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 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 January 2017;
- Background information on the setting, marking and adjudication of SAICA examinations;
- General comments on the ITC January 2017; and
- Detailed comments by question in each of the professional papers (1–4).
## STATISTICS FOR ITC JANUARY 2017

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Average marks per question (all candidates)

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<td>Average marks</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:

- Ahmed Haji
- Anton du Toit
- Arson Molola
- Azile Nkabinde;
- Carmen Westermeyer
- Carol Cairney
- Cobus Rosssouw
- Dewald Joubert
- Eihorere Wesigye
- Elton Pullen
- Ferdinand Mokete
- Francois Liebenberg
- Frans Prinsloo
- Francois van den Berg
- Giel Pieterse
- Goolam Modack
- Graeme Berry
- Greg Beech
- Jack Jonck
- Jackie Arendse
- Jacobus Rossouw
- Janine Claassens
- Hugh Harnett
- Koubus Swanepoel
- Linda van Schalkwyk
- Lisa Vidulich
- Lyndsay Maseko
- Mandi Olivier
- Mariaan van Staden
- Marielienne Janeke
- Neville Dipale
- Nico Fourie
- Pieter Landsdell
- Pieter van der Zwan
- Reghardt Dippenaar
- Ross Peasey
- Shelly Nelson
- Stéfani Coetzee
- Tracy Krause
- Zwelodumo Mabhoza
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 January 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. Only once the double blind marking of each batch of scripts had been completed did the markers confer and jointly decide on the final raw mark to be awarded for a particular answer. Thereafter each marker's mark, as well as the final mark, was noted down on the cover of the script. If the markers were unable to agree upon the number of marks to be awarded for a particular answer, the script was referred to the umpire, who then awarded the final mark. The SAICA secretariat was responsible for capturing and final checking of the marks of all candidates.

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

4. **Adjudication**

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

- Whether candidates encountered any time constraints;


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

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

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

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

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

5. **Borderline review**

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

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

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<td>60 – 80 marks</td>
<td>60 – 80 marks</td>
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<tr>
<td>25 – 30%</td>
<td>10 – 15%</td>
<td>15 – 20%</td>
<td>15 – 20%</td>
<td>10 – 15%</td>
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<th>Audit &amp; Assurance</th>
<th>Tax</th>
<th>Financial Management</th>
<th>Management Decision Making &amp; Control</th>
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<td>12%</td>
<td>4%</td>
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3. Overall comments on the papers

The January 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 4, part I on audit the most difficult and coped best with paper 3, question 1.

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

Paper 1 Question 1 consisted of two parts, with part I ranging from straightforward to difficult for the second and third sections, mainly due to the open-ended nature of these parts. The second part was considered to be moderate to difficult, but fair. The question integrated accounting and external reporting with management decision making and control topics in a relevant and realistic cell phone industry scenario. While there were distinct portions to the scenario, the integration tested candidates’ ability to see a single scenario through multiple lenses. Part I dealt with a total revenue split between contract and prepaid customers, a variance analysis on budgeted revenue and actual revenue and an analysis and commentary on the budget versus actual revenue. Part II dealt with IFRS 15 (revenue) and IFRS 9 (financial instruments), and specifically performance obligations, financing components, allocation of a transaction price, recognition of revenue and a right of return and loss of allowances. There was a mix of discussion and calculations, some demonstrated by means of journal entries. Although the principles of IFRS 15 were fairly straightforward, the application was complicated by the introduction of time value of money and the finance components.

Paper 2 was also a single, 100-mark scenario. Part I integrated financial management with accounting and external reporting. The question was balanced between easy to obtain marks and challenging sections that required higher level thinking skills and a narrative approach. It was overall at a moderate level. The question offered a comprehensive valuation scenario that reflected the strategic and financial decisions facing South African firms expanding into other African countries. The question tested candidates’ knowledge of both DCF and earnings based valuations and required them to consider the strategic issues and risk aspects arising from investing in a company in another African country. Candidates were required to determine the target company’s WACC, analyse a free cash flow to equity valuation model, provide a method discussion for an earnings-based valuation, and consider qualitative issues with regard to valuation methodologies and numbers, the risks of an African acquisition and a contingent performance-based acquisition payment strategy.

Paper 2 Question 1 Part II dealt with strategy and risk management and tested a good mix of skills. The question was regarded as fair and tested topical issues. There was also a good balance of easier and difficult marks. There candidates achieved a poor average mark, which was considered to be due to candidates’ lack of knowledge and application, rather than being a difficult question. One section was quite technical and assessed candidates’ understanding of hedge accounting. Different aspects of IFRS were integrated into a group scenario with a mix of theory and journal entries. Candidates had account for an inventory fraud in separate and consolidated financial statements as a post-balance sheet event. They also had to discuss whether a company would be able to apply hedge accounting and had to present an extract of consolidated financial statements.

Paper 3 Question 1 dealt with accounting and external reporting, and covered the calculation of the cost of investment property, subsequent measurement thereof and accounting for 15% of the property becoming owner-occupied by the parent company in the group. These were mostly addressed by means of journal entries. There was also a discussion section on the impact of an onerous contract on the financial statements. It was a good conceptual test of adjusting journal entries and group accounting principles through pro forma journal entries, with a fairly easy
discussion of an onerous contract. The question was of moderate difficulty. The inclusion of inter-company leases in a predominately investment property scenario distinguished between those candidates who understood the principles from those who may have seen, but not understood, a similar scenario.

Question 2 of paper 3 dealt with **taxation**, and was set in a case study with an international scenario. Candidates had to calculate the normal tax implications of a sale and leaseback transaction, discuss an asset for share transaction (with calculations), and upfront receipt for a tender and pre-payment and they also had to perform a calculation for a group of companies where the holding company ceased to be a resident. This question tested advanced tax issues covered in the examinable pronouncements and required a deep application of principles coupled with anti-avoidance in relation to a company ceasing to be a resident, and taxation on sale and leaseback transactions and on the acquisition of asset as consideration for shares issued. The first three sections of the question were considered to be moderate to difficult and the last section was difficult.

Paper 4 was a 100-mark integrated question set in an interesting and different business and scenario, on gas-to-liquid technology, fertilisers and explosives and gas extraction from the seabed. Part I tested **audit and assurance** and dealt with considerations and actions of a group auditor regarding component auditor’s work, substantive audit procedures to audit the impairment loss from value in use and the fair value less cost to sell. The last part related to substantive audit procedures to audit the invoice and related cost of a gas extraction chamber. The question was of a good standard, practical and relevant. Candidates had to demonstrate the ability to apply knowledge to solve the problems.

Paper 4 Part II related to **ethics** and **strategy, risk management and governance**. It dealt with broader ethical principles, as well as professional ethics applicable and relevant to a CA(SA) in business who is also a director, and professional ethics applicable to a trainee accountant and was considered to be moderate, and moderate to difficult. The second part dealt with business risks pertaining to the international operations of the gas/fertilizer/explosives company. This section was fairly difficult, because of the industry and scenario. The issue of confidentiality tested candidates’ overall understanding of the Code of Professional conduct and ethics in general as it integrated the various fundamental principles.

4. **Specific comments**

From a review of candidates’ answers to the eight required sections for the ITC January 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 scenario provided.

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

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

4.3 Communication

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

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

4.4 Journal entries

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

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

4.5 Time management

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

4.6 Layout and presentation

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

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

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

### 4.7 Irrelevancy

Marks are awarded for quality, not quantity. Verbosity is no substitute for clear, concise, logical thinking and good presentation. Candidates should bear in mind that a display of irrelevant knowledge, however sound, will gain no marks.

### 4.8 Drilling down

Responses, particularly in the Financial Management, Management Decision Making and Control and the Strategy, Risk Management and Governance areas are often provided by simply repeating the information given in the question. Candidates are unable to drill down to assess what the underlying problem areas are and do not put any effort into going beyond what is stated in the question. Candidates need to draw on their entire knowledge base in order to provide more deep and meaningful insight, particularly in analysis type questions.

### 4.9 Recommendations / interpretations

Responses to these requirements are generally poor, either because candidates are unable to explain principles that they can apply numerically or because they are reluctant to commit themselves to one course of action. It is essential to make a recommendation when a question calls for it, and to support it with reasons. Not only the direction of the recommendation (i.e. to do or not to do something) is important, but particularly the quality of the arguments – in other words, whether they are relevant to the actual case and whether the final recommendation is consistent with those arguments. Unnecessary time is wasted by stating all the alternatives.

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

### 4.10 Examination technique

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

### 4.11 Open-book examination

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

- **No loose pages** (of any kind) may be brought into the exam.; and
Writing on flags – as per section 4.4 of the SAICA examination regulations:

‘Candidates are only be allowed to highlight, underline, sideline and flag in the permitted texts. Writing on flags is permitted for reference and cross-referencing purposes only, that is, writing may only refer to the name or number of the relevant discipline, standard, statement or section in the legislation’.

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

Candidates are advised to familiarise themselves with SAICA’s Examination Regulations prior to writing the examination.

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

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

4.12 Paying equal attention to all the competency areas

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

' 4.2 A minimum of 200 marks (thus 50%) are required to pass the ITC.
4.3 Candidates need to demonstrate an appropriate level of competence in ALL areas and disciplines, and therefore the overall pass mark of 50% shall be subject to the candidate achieving a sub-minimum of 40% in at least three of the four professional papers.'

We have been in the position, in the past, where we unfortunately had to fail a candidate because that candidate did not achieve the 40% subminimum in two of the four papers. This is really unfortunate and candidates are advised to pay equal attention to all the competency areas in order to obtain an overall pass in the ITC.

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

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

Best of luck!!
PROFESSIONAL PAPER 1

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

Question 1 Part I

(a) A calculation of the revenue composition attributable to contract and prepaid cell phone user customers.
(b) A reconciliation of actual revenue for prepaid and contract customers to the budget.
(c) An analysis and commentary on actual versus budgetary revenue performance.

Question 1 Part II

(d) A discussion on whether, with regard to a cell phone contract, a 12-month warranty should be identified as a separate performance obligation; whether there was a significant financing component for each separate performance obligation; and how to allocate the transaction price to the separate performance obligations.
(e) Journal entries to account for all consequences arising from computer and data contracts sold.
(f) A calculation of and explanation for an amount of a loss allowance that should have been recognised regarding contracts with customers.

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

QUESTION 1 PART I

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<tr>
<th>Maximum mark</th>
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<th>Marks &lt; 50% (fail)</th>
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<tbody>
<tr>
<td>42</td>
<td>22.12</td>
<td>895 (34%)</td>
<td>2 632 (66%)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

Part (a) required candidates to split mobile voice revenue between contract and prepaid customers. Part (b) required a reconciliation of budgeted revenue to actual revenue, with the volume variance needing to be split between the variance due to a change in the average number of minutes and the variance due to a change in the number of customers. Part (c) involved an analysis and commentary on the budgeted versus the actual revenue.

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

In part (b) the majority of candidates were able to calculate a price variance but many did not demonstrate a sound understanding of volume variances. In particular, candidates were not able to split the overall volume variance between the component arising from the change in customers and the component relating to a change in the average number of minutes. Furthermore, many candidates were able to apply the basic principle of standard costing that when doing a variance analysis it is necessary to consider only one variable at a time. Most of these candidates tried to apply a formulaic approach which was not possible in this scenario.

As in prior years, candidates in general struggled with open-ended questions, in this case in part (c). Candidates appeared not to understand what was required by ‘analyse and comment’. Many tried to force rehearsed answers and lacked the ability to provide explanatory commentary that showed some critical and integrated thinking. Instead, many repeated information given in the scenario or simply stated the obvious ‘this has increased/decreased’.
3. **Common mistakes made by candidates**

Some candidates had poor exam technique, whereby they did not have any associated workings to support their calculations in part (b).

A number of candidates incorrectly used the actual revenue per minute (rather than the standard revenue per minutes) when calculating the variances arising from the change in customers and the change in the average number of minutes.

In part (c) many candidates re-performed the calculation of ratios that had already been given in the scenario. No marks could be awarded for this and wasted candidates' time.

Many candidates incorrectly commented that a key reason for the changes in voice revenue was a decrease in calls. This was not correct as the total number of voice minutes were actually above budget. Some candidates did not understand that an increase in interconnect revenue meant that a greater proportion of the company's customers than budgeted for were communicating with users from other networks.

A number of candidates commented that variances between actual and budget were an indication of a faulty or incorrect budget. Although this is a possibility, it is not an absolute truth and can most certainly not be the reason for all the variances.

A large number of candidates discussed future performance, ideas and/or strategic options for the company which was not required.

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

The vast majority of candidates performed well in part (a) of the question.

Most candidates were able to comment on the impact of alternative messaging platforms on SMS revenue and the impact on data revenue that the increasing demand for data arising from the increased availability of smart phones had. A number of candidates were able to correctly comment on the composition of revenue.

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

Please refer to comments above.

**QUESTION 1 PART II**

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<td>49</td>
<td>28.14</td>
<td>1 916 (73%)</td>
<td>718 (27%)</td>
</tr>
</tbody>
</table>

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

The question covered IFRS 15 and IFRS 9, including the following:

- An IFRS 15 discussion dealt with whether warranty is a separate performance obligation, whether a significant financing component exists in the contract and the allocation of a transaction price.
- Candidates had to provide IFRS 15 journal entries dealing with the allocation of a transaction price, recognition of revenue and accounting for a right of return.
1. The IFRS 9 aspect concerned calculation and discussion of a loss allowance in respect of contracts with customers.

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

In general, candidates displayed a good basic knowledge of IFRS 15 but struggled to deal with some of the more complex issues, e.g. a significant financing component and accounting for a right of return. Answers generally lacked in-depth application and seemed rushed, considering this was a 50 mark question.

3. Common mistakes made by candidates

Although the question explicitly required a discussion for certain sections, many candidates included very little discussion and mainly focused on calculations, especially for part (d)(iii) and part (f). Some discussions were very theoretical without proper application. Some candidates did not attempt certain sections of the question while other sections seemed rushed, which could be indicative of time management issues.

4. Areas that the candidates handled well

Candidates displayed a good basic knowledge of IFRS 15, especially with regard to identifying performance obligations and the basic allocation of the transaction price to each separate performance obligation. Candidates with good exam technique performed well in part (d) of the question.

5. Specific comments on sections of the question

Part (d)(i)
For this section, both the general principles of IFRS 15 (i.e. par. .27(a) & (b)) and the specific guidance of IFRS 15 regarding warranties (i.e. par. .B30 & .B31) should have been considered. Many candidates, however, only considered the one or the other. Good exam technique suggests that candidates should be guided by the mark allocation. Since the discussion was for 9 marks, candidates should have realised that a discussion of only the general principles or only the specific guidance was not enough and that additional arguments needed to be made. Some candidates who attempted to address both the general principles and the specific guidance mixed their discussion between the two sections of the standard and were not clear and concise. Candidates with good exam technique performed well in this section.

Part (d)(ii)
Many candidates considered a significant financing component for the contract as a whole and not for each separate performance obligation. Many candidates failed to identify the applicable theory (i.e. IFRS15.60-.63) and some of those who did identify the theory, struggled with the application.

Part (d)(iii)
Candidates generally included very little discussion and focused mainly on calculations. Most candidates only included a calculation to allocate the cash consideration based on the relative stand-alone selling prices and very few actually considered the financing component or any issues relating to the discount.

Quite a number of candidates mixed up total vs monthly amounts in determining the sum of stand-alone selling prices, i.e. they included the total amount of R8 000 for the phone and monthly amounts for the data, sms messages and voice minutes. Many candidates took the additional discount of 15% into account in determining the stand-alone selling prices for the data, sms messages and voice minutes, which was incorrect.
Some candidates included a lengthy discussion of IFRS15.82 (allocating discount to specific performance obligations in the contract), even though in terms of IFRS15.81, there was no discount in the contract as a whole.

**Part (e)**
Candidates did not perform well in this section. Journal entries were generally very poorly formulated with a number of repeat journals, journals not balancing and a general lack of logic in the composition of the journals.

Very few candidates accounted for the right of return appropriately. The financing component were very seldom identified and accounted for. Many candidates struggled to identify that revenue in respect of the computer should be recognised on 1 December while revenue in respect of the data should only be recognised on 31 December, based on when the respective performance obligations were satisfied. Very few candidates accounted for the ‘income received in advance’ and the ‘interest income’ on 31 December.

**Part (f)**
Very limited discussion was provided in this section and most candidates only included a calculation. Although the specific election of lifetime expected credit losses was stated in the question, candidates either missed this information or they did not understand what this election actually entails.

**PROFESSIONAL PAPER 2**

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

**Question 1 Part I**

(a) An estimate of a company’s weighted average cost of capital and candidates also had to list any further information they might have required to finalise their calculation.

(b) The candidate had to advise one company on the acquisition of another and critically comment on a free cash flow valuation of the latter provided in the scenario.

(c) A discussion of the approach and steps to be followed to perform an earnings-based valuation of a company.

(d) A description of the key risks faced by a company arising from its acquisition of a controlling interest in another company.

(e) On the assumption that the candidate was advising a company, he/she had to critically discuss a shareholder’s proposed terms of the sale of her shareholder’s interest in another company.

**Question 1 Part II**

(f) Candidates had to explain how an inventory fraud should be accounted for in the separate financial statements of that company and in the consolidated financial statements of its holding company.

(g) A critical discussion of whether the holding company would be able to apply hedge accounting in its consolidated financial statements, if it entered into a forward exchange contract to hedge its potential dividend to be received from a foreign company.

(h) A presentation of the relevant extracts of the consolidated statement of financial position of the holding company relating to the foreign company.

Five presentation marks were available for this paper. These marks were clearly and separately stated in the ‘required’ sections of each question.
1. **What general areas the question covered**

This was a comprehensive valuation scenario, which reflects the strategic and financial decisions facing South African firms expanding into other African countries. Candidates were required to determine the target company’s WACC, analyse a free cash flow to equity (FCFE) valuation model, provide a method discussion for an earnings-based valuation, consider qualitative issues with regard to valuation methodologies and numbers, consider the risks of an African acquisition, and consider a performance-based acquisition payment strategy.

The question achieves an effective integration of understanding valuation theory and practice as well as strategic issues of making an investment decision in a company in Nigeria, which is facing challenges relating to the fall in the oil price and Nigerian currency.

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

Candidates generally performed poorly in understanding the difference and nuances in the free cash flow to equity method in required (b), with some candidates stating that the preparer had made an error with the starting point of cash, indicating no understanding of the method. Although the method is used less frequently in general assessments of valuations due to the difficulties associated with forecasting of an income statement, balance sheet and cash flow statement in exam conditions, this method has been used previously in the form of a critical analysis of a provided valuation in the ITC assessment.

Candidates also performed poorly in commenting on the proposed contingency payment for the company purchase. This section required candidates to shift their mindset into a performance evaluation mode, which most were unable to achieve.

3. **Common mistakes made by candidates**

Presentation and examination technique were generally good. There were however many instances where candidates missed more straightforward marks such as adjusting for risks, or requesting additional information.

Candidates generally did not identify the FCFE approach used in the scenario for required (b), and therefore based their comments on an incorrect explanation of the free cash flow to firm (FCFF) approach. Marks were still awarded if this alternative approach was explained correctly.

Part (e) was answered particularly badly, and in many cases not attempted. Candidates battled to identify that the section was actually using performance evaluation principles, and therefore answered from a valuation point of departure.

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

Candidates performed well on parts (a), particularly on the WACC calculations, part (c) where the earnings approach was explained relatively well, and part (d) where risk identification was good.
5. Specific comments on sections of the question

Part (a)
Candidates performed relatively well in this required. The WACC calculation for 6 marks was straightforward and well answered, but the comments on other information required were generally weak and superficial. This was expected as it required the application of more insight. This actually required a criticism of the WACC, with which candidates generally struggle as it requires a higher-level understanding.

Part (b)
Candidates performed poorly in this section as it first required a criticism, and thus a conceptual rather than a mechanical answer, and second as the valuation was in the form of a FCFE, with the starting point the cash movement in the cash flow statement. Most candidates battled with this method, and therefore arrived at inappropriate criticisms and adjustments. The solution did allow for the application of the answer using the FCFF approach, with which most candidates were more familiar, and they therefore earned marks for explanations using this method, provided it was given in context.

Part (c)
Candidates generally scored better in this section, with some marks being lost due to a lack of a contextual application of the earnings method. Few candidates realised that the PE approach should not be used, and many did not discuss the approach but rather focussed on the steps to perform the valuation.

Part (d)
The risk section was generally answered well, with most candidates earning at least a pass mark for this section, and many performing well. In some cases candidates identified points but did not articulate them to the consequence, resulting in them earning one mark instead of two.

Part (e)
Candidates either did not answer this section at all, or answered it poorly. The question required candidates to apply their minds to the proposal of a contingent consideration for the purchase price, with the practical considerations thereof. This required candidates to consider the principles of performance evaluation, including controllability, contingency, recoverability, and manipulation. Few identified these, perhaps not shifting mindset for the integration of the section, and therefore answering while trapped in valuation topic principles.

When considering the performance in section (e), the required was not flawed in any way, and the change in mindset, realising that this was performance evaluation concepts in a different context, was perhaps the issue.

Overall therefore candidates’ performance was mediocre on the question as a whole.

QUESTION 1 PART II

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<th>Maximum mark</th>
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<th>Marks &gt; 50% (Pass)</th>
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<tr>
<td>36</td>
<td>20.90</td>
<td>1860 (71%)</td>
<td>774 (29%)</td>
</tr>
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</table>

1. What general areas the question covered

Part (f) required a discussion relating to fraud that occurred with respect of inventory that had been ordered by an associate ordered and was seized at port. It had to be discussed with regard to the accounting treatment of the fraud in both the associate’s statements (a discussion of a contingent asset) and group financial statements (a discussion of a...
contingent consideration). It also required the identification of events after the reporting period and the adjustment that needed to be made due to the events after the reporting period.

Part (g) related to a dividend expected from a foreign associate and a discussion on whether hedge accounting could be applied in the group statements to hedge the foreign currency risk of the expected dividend receivable.

Part (h) required the candidate to equity account for the foreign associate and present relevant extracts of the statement of financial position relating to the foreign associate.

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

Candidates should ensure that they read, and discuss, all parts of the required. They should also take note of the mark allocation and base the depth of their answers on the mark allocation: for example, three line items will not be sufficient to obtain seven marks in a seven-mark discussion question.

Candidates should further ensure in a presentation/calculation question that they focus on the completeness of their answers and that they address all aspects relating to the required, again based on the mark allocation. In the present question many candidates only performed a calculation of the analysis of the shareholders’ interest in the associate, although the required expected candidates to present the relevant extracts from the consolidated financial statements.

3. Common mistakes made by candidates

Candidates should ensure that they take all relevant information into account in answering a question and that they work accurately, as easy marks are often lost by ignoring some necessary information or including it incorrectly in their solutions. For specific comments, refer to par. 5 below. Candidates should refrain from quoting excessive theoretical extracts from standards and not concentrating on applying the information of the scenario.

4. Areas that the candidates handled well

The candidates mostly obtained most communication skills marks and the layout of their solutions was generally good and in accordance with the required. For specific comments, refer to par. 5 below.

5. Specific comments on sections of the question

Candidates that identified the issues correctly, scored well. In sections (f) and (g) candidates did not always identify the issue correctly and discussed many points relating to irrelevant items. For example, in part (f) many candidates identified the write down of a prepayment asset due to uncertainty around the recovery as a possible provision or contingent liability (whereas the discussion should have centred around the existence of an asset), and therefore wasted time and effort in writing and applying theory that was not relevant in the scenario.

In part (g), candidates began by concluding that the hedge is in the group and that hedge accounting therefore could not be applied, without any further application of the other theoretical points (whether there is a eligible hedging instrument (the FEC) and an eligible hedged item (dividend receivable) and whether this is reliably measurable), and hence they lost many application marks. Many candidates did not attempt part (g) at all.

Part (h) performance was average, for the following reasons: The candidates obtained the easier marks in terms of the straightforward at acquisition equity and consideration, but did not make all the fair value adjustments correctly. They also struggled to perform subsequent pro-forma adjustments in order to equity account for the associate. Candidates ignored certain post-acquisition equity adjustments and many did not calculate the goodwill/gain on bargain purchase. The candidates also did not identify all the relevant line items to be presented in the consolidated statement of financial position, and hence did not answer the required and lost some marks.
Areas where candidates performed well:

- The general approach to equity accounting in the analysis of owners’ equity (AoE) was correct. However, with regard to the presentation in the statement of financial position, candidates did not generally demonstrate the ability to convert the work performed in the calculations into line items that would typically be found on the face of the statement of financial position, and a general lack in insight was apparent.
- If candidates calculated the ‘at acquisition’ equity and consideration correctly, they generally scored a few easy marks.
- Candidates generally used the correct exchange rate for translations, although a few multiplied instead of divided with the exchange rate in order to convert from Kenyan shillings to rand.
- In the discussion questions, candidates performed very well if they identified the issue correctly.

Areas where candidates performed poorly:

- In the discussion questions, candidates identified some issues correctly, but failed to see the context (the bigger picture) based on the required. They then only discussed one aspect of the scenario or an issue without considering the actual required and/or other implications and considerations. It is almost as if candidates anticipated certain issues and then focussed on those issues, without answering the actual required.
- In part (f) candidates were required to discuss the accounting treatment from the perspective of an associate’s separate financial statements and the group’s consolidated financial statements, yet some only discussed the separate financial statements and not the group or limited discussion of group figures to a few lines only.
- Many candidates failed to think through their answers to part (g) and for example did not test/apply all the necessary elements of the theory for eligibility, and without taking into account the number of required marks. Many candidates did not attempt part (g) at all.
- Candidates do not discuss sufficient points for the number of marks stated in the required.
- When a question is phrased slightly differently to expectation, i.e. presentation of all relevant items relating to the associate, candidates did not consider all the information and only presented the basic information (for example most candidates only presented the line item – ‘investment in associate’ without considering the impact of the entire scenario on all other relevant line items, including (but not limited to) items in equity as well as some other assets and liabilities that arose due to the method of consideration and the inventory fraud/contingent consideration issue.

PROFESSIONAL PAPER 3

**Paper 3** consisted of two questions that dealt with the following aspects:

**Question 1**

(a) The preparation of adjusting journal entries to correctly account for a building (The Grudem) in a company’s separate financial records for the financial year.

(b) The preparation of the pro forma journal entries required to correctly account for The Grudem and a new related lease agreement in the consolidated financial statements of the group of companies for the financial year.

(c) A discussion on how the company’s lease with an unrelated third party would affect –

(i) the group’s consolidated statement of financial position as at the end of the previous financial year; and

(ii) the group’s consolidated statement of profit or loss and other comprehensive income in the next financial year.

**Question 2**

(a) A determination of the normal tax implications for both a bank and company to which it lent money stemming
from a sale and leaseback arrangement. Candidates were also required to provide brief reasons for each item in their calculations.

(b) Candidates were required to discuss and calculate the tax implications in terms of the Income Tax Act for both an individual (Mr Xula) and the company in which he considered investing of the subscription for a 15% shareholding by Mr Xula in exchange for a vehicle on the assumption that –

- Mr Xula’s valuation of the shareholding is equal to the arm’s length value; and
- the company’s valuation of the shareholding is equal to the arm’s length value.

(c) A discussion of the tax implications for a company in relation to the upfront receipt from Sanral for the tender to build a bridge over a river as well as a payment of an annual membership subscription to a builders association.

(d) The calculation of the South African normal tax liability of a company incorporated in a foreign country as a resident for a year of assessment. Candidates had to provide brief reasons for their treatment of the capital gain and the foreign dividend.

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

QUESTION 1

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<tr>
<th>Maximum mark</th>
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<th>Marks &gt; 50% (Pass)</th>
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<td>21.63</td>
<td>1 944 (74%)</td>
<td>690 (26%)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

This question covered the calculation of the cost of investment property, subsequent measurement thereof and accounting for 15% of the property becoming owner-occupied by the parent company in the group. In part (a) candidates were required to prepare the adjusting journal entries to correctly account for the building in the separate financial statements. The candidates had to evaluate the journal entries already processed by the company which contained some errors and omissions. In part (b) candidates were required to prepare the pro forma journal entries to correctly account for the building and the new related lease agreement following the fact that 15% of the building became owner-occupied by the parent company in the group. Marks were awarded for presentation, specifically journal narrations. Part (c) consisted of two sub-parts: in part (i) candidates were required to discuss how the lease with an unrelated party would affect the consolidated statement of financial position and in part (ii) candidates were required to discuss how the lease with the unrelated party would affect the consolidated statement of profit or loss and other comprehensive income.

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

- Some candidates did not adjust for deferred tax in part (a) or (b).
- Some candidates did not provide a step-by-step and logical layout for their calculations. This resulted in calculations not used or not used in context.
- Some candidates did not provide journal narrations.
- Some candidates did not identify the onerous contract relating to the lease.

3. Common mistakes made by candidates

- Candidates did not plan their approaches well enough which filtered through to the exam technique used in preparing the adjusting journal entries, pro forma journal entries and their discussion. 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 deferred consideration and calculated this correctly in part (a).
- Candidates recognised the subsequent fair value adjustment and associated deferred tax thereon in part (a).
- Candidates generally provided reasonable adjusting journal entries for part (a) and pro forma journal entries in part (b).

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

**Part (a)**

In this section, candidates were required to prepare the adjusting journal entries to correctly account for the building in the separate financial statements. The candidates had to evaluate the journal entries already processed by the company, which contained some errors and omissions.

Candidates who performed well in this sub-section were those who identified the majority of the errors and omissions and adjusted for these correctly. These candidates could reconcile what the line items should be versus what they were and process the corresponding adjusting journal entries. Some candidates did follow an approach of reversing what was done completely and replacing this with a new set of entries. While the net effect is the same, this approach was longer and wasted some time.

Candidates made the following errors or omissions:

- Candidates recognised the profit on disposal as a revaluation through other comprehensive income rather than a profit on disposal through profit or loss.
- Candidates missed the asset exchange transaction, being that the asset given up (land) should be measured at its fair value resulting in the corresponding gain.
- Some candidates credited land instead of profit on disposal, without a corresponding de-recognition of the land. This is incorrect as the land was transferred in the purchase consideration.
- Very few candidates raised a current tax liability on the fair value gain. As this disposal took place on a date before the new inclusion rate for capital gains tax became effective, they did not apply an inclusion rate.
- Some candidates capitalised the share issue costs to the investment property, which is incorrect. These should be recognised in equity. Also many candidates missed that the share issue costs are non-deductible for tax purposes.
- Candidates accounted for the deferred tax on the fair value adjustment of the investment property using the incorrect inclusion rate.

**Part (b)**

In this section candidates were required to prepare the pro forma journal entries to correctly account for the building and the new related lease agreement following the fact that 15% of the building became owner-occupied by the group.

Candidates who performed well in this sub-section were those who accounted for the change from investment property to property, plant and equipment and accounted for the intercompany lease. A small number of candidates argued that the 15% portion was insignificant and therefore the entire property remained investment property. These candidates had to provide reasons for such conclusion to be awarded marks.

Candidates made the following errors or omissions:

- Some candidates did not work with the cost that was given in the requirement.
- Candidates provided the reversal of the fair value gains but did not provide a journal entry for the classification from investment property to property, plant and equipment.
Some candidates provided journal entries for the acquisition of the building as a business combination in terms of IFRS 3, despite the scenario being clear that it did not constitute a business or provided the at acquisition pro-forma consolidation journal entries (main elimination journal entry and non-controlling interest, etc).

**Part (c)**
Candidates who performed well in this sub-section were those who provided a good account of the implications of the onerous contract on the (i) statement of financial position and (ii) statement of profit or loss and other comprehensive income. Calculations were not required. These candidates thought about the implications first, perhaps by way of journal entries and timelines, and followed this up with the appropriate implications. Candidates should plan their response first before committing to the answer.

Candidates made the following errors or omissions:
- Some candidates provided implications for the incorrect financial period.
- Many candidates did not discuss the tax implications that arose.

**QUESTION 2**

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<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
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<td>72</td>
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<td>1 724 (65%)</td>
<td>910 (35%)</td>
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</table>

**Part (a)**

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

This part required the determination of normal tax implications for both the lessor (buyer) and the lessee (seller) involved in a sale and leaseback transaction. The action word ‘determine’ used within the required section required candidates to perform calculations and to provide brief explanations (reasons) for calculations. The tax implications covered the following: the interaction and application of section 11(e) and section 12C section, section 8(4)(a) recoupment with capital gains tax consequences, section 11(a) and section 1 (gross income) and the consideration of the anti-avoidance provisions contained in section 23D and section 23A all provisions of the Income Tax Act.

The question clearly indicated that Value-Added Tax (VAT) should be ignored.

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

- As the instruction to ignore VAT was mentioned before the information relating to the question, some candidates missed or forgot that and therefore incorporated VAT into their discussions and/or calculations.
- In a question where candidates were required to determine normal tax implications they needed to explain their calculations and the brief reasons for the application of the various provisions of the Income Tax Act – this was not done.
- Candidates displayed a poor understanding of the anti-avoidance provisions contained in section 23D and section 23A of the Income Tax Act – some candidates even applied it to the lessee (Ukwaka) instead of the lessor (Republic Bank) in terms of the sale and leaseback transaction.

3. **Common mistakes made by candidates**

The following mistakes were commonly made by candidates with regard to part (a):
• With regard to the company:
  o Some candidates calculated the s8(4)(a) recoupment on a different amounts to the one used to claim the deduction or allowance. This shows a lack of understanding of what the principle of a recoupment entails and what it tries to achieve.
  o For the capital gains tax (CGT) computation, most candidates assumed that the tax value used in the recoupment calculation would be the same as the base cost. This only worked where the candidates used the R850 000 to claim the section 11(e) or section 12C allowance (Income Tax Act) but it is still technically incorrect to use the calculated tax value within the CGT calculation. If students used R800 000 as the basis for claiming capital allowances the base cost for CGT would have to be recalculated by taking the actual cost of R850 000 and reducing it with the allowed capital allowances. Candidates must be careful, and always use the method prescribed by the Tax Acts for application.
  o A number of candidates, in calculation the CGT on disposal, did not reduce the amount received, accrued or deemed to be received by taxpayer which were included in that taxpayers' gross income or taken into account in calculating his or her taxable income (to arrive at ‘proceeds’ (par. 35 of the Eighth Schedule)), and similarly, reducing the par. 20 Eighth Schedule amount with the deductions or allowances previously allowed. Candidates should use the correct terminology within their calculations.
  o The majority of candidates incorrectly applied the capital gains tax inclusion rate of 80% while the correct rate to be used for the 2016 year of assessment was 66.6%. Candidates need to be aware of effective dates on which monetary rates are amended. The company in the question had a 31 December 2016 year end, commencing 1 January 2016. The new inclusion rate of 80% for company’s only applies to years of assessment commencing on/after 1 March 2016.
  o Candidates did not identify that building and road construction is a process similar to manufacturing and thus section 12C was applicable. A number of candidates used a write-off period of three years instead of four years for capital allowances claimed in terms of section 12C.
  o Some candidates appeared to be confused by the fact that the company had purchased a bulldozer from a non-connected person at a prize above market value. They used one of the amounts to calculate the allowance and the other amount to calculate the tax value. Candidates need to make an assumption, based on tax principles, and continue to apply their assumption consistently.

• With regard to the lessor (a bank):
  o Some candidates missed the easy marks for stating that the acquisition of capital asset does not qualify for a deduction under section 11(a) of the Income Tax Act, and that the provisions of section 23A of the Income Tax Act does not apply because the asset in question is not an ‘affected asset’ as defined as it was an operating lease.
  o Most candidates failed to state that the provisions of section 12C of the Income Tax Act cannot apply to the lessor even though the legislation is clear that one cannot use section 12C if an asset is brought into use (in this case by the lessee) for a second time in a process of manufacturing. Those who did give a reason why 12C was not applicable, gave an incorrect reason, i.e. the bank was not carrying on a process of manufacture or one similar to it.
  o Some candidates do not understand that section 23D of the Income Tax Act is not used to prescribe a cost on which a deduction or allowance can be claimed, but to limit, under certain circumstances, the allowance or deduction a lessor can claim for an asset used by a lessee under a sale and leaseback arrangement.
  o Very few candidates identified that the remaining life of the bulldozer was four years (the lease period).

4. Areas that the candidates handled well

• Candidates performed reasonably well in the determination of the sale and leaseback tax implications for both the lessee and the lessor. It was good to see that many students referred to the limitations of section 23D of the Income Tax Act when calculating the capital allowances of the bank (the lessor).
The application of the recoupment and capital gains tax for the company on the sale section of the sale and leaseback transaction was in general attempted although the calculations were not always totally correct because the wrong wear and tear rate was used.

5. Specific comments on sections of the question

The required clearly stated that candidates should determine the normal tax implications for both the bank and the company stemming from the sale and leaseback transaction yet the layout of the solutions where poorly done. It was clear that candidates did not plan there solution before starting to write. This is a basic skill that candidates need to practice and that will be helpful in writing future exams and even in writing reports within the workplace.

Part (b)

1. What general areas the question covered

This part of the question required a discussion and a calculation of the tax implications in terms of the Income Tax Act for an asset for share transaction where (i) the value of the asset exceeded the value of the shares (i.e. a capital gain); and where (ii) the value of the shares exceeded the value of the asset (i.e. a deemed dividend in specie). The tax implications for both the mentioned options had to be provided for both parties (Mr Xula and Ukwaka) involved in the asset for share transaction. The information clearly indicated in the question that section 42 of the Income Tax Act did not apply. This part of the question covered the section 24BA mismatch (excess), the treatment of a personal use asset for CGT purposes (par. 53 of the Eighth Schedule), section 40CA, the treatment of a dividend in specie distribution in terms of sections 64EA, 64FA and 64K and candidates also needed to test if the parties to the transaction were persons in terms of the ‘connected persons definition of section 1’ and whether par. 38 of the Eighth Schedule would apply.

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

- Although the question clearly stated that the two parties agreed in writing that the provisions of section 42 of the Income Tax Act would not apply to the transaction, candidates still wasted time on discussing and/or applying the provisions of section 42.
- The company in the question had a 31 December 2016 year end, which meant that the year of assessment in question commenced on 1 January 2016. The new inclusion rate of 80% for company’s only applies to years of assessment commencing on/after 1 March 2016. Despite this, many candidates still used the incorrect CGT inclusion rate (80%) and did not apply 66.6% to the capital gain realised by the company.
- Candidates did not use correct terminology and forfeited easy marks, for example candidates indicated that the company need to ‘pay’ dividends tax, or is ‘responsible to withhold’ dividends tax instead of indicating that the company is ‘liable to pay’ the dividends tax as it constituted a dividend in specie per the provisions of section 64EA of the Income Tax Act.
- Basic implications were not dealt with, for example the fact that the disposal of a personal use asset does not attract capital gains tax, nor does the issue of shares trigger a disposal.
- Most candidates incorrectly concluded that Mr Xula was a connected person in relation to the company.
- A few candidates incorrectly discussed donations tax.

3. Common mistakes made by candidates

- Many candidates only discussed only one of the options and failed to recognise that the question essentially had four parts: discussing the tax consequences for 2 taxpayers (Mr Xula and Ukwaka) in 2 scenarios.
- Candidates mixed the tax implications of the two options in a single discussion and markers could only mark one of the two options.
Candidates might be of the opinion that the ‘required’ for this part of the question were not formulated well, which contributed to how the candidates formulated their solutions but candidates could also, by just reading the scenario, have identified that there was two options to fund the transaction and that they needed to discuss both options – for both taxpayers.

Given that this question required candidates to ‘discuss the tax implications…’ candidates were expected to state whether and why the provisions of sections 24BA and 40CA of the Income Tax Act would apply to this transaction before calculating the actual application. Very few candidates provided the reasons why the sections were applicable.

Candidates were also required to identify that both parties (the individual and the company) were parting with something (the individual with his vehicle, and the company with shares), in order to acquire something else and therefore candidates also needed to discuss the capital gains implications of such disposals (‘parting’) (or deemed non-disposals). This required the candidates to state that the issuing of the company’s shares by the company does not constitute a disposal in terms of the Eighth Schedule and that the transfer of the asset by the individual does constitute a disposal, but that the gain/loss on the disposal must be disregarded for capital gains purposes because the asset is a personal use asset as defined.

Candidates seemingly do not understand the difference between a ‘deemed dividend’ and an actual dividend. Some candidates went on to discuss the inclusion of the ‘deemed dividend’ in the individual’s gross income, which technically suggests that an actual dividend was declared to him. This does not make sense, given that the individual is assumed to have held no shares in the company prior to this transaction. Furthermore, section 24BA states that it is only a deemed dividend for the purposes of section 64D, thus for dividends tax and not for the entire Income Tax Act.

The provisions of section 24BA do not apply where the parties are connected persons as defined. Candidates needed to test and state that the individual and the Ukwakwa are not connected for the provisions of the section to apply.

Most candidates have a tendency to quote sections of the Act verbatim, without any application to the given scenario. Candidates are reminded that this is an open book exam, and therefore marks are not awarded for transcribing sections of the Act to the answer book – they need to apply it to the scenario and conclude on whether the applicable provisions are applicable or not.

In the discussion of part (ii) on the Mr Rani’s valuation of the shareholding as equal to the arm’s length value became confused between Mr Rani and the company and referred to the company’s tax implications as those of Mr Rani.

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

Candidates were able to identify that the mismatch under assumption 2 gives rise to a dividend *in specie*.

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

In general, candidates’ presentation and layout for this question showed lack of planning and poor exam technique. Solutions were not well planned and that resulted in an execution of the required into a solution that was rather all over the place. At times markers could not tell whether the discussion was done in the context of the company or the prospective shareholder or whether assumption 1 or assumption 2 was being addressed.

**Part (c)**

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

This part of the question required a discussion of the tax implications of (i) an upfront receipt received by a taxpayer in the construction industry (covering gross income definition (section 1) and the application of section 24C allowance for future expenditure on the contract); as well as (ii) the payment of an annual membership subscription to a builder’s
association which was a voluntary payment not required in terms of legislation (covering a discussion of the apportionment between a section 11(a) deduction of current expenditure and the limitation of pre-paid expenditure in terms of section 23H).

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

- Candidates wrote pages on the discussion of the various elements of the ‘gross income definition per section 1’ and the various elements of the ‘general deduction formula in terms of section 11(a)’ instead of identifying the pre-paid element of the expenditure and the possible section 24C allowance in terms of the upfront payment received.
- The majority of candidates incorrectly calculated the section 24C allowance by applying the gross profit percentage to the advance payment received instead of applying the cost as a percentage of the total contract price to the advance payment received.
- Some candidates became confused between the section 24 debtor’s allowance and the section 24C allowance for future expenditure.
- Very few candidates actually considered the expenditure not imposed by legislation requirement as part of the application of section 23H of the Income Tax Act.
- In respect of the member subscription paid, some of the candidates gave a long discussion on whether the amount was deductible and came to the conclusion that the amount was not deductible in terms of section 11(a) because the expense was voluntary. Because they concluded that the amount was not deductible candidates did not identify the pre-paid issue.

3. Common mistakes made by candidates

- Many candidates spent far too long in discussing the application of the various elements of the gross income definition to the upfront payment, when in fact there were no factors indicating that this was a contestable inclusion – just the amount needed to be addressed.
- The same happened in the case of the pre-paid expenditure.
- The candidates included the full amount in ‘gross income’ instead of the pre-paid portion of 60%.
- Candidates stated that the amount would be included in ‘taxable income’ instead of ‘gross income’. This is technically incorrect because if you refer to ‘taxable income’ you are saying that the amount you are including is after allowing deductions and then you start with a discussion of deductions – candidates need to use the correct terminology.
- Some candidates believed that the R100 000 threshold in terms of section 23H applied to the total payment – not only to the pre-payment portion.

4. Areas that the candidates handled well

- Candidates that identified that the payment to the builders association was a pre-paid expense (section 23H) and discussed the fact that the pre-payment must extend six months into the next year of assessment and that the pre-payment must exceed R100 000.
- Most candidates did not simply state the requirements of section 23H but also applied it to the scenario.

5. Specific comments on sections of the question

- Candidates should use the mark allocation as a basis for determining the length of their discussion.
- Candidates should take into account that any discussion on the inclusion of income or deductibility of expenditure will only require them to discuss the issue and not all requirements and should a candidate apply this principle to this part of the required, they would have realised that they were missing out on the discussion of other provisions of the Income Tax Act.
• If more than one transaction is discussed, candidates should use headings to structure their solutions.

Part (d)

1. What general areas the question covered

This part required a calculation of the normal tax liability of a company ceasing to be a resident due to a shift in the place of effective management from South Africa to Dubai. The company had business operations in both South Africa and Swaziland, resulting in section 9H deemed disposal implications for all the assets located in Swaziland. This part of the question required candidates to identify the foreign dividend claw-back provisions of section 9H(3)(f), disposal of foreign shares in terms of par. 43(1A) of the Eighth Schedule and possible disregarding of the capital gain within the provisions of par. 64B of the Eighth Schedule. Candidates were also tested on various capital allowance provisions such as section 12C, section 13(1) and the fact that there is no capital allowance for land. As a result of foreign income included in taxable income candidates also needed to consider the application of the s 6equat rebate. All of the above are provisions in terms of the Income Tax Act.

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

• Candidates struggled with the application of the section 9H(3)(f) foreign dividend claw-back provision as well as the claw-back of a capital gain in terms of section 9H(3)(e). They also struggled with the correct application of the conversions in terms of par. 43(1A) of the Eighth Schedule, as well as the application or testing of whether par. 64B of the Eighth Schedule would be applicable.
• Candidates applied the deemed disposal provision and forgot that it would not apply to the South African assets because such assets would remain in the tax net as long as it was part of immovable property and assets attributable to a permanent establishment in South Africa.
• The majority of candidates do not understand the term ‘permanent establishment’. Candidates would state in words that there was no deemed disposal for assets attributable to a permanent establishment in SA, yet they calculated recoupment and CGT in relation to the plant and equipment of the SA factory.
• Under note 2.2 of the information within the question it clearly stated that the official currency of Swaziland is at par. with the South African rand yet a number of candidates tried various conversion rates to convert the lilangeni (SZL) into rand.
• Some candidates concluded that since there was a double tax agreement between Swaziland and South Africa, the Swaziland taxable income was not taxable in South Africa even though the scenario stipulated that the company was a ‘SA resident’ for tax purposes and that in terms of the double tax agreement Swaziland may also tax the income. Candidates do not understand the general workings of a double tax agreement.

3. Common mistakes made by candidates

• Some candidates identified the deemed disposal of assets and then only did a CGT calculation – not realising that the recoupments must first be calculated as it should be used in the CGT calculation.
• Most candidates correctly calculated capital allowances, recoupments and capital gains but then did not transfer the amounts to a taxable income calculation. The required part of the question stated that candidates needed to calculate the South African normal tax liability, thus no marks could be awarded unless it was part of the normal tax liability calculation.
• Many candidates do not indicate deductions with brackets or inconsistently applied brackets to some of the deductions – this was bad exam technique and resulted in an unnecessary loss of marks.
• Candidates applied an CGT inclusion rate of 80% even though the new inclusion rate of 80% for company’s only applies to years of assessment commencing on/after 1 March 2016 and the company in question had a year of assessment that commenced on 1 October 2015. Thus candidates should have applied the inclusion rate of 66,6%.
Candidates did not include any of the Swaziland income or allowances for the part of the year (nine months) that the company operated from South Africa.

Candidates apportioned the building allowance in terms of s 13(1) for nine months – the building allowance never gets apportioned for a period shorter than a year.

A number of candidates calculated the tax values of the Swaziland building and Swaziland plant and equipment correctly BUT because candidates do not correctly calculate the proceeds (par. 35 of the Eighth Schedule) and base cost (par. 20 of the Eighth Schedule), they ended up with a capital loss instead of including a recoupment.

Areas that the candidates handled well

Candidates performed fairly well in identifying the deemed disposal in terms of section 9H (due to the change in residency status).

Most candidates were able to calculate the capital allowances, recoupments and capital gains tax implications of these deemed disposals.

Specific comments on sections of the question

With the disposal of a company’s shareholding in another company incorporated in the Isle of Man, the scenario failed to provide candidates with the ‘spot rate’ on the date the sale took place – candidates must always use information provided and should have written down the conversion rule in terms of par. 43(1A) of the Eighth Schedule and only used the rate that was provided in the calculation.

We recommend that if a candidate runs out of time, he/she should at least indicate that the company would pay tax at a rate of 28%.

General comments of interest

Candidates fail to approach their solutions systematically and do not always refer to all aspects of each transaction in the question or generalise their answer. The requireds are specific and the solutions should address the specifics of the required.

In general it seems as if candidates could still improve their exam technique as far as addressing various options within a single required section is concerned. Candidates either addressed only one of the options as part of their answers (this could be due to poor time planning) or providing a mix of the options without using proper headings and a structured layout. Candidates must make use of proper headings.

Incorrect use of terminology and use of accounting terminology (such as those relating to revenue recognition and stage of completion) when addressing a tax issue is not acceptable.

Candidates should guard against addressing irrelevant aspects (such as VAT consequences and securities transfer tax) not listed in the required.

In a calculation question candidates should indicate the deductibility of deductions, inclusion of gross income and recoupments as well as aggregating capital gains and correctly including these in the calculation at the correct inclusion rate.

Companies DO NOT qualify for an annual exclusion in terms of the Eighth Schedule.

Candidates should bear in mind that a well-structured solution will result in a better mark.
**PROFESSIONAL PAPER 4**

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

<table>
<thead>
<tr>
<th>Question 1 Part I</th>
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<tbody>
<tr>
<td><strong>(a)</strong> Candidates had to identify and discuss the matters that the group auditor should consider, and the actions he should take, following a communication received from a foreign component auditor.</td>
<td></td>
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<tr>
<td><strong>(b)</strong> A description of the substantive audit procedures the audit firm needed to perform to obtain sufficient appropriate audit evidence about an impairment loss recognised in respect of an explosives cash-generating unit.</td>
<td></td>
</tr>
<tr>
<td><strong>(c)</strong> A description of the substantive audit procedures required to obtain sufficient appropriate audit evidence that the invoice from a German company and any related costs had been appropriately recognised and measured.</td>
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**Question 1 Part II**

| **(d)** A discussion of concerns, from an ethical perspective, with regard to the chief executive officer's behaviour in investigating the possibilities for investing in the manufacture of organic fertilizers; and the audit senior's actions after reviewing the minutes of a directors' meeting. |  |
| **(e)** Candidates has to prepare a brief memorandum highlighting the current business risks facing the company. These had to be summarised under four categories, namely a new head office, the company's natural gas operations, its fertilizer and explosives operations and its cash-generating operations. |  |

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

**QUESTION 1 PART I**

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
</tr>
</thead>
<tbody>
<tr>
<td>57</td>
<td>33.83</td>
<td>1 799 (68%)</td>
<td>835 (32%)</td>
</tr>
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</table>

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

The auditing aspects of 63 marks formed part of an integrated 100 mark question, with strategy, governance and professional ethics. It covered considerations and actions of a group auditor regarding a foreign component auditor's work, substantive audit procedures to audit an impairment loss and substantive audit procedures to audit the invoice and related cost for a gas extraction chamber.

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

Candidates would have fared better in the question if they had focused on the information of the scenario and the relevant facts provided. The substantive procedures were also often of a general nature and not specific to the relevant information and facts presented.

The required of the question were also often not properly interpreted and answered. This was evident in for example section (a) where candidates applied many South African legislative frameworks to the foreign operation as well as to the foreign auditors, which was inappropriate. They could also not clearly articulate the result of the limitation of scope on the group audit. It seemed as if they did not have fully understood what was required of them. The poor interpretation was also evident in section (b) where candidates often focused too much on general procedures and dealt with impairment in its entirety instead of auditing the components that the impairment calculation comprised of.
and in section (c) where candidates often discussed the invoice and all costs, which was not related to the invoice (depreciation, de-recognition, etc.) and was not required.

3. **Common mistakes made by candidates**

As stated above, candidates did not always apply the information of the scenario in answering the required. Candidates often also did a memory dump of standard procedures that was not related to the information at hand. This is also indicative of generally poor examination technique.

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

Section (c) on the substantive audit procedures to audit the invoice and related cost for a gas extraction chamber was well answered.

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

**Part (a)**
- Candidates struggled to articulate whether they were referring to the group or the subsidiary when it came to the scope limitation, audit report and reportable irregularities.
- Candidates discussed the scope limitation but in the subsidiary’s financial statements when the required asked for the position of the group auditor.

**Part (b)**
- Candidates’ answers lacked structure and they often answered value in use and fair value less cost to sell procedures together.

**Recoverable amount**
- Some students failed to link the new sales contracts to the actual cash inflows and no mark was awarded
- Very few students discussed the reasonability of selling prices
- Only one candidates identified ammonia costs
- Very few students discussed why terminal value has not been included in the value in use calculation
- Candidates often failed to explain how they assessed the reasonableness of the growth and discount rates.

**Fair value less costs of disposal:** Candidates often did not explain how they would consider placing reliance on the expert and accordingly did not earn marks.

**Impairment loss:** Only a few candidates identified that a new fair value less cost to sell had to be calculated and that it would result in a new impairment loss.

**Part (c)**
- Candidates often discussed the invoice and all costs (depreciation, de-recognition, etc.), although only costs related to the invoice were required.
- For the other qualifying costs, candidates often tested occurrence but not completeness of transactions

**QUESTION 1 PART II**

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>18.81</td>
<td>1 400 (53%)</td>
<td>1 234 (47%)</td>
</tr>
</tbody>
</table>
1. **WHAT general areas the question covered**

Part (d) covered auditing and assurance and the broader ethical principles relevant to legislation and codes. Part (d)(i) dealt with professional ethics applicable and relevant to a CA(SA) in business, who is also a director and part (d)(ii) with the professional ethics applicable to a trainee accountant. Part (e) covered risk management as part of strategy, risk management and governance and dealt particularly with business risks.

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

- Part d(i): Candidates who applied the information in the scenario to their knowledge of the Code of Professional Conduct, Companies Act and King III requirements performed well in this section.
- Part d(ii): Candidates struggled with this section, even though they identified the ethical issue of sharing confidential information. Candidates did not provide depth to their answers by discussing the confidentiality issue and giving reasons why it was in breach of the code.
- Part (e): Candidates struggled with this section. Those candidates who identified the particular business risk did not go further to explain the impact of the business risk. For example, if non-compliance with laws and regulations was identified as the business risk; candidates did not state that this could result in penalties, reputational damage, etc.

3. **Common mistakes made by candidates**

**Part d(i)**
- Certain candidates did not contextualise their answers in terms of the scenario, i.e. a trainee accountant working on an audit.
- They did not take into consideration that the person in question was a CEO of the client but also a CA(SA) and therefore the Code of Professional Conduct would be applicable to her. Being a director, certain Companies Act sections would also apply to her, as well as relevant sections of King III on conduct of directors.
- Candidates should note that ethical considerations are not limited to the Code of Professional Conduct, but also include the Companies Act and King III, insofar it affects the ethical conduct of a director.
- Candidates should note that ethical considerations from the CEO’s position as a director exclude any safeguards suggested by the Code of Professional Conduct (candidates did not read the required carefully in this regard).

**Part d(ii)**
- Some candidates failed to identify that a trainee accountant, as per the training regulations of SAICA, is bound by the Code of Professional Conduct.
- Furthermore, candidates did not provide depth to their answers by discussing the confidentiality issue further and why it was in breach of the code.

**Part (e)**
- Some candidates did not respond in the form of a memorandum (as per the required).
- Even if candidates identified the particular business risk, they did not explain the impact that risk would have on the business.

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

**Part d(i):** Candidates who applied the information in the scenario to their knowledge of the Code of Professional Conduct, Companies Act and King III requirements performed well in this section.
Part (e)
- Candidates who applied the information in the scenario to the industry, were able to provide insightful business risks.
- Answers were well structured under the four categories, which helped to focus the candidates’ answers in addressing the various business risks.

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

Please see above, information has been given on each sub-section for most areas.