OBJECTIVES OF THIS REPORT

This report has been compiled from the analysis of examiners on candidates’ performance in the Initial Test of Competence (ITC) (previously known as Part I of the Qualifying Examination), which was written in June 2018. Its objectives are to –

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

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

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

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

- Statistics for the ITC June 2018;
- Background information on the setting, marking and adjudication of SAICA examinations;
- General comments on the ITC June 2018; and
- Detailed comments by question in each of the four professional papers.

STATISTICS FOR ITC JUNE 2018

<table>
<thead>
<tr>
<th></th>
<th>% Pass</th>
<th>Passed</th>
<th>Failed</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>All candidates</td>
<td>61%</td>
<td>634</td>
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Average marks per question (all candidates)

<table>
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<tr>
<th>Paper</th>
<th>Question 1</th>
<th>Question 2</th>
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<tr>
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<tr>
<td>Average marks</td>
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<td>Paper 2</td>
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<tr>
<td>Total marks</td>
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<td>Average marks</td>
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<tr>
<td>Average marks</td>
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<tr>
<td>Average marks</td>
<td>26,10</td>
<td>26,04</td>
<td>52,14</td>
</tr>
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</table>

More detailed statistics can be found on the SAICA website at www.saica.co.za

BACKGROUND INFORMATION ON THE SETTING, MARKING AND ADJUDICATION OF SAICA EXAMINATIONS

The ITC Examinations Committee (ITC 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:

- Adnan Patel
- Adrian Sameuls
- Andrew van der Burgh
- Ben Marx
- Carmen Westermeyer
- Eihorere Wesigye
- Elton Pullen
- Ferdinand Mokete
- Francois Liebenberg
- Francois van den Berg
- Frans Prinslo
- Giel Pieterse
- Goolam Modack
- Greg Beech
- Greg Plant
- Helouise Burger
- Jack Jonck
- Jackie Viljoen
- Jacobus Rossouw
- Janine Claassens
- Linda van Heerden
- Lisa Vidulich
- Mandi Olivier
- Marielienne Janeke
- Muneer Hassan
- Paula van de Wouw
- Piet Nel
- Pieter van der Zwan
- Reghardt Dippenaar
- Riyaan Mabutha
- Ross Peasey
- Shelly Nelson
- Stéfani Coetzee
- Sufyaan Bhaiyat
- Vanessa van Dyk
- Veryl Mulder
- 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 June 2018 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, using an electronic marking tool. The tool records marks per subsection, section and question automatically. 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. This was also recorded on the marking tool. 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 electronic tool automatically captures the final marks of all candidates and prepares a report for the ITC Examco.

Consistency marking was introduced in 2012, which entails that a pack of ten scripts 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;
- Whether the level of difficulty of each question was appropriate for the ITC;
- 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. During the adjudication four secretaries marks (one per paper) are added to each candidate’s score. The objective of these secretaries marks is to compensate for any errors that may have occurred during the marking process.

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 has been complete, the scripts of candidates who just failed (based on a range determined by the IPD Committee); who achieved less than 25% for the exam as a whole; or who did not achieve the requirement of a 40% minimum per paper (see par. 4.12 of the section on the general comments) 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 a mark team. The marks during this process may either go up or down and is again done on a question by question basis so the final result is not
contrived. A sub-committee of the IPD Committee then meets to discuss the outcome of the borderline review and thereafter the pass percentages and other detailed statistics for the examination are prepared. Candidates who are selected for the borderline review are not awarded the secretaries mark because they have had the benefit of a further and more detailed review of their papers.

*In view of the above stringent marking process no request for re-marks will be entertained (also refer to our Examination Regulations for the ITC in this regard).*
GENERAL COMMENTS ON THE ITC JUNE 2018

1. Objective

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

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

2. Analysis of topics

<table>
<thead>
<tr>
<th>Accounting &amp; External Reporting</th>
<th>Strategy, Risk Management &amp; Governance</th>
<th>Audit &amp; Assurance</th>
<th>Tax</th>
<th>Financial Management</th>
<th>Management Decision Making &amp; Control</th>
<th>Ethics</th>
<th>Comm</th>
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<tr>
<td>Required ranges in terms of the SAICA guidelines (2013 onwards)</td>
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<td>60 – 80 marks</td>
<td>60 – 80 marks</td>
<td>40 – 60 marks</td>
<td>40 – 60 marks</td>
<td>0 – 20 marks</td>
<td>20 – 40 marks</td>
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<tr>
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<td>45</td>
<td>3</td>
<td>58</td>
<td></td>
<td></td>
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<td>P2 Q1 part I</td>
<td></td>
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<td>3</td>
<td>58</td>
<td></td>
<td></td>
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<tr>
<td>P2 Q1 part II</td>
<td></td>
<td>20</td>
<td>2</td>
<td>42</td>
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<tr>
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<td></td>
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<tr>
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<tr>
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<td>11%</td>
<td>17,5%</td>
<td>17%</td>
<td>10%</td>
<td>12%</td>
<td>2,5%</td>
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Markers’ and umpires’ comments 6 © SAICA 2018
3. **Overall comments on the papers**

The June 2018 ITC examination was considered to provide a fair assessment of technical competence overall, with a mix of easier and more challenging areas. There was a good balance between easy, moderate and difficult sections within each question and the themes and scenarios were topical and relevant.

From result statistics, it was evident that candidates found the accounting and tax questions in paper 2 question 1 part II as well as paper 3 question 1 part I particularly difficult, and also struggled with paper 4 question 1 on tax. They coped better with the subjects of the other papers.

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

Paper 1 consisted of a single, 100-mark scenario that dealt with **accounting and external reporting** topics, integrated with **strategy, risk management and governance**. There was an appropriate balance between calculations and discussion, although the tax and deferred tax consequences on the convertible bonds were challenging, as was the integration of current and deferred tax. This tested candidates’ ability to follow the underlying transaction, as there was a split between the financial liability and equity option.

Most universities considered part I of paper 1 question 1 to be of a moderate level of difficulty, but with discussion elements that raised the difficulty of the question. The end result was a good balance between the easier calculation and more difficult discussion aspects in which candidates had to apply knowledge.

The topics were assessed in a novel and interesting manner. It was a fair mix of investment appraisals, sources of finance and risk management and considered numerous aspects of a business. The whole issue around the pricing of the packages and the links between advertising revenue and total revenue was thought provoking. The application of capital budgeting principles was fairly straightforward, as were the no par value calculations.

Part II of paper 1 question 1 concerned some current practical aspects in which candidates had to deal with issues arising in a business rather than just processing information. Candidates thus had to apply theory to the answers in the discussion portions of the required and had to ‘separate’ the financial accounting, managerial accounting and taxation issues from a fairly dense set of integrated information. The questions was a fair evaluation of classification in the cash flow statement, accounting for compound instruments and IAS 36. The scenario dealt with the fundamentals of costing issues as well as transfer pricing and a long-term special order. It tested a good mix of financial accounting and managerial accounting skills.

Paper 2 Question 1 was a 100-mark, integrated question that dealt with **accounting, audit and assurance, taxation** and **ethics** topics. Most universities considered the question to be of a moderate level of difficulty, with some more challenging sections. It was considered to be a practical but rich scenario in which the information was set out in a logical manner. The scenario highlighted relevant industry issues, and equated to matters that would be encountered in real life. It furthermore required candidates to think laterally and analyse the information.

Part I of this question related to audit and ethical considerations and was a good test of candidates’ core understanding of controls, tests of controls, substantive procedures and ethics. It tested substantive procedures, which are crucial in practice and therefore is an important element to test for a significant percentage in professional examinations. These were set against the background of a new accounting standard (IFRS 16) as it relates to auditing procedures.
Paper 2, question 1 part II was considered to be fair, and contained a good integration between value-added tax and income tax, tested in the context of a lease falling within par. (b) of the definition of an instalment credit agreement in the VAT Act. Although the focus was on lessor accounting, which did not change significantly (IAS 17 compared to IFRS 16), it is a relevant accounting topic in view of recent amendments. There was also a good integration of both basic principles (e.g. the definition of a lease, the lessee exemptions) and more complex principles (e.g. calculating the rate implicit in the lease and deferred tax implications for the lessee). The deferred tax on leases was more challenging, as it applied horizontal integration on that topic with another subject. This section introduced some discussion on financial reporting, which balanced the calculations in part I. The strength of the question lies in the fact that it combines both theory and calculations, as well as a consideration of the accounting requirements from both the perspective of the lessor and the lessee.

Paper 3, question 1 was also an integrated 100-mark question and dealt with accounting and external reporting, strategy, risk management and governance and audit and assurance. Universities considered it to be fair to difficult, for the information in the question is complex, and candidates had to analyse the information with care to distinguish between accounting and auditing aspects. Each transaction required application of a great deal of information and interconnectedness of the scenario for the various required sections.

Universities considered part I of paper 3, question 1 to be challenging in terms of transactions and tax implications that were examined. The calculation of profit/loss before tax was an efficient method of testing a wide variety of accounting concepts in one question, and there was a good integration of different standards and various accounting principles. It was a fair test of the deferred tax implications on buildings (tax deductions not allowed), which were classified as assets held for sale. The hedge accounting on a sales transaction and the tax rate reconciliation increased the level of difficulty.

Part II of paper 3, question 1 was considered to be moderate to difficult (with reference to the sections on deferred tax). In this part strategic, management decision-making and risk management principles were integrated with auditing and some tax into a scenario in which candidates had to analyse the information carefully to distinguish accounting and auditing aspects. The examination of substantive procedures by providing it in the form of key audit matters was a very practical way of testing auditing aspects. It was a good test of candidates’ core understanding of controls, tests of controls, substantive procedures and ethics. The integration reinforced the principle that it is possible to combine taxation and auditing. Such integration tests candidates’ ability to move away from silo-structured thinking.

Question 1 of paper 4 dealt with taxation and most universities considered it to be of moderate difficulty. However, the level of difficulty was increased by the great deal of information in the scenario and preponderance of sections that required discussion.

The focus of the question was on individuals, and covered income tax, section 24J, the Seventh Schedule, the application of double tax agreement provisions, lump sums, and fringe and retirement benefits. There was also a good integration with VAT matters. The question did not focus on a single natural person, and this tested whether candidates were able to deal with multiple taxpayers and integrated scenarios. The inclusion of a double tax agreement added an extra dimension to the question. There were very few calculation marks and the discussion questions dealt with the decisions that were in line with the CA2025 vision of equipping future CAs with rare skills that cannot be replaced by computerisation.

Question 2 of paper 4 was considered to contain a good balance of calculations, which were relatively easy, and discussions, which were more challenging.

It was a good scenario with some topics that have not been examined recently, such as activity-based costing, and specifically cost estimation and cost allocation principles. The focus on the cost-leader aspects of the strategy was an interesting twist. This meant that candidates were required to show insight and understanding and also to provide thoughtful analysis to be able to reach a meaningful conclusion with regard to the context and different pieces of
information in the scenario, which was set in a service-based aviation organisation. There was a good overall integration of strategic management with performance management principles, together with some fundamental cost accounting principles. It tested technical (critical discussion on allocation bases and cost drivers) and business (business strategy level competitive advantage) aspects and whether candidates could use performance measures to gauge the competitive position of the division.

4. General comments

From a review of candidates’ answers to the eight required sections for the ITC June 2018 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 your next exam!

Best of luck!!
PROFESSIONAL PAPER 1

Paper 1 consisted of a single question with two required sections that dealt with the following aspects:

Question 1 Part I
(a) A calculation and conclusion on which alternative for settling a Competition Commission fine would be cheaper for the company.
(b) The identification of and discussion on the factors the company should have considered in determining which of two alternatives it should have selected to settle the Competition Commission fine. Calculations were not required.
(c) The identification of and discussion on the disadvantages of each of four funding options that had been identified by the Chief Financial Officer for settling the Competition Commission fine.
(d) Based on updated information for an initial feasibility study –
   (i) an estimation of whether a British Premier League broadcasting deal would have been financially feasible and lucrative; and
   (ii) an identification of any other factors that should be considered in evaluating the broadcasting deal.
(e) The identification and description of potential mitigating actions the company could undertake to respond to the risks and issues raised under a market dominance action plan.

Question 1 Part II
(f) A discussion of the classification under which the company should present the following items in its statement of cash flows for FY2017:
   (i) A good faith payment of R50 million;
   (ii) A purchase of the British Premier League broadcasting rights; and
   (iii) The issuance of the debentures.
(g) The preparation of all journal entries required to account for the debentures issued by the company in its financial statements for that financial year. Candidates had to –
   • include journal entries relating to current and/or deferred taxation;
   • ignore closing journal entries; and
   • round all amounts to the nearest rand.
(h) The preparation of all adjusting journal entries required to correctly account for the British Premier League broadcasting rights in the company’s financial statements for the 2017 financial year. Candidates had to –
   • include journal entries relating to deferred taxation;
   • ignore current taxation;
   • for financial reporting purposes assume that a discount rate reflective of the risks associated with the broadcasting rights was 25% (before tax) and 20% (after tax);
   • ignore closing journal entries; and
   • round all amounts to the nearest rand.

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

<table>
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</table>

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

The question was based on a company providing Pay TV services within the entertainment industry. The core of the scenario was based on a company battling in a rapidly changing industry which is being disrupted by new technologies and streaming services, as well as being challenged on its monopoly position.

The firm had been recently subjected to a competition commission investigation, which had resulted in a significant adverse finding on price fixing, resulting in a large fine combined with restitution activities.

The question required candidates to assess the cheapest form of settling the fine using a relatively straightforward NPV calculation (Part (a)), followed by a consideration of the strategic consideration to be considered in choosing between the two fine options (Part (b)). The question then suggested different forms of financing the payment of the fine, and required candidates to identify disadvantages only on each of suggested funding options to settle the fine (Part (c)).

Part (d)(i) then required candidates to calculate the net present value of purchased international football viewing rights, to determine if the correct decision had been taken to purchase these rights. This was followed by a discussion of what other factors should have been considered in evaluating the broadcast deal. Being a second part of (d), this discussion was limited to the consideration of the specifics of the deal.

The question then provided a number of identified risks for the company, and required candidates to identify mitigating actions which could be applied by the company to address these risks.

The question has a good mixture of basic, intermediate and advanced marks. The information in the scenario was unambiguous and succinct. The question is of a moderate to easy standard. The relative 'simplicity' of the question is effectively balanced against (1) the rather long scenario, (2) the fact that the NPV needs to be criticised, and (3) the fear factor of an 'integrated' question.

Overall, we felt the question was well balanced, and would expect an average candidate to pass the question. To perform well would however be a lot more difficult, and therefore we feel that this is a good question for differentiation between top performers.

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

Candidates battled in general to answer the discussion aspects of the question.

In part (b) candidates either did not provide sufficient points to earn the 8 marks available, or expressed themselves poorly in explaining the points identified, often providing generic points which were not applied to the scenario.

Candidates also performed poorly in part (d)(ii). This was a more difficult discussion area, and required candidates to question the assumptions used in the net present value, requiring them to display more insight and understanding of what drives the net present value.

The final required was a twist on risk identification, where candidates were provided the risks the company was exposed to (which previous questions asked them to identify), and candidates were required to find mitigating factors.
to address these risks. This was considered to be challenging for candidates, requiring them to show insight into how to address risks, rather than just identifying them. Although the marks were lower for this section, candidates performed relatively better in this discussion section than in part (d)(ii), but in line with part (b).

3. **Common mistakes made by candidates**

Candidates appeared to manage their time well, distributing their time well according to the mark allocations of each section. Communication was however in many instances relatively poor, with explanations not forming clear and crisp answers.

The provision of generic points without applying to the scenario was also an issue, resulting in candidates not being awarded these marks. Application of the point to the scenario presented is vital.

Many candidates did not construct a net present value timeline table, and rather attempted to performed the calculations using calculator inputs. This often resulted in them losing track of what needed to be included, and forgetting about tax effect, net present value etc. Candidates should generally always create a net present value table to manage the information in their solution more coherently.

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

The topics examined are generally introduced from undergraduate level, and are pervasive throughout the syllabus. Candidates therefore performed well in the two net present value section of the paper, parts (a) and (d)(i). These calculations were considered to be relatively straightforward, and definitely the easier parts of the question.

Candidates also performed well on the disadvantages of the sources of finance. The markplan was relatively more generous on this required, having slightly more than double available marks when compared to maximum.

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

*Part (a)*

Candidates generally performed well in this section on obtaining the cash flows and discounting these. Many candidates however missed the tax aspects, including the timing of the tax cash flows.

*Part (b)*

In part (b) candidates either did not provide sufficient points to earn the 8 marks available, or expressed themselves poorly in explaining the points identified, often providing generic points which were not applied to the scenario.

*Part (c)*

Candidates generally performed better in part (c), but often provided generic points, not applying these to the scenario, or not realising that based on the information given, that a certain form of finance was either not appropriate or was applied incorrectly. In some cases candidates also provided advantages of the instruments, while only disadvantages were required.

*Part (d)*

Candidates performed poorly in part (d)(ii). This was a more difficult discussion area, and required candidates to question the assumptions used in the net present value, requiring them to display more insight and understanding of
what drives the net present value. Candidates did not seem to look into what the numbers meant, or whether they were reasonable, and therefore did not challenge the assumptions effectively.

Part (e)

Candidates were required to find mitigating factors to address given risks. This was considered to be challenging for candidates, requiring them to show insight into how to address risks, rather than just identifying them. Although the marks were lower for this section, candidates performed relatively better in this discussion section.

QUESTION 1 PART II

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<th>Marks &gt; 50% (pass)</th>
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1. What general areas the question covered

Part (f)

Classification of specific transactions in the statement of cash flows (IAS 7). Candidates were required to discuss and conclude on the appropriate classification of an expense, intangible asset and the issuance of debentures in the statement of cash flows.

Part (g)

A compound financial instrument with related transaction costs (IAS 32 / IFRS 9), including deferred and current tax implications (IAS 12). Candidates were required to prepare all the journal entries, including journal entries relating to current and deferred tax, to correctly account for convertible debentures issued.

Part (h)

An intangible asset including amortisation (IAS 38) and an impairment loss (IAS 36) together with related deferred tax implications (IAS 12). Candidates were required to prepare all adjusting journal entries, including the related deferred tax implications, required to correctly account for an intangible asset for which an amortisation expense and an impairment loss were not recorded.

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

Part (f)

- Some candidates discussed the classification of the transactions in terms of the Conceptual Framework (i.e. the classification as an expense, asset or liability) as opposed to discussing the correct classification in the statement of cash flow in terms of IAS 7 (i.e. classification as an operating, investing or financing activity). Consequently, these candidates did not get any marks for their discussion. Candidates should read the required carefully.
- Candidates had to write logical, full sentences to earn the clarity of expression mark. Some candidates wrote incoherently and as a result the clarity of expression mark was not rewarded. Refer to SAICA’s ‘Guidelines for candidates relating to the assessment of communication skills in the initial test of competence’ which lists the linguistic features for ‘clarity of expression’.
Part (g)

- Many candidates did not identify that the issue of the debentures was a compound financial instrument with a financial liability as well as an equity component.
- Many candidates expensed the transaction costs in respect of the convertible debentures, instead of allocating it to the financial liability as well as the equity component. These candidates did not do a second PV calculation to calculate a new effective interest rate (i.e. after deducing transaction costs allocated to the liability, from the PV of the ‘original’ liability component).

Part (h)

- Many candidates did not identify the impairment indicators in the reading part and consequently did not calculate a recoverable amount for the intangible asset.
- A number of candidates did not provide journal narrations for part (g) and (h).

3. Common mistakes made by candidates

Part (g)

- Many candidates expensed the transaction costs incurred to issue the debentures, instead of allocating the transaction cost to the financial liability as well as the equity component.
- Candidates often got the direction of their deferred tax and current tax journals wrong.
- Candidates wasted a lot of time by writing a deferred tax journal for each transaction instead of one deferred tax journal to account for the total movement in deferred tax for the year.
- Candidates wasted a lot of time by writing journal entries which were not required, for example, four interest journals (a journal for each three-month period) and four deferred tax journals up to 31 December. The entity had a 30 June year end and journal entries for the period 1 July to 31 December were not required.

Part (h)

- Candidates included 2017 in their projected NPV calculation.
- Candidates often got the direction of their deferred tax journals wrong.
- Candidates wasted a lot of time by writing a deferred tax journal for each transaction instead of one deferred tax journal to account for the total movement in deferred tax for the year.

4. Areas that the candidates handled well

- Candidates mostly correctly identified the appropriate classification of the specific items in the statement of cash flows.
- Candidates generally provided reasonable journal entries in part (h) despite not doing an NPV calculation.

5. Specific comments on sections of the question

Part (f)

In this section, candidates had to discuss under which classification an expense, intangible asset and convertible debentures had to be presented in the statement of cash flows.

Candidates who performed well in this section were those who concluded on the correct cash flow activity, supported by a valid argument in this regard.
Although most candidates came to the correct conclusions, i.e. operating, investing or financing activity, supporting arguments were not always valid / logical and often insufficient.

SAICA’s ‘Guidelines for candidates relating to the assessment of communication skills in the initial test of competence’ lists the linguistic features for ‘clarity of expression’ as the use of well-structured sentences and technical and sub-technical vocabulary. Many candidates had very brief discussions and did not use well-structured sentences to formulate their answers, thereby losing out on the communication skills mark.

Part (g)

In this section, candidates were required to prepare all the journal entries to correctly account for convertible debentures issued. In addition, candidates were also required to prepare journal entries for the related current and deferred tax implications. Candidates mostly struggled with the deferred and current tax calculations and journals.

Candidates who performed well in this section were those who:
• Provided journal entries to account for both the liability and equity component of the compound instrument.
• Allocated the transaction cost to both the liability and equity components.
• Attempted the deferred and current tax.

Candidates struggled with the following:
• Many candidates included a separate deferred tax journal and calculation after each journal entry (i.e. after accounting for the transaction costs, after each coupon payment, etc.) It would have been more effective to use the statement of financial position approach to calculate the net deferred tax liability and only journalise the total movement in deferred tax for the year by means of a single journal entry.
• Candidates expensed the transaction costs to profit or loss, instead of allocating the transaction costs to the liability and equity components of the compound financial instrument.
• Only a few candidates included journal entries and/or calculations for the current tax implications.
• Very view candidates calculated an effective interest rate for tax purposes and a new effective interest rate on the liability component (after taking transaction costs into account). Finance cost for accounting purposes was then recognised based on the original effective interest rate.
• Most candidates struggled with the initial PV calculation, mostly getting the input relating to the interest payments wrong, (i.e. many candidates did not take the quarterly interest payments into account, but only included an annual interest payment in the PV calculation).
• Quite a number of candidates included journal entries up to 31 December 2017 while the question only required journal entries for FY2017, i.e. up to 30 June 2017.

Part (h)

In this section, candidates had to prepare all adjusting journal entries, including the related deferred tax implications, required to correctly account for an intangible asset for which an amortisation expense and an impairment loss were not recorded

Candidates who performed well in this section were those who:
• Did a NPV calculation to calculate the value in use for the broadcasting rights.
• Compared their NPV with the carrying amount of the intangible asset after deducting amortisation for six months.
Candidates struggled with the following:

- Many candidates did not include an impairment loss calculation and for that reason, did not perform well in this subsection. Some of the candidates who did calculate a recoverable amount for the broadcasting rights calculated a PV (not a NPV).
- Quite a number of candidates included 2017 amounts in their value in use calculation and got a value in use amount in excess of the carrying amount, for which they still recognised an impairment loss or treated the excess as a revaluation through OCI.
- Many candidates included a separate deferred tax journal and calculation after each journal entry as mentioned in part (g) above, for example, they would include a deferred tax journal after recording the amortisation and again after recording the impairment loss. This wasted a lot of time.

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) With reference to its Fleet Management Solutions System (FMSS) database —
   (i) a description of the business continuity risks to which a company is exposed with regard to the integrated nature of the FMSS and because it is partly operated in the cloud; and
   (ii) an identification of the application controls that ensure that the processing of information with regard to the client contracts is valid and complete.

(b) A description of the substantive audit procedures to be performed to verify the valuation of the 'net investment in the leases' balance as at 30 September 2017 in the accounting records of the company. Candidates —
   - had to exclude substantive audit procedures regarding the recognition, initial measurement or classification of the net investment in the leases;
   - were informed that they could rely on the completeness, validity and accuracy of the lease data initially loaded onto the FMSS (i.e. that used to generate the lease contracts); and
   - could ignore the effects of the lease contract with another company as described in one of the workpapers.

(c) A description of the tests of controls to be performed on the system of preventative maintenance on the FMSS. Candidates could rely on the general computer controls.

(d) A discussion, with reference to the SAICA Code of Professional Conduct, of —
   (i) the ethical conduct of a trainee accountant regarding his interactions with the tax accountant of the company; and
   (ii) the ethical implications arising from a partner’s attendance of a golf event.

**Question 1 Part II**

(e) A discussion, supported with calculations where necessary, of the following with respect to the contract entered into between the original company with a second one:
   (i) The VAT implications for the second company as a result of a lease agreement for the July and August 2016 VAT periods; and
   (ii) The income tax implications for the second company arising for the 2017 year of assessment. Candidates had to provide reasons where no tax implications arose.

(f) A discussion of the accounting treatment of the contract with the original company in the statement of financial position of the second company for the reporting period ended 30 June 2017 in terms of International Financial Reporting Standards. Candidates had to limit their discussion to —
   (i) IFRS 16 *Leases* (on the assumption that the second company has early adopted IFRS 16); and
   (ii) IAS 12 *Income Taxes*.
Candidates had to –
• include all relevant calculations;
• round all amounts to the nearest rand;
• assume all amounts were material; and
• ignore current tax.

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

**QUESTION 1 PART I**

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<th>Marks &gt; 50% (Pass)</th>
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<tr>
<td>39</td>
<td>26.68</td>
<td>378 (36,13%)</td>
<td>668 (63,86%)</td>
</tr>
</tbody>
</table>

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

*Part (a)(i)* Describing business continuity risks due to the integrated nature of a computer system and also due to using cloud computing.

*Part (a)(ii)* Identifying processing application controls to address completeness and validity given in an automated/manual system.

*Part (b)* Substantive audit procedures on the ‘net investment in leases’ balance in a computer environment.

*Part (c)* A description of test of controls for key controls in an automated/manual maintenance system.

*Part (d)* A discussion of the ethical conduct of a trainee accountant; and a discussion of the ethical implication of an engagement partner accepting gifts and hospitality.

**General**

The auditing part formed 58 marks of a 100 mark question, with financial reporting and taxation. The auditing part covered business continuity risks, application controls in a computerised environment, substantive procedures on IFRS16 and IFRS9; test of controls on a maintenance system; ethical conduct of a trainee accountant and ethical implications for an engagement partner.

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

*Part (a)* Candidates did not always use (or referred) to the information in the background information and based their answers on the facts of the scenario.

*Part (b)* Candidates did not write enough for the required amount of marks.

*Part (c)* Some candidates recommended controls when test of controls has been asked for. This indicates that candidates do not read their required properly. Candidates supplying answers for areas that were specifically excluded from the required.

*Part (d)* Overall, it seems although there may be a general lack of knowledge of controls, key controls and test of controls.

3. **Common mistakes made by candidates**

*Part (a)* As stated above, candidates did not always apply the information of the scenario in the answering of the required. Some candidates often did a memory dump of theory that was not related to the information.

*Part (b)* It seems candidates did not apply good time management in answering the question.
4. Areas that the candidates handled well

**Part (a)**  Part (a)(i) of the business continuity risks and part (d) on the professional ethics have been handled well by candidates.

**Part (b)**  Overall candidates attempted all sections of this part of the question.

5. Specific comments on sections of the question

**Part (a)(i)**

Describing business continuity risks due to the integrated nature of a computer system and also due to using cloud computing.

- Candidates did fairly well here but did not write enough.
- Some candidates provided general IT related risks without linking it to business continuity risks.
- Students only listed risks without indicating what the effect will be.

**Part (a)(ii)**

Identifying processing application controls to address completeness and validity given in an automated/manual system.

- Most candidates did not get the communication skills mark since their answers did not differentiate between the application controls for completeness and for validity.
- Some candidates that made recommendations did not apply the information (fields given in the information) in the scenario to their answers and only did a theory dump without applying to the background information. Some candidates struggle to identify any controls.
- Candidates recommended controls which are already within the system.

**Part (b)**

Substantive audit procedures on the ‘net investment in leases’ balance in a computer environment.

- Even though candidates should have been able to pass this question based on ‘general audit procedures’, it did seem that candidates lack some accounting knowledge and/or are not able to answer integrated questions.
- Poor formulation of substantive procedures and only focussing on auditing the initial recognition of one contract and not the balance. Most candidates did not consider the impairment of the net investment in the lease.
- Candidates did not read the required carefully and included procedures that were not necessary. Candidates formulated audit procedures for initial recognition which were excluded from the required.
- Candidates focused on the procedures from the lessee’s perspective not the lessor’s as they referred to procedures with regards to the leased asset and liability. Some candidates also focused on audit procedures on property, plant and equipment.

**Part (c)**

A description of test of controls for key controls in an automated/manual maintenance system.

- This part was answered very poorly.
- Candidates struggle to identify controls that are relevant to the audit (key controls) and then wasted time to formulate tests of controls to audit the process (business controls) and not the controls as the question stated you are the auditor.
- Poor formulation of test of controls. Candidates also used the verb ‘Observe’ when describing the key control tests. This is not possible due to the fact that the system in the scenario was highly automated. In addition the observation occurred after year end, not during the financial year. The audit evidence needs to be obtained
during the financial year and observation would not provide the evidence required. This indicates a clear lack of understanding with regards to key controls.

Part (d)

A discussion of the ethical conduct of a trainee accountant; and a discussion of the ethical implications of an engagement partner accepting gifts and hospitality.

- Most candidates only identified the conduct that related to confidentiality and did not identify the other issues relating to the trainee’s conduct. Candidates identify one issue and then try to write enough for the allocated marks on that specific issue without identifying and discussing other ethical conduct and repeating the same point.
- The candidates that wrote enough for part d(ii) did fairly well as they were able to identify the implications.
- Some candidates do not discuss and only rewrite the Code of Professional Conduct.
- Candidates focused on the fact that the event was for charity and could consequently be attended without taking the Code of Professional Conduct into account.
- Candidates discussed Reportable Irregularities although this is not within the Code of Professional Conduct Scope or relevant.

QUESTION I PART II

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1. What general areas the question covered

Part (e)(i): Discussion on the VAT implications of a lease contract from the lessee’s perspective

- Part (e)(i) required of candidates to discuss the VAT implications for AHire (lessee) as a result of the lease agreement for the July and August 2016 VAT periods.
- The principles tested were standard principles that candidates should have been comfortable with.
- Candidates in general answered this part of the question poorly due to a lack of the ability to identify that the transaction is an ‘instalment credit agreement’.

Part (e)(ii): Discussion on the income tax implications of a lease contract from the lessee’s perspective

- This part required a discussion on the income tax implications of a lease contract from the lessee’s perspective.
- The question integrated VAT principles with various sections in the income tax act, such as s11(a), s23C, s11(d) and s24J.
- Although this discussion was relatively easy and followed from the conclusion in part (e)(i), candidates did not perform well in this question due to a lack of identifying the applicable income tax sections as well as due to the fact that candidates contradicted themselves.

Part (f)(i): Discussion on the accounting treatment of a lease contract from the lessee’s perspective

- Part (f)(i) required of candidates to discuss the accounting treatment of a lease contract from AHire’s (the lessee) perspective.
- The latter required of candidates to consider each element of the accounting treatment process (excluding presentation and disclosure requirements) which includes:
– Identification of whether the contract contains a lease;
– Initial classification and recognition;
– Initial measurement; and
– Subsequent measurement.

• Overall, candidates performed slightly better in this section, although not particularly well.

**Part (f)(ii): Discussion on the accounting treatment of the deferred tax implications of a lease contract from the lessee’s perspective**

• This part required of candidates to discuss the accounting treatment of the deferred tax implications of a lease contract from AHire’s (the lessee) perspective.
• The latter would result in candidates having to discuss each element of the deferred tax calculation i.e. carrying amount, tax base, tax rate, recognition as a deferred tax asset / liability and any limitations to the recognition if a deferred tax asset arises.
• Overall, candidates very seldom attempted this section and if attempted, mainly calculations were provided, not supported by a discussion.

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

• Most candidates cannot write a logical argument and make a proper conclusion: e.g. candidates were not coming to a conclusion of whether the lease was an ‘instalment credit agreement’ or a rental agreement.
• The same applies to some candidates who ‘dived’ in to discussing the lease accounting without first determining if the contract contains a lease agreement, in terms of IFRS 16 Leases, or not.
• It was also clear that candidates are comfortable with performing calculations but struggle to explain the results / impact of their calculations, in a discussion (using the principles from IFRS and the VAT or Income tax Act(s)).
• It appears that the majority of the candidates do not have the proper exam technique in attempting discussion questions, as most are quick to get to the conclusion and end up losing all the discussion marks leading to the conclusion.
• Most candidates had contradicting statements: e.g. concluding that the contract is an ‘instalment credit agreement’, but then going on to say VAT will be claimed on each payment as payments are made for income tax purposes.
• The deferred tax discussion was seldomly attempted or just included calculations.

3. **Common mistakes made by candidates**

**Part (e)(i)**

• A fair number of candidates simply regurgitated requirements for an ‘instalment credit agreement’ from the VAT Act without applying the information provided in the scenario.
• A number of candidates would identify the relevant issues to discuss and apply the information provided in the scenario without concluding whether the contract is an ‘instalment credit agreement’.
• Some candidates just made a conclusion in respect of ‘instalment credit / rental agreement’ without a discussion to support their conclusion.
• A number of candidates got confused whether VAT is included or excluded: e.g. in comparing cash value to total amount payable as well as the value of the supply.
• Some candidates discussed the requirements for an ‘instalment sale agreement’ instead of an ‘instalment credit agreement’. Candidates did not appear to know the difference between the two.
• Some candidates contradicted themselves by stating that input VAT is denied but still continued to calculate input VAT that should be claimed by AHire.
• A lot of candidates did not make the link that even though input VAT is denied on motor vehicles, the fact that AHire acquired the vehicles to make taxable supplies under an ‘instalment credit agreement’, AHire can claim the VAT input.
• Candidates lost marks by not discussing whether the input VAT for repairs and maintenance and insurance can be claimed.

Part (e)(ii)

• In some instances, candidates failed to display the interaction between VAT and Income Tax in a leasing scenario: e.g. candidates will identify that the agreement is an ‘instalment credit agreement’ (part (e)(i)), but then applied the incorrect VAT treatment in the income tax calculation.
• A number of candidates discussed the deferred tax implications in this section, which was only required in part (f)(ii).
• There were instances where candidates discussed the tax treatment from the lessor’s perspective, the question clearly required the tax treatment for the lessee.
• Some candidates got confused in respect of the deduction of interest as they were unsure of the treatment of leases’ interest in terms of s24J.
• Some candidates did not know how to treat the claimed input VAT when lease payments are deducted (to exclude VAT).
• Candidates also forgot to mention the applicable Income Tax section (s11(a)), or to provide a reason, i.e. in the production of income, when concluding that lease payments are deductible.
• Some candidates didn’t support their discussion of the deduction of lease payments with the applicable calculation (to exclude VAT portion).
• Some candidates stated that repairs and maintenance are deductible under s11(a), this is incorrect. Repairs and maintenance are deductible under s11(d), special deductions take preference over the general deduction formula.
• Some candidates did not read the required properly as they discussed the income tax implications for CLease (the lessor) and not AHire (the lessee) as required.
• Most of the candidates who correctly concluded in part e(i) that the agreement between AHire and CLease was an ‘instalment credit agreement’ did not exclude from the lease payments an amount which bears to the input VAT the same ratio as such rental payment bears to the sum of all rental payments (i.e. did not exclude VAT in the correct ratio).

Part (f)(i)

• There were instances where candidates discussed the accounting treatment from the lessor’s point of view, the question clearly required the accounting treatment for the lessee.
• Several candidates applied IAS 17 Leases in discussing the recognition and measurement requirements when answering this question.
• A number of candidates did not identify that the right-of-use asset is initially measured at cost, which comprises the initial measurement of the lease liability.
• Some candidates didn’t firstly discuss whether the contact contains a lease in terms of IFRS 16 Leases and started answering section from the recognition and measurement criteria.
• Some candidates discussed ‘presentation and disclosure’, which was not required.
• A number of candidates struggled to calculate the present value of the liability correctly. They mixed annual inputs with monthly inputs.
• Some candidates just stated the theoretical principles without correctly applying it to the scenario given.
**Part (f)(ii)**

- Part (f)(ii) of the required asked candidates to discuss (supported with calculations) the deferred tax implications. Contrary to the required, most candidates only provided a calculation if they attempted the section.
- There were instances where candidates discussed the accounting treatment from the lessor’s point of view, the question clearly required the accounting treatment for the lessee.
- A fair number of candidates did not conclude whether a deferred tax asset arose due to the recognition of the right-of-use asset and lease liability. Candidates would calculate and/or discuss the individual components without considering the 'net effect'.
- Some candidates mixed the SOFP and SOCI approach in calculating deferred tax.
- Some candidates only discussed or calculated one item (either lease liability or the right-of-use asset) of the lease transaction and did not discuss the other leg (asset/liability).
- Some candidates did discuss that the tax base of the right-of-use asset is zero but did not provide a reason.
- Candidates in general did not calculate the tax base of the lease liability correctly.
- Majority of candidates did not attempt this section.

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

None of the sections were handled particularly well. The candidates did however perform better in Part (f)(i).

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

**Part (e)(i)**

- The candidates that identified that they need to consider whether the lease agreement is an 'instalment credit agreement' performed better in this section.
- Despite the latter, this section was poorly answered and lacked application from the information in the scenario.
- Numerous contradicting statements were found within this section specifically, which resulted in candidates losing a number of marks.

**Part (e)(ii)**

Although a fairly easy question, it was clear that candidates were not as comfortable with the income tax implications of an 'instalment credit agreement'.

**Part (f)(i)**

- If candidates did consider whether the lease agreement contains a lease in terms of IFRS 16 Leases they performed better in this section.
- Overall, a lack of application of the information in the scenario resulted in candidates failing to obtain marks.

**Part (f)(ii)**

As mentioned previously, this section was very seldom attempted by candidates.
PROFESSIONAL PAPER 3

Paper 3 consisted of an integrated question with two parts that dealt with the following aspects:

Question 1 Part I
(a) A calculation of the corrected consolidated profit before tax for a group of companies for FY2017. Candidates had to –
   - begin their calculations with the consolidated profit before tax of that had been given in the scenario; and
   - round all amounts to the nearest ZAR.
(b) A preparation of the tax reconciliation note to the consolidated financial statements of the group for FY2017, as required in terms of IAS 12 Income Taxes, par. 81(c)(i). Candidates had to –
   - assume, for purposes of this required only (thus independent of required (a)), that the corrected consolidated profit before tax after all adjustments was ZAR1 million;
   - round all amounts to the nearest ZAR; and
   - not calculate the final consolidated tax expense.

Question 1 Part II
(c) An identification of and discussion on the key factors that the management of a company should consider in evaluating in which African market(s) (South Africa, Kenya, Zambia) it should sell its product.
(d) Preparation of a memorandum addressed to the Risk Committee of the group setting out the key business risks for the group arising from its strategy to operate in greater Africa.
(e) A discussion of the alternative courses of action that could be taken by the Board of Directors to address the liquidity issues that the group is facing.
(f) A discussion of the advantages to the quality of the external audit that should be considered if it is decided to change auditors as requested by the non-executive directors of the group.
(g) Provision of a list the substantive audit procedures that the auditors should perform to address the following key audit matters:
   (i) Accuracy, valuation and allocation of the deferred tax asset on the tax loss of a subsidiary of the group; and
   (ii) The fair value of a company’s properties included in assets held for sale.

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

QUESTION 1 PART 1

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
</tr>
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<tbody>
<tr>
<td>32</td>
<td>20.22</td>
<td>668 (63.86%)</td>
<td>378 (36.13%)</td>
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</table>

1. What general areas the question covered

This question was an integrated scenario between financial accounting and auditing and strategy, risk management and governance. The first part to which these comments relate was financial accounting. The financial accounting part specifically dealt with:

Part (a): Calculation

Candidates were required to calculate the corrected consolidated profit before tax after a preliminary consolidated
profit before tax of R1 960 264 was provided, which did not include any necessary adjustments in terms of the matters listed in the question to correctly account for the items (26 marks in total).

**Part (b): Calculation**

Candidates were required to prepare the tax reconciliation note as is required in terms of IAS 12 *Income Taxes*, paragraph 81(c)(i). A communication skills mark was awarded for presentation (11 marks in total).

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

Some candidates did not follow a logical response to the adjustments. Their workings were not logically set out. Candidates need to improve on the way they show, label and cross reference their workings. Some calculations were really hard to follow or understand.

3. **Common mistakes made by candidates**

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

Firstly, a key aspect was that the necessary adjustments had to be identified. This meant that candidates needed to continually assess and go through a thinking process which involved:

Example: Note 1.4.1 *Investment Property*

- What had been done? The scenario stated that the land was accounted for at year-end. Therefore, fair value adjustments have already been processed.
- If something has been done, was it correct/complete? The scenario stated that the land was correctly accounted for. Therefore, no further adjustments were necessary.

Secondly, candidates should have analysed and interpreted the information for both part (a) and part (b) simultaneously. Using the investment property example, candidates should have identified that a permanent difference exists on the fair value adjustment relevant for part (b).

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

**Part (a)**

In this section, candidates were required to calculate the corrected consolidated profit before tax after a preliminary consolidated profit before tax of R1 960 264 was provided, which did not include any necessary adjustments in terms of the matters listed in the question to correctly account for the items.

Candidates who performed well in this section were those who adopted a logical approach to their responses and had dealt with enough of the issues.

Candidates made the following errors or omissions:

- Candidates missed some of the easy marks, for example, simply adding up the consolidated profit before tax number and answering the question.
- Candidates made adjustment for the fair value of the investment property. However, this was not a necessary adjustment as the scenario indicated that the investment property was correctly accounted for at year end.
- Candidates treated the realisation of the hedging reserve to profit or loss poorly.
• A number of candidates used the coupon payment on the bonds as their interest income. This displays a lack of understanding of effective interest.
• Candidates recognised the balance of the expected credit loss in profit or loss and not the movement. Only the top-up/movement in FY2017 was to be adjusted against profit. Further candidates recognised lifetime expected credit losses (3.6%) and not 12-month expected credit losses. Although the scenario stated that the ‘bonds was not considered as low credit risk’, this does not mean that it automatically implies that there is a significant increase in credit risk and therefore stage 2. The concept of low credit risk is referred to in IFRS 9, paragraph B5.5.22. Further, IFRS9.B5.5.24 states that ‘lifetime expected credit losses are not recognised on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date… An entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognised…”
• A number of candidates made mistakes which may be associated with a lack of attention to detail when reading, such as they compared the given NRV per unit of R7 000 per item to the total cost of R366 000.

Part (b)

In this section, candidates were required to prepare the tax reconciliation note as is required in terms of IAS 12 Income Taxes, paragraph 81(c)(i). A communication skills mark was awarded for presentation.

Candidates answered this section very poorly. Candidates made the following errors or omissions:
• Candidates made adjustments in the wrong direction – therefore deducting from tax on accounting profit for non-deductible expenditure, when this should be added back to tax on accounting profit as it increases the tax expense.
• Did not adjust for the non-taxable capital portion of the fair value adjustment of the investment property, or made an adjustment, but multiplied by 80% (taxable portion) instead of 20% (non-taxable portion).
• Did not adjust for the historic depreciation on the head office building.
• Some candidates had other comprehensive items in the tax rate recon. These should not be in the tax rate recon.

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>
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</thead>
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<tr>
<td>52</td>
<td>32.65</td>
<td>585 (56.03%)</td>
<td>461 (44.07%)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

Part II of the question dealing with auditing, and business risk and strategy of 63 marks formed part of an integrated 100 mark question, with corporate governance and strategy. The 63 marks covered the following:

(c) Factors to consider regarding which African markets to invest in (15 marks)
(d) Key business risk form strategy to operate in Africa (14 marks)
(e) Alternative courses to fund liquidity problem (7 marks)
(f) Impact of audit changes on quality of audit (7 marks)
(g) Substantive audit procedures
   (i) Deferred tax asset (9 marks)
   (ii) Fair values of properties (9 marks)

Presentation on part (g) (2 marks)
2. In what respect candidates' answers are considered to fall short of requirements.

Candidates did not always consider the information of the question and accordingly failed to base their answers on the facts of the scenario.

As in prior examinations, examination technique remains a problem with candidates often making mere statements, or rewriting the information of the scenario, instead of applying themselves to the information at hand and describing the considerations, risks, procedures, etc.

3. Common mistakes made by candidates

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

4. Areas that the candidates handled well

Candidates overall handled all sections reasonably well, but struggled in the part f) dealing with the advantages to audit quality when changing auditors.

Candidates also clearly ran out of time towards the end of the question and did not properly apply themselves to part g) dealing with the substantive procedures section. This is again indicative of a lack of proper examination technique.

5. Specific comments on sections of the question

Part (c)

Candidates did not always focused on answering what was required, namely to identify and discuss the key factors to consider in which of the three countries of South Africa, namely Kenia, or Zambia to sell the iDish product.

Candidates faired reasonably well in this section and wrote a sufficient amount for the number of marks to be earned. Many candidates, did however, not make their responses specific enough for each country to be considered and provided answers that were very generalised. Some candidates also did not use the information provided in the scenario, and gave responses outside of what was given to in the scenario.

Parts (c) and (d) were marked interchangeably as some candidates wrote risks (relevant to part (d)) under the considerations in part (c) and vice versa.

Part (d)

In many instances, candidates identified several risk indicators but did not describe the risks appropriately (i.e. the impact that risk has on the entity).

Part (e)

This part was reasonably answered. Many candidates, however, did not provide enough points for the marks required.

Part (f)

Candidates did not perform as well in this section as in other parts of the question.
There was evidence in many of the responses that the candidates did not fully understand the requirement of the question and applied their mind thereto.

Most candidates identified the familiarity threat, but often very little after that.

Part (g)(i)

It was noted that in some of the responses that candidates began to run out of time as some of these responses were very short for the available marks.

Candidates did struggle with differentiating between the deferred tax asset and the taxation calculation and therefore their responses were focused on the incorrect balance.

Candidates also did not identify that there was only one amount on the schedule and therefore provided irrelevant audit procedures regarding selecting samples etc.

Part (g)(ii)

Some of the candidates did not identify that the company had appointed an expert and that they had to do procedures as per ISA 500 to substantiate reliance on the experts work.

Where candidates did recognised the management expert, they identified the procedures to be performed but lacked in describing the procedures adequately and therefore lost marks.

PROFESSIONAL PAPER 4

This question consisted of two separate questions, as follows:

Question 1

(a) Advice to a person on whether the interest expense incurred by her on her mortgage bond would be deductible in the determination of her 2017 taxable income. Candidates had to refer to case law where applicable.

(b) A discussion of the possible normal income tax consequences, if any, for marketing assistants on flats sold to them by the company during the 2017 year of assessment.

(c) A discussion of the normal income tax implications for a person in terms of a temporary employment agreement with the company for the marketing of shoes in Brazil for the 2017 year of assessment.

(d) A calculation of the amounts that would qualify to be claimed as input tax in the company’s VAT return relating to a person’s trip to Durban in February 2017. Candidates had to provide reasons for any amounts not included in their calculations.

(e) An Identification and correction of the errors in an assessment that was issued to a person for the 2017 year of assessment.

(f) A calculation of the amounts to be included in a person’s gross income for the 2017 year of assessment. Candidates had to provide reasons for any amounts not included in their calculations.

Question 2

(a) A completion of a cost allocation for a report to the International Civil Aviation Organisation, by allocating the costs to two flight divisions for FY2017.

(b) A critical discussion of the allocation bases used to allocate the operating expenses between the two divisions.

(c) A discussion of the factors that demonstrate that one of the divisions could have a competitive advantage in the low-cost airline market.

(d) The provision of an explanation for the over/(under) allocation or recovery of the fixed overheads in response to
a query by a new member of the financial management team.

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

QUESTION 1

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<td>43</td>
<td>26.14</td>
<td>645 (61.78%)</td>
<td>401 (38.34%)</td>
</tr>
</tbody>
</table>

1. What general areas the question covered

Part (a)

Part (a) required candidates to advise Nomzamo on whether the interest expense incurred by her on her mortgage bond would be deductible in the determination of her 2017 taxable income. The loan to Uhuru was obtained by increasing the mortgage bond on Nomzamo’s private residence and the amount was directly deposited into the company’s (Uhuru) bank account. As a result, the loan partly financed the taxpayer’s personal residence (bond) and partly financed a loan advanced to a company as part of a business rescue plan. The mortgage bond was subject to interest payable to the bank at prime less 1.5%, while interest was charged at prime on the loan advanced to the company.

Candidates were specifically required to refer to case law principles (where applicable) as part of their advice to be provided. The question covered the consideration of the following sections: s 23B, s 24J(2) and s 23(b) of the Income Tax Act and s 102 of the Tax Administration Act, and various case law principles.

Part (b)

Part (b) required a discussion of the possible normal income tax consequences, if any, for the marketing assistants (employees) on the flats sold to them by Uhuru (company) during the 2017 year of assessment. The candidates had to address acquisition of an asset (flat) from an employer by the employees a consideration that below the asset’s market value. This would constitute a taxable benefit on terms of the Seventh Schedule of the Income Tax Act. As the asset (a flat) constituted immovable property, candidates had to consider the additional provisions of paragraph 5(3A) of the Seventh Schedule to test if the requirements were met in order for ‘no value being placed on such a benefit’ to apply.

Part (c)

This part required a discussion of the income tax implications of an employee (south African resident) appointed by a resident company in terms of a temporary agreement to render services outside of the Republic (in Brazil). This question required of candidates to identify and apply relevant articles of the Double Taxation Agreement (DTA) between South African and Brazil of which an extract of the DTA was provided to candidates as part of the question.

Part (d)

This part required a calculation of the amounts that would be allowed to be claimed as input tax in an employer’s VAT return in respect of expenditure incurred to send an employee away from its usual pace of residence in the Republic (Durban) to perform her duties in rendering services. This part of the required covered input tax principles in respect of: Domestic flight transport (standard rated supply); a subsistence allowance (money not a supply of goods/services); restaurant bills for employee (input tax allowed, in terms of an exception to entertainment) and for clients
(entertainment, input tax denied) and domestic transport by road (exempt supply). Candidates were required to provide reasons where input tax could not be claimed.

Part (e)

This part required of candidates to identify and correct errors made on an income tax assessment issued by SARS to a Siphokazi (natural person). The question also covered the taxability of retirement lump sum benefits and the application of the section 6A medical expense credit and the section 6B additional medical expenditure credit.

Part (f)

Part (f) required a calculation of amounts to be included in the gross income of a natural person for the 2017 year of assessment. The question covered the receipt/accrual of salary (s 1, Gross income, par (c)); variable remuneration (s 7B); the right of use of assets (fringe benefits, par 6 of the Seventh Schedule); the right of use of a vehicle (par 7 of the Seventh Schedule); and retirement annuity contributions paid by the employer on behalf of the employee (par 12D of the Seventh Schedule). Candidates were required to provide reasons where amounts were not included in their calculations of gross income.

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

Part (a)

Part (a) required a discussion on the deductibility of the interest incurred by Nomzamo on the mortgage loan. Many candidates did not correctly identify that s 24J is the specific provision regulating the deductibility of interest expense from income/taxable income.

Majority of the candidates discussed the deductibility of interest expense only in the context of the general deduction formula (s 11(a)) without any reference to s 24J. Several candidates did identify that s 24J would apply but continued with a discussion of s 11(a) deduction.

Candidates did not apply the case law principles of in the ‘production of income’ to the facts in the scenario and some who did, did so incorrectly. Very few candidates were able to separate the interest incurred on the private home loan from the extra interest incurred to facilitate the provision of a loan to Uhuru (which will produce income for the individual).

Some candidates just provided a discussion without applying the information in the question to the requirements of the relevant section in the Act and the relevant court case principles, or without clearly concluding on their discussion or contradicted themselves.

Some candidates discussed the interest received from the company as well, but the required only asked for the deductibility of interest incurred.

Part (b)

This part required a discussion of the possible normal income tax consequences for the marketing assistants (employees) on the flats sold to them by Uhuru (company).

Candidates had to identify the taxable benefit in terms of the Seventh Schedule of the Income Tax Act and that the value to be placed on the benefit. Candidates did not state the basic requirements of the fringe benefit but went straight to nil value provisions.
The question had two distinct parts; within the first part, some candidates struggled to differentiate between market value and cost. Candidates did not mention that the taxable benefit needed to be included in gross income. For the requirements of par 5(3A) in respect of if a nil value (second part) will apply, many candidates answered that remuneration and the market value needed to exceed the thresholds, thus applying and concluding in the opposite manner to the legislation.

**Part (c)**

Candidates had to discuss the income tax implications of an employee appointed in terms of a temporary agreement to render services outside of the Republic for an resident employer company. Candidates did not identify that the taxpayer is an employee even though temporarily employed and thus article 15 of the Double Tax Agreement (DTA) in respect of employment should be applied. Some candidates applied article 14 instead of article 15 of the DTA.

**Part (d)**

Candidates had to calculate the amounts that would be allowed to be claimed as input tax in an employer’s VAT return in respect of expenditure incurred to send an employee away from its usual pace of residence in the Republic (Durban) to perform her duties in rendering services.

Candidates discussed and calculated the VAT on the Brazil trip as well, even though the required was specific on the Durban trip.

Candidates would often miss the distinction between local and international flights, as well as the distinction between something being zero rated as opposed to exempt. VAT terminology needs to be accurate. No marks can be awarded if a candidates states ‘input cannot be claimed’ as such a statement in essence do not provide a reason for the application of legislation.

**Part (e)**

Candidates needed to identify and correct errors made on an income tax assessment issued by SARS to Siphokazi (natural person). Many candidates focused on only a singular aspect of errors in this question, by either focusing on the retirement lump sum errors or the medical rebates. As such, few candidates presented a complete analytical answer.

Candidates seem not to be comfortable with an IT34 assessment and defaulted to re-doing the full tax computation.

**Part (f)**

Candidates needed to calculate the amounts to be included in the gross income of a natural person. The salary, commission and retirement fringe benefit were dealt with quite well, the deficiencies of candidates were mainly found in not identifying that if an item is to be granted for the majority of its useful life (the cell phone) the full value is included in gross income in that year.

Additionally, the question did not mention a maintenance plan for the motor vehicle, and as such, no assumptions in this regard must be made. A few candidates treated the company car as a lease, even though the question stated otherwise.
3. Common mistakes made by candidates

Part (a)

Candidates made to following common mistakes:

- The question required candidates to discuss the deductibility of the interest incurred. Most candidates immediately started their discussion with s11(a) requirements regarding the interest incurred instead of discussing specific section 24J and lost on a few marks in this question.
- Most candidates do not understand that s 24J is a specific charging section. Candidates discussed s 24J as though it is an alternative to section 11(a), the general deduction formula.
- Court case principles were not discussed or applied. Some candidates only mentioned case law without applying the principles of the court case to the information in the question. Mark are only awarded for principle applied to the scenario not names of cases.
- Most candidates did not identify and apply the correct ‘trade’ application to the question, regarding the interest charged to ensure the company is making a profit, which constitutes trade.
- Some candidates who identified that s 24J applied did not discuss the value of the interest using the yield to maturity and that this the amounts accrue or are incurred on a day-to-day basis.
- A number of candidates discussed the requirements of s 24O, which was not relevant as the purpose of the loan was not to finance the acquisition of equity shares.
- Majority of the candidates did not apply the ‘production of income’ requirement correctly. They did not identify that the purpose of incurring the loan was to lend it to the company at a profit (which constitutes a ‘trade’) and therefore closely connected the production of income (interest).
- Candidates did not identify the difference between the portion of the interest which was private and that which was trade.
- Some candidates confused the potential trade of providing finance with the taxpayer’s employment. There are two separate trades.
- Some candidates contradicted themselves. They would discuss everything correct but conclude differently.
- Some candidates mentioned that the interest incurred is capital in nature and did not know that interest is not capital in nature.

Part (b)

Candidates made to following common mistakes:

- Candidates did not use the correct tax terminology in their answers and lost easy marks, for example stating that a taxable benefit should be included in ‘taxable income’ while it needs to be included in ‘gross income’.
- Candidates’ answers were incomplete as they only addressed some of the requirements under par 5(3A) of the Seventh Schedule (for example did not discuss the requirement on the fact that no value to be placed on the taxable benefit will not apply if the employer and the employee are connected persons in relation to each other). Some candidates discussed the normal income tax implications of the employer (capital allowances in terms of s 13sex etc.) and not that of the employees.
- Some candidates erroneously discussed and applied the rental value formula in terms a residential accommodation benefit received under par 9 of the Seventh Schedule, while this transaction effectively constituted the acquisition of an asset (immovable property) at less than market (actual) value in terms of par 5 of the Seventh Schedule.
- Few candidates discussed the gross income definition and the capital nature part of the assets (flats) and no marks were awarded, as there was no identification of the fringe benefit in terms of the Seventh Schedule.
Part (c)

Candidates made to following common mistakes:

- Easy marks were lost, as candidates did not mention that Aisha is a South African resident and therefore taxed on worldwide income and that all amounts are included in her gross income.
- Some candidates did not identify that the Double Tax Agreement (DTA) was relevant to this part of the required and did not discuss it at all, forfeiting many valuable marks.
- Some candidates, who did correctly identify the applicability of the DTA, struggled to apply the information in the question to the requirements of the relevant article in the DTA. Candidates should not perform a ‘theory dump of legislation’ from the DTA, but need to apply and discuss its requirements in context of the scenario and information provided in the question.
- Some candidates concluded that Aisha (taxpayer) in not an employee but provided independent services but applied article 15 which related to employment.
- Candidates mentioned that the flights and accommodation received were not excluded from gross income because the employee was away for more than one night,
- Some candidates did not provide reasons on why the cost of the flight and accommodation would not be included in gross income.
- Some candidates provided calculations instead of discussion as per the required.

Part (d)

Candidates made to following common mistakes:

- Candidates overall did not perform well in this sub-section of the required.
- Although the required specifically stated that reasons should be provided for any amounts not included in the calculation, many candidates did either not provide reasons or did provide incorrect reasons (for example that entertainment is ‘exempt’; or that local road transport (tax fare) is ‘zero rated’).
- Some candidates incorrectly applied the tax fraction of 15/115 instead of 14/114. The new tax fraction of 15/115 is only applicable from 1 April 2018, while the 2017 year of assessment (ending 28 February 2017) was still correctly assessed in this question in terms of the SAICA Examinable Pronouncements for Taxation for ITC 2018.
- Some candidates did not identify the split of the entertainment between R700 (s17 (2)(a)(ii)) where the input tax is not dened and the R500 (s17(2)(a)(ii) where input tax was denied.
- Candidates would often miss the distinction between local and international flights, as well as the distinction between goods and services being zero rated as opposed to exempt.
- Most candidates did not identify that the allowance has no VAT implications due to the fact that is cash received and not goods as defined.

Part (e)

Candidates made to following common mistakes:

- Candidates did not identify that the lump sum was taxed using the incorrect table.
- Many candidates added the severance benefit received in a previous year, in taxable income and not as part of the lump sum.
- Although many candidates correctly recognised that the s 6A and s 6B credits were erroneously omitted from the assessment, some candidates incorrectly indicated that it should be deducted from taxable income instead of deducting it from the tax liability.
- Some candidates still applied old legislation in terms of tax tables for retirement lump sum benefits and the monthly credits for main members and dependants of medical schemes in terms of s 6A.
- Some candidates provided only calculations without any explanations.
Part (f)

Candidates made to following common mistakes:
- Some candidates calculated the taxable income and not the gross income as per the required.
- Candidates confused the right of use of company vehicle with the travel allowance calculations (deemed costs).
- Candidates did not identify that an asset (the cell phone) given for the major portion of its useful life in included in the year it is awarded.
- Some candidates’ answers for part (f) was either incomplete or not attempted. This is an indication that students struggled to manage their time in the paper and that they went over their time on other sub-sections of the required resulting in them not having sufficient time for parts (e) and (f).
- Very few candidates treated the right of the use the assets (smart phones) in terms of par 6 of the Seventh Schedule in the correct manner.
- Although only the gross income was required, some students also calculated the s 11(k) deduction and wasted time on performing calculations that were not required.
- In respect of the ‘right of use of a vehicle’ many candidates used the incorrect number of months in their calculation or multiplied with ‘9/12’ instead of only multiplying with ‘9’ months.
- Many candidates calculated the right of use of motor vehicle incorrectly and applied the par 7(7) and 7(8) adjustments incorrectly.
- Some candidates applied the operating lease principle on the company car, however the scenario mentioned that the lease agreements are not operating leases as defined in section 23A(1) of the Income Tax Act.

4. Areas that the candidates handled well

Part (a)
- Most candidates who identified and correctly applied the provisions of s 24J did very well.
- Most candidates reached some conclusion on their discussion on the deductibility of interest.
- The burden of proof requirement and the discussion of ‘incurred’ and trade were handled well

Part (b)
- Most candidates did well in identifying that there is a fringe benefit (acquisition of an asset at less than market value) and how it should be valued.
- Candidates could also identify that there is a provision that provides a nil value if the provisions apply.

Part (c)

Candidates did well in identifying that a resident is taxed on worldwide income, gross income inclusion and in identifying that a DTA is in place. Those that identified that a DTA is in place also did well in applying the three major requirements of article 15 of the DTA.

Part (d)

Most candidates did well in identifying the correct tax fraction and the input tax claimable on the domestic flight as well as the treatment of entertainment.

Part (e)

Candidates were able to identify the exclusion of medical rebates under s6A quite well, and were able to identify that previously disallowed deduction should reduce the lump sum benefit received.
Part (f)

The salary, commission and the retirement fringe benefit marks were achieved by most candidates.

5. Specific comments on sections of the question

Part (a)
Candidates generally struggle with discussion type questions and mostly did not do well in this part of the question. The main issue in this part was the identification and the application of the requirements of s 24J.

Part (b)
This part was also a discussion question but candidates did fairly well by identifying the fringe benefit in terms of the Seventh Schedule. Some of the candidates did not deal with all the requirements of the provisions of par 5(3A) of the Seventh Schedule (for example did not discuss the requirement on the fact that the no value to be placed on the taxable benefit will not apply if the employer and the employee are connected persons in relation to each other). Answers need to be complete and candidates need to discuss and consider all requirements relevant in the context of a specific provision.

Part (c)
Some candidates who did correctly identify the applicability of the DTA, struggled to apply the information of the question to the requirements of the relevant article in the DTA. Candidates should not perform a ‘theory dump of legislation’ from the DTA, but need to apply and discuss its requirements in context of the scenario and information provided in the question.

Part (d)
This was regarded to be an easy part of the question. However, candidates overall did not perform well in this sub-section of the required. This was a VAT calculation question and generally candidates should perform well in the calculation type questions.

Part (e) and (f)
Some candidates’ answers for part (e) was either incomplete or left out. This is an indication that students struggled to manage their time in the paper and/or that they went over their time on other sub-sections of the required resulting in them not having sufficient time for parts (e) and (f).

Overall
- Candidates are generally comfortable with calculation type questions, but discussion type questions remain problematic and that could clearly be seem in this question.
- The question was well balanced with easy, moderate and challenging sections. A well-prepared candidate should be able to pass the question.
- Some candidates left out sub-sections of the required without any attempt. The latter has a significant negative impact on these candidates’ overall score for the question. Candidates need to demonstrate proper time planning/time management and need to address all sub-sections of the required. Take a bit of extra time before you start your solution to plan it and then demonstrate you planning within your layout and presentation.
- Some candidates provided more than one alternative solution for some questions, especially in part (a) dealing with the discussion on the deductibility of interest incurred. This demonstrates indecisiveness on the candidate’s part and is only acceptable if the required ask for alternatives. Take more time to evaluate the information, make a decision and motivate your decision.
In general it seems as if candidates could still improve on their exam technique in respect of applying the information provided in the question to the relevant legislation and not only providing the requirements directly from the legislation (i.e. ‘theory dumping’).

**QUESTION 2**

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50% (Pass)</th>
<th>Marks &lt; 50% (Fail)</th>
</tr>
</thead>
<tbody>
<tr>
<td>37</td>
<td>21.05</td>
<td>633 (60.51%)</td>
<td>413 (39.48%)</td>
</tr>
</tbody>
</table>

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

This question integrated cost allocation (specifically activity-based costing) and the over / (under) recovering of fixed overheads with strategy.

The question examined candidates' ability to apply theory and think critically.

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

Many candidates simply restated the information given in the scenario without any application to the scenario and / or providing any link to how the information written answered the required.

Candidates typically showed a poor understanding of activity-based costing and the over / (under) recovery of fixed overheads. Many candidates confused absorption costing, variable costing, standard costing and activity-based costing principles.

3. **Common mistakes made by candidates**

**Part (a)**

Although part (a) was generally well answered, the most common error in this part related to the allocation of the maintenance and overhaul costs. Candidates did not realise that the spare parts were directly attributable to each division and that it was therefore only the maintenance labour costs that had to be allocated.

Another common mistake made by candidates was with calculating the ratios for splitting Ticketing and sales expenses (splitting the cost equally between Fly and Grand instead of 0.5/1.5 and 1/1.5) and General and administration costs (not splitting in the ratio of 0.4/1.4 and 1/1.4).

Some candidates also lost marks for showing workings for the allocation of the cost items, but not showing the actual calculation of the split and thereby not demonstrating that they had accurately calculated the final split.

Some candidates also unnecessarily lost a mark for not totalling the final allocations of each division.

**Part (b)**

Candidates struggled with this part. Common short commings were:

- A lack of critical discussion. Candidates simply stated what the allocation base was without indicating whether this was appropriate or not;
• Candidates not recognising that some of the costs were directly attributable to a division and therefore a cost allocation base was not required.

**Part (c)**

Part (c) was also poorly answered. The most common reasons for candidates performing poorly in this part were due to:

• Candidates repeating information in the scenario without explaining how this was a competitive advantage (for example, candidates would state: ‘no safety incidents occurred during the year’ rather than ‘no safety incidents occurred during the year impacting positively on their airline’s reputation’); and

• Candidates merely comparing Fly to Grand and not linking how this would give Fly a competitive advantage in the low-cost airline industry;

**Part (d)**

Some candidates simply answered the required with a statement along the lines of ‘no over / (under) arises as Ta-ta only recognises fixed costs when they are incurred’, and seemed not to realise that since part (d) was out of six marks, it required more than just a one line answer.

Candidates also typically showed a poor understanding of activity-based costing and the over / (under) recovery of fixed overheads and stated that since ABC was used, no over / (under) recovery of fixed overheads would occur. This is incorrect, as ABC can still lead to an over / (under) recovery of fixed overheads if costs are allocated to products / services during the course of the year.

We also noted that some candidates had not managed their time across the whole paper and therefore did not have sufficient time to answer this part.

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

Candidates scored well in part (a) and displayed a good understanding of allocating costs using an activity-based costing system.

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

Please refer to sections 3 and 4 above.