderate and balanced in terms of both technical content and skills assessed. Candidates had to display an understanding of the definition of remuneration and the calculation of the taxable benefit values that will be included into remuneration, severance benefits and income protection policies and calculate the VAT consequences on some fringe benefits. Question 2 of Paper 4 dealt with management decision making and control, integrated with strategy, risk management and governance. The question was easy to moderate and tested the basic principles of activity-based costing and the issues surrounding a long-term supply contract. There was a balance between requirements for decision-making principles and analytical skills, as well as between calculations and application discussions. The question tested candidates’ conceptual understanding of relevant costing. However, as in the past candidates performed poorly in the parts that required discussion.

4. Specific comments

From a review of candidates’ answers to the eight required sections for the ITC June 2017 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 scenarios that’s were 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. Working 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 basic 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, while the difficult sections that were attempted and clearly had taken more time to address, often resulted in no marks being awarded.

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 who 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. Candidates should check whether taxation may be ignored, for in many cases time is spent on tax implications where these are specifically excluded.

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 will be 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 in this paper Taxation. 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.

4.13 General

Candidates are also reminded not to identify themselves in any way in their responses as this is considered misconduct in terms of the ITC exam regulations and results in candidates being subjected to SAICA disciplinary processes through a hearing at the professional Conduct Committee.

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

\textit{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!

\textit{Best of luck!!}
DETAILED COMMENTS ON EACH OF THE PROFESSIONAL PAPERS

PROFESSIONAL PAPER 1

**Question 1 of Paper 1** consisted of three sections, that dealt with the following aspects:

(a) The provision of journal entries required to correctly measure the inventory of printers at year end of a company that manufactures and sells standard heavy-duty business printers.

(b) A memorandum to the Financial Director of the company, advising her how to should recognise and measure a revenue transaction with another company in terms of IFRS 15 *Revenue from Contracts with Customers*, using five steps of IFRS 15, namely identifying the contract; identifying the performance obligations; determining the transaction price; allocating the transaction price to the performance obligations; and recognising revenue as the performance obligations are satisfied.

(c) The preparation of the journal entries to account for a contract for the construction of a newspaper printing press.

**Question 2 of Paper 2** consisted of five parts, that dealt with the following aspects:

(a) The calculation of the effective pre-tax interest rate of debentures, on the assumption that the company issued debentures in US dollar on proposed terms and conditions.

(b) The calculation of the ZAR equivalent per share that each shareholder electing the partial share alternative would have received if the purchase price had been settled on two different dates and a comparison of both with the cash offer.

(c) A discussion of the factors that South African based shareholders needed to consider when they decided whether to elect the cash offer or the partial share alternative.

(d) A calculation of the weighted average cost of capital on a certain date.

(e) An analysis and discussion of the group’s gearing levels after the acquisition of another company.

Five communication and 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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1. **What general areas the question covered**

Part (a) of the question dealt with the valuation of inventory where candidates were required to apply the principles of IAS 2 to correctly account for inventory at year end, by providing correcting journal entries.

Part (b) of the question dealt with the recognition and measurement of revenue in terms of IFRS 15. In this section, candidates were required to write a memorandum to discuss the recognition and measurement of revenue relating to a specific contract with a customer, including a 30 day money back guarantee, a standard one year warranty and a 2 year service & maintenance plan.
Part (c) of the question dealt with the recognition of revenue where the promised consideration included variable consideration in terms of IFRS 15. Candidates were required to provide journal entries to recognise revenue relating to the contract, including incremental costs of obtaining a contract.

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

In general, candidates struggled to provide relevant journal entries and occasionally resorted to dumping journal entries, which included quite a number of irrelevant journal entries. This resulted in answers not having a logical flow where journal entries were required and possible time wastage. Candidates also struggled to illustrate a proper understanding of the principles relating to the recognition and measurement of revenue in terms IFRS 15, with appropriate application often lacking.

3. Common mistakes made by candidates

Many candidates resorted to dumping irrelevant information / journal entries, with appropriate application of IFRS requirements often lacking.

4. Areas that the candidates handled well

Candidates managed to answer all three sections of the question. In part (b), candidates did well to limit their answers in line with the mark allocation that was indicated for each step.

5. Specific comments on sections of the question

Part (a)

Calculations relating to the cost of inventories were mostly appropriate, but candidates struggled to provide the correct and relevant journal entries to correctly measure the inventory at the reporting date. Some candidates included inappropriate items in the cost price of inventories, thereby losing some unnecessary marks.

Part (b)

Candidates struggled to correctly apply the principles of IFRS 15 to the scenario. This was mostly evident from the following:

- Step 2: Identify the performance obligations: Candidates struggled to correctly apply the requirements of IFRS 15 in order to identify the various performance obligations. Candidates would often come to the correct conclusions, but their reasoning was not always sufficient and/or appropriate.
- Step 3: Determine the transaction price: Candidates struggled to correctly apply the principles of variable consideration in terms of IFRS 15. While candidates mostly identified that a refund liability should be recognised for the money back guarantee, the requirements of IFRS 15 relating to variable consideration (which was present as a result of the money back guarantee), were not sufficiently addressed.
- Step 4: Allocate the transaction price to the performance obligations: This step was handled rather well, although candidates seemed to be confused with the 10% discount (rebate) that was granted at the inception of the contract, and the principles relating to the identification and allocation of a discount in terms of IFRS15.82.
- Step 5: Recognise revenue: This step was handled well, but articulation of the principle relating to control was often lacking. Candidates also often failed to justify why a certain performance obligation was either satisfied at a point in time or over time.
Part (c)

Candidates struggled with the determination of the transaction price, mainly due to the variable consideration that formed part of the promised consideration and more specifically, constraining the variable consideration where necessary. In some instances candidates ignored the variable consideration when determining the transaction price or recognised a provision for the variable consideration, which is incorrect. Candidates also struggled to correctly recognise the revenue based on the ‘percentage of completion’ that was stated in the question. Candidates struggled to correctly deal with the incremental costs of obtaining a contract (i.e. the commission paid to employees).

QUESTION 2

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1. What general areas the question covered

The question consists of a consideration of capital structure and debenture cost for a merger transaction, together with a calculation and consideration of the decision to be made as to whether to accept a partial share offer, or all cash, in the acquisition transaction. This is followed by a post-acquisition WACC calculation, and a consideration of the resulting gearing situation of the new group.

Part (a) dealt with the cost of debt, part (b) and (c) with mergers and acquisitions, a cash versus a share settlement and exchange rates, part (d) with the weighted average cost of capital, takeover share issue, the debt-equity ratio, a capital asset pricing model, the use of the Hamada model for leveraging the beta and weightings of debt and part (e) dealt with a capital structure, gearing levels after a merger transaction and the consideration of debt equity and interest cover.

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

Candidates battled to apply the theoretical aspects related to the partial share vs cash alternative to the transaction in the scenario. This resulted in points appearing as a theory dump at times. For instance, candidates answered that ‘tax aspects should be considered’ rather than relating this directly to the tax consequences within the transaction.

Candidates also generally had poor commentary on the gearing considerations, which resulted in generic comments such as ‘the debt equity ratio increased’, rather than applying this to the scenario, stating that this was due to the issue of the new debentures, and that this would increase the risk in the merged firm as their overall gearing would deteriorate substantially.

3. Common mistakes made by candidates

- Candidates battled to apply the Hamada formula, often solving for the incorrect variable.
- Candidates did not combine the different debt and equity instruments in the debt equity calculations, resulting in their gearing calculations being incorrect.
- Candidates often did not understand when to use market and book values, and incorrectly used market value in their debt equity calculations, and book values in their WACC calculations.
- Many candidates did not calculate any ratios in part (e), thereby losing those marks, and also leaving them with nothing to comment on.
4. **Areas that the candidates handled well**

   (a) Candidates were generally able to calculate the cost of the debentures in required (a).
   (b) Candidates applied the exchange rates and exchange ratio well in required (b).
   (c) Candidates generally were able to apply the CAPM formula, calculate the debt and equity weightings, and complete the WACC calculation.

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

   (a) Candidates generally performed well on this section, getting the numbers for a relatively easy interest rate on debenture calculation.
   (b) Candidates generally made a reasonable attempt at these calculations. There were however a few of non-attempts.
   (c) Discussions in general were particularly poor and superficial, with candidates providing generic points rather than tailoring their points to the context of the acquisition. This resulted in either meaningless generic comments, or comments which were incorrect in the context.
   (d) Candidates generally performed well in the WACC calculation, with some errors. The levering was poorly performed.
   (e) Very few calculations attempted, and discussion very poor, and often not relevant per the required or contextual.
PROFESSIONAL PAPER 2

Paper 2 consisted of a single question with two required sections:

Question 1 Part I consisted of four sections, covering the following aspects:

(a) An assessment of the risk of material misstatement at the overall financial statement level for the FY2016 audit of the consolidated financial statements of the company, based on the information provided in the scenario.
(b) A discussion, with reasons, of the effect of each of the actions taken by the council of the company on how the candidate would assess the risk of material misstatement of revenue in the company’s 2016 consolidated financial statements.
(c) A description of the substantive procedures to be performed to audit the accuracy, valuation and presentation assertions for trade receivables included in the company’s statement of financial position.
(d) A description of the audit procedures to be performed regarding the reasonableness of the cash flow forecast for FY2017 prepared to support the appropriateness of the going concern basis of accounting used in the consolidated financial statements of the company for FY2016.

Question 1 Part II consisted of three sections, dealing with the following aspects:

(e) A discussion, with reference to the information provided under a section dealing with the conduct of a trainee accountant, of –
   (i) any ethical concerns regarding the alleged conduct of the trainee and his position as a member of the audit team, with the provision of required actions to address concerns; and
   (ii) the course of action that a CA working at the company should follow in terms of SAICA’s Code of Professional Conduct regarding the instruction by her boss to write off student debt.
(f) With reference to a work paper –
   (i) a discussion, with a calculation where necessary, of the employees’ tax implications arising on the monthly payment by the company to another company, which provides security services; and
   (ii) a calculation, supported with reasons, of the normal tax liability of the security company for the year of assessment ended 29 February 2016.
(g) A critical evaluation of the proposed accounting treatment relating to two events at the company:
   (i) Damage to company property during student protests and a related insurance claim; and
   (ii) A claim instituted against the company by a student who had been injured on university property during the protests.

Seven communication and 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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1. What general areas the question covered
   - Risk of material misstatement at overall financial statement level;
• Effect on actions of risk of material misstatement for revenue;
• Substantive procedures on trade receivables; and
• Audit procedures on reasonableness of cash flows (going concern).

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

Candidates performed well in discussing the risk of material misstatement at both overall financial statement level as well as assertion level. Unfortunately candidates performed more poorly on substantive procedures, specifically audit procedures on cash flows. As is generally found with the answering of audit procedure questions, candidates do not express themselves well in the description of a substantive procedure. Many candidates describe an issue rather than the procedure that needs to be done.

3. Common mistakes made by candidates

Candidates generally did not describe audit procedures well, as discussed in part 2 above. This is an indication that their exam technique for audit procedures questions needs some attention. It may be due to the fact that many candidates have not been exposed to performing audit procedures in a practical audit environment.

Communication, layout and time management did not appear to be a problem.

4. Areas that the candidates handled well

Candidates performed well in discussing the risk of material misstatement at both overall financial statement level as well as assertion level.

5. Specific comments on sections of the question

Part (a) Risk of material misstatement at overall financial statement level
• This section was well answered by candidates in general. Some candidates do not describe the risk well by linking the risk to the effect that it would have on the financial statements.
• Many candidates also feel short by not addressing the assessment of risk (factors that increase AND decrease) they focused only on factors that increase the risk and did not conclude overall that the risk is high.

Part (b) Effect of actions of risk of material misstatement for revenue
This question was well answered, candidates expressed the effect of the actions on the ROMM for revenue adequately.

Part (c) Substantive procedures on trade receivables
This question was reasonably well answered. Many candidates still do not describe the audit procedures well and don’t use ISA 500 terminology. However, most candidates did address the issues in the trade receivables.

Part (d) Audit procedures on reasonableness of cash flows (going concern)
This section was poorly answered. The candidates did not describe the audit procedures to be performed on the cash flows well. It is surprising as this was considered to be a relatively fair part of the question and candidates’ were expected to perform well.
1. What general areas the question covered

Part e(i)

*Ethical concerns in connection with the audit trainee’s position on the audit team*

In discussing ethical concerns by applying the Conceptual Framework of the SAICA Code of Professional Conduct (COPC), the COPC requires consideration of the following:

- The identification of whether the COPC is applicable; and if so;
- That the threats and the fundamental principles affected be identified;
- That the significance of the identified threats be evaluated based on the guidance provided in the COPC applicable to the specific threat/issue; and
- If significant, identifying the safeguards, if any, that could be implemented to eliminate or reduce the threat to an acceptable level.

*Ethical concerns in connection with the audit trainee’s alleged conduct*

The question required the candidates to also discuss their ethical concerns in connection with the alleged conduct of the audit trainee. The latter would result in the consideration of ethical concerns in both instances, i.e. if the allegations are true and if it were untrue.

*Required actions to address the concerns identified*

This section of the question required candidates to provide actions, i.e. safeguards that can be put in place to eliminate the identified threats, or deuce it to an acceptable level.

Part e(ii): Courses of action to be followed in terms of the COPC

The question required of the candidates to discuss courses of action specifically in terms of the COPC that a CA (SA) in business should implement when confronted with an ethical issue.

Part f(i): Discussion of employees’ tax consequences

- The question required of candidates to discuss the employees’ tax consequences in connection with a company, which qualifies as a personal service provider.
- Candidates were required to identify and discuss that it is a personal service provider, followed by stating, with a calculation, the employees’ tax implications thereof.

Part f(ii): Calculation of normal tax liability supported with reasons

The question required of the candidates to calculate the normal tax liability and provide reasons as part of their calculation, based on their conclusion reached in f (i) on whether the company in the question is a personal service provider or not.

Part g: Overall

The question required candidates to critically evaluate the suggested accounting treatment of various issues given in the scenario. This would entail the following for each of the suggested accounting treatments for the various suggestions provided in the scenario:
• A detailed discussion with application of the information provided in the scenario to the principles in the applicable International Accounting Standards (IASs) and the International Financial Reporting Standards (IFRS);

• Followed by a conclusion on whether the candidate agrees or disagrees with each of the suggested accounting treatments as provided in the scenario.

Part g(i)

Critical evaluation of suggested recognition of an impairment loss
In critically evaluating whether an impairment loss should be recognised, the following should be considered as a minimum as per IAS 36 to be able to come to a conclusion:

• Whether there is an indicator of impairment; and

• If so, whether the carrying amount of the asset is higher than the recoverable amount of the asset.

Critical evaluation of suggested recognition of insurance proceed income
In critically evaluating whether insurance proceed income should be recognised, candidates were required to discuss with reference to IAS 37 or IAS 16, whether it would be correct to recognise the insurance proceed income before it becomes receivable.

Critical evaluation of suggested presentation of the impairment loss net of the insurance proceed income
In critically evaluating whether presenting the proposed impairment loss net of the insurance proceed income would be correct, candidates were required to discuss whether it would be correct in terms of IAS 1 to present the impairment loss on the damaged property net of the insurance proceed income.

Part g(ii): Critical evaluation of suggested disclosure of a contingent liability

The question specifically required candidates to critically evaluate the suggested disclosure of a contingent liability. This would entail discussing firstly, whether the claim instituted against the university constitutes a contingent liability as defined in IAS 37, followed by whether it should be disclosed (i.e. only required if settlement is not remote).

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

• From the answers provided by candidates, it was evident that most candidates can identify the issues in the question however; they lack exam technique. They are unable to apply the theory of the relevant subject area to the scenario.

• Overall, candidates displayed a lack of exam technique in discussion questions. Their answers were not focused and in many instances the discourse was contradictory and not in line with what was required.

3. Common mistakes made by candidates

• Candidates displayed a lack of exam technique by not managing the time on each section adequately. Candidates would spend too much time stating the theory, which was not relevant, resulting in them not having time to appropriately address all issues in each section of the required.

• Candidates did not read and interpret the required correctly, which led to irrelevant information being stated as part of their answers.

• Candidates also struggled to express themselves and regularly contradicted themselves.

• From the above, it is evident that candidates struggled with appropriately communicating the relevant information and to express themselves.
4. Areas that the candidates handled well

- Candidates handled the calculation section of the tax component in part f (ii) well.
- Having said that, candidates just attempted the calculation and did not provide reasons for the amounts included and deducted from taxable income.

5. Specific comments on sections of the question

Part e(i)
- Candidates did recognise that they should consider the principles of the COPC. Despite this fact, candidates did not apply the Conceptual Framework of the SAICA COPC correctly.
- The latter was evident in instances such as candidates identifying the issues, but they did not always link the issue with the type of threat, nor to the specific fundamental principle under threat.
- Furthermore, when the issue was identified (whether linked to a specific threat or not), only a few candidates discussed whether it is significant or not, and then based on that, what the specific safeguards should be or when appropriate safeguards could be implemented.
- Finally, candidates do not know that the audit firm institutes the disciplinary action and the outcome is only then reported to SAICA. Most candidates wanted to report the matter to SAICA for disciplinary action.

Part e(ii)
- Most candidates went the route of a Reportable Irregularity in terms of the Auditing Profession Act (APA). They wasted time discussing this matter which was irrelevant.
- Candidates also did not read the scenario properly to understand that Ms Max is part of the client and not the audit team, which resulted in the discussion of irrelevant actions and threats.

Part f(i)
- Candidates did not understand the principles of a personal service provider.
- Many concluded that BJSS meets the criteria of a personal service provider, but then stated it is not a personal service provider. Some candidates would conclude that it is a personal service provider but then state no employees’ tax to be deducted. Candidates, therefore, structured their arguments poorly and in most instances contradicted themselves.
- Again, candidates appropriately identified the theory but did not apply it to the scenario.
- Finally, the calculation of the employees’ tax was very poorly answered. The required asked for the monthly employees’ tax, most candidates calculated the employees’ tax for the four-month period from 1 October 2016 to 28 February 2017.

Part f(ii)
- The calculation of normal tax liability was attempted fairly well, however, the candidates struggled with identifying the relevant section, i.e. s23(k) which is applicable to personal service providers.
- Many candidates did the calculation but did not provide the reasons, or provided incorrect or irrelevant reasons, as per the required which resulted in them losing marks.

Part g(i)
- Most candidates struggled with the meaning of critically evaluate. Most candidates discussed the issues without concluding or some concluded without discussing the issues with reference to the appropriate IAS and/or IFRS.
- Overall candidates did not structure their arguments in a logical manner and in many instances provided contradictory statements and conclusions.

Part g(ii)
- Again, most candidates struggled with this section.
Candidates confused the concepts of present obligation, possible obligation, and contingent liability. It was also evident that candidates did not know how these three principles are connected in terms of IAS 37 as to being able to come to a conclusion on whether a contingent liability should be disclosed or not.

Overall, several candidates concluded that a contingent liability should not be recognised, which is irrelevant as contingent liabilities do not get recognised, as they are only disclosed when settlement is not remote. The latter resulted in candidates losing marks for inappropriate conclusions.

Only a few candidates identified that there is no present obligation based on no legal obligation or constructive obligation.

Many candidates also do not understand the principle of remote as they still argued the disclosure of a contingent liability when they concluded that settlement is in fact remote.

Candidates did not plan or structure their answer adequately in this part especially, which resulted in poor discourse in the answers provided.
PROFESSIONAL PAPER 3

Paper 3 consisted of a single question divided into two parts:

Part I consisted of three parts that dealt with the following aspects:

(a) A discussion on whether two entities should consolidate another company in its consolidated financial statements.
(b) A discussion on whether a loan provided by one company to another should be classified as a financial asset measured at amortised cost in the financial statements of the first company.
(c) A discussion on the appropriate accounting treatment of a service level agreement with an entity in the separate financial statements of another for FY2016. The discussion should address any accounting considerations related to the trucks used by the entity.
(d) The preparation of journal entries to correctly account for an office building in the financial records of the company.

Part II consisted of three parts that dealt with the following aspects:

(e) The identification and description of four ways in which the company could reduce its carbon footprint.
(f) A description of the key risks with regard to the establishment of the owner-driver scheme for the company and the owner-drivers.
(g) A discussion, with reasons, of any concerns a candidate may have about corporate governance at a company in connection with a logistics service contract with a South African department for sports events.

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

QUESTION 1 PART 1

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1. What general areas the question covered

This question covered control over an entity, the amortised cost classification of a financial asset, lease identification and the transfer of an identifiable part of property, plant and equipment to investment property, which totalled 50 marks. The question specifically dealt with:

Part (a): Discussion: Candidates were required to discuss and conclude on the consolidation of Roadstarters from two specific entities perspectives. Marks were awarded for logical argument and clarity of expression.

Part (b): Discussion: Candidates were required to discuss whether a loan asset should be classified as a financial asset measured at amortised cost.

Part (c): Discussion: Candidates were required to discuss the appropriate accounting treatment of a service level agreement concluded. Marks were awarded for clarity of expression.

Part (d): Journal entries: Candidates were required to prepare the journal entries to correctly account for an office
building in the 2016 financial year. Marks were awarded for presentation, specifically journal narrations.

2. In what respect candidates’ answers are considered to fall short of requirements.
   - Some candidates provided tax effects despite the scenario being clear that tax should be ignored. The scenario stated “Ignore taxation” on the top of the first page of the scenario. These candidates wasted time in providing tax effects for which no marks were allocated. Candidates should read all their information carefully.
   - Some candidates did not follow a step by step logical response to the IFRS 9, IFRS 10 and IFRIC 4 discussions.
   - Some candidates did not provide a step-by-step and logical layout for their calculations in part (d). This resulted in calculations not used or not used in context.
   - Some candidates did not provide journal narrations in part (d).

3. Common mistakes made by candidates

Candidates did not plan their approaches well enough which filtered through to the exam technique used in preparing their responses. This planning related to an analysis of the information provided, followed by an approach to solving the problems.

4. Areas that the candidates handled well
   - Candidates identified the IFRS 10 control discussion in part (a). Many candidates applied the relevant theory to the information in the scenario.
   - Candidates applied the correct IFRS 9 classification principles in part (b).
   - Candidates generally provided reasonable journal entries in part (d).

5. Specific comments on sections of the question

Part (a)

In this section, candidates were required to discuss and conclude on the consolidation of Roadstarters from two specific entities perspectives, Azimuth and Truck Supply.

Candidates who performed well in this section were those who adopted a logical approach to their responses. These candidates discussed the core principles first, this being the key definitions in solving the problem. Thereafter, they had two separate sections applying the principles to Azimuth and Truck Supply separately. Each section applied the 3 elements of the definition of control comprehensively to each entity.

Candidates made the following errors or omissions:
   - Some candidates concluded that both Azimuth and Truck Supply should consolidate Roadstarters at the same time.
   - Some candidates stated that Azimuth had power due to 10% of the voting rights only – and made no reference or showed insight into the ability to direct the relevant activities.
   - Some candidates discussed joint arrangements instead.
   - Some candidates did not identify the substantive and protective rights.

Part (b)

In this section, candidates were required to discuss whether a loan asset should be classified as a financial asset measured at amortised cost.
Candidates who performed well in this section were those who adopted a logical approach to their responses. These candidates stated the core principles first and then applied each principle carefully.

Candidates demonstrated poor insight into the components of interest – with many simply stating that there was interest and principal and therefore contractual cash flows. There was little of evidence of applying the principles of time value of money and compensation for credit risk.

**Part (c)**

In this section, candidates were required to discuss the appropriate accounting treatment of a service level agreement concluded.

Candidates who performed well in this section were those who identified and applied IFRIC 4 principles. These candidates stated the core principles first and then applied each principle carefully. They discussed the accounting treatment, which included lease identification, recognition, measurement and subsequent measurement comprehensively.

Candidates made the following errors or omissions:
- Many candidates did not identify IFRIC 4.
- Some candidates classified the lease incorrectly.

**Part (d)**

In this section, candidates were required to prepare the journal entries to correctly account for an office building in the 2016 financial year.

Candidates who performed well in this section were those who provided journal entries for all events during the 2016 financial year. They clearly identified the depreciation, effects of the transfer to investment property, and subsequent depreciation and fair value measurement of the investment property. These candidates had a clear understanding of the sequence of events and demonstrated technical competence by accounting for these events correctly.

Candidates made the following errors or omissions:
- Accounted for the transfer to investment property incorrectly by taking the value increase to profit or loss as a fair value adjustment.
- Did not provide journal narrations.
- Ignored the residual value in their depreciation calculations.
- Transferred the property at the incorrect date.

**QUESTION 1 PART II**

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<td>38</td>
<td>21,02</td>
<td>236 (25,88%)</td>
<td>676 (74,12%)</td>
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</table>

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

The risk, strategy and governance aspects of 50 marks formed part of an integrated 100mark question, with accounting. The question covered ways to reduce the carbon footprint, key risks resulting from the establishment of the owner-driver scheme from a company perspective, key risks resulting from the establishment of the owner-driver
scheme from the owner-driver perspective, concerns regarding corporate governance relating to a service contract.

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

Candidates could have done better in the question if they had focused on the information of the scenario and the information provided. The answers provided were often of a general nature and not made specifically applicable to the situation at hand.

Examination technique also remains a problem as risks and concerns were not always appropriately described, but mere statements made by repeating the information of the question.

3. **Common mistakes made by candidates**

As stated above, candidates did not always apply the information of the scenario in the answering of the required. This is also indicative of generally poor examination technique.

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

Section (e) was well answered on ways to decrease the carbon footprint.

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

**Part (e) Ways to decrease the carbon footprint**

The question required four ways in which the company can reduce its carbon footprint. Candidates in general applied their mind to the information at hand and came up of a variety of innovative ideas. This is encouraging to see evidence of critical thinking applied by the candidates.

**Part (f) Key risks resulting from the establishment of the owner-driver scheme**

- Candidates did not always consider what the nature of the scheme entail and accordingly the risks that would result therefrom.
- The risks were also not always appropriate describe, but instead the information of the question rewritten.
- Candidates did also not always apply themselves to the scenario at hand, but rather wrote general risks that is outside the scope of the scenario.

**Part (g) Concerns regarding the corporate governance at Azimuth relating to the Ke Nako service contract**

Candidates did not do well in this section of the question as they often made general corporate governance statements, instead of applying the information the required principle, and stating why it is a concern.
PROFESSIONAL PAPER 4

Paper 4 consisted of two questions.

Question 1 consisted of five parts that dealt with the following aspects:

(a) A discussion of whether, and if so when, a company will be allowed to deduct an amount related to the settlement for damages in the determination of its taxable income.
(b) A calculation, with supporting reasons, of a private individual’s balance of remuneration for employee’s tax purposes for a certain month.
(c) A discussion of the income tax consequences for a private individual for his 2017 year of assessment of an amount paid to him by a company on the termination of his employment and of income from an income protection insurance policy.
(d) Drafting of a memo in which the candidate had to advise a company, with reasons, of all the VAT consequences for the company for, first, a specific VAT period of a company-branded single-cab bakkie, and second, refreshments, accommodation and golf shirts purchased for the company’s team-building event.
(e) Advising a foreign person working in South Africa on the income tax consequences for her of payments made by a company during her stay in South Africa.

Question 2 consisted of four parts that dealt with the following aspects:

(a) A recalculation of the budgeted gross profit margin of each of two coffee products on the assumption that indirect manufacturing overheads are allocated to products based on a new proposed allocation basis.
(b) A critical commentary on and comparison of the components of a revised gross profit margin of two coffee products.
(c) An estimate of the impact on a company’s profitability of entering into a long-term supply agreement with another company.
(d) A discussion of the key factors the company should consider in evaluating whether or not to enter into the long-term supply agreement.

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

QUESTION 1

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
</tr>
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<tr>
<td>37</td>
<td>23,09</td>
<td>363 (39,85%)</td>
<td>548 (60,15%)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

Part (a)

Part (a) required candidates to discuss whether Speak Easy would be allowed to deduct an amount of R250 000 related to the settlement for damages, including the timing of the deduction, if applicable. The question focused on the general deduction formula in terms of section 11(a) read together with section 23(g), as well as section 23(c). The candidates had to identify that the main issues in the questions were “actually incurred” and “in the production of income” and discuss the impact of the insurance payout on the amount of the deduction if applicable. Since the
question was not clear on a specific year of assessment, the tax effect on the 2016 and 2017 year of assessments had to be considered.

**Part (b)**

Part (b) required a calculation, supported by reasons, of the balance of remuneration for the month of June 2016. The calculation covered the salary, right of use of a motor vehicle, accommodation, acquisition at less than market value, provision of meals, contribution to RAF by the employer and section 18A donation. Candidates needed to identify all the amounts that are included and deducted to get to the balance of remuneration.

**Part (c)**

Part (c) required a discussion on the income tax consequences of the amount of R30 000 and the income protection insurance policy for Mr Maartens during the 2017 year of assessment. This question focused on severance benefit, the deduction of the premiums and the compensation from income protection insurance policy. Candidates had to identify and discuss the severance benefit. Candidates had to also discuss the income tax consequences of the premiums and the compensation from the income protection insurance policy.

**Part (d)**

Part (d) required the candidates to draft a memo, in which they advise the company, of all the VAT consequences for the company for the 2-months VAT period ending on 30 June 2016, for the company-branded single-cab bakkie and refreshments, accommodation and golf shirts purchased for the team-building event. The candidates had to address the deemed supply on the right of use of the company car and the provision of entertainment by the company. Candidates needed to also identify that only the refreshments and the accommodation were entertainment and the golf shirts were not entertainment but the right of use of an asset fringe benefit.

**Part (e)**

The last part of the question, part (e), required advice on the income tax consequences of payments made to a non-resident. This part covered the following fringe benefits; right of use of accommodation, free service or debt paid on behalf of employee and a benefit granted to the relative of employee, received by a non-resident from a South African source. Candidates had to identify that these amounts were fringe benefits received by a non-resident. Candidates had to discuss that the remuneration proxy was above the limit in terms of section 10(1)(q) and therefore the exemption for the school fees was not applicable,

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

**Part (a)**

Part (a) required a discussion on the deductibility of the settlement amount. The required did not specify the year of assessment to be addressed and this left the candidates a bit confused. Therefore, some candidates only addressed 2017 and not 2016. Some candidates interpreted the settlement payment as legal expenses in terms of section 11(c). The required was clear that candidates had to determine if the amount was deductible but some candidates did not provide a conclusion, and therefore did not address the required.

**Part (b)**

This part of the question clearly stated that the balance of remuneration for the month of June had to be calculated. Candidates calculated the amount for the year. This might be due to the fact that they did not read the required correctly or forgot to divide by twelve to get the amount for the month. Some candidates also included the severance
benefit amount that was not received in June. Some candidates do not seem to know what is to be included in the “balance of remuneration”.

**Part (c)**

Part (c) required candidates to discuss the income tax consequences. Some candidates started by discussing the gross income and did not get to the severance benefit. This might be due to not understanding the required and lack of knowledge. There was no need to discuss the gross income definition as a severance benefit is a special inclusion in terms of par (d)(i) of the gross income definition. Candidates did not address the income tax consequence (which was required), as they did not discuss the relevant tax tables.

**Part (d)**

The required was clear in terms of the 2-months VAT period to be addressed. However, candidates did not only address the transactions that took place in the 2-months VAT period but also the transactions that took place outside the 2-months VAT period. This indicated that the candidates did not read the required properly.

Even though the required indicated “the refreshments, accommodation and golf shirts purchased for the company’s team-building event”, candidates had to apply their mind and identify that not all the items in the heading have the same VAT implications.

**Part (e)**

The required of this last part was clear. Few candidates discussed the test for physical presence test. This might be due to the fact that they did not understand what was required, as it was clear that the taxpayer was a non-resident.

3. **Common mistakes made by candidates**

**Part (a)**

- Candidates were required to discuss whether the settlement of R250 000 is deductible in the determination of Speak Easy's taxable income. The incident that gave rise to the settlement occurred in the 2016 year of assessment whilst settlement took place in the succeeding year of assessment. Candidates were therefore expected to discuss the deductibility of the settlement from income for the two consecutive years. Most candidates only restricted their discussion to the 2017 year of assessment.
- Some candidates discussed section 11(c), or they concluded that section 11(c) is not applicable but they did not go further with section 11(a).
- Most candidates did not mention that the burden of proof is on the taxpayer to proof deductibility. This is an easy mark to obtain in a discussion.
- Few candidates mentioned section 102 it terms of the Income Tax Act which is incorrect.
- Some candidates used the Fruit vs Tree court case when they discussed capital in nature, these principles are for Gross Income discussions and not deductibility in terms of s11(a) discussion.
- Some candidates just mention the theory without any application. The ITC examination is an open-book assessment, and merely writing down the general deduction formula without any application does not score maximum marks. For example:
  - Some candidates will state the following without any reasons or application to the case study:
  - “….R250 000 is not capital in nature”
  - “….Speak Easy is carrying on a trade”
- Court cases and the correct principle were not discussed. Some candidates only mentioned case law without applying the principles of the court case to the information in the question.
• Most candidates did not discuss the impact of section 23(c) on the amount of the deduction. Some candidates mentioned that the payment from the insurance was to be included in gross income, which is incorrect.
• Some candidates contradicted themselves. They would discuss everything correct but conclude differently.

Part (b)

• Candidates who worked with annual amounts failed to convert their answers back to monthly as required by the question.
• Candidates failed to test that the business travel was more than 80%, therefore could include the fringe benefit at 20%.
• Candidates confused 3.25% of the Income Tax Act with the 0.6/0.3% in the VAT Act.
• Most candidates reduced the cash equivalent of the use of an employer provided vehicle benefit by business use as per Par 7(7) of the Seventh Schedule. This is incorrect as this reduction is done on assessment at the end of the year and not for employees’ tax purposes. A number of candidates deducted the fuel cost of R85 in the calculation.
• Some candidates still confuse the treatment of benefits in terms of Par 7 of the Seventh Schedule to those of allowances in in section 8(1)(a) of the Income Tax Act.
• Most candidates lost marks because they failed to include the nil fringe benefits in their solutions. For example, the refreshments, accommodation and golf shirts provided to Mr Maarten’s during the company’s team building are fringe benefits that have no rental value. Although the effect on the balance of remuneration is nil, the item still must be disclosed.
• Candidates did not convert the limits in section 11(k) to monthly amounts if they are working with monthly figures.
• Most candidates did not address the section 18A donation, some of those who did, did not identify that the deduction was not allowed as a deduction because it was not made on behalf of Mr Maarten’s.

Part (c)

• Some candidates discussed the gross income definition in this part, and missed the severance benefit discussion.
• Candidates mentioned that the severance benefit and the payment from the income protection policy should be included in taxable income. Candidates had to mention that the amounts should be included in gross income as this shows that a candidate considered the paragraphs and special inclusion paragraphs of the gross income definition.
• Some candidates discussed severance benefit requirements but contradicted themselves when writing the conclusion and mentioned that it was not a severance benefit.
• Many candidates that concluded that it was not a severance benefit due to the way that Mr Maarten’s employment was terminated. The method of termination was not relevant to the question and this demonstrates misinterpretation of the Act.
• Very few candidates identified that there would be no hypothetical tax as there were no lump sums received in the past.
• Candidates did not properly discuss the tax implication of the severance benefits, with reference to the applicable tax table.
• Some candidates mention that the income protection insurance policy premiums were not deductible in terms of section 11(w) and should have been in terms of section 23(r).
• A vast majority of the candidates did not discuss the Capital gains tax implications of the income protection insurance premium.
Part (d)

- Few candidates lost the easy mark for presenting their solutions in the form of a memo.
- Most candidates discussed issues relating to the claiming of input tax on the purchase of a single-cab bakkie even though this VAT event falls outside the VAT period required by the question.
- The determined value was confused with the fringe benefit for employees tax purposes in part (b).
- Some candidates did not identify that the single-cab bakkie was not a “motor car” as defined and did not use the 0.6% in the calculation of the VAT on the fringe benefit.
- Some candidate did identify that the single-cab bakkie was not a motor car as defined but used the wrong rate of 0.3%.
- Most candidates did not multiply the VAT on the fringe benefit by 2 months for the VAT period in question.
- Refreshments and accommodation were often discussed in conjunction with the golf shirts, candidates need to differentiate between the three as the golf shirts were not entertainment as defined.
- Some candidates also mentioned that the accommodation is residential accommodation and therefore exempt – which is incorrect.
- Candidates missed the fact that the use of golf shirts was considered as incidental use and had a nil value.
- Some candidates applied the requirements of section 10(4) of the VAT act, but it was not applicable as the connected person could claim the full input tax.
- Candidates identified the sale of the golf shirt to the employee as the sale to a connected person, which was not correct.
- Generally, the input and output tax on the Golf shirts were poorly answered.
- Candidates did not clearly indicate if the amounts they are calculating are input or output tax.

Part (e)

- A number of candidates did not attempt this part probably due to poor time management.
- Some candidates performed the physical presence test or discussed the residency and did not get to the income tax implication as per the required. The discussion on the physical presence test was not necessary as the information was clear that Mrs Adeyemi is a non-resident.
- Candidates did not start the discussion the way the a non-resident is taxed (South African source income).
- Majority of the candidates did not discuss the originating cause requirement.
- Candidates did not discuss that the value of the right of use of the residential accommodation is the lesser of the amount calculated per the formula and the cost incurred, but only calculated the amount per the formula.
- Only a few candidates applied par 9(7A) and par 9(7B) of the Seventh Schedule.
- Candidates did not discuss the reasons for inclusion of amounts and merely stated that they are fringe benefits, which was not sufficient. In order to earn the marks the candidates had to discuss that the security payment is a free service or payment of debt of employee and the payment of school fees is a benefit granted to the relative of the employee.
- Candidates either failed to identify section 10(1)(q) or discussed it incorrectly. They had to mention to that it was not applicable as the remuneration proxy was above R250 000.

4. Areas that the candidates handled well

Part (a)

Most candidates were able to identify that the general deduction formula, in terms of section 11(a), applies. A vast majority of the candidates could identify which requirements of the general deduction formula were an issue in the
question and discussed these correctly and came to the correct conclusion based on their discussion. Most candidates identified the issue with regards to ‘production of income’ in the general deduction formula.

**Part (b)**

Candidates were able to identify the amount of salary to be included in remuneration. A number of candidates were able to include a correct percentage of the right of use of the motor vehicle in the calculation. A vast number of candidates included the employer contribution to the retirement annuity fund benefit in the calculation and applied the limitation of the deduction in terms of s 11(k).

**Part (c)**

Candidates identified and discussed the severance benefit. Majority of the candidates identified that the premium paid to income protection insurance policy were not deductible. Most candidates correctly identified that the amount of the severance benefit and from the income protection insurance were included in gross income. Some candidates correctly discussed that the income from the income protection insurance policy was exempt from income tax.

**Part (d)**

Most candidates answered in the memo format as per the required. The VAT on the deemed supply of single-cab bakkie was well attempted by most candidates. Candidates generally applied the tax fraction (14/114) correctly.

**Part (e)**

Candidates were able to identify and discuss the source rules and the taxable fringe benefits.

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

**Part (a)**

Candidates generally answered the part well. The principle errors made were the discussion of section 11(c), mentioning the theory and case law without application and not identifying and applying section 23(c).

**Part (b)**

- Generally, candidates seem to struggle with the VAT questions, and the integration of VAT and the calculation of the balance of remunerations seemed to have been an issue. There was uncertainty concerning the determined value to be used, therefore some candidates removed the VAT, which was not correct.
- Some candidates who identified the accommodation, meals and golf shirts as fringe benefits did not provide valid reasons; they mentioned that these were not fringe benefits. This is incorrect as these are fringe benefits but have nil value.
- Candidates who calculated the monthly amounts did not apply section 11(k) limitation of R350 000 for the month (i.e. divide by 12) and therefore did not compared and annual amount with a monthly amount.

**Part (c)**

- Generally, this part was poorly answered. Candidates seemed to have been uncertain as to how to answer the question and ended up discussing gross income definition and did not get to the severance benefit.
- Most candidates cannot differentiate between gross income and taxable income. This was very fundamental for this question, as the severance benefits is specifically included in gross income in terms of par (d)(i) of the
gross income definition and the payment from income protection policy is exempt from income tax in terms of section 10(1)(g) (therefore does not form part of taxable income).

Part (d)

- Candidates tended to confuse what is a motor and not a motor car as defined. Some candidates who mentioned that the single cab bakkie was a motor car as defined used 0.3%, indicating that candidates do not take advantage of the open book exam as they could open the legislation and applied the correct percentage.
- Candidates struggle with the correct VAT terminology for example input vat versus input tax that amounts are exempt when in fact, the input tax is denied and accommodation was residential accommodation when it was fringe benefit.
- The most important principle errors were treating the provision of golf shirts as entertainment and not addressing the output tax on the sale and fringe benefit to Mr Maartens.

Part (e)

- A number of candidates did not get to this last part either due to poor time management or did not know how to answer the required. A number of candidates who managed to write this part did fairly well.
- The most important principle error was not mentioning the source rules and providing valid reasons for inclusion of fringe benefits. There was a mark allocated for identifying that the amounts are fringe benefits and additional marks for the valid reasons and candidates missed the latter marks.

Overall

- Candidates are generally comfortable with calculation type questions but discussion type questions remain problematic. However, for this paper part (b) was the only part that was purely calculation but was a problem, as candidates seem to have not read the required properly and did not calculate for the month as per the required.
- Part (d) had a discussion and calculation components and the calculation part was not a major problem.
- With the majority of the paper, i.e. parts (a), (c), (d) and (e) being discussion, it was a challenge to the candidates. Candidates where not certain how to answer and their answers ended up not being in a logical manner and poorly structured. Candidates also repeated themselves, causing time management problems. Some candidates contradicted themselves within a discussion section.
- In the discussion questions candidates failed to apply the theory from the applicable provisions of the relevant legislation and the principles from the case law to the scenario provided in the question.
- The fact that some candidates did not complete all the section comprehensively could be due to time management problems but their answers seem to suggest a lack of knowledge in the specific areas of the subject area examined.
- The questions did not ask the candidates to mention the applicable legislation provisions and the candidates who mentioned the incorrect sections forfeited the marks. A good exam technique is, if not asked to refer to legislation would be no to mention it if not sure but rather mention the correct principle in the applicable section.
- Candidate do not seem to consider the proviso's in the applicable sections, this was evident in the lack of application of par 9(7A) & 9(7B)) in part (e).

Overall candidates could still improve their exam technique in respect of discussion type of questions. This was evident in the discussion type questions that required the tax implications for various taxpayers (e.g. part (a), part (c), part (d) and part (e) of the required) Candidates struggle to address all required aspects and answers seem to be incomplete or contradictory. This results in candidates forfeiting communication marks due to contradiction/ incomplete answers, not answering in the required format and lacking logical argument. Taking a few minutes to plan an answer before starting with the question could assist them with this problem. Looking at the mark allocation helps in determining how
much information to provide and to address only what is required (for example only the 2-months VAT period) would result in better time management.

**QUESTION 2**

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<th>Maximum mark</th>
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<th>Marks &gt; 50% (Pass)</th>
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<tbody>
<tr>
<td>39</td>
<td>25.94</td>
<td>562 (61.69%)</td>
<td>349 (38.31%)</td>
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1. **What general areas the question covered**

This was a management decision making and control question. Part (a) required candidates to calculate a revised gross profit margin after reallocating indirect overheads using an activity-based costing approach. In part (b), candidates were required to critically comment on and compare the revised gross profit margin on two products. Parts (c) and (d) required candidates to evaluate a long-term special order.

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

Candidates were not able to show a sufficient level of critical thinking to score well in part (b) or the level of insight and understanding of the scenario to perform well in part (d).

3. **Common mistakes made by candidates**

- In part (b) most candidates failed to do any calculations to support their commentary and comparison and therefore failed to score the easier marks in this section.
- Many candidates were not able to calculate the opportunity cost of sacrificing existing production in part (c).
- A number of candidates did not identify enough factors that CB needed to considered as some of the factors that were identified were not considered to be key.

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

Most of the candidates scored very well on part (a) and demonstrated a good understanding of activity-based costing principles.

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

Please refer to comments above.