OBJECTIVES OF THIS REPORT

This report has been compiled from the analysis of examiners on candidates’ performance in the Initial Test of Competence (ITC) – previously known as Part I of the Qualifying Examination, which was written in January 2015. Its objectives are to –

- assist unsuccessful candidates in identifying those areas in which they lost marks and need to improve their knowledge and/or presentation; and
- assist future exam candidates, by providing a commentary for them to use when working through past papers.

To accomplish these objectives, the report provides background information on how the examination questions are chosen, marked and adjudicated, comments on general shortcomings in answers and specific comments on each question of the four examination papers.

The purpose of the ITC is to test the integrated application of technical competence, preferably as soon as possible after the prescribed academic requirements have been met.

The remainder of this report is discussed under the following headings:

- Statistics for the ITC January 2015;
- Background information on the setting, marking and adjudication of SAICA examinations;
- General comments on the ITC January 2015; and
- Detailed comments by question in each of the professional papers (1–4).
### STATISTICS FOR ITC JANUARY 2015

<table>
<thead>
<tr>
<th>% Pass</th>
<th>Passed</th>
<th>Failed</th>
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<tbody>
<tr>
<td>All candidates</td>
<td>76%</td>
<td>1891</td>
<td>589</td>
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#### Average marks per question (all candidates)

<table>
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<tr>
<th>Paper</th>
<th>Question 1</th>
<th>Question 2</th>
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<tr>
<td>Paper 1</td>
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<td>73</td>
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<td>Total marks</td>
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<table>
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<th>Question 2</th>
<th>Total</th>
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<td>Total marks</td>
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<table>
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<th>Total</th>
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<tr>
<td>Total marks</td>
<td>36</td>
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More detailed statistics can be found on the SAICA website at www.saica.co.za.
BACKGROUND INFORMATION ON THE SETTING, MARKING AND ADJUDICATION OF SAICA EXAMINATIONS

The Examinations Committee (Examco) constantly strives to improve its ability to determine whether candidates demonstrate a readiness to continue with their accounting education and training. This is done by means of an ongoing process of evaluation and improvement of the way in which it selects questions for inclusion in the examination and decides on the final mark plans.

1. Source of the questions

Examco is a sub-committee of the SAICA Initial Professional Development Committee (IPD Committee), and takes overall responsibility for the setting of the examination papers. Examination questions are drawn from different sources:

- Questions may be submitted by practitioners, accountants in commerce and industry, as well as academics. These questions are added to a question pool that has been built up over the years and from which questions may be selected; or
- Questions on a particular subject may be commissioned from persons in commerce and industry or public practice or from academics.

Academics or former academics are also involved in reviewing exam questions in each of the core subject areas. Academics who have any involvement whatsoever in the presentation or otherwise of Board courses may NOT act as reviewers. These academics or former academics are appointed by core subject area and their role is to –

- review questions for conceptual problems and consistency in use of terminology;
- give an indication as to whether the relevant examination questions are set at an appropriate level;
- provide comments on whether the number of marks and time limit are appropriate; and
- provide comments on the validity and reliability of such assessment.

In addition, two external examination sitters, who are independent of the exam setting process, are appointed to review the entire set of questions. The examination sitters provide independent comments on the examination paper, suggestion solutions or mark plans which are reported to the Examco.

SAICA would like to acknowledge and thank all the people involved in the examination setting process. An alphabetical list of all the people involved in various roles, including members of the Examinations Committee, question composers, subject specific reviewers and external examination sitters, is as follows:

Alex Brettenny Janine Claassens
Alex van der Watt Jo Pohl
Amanda Singleton Jodi Lee Harebottle
Ben Marx Kobus Swanepoel
Carmen Westermeyer Lisa Vidulich
Dirk Steyn Mandi Oliver
Elmar Venter Marielienne Janeke
Erica Say Neville Dipale
Ernst Koch Oliver Nouwens
Ferdinand Mokete Petri Ferreira
Francois Liebenberg Piet Nel
Frans Prinsloo Pieter van der Zwan
Giel Pieterse Reghardt Dippenaar
Goolam Modack Renshia van Noordwyk
Graeme Berry Shelly Nelson
2. Security and confidentiality of examination papers

The examination papers for each year are compiled, printed and sent to each examination centre under very stringent conditions of security. The only persons who know the contents of a particular paper are the members of the Examco. They are all selected with great care regarding their integrity and professional standing and are sworn to secrecy.

3. The marking process

The Examco devotes a great deal of time to the review and refinement of mark plans to ensure that the plans are consistent with its expectations for each question.

Before marking of the scripts commences, copies of the examination papers and suggested solutions are forwarded to all participating universities for comment. The markers and umpires decide on a suggested solution and mark plan once all these comments have been considered and a test batch of scripts has been marked. The suggested solutions, mark plans and test batch results are then reviewed by the Examco, which authorises the final suggested solutions and the mark plans that will be used in the marking process.

Marking is undertaken by teams, with each team consisting of a number of markers (comprising academics, practitioners and representatives from commerce and industry) and an umpire, who are on the whole fully bilingual and equally capable of marking both English and Afrikaans scripts. Markers and umpires are assigned to specific questions based on their fields of expertise.

All markers and umpires sign a declaration of secrecy regarding the handling of scripts, questions, solutions and mark plans. SAICA holds the copyright of the solutions and mark plans.

Marking of ITC January 2015 took place at a central mark centre. An administration hub was set up, from which administrative personnel controlled which scripts were signed out, to whom and when the marked scripts were returned. Each script was marked independently by two persons who recorded their marks on separate mark sheets. Only once the double blind marking of each batch of scripts had been completed did the markers confer and jointly decide on the final raw mark to be awarded for a particular answer. Thereafter each marker's mark, as well as the final mark, was noted down on the cover of the script. If the markers were unable to agree upon the number of marks to be awarded for a particular answer, the script was referred to the umpire, who then awarded the final mark. The SAICA secretariat was responsible for capturing and final checking of the marks of all candidates.

Consistency marking was introduced in 2012, which entails that a pack of ten scripts (consisting of six scripts selected from first-timer and four from repeat candidates) are selected on a random basis by SAICA’s Examinations Unit, and the exam numbers removed. These scripts are then numbered from 1 – 10 and photocopied. Every person on the mark team has to mark the question to which they have been assigned in the batch of ten scripts. This takes place on the first two days of the main marking process and the umpire, together with his/her mark team, then discusses how the individual markers award the marks point by point for each question. The aim of this process is to identify any concerns, differences and discrepancies in interpretation that the marker(s) may have in awarding of marks as per the final mark plan before actual marking commences. The main objective is to achieve consistency in the way the different markers within a mark team award marks.

4. Adjudication

Adjudication is a process during which the IPD Committee considers all relevant evidence, including the following, to determine the final marks to be awarded for each question:

- Whether candidates encountered any time constraints;
- The level of difficulty for each question;
- Possible ambiguity in the wording or translation; and
• Any other problems that may have been encountered relating to the examination.

The members of the Committee do not know the candidate details (including the raw pass mark) at the time the adjudication process takes place.

Adjudication is done by the full IPD Committee as soon as possible after the marking process has been finalised and checked by the SAICA secretariat.

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

In order to ensure that the whole marking and adjudication process remain anonymous, the instructions to candidates clearly state that their names should not appear anywhere on their scripts.

5. Borderline review

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

In view of the above stringent marking process no request for re-marks will be entertained (also refer to our examination regulations for ITC in this regard).
GENERAL COMMENTS ON ITC JANUARY 2015

1. Objective

In view of the primary objective of ITC, namely to test the integrated application of technical competence, candidates are tested on their ability to –

- apply the knowledge specified in the subject areas set out in the prescribed syllabus;
- identify, define and rank problems and issues;
- analyse information;
- address problems in an integrative manner;
- exercise professional judgement;
- evaluate alternatives and propose practical solutions that respond to the users’ needs; and
- communicate clearly and effectively.

2. Analysis of topics

<table>
<thead>
<tr>
<th>Required ranges in terms of the SAICA guidelines (2013 onwards)</th>
<th>Accounting &amp; External reporting</th>
<th>Strategy, risk management &amp; Governance</th>
<th>Audit &amp; Assurance</th>
<th>Tax</th>
<th>Fin Man</th>
<th>Management decision making &amp; control</th>
<th>Ethics</th>
<th>Comms</th>
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<td>100 – 120 marks</td>
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<td>25 – 30%</td>
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<th>Audit &amp; Assurance</th>
<th>Tax</th>
<th>Financial Management</th>
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<td><strong>11%</strong></td>
<td><strong>17%</strong></td>
<td><strong>21%</strong></td>
<td><strong>10%</strong></td>
<td><strong>10%</strong></td>
<td><strong>0%</strong></td>
<td><strong>5%</strong></td>
</tr>
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</table>
3. Overall comments on the papers

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

- The Paper 1 Question 1 tax question’s level of difficulty was generally described as moderate to fair with regard to level of difficulty, with a mix of easy and difficult marks. This question is well balanced with time and mark allocation to be appropriate. The overall structure of the question and the required relating to one larger fact set serves as a good basis for testing competencies. It was considered practical and covered a range of issues on deceased estates and trusts without being intensely focused on any specific area. Appropriate level with higher emphasis on numerical skills (focusing on calculations and journals) and limited discursive questions.

- The Paper 1 Question 2, Paper 3 Question 1 and Paper 3 Question 2 accounting and external reporting (integrated tax) questions were assessed as fair and the candidates’ performance reflected this. In Paper 1 Question 2, the scenario manages to test equity accounting, business combinations and changes in holdings with relatively few marks, though the background information provided could have been less detailed to save time. A lot of integration with new concepts not addressed in typical textbooks: fraud leading to a prior period error leading to a misstatement of retained earnings. The candidates’ knowledge on a wide variety of IFRSs and topics were tested (IFRS 10, IFRS 11, change in ownership (equity transactions), IFRS 3, IAS 37 etc.) and it was an interesting and testing question. An unusual scenario to test some important issues in group accounting i.e. gaining control with an existing shareholding and a subsequent change in percentage shareholding without a change in control, combined with some interesting fair value adjustments (receivable, lease agreement and contingent liability). This question does a better job than most of testing candidates’ understanding of the principle of pro-forma journal entries. Paper 3, Question 1 was considered to be very relevant and an excellent question that integrates Accounting and Taxation knowledge on a deeper level than some previous examples. In particular, it was found part (c) to be a particularly innovative line of testing and a positive example of testing competency and not merely technical knowledge. Paper 3, Question 2 was a good integrated coverage of a number of topics in EPS. Candidates found certain aspects of the question challenging.

- Paper 2, Question 1, the audit and strategy, risk management & governance question Overall the paper seems to have good high level coverage of some key parts of the audit process. The difficulty of the paper seemed easier than in prior years but it is promising that the ITC is assessing the basics of auditing, generally in the past this is where students have struggled. The question was well answered by candidates, with candidates displaying adequate knowledge of the disciplines and competency being assessed. Candidates scored well in most sub-sections with an evident lack of examination technique and description of substantive procedures.

- Paper 4 Question 1, the financial management and management decision making and control question The question successfully integrates three competency areas and has a good overall balance between calculations and discussion. Relevant topics are assessed. Pervasive skills are very effectively assessed. Candidates overall performance was good, with exception of part II of the question, which were surprisingly poorly answered.

4. Specific comments

From a review of candidates’ answers to the six questions (eight required sections) for the ITC January 2015 examination, the general deficiencies set out below were identified. These problems affected the overall performance of candidates, and it is a matter of concern that candidates make the same mistakes year after year. Although these aspects seem like common sense, candidates who pay attention to them are likely to obtain better marks, and it may even turn a low mark into a pass.
4.1 Application of knowledge

A serious problem experienced throughout the examination was that candidates were unable to apply their knowledge to the scenarios described in the questions. Many responses by candidates were a ‘shopping list’ of items in the form of a pure regurgitation of what candidates may have learnt about the theory at university, but with no real relevance to the question in hand. Candidates also do not appear to be able to identify the correct issues in the scenario provided.

This is a major concern, because by the time candidates qualify for entry to these examinations, one would expect them to have assimilated the knowledge, at least to the extent of being able to apply it to simplified facts as set out in an examination question. Obviously, candidates who are unable to identify the correct issues did not do well in the examination.

4.2 Workings

It is essential that candidates show their workings and supply detailed computations to support the figures in their answers. Marks are reserved for methodology, but can only be awarded for what is shown. Workings should, like the rest of the paper, be done in blue or black ink to ensure legibility. In many instances workings were performed by candidates but not cross-referenced to the final solution. Markers could not award marks as they were unable to follow which working related to which part of the final solution. Candidates must ensure they show their workings and that these are properly and neatly cross-referenced to the final solution.

4.3 Communication

Candidates fared better in questions requiring calculations than in discursive questions. This is a disturbing trend as the ITC is a stepping stone in the qualification process where the final assessment of professional competence (APC) requires that significantly more focus and attention is given to these important skills. It is important that candidates bear in mind that written answers are a large component of the Qualifying Examination, because written communication is a key competency required in the workplace. Candidates should learn to answer discursive questions properly. This can be done by practicing exam-type answers under exam conditions in preparation for the examination.

In addition markers found that candidates used their own abbreviations (sms messaging style) in their answers. Marks could not be awarded here as it is not up to the markers to interpret abbreviations that are not commonly used. Candidates should pay specific attention to the way in which they write their answers, and bear in mind that this is a professional examination for which communication and presentation marks are awarded.

4.4 Journal entries

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

This is inexcusable and candidates must ensure that they understand what impact transactions would have on specific account balances, by showing that they know which account in the income statement or balance sheet has to be debited or credited. It is not sufficient for a candidate with Accounts IV to be a technocrat – understanding of the fundamental principles of accounting is critical to the success of a candidate at the ITC level.

4.5 Time management

Candidates are advised to use their time wisely and budget time for each question. The marks allocated to each question are an indication of the relative importance the examiners attach to that question and thus the time that should be spent on it. Candidates should beware of the tendency to spend too much time on the first question attempted and too little time on the last. They should never overrun on time on any question, but rather return to it after attempting all other questions. By not managing time appropriately it was evident that candidates left out many marks, often easier marks, whilst the difficult marks were attempted and clearly taken more time to address, but resulted in no marks.
4.6 **Layout and presentation**

Candidates should allocate time to planning the layout and presentation of their answers before committing thought to paper. Very often, candidates start to write without having read the question properly, which invariably leads to, for example, parts of the same question being answered in several places or restatement of facts in different parts. Marks are awarded for appropriate presentation and candidates should answer questions in the required format, that is, in the form of a letter, memorandum or a report, if this is what is required.

The quality of handwriting is also an ongoing problem and was of particular concern in this year’s examination. **The onus is on the candidate to produce legible answers.**

Separate books are used to answer each question of the ITC. Each book is clearly marked and colour coded. Candidates are given explicit instructions to write the correct answer in the correct book. Despite this some candidates did not write the correct answer in the correct book, the secretariat did ensure that candidates who wrote answers in the incorrect book were marked by the correct mark team.

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. Ad discussion of a case study should always have a conclusion. Or if it requires a decision, a conclusion alone is not sufficient, discussion beforehand is required.

4.10 **Examination technique**

Examination technique remains the key distinguishing feature between candidates who pass and those that fail. Many candidates did not address what was required by the questions and, for example, provided a discussion where calculations were required or presented financial statements where a discussion of the appropriate disclosure was required.

4.11 **Open-book examination**

Candidates are reminded that they **MUST** familiarise themselves with SAICA’s open book policy and be aware that this may differ from that of their CTA university. Candidates are also reminded that only SAICA has the authority to interpret its own open book policy. To this end candidates are advised of the following:

- **No loose pages** (of any kind) may be brought into the exam.; and
• Writing on flags – As per section 4.4 of the SAICA examination regulations:
  ‘Candidates are only allowed to highlight, underline, sideline and flag in the permitted texts. Writing on flags is permitted for reference and cross-referencing purposes only, that is, writing may only refer to the name or number of the relevant discipline, standard, statement or section in the legislation’.

Any contravention of regulation 4 will be considered to be misconduct.

• Candidates are advised to familiarise themselves with SAICA’s exam rules prior to writing the examination.

Another problem relating to the open-book examination was that candidates did not state the relevant theory and/or definitions in their answers. One cannot build a logical argument without using the theory as a base and starting point. Reference to theory and definitions is essential to create the perspective from which the question is answered and is required to enable markers to follow the argument. However, since candidates have this information at hand, marks are not awarded for stating detailed definitions only. This type of examination does affect the answer that is expected and application and demonstration of insight into the use of the definition have gained in importance.

Candidates should also remember that one has to be very well prepared for an open-book examination. There is not enough time in the examination to look up all information from the texts. With regard to certain aspects one would be expected to offer an immediate response based on embedded knowledge. Complex information needs to be fully understood before the examination. Candidates who enter the examination hoping to look up data that they have not processed in advance will be at a disadvantage as they are unlikely to finish the papers.

4.12 Paying equal attention to all the competency areas

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

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

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

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

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

Please start preparing for the next examination in good time. Don’t give up - sufficient preparation and a review of the basics will stand you in good stead for you next exam!

Best of luck!!
PROFESSIONAL PAPER 1

Paper 1 consisted of one question that dealt with the following aspects:

**Question 1**

(a) Required a calculation of the taxable income of an individual for the period of assessment up to the date of his death
(b) Required a discussion of the estate duty and normal tax implications of a waiver of the loan account
(c) Required a discussion of the normal tax implications in respect of the trading operations and sale of business assets of a business entity after the death of its owner.
(d) Required a discussion of the VAT consequences of the sale of the business as a going concern
(e) Required a calculation of the taxable income of a Trust for the 2015 year of assessment

**Question 2**

Required pro forma journal entries to account for a joint venture and acquisition of control.

5 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></th>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>60</td>
<td>31</td>
<td>61% (1516)</td>
<td>39% (963)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

Paper 1: Question 1, part (a)
Part (a) required candidates to calculation of the taxable income of a natural person who passed away during the year of assessment, including the deemed income and expenditure up until the date of death. The calculation included lump sum payments received, local interest, local and foreign dividends, sales, trading stock, interest and dividend exemptions and allowable deductions included rentals, lease premium from sole proprietor business and a retirement annuity fund contribution. The calculation also required candidates to calculate the deemed disposal of all the deceased’s capital assets on death that resulted in capital gains tax, roll-over relief to the spouse, disposal of assets denominated in foreign currencies and disposal of small business assets.

Paper 1: Question 1, part (b)
Part (b) required from candidates a discussion of the estate duty and normal tax implications for a natural person, his deceased estate and a trust in respect of a debt reduction granted in terms of the deceased’s last will. This question focused on deemed disposals, due to death, in the hands of the deceased, acquisition in the hands of the deceased estate with the application of par 40(3) and paras 56 and 39 of the Eighth Schedule due to the fact that the taxpayers (the deceased estate and the trust) were connected persons in relation to each other. It also dealt with the debt reduction in terms of par 12A of the Eighth Schedule. Candidates then also needed to discuss whether the asset in question would be included in the estate duty calculation.

Paper 1: Question 1, part (c)
Part (c) of the question required a brief discussion of normal tax implications of trading operations and the sale of the business subsequent to Tyrone’s death. The question stated that the net proceeds of the sale vested with the Trust so
candidates needed to discuss the normal tax consequences of the additional month’s trading activities (from date of death till disposal) as well as normal tax consequences of the disposal of the business that included the disposal of trading stock and the capital gains tax on the other assets: goodwill and lease.

Paper 1: Question 1, part (d)
Part (d) required a discussion on the VAT consequences resulting from the sale of a business. The candidates needed to discuss the type of supply, time of supply and value of supply and briefly mention whether the sale can be a sale of a going concern. As the question was not clear on whether only the VAT consequences of the sale or VAT consequences for both the seller and the purchasers should have been discussed, provision were made for both interpretations.

Paper 1: Question 1, part (e)
The last part of the question part (e) required candidates to calculation the taxable income of the Trust. This calculation covered the inclusion of rental income, local interest and local dividends. Local dividend exemption and deductions for interest on loan, maintenance, trustees’ remuneration, audit fees, annuities paid to beneficiaries and air flights needed to reduce the income, with the exception of certain non-deductible expenses. Candidates needed to identify and add capital gains tax on the vesting of the trust property.

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

Paper 1: Question 1, part (a)
Part (a) required candidates’ to calculate taxable income. Some candidates continued to calculate the normal tax liability. This had the effect of candidates spending time on calculations that were not required, which in turn resulted in some candidates possibly struggling to complete the question. This indicates that some candidates do not have a comprehensive understanding of key terminology such as ‘taxable income’ and ‘tax payable’.

Paper 1: Question 1, part (b)
This part of the question clearly state that candidates must discuss the “estate duty” and “normal tax” implications of only the waiver of the loan account, yet a number of candidates only discussed the “estate duty” implications for all the assets provided in the question. An important part of the required namely “income tax” for the deceased person and trust were not discussed. Several candidates did not use the correct terminology in their discussion for example “property” when discussing Estate Duty.

Paper 1: Question 1, part (c)
Some candidates only discussed the trading income for the additional month or the sale of the business. This might be due to the fact that they did not read the information carefully to see that both events should have been discussed. Some candidates include the trading income and expenses in the individual calculations up to death indicating, that they did not understand the required or did not know how to answer this part.

Paper 1: Question 1, part (d)
This part was well addressed and the required did not seem to pose any uncertainty to the candidates. A number of candidates wrote only a sentence or two for this part whilst others wrote a number of pages. Candidate should remember to not only read the required but to consider the mark allocation in determining the appropriate level of detail required in their solution.

Paper 1: Question 1, part (e)
The required of this last part was clear. A very small number of candidates either misunderstood the part that read: ‘ignore the capital gains implications, if any, arising from assets inherited from Tyrone’ or did not realise that there was other capital gains, thus did not include any capital gains implications in their answers.

3. Common mistakes made by candidates
Paper 1: Question 1, part (a)
Candidates generally did not address the following or made the following mistakes in the individual's taxable income calculation:
Candidates did not reduce the value of the lump sum with the transfer of the funds to the living annuity.
Some candidates did not 'gross up' local and/or foreign dividend by including the dividend withholding tax with the 'net' amount provided.
Candidates calculated the retirement annuity fund contribution’s limitation on the incorrect 'non retirement funding income (NRFI)' by simply using only the profit before tax amount instead of all NRFI and/or by adding the lump sum amount and/or taxable capital gain to the amount of NRFI.
In terms of the Eighth Schedule, the gain or loss of each capital asset must be calculated separately, thus if a taxpayer disposes of a business he disposes of each asset in the business individually for capital gains tax purposes. Most candidates either did not account for the disposal of the business assets as part of their capital gains tax calculation or accounted for the capital gains as one amount instead of a separate calculation for each asset (which included the disposal of goodwill, the trading stock and the lease).
Candidates did not apply paragraph 40 (disposal of all assets to the estate), for example the loan account. Candidates calculated the gain or loss based on the provisions of the will or the values the executor sold the assets for.
The sale of the business assets also qualified as active small business assets in terms of paragraph 57 of the Eighth Schedule. Thus the exclusion where the relevant taxpayer may disregard a gain up to R1 800 000 were not identified by most candidates.
For the capital gains tax calculation of the foreign shares the candidates needed to first calculate the gain/loss in the applicable foreign currency, before converting the gain/loss into Rands. Most candidates incorrectly converted the proceeds and base cost into Rands before calculating the gain/loss.
Candidates also did not add the lump sum from the retirement annuity fund to the taxable income.

Paper 1: Question 1, part (b)
Candidates made the following common mistakes:
Candidates failed to identify that death of the taxpayer will trigger the deemed disposal for capital gains tax (par 40 of the Eighth Schedule) in the tax calculation of the deceased and not the waiver of the loan. Most candidates thus erroneously refer to the waiver of the loan as a deemed disposal.
Candidates mainly referred to the deceased estate as the entity paying the estate duty and did not consider any income tax consequences of the deceased estate as a tax paying entity.
Candidates did not understand the connected person definition, with several candidates only discussing that the deceased person and the trust are connected persons (instead of the deceased estate and the trust (paras 39 and 56 of the Eighth Schedule).
Several candidates saw the waiver of the loan as a debt reduction by the deceased, while the event actually took place in the trust.
Most candidates did not consider the exclusion of the reduction of debt in terms of par 12A(6)(a) of the Eighth Schedule. A number of candidates did a full estate duty calculation instead of only a discussion of the estate duty implications of one 'asset' (the waiver of the loan account).

Paper 1: Question 1, part (c)
Candidates made the following common mistakes:
Few candidates recognised that if a taxpayer has a vested right to any income, the associated expenditure will be accounted for in the hands of the taxpayer with the vested right (in this case the trust). Most candidates did not correctly apply (or apply at all) the provisions of section 25, dealing with income and expenditure earned after death.
Candidates failed to answer the required in full. Candidates either addressed the trading operations or the sale of the business, but not both.
Where candidates did address the sale of the business they failed to discuss the tax effect on each asset, which included the disposal of goodwill, the trading stock and the lease, as required by the Act.
In most cases candidates failed to identify who will be taxed on trading income subsequent to Tyrone’s death.
Very few candidates identified that the deceased estate is entitled to the annual exclusion of R30 000 (par 5 of the Eighth Schedule) and inclusion rate of 33.3% (par 10 of the Eighth Schedule) for capital gains tax purposes.

Paper 1: Question 1, part (d)
Candidates made the following common mistakes:
Candidates did not illustrate good exam technique in discussing the VAT consequences of the sale of the business. A discussion of VAT consequences always requires an discussion of the ‘kind of supply’ indication whether the transaction will result in output VAT, input VAT or no VAT at all. Very few candidates discussed the ‘value of the supply’ and the ‘time of supply’ as part of their answers. Several candidates either incorrectly concluded that ‘goodwill’ cannot be part of the sale of a going concern or concluded that ‘goodwill’ will not be subject to VAT.

Paper 1: Question 1, part (e)
Candidates made the following common mistakes:
Very few candidates addressed the deemed income of R4.6 million and the sale of the trading stock of the same amount as part of the taxable income calculation for the trust. Candidates applied deductions against dividends received and then applied the exempting on the net amount, instead of firstly exempting the dividend amount and then claiming the expenses against the income. The expenses will however not be deductible in terms of section 23 as no ‘income’ was included.

4. Areas that the candidates handled well

Paper 1: Question 1, part (a)
Most candidates were able to calculate the correct investment income and applied the correct exemptions. Candidates were able to calculate the taxable income from the trading activities including the deductions associated with the lease. The vast majority of candidates did identify that there were capital gains tax implications in the question could apply the framework correctly (even if they struggled to identify all the different capital gains (as discussed above)).

Paper 1: Question 1, part (b)
Candidates were able to identify that despite the loan being waived after death it was still an asset for estate duty purposes. The majority of candidates identified that the waiver of a loan is a debt reduction for tax purposes.

Paper 1: Question 1, part (c)
Candidates did identify that the amount received between death and sale of the business must be included in gross income and that the taxpayer will also be able to claim a deduction of expenditure.

Paper 1: Question 1, part (d)
Candidates were able to identify that the sale of a going concern will be a zero rated supply for tax purposes.

Paper 1: Question 1, part (e)
Candidates were able to identify the amounts to be included in gross income and the expenditure that could be claimed against this income. The calculation of the trust’s taxable income were well attempted.

Specific comments on sections of the question
Paper 1: Question 1, part (a)
It is concerning that even with the monetary values were provided in the paper, the candidates failing to use the latest monetary values. Examples of this includes the section 10(1)(i) interest exemption, section 10B(3) foreign dividend ratio exemption and the Capital Gains inclusions rate in terms of paragraph 10 of the Eighth Schedule.

5. There was some principle errors made which was of concern:

Some candidates failed to calculated the capital gain on each individual asset before applying the annual exclusion (R300 000 upon death) and then use 33.3% inclusion rate.
Some candidates used the incorrect capital gains tax inclusion rate as set out in paragraph 10 of the Eighth Schedule, but used 33.333, 33.34 or ‘a third’.
Candidates failed to recognise that where there are deemed disposals of all capital assets owned at date of death for CGT purposes, ‘proceeds’ is at market value at the date of death.
Some candidates struggled with the application of the tax consequences of death. Some candidates incorrectly ignored VAT in claiming deductions for income tax purposes or did a separate VAT calculation and deducted the VAT in terms of
section 11(a) against income.

Paper 1: Question 1, part (b)
Candidates that identify the connected person relationship between the related parties tended to apply paragraph 38 of the Eighth Schedule. This is incorrect for this particular scenario. They also disregarded the capital loss in the taxable income calculation of the deceased individual instead of the deceased estate.
Some candidates identified the waiver of the loan account as a donation and thus only calculated donations tax, despite the fact that assets donated will also have capital gains tax implications.

Paper 1: Question 1, part (c)
Candidates tended to replicate legislation without applying it to the scenario. This could indicate a lack of understanding of how to apply the tax principles. Several candidates did not attempt to answer this part of the question.
The most important principle error made by some candidates was identifying the incorrect inclusion rate for the deceased estate (should be 33.3%) and for the trust (should be 66.6%).

Paper 1: Question 1, part (d)
As in the previous section, candidates tended to just replicate legislation without applying to the facts to the scenario. Although identifying that the sale is zero rated, candidates failed to display their understanding of the VAT consequences of a sale of a going concern. The basic principles such as identifying that the sale of a going concern is a taxable supply, the time and value of the supply were omitted. The majority of candidates who identified the above only provided the theory without applying it to the scenario.

Paper 1: Question 1, part (e)
Candidates generally answered the part of the well. The only principle errors were that candidates exempted the local dividend after deducting the expenses and some candidates exempted the interest received in terms of section 10(1)(i) - which is only available to natural persons and not to a trust.

6. Overall:
The majority of candidates showed detailed calculations and referenced it where appropriate. Candidates appear to have a good understanding of the taxable income calculation of both individuals and trusts. This shows that candidates are comfortable with calculation based questions.
The discussion parts of the question were problematic for most candidates (part b) and c)). Candidates sometimes repeat themselves in a part or provided the same discussion in different parts, 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 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.
Candidates failed to indicate the negative effect of exemptions and deductions in their calculations. Some amounts were provided in brackets or under a heading “Less: deductions” but unfortunately some candidates also listed some amounts with a bracket and some without. As some deductions in the question had to be added back, this lack of attention to examination technique could have resulted in candidates penalising themselves as the examiners could only mark the information provided in the script.
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 in respect of various tax types (e.g. part (b) and part (c) 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 incomplete answers lacking clarity of expression and logical argument. Taking a few minutes to plan an answer before starting with the question could assist them with this problem.
QUESTION 2

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<th>Maximum mark</th>
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<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
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<td>44.94% (1114)</td>
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1. What general areas the question covered

The question required pro-forma journals for an investment which was a joint venture for only 4 months of the year. The investor then obtained control of the investee without buying an additional equity interest (hence control with a 20% investment, NCI = 80%) and at year-end obtained the additional 80% in order to have 100% interest (hence purchasing an additional interest without any change in holding).

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

The students seems to struggled with 2 aspects in particular:
- Subsequent adjustments after IFRS 3 at-acquisition journals are processed, i.e. if an asset is remeasured to fair value at acquisition and is subsequently dealt with i.t.o. its own standard and needs to be amortised, reversed, etc. IFRS 3 application therefore appears appropriate, but students struggle with subsequent adjustments.

3. Correction of the prior period error due to the fraud. The difficulty could have been in the way the question was structured and all the places the adjustment had to be taken into account, as students generally realised that some adjustment had to be made, but did not consistently made those adjustments throughout all the sections in the scenario.

4. Common mistakes made by candidates

The students generally understand basic equity accounting and consolidations (and would probably perform well if these sections are asked independently), but seemed to struggle somewhat with the different sections in the question in applying equity accounted up to 31 October 2014, and then accounting for the change in holding to a subsidiary without obtaining additional equity. The students also struggled to incorporate the prior year error into the different sections of the question and only partly dealt with the adjustments.

Although some students addressed certain parts of the consolidation well and performed all calculations relating to all aspects of that section (i.e. the equity accounting or main elimination journal), they will then either forget or didn’t have time for other aspects of the consolidation, i.e. post-acquisition adjustments, allocating NCI to P/L or the change in ownership (additional purchase of 80%).

The students did not perform well in the following areas:
- Subsequent journals for the post-acquisition adjustments for the reversal of the receivables and the amortisation of the favourable operating lease asset was either ignored or not taken into account.
  o It therefore appears in general when IFRS 3 refers that you have to deal with at-acquisition assets/liabilities subsequently in terms of their own standards, is generally not appropriately dealt with.
- Although students had some understanding to adjust for the fraud prior period error, they rarely corrected it in all the places, i.e. in the JV calc (Share of profit of JV) and again in the main elimination journal.
- Inconsistent application of consolidation principles, i.e. incoherent application of equity vs proportionate consolidation vs full consolidation. There were also no proper structure according to the timeline of events per the scenario.
- Students got confused with some of the easy numbers, i.e. profits for the separate times of the year, and students used profit in the after-acquisition period for example as the profit for the entire year, or use profit given for only 4 months, but then still allocate it as 4/12, etc.
- Students should try to avoid repeating calculations and journals that are effectively the same.
5. Areas that the candidates handled well

The students did well in the following areas:
- Basic equity accounting of the joint venture.
- At-acquisition main elimination journal – IFRS 3 application performed fairly well. There were a few incorrect applications of the at-acquisition fair value adjustments, but generally this area was well answered.
- Obtaining the communication skills mark

PROFESSIONAL PAPER 2

Paper 2 consisted of one question that dealt with the following aspects:

Question 1 Part I
(a) Pre-engagement activities
(b) Risk of material misstatement at overall financial statement level
(c) General controls over server and client database
(d) Risk of material misstatement relating to valuation of inventory
(e) Substantive audit procedures on completeness and existence of inventory
(f) Loan to director - regulatory implications, impact on audit report and rest of audit

Question 1 Part II
(g) (i) key business risks
(ii) mitigating actions

6 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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<tr>
<th>Maximum mark</th>
<th>Average mark</th>
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<tbody>
<tr>
<td>73</td>
<td>43</td>
<td>84.9% (2105)</td>
<td>15.1% (375)</td>
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</table>

1. Common mistakes made by candidates

Candidates’ examination technique did let them down as they defaulted to laundry lists for pre-engagement activities without considering the information in the scenario. Many candidates did not read the required properly for part (e) – substantive procedures to verify the existence and completeness of inventory, but focusing on procedures for verification of valuation of inventory. Time management did not seem to be an issue as candidates answered all parts of the question and scored well in the last part.

2. Areas that the candidates handled well

Candidates performed particularly well in part (c) general controls with an average of 73.64% as well as part (f) – Loan to director - regulatory implications, impact on audit report and rest of audit with an average of 89.50% with many candidates scoring 9 out of 9 for this question.
3. Specific comments on sections of the question

Part (a)
This part of the question assessed pre-engagement activities. There does not appear to be any misinterpretation of the requirements in the candidates answering. However, the candidates did not apply the scenario in their answers as many defaulted to a laundry list of considerations of accepting the engagement (e.g. many candidates discussed that there should be discussions with the previous auditors, however the company was not audited in the past).

Part (b)
Overall the candidates answered the question well and were able to extract information from the scenario and apply it to the risks for the company. Candidates did, at times, not describe the risks well and merely noted the indicator without describing the risk of misstatement at overall financial statement level.

Part (c)
Overall candidates answered this question adequately and were able to identify and discuss the general controls that SET should implement to restrict access to the server and ensure the integrity and validity of the client data on the database.

Part (d)
The candidates mostly answered this part of the question adequately. They identified and discussed the easier risks associated with the valuation of inventory.

Part (e)
Many candidates scored marks for the standard audit procedures to be performed to verify the existence and completeness of SET’s inventory on hand at year end. However, many candidates did not describe enough specific audit procedures to perform and concentrated on the valuation assertion rather than the completeness and existence assertions. The markers considered this to be due to the risk question in part (d) referring to valuation and candidates did not read the required properly.

Part (f)
Candidates answered this question very well. They were able to identify and discuss the regulatory implications as well as the impact on the audit report as well as the rest of the audit.

QUESTION 1 PART II

<table>
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<th>Maximum mark</th>
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<td>24.5% (607)</td>
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1. What general areas the question covered

The question covered risk management and strategy and dealt with key business risks and mitigating actions.

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

A number of candidates repeated/motivated business risks already given in the scenario and some candidates presented their answer very poorly by stating the indicator of potential business risks, as opposed to properly describing the actual business risk. Audit risks were also presented as part of many candidates’ answers whilst the required asked for the key business risks.
3. Common mistakes made by candidates

In general examination technique were lacking as was evident from the following:
- Many candidates did not read and consider the information in the scenario carefully, or applied it in answering the question.
- A number of candidates failed to provide the answer in a memorandum format (as was specifically required), or provided memorandums which rather resembled a letter or an email.
- Many candidates did not present their answer in a logical way; they did not link the key business risks to the mitigating actions.

4. Areas that the candidates handled well

This question was reasonably well answered by candidates who applied the information in the scenario to the required part (as opposed to candidates who did a “memory dump” of general business risks and mitigating factors).
Part II g(i) on the key business risks was well handled. Candidates should however guard against merely stating the indicator of potential business risks, and not properly describing the actual business risk.

5. Specific comments on sections of the question

For part II g(ii) on the mitigating actions a number of candidates did not provide the corresponding mitigating factor per business risk listed, but rather provided a broad range of mitigating factors or impractical mitigating factors. In many instances the mitigating factors were not linked to the corresponding key business risks.

PROFESSIONAL PAPER 3

<table>
<thead>
<tr>
<th>Paper 3 consisted of one question that dealt with the following aspects:</th>
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<tbody>
<tr>
<td><strong>Question 1</strong></td>
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<tr>
<td>a) Taxation: Discussion – Capital vs Income</td>
</tr>
<tr>
<td>Communication skills</td>
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<tr>
<td>b) Financial reporting &amp; Tax: Tax rate recon</td>
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<tr>
<td>Communication skills</td>
</tr>
<tr>
<td>c) Strategy, risk management and governance</td>
</tr>
<tr>
<td><strong>Question 2</strong></td>
</tr>
<tr>
<td>Earnings per share and diluted earnings per share (IAS 33)</td>
</tr>
<tr>
<td><strong>6 presentation marks were available for this paper. These marks were clearly and separately stated in the 'required' sections of each question.</strong></td>
</tr>
</tbody>
</table>
1. What general areas the question covered

This question integrated external financial reporting with taxation, and totalled 60 marks. The question dealt with:

- Part (a): Taxation

Candidates were required to discuss whether a receipt arising from the sale of an entity’s own office building is of a capital nature in terms of the gross income definition in section 1(1) of the Act. This required discussion of the relevant case law and related principles.

Marks were awarded for clarity of expression and logical argument.

- Part (b): Financial Reporting

Candidates were required to prepare a corrected consolidated tax rate reconciliation of the group in terms of IAS 12 *Income Taxes*. Candidates were required to provide a brief explanation for each reconciling item included in the corrected tax rate reconciliation and an explanation as to why any reconciling items have been excluded.

Marks were awarded for presentation and layout and structure.

- Part (c): Financial Reporting

Candidates were required to discuss whether in their opinion the group’s effective tax rate supports or contradicts the headline that appeared in the business media.

2. Level of difficulty of the question

The level of difficulty was generally described as “moderate” or “fair”, with some universities describing the financial reporting as challenging.

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

- Candidates did not provide a step-by-step and logical application of principles in reaching the conclusion as to whether the receipt was capital or income in nature in part (a). In certain instances candidates reached conclusions which were not supported by the preceding discussion.
- Candidates found it difficult to assess the starting point of the tax rate reconciliation i.e. the corporate tax rate of 28%, the effective tax rate proposed by Miss Nerves, or the effective tax rate proposed by Mr Cash. In certain instances, candidates did not indicate which rate was used as a starting point.
- Candidates appeared to deal with part (c) in isolation and did not link the tax rate reconciliation, and related reconciling items prepared in part (b) to the business media headline. In many instances, candidates merely concluded as to whether the headline was justified or not, but did not substantiate their answer.

4. Common mistakes made by candidates

- Candidates did not make use of case law when presenting their discussion. Alternatively, candidates made use of case law but linked case law principles to incorrect cases.
Candidates provided unnecessary information regarding the application of capital gains tax, after concluding that the receipt was capital in nature. Candidates provided a reconciliation which effectively illustrated the corrections to be made to the provided draft tax rate reconciliation i.e. a starting point of the incorrect effective tax rate of 24.10%. The requirement did refer to a ‘corrected tax rate reconciliation’ as per IAS 12. When candidates provided a tax rate reconciliation with a starting point of which was either the effective tax rate proposed by Miss Nerves or Mr Cash, the reconciling items were often added / subtracted incorrectly. Candidates did not link the reconciling items per the tax rate reconciliation to the discussion regarding the business media headline. Furthermore, it appeared that candidates do not understand the purpose of the tax rate reconciliation.

5. Areas that the candidates handled well

Candidates generally attempted all subsections which indicates that time allocated to the question was appropriate. Candidates were able to identify the need to make use of case law and related principles in determining whether the receipt was of capital or income in nature in part (a). Candidates generally provided supporting explanations and calculations for the inclusion or exclusion of the reconciling items in part (b), and substantiated with appropriate Income Tax Act principles.

6. Specific comments on sections of the question

Part (a)

In this section, candidates were required to discuss whether a receipt arising from the sale of an entity’s own office building is of a capital nature in terms of the gross income definition in section 1(1) of the Act. This required discussion of the relevant case law and related principles.

Candidates who performed well in this sub-section were able to respond to the need to consider and apply case law and related principles. Candidates presented a logical, well-structured argument which applied such principles to the facts of the specific scenario, and provided a conclusion which was supported by the argument presented.

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

- Candidates did not present a logical, well-structured answer. Such candidates did not commence with a discussion in which the intention of the tax payer was considered, followed by a discussion of possible intentions such as profit-making, drawing on principles such as the realisation of an asset to its best advantage and ‘crossing the Rubicon’, at each stage applying the principles to the facts of the specific scenario. In such instances, certain essential considerations, such as intention, was often then discussed in a disjointed manner at the end of the discussion.
- Candidates made use of case law principles but did not reference the specific case, or in certain instances, referenced the incorrect case.
- Candidates provided a conclusion which was not supported by the preceding discussion.
- Candidates presented a brief discussion as to the nature of the receipt, concluded that the receipt was capital in nature and unnecessarily provided a discussion of the capital gains tax consequences.

Part (b)

In this section, candidates were required to prepare a corrected consolidated tax rate reconciliation of the group in terms of IAS 12 Income Taxes. Candidates were required to provide a brief explanation for each reconciling item included in the corrected tax rate reconciliation and an explanation as to why any reconciling items have been excluded.

Candidates who performed well in this sub-section were able to identify the starting point of the tax rate reconciliation i.e. the corporate tax rate, and were able to provide correct, concise explanations for the inclusions or exclusions of any reconciling items.
Candidates who did not perform well commonly made the following errors or omissions:

- Candidates did not identify the correct starting point of the tax rate reconciliation and used the effective tax rate proposed by Miss Nerves or Mr Cash.
- Candidates incorrectly added or subtracted the reconciling items. This was seen more frequently when candidates commenced the tax rate reconciliation with the effective tax rates proposed by Miss Nerves or Mr Cash.
- Candidates merely left out the reconciling items which were to be excluded from the tax rate reconciliation and did not provide explanations as to why they had made this decision.
- Candidates provided explanations which contradicted the manner in which the reconciling item had been treated (i.e. added, subtracted or omitted) on the tax rate reconciliation.
- Candidates failed to explain why items were considered to be temporary or permanent differences, and the related impact on the tax rate reconciliation. For example, candidates were unable to explain why dividends included from an accounting perspective, yet exempt from a tax perspective, were considered a permanent difference.
- Candidates failed to explain why a revaluation recognised in other comprehensive income should be excluded from the tax rate reconciliation.
- Candidates were unable to articulate why dividends withholding tax is excluded from the tax rate reconciliation and merely stated that this is ‘not an income tax’.
- Candidates failed to explain the corporate tax rate to the effective tax rate, and in essence, merely provided a list of reconciling items.
- Candidates’ supporting workings contradicted the amounts used / recognised in the tax rate reconciliation.

Part (c)

In this section, candidates were required to discuss whether in their opinion the group’s effective tax rate supports or contradicts the headline that appeared in the business media.

Candidates who performed well in this section were able to consider the business media headline from the perspective of the public and from the perspective of someone with an understanding of financial reporting. Furthermore, it was clear that such candidates understand the purpose of the tax rate reconciliation, as they were able to discuss the business media headline in light of the significant reconciling items in part (b).

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

- Candidates did not consider the impact of significant reconciling items used in part (b).
- Candidates did not consider the possibility of tax avoidance, and therefore did not differentiate between tax evasion and tax avoidance.
- Candidates did not spend the appropriate amount of time answering this question. This was indicated by the inadequacy, both in depth and breadth, of the discussion provided.

QUESTION 2

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
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<tbody>
<tr>
<td>40</td>
<td>24.9</td>
<td>84% (2082)</td>
<td>16% (397)</td>
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1. **What general areas the question covered**

The question tested IAS 33 *Earnings per Share* principles, including the calculation of basic earnings per share and diluted earnings per share as well as the disclosure thereof, by means of the preparation of the reconciliations as required by IAS33.70(a) and .70(b). The question also tested certain IFRS 2 *Share-based Payment* principles.

2. **In what respect candidates’ answers are considered to fall short of requirements.**
Many candidates were not able to distinguish between issues that affect basic earnings per share and issues that affect diluted earnings per share, and either included it in both or in the incorrect calculation.

Candidates generally struggled with the calculation of diluted earnings per share. Many candidates failed to treat the effect of the contingently issuable shares of the subsidiary correctly. Candidates also generally struggled to correctly include the effect of the share-based payment options in diluted earnings per share.

3. Common mistakes made by candidates

Some candidates did not thoroughly / methodically work through each issue of the question in order to ensure completeness of their answer (i.e. leaving out certain issues all together or, for certain issues, only considering the effect on WANOS and not the effect on earnings or vice versa).

Some candidates did not provide a well-structured answer, only dumping a bunch of calculations with no logical structure or layout.

Some candidates did not show all their workings (which caused them to lose unnecessary marks) or did not properly cross reference workings / calculations.

Some candidates did not present a proper reconciliation as required by IAS33.70(a) & .70(b).

The number of basic mistakes were concerning, e.g. adding the effect of the share based payment in calculation 1 instead of deducting it, or adding the treasury shares in calculation 3 instead of deducting it. Some candidates also, for example, calculated the effect of the share based payment correctly, but never included this in their calculation of basic earnings or calculated the theoretical ex-rights value in respect of the rights issue, but never used this to adjust the WANOS.

4. Areas that the candidates handled well

Since this was a calculation based question for which there is a standard acceptable structure, most candidates had a good approach and technique towards answering the question.

Candidates also generally illustrated a solid basic knowledge regarding the calculation of earnings per share.

5. Specific comments on sections of the question

Some candidates were not able to correctly account for the effect of the rights issue on basic earnings per share. Furthermore, some candidates split the rights issue between the basic WANOS and the diluted WANOS which is a basic principle error. The rights issue should be taken into account in the calculation of basic earnings per share since it does not entail potential ordinary shares, but rather actual ordinary shares issued.

Many candidates misinterpreted the information on the contingently issuable shares, not realising that it was the subsidiary’s shares to be issued and not the shares of the reporting entity. The transaction should therefore not affect the diluted shares of the reporting entity, but the diluted earnings.

Some candidates also included the 200 000 contingently issuable shares in the calculation of the basic WANOS, although this issue in principle relates to the calculation of diluted earnings per share. This is a basic principle error.

Regarding the share-based payment, many candidates took the modification into account in the calculation of the profit/loss attributable to the parent (basic earnings), which is incorrect since it should only be accounted for prospectively. Some candidates also added the effect of the share based payment to the profit/loss attributable to the parent instead of deducting it or included the effect of the share based payment after tax.
PROFESSIONAL PAPER 4

Paper 4 consisted of one question that dealt with the following aspects:

Question 1 Part I
(a) GP calculation & overhead allocation
(b) GP calculation & overhead allocation
(c) Analysis of financial information and related discussion
(d) Capital budgeting

Question 1 Part II
(e) Investment and finance decision making
(f) Business risks

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

QUESTION 1 Part I

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<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
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<tbody>
<tr>
<td>71</td>
<td>36</td>
<td>49.9% (1235)</td>
<td>50.1% (1241)</td>
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1. What general areas the question covered

Parts (a) and (b) covered overhead allocation and the calculation of gross profit. Part (c) was an analysis, comparison and discussion of gross profit across two years. Part (d) required candidates to calculate the incremental cash flows when considering investing in a new machine.

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

Some candidates’ demonstrated poor basic mathematical skills with totals been added up incorrectly and growth in expenses being calculated incorrectly.

Candidates demonstrated a lack of costing knowledge by not being able to distinguish between contribution margin and gross profit margin. Furthermore, many candidates simply stated that the gross profit percentage for the different products increased or decreased, but did not make the link as to why there may have been an increase or decrease in the gross profit percentage. This shows a lack of conceptual understanding of basic costing principles.

It was disappointing to still see that some candidates weren’t able to demonstrate basis finance concepts as evidenced by:

- Some including the coupon payments of the preference shares, the interest on the loans or the capital payment of the financing activities in the cash flow analysis.
- the inability to distinguish revenue and costs from cash flows as a large number of candidates included depreciation changes in their incremental cash flow calculations in part (d).
3. **Common mistakes made by candidates**

A number of candidates demonstrated poor exam technique as evidence by:

- Poor planning of answers, for example in part (a) and (b) where GP calculations for the three products were done vertically instead of horizontally and in part (d) where the incremental cash flows calculation were also done vertically instead of horizontally. This results in the duplication of writing and therefore wastes time;

- In part (a) and (b), a few candidates wasted time by working in total – they essentially grossed up each of the line items, only to have to divide the total at the end; and

- Not showing calculations or not referencing calculations properly.

Many candidates did not read the required carefully and therefore ended up getting dates confused (parts (a) to (c)) and performing calculations for years that were not required (part (d)).

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

Most candidates performed well in part (a) and nearly all candidates performed very well in part (b).

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

- **Part (a)**

  A number of candidates did not recalculate the depreciation charge for the new machine and did not re-calculate the cost of surplus labour hours which had decreased due to an increase in sales (and therefore production) volumes from 2016 to 2017.

  Some candidates incorrectly included sales and marketing expenditure in gross profit.

- **Part (b)**

  Once again, some candidates incorrectly included sales and marketing expenditure in gross profit.

- **Part (c):**

  Many candidates simply stated that the gross profit percentage for the different products increased or decreased, but did not make the link as to why there may have been an increase or decrease in the gross profit percentage. This shows a lack of conceptual understanding of basic costing principles. It is important that candidates not only crunch numbers but also have a conceptual understanding of the numbers.

- **Part (d):**

  Candidates battled with the incremental cash flow calculations in part (d) and it was evident that there was lack of practice in this area. Candidates who attempted this approach often got it mixed up with the long approach. Exam pressure also had an impact on some of the candidates providing incorrect years of the incremental cash flows.

  Some candidates calculated the 'incremental' cash flow as the difference in cash flows from 2018 to 2019 instead of the difference between the two options for investment which in terms of the question made no sense.

  A number of candidates incorrectly included depreciation (a non-cash flow item) and fixed overheads (unavoidable) in their incremental calculations.
Many candidates provided a capital budget for the full five year period instead of only the 2019 year as required.

Most candidates who followed the incremental approach failed to include the variable production overhead savings resulting from the reduction in machine hours required by the new machine.

### QUESTION 1 Part II

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<tbody>
<tr>
<td>29</td>
<td>13</td>
<td>31.5% (779)</td>
<td>68.5% (1697)</td>
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1. **What general areas the question covered**

The sections covered the area of Strategy, Risk Management and Governance and was part of a 100 mark integrated questions.

**Required e)** dealt with financing decision making and required of candidates to discuss the two finance proposals available to fund the acquisition of the new equipment and to recommend which of these should be pursued by the company. Further issues should also be included that would need to be clarified in regard to each proposal.

**Required f)** focused on business risks and required of candidates to identify and describe the key business risks that the company faces for the foreseeable future, assuming that the company invest in the new manufacturing equipment.

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

It did not appear that candidate’s lacked the knowledge to answer the section, but rather that they failed to apply themselves to the scenario and the information at hand. Insight into understanding the context on the scenario and the task required also appeared to be a problem.

3. **Common mistakes made by candidates**

Candidates did always consider the information given and applied that in answering the required.

Proper attention was also not always given to what was required, resulting in students not answering that which was required, or limiting their answers rather than answering the full spectrum of the required.

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

The investment decision part (e) was answered rather well, whilst candidates struggled with the business risk section (f).

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

**Part e) Finance decision**

1. In general most candidates seemed to understand the task and succeeded in presenting their answers in a structured and logical manner. Most candidates showed relatively good insight into both the scenario and the calculations required to compare the options.
2. Many candidates failed to recognise that the effective rate of the loan should be after tax. They therefore compared the effective rate of 8.68% calculated for the preference shares with the 10% (pre-tax rate) of the loan. These candidates therefore made the incorrect conclusion that the loan was in fact more expensive than the preference shares.

3. Most candidates argued that paying fixed annual instalments was a better option than paying a once-off amount in five years' time. These candidates however failed to identify the benefits of investing the money for five years during which interest could be earned.

4. A limited number of candidates identified and discussed the difference in the transaction costs related to the two options.

5. Very few candidates identified that there might not be sufficient trade receivables and inventory to pledge as security for the loan.

6. A limited number of candidates discussed the possible restrictions that could be imposed by the company’s Memorandum of Incorporation or the fact that there might not be enough authorised preference shares to issue. Most candidates also failed to identify and discuss the possible administrative burden of dividend taxes relating to the preference share option.

**Part f) Business risks**

1. Although this part specifically required the candidates to identify and discuss the key business risks, many candidates only identified these risks in short sentences without discussing them in detail.

2. A limited number of candidates misinterpreted the required and only discussed key business risks relating to the investment in the new manufacturing equipment. The required however stated that key business risks of the company should be discussed assuming that they do invest in the new equipment. These key risks would then include risks specifically relating to the new equipment but would also include normal key risks of the company in their normal day to day activities and operations.

3. 33 possible marks were available for a maximum of 17 marks. The suggested solution encompassed various possible marks of which many could have been derived directly from the scenario provided to the candidates. Many marks related to current challenges faced by South African companies such as load shedding, electricity price hikes, labour unrest and strikes etc. It was therefore considered very topical.

4. Candidates were awarded the communication skills mark if their answer was set out clearly and in an understandable manner.

5. A limited number of candidates misinterpreted the required and discussed the key business risks related to the loan and the preference shares that were set out in part e.