2003 QUALIFYING EXAMINATION

Part II – Financial Management

This report has been compiled from the analysis of examiners on candidates’ performance in the Part II Qualifying Examination (Financial Management), which was written in November 2003. 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;
• tutors in preparing candidates for the Qualifying Examination; and
• future 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 examination paper.

The purpose of Part II of the Qualifying Examination is to test the integrated application of practical knowledge gained in commerce and industry.

STATISTICS FOR THE PART II FINANCIAL MANAGEMENT EXAMINATION

In 2003, 55 candidates passed Part I of the Qualifying Examination, compared to 49 in 2002.

<table>
<thead>
<tr>
<th></th>
<th>% Pass</th>
<th>Passed</th>
<th>Failed</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>First attempt</td>
<td>84%</td>
<td>42</td>
<td>8</td>
<td>50</td>
</tr>
<tr>
<td>All candidates</td>
<td>77%</td>
<td>55</td>
<td>16</td>
<td>71</td>
</tr>
</tbody>
</table>

Average marks per question:

<table>
<thead>
<tr>
<th></th>
<th>Question 1</th>
<th>Question 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total marks</td>
<td>120</td>
<td>80</td>
<td>200</td>
</tr>
<tr>
<td>Average marks</td>
<td>69</td>
<td>39</td>
<td>108</td>
</tr>
</tbody>
</table>
BACKGROUND

The Examinations Committee constantly strives to improve its ability to determine whether candidates demonstrate the educational ability to qualify as Chartered Accountants. This is done by means of an ongoing process of evaluation and improvement in 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 examination questions are drawn from three sources:

- Questions (the majority) are set specifically for a particular examination by the members of the Examinations Committee (a subcommittee of the Education Committee), who are all specialists in a particular subject area;
- Questions on a particular subject may be commissioned from persons in commerce and industry as well as in public practice by the Senior Executive: Education and Training; and
- Questions submitted by practitioners, accountants in commerce and industry, and academics are added to a question pool that has been built up over the years and are also used in the examination papers.

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.

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 at least two individuals (comprising academics, practitioners and representatives from commerce and industry), who are on the whole fully bilingual and equally capable of marking both English and Afrikaans scripts.

Each script is marked by two different persons who record their marks on a mark list that they retain. 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 an 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 representatives of the Education Committee as soon as possible after the Senior Executive: Education and Training has received the mark list.
The members of the Committee receive lists of candidates – who are identified only by a ranking number based on marks obtained for the examination – together with the marks awarded to every candidate for every question. The members of the Committee base their decisions of which candidates passed with honours, which candidates passed, and which did not pass, on the marks as set out in these lists.

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

- The Education Committee’s expectations for each question;
- The level of difficulty for each question;
- Comments from markers and umpires with regard to any marking difficulties which were encountered or candidate time constraints which were noticed;
- 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.
GENERAL COMMENTS ON RESPONSES

1 Objective

In view of the primary objective of Part II of the Qualifying Examination (Financial Management), namely to test the integrated application of practical knowledge gained, 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 Comments

From a review of candidates’ answers to the two examination questions for the November 2003 examination the following basic 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.

2.1 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, such as a letter, memorandum or report.

The quality of handwriting is also an ongoing problem. The onus is on the candidate to produce legible answers.

2.2 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.

2.3 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.

2.4 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 conclusion, a message to those who were unfortunately not successful in the examination: Please start preparing for next years’ examination in good time.

Opera singer Beverly Sills once observed: “There are no shortcuts to any place worth going” and John C. Maxwell said: “A person who has a dream knows what he is willing to give up in order to go up.”

Best of luck!!
The paper consisted of two questions, which dealt with financial statement analysis, customer profitability analysis, capital budgeting, net present values and discounted cash flows, business risks, foreign exchange, incentivisation policies, valuation of a business, a black economic empowerment proposal and ethical issues.

Question 1

Number of scripts marked: 71

<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>120</td>
<td>69</td>
<td>61 (86%)</td>
<td>10 (14%)</td>
</tr>
</tbody>
</table>

Level of difficulty: Difficult

In this question candidates had to analyse the income statement of a company that operates in the Information, Communication and Technology (ICT) industry and had to discuss important issues evident from the ratio analysis. Secondly, candidates were provided with a customer profitability analysis which they had to analyse and provide detailed comment. Part (c) required the critical evaluation of a draft capital budget that was presented in the scenario. In part (d) candidates had to discuss the deduction of specific costs relating to the establishment of a new business unit for income tax purposes. Candidates were further required to perform a net present value calculation (part (e)) and to discuss the validity of using a discount rate higher than the cost of capital of the business (part (f)).

The scenario in the question included information regarding a new business opportunity and candidates were required to explain the risks faced by the company in pursuing this opportunity (part (g)) and to discuss the accounting treatment of the costs relating to setting up this business unit (part (h)). Part (i) required an outline of risks relating to movements in exchange rates and recommended hedging techniques.

Finally candidates were required to discuss potential shortcomings of an incentivisation policy for sales representatives (part (j)) and to list potential pitfalls of an incentivisation policy for executive directors (part (k)).

Part (a) was generally well answered. Most candidates identified and computed the key ratios, and as a result scored well in the question.

Answers to part (b) were most disappointing. Activity based costing (ABC) has not been examined in the Qualifying Examination for some time and candidates may have been taken aback by the subject matter. The question required interpretation of an ABC analysis, and hence candidates could have scored well with a limited knowledge of ABC costing.

Parts (c), (d) and (e) were generally well answered. Candidates should ensure that all workings are set out in order to achieve marks. In part (e), candidates would have been penalised if workings supporting capital budget were not included in answers.

Part (f) was unusual but most candidates coped well with this section, and some interesting arguments were presented.
It was clear in marking part (g), that candidates had a thorough understanding of risks. Candidates scored well in this section. Part (h) was also well answered.

Part (i) proved difficult for most candidates. Many omitted to list general risks and hedging techniques. Exchange rate risk was examined in a practical manner, and this may have confused candidates.

Part (j) was generally poorly attempted. Candidates were required to identify shortcomings of the incentivisation policy for sales representatives from the company’s perspective. Candidates failed to identify valid limitations of this scheme, and instead listed failings of the company incentivisation policies.

Part (k) was well attempted.
Question 2

Number of scripts marked: 71

<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>80</td>
<td>38</td>
<td>37 (52%)</td>
<td>34 (48%)</td>
</tr>
</tbody>
</table>

Level of difficulty: Difficult

Candidates were presented with a piece of information about a company that is a supplier of photocopier and facsimile machines and were required to value the business using the earnings yield valuation method (part (a)), the free cash flow valuation method (part (b)) and to discuss the reasons for the difference in the valuations (part (c)).

The scenario in the question included a proposal from a potential black economic empowerment partner and candidates were required to list the potential benefits of introducing a black economic empowerment shareholder (part (d)), to evaluate the proposal and to list the key issues to be considered in evaluating the proposal (part (e)).

In part (f) candidates had to identify ways in which the company could enhance its ability to fund growth of its rental activities and finally had to list ethical issues arising from the facts given in the scenario.

The answers to this question were rather disappointing. Many candidates did not explain what they were doing and did not provide any reasoning as to why they followed a specific route.

The question provided almost all of the information needed to be able to perform the computations required in part (a) and part (b). Notwithstanding this, many candidates were unable to distinguish between an earnings and cashflow valuation and further make the respective adjustments, with the result that many candidates performed poorly.

In part (c) candidates provided theoretical textbook answers without making reference to or applying the information of the question in their answers.

Candidates provided a mind dump of information in part (d) without applying the facts of the question to their answers or applying any methodology in formulating their answers. Notwithstanding this candidates still performed well in this part.

The answers to part (e) were generic in nature and lacked a certain "feel" for the relevant issue of black empowerment in South Africa and its implications. Most students gave enough points to pass this part.

Most of the students answered part (f) well and identified many ways to raise finance that were relevant to the facts of the question.

In part (g) most students were able to identify from common sense that ethics were compromised but failed to provide practical recommendations on how to overcome the dilemma. Some students did not identify the conflict of interest at all, which is a cause for concern.