OBJECTIVE OF THIS REPORT

This report has been compiled from the analysis of examiners on candidates’ performance in Part I of the Qualifying Examination, which was written in March 2008. 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 two examination papers.

The purpose of Part I of the Qualifying Examination is to test the integrated application of cognitive knowledge, 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 Part I of the qualifying examination 2008
- Background information on the setting, marking and adjudication of SAICA examinations
- General comments on Part I of the Qualifying Examination 2008
- Professional paper 1 – detailed comments by question
- Professional paper 2 – detailed comments by question
### Statistics for Part I of the Qualifying Examination 2007

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<th>Passed</th>
<th>Failed</th>
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<td>75%</td>
<td>1 469</td>
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<td>1 968</td>
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<tr>
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<td>1 307</td>
<td>1 934</td>
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<td>All candidates</td>
<td>53%</td>
<td>2 096</td>
<td>1 806</td>
<td>3 902</td>
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#### Average marks per question:

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<th>Question 2</th>
<th>Question 3</th>
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<td>Paper 1</td>
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<tr>
<td>Total marks</td>
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<tr>
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<td>28.32</td>
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More detailed statistics can be found on the SAICA website at [www.saica.co.za](http://www.saica.co.za)
BACKGROUND INFORMATION ON THE SETTING, MARKING AND ADJUDICATION OF SAICA EXAMINATIONS

The Examinations Committee 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 Examinations Committee, a sub committee of the SAICA Education Committee takes overall responsibility for the setting of the examination paper. Examination questions could be 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, public practice or from academics should suitable questions not be available in the above mentioned question pool.

Academics or former academics are also involved in reviewing exam questions by subject area after their teaching commitments for the year have been completed. Four 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 around whether the number of marks and time limit is appropriate; and
- Provide comment on the validity and reliability of such assessment.

In addition an examination sitter, who is independent to the exam setting process, is appointed to review the entire set of questions after the review from the academics has taken place. The examination sitter provides independent comment on the examination paper, suggestion solution or mark plan and reports back to the Examinations Committee.

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 Examinations Committee. They are all selected with great care regarding their integrity and professional standing and are sworn to secrecy.

2.1 Marking of the scripts

The Education Committee 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 after 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 Education Committee, who authorises the final suggested solutions and the mark plans that will be used in the marking process.

All markers and umpires have to 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, and they are returned to SAICA together with the mark lists once the marking has been completed.

Each marking team consists of a number of individuals (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.

Each script is marked independently by two different persons who record their marks on separate mark sheets. Once the marking has been completed, the markers confer and jointly decide on the final mark to be awarded. Then each marker's mark, as well as the compromise mark, is noted down on the cover of the script. In the event of the markers being unable to agree upon the number of marks to be awarded for a particular answer, the script is referred to the umpire, who then awards the final mark.

In view of the above stringent marking process no request for re-marks will be entertained.

2.2 Adjudication

Adjudication is done by the full Education Committee as soon as possible after the mark lists have been received and checked by the SAICA Secretariat.

Candidate names are not known by the members of the Committee at the time the adjudication process takes place.

During the adjudication process, the Education Committee considers all relevant evidence, including the following:

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

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

In order to ensure that the whole marking and adjudication process remains anonymous, the instructions to candidates clearly state that their names should not appear anywhere.
GENERAL COMMENTS ON PART I OF THE QUALIFYING EXAMINATION 2006

1 Objective

In view of the primary objective of Part I of the Qualifying Examination, namely to test the integrated application of cognitive knowledge, 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 Overall comments on the papers

Overall comments received from universities indicated that the papers were of an appropriate standard for Part I of the Qualifying Examination.

- The accounting questions were of an appropriate standard and both questions were answered reasonably well. High marks were scored by a few candidates in both the financial accounting questions.

- The tax questions were of an easy standard and most candidates passed the tax questions. Despite this, candidates did not score as well as expected and markers continue to comment on the lack of candidate’s basic and current tax knowledge.

- The standard of the management accounting and financial management questions was also considered appropriate for Part I of the Qualifying Examination. Despite this both questions were not answered terribly well by most candidates. Candidates failed to perform basic calculations.

- The standard of the audit question was moderate and considered appropriate for Part I of the Qualifying Examination. The auditing tested basic theoretical knowledge which is appropriate for Part I of the Qualifying Examination. Candidates did not fare well in this question mainly due to the fact that they were unable to apply their theoretical knowledge to the facts presented in the question. Although time management may have been an issue in answering this question, examiners are increasingly concerned about candidate’s inability to score well in auditing questions at a QE Part I level. Candidates who regurgitated “shopping lists” of information did not score marks.
3 Specific comments

From a review of candidates’ answers to the seven examination questions for the March 2008 examination the following specific deficiencies were identified.

3.1 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 – this being a pure regurgitation of what candidates may have learnt about the theory at university, but of no real relevance to the question in hand. Candidates also do not appear to identify the correct issues in the scenario provided.

This is a major concern, because by the time candidates qualify for sitting for 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. Candidates who are unable to identify the correct issues do not do well in the examination.

In addition, examiners expressed concern about the poor application of knowledge in ethical issues. This is an increasingly important area in practice and the scenario in the question was not complicated. Candidates need know the SAICA’s Code of Professional Conduct and how to apply this.

3.2 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. In many instances workings were performed by candidates but not cross referenced to the final solution. Once again, 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 these must be properly and neatly cross referenced to the final solution.

3.3 Communication

Candidates fared better in questions requiring calculations than in discursive questions. It is important that candidates note that written answers are a large component of the Qualifying Examination as written communication is a key competency required in the work place. Candidates should learn to answer discursive questions properly. This can be done by practicing exam type questions 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. It is concerning to note the increased use of SMS style of writing in a professional examination. Candidates should pay specific attention to the way in which they write their answers bearing in mind that this is a professional examination.
3.4 Journal entries

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

This is inexcusable and candidates must ensure they understand the impact transactions would have on specific account balances by knowing which account in the income statement or balance sheet to debit or credit. 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 a Part I level.

Examiners were also concerned about candidate’s lack of knowledge of at-acquisition journal entries for consolidation journals.

4 General Comments

From a review of candidates’ answers to the seven examination questions for the March 2006 examination the following general deficiencies were identified. These problems affected the overall performance of candidates, and it is a matter of concern that candidates annually make the same mistakes. 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 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 relevant 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.

4.2 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, i.e. in the form of a letter, memorandum or a report.

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 were used to answer each question for the first time in 2007. Each book was clearly marked and colour coded. Candidates were also given explicit instructions to write the correct answer in the correct book. Despite this many candidates did not write the correct answer in the correct book which resulted in significant delays in the marking as the correct question had to be found and then sent to the correct mark team. Despite this the
secretariat has made quite sure that candidates who answered in the incorrect book had all their answers appropriately marked.

4.3 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.

4.4 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.

4.5 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, answered questions in words where calculations were required or presented financial statements where a discussion of the appropriate disclosure was required.

4.6 Open-book examination

Several practical problems were experienced with regard to the application of the open book policy in this years exam. Some candidates failed to take into account that the open book policy applied at their university at CTA level was different to the SAICA open book policy. Candidates are reminded that they **MUST** familiarise themselves with SAICA’s open book policy and be aware that this may be different to 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. This includes index pages which was seen by some candidates in this years exam not to “supplement texts” and therefore considered appropriate;
- The use of correction fluid of any kind is **NOT** considered appropriate at all by the Examinations Committee. To this end the SAICA open book exam has been made clearer by adding the following to rule 4.3:
  “Candidates also may not delete or obscure any of the printed text in the prescribed texts.”
- Candidates are also advised that from 2010 SAICA will no longer allow NOTES of any kind in the prescribed books allowed to be brought into the exam.
- Candidates are advised to familiarise themselves with SAICA exam rules prior to writing the examination.
Another problem relating to the open-book examination was that candidates did not state the relevant theory and/or definitions in their answers. One can not 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 essential 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. In 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 before will be disadvantaged as they are unlikely to finish the paper.

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

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

*Best of luck!!*
Paper 1 consisted of four questions that dealt with:

**Question 1:**
The question was divided into two parts and consisted in total of 65 marks financial accounting and 10 marks auditing.

Part 1 of the question counted 53 marks and dealt with the acquisition date of a business combination, calculation of the cost of acquisition, procedures to audit contingent consideration payable in terms of a business combination agreement, as well as pro-forma consolidation journal entries. This part of the question required of the candidate to have a thorough knowledge on allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed, specifically by applying Appendix B.16 to determine the appropriate fair values of assets, liabilities and contingent liabilities.

Part 2 of the question counted 22 marks and dealt with the accounting treatment of available-for-sale financial assets and the corresponding tax implications. These principles were tested in a statement of changes in equity.

**Question 2:**
The Auditing question included the following:

Business risks (excluding EDI related); Steps to reduce risks; Audit procedures on revenue (occurrence, accuracy and completeness); Ethics; Companies Act; Auditing standards; and corporate governance

**Question 3:**
This bulk of this management accounting question covered standard costing calculations and discussion while 7 marks covered break-even analysis.


**Question 4:**
The question consisted of two parts:

Part 1 consisted of a calculation of an individual’s taxable income. Part 2 dealt the calculation of the estate duty payable of the individual’s deceased estate.
Question 1

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<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50%</th>
<th>Marks &lt; 50%</th>
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<tr>
<td>75</td>
<td>37</td>
<td>51 % of candidates</td>
<td>49 % of candidates</td>
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**Level of difficulty:**
University comments supported the assessment of this question as an appropriate level question for the examination with adequate topic coverage. Some universities found the level of integration to be low.

**Main subjects/topics examined in the question:**
The question was divided into two parts and consisted in total of 65 marks financial accounting and 10 marks auditing.

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Part 2 of the question counted 22 marks and dealt with the accounting treatment of available-for-sale financial assets and the corresponding tax implications. These principles were tested in a statement of changes in equity.

**General comments:**
- This was a relatively straight-forward question in which candidates could have done really well.
- Marks were awarded generously in the mark plan / solution and the mark plan / solution catered for various possible interpretations of information given in the question.
- It was again evident that basic accounting knowledge (debits & credits and the meaning of pro-forma consolidation journal entries) amongst some candidates is poor.
- Part 2 of the question relating to available-for-sale financial assets was answered very poorly. Very few candidates managed to get the detailed calculations correct and most candidates just scored marks for principles and presentation.

**Areas the candidates handled well:**
- Where the question required discussion, candidates used clear and concise language for the most part and expressed themselves well.
- The majority of candidates disclosed their calculations clearly and referenced them to journal entries or the statement of changes in equity. Clear referencing to calculations has improved year on year.

**Areas the candidates handled poorly:**
The following problem areas are highlighted, which may be of use to candidates for future examination purposes relating to general exam technique:

- Poor time management and planning were evident, as many candidates did not attempt Part 2, or the attempts of certain sub-sections of the questions were not complete.
- It was evident that basic accounting knowledge (debits & credits and the meaning of pro-
forma consolidation journal entries) amongst some candidates is poor. Candidates should go back to the basics of accounting and understand how the double entry system and pro-forma consolidation journal entries work. Many candidates swapped their debits and credits in the pro-forma consolidation journals.

- In some instances, candidates did not read the “required” carefully and hence answered the question incorrectly.

Specific comments on sections of the question:

Part 1(a)
In this section, candidates were required to discuss, with supporting reasons, the appropriate date of acquisition of the subsidiary.

- Generally, candidates passed this part of the question.
- However, most candidates failed to utilise all information given in the question to support their arguments.
- There were also various instances where candidates provided good arguments, but failed to make a clear conclusion, or the conclusion was not in line with the arguments.

Part 1(b)
In this section, candidates were required to calculate the cost of the acquisition of the subsidiary in accordance with IFRS 3 *Business Combinations*.

This section was generally well-answered and most candidates obtained very good marks. Where candidates did not do well, it was generally due to the following:

- Incomplete calculation (i.e. did not utilise all information given in the question).
- Failure to discount amounts given in the question where settlement is deferred.
- Including the creditor settled on behalf of the subsidiary as a negative.
- Not including the consideration at fair value.

It should also be noted that some candidates misunderstood the term “cost of acquisition”. These candidates calculated the cost as equal to the fair value of the net assets of the subsidiary and not the fair value of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer. This is a relatively basic concept although candidates who misinterpreted this were in the minority, this is a concern.

Part 1(c)
In this section, candidates were required to describe the substantive audit procedures to be performed to test the accuracy and valuation, and rights and obligations of the probable contingent consideration (payment) of R500 000 as stated in the purchase agreement.

This section could have been answered much better. The solution catered for a vast range of possible procedures and candidates could have done very well. However, the following problem areas resulted in candidates losing marks:

- Lack of identification of the issue (payment is contingent on a certain profit target being achieved; therefore the majority of procedures should focus on auditing the reliability of budgets/estimates).
- Audit procedures not thoroughly described and applied to the information given in the question, i.e. the use of cryptic statements rather than thoroughly explaining the procedure (“what, when and how”).

Furthermore, a relatively large proportion of candidates did not discuss audit procedures for the contingent payment, but rather the contingent liability arising from the legal claim due to
environmental damages caused. This emphasises the fact that candidates fail to read the "required" carefully.

**Part 1(d)**
In this section, candidates were required to prepare the pro-forma (i.e. consolidation) journal entries at the date of acquisition that are necessary to include the subsidiary in the consolidated financial statements.

This section could have been answered much better. Candidates scored better on the calculations as opposed to the journal entries – being the required. Some candidates swapped debits and credits and failed to provide all the possible pro-forma entries needed for consolidation (for example goodwill/excess and minority interest).

It was also clear that many candidates confused the accounting for the business combination in the form of a purchase of an equity interest in another entity with the direct purchase of the net assets of another entity. This was evident because many brought in the subsidiary’s net assets at their full respective fair values, rather than journalising only the fair value adjustments needed.

Some candidates also failed to provide journal narrations and in some cases the narrations were not relevant or not sufficient to assess understanding, e.g. "pro-forma journal".

**Part 2**
In this section, candidates were required to present extracts from the consolidated statement of changes in equity to the extent that they relate to the available-for-sale financial assets (and net of related income taxes).

The following problem areas were identified:

- Only a limited number of candidates succeeded in identifying that the investment held in Multivest Ltd should be accounted for as treasury shares in the consolidated financial statements (because the investment and corresponding share capital are eliminated upon consolidation). Furthermore, those that did identify that treasury shares were involved were not able to account for the treasury shares.
- Some candidates assumed that the debt investment in Euro Mines should be ignored as I4A intends to hold the investment until maturity. This assumption cannot be made because the question states that I4A has appropriately accounted for these investments as available-for-sale financial assets in terms of IAS 39 (IAS 39.9 allows an entity to designate any financial asset as available-for-sale).
- Some candidates did not consider the taxation implications or understand the different tax implications.
- Some candidates also failed to identify the prolonged decrease in fair value of the equity investment in Vaal Mines Ltd as an impairment indicator.
- Many candidates did not understand how to subsequently measure the debt investment in Euro Mines. Candidates understood that fair value movements should be recognised in equity, but did not accrue for the interest using the effective interest rate method in terms of IAS 39 (IAS 39.55(b) which requires that a gain or loss on an available-for-sale financial asset is recognised in equity. However, interest calculated using the effective interest rate is recognised in profit or loss.
Question 2

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<th>Maximum mark</th>
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<th>Marks &lt; 50%</th>
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<tbody>
<tr>
<td>55</td>
<td>27.37</td>
<td>49 % of candidates</td>
<td>51 % of candidates</td>
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Level of difficulty
This was not considered to be a difficult question. It appeared that many candidates attempted this question (Paper 1, question 2) last, because many of the poor marks could be ascribed to candidates not attempting the question at all, or not attempting certain sections of the question. It appeared that many candidates had insufficient time available to answer the question properly.

Main subjects/topics examined in the question
The Auditing question included the following:

- Business risks (excluding EDI related);
- Steps to reduce risks;
- Audit procedures on revenue (occurrence, accuracy and completeness);
- Ethics;
- Companies Act;
- Auditing standards; and
- Corporate governance.

General comments
None

Areas the candidates handled well
Part (c) of the question was well answered. Candidates could identify the regulatory implications and knew the ethical requirements and requirements of the Companies Act and corporate governance.

Areas candidates handled poorly
Sections (a) and (b) were poorly answered. Candidates failed to answer what was required and demonstrated poor exam technique.

Specific comments on sections of the question
Part (a)
This section was required to be answered in a tabular format, a requirement followed by nearly all candidates.

Candidates had to identify and explain the risks to Mobile Creations (Pty) Ltd that will arise from the outsourcing arrangement with WASP Innovations CC. They were also required to include in the explanation a description of the potential consequences of each risk (not any risks related to the introduction and use of the EDI link). Candidates identified risks, but in many instances poor explanations were given, which lacked potential consequences. Thus even though the question was very clear, the candidates demonstrated poor examination technique. Candidates wrote a lot but failed to provide the required explanation and consequences.

Candidates also had to describe the specific steps that Mobile Creations (Pty) Ltd should have implemented to reduce each of the risks identified above to a low level. In cases where the mitigating step is to modify the proposed agreement with WASP Innovations CC, candidates had to clearly describe the specific requirements that should be incorporated into the agreement to
manage the risk. Some candidates did not attempt this requirement and others repeated explanations on risks and related consequences. This again demonstrates poor examination technique.

**Part (b)**

In Part (b) candidates were required to describe the audit procedures (both manual and computerised) that should be performed to obtain sufficient appropriate audit evidence about the occurrence, accuracy and completeness of the revenue of Mobile Creations (Pty) Ltd.

Some of the candidates attempted parts (a) and (c), but not Part (b). Many demonstrated poor examination technique by means of poorly formulated audit procedures. Other did not read the question properly and did not limit their audit procedure to the occurrence, accuracy and completeness of the revenue of Mobile Creations (Pty) Ltd.

**Part (c)**

Judging by the extent of the answers on Part (c), this section of the question was regarded by candidates as the easiest part in which to score marks. Most of the candidates attempted this part of the question. Candidates had to describe any ethical (with reference only to the SAICA Code of Professional Conduct), professional, statutory and / or corporate governance concerns that may arise from your lunch meeting with Mr Byte. Many candidates went into a lot of detail but did not address all the issues.
Question 3

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<th>Maximum mark</th>
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<th>Marks &lt; 50%</th>
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<tbody>
<tr>
<td>40</td>
<td>23.23</td>
<td>68 % of candidates</td>
<td>32 % of candidates</td>
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Level of difficulty:
Medium to Easy.

Main subjects/topics examined in the question:
This bulk of this management accounting question covered standard costing calculations and discussion while 7 marks covered break-even analysis.


General comments:
The question relates to a private manufacturing company that manufactures two products and operates a standard costing system.

Candidates were provided with budgeted (based on standards) and actual results for the financial year and some background information relating to the introduction of the second product, change in market focus of the company the responsibilities of three divisions (manufacturing, sales and procurement) within the company.

Areas the candidates handled well:
Most candidates were able to calculate (at least some) of the variances relating to deviations from the standards set. and to some extent provide feedback on the performance of the divisions.

Areas the candidates handled poorly:
A few areas should however be highlighted, which may be of use to candidates for future examination purposes relating to general exam technique:

- Language and communication skills were poor.
- Differentiation between the differed required areas was poor (Part B (i) and (ii)).
- Presentation in general was of a poor quality.
- Many basic errors, such as directions of variances and mechanical errors.
- Evidence that candidates did not read the question and the required properly.

Specific comments on sections of the question:
Part (a)
In this section, candidates were required to calculate all the possible variances not yet calculated (provided in the question) and to reconcile budgeted to actual profit/loss for the year.

The section was generally well-answered as far as the expense variances were concerned. The majority of candidates seemed unable to calculate the sales mix and sales quantity variances (which is specifically applicable where an organisation sells more than one product).

Although many candidates attempted a reconciliation between budgeted and actual profit, very few candidates performed the calculation of actual profit (which includes closing inventories and only deduct material used in production – as opposed to material purchased.)
Part (b)
This section required of candidates to discuss the key reasons for the lower than expected profitability of the company and to provide feedback on the performance of the manufacturing, procurement and sales divisions.

This section was generally poorly answered. In many cases candidates were merely re-stating the calculated variance calculations in words. This did not earn marks as the question specifically required comments on the performance of the divisions.

Very few candidates were able to give comments at a general level as required in section (b)(i) as they focused on the detail in the calculated variances. It is important to develop the skill to identify the most significant reasons and provide that in a summary format (3 marks) – similar to providing high level information to senior management of an organisation.

Some candidates were unable to link the calculated variances to performance (i.e. did not seem to understand that a favourable price variance actually means that material was acquired at a cost lower than budget!)

Very few candidates presented their answers to this section in a structured fashion (for example, providing sub-headings in order to deal with the three divisions separately). This meant that candidates were not awarded one or both of the presentation marks.

Part (c)
In this section, candidates were required to calculate the number of units (of both products) that the company needed to sell to break even based on the actual results achieved.

As this is a very basic calculation involving fixed cost and contribution per unit most candidates scored some marks for this section and many candidates obtained full marks.

Many candidates, however, used the budgeted contribution per unit to calculate the breakeven number of units (despite the fact that the question specifically stated “based on the actual results”) and included the patent cost as a fixed cost for the year.

Many candidates also did not apply the principle of calculating a weighted contribution per unit in order to do a break-even analysis for both products while others used the budgeted sales mix in this calculation (in stead of the actual sales mix by product as specifically stated in the question).
Question 4

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<th>Marks &lt; 50%</th>
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<td>30</td>
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<td>76 % of candidates</td>
<td>24 % of candidates</td>
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**Level of difficulty:**
The question was relatively easy and was set at an appropriate level for Part 1 of the Qualifying Examination. The question adequately addressed practical issues that entry level chartered accountants should handle with confidence.

**Main subjects/topics examined in the question:**
The question consisted of two parts:

- Part 1 consisted of a calculation of an individual’s taxable income.
- Part 2 dealt the calculation of the estate duty payable of the individual’s deceased estate.

**General comments:**
It was a relative easy calculation question on individuals and estate duty. Only basic principles were tested on estate duty.

The mark plan was generous and catered for many alternative marks.

In general students did not read the question properly resulting in a vast number of students doing the CGT calculation - therefore wasting their time. They also got very confused between the difference in CGT and estate duty resulting in candidates doing CGT calculations within the estate duty calculation. Concern was expressed regarding the ability of candidates to calculate estate duty.

**Areas the candidates handled well:**

**General comments:**
In general the question was well attempted. Candidates did well in this question and used the right terminology and presentation. Queries were answered in the right sequence with definite differentiation between part a and part b. The presentation, language and layout used by most candidates were of a good standard.

**Specific comments in respect of Part 1:**
Part 1 of the question proved not to be a problem for most of the candidates. The answer was well worded and systematic. Most candidates knew how to calculate an individual’s income tax liability.

**Specific comments in respect of Part 2:**
Part 2 was well answered. Most candidates could determine the estate duty payable.

**Areas the candidates handled poorly:**

**Specific comments in respect of Part 1:**
In respect of Part 1, candidates did not handle the following well:

- Most candidates did not know that only the actual cost of the motor vehicle can be deducted.
- Candidates used 12 months to calculate the medical fringe benefit instead of 11 months (because he retired because of ill health). Some candidates did not add the fringe benefit at all because they thought the handicapped child would result in the fringe benefit being
exempt.

- Quite a few candidates did not update their knowledge on the basic fringe benefit calculation (they used the benefit less 2/3 of the amount) as well as the 2008 interest exemption of R18 000 (not R16 500 as in 2007). They also did not allocate the first R3 000 to foreign dividends and interest and then the residue of R15 000 against local interest and dividends.
- Candidates did not understand the exemption in terms of section 10(1)(iA) at all.

**Specific comments in respect of Part 2:**
In part two candidates calculated capital gains tax instead of estate duty or confused the two with each other and did a combination of the two. Quite a few candidates did not attempt this part at all. Again a few candidates did not update their knowledge and used a section 4A rebate of R2.5 million instead of R3.5 million.
Paper 2 consisted of three questions, and dealt with:

**Question 1:**
This question was a financial accounting question counting 90 marks in total. 10 marks of the question were allocated to audit steps of a share-based payment. The financial accounting part of the question dealt with the following issues:

- The separate classification of a lease of land and buildings between a finance and operating lease where the candidate was required to utilise his/her knowledge to classify such a lease correctly in terms of IAS 17 Leases;
- The treatment of the deferred tax consequences of the classification of a lease of land and building where the candidate was required to discuss the main implications in terms of IAS 12 Income Taxes;
- The treatment of an identified error in the classification of an IFRS 2 Share-based Payment transaction in a single entity where the candidate was required to correct such misclassification by means of correcting journal entries;
- The correct classification of the debt and equity components of a convertible debenture where the candidate had to discuss this classification using the underlying principles of IAS 32 Financial Instruments: Presentation.
- A discussion of the impact of the convertible financial instrument (debenture) on the calculation of the basic and diluted earnings per share.

**Question 2:**
The question counted 50 marks in total. The question consisted of a discussion on the treatment of transfer prices for the purposes of an earnings valuation, a critical analysis of the suitability of a transfer pricing system for the company in question, a discussion of the adjustments to be made to maintainable earnings and the PE-ratio for an earnings valuation, as well as a cash flow valuation where the cash flows had already been provided, and finally, a discussion of the business risks faced by the company under review.

**Question 3:**
This question was solely a computation of normal tax payable by a company as well as the secondary tax on companies question counting 60 marks in total.

In part (a) the question dealt with the following topics:
- A number of dividends received from both South African companies and non resident companies. The companies declaring the dividends were either listed or unlisted. It also included a liquidation distribution received.
- The question then continued to examine the tax allowances in respect of second hand equipment acquired from a connected person (the error in translation referred to above was made here).
- The next item dealt with was the write off of a loan where the recipient of the loan was unable to repay the loan. This had capital gain consequences.
The next part dealt with a loan from a non resident where section 31 had to be applied.

It then examined the situation where the purchase price of a warehouse that was acquired by the taxpayer was amended.

The tax consequence of the acquisition of a trade mark was then tested.

Lastly the part examined a loan obtained for purposes of paying provisional tax.

Part (b) required that the secondary tax payable in respect of a dividend declared and a deemed dividend be calculated. The dividends received in part (a) had to be considered to determine whether they qualify as dividends accrued.
Question 1

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<td>90</td>
<td>45.33</td>
<td>53 % of candidates</td>
<td>47 % of candidates</td>
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**Level of difficulty:**
The question was considered to be of a good standard. The question was adequately integrated between accounting topics and also incorporated auditing steps. The question was not exceptionally difficult but required candidates to have a good knowledge of and a solid foundation regarding the basic principles underlying the topics. Topics examined were relevant and of importance both in practice as well as in the academic syllabus.

**Main subjects/topics examined in the question:**
This question was a financial accounting question counting 90 marks in total. 10 marks of the question were allocated to audit steps of a share-based payment. The financial accounting part of the question dealt with the following issues:

- The separate classification of a lease of land and buildings between a finance and operating lease where the candidate was required to utilise his/her knowledge to classify such a lease correctly in terms of IAS 17 Leases;
- The treatment of the deferred tax consequences of the classification of a lease of land and building where the candidate was required to discuss the main implications in terms of IAS 12 Income Taxes;
- The treatment of an identified error in the classification of an IFRS 2 Share-based Payment transaction in a single entity where the candidate was required to correct such misclassification by means of correcting journal entries;
- The correct classification of the debt and equity components of a convertible debenture where the candidate had to discuss this classification using the underlying principles of IAS 32 Financial Instruments: Presentation.
- A discussion of the impact of the convertible financial instrument (debenture) on the calculation of the basic and diluted earnings per share.

**General comments:**
The question dealt with issues that are commonly encountered in practice. There is still concern about some candidates’ general exam technique when completing a long question like this. The question tested the candidates’ abilities to integrate their knowledge across topics and subjects and to plan their answers within the time allocated to each section of the question. The question was generally viewed as at the right level of difficulty by most universities.

**Areas the candidates handled well:**
The question was generally well.answered by candidates and they appeared to have a good general knowledge of the topics examined. Lease classification was handled very well and candidates appeared to have a good knowledge of the difference between finance and operating leases. The audit steps in respect of share-based payment transactions were also completed very well by candidates.

**Areas the candidates handled poorly:**
A few areas should however be highlighted, which may be of use to candidates for future examination purposes relating to general exam technique:

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• Poor exam technique was evidenced in the calculations and journal entries of the share-based payment transaction. Although many candidates illustrated a good knowledge of the underlying calculations to a share-based payment transaction, most candidates failed to leave a proper audit trail of what they were doing and also failed to cross-reference their calculations to their final answers. It should be noted that the onus is on the candidate, and not on the marker, to provide legible, logical and well-presented answers in a professional exam.

• Candidates struggled with the correcting journal entries and seemed not to have an adequate ability to correct what the client had done in the question. It should be noted here that providing the originating journal entries was considered inappropriate because the question specifically asked for correcting journal entries.

• Many candidates failed to provide the deliverable in the question. The question asked for the correcting journal entries to be provided and not a set of calculations. It is important that candidates read the “required” and address the required parts adequately by making sure that they deliver the final product as required of them from the question.

• There seems to be a general lack of knowledge regarding the application of the principles relating to financial instruments and specifically debt versus equity. The components of the transaction were not separately considered. Focus was also only placed on recognition and not measurement of the instrument after initial recognition and measurement. Definitions were written down from the standard but not applied and marks were not awarded for that. Many candidates also failed to provide a final conclusion on whether the item was debt or equity or a compound financial instrument. Unnecessary marks were lost due to this.

• Candidates did not adequately indicate whether they were discussing the impact on basic or diluted earnings per share and answers were therefore very general. There also seems to be a lack of understanding of the impact of financial instruments on the calculation of the diluted earnings per share figure. This is a concern.

• Candidates seem to be providing a lot of irrelevant theoretical information thereby wasting their time and not getting around to addressing all the issues present in the question.

• Time management still seems to be a problem for many candidates. There was no time problem in the question and yet many candidates appeared to not even attempt the last parts of the question adequately.

• Certain candidates have a major problem in providing legible answers. Their handwriting is very difficult to read and this, together with a poor layout, makes their answers very hard to mark. This is a problem that candidates should address to the best of their abilities.

• The use of Tippex in answers does not seem to be very helpful. Candidates write over Tippex that has not dried or forget to come back to their incomplete answers due to Tippex that was used. This practice is not recommended for the Qualifying Exam.

Specific comments on sections of the question:

Part (a)
In this section, candidates were required to appropriately classify the lease of land and buildings separately in terms of the requirements of IAS 17 Leases. This section was generally well-answered by candidates and due to the generous mark allocation of the section candidates had ample time to address all the issues that needed to be considered to enable them to appropriately conclude. The deferred tax implications of the lease of land and buildings were not addressed very well by candidates and this could have been due to the fact that candidates had to discuss, and not calculate, these implications. Basic and straightforward marks were not obtained as candidates did not state the obvious information.
Part (b) (i)
This section of the question required candidates to correct an identified error in respect of a share-based payment transaction in terms of IFRS 2 Share-based Payment. Candidates did not do well in this section as it was not a straightforward requirement. The candidates got lost in calculations and did not complete the required part of the question adequately as they did not journalise their calculations properly. Poor audit trails were left and markers really struggled immensely in figuring out what candidates had done in their journal entries. Many candidates did not provide journal entries and lost valuable marks.

Part (b) (ii)
This section of the question required candidates to provide the audit steps to audit a share-based payment transaction. This section was generally well-answered.

Part (c) (i)
This section of the question required candidates to discuss whether a convertible debenture is to be classified as debt or equity or a compound financial instrument. Many candidates did not consider the fact that the instrument is convertible into a variable number of the entity’s own shares and therefore missed the fact that also that component was to be classified as a liability. As the option lay with the holder of the instrument and not the issuer, this option to convert or to require cash settlement was to be classified as a liability. It is evident from this section of the question that candidates have an extremely poor understanding of the requirements of IAS 32 Financial Instruments: Presentation. This is a concern that should be addressed by candidates for future Qualifying Exams.

Part (c) (ii)
In this section of the question students were asked to evaluate the impact of the above financial instrument on the calculation of basic and diluted earnings per share. Due to the lack of knowledge on financial instruments, this section of the question was also answered extremely poorly. The lack of knowledge was evident by the poor arguments and low marks of this section of the question. The candidates also appeared to apply poor exam technique and markers were frequently not sure of whether the candidate was addressing basic or diluted earnings per share in their answers. This section’s poor performance appeared to be a follow-through of the lack of knowledge in the section dealing with the financial instrument in part (c)(i).
Question 2

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<th>Marks &gt; 50%</th>
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<tr>
<td>50</td>
<td>20.38</td>
<td>24 % of candidates</td>
<td>76 % of candidates</td>
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**Level of difficulty:**
The question was of a mixed level of difficulty. Parts (a)(i) and (d) which required insight, proved to be too difficult for most candidates. Parts (a)(ii) to (c) which were straightforward and very clear from the given case study, was handled with ease. Overall, the question was adequately integrated and set at an appropriate level of difficulty for Part I of the Qualifying Examination.

**Main subjects examined in the question:**
The question counted 50 marks in total. The question consisted of a discussion on the treatment of transfer prices for the purposes of an earnings valuation (7 marks), a critical analysis of the suitability of a transfer pricing system for the company in question (7 marks), a discussion of the adjustments to be made to maintainable earnings (8 marks) and the PE-ratio (6 marks) for an earnings valuation, as well as a cash flow valuation (10 marks) where the cash flows had already been provided, and finally, a discussion of the business risks faced by the company under review (9 marks). Three marks were available for the presentation of the solution, with 1 mark being awarded for logic, and 2 marks for neatness and layout.

**General comments:**
It is a great pity that candidates were not able to deal with the integration in this question, and nor were they able to reason out a suitable answer. It indicates that topics are still studied by heart, with little understanding and insufficient cross-sectional application.

Candidates also generally lack decisiveness – instead of deciding on a suitable answer, a lot of theory is ‘dumped’ in the hope that the marker will look for available marks in the superfluous answer provided.

**Areas the candidates handled well**
The candidates dealt with the adjustments to the maintainable earnings and the PE-ratio very well. The business risks were also addressed adequately.

**Areas the candidates handled poorly**
The candidates performed poorly on part (a)(i) – the discussion of the adjustments to the maintainable earnings for the transfer pricing policy adopted by the company, and part (d) – the discussion and critical analysis of the suitability of the current transfer pricing system for the company.

**Specific comments on sections of the question**
**Part (a)(i)**
In this section, candidates were required to comment on the adjustments that would have to be made in order to determine the maintainable earnings of a company where transfer prices based on market prices had been included in the profit figures of the company.

The answers to this section of the question were generally dismal, and it is clear that most candidates had no idea what was required of them, did not understand the question, and could not reason out a suitable answer.
Most candidates therefore addressed how a transfer price should be set within minimum and maximum levels for negotiation. The question was clear in that it asked how to calculate maintainable earnings for an earnings valuation when the sales at market prices had been recorded in the financial records of the company.

A correct answer would have focused on the incorrect inclusion of unrealised profits in the records of the company, which would have to be eliminated, together with any tax implication (if the profits had been thus inflated for tax purposes as well), for valuation purposes. Furthermore, the inclusion of unrealised profits would have affected the book value of the assets purchased by the receiving division, and an adjustment to the depreciation on the assets was therefore also required.

Many of the candidates who realised that the financial records of the company were incorrect, only addressed the revenue of R30 million as a possible adjustment, without realising that the cost of sales would similarly have to be reversed – only the gross profit needs to be eliminated.

Quite a few candidates noted that, since the transaction had occurred at market price, it was an arms’ length transaction and therefore no adjustment was needed. As the assets and profit are overstated, the profit unrealised, and the two divisions within one company (they are not subsidiaries), this answer is clearly wrong.

Too many candidates stated that the transaction represents a sale to one division (manufacturing), and a cost of sale to the other (rental) and that the transaction therefore cancels out, so that no adjustment is required. If an item is a sale in the manufacturing division, it will also be a cost of sale item in the same division, and in fact will be listed as an asset in the rental division, which is why it is so important for the unrealised profit to be eliminated.

It was also evident that candidates failed to read the full ‘Required’ section before attempting the question, as the same answer was often offered for both parts (a)(i) and (d) of the question – clearly, candidates had misinterpreted what was required of them in this part of the question.

Part (a)(ii)
In this section, candidates were required to state what adjustments were required to earnings in order to calculate maintainable earnings. Candidates performed well, mostly because the adjustments were given in the question in bullet format and candidates merely had to rewrite the given information and note the direction of the adjustments to be made. The following common errors were encountered:

- Candidates had a tendency to write ‘Adjust for...’ without any clear indication of the direction of the adjustment. It was therefore not possible to determine whether the amount would be deducted or added back, and consequently no marks were awarded for these answers.
- Candidates still don’t know or understand the difference between an earnings valuation and a free cash flow valuation. Many noted that depreciation should be added back to earnings as a non-cash flow item. An earnings valuation would use maintainable earnings, i.e. the amount available to ordinary shareholders of the company, which would be after depreciation, interest, tax and preference dividend payments!
- Similarly, many noted that the interest on the shareholders’ loan had to be added back to the earnings figure as interest is already included in the Weighted Average Cost of Capital. This would of course be true in either a capital budgeting question or a cash flow valuation, but is completely illogical in an earnings valuation. It would have been accurate, however, to note that the interest could be added back as the shareholders’ loan is treated as indivisible to shares.
• Candidates correctly added back the BEE-cost as a once-off, non-recurring cost, but made the addition an after-tax adjustment, which is clearly wrong when the question specifically notes that the BEE-transaction was not tax deductible.

Sadly, a few candidates discussed these ‘other adjustments’ (other than for the transfer pricing arrangement) under part (a)(i) of the question, in which case they received no marks for their discussion. It is important for candidates to read the whole question carefully.

Part (a)(iii)
In this section, candidates were required to calculate and discuss an appropriate Price-Earnings (PE) multiple for the earnings valuation.

Candidates are still not sure of the direction of the adjustments, and no marks were awarded where the adjustments were made in the wrong direction. For instance, the fact that the company is unlisted and private, and therefore the shares have limited marketability and tradability, would increase the risks attached to owning shares in the company, which would lower the PE ratio. Surely, as earnings would be multiplied by the PE ratio, it should be perfectly obvious that the higher the risk of a company, the lower its value would be, and consequently, the lower the PE ratio of the company should be set.

Candidates who did not indicate a direction at all, merely noting that the company has a higher or lower risk than similar listed companies also received no marks. Candidates who stated the PE ratio as a percentage, thereby confusing the PE ratio and the Earnings Yield ratio, were not awarded any marks either.

The question also called for a discussion of the adjustments that would have to be made. Many candidates merely listed or noted in an abbreviated format what the risk adjustments were, without embellishing on the risks, in which case marks were lost on presentation. Also, noting that the company is not listed, but not stating that the risks of not being listed are that the company’s shares may be more difficult to trade, the company is likely to be smaller or it could be more difficult to access financing, did not earn any marks.

Many candidates noted that the company is listed, which is impossible for a private company. This either indicates that candidates did not read the question properly, or do not understand what listing requirements are.

Candidates should also bear in mind that adjustments would only be required for items that differ between the company under review and the average listed companies used as comparison. Noting that the industry is in a growth phase or that the company has BEE shareholders, is irrelevant. All companies in the same industry would be thus affected, and therefore these risk or growth factors would already be incorporated into the average PE of the listed companies.

Some candidates compared the net profit of R3,6 million with the R175 million turnover of the industry in order to discuss the size of the company in relation to similar listed companies – clearly, apples are not compared with apples.

A number of candidates used the growth in the headline earnings per share as the starting point for their PE calculation, instead of the PE ratio of a similar listed company, which makes no sense at all, and seems to indicate a complete lack of understanding, and certainly a complete lack of preparation for the examination.
Candidates sometimes did not offer an appropriate conclusion on the appropriate PE ratio to use, losing a very easy mark. The question clearly asked for an appropriate PE ratio to be suggested, and therefore merely stating a number without a conclusion, or offering a ratio which is completely out of the relevant range (any figure between 7 and 14 was accepted) was inappropriate.

Lastly on this section, quite a few candidates calculated the value of the company using the adjusted PE ratio. An earnings valuation was not required by the question and these calculations were therefore a waste of precious time. Candidates should answer exactly what is asked – no more, no less.

Part (b)
In this section, candidates were required to use the cash flows which had been supplied, in order to perform the free cash flow valuation.

A lot of candidates were completely thrown by the fact that the cash flow statement was provided, and could not understand where the ten marks available for this section were supposed to be obtained.

Many rewrote the entire cash flow statement (for which they received no marks), or made illogical adjustments, such as increasing every year’s cash flows with 2%, which is the sustainable growth rate after 2010. No marks were awarded.

A few fundamental errors were made, which indicated that candidates were not expecting another valuation question after its appearance in the 2007 paper, and did not pay sufficient attention to this fairly easy section of the work. Candidates and universities alike should be very careful to study all the prescribed work, and not to spot the questions which might come up in a QE exam.

The fundamental errors included:
- not using the cash flows supplied for all three years, i.e. using only the cash flows for 2008. When the future cash flow predictions are given for three years, the cash flow valuation must be performed over the full three years;
- adding the 2007 cash flows to the calculation. Past cash flows are sunk and not relevant to the valuation;
- not knowing the terminal value formula or how to apply it;
- not adding 2% to the 2010 cash flows in order to calculate the 2011 cash flow for the terminal value;
- not deducting the 2% growth from the weighted average cost of capital in order to determine the denominator for the terminal value calculation;
- not discounting the terminal value to the present value, or using the discount factor for either two or four years to find the present value, instead of the discount factor for year three;
- using the discounted cash flow for year four in the terminal value, and then discounting the answer again, i.e. discounting the terminal value twice;
- using a discount rate other than the weighted average cost of capital (WACC) which was supplied in the question; and
- using the growth in the headline earnings per share as the discount rate.

If a candidate started the calculation of the free cash flow with the net cash movement on the income statement, it was necessary to add back the interest (already included in the WACC), the tax effect of the interest, and the debt payments which had been included in the cash flows, and which do not form part of the operating cash flows of the company (and the loans are valued separately as well).
Many candidates:
- did not make any of the above adjustments, merely using the net cash movement as the free cash flow – this is clearly wrong, for instance as the WACC will already take the interest into account, which would therefore imply double-counting;
- adjusted only the interest-bearing debt, and not the interest payments, which shows a lack of understanding;
- adjusted for depreciation being a non-cash flow item, which is again double-counting as the adjustment had already been made in the net cash movement which had been supplied.

If a candidate started the calculation of the free cash flow with the earnings before interest and tax, all of the adjustments as per the cash flow statement had to be made, with the exception of the interest payment and debt repayments (which should have been ignored) and the tax on the interest payment, which had to be deducted.

The following common errors occurred:
- Interest was included in the free cash flow calculation. It should not be, as it is already accounted for in the discount rate and the loans will be valued separately;
- The interest was added back, even though the earnings before interest had been used as a starting point, thereby double-counting the interest payments;
- No adjustment was made for the tax on the interest payment, or else the direction of the adjustment was incorrect – as the interest is added back, the company ‘loses’ the tax deductibility thereof in the free cash flow statement, and consequently the tax payment should be higher, i.e. more tax should be deducted;
- The change in the working capital for the three years was calculated – this was extremely frustrating, as the cash flow statement would of course already show the movement in the working capital! To recalculate the movement in the working capital, is sheer madness or an indication of a complete lack of understanding of what a cash flow statement consists of. A mark was lost on logic for candidates who made this ridiculous error;
- The tax for the company was recalculated, without excluding the debt payments. Some candidates even specifically calculated the tax effect of the debt payment! Of course, debt repayments are not tax-deductible expenses but rather capital repayments.

Finally, the value of the company is found by adding the discounted cash flows and terminal values as well as the cash resources, and deducting the value of the interest-bearing debt, including the short term loans and shareholders’ loan.

Many candidates stopped at the calculation of the free cash flows, without taking the cash and debt into account, losing three very easy marks (as all of the information was given in the question).

Quite a few candidates ignored the short-term interest bearing debt, without stating why they were omitting the cost. The question asked for any specific assumptions to be listed, and a candidate who motivated why there were ignoring the short-term debt would have received their full mark.

Marks were also not awarded if a candidate did not indicate what the amounts were that were added or deducted from the free cash flow value. For instance, if a candidate deducted R24,4 without stating that the R24,4 related to interest-bearing debt, no marks were given. Marks were also not awarded if no distinction was made between the ordinary interest-bearing debt and the shareholders’ loan.
A few candidates incorrectly deducted the cash balance (indicating that the question had not been read properly and attentively) and added the shareholders’ loan to the value of the company (which makes little sense, as the shareholders’ loan and shares are treated as indivisible, and therefore make up the value of the company in total, or together).

Almost none of the candidates referred to the adjustments that would have to be made to the cash flow figures to take cognisance of the transfer pricing arrangement and internal transfers taking place within the company. The question leads you to bear this in mind, by asking for the transfer pricing adjustments in question (a)(i), but despite being lead towards the answer, most candidates did not even refer to the transfer pricing arrangement and its possible impact on the cash flow forecasts (i.e. in the capex figures) at all.

Very few candidates questioned the accuracy of a 2% growth prediction for a company which is considered to be the market leader in its field.

Finally, candidates should remember to let the number of marks awarded for a question lead them as to the volume of information or calculations which are required from them. Merely taking the supplied net cash movement and discounting it with the WACC on a financial calculator, can’t possibly be worth ten marks in a Qualifying Exam.

Part (c)
In this section, candidates were required to identify and explain the business risks facing the company. Most candidates performed well in this section as the business risks were fairly clear from the given information.

Some candidates only received half of the available marks for the question, as they merely stated the business risk that the company faced, i.e. continued strikes, without explaining how it is a risk for the company or what effect it might have on the company in future.

It was inappropriate in this section to address auditing or financial accounting risks. Therefore, candidates who referred to an inappropriate control environment, the risk of misstatement of the financial statements, the risk of not accounting for the BEE transaction or transfer pricing transactions correctly or the risk of not applying IFRS correctly, did not receive any marks.

Again, a couple of candidates did not read the question attentively, or else forgot what information had been supplied in the case study. Some addressed the risks for Xtatic Limited, whereas the question asked for the business risks of PreFab (Pty) Ltd. The risk that PreFab might not comply with the listing requirements of the JSE, is not a business risk faced by the company, but the risk of a single transaction which has yet to occur.

The risk of having high debt levels is in fact a financial risk and not a business risk per se. The question specifically asked for business risks to be addressed, but many candidates focused on the financial risks facing the company to the exclusion of the numerous business risks that could have been addressed. As the high debt levels are likely to impact on the company’s cash flows, which are already under strain as most of the historical cash flows have been used, thus affecting the company’s liquidity and ability to continue as a going concern, two marks were awarded for a discussion of the company’s gearing levels. However, candidates should ensure that they answer exactly what is required, and that they are aware of the differences between business, financial, auditing and single transaction risks.

Finally, the question asked for five risks only. It was however decided to award marks for any business risks listed, but it would have been more appropriate to limit the marking to the first five
risks offered. Candidates should be careful to read the question and to stick to what is required. It also makes sense to list the more important and obvious risks first.

Part (d)
In this section, candidates were required to discuss the merits of the current transfer pricing arrangement. This section was answered very badly, with less than 5% of candidates obtaining any marks for their answers, which often ran over two or three pages.

The question did not call for a discussion of how a transfer price should be set, or what the goals or advantages of an appropriate transfer pricing system are, which were the answers most often offered by candidates. Most candidates apparently thought that a ‘theory dump’ would suffice for this section.

Instead, the question asked for a critical analysis of the transfer pricing arrangement, which indicated that candidates ought to consider the merits and disadvantages of the current system, as well as any other considerations that may be relevant to the transfer pricing arrangement.

Consequently, the answer focused on how the performance measurement of the manufacturing division may be prejudiced if the transfer pricing arrangement was changed, instead of focusing on the fact that currently the rental division is charged a high market-related price which limits or negates its profitability.

Similarly, the suggested solution also addressed the fact that the Rental division may in fact not be able to find a cheaper supplier outside the company, which would make the market transfer price a reasonable price to use, whereas most candidates simply assumed that cheaper external units would automatically be available.

Insight was definitely required for this section, as well as an ability to think ‘out of the box’. A standardised answer did not receive any marks.

Presentation
Marks were awarded for logic, layout and presentation. Candidates are again cautioned not to use sms-style abbreviations or any abbreviations which do not appear in an acknowledged dictionary.
Question 3

<table>
<thead>
<tr>
<th>Maximum mark</th>
<th>Average mark</th>
<th>Marks &gt; 50%</th>
<th>Marks &lt; 50%</th>
</tr>
</thead>
<tbody>
<tr>
<td>60</td>
<td>28.32</td>
<td>47 % of candidates</td>
<td>53 % of candidates</td>
</tr>
</tbody>
</table>

Level of difficulty:
The question was adequately integrated and set at an appropriate level of difficulty for Part I of the Qualifying Examination.

Main subjects/topics examined in the question:
This question was solely a computation of normal tax payable by a company as well as the secondary tax on companies question counting 60 marks in total.

In part (a) the question dealt with the following topics:
- A number of dividends received from both South African companies and non resident companies. The companies declaring the dividends were either listed or unlisted. It also included a liquidation distribution received.
- The question then continued to examine the tax allowances in respect of second hand equipment acquired from a connected person (the error in translation referred to above was made here).
- The next item dealt with was the write off of a loan where the recipient of the loan was unable to repay the loan. This had capital gain consequences.
- The next part dealt with a loan from a non resident where section 31 had to be applied.
- It then examined the situation where the purchase price of a warehouse that was acquired by the taxpayer was amended.
- The tax consequence of the acquisition of a trade mark was then tested.
- Lastly the part examined a loan obtained for purposes of paying provisional tax.

Part (b) required that the secondary tax payable in respect of a dividend declared and a deemed dividend be calculated. The dividends received in part (a) had to be considered to determine whether they qualify as dividends accrued.

General comments:
None.

Areas the candidates handled well:
The question was generally not well-answered by candidates and they appeared not to have a good general knowledge of the topics examined.

Areas the candidates handled poorly:
Part (a) of the question required of candidates to commence their answer with the net income as reflected in the income statement. This meant that candidates had to either add to the net income or deduct from the net income when an adjustment was required. A number of candidates arrived at the correct answer for an adjustment, but then incorrectly adjusted the net income, i.e. added something that should have been deducted. Candidates that used brackets to indicate that the amount should be deducted often did not apply this consistently.

Where the question required reasons to be given candidates often did not provide them.
Specific comments on sections of the question:

Part (a)
In this section, candidates were required to calculate the normal tax payable by a company. The answers in this section were generally better than in part (b). The following specific comments apply:

- The foreign dividends received proofed difficult for candidates and they either knew the tax treatment thereof or did not get it right at all.
- A number of candidates still did not know how to determine the aggregate capital gain and how a capital loss should be treated in the tax calculation.
- Interest paid on provisional tax payment – students mostly forgot about this not being deductible (quite an easy mark lost).

Part (b)
In this section, candidates were required to calculate the secondary tax payable. Part (b) was either well attempted or candidates did particularly poor in it. Many candidates did not finish this part and it was clear that this question was not expected. The fact that answers (or amounts) computed in part (a) had to be used here also presented some problems. Candidates also did not know the format for the calculation of the net amount due and the credit amount brought forward from the previous dividend cycle was often added to the dividend declared.

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