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 2006. 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;
- Assist tutors in preparing candidates for the Qualifying Examination; 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 2006
- Background information on the setting, marking and adjudication of SAICA examinations
- General comments on Part I of the Qualifying Examination 2006
- Professional paper 1 – detailed comments by question
- Professional paper 2 – detailed comments by question
STATISTICS FOR PART I OF THE QUALIFYING EXAMINATION 2006

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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.

This role will be rotated between suitable academics from different universities in each subject area from year to year.

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.

It is important to note that no person from the academe is allowed to serve on the Examinations Committee. Academics do participate in the setting of the exam papers to a limited extent and this has been described above.

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. The compromise mark is calculated as follows:

- Markers agree – the mark they agree on is awarded
- Markers differ by one mark – the high mark is awarded
- Markers differ by two marks – the average mark is awarded

*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.

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.

Another important aspect of the marking process to note is 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 on their written scripts.
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 a fair 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 a moderate to easy standard. Despite this, candidates did not score as well as expected and markers continue to comment on the lack of basic and current tax knowledge. Candidates often got confused when performing the tax calculation – not knowing whether or not they were adding or subtracting different items and treated similar items in an inconsistent manner.

- The standard of the management accounting and financial management questions was also considered appropriate for this exam and both questions were considered easy to fair. Despite this both questions were not answered well by most of the candidates. Although this could be attributed to the fact that both questions were the last question in each paper and candidates may have run out of time, candidates still failed to perform basic calculations.

- The standard of the auditing question was fair and considered appropriate by the majority of universities, with two universities commenting that the standard could even be considered too easy. 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. Examiners are increasingly concerned about candidates’ 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 the candidates' answers to the seven examination questions for the March 2006 examination the following specific deficiencies were identified:

Application of knowledge

- A serious problem experienced throughout the examination (but more specifically in the auditing questions) was that candidates were unable to apply their knowledge to the scenarios described in the questions. Many candidates responded with a “shopping list” of items – a pure regurgitation of theory with no real relevance to the question. 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.

Workings

- It is essential that candidates clearly show and properly reference 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, marks could not be awarded as markers 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.

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 workplace. 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.

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. 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.
Tax knowledge

- On the whole the candidate’s tax knowledge was found to be extremely poor. Both tax questions were relatively easy and candidates with up to date tax knowledge scored well. Repeat candidates must make this an area to focus on when preparing for next years exam.

General Comments

From a review of the candidates' answers to the seven examination questions for the March 2006 examination, certain general problems were identified which ultimately affected the overall performance of the candidates. It was also noted that candidates make the same mistakes every year. While the list below may seem like common sense issues to some, candidates who don’t pay attention to these points are likely to score very low marks.

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.

Irrelevance

- 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 not gain marks.

Time management

- Candidates are advised to use their time wisely and allocate 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 be aware not to spend too much time on the first question answered and too little time on the last. Candidates should never overrun on time on any question, but rather return to it after attempting all other questions.

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.
Examination technique

- Examination technique remains the key distinguishing feature between candidates who pass and those who fail. Many candidates do not address what is 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.

Open-book examination

- A particular 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 has 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 the 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.
- The above comments on the open book technique becomes more relevant for the 2007 examination as SAICA has revised its open book policy to allow ANY annotations / writing in the prescribed books. Students should NOT be tempted to go mad and write on every blank page in their books. This will only be to the detriment of the candidate in the exam as there is NOT ENOUGH time to go searching for detailed knowledge on the day of the exam. Embedded knowledge should be learnt PRIOR to entry into the exam.

Conclusion

It will stand candidates in good stead if they prepare timeously for their examinations. For those who didn't make this years QE 1, don't give up! Practice, practice, practice!!! Sufficient preparation (and I mean consistently studying from now until the next exam), a review of the basics, updating your knowledge (especially tax), and taking heed of all our comments should make your next attempt a more successful one.

Best of luck for Part I of the Qualifying Examination 2007 to those who didn't make it this year!

Students who require access to their exam scripts may do so by making formal application in terms of the Access to Information Act. The required form is available on the SAICA website and should be accompanied by the required fee payable.
Paper 1 consisted of four questions that dealt with:

**Question 1**: Financial accounting question dealing with the accounting treatment of non-current assets held for sale, the journalizing of foreign exchange transactions with the relating hedging thereof and the calculation of depreciation on consolidated assets.

**Question 2**: Auditing question with a few marks allocated to accounting (revenue recognition). The question required substantive audit procedures, identification of control weaknesses, controls that should have been in place to prevent or detect weaknesses identified, responsibilities of external auditors, adjustments to be made to the audit plan in response to risks identified, ethics, and Companies Act.

**Question 3**: Tax question relating to an individual. Candidates had to provide advice regarding a proposed remuneration package (including a cash salary, membership of a provident fund, granting of share options and choosing between a car allowance and a company car). The individual also received gifts from his ex employer at a farewell party and exercised share options granted to him by his previous employer.

**Question 4**: Financial Management question dealing with the acquisition of a new plant to manufacture anti-malaria tablets.
Question 1

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<td>40</td>
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<td>41% of candidates</td>
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**Level of difficulty:**  Fair

**General comments**

This question was solely a financial accounting question counting 40 marks in total. The question dealt with the accounting treatment of non-current assets held for sale, the journalizing of foreign exchange transactions with the relating hedging thereof and the calculation of depreciation on consolidated assets.

The question was generally well-answered by candidates and they appeared to have a good general knowledge of the topics examined. The question was adequately integrated and set at an appropriate level of difficulty for Part I of the Qualifying Examination.

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

- Illegible handwriting is still a major problem area for some candidates and candidates should realize that the onus is on them to provide clear, concise and legible answers to all questions.

- Relevance is a major problem in most theoretical discussions provided by candidates. This is mainly due to the fact that candidates do not properly read and analyse the required part of the question and do not spend enough time planning and structuring their answers. This led to the fact that many candidates discussed issues that were not required and may well have contributed to the shortage of time that examiners believe candidates experienced in the first paper of the examination.

- Many candidates still do not realize that open-book examinations require a great part of application and not just theoretical listing of requirements. Candidates did not apply the information in the question to the requirements of the standards being examined and therefore lost valuable marks in the question. It should however be noted that it still remains important for candidates to list the theoretical aspects and requirements that support their answers and conclusions, but that these requirements should also be applied in the answer.

- General layout and planning of theoretical answers is still poor. This indicates that candidates do not plan their answers properly and do not spend enough time developing an approach that will earn the most marks in the least time available. Simple aspects are not addressed and candidates do not state obvious information that would earn them relatively easy marks.

- Many candidates still do not realize that “accounting treatment” requires the recognition, measurement and disclosure of transactions to be discussed.
Part (a)

This part of the question required candidates to discuss the accounting treatment of non-current assets held for sale, when these assets are acquired in a business combination. Candidates therefore had to identify that control is obtained through potential voting rights and that IFRS 3 Business combinations is therefore applicable to the transaction.

- Many candidates incorrectly concluded that potential voting rights should be left out of consideration when assessing whether control is obtained in a business combination. This is a direct violation of the principle in IAS 27 Consolidated and separate financial statements.

- Most candidates did not identify the fact that the treatment of the non-current assets held for sale in the individual financial statements of the entity was not required to be discussed. This led to many irrelevant points being discussed by candidates and a lot of time was therefore wasted.

- Many candidates included non-current assets held for sale at 40% on a line-by-line basis, which is effectively a combination of the conventional consolidation method and equity accounting, which is incorrect.

- Many candidates referred to non-current assets held for sale as non-current assets available for sale (especially Afrikaans candidates) – there is a conceptual difference between the two classifications and distinction is essential.

- Candidates did not take into account that this part of the question only counted 12 marks and discussed at length the recognition of non-current assets held for sale without even referring to the measurement and disclosure thereof. Candidates should take the mark allocation provided into account when planning the length of their answers.

- Most candidates suggested that non-current assets held for sale should be recognised at the lower of their carrying amounts and their fair value less cost to sell at the date of acquisition. This is not correct as the assets were acquired in a business combination (control was obtained) and should therefore have been recognised at their fair values less cost to sell at the date of acquisition.

Part (b)

This section of the question required candidates to journalise a firm commitment where the company has elected to hedge the commitment by means of a cash flow hedge in terms of the IAS 39.87 choice available to companies.

- Many candidates do not understand the concept of the firm commitment. When a firm commitment is hedged by means of a fair value hedge, the firm commitment as well as the fair value hedge must be valued and processed to the income statement while the fair value hedge is effective. This is not the case when the firm commitment is hedged by means of a cash flow hedge, as was the case in the question. Then only the cash flow hedge should be valued and fair value adjustments deferred in equity while the hedge is effective up to the transaction date. Candidates valued both the firm commitment and the cash flow hedge in the question, which is incorrect.
Most candidates missed the fact that whilst a hedge may be overall effective (i.e. between 80% and 125% borders), there may still be a limitation on the fair value movements in respect of the hedge to the fair value movements on the underlying hedged item. In the question, the fair value movements on the FEC (the hedge) had to be limited to the fair value movements on the underlying firm commitment, and the excess fair value movements on the hedge processed to the income statement. Most candidates did not apply this limitation in their answer and deferred the full fair value movement on the hedge to equity, which is incorrect.

The journals in respect of the foreign exchange transaction were generally well-answered. Certain candidates did however switch around debits and credits, certain journals did not balance and certain journal entries did not indicate dates and debits or credits, which is indicative of poor exam technique.

Candidates neglected to indicate whether the fair value adjustments on the hedge and the underlying foreign creditor (a monetary item in terms of IAS 21) had to be processed to equity or to profit or loss. In this section of financial accounting, it is essential for candidates to indicate this information as the distinction between equity and profit or loss is crucial to their understanding and underlies the topic.

**Part (c)**

In this section, candidates were required to calculate the depreciation for the group on all identified assets. This section was generally well-answered.

- Many candidates calculated depreciation on non-current assets held for sale which is in direct violation of IFRS 5 *Non-current assets held for sale*.

- Many candidates did not apply discounting to the provision for dismantling or did not deal with this aspect at all in their calculations. This indicates that candidates do not understand the interest element on provisions, the latter of which is purely a financing transaction in substance. Candidates also deducted the provision for dismantling costs from the cost price of the asset, instead of adding it.

- Many candidates calculated the number of months for which an asset should have been depreciated incorrectly. This is a serious oversight as candidates should realize by now that the depreciation of assets commences when the asset is available for use and not when the asset is brought into use.
Question 2

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<td>75</td>
<td>28.71</td>
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<td>89% of candidates</td>
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**Level of difficulty:**  Fair

**General**

Examiners felt that a basic understanding of auditing was lacking. A basic understanding of auditing concepts is required before a candidate can properly describe an audit procedure in an examination.

This question was poorly answered because of candidates’ inability to apply their knowledge to the question at hand. Candidates gave “shopping lists” or mind dumps of information which was not relevant to the information provided in the question. In addition, many candidates displayed a lack of exam technique. Candidates appear in some instances to have the knowledge, but do not score marks because they make statements as opposed to properly describing procedures, recommendations and weaknesses. For example making a statement like “segregation of duties is lacking” will not score a candidate a mark – the candidate needs to explain why as well as indicate where the lack of segregation of duties is lacking.

In addition examiners felt that students neglected the auditing question, perhaps because they felt that auditing did not carry as much weight as other questions such as Financial Accounting. The marks above reflect that candidates did NOT do well in this question.

**Part (a)**

Part (a) counted 8 marks. Candidates were required to discuss the appropriate accounting treatment for advertising revenue. The candidates generally answered the question appropriately. However, candidates lost marks for not applying the theory available in the supplied texts to the scenario. In particular, many candidates simply listed the criteria for recognition of service revenue, rather than discussing how the circumstances described in the question met the criteria.

**Part (b)**

Part (b) counted 12 marks. Candidates were required to describe substantive audit procedures which tested the accuracy of advertising revenue. This part was not answered well. The candidates wasted time and lost marks by:
- Describing too many procedures which addressed the same audit objective;
- Not recalculating the deferral and spreading of revenue;
- Only considering revenue and not the related cost;
- Not recalculating the cost estimates used as a basis for revenue recognition;
- Not describing how an analytical procedure would be performed; and
- Addressing disclosure (which was not in the scope of the question).
**Part (c)**

Part (c) comprised three parts, (c)(i) counted 19 marks while part (c)(ii) counted 7 marks and part (c)(iii) counted 8 marks.

In part (c)(i) candidates were required, in the context of the scenario, to identify the internal control weaknesses that would have enabled the fraud and to describe the internal controls that should have been in place. This section was answered poorly. Many candidates did not identify internal controls which were relevant to the scenario, but instead provided a mind dump of generic weaknesses and internal controls. Candidates did not explain how the weaknesses could have resulted in the fraud.

In part (c)(ii) candidates were required to discuss the responsibilities of the auditors for identifying internal control weaknesses. Although this section required the candidates to discuss basic theory, it was answered poorly. It was clear to the marking team that many candidates did not have a satisfactory understanding of the audit standard.

In part (c)(iii) candidates were required to describe the specific adjustments which should be made to the audit plan in the light of the internal control weaknesses identified. This section was poorly answered. Many candidates simply stated generic audit theory and did not tailor their answer to reflect the scenario and the fraud risk.

**Part (d)**

Part (d) counted 18 marks. Candidates were required to discuss the ethical and Companies Act requirements which the directors should have considered in respect of the transactions and circumstances described in the scenario. This section was answered satisfactorily.
Question 3

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<td>35</td>
<td>14.97</td>
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<td>68% of candidates</td>
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**Level of difficulty:** Fair

**General comments**

The question required a discussion of the tax implications for an individual (Mr Executive) of various issues. Mr Executive resigned from one employer and accepted a position at another employer. Candidates had to advise Mr Executive regarding a proposed remuneration package from his new employer (including a cash salary, membership of a provident fund, granting of share options and choosing between a car allowance and a company car). Mr Executive also received gifts from his ex employer at a farewell party and exercised share options granted to him by his previous employer.

The overall impression of markers was that this question was answered fairly well. However, candidates lost marks for making basic mistakes, not stating the obvious, being too vague in their advice and not always applying the theory to the facts provided.

Only a few candidates answered this question in a letter or memorandum format. This was not specifically required; candidates were asked to advise the taxpayer. However, a bonus mark was awarded for the use of a specific format.

**Part (a)**

Part (a) required advice on the tax implications of Mr Executive's proposed remuneration package from his new employer. Candidates could obtain a maximum of 3 out of a possible 7 marks.

- Most candidates correctly mentioned that the salary will be included in Mr Executive's gross income in terms of paragraph (c) of the gross income definition. Many candidates were too vague in their comments and marks could not be awarded.
- Most candidates argued that the contributions to the provident fund paid by the employer will not be a fringe benefit, but the reasoning behind it was incorrect. They argued that paragraphs 2(i) and 12A of the Seventh Schedule are not applicable as the employer's contributions will not exceed two thirds of the total contributions. This paragraph, as you know, only applies to contributions to medical aid funds.
- Some candidates were (incorrectly so) of the opinion that Mr Executive should be taxed on the employer's contributions to the provident fund, being a release of an obligation (paragraph 2(h) and 13 of the Seventh Schedule).
- Only a few candidates mentioned that he will not be taxed on the employer's contributions to the provident fund, as he has not become unconditionally entitled to it. Again, marks could often not be awarded as comments were too vague ("entitled" or phrases such as "will be paid to him on retirement").
- Very few candidates mentioned that the salary will be classified as retirement-funding employment.
Part (b)

Part (b) counted 6 marks and required candidates to advise Mr Executive on the income tax implications of share options granted to him.

- Most candidates were aware that this is a section 8C application and not section 8B and could argue the fact. Only a few applied section 8A.
- Not many candidates were aware of the section 10(1)(nD) exemption until vesting.
- Many candidates had the date of vesting correct, namely in four years’ time when the restriction on selling the shares is lifted. However, in calculating the gain on vesting, they used the R25 instead of stating that the market value on the date of vesting should be used.
- Some candidates calculated capital gains tax on the above gain.

Part (c)

Part (c) counted 10 marks and required the candidate to advise Mr Executive whether he should opt for a company car or a car allowance.

General

- Many candidates still do not understand the basic difference between the tax treatment of a company car and that of a travel allowance.
- Some candidates discussed the two options in theory and never calculated amounts which could be compared.

Company cars

- Common errors included:
  - using the determined value including VAT;
  - candidates incorrectly applied 4% to the car with the highest value and the 1.8% to the car with the lowest value;
  - reducing the value of the benefit with R120 and R85 per month for cost borne by the employee; and
  - calculating the benefit for a period shorter than twelve months.

Travel allowance

- Common errors included:
  - used the cost price excluding VAT for determining wear and tear;
  - did not limit the cost price to R360 000;
  - limited the combined cost prices to R360 000;
  - wrote the vehicles off over 5 years instead of 7;
  - excluded VAT from the R20 000 for insurance, services and tyres;
  - used deemed kilometers (7 000 / 23 000); and
  - some candidates calculated the value of the private travel but never deducted this amount from the allowance.
Part (d)

Part (d) required advice to Mr Executive on the current income tax implications of gifts received from his ex employer. This section was answered fairly well. Part (d) counted 8 marks.

Cash cheque
- Many candidates forfeited marks due to not being specific enough in their answers. For example: not specifically mentioning that the R200 000 will be included in gross income (paragraph (d)), but rather taxable income.
- Some candidates said that Mr Executive does not qualify for the R30 000 exemption (section 10(1)(x)) because he was one of the directors of Top Notch. Some thought that all the requirements of section 10(1)(x) must be met before he qualifies for the R30 000 exemption.
- Although most candidates mentioned that the general rating formula will apply, it was not clear from their answers that only the R170 000 will be subject to the average rate and not his total taxable income.
- Only a few candidates mentioned section 7A(4A) and the three times his annual salary limitation.

Television Set
- Many candidates taxed him on the market value (R25 000) and not the cost of the television to the employer (R15 000).
- Most candidates identified correctly that this was not long service (15 years vs. 13 years).

Part (e)

Part (e) required advice to Mr Executive on the current and future tax implications of the exercise of share options, assuming he would hold the shares so acquired as an investment. Part (e) counted 8 marks (a possible 12 marks could be obtained, limited to 8). This part was answered well. However the following comments can be made:

- Only a few candidates applied section 8C.
- Some candidates spread the gain over three years instead of deferring it in total.
- CGT-consequences were answered well. A common error was to first multiply by 25% and then granting the annual exclusion of R10 000. Some candidates used the inclusion rate for companies, namely 50%.
- Some candidates discussed section 9B (safe haven) under future tax implications.
Question 4

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<tr>
<th>Maximum mark</th>
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<th>Marks &lt; 50%</th>
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<tr>
<td>50</td>
<td>27.56</td>
<td>63% of candidates</td>
<td>37% of candidates</td>
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</table>

Level of difficulty: Fair to easy

General comments

This is a Financial Management question dealing with the acquisition of a new plant to manufacture anti-malaria tablets. The question required students to perform a net present value analysis of the project, including cash flow issues, relevant costing issues, and cost volume profit relationships, advice on setting an appropriate discount rate, perform a break even analysis, and identify key strategic issues.

The overall impression of the markers was that this question was answered fairly well. The theory sections of the question were however generally answered badly.

Part (a)

Candidates were expected to prepare a net present value analysis of the project, including cash flow issues, relevant costing issues, and cost volume profit relationships. The structure of answers was generally acceptable.

At least half the candidates repeated the information for the first 4 years and consequently their marks were limited. This could be poor reading of the question or not realizing the impact of the escalation rates.

The question required 11 years of analysis. The University comments criticized this as being too long and time consuming for repetitive calculations. The markers agreed with the comment, and amended the mark plan minimizing penalties for not completing the entire 11 year calculations by allocating marks to the 5th year of calculations.

The head office allocation correction was not handled too well and often where it was picked up, candidates did not pull the adjustment through to the tax side.

Part (b)

The second part of the question asks for the calculation of the break-even revenue for the third year of production.

It was distressing to see the low level of understanding of how to determine the break-even levels. About a third of the candidates attempting this section had no idea of how to perform this calculation. This came across in the following way:

- Costs not defined;
- Break even point (BEP) equated to total cost or fixed costs or variable costs;
- Gross Profit percentage (GP%) used for marginal income/contribution;
- Cash flow approaches;
• Quoting the formula, defining the costs and then clearly not being able to proceed or doing so incorrectly.

Part (c) (i) and (ii)

Part (c) deals with the minimum revenue required if VPharm sells its entire production to MBX Ltd, and to comment on the pricing issues surrounding this option. Although the calculations were relatively straightforward, few students attempted this section, and those that did attempt did not perform well.

Two alternative answers for part (i) were provided following the University comments.

The theory required in part (ii) was considered by the markers and University comments to be relatively easy, and where students were expected to score marks. This was not found to be the case. Most students did not provide comments which were specific to the pricing of the MBX order, and instead provided generic lists of considerations. The markers felt that the students’ examination technique was weak in this regard, particularly in view of the nature of an open book examination. Marks were only awarded when comments were explained in the context of the specific scenario.

Part (d)

Part (d) asked for a list of the key risks that VPharm will face in pursing this project.

This section was considered by the markers and the University comments to be relatively easy, and where students were expected to score marks. This section was answered adequately and the layout of answers, in the majority of cases, was in a bullet approach, which assisted the marking. Some candidates however did not spend sufficient time on this part of the question, indicating bad time management. Some candidates also provided generic answers which were not specific to the scenario, indicating bad presentation and examination technique.
PROFESSIONAL PAPER 2

Paper 2 consisted of three questions, and dealt with:

**Question 1:** This was primarily a financial accounting question with some auditing marks. It covered share based payments – accounting entries, goodwill movements’ reconciliation – consolidation principles, share buybacks – accounting entries, audit of share buyback, consolidation – calculation of net profit, foreign currency translation reserve and minority interest – calculation.

**Question 2:** A company tax question containing two parts dealing with taxation (a company tax calculation) and financial accounting - requiring the calculation of temporary differences.

**Question 3:** A Management Accounting question covering income statement analysis, decision making and analysis of options and capital budgeting.
Question 1

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<th>Maximum mark</th>
<th>Average mark</th>
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<th>Marks &lt; 50%</th>
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<tr>
<td>95</td>
<td>46.30</td>
<td>45% of candidates</td>
<td>55% of candidates</td>
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**Level of difficulty:** The question is considered to be of a fair standard, with aspects of the question considered to be easy.

**General comments**

The question covered the following areas:

- Share based payments – accounting entries and tax entries
- Goodwill movements reconciliation – consolidation principles
- Share buybacks – accounting entries and tax entries
- Audit of share buyback
- Consolidation – calculation of net profit
- Foreign currency translation reserve and minority interest - calculation

The following general comments can be made about candidates’ responses:

- The question required effective planning and the marks evidence the lack of planning.
- Candidates’ exam technique leaves much to be desired (pages and pages of useless, not required journals, and pages of explanations).
- Handwriting once again was an issue with a number of scripts extremely difficult to read. This is to the detriment of the candidates.
- Workings were poorly cross referenced in general and markers had to dig in the body of the scripts to find the relevant numbers. Candidates would do well to set aside answer sheets for calculations. To properly describe those calculations and to use a referencing system that allows someone else to follow the various amounts.

**Part (a)**

Candidates were required to prepare journal entries relating to a share-based payment (including tax effects) for 12 marks. Candidates either got this correct, or completely wrong.

- It is very troubling to see how many candidates incorrectly provide for the SBP at the beginning of the contract (taking 100% to Income statement), and then ‘reversing’ this over the years, i.e. reversing the expense and liability/equity as a credit to the income statement.
- Very few candidates knew that deferred tax is not provided in the income statement on the equity portion.
- Most candidates provided a liability, and did not argue about the market vesting condition that is unlikely to be met.
- Most candidates did not distinguish between the equity and cash settled scheme demonstrating a poor understanding of IFRS2.
Part (b)

This part required candidates to prepare a reconciliation of the goodwill balance as it should appear in the notes to the annual financial statements for 16 marks. This part was the best answered section of the question and few candidates failed this section.

- It is troubling to see that many candidates do not understand what a ‘reconciliation’ means as this was evidenced in the layout. Many candidates merely calculate the opening balance or closing balance with nothing in between. The candidates’ answers did not demonstrate a clear understanding of the movement between the opening and closing balances.
- Very few candidates calculated the 33.33% for Property.

Part (c)

Candidates were required to calculate the consolidated profit or loss on share buy back as it should appear in the annual financial statements for 8 marks. This was the worst answered section in the question.

- The concept of calculating a Net Asset Value (NAV) at the beginning and after the buy-back is not really understood by candidates, this should be a relatively easy concept to grasp, however the principles were not addressed in the answer.
- Candidates do not understand the difference between the profit/loss at group level versus entity level.
- Many candidates increased the minority shareholding with the portion sold.
- Candidates should note that a share buy-back is not the same as selling shares to outsiders / minorities.

Part (d)

Candidates were required to describe the audit procedures that should be performed to audit the share buy back for 12 marks. This section was relatively well answered, however:

- Many candidates do not understand how to formulate an audit procedure.
- Memory dumps and “SMS” language was often used – this is inappropriate to a professional examination.
- Many candidates did not distinguish between ‘directors meetings’ and ‘shareholder meetings’ and as such the relevant level of authorization required, quorum requirements etc. were not correct etc. A general understanding of the Company’s Act was not evident.

Part (e)

This part required the calculation of net profit or loss before minority interests for the GROUP for 22 marks. This section was relatively well answered.

- It is troubling however to see candidates who include the percentage of subsidiaries profits, instead of 100%.
- Most candidates got the unrealised profit in inventory correct, however, very few candidates raised the additional depreciation charges.
- Candidates are also not always clear about ‘under which company the journals get processed’ (i.e. does the R7 000 000 get deducted from Manufacture or Retail). Net effect in the consolidated financial statements is same, but we don’t think enough emphasis is made on the distinction at universities.
- In many instances candidates included VAT claims and wear and tear allowances in the Income Statement as direct entries to the accounts.
- The impact of the leasing was poorly answered and very few candidates addressed this properly.
- Many candidates did not take into account the share based payment (SBP) and the related accounting change, i.e. from a subsidiary to an associate. This also impacted on the answer for (f).
- Had the workings been done properly for section (b), this would have been an easy question to answer. This is also relevant for part (f).

Part (f)

This part required candidates to show how foreign currency translation reserve and minority interest should be disclosed in the consolidated financial statements of the GROUP.

- Candidates did not layout workings in a clear form, with referencing and an adequate description of the various amounts being calculated.
- Where candidates carried amounts forward from one section to another, or from one calculation to another, the amounts where often carried forward with no description of what the amount represented and no referencing as to where the amount came from.
- Many candidates did not take into account the SBP and the related accounting change, i.e. from a subsidiary to an associate.
Question 2

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<tr>
<td>60</td>
<td>33.33</td>
<td>69% of candidates</td>
<td>31% of candidates</td>
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</table>

**Level of difficulty:**  Easy to fair

**General comments**

The question counted out of 60 marks and contained two parts dealing with taxation and the combination between accounting and taxation in the calculation of temporary differences. The results for this question were good.

However, in the opinion of the mark team, the marks achieved by the candidates do not necessarily reflect the depth of their tax and accounting knowledge, for mainly the following reasons:

- Twelve marks were awarded for accounting add backs in part (a) of the question. These add backs, for example for depreciation and fair value accounting adjustments that are not tax deductible, do not test in-depth tax or accounting knowledge to any real extent.
- The taxable capital gain had to be calculated from the information in notes 9 and 13. Neither of the two notes tested the capital gains tax knowledge of candidates in any depth, as most of the information required to calculate the taxable capital gain was provided in the question.
- Errors made by candidates in the calculation of taxable income were marked through in part (b) dealing with the calculation of temporary differences.

A range of alternatives were catered for to allow for alternate interpretations of the question.

The hand writing of candidates appeared to be more legible than in previous years, but there were still a number of cases where it was very difficult to understand what candidates had written. In addition, fewer candidates used unexplained abbreviations as was the case in previous years, however “SMS” style writing using uncommon abbreviations was still evident from some candidates.

**Areas handled well by students:**

- The general lay-out for answers to part (a) was fairly good. Few candidates used the method that showed a "shortened" version of the calculation of taxable income with separate pages for notes and calculations. This latter practice should be discouraged as candidates do not reference their notes and calculations well enough and examiners struggle to follow the thought process of these candidates.
- A large number of candidates handled the add back of accounting entries correctly and earned numerous marks in this way.
- Candidates appeared to have managed their time well and a large proportion of candidates completed the question successfully.
- Candidates who demonstrated a balance between accounting and tax knowledge did very well in this question.
- The following notes to the question were handled fairly well in respect of part (a) to the question:
  - Investment in rent-producing property
  - Investment in ‘local’ shares
- Impaired plant
- New plant
- Doubtful debts.

**Part (a)**

Part (a) dealt with the calculation of taxable income. This part counted 42 of the 60 marks.

**Areas handled poorly by candidates in part (a):**

- The knowledge of many candidates in respect of the capitalised finance lease was poor. The differences between the tax treatment and accounting treatment of the finance lease were not handled well by many candidates. A large number of candidates struggled to correctly eliminate the VAT from the lease rental that is deductible for tax purposes.
- Many candidates incorrectly applied the prepayment rules in section 23H to the rentals received in advance. Section 23H applies to expenditure and losses that may be deducted under sections 11(a), 11(c) and 11(d) and not to receipts.
- The knowledge level of candidates of section 23H and the treatment of prepayments are very poor. A large number of candidates did not recognise the capitalised finance lease payment as a prepayment. A large number of candidates applied the R50 000 rule to each prepayment separately, instead of applying it to the aggregate of all amounts of expenditure incurred which would otherwise be limited by section 23H. Candidates showed incorrect reasoning for their adjustments or not adjusting for prepayments. The journals passed for the prepayments were misunderstood by many candidates. Many candidates used amounts that were not posted through the income statement as a starting point.
- A number of candidates did not know how to calculate the section 13ter allowance or apportioned it for part of a year.
- Many candidates portrayed a poor knowledge of share options and the tax implications thereof.
- The defined benefit pension fund note was misunderstood by many candidates. It would appear as if these candidates do not have an updated knowledge of the relevant IAS.
- A number of candidates calculated a recoupment on the sale of the land and administration building, even though these assets do not qualify for tax allowances at all.
- Very few candidates recognised that the bad debt owing by Mr Mali was a capital loss.
- Even though the question asked for supporting workings and reasons, too many candidates did not provide reasons in general for their calculations; and specifically did not consider the 20% of proceeds rule for the determination of the capital gain on the disposal of the land and administration building.
- Some candidates followed their calculations up with pages of unnecessary notes that again explained the tax calculations provided. Time spent on the writing of these notes could have been used better.
- Some candidates used a 25% inclusion rate for the capital gain and some even applied the annual exclusion for natural persons to the capital gain. This again points to the general lack of knowledge about CGT, even though it appears to be better than in previous years.
- It was apparent that many candidates do not have a working knowledge of the fairly new provisions with regard to the tax implications of research and development costs. The general knowledge of section 11B was poor.
- Many candidates lost easy marks by not indicating why an amount was not deductible; such as that it is capital in nature.
- The exam technique required to correctly and comprehensively address capital gains and capital losses and setting out an appropriate answer for this aspect is still lacking with many candidates.
- Many candidates wrote pages of notes without coming to a particular point.
• A number of candidates would write that an amount must be added back, but would then deduct the amount in their tax calculations (the same problem was also encountered the other way around). No marks can be awarded for such a discrepancy. It cannot be left up to the markers to decide which method or wording of the candidate is correct.
• Some candidates still apportion the section 12C allowance.

**Part (b)**

Part (b), which counted 18 of the 60 marks, dealt with the calculation of temporary differences in respect of:
- A capitalised finance lease;
- Prepaid expenses;
- Cottages for the employees; and
- Capitalised development costs.

**Areas handled poorly by candidates in part (b):**

• A large proportion of candidates did not follow the instruction of the question. The question clearly asked that candidates state in each case whether the temporary difference is **taxable or deductible**. In many cases no indication was given as to the nature of the temporary difference and in many other cases candidates classified the temporary differences as assets or liabilities. It is critical that the required part of a question is read and followed.
• A large number of candidates did not know how to calculate the temporary difference in respect of the lease liability. Given the difficulties that many candidates had with the tax position of the lease, it is indicative of a serious lack of knowledge about leases. This is a worrying situation given the wide use of leases in practice.
• A number of candidates did not use the information that they had provided in the calculation of taxable income as the tax base for the calculation of the temporary differences. It was, therefore, not possible to mark through errors for these candidates.
• Some candidates followed their calculations up with pages of unnecessary notes that again explained the calculations of the temporary differences as if they were not sure about their calculations. Time spent on writing these notes could have been used better.
Question 3

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<th>Marks &lt; 50%</th>
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<tbody>
<tr>
<td>45</td>
<td>21.16</td>
<td>42% of candidates</td>
<td>58% of candidates</td>
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</table>

Level of difficulty: Fair

General comments

This question covered income statement analysis, decision making and analysis of options and capital budgeting.

It is apparent that the majority of candidates failed this question due to not reading and assimilating the information in the question and not comprehending the required section. This is a perennial issue in financial management and costing questions in the Qualifying Examination and a disturbing reflection on the quality of candidates attempting the examination.

Part (a)

Candidates were required to analyse the 2006 divisional income statements of a training organisation and discuss the issues arising from their analysis. Ratio analysis for a service organisation is slightly different to other organisations however, candidates should have been able to intelligently analyse and comment on results. The final mark plan was generous and 31 marks were available subject to a maximum of 15 for the section. This may appear unduly generous however, candidates could validly calculate many ratios and discuss these.

- The required section specifically asked candidates to analyse and discuss the financial performance of all training sites and the lodge. Unfortunately, many candidates omitted to cover all venues and hence, scored poorly. Failure to carefully read the required section is a perpetual issue in the Qualifying Examination.
- Capacity utilisation at training sites and the lodge is a critical issue for the business. Many candidates did not assimilate the information in the question and forgot to multiply the number of attendees on 2 and 3 day courses by 2 or 3 in order to calculate the total number of attendees during the financial year. This could have been checked had a simple logical calculation been performed by candidates.
- Certain candidates assumed that the information in the question was incorrect. For example, they assumed that presenters’ salaries were variable costs instead of fixed costs as indicated in the question. It follows that any contribution ratios calculated were incorrect as a result. This was a result of candidates making an assumption about salaries being variable costs (as they may have been taught) without actually applying the facts as presented in the question.
- It was apparent that candidates did not understand the nature of business that ABS operates in. They seem to be more comfortable analyzing manufacturing operations. Certain students mentioned that fixed costs as a % of total costs were very high indicating a “capital intensive production environment”. Given that ABS is a training (i.e. service) organisation, these comments were most disturbing.
- Overall performance in part (a) was poor. This poor performance is consistent with prior years where financial analysis has been examined but exacerbated in 2006 due to the different nature of business covered.
**Part (b)**

Candidates were required to analyse various options associated with the Irene training venue. The required section was very specific. This part counted 15 marks.

Most candidates were very confused in attempting to compare the financial implications of continuing to operate the Irene site, closing it down or outsourcing operations. This analysis could either be performed using the “total” or incremental” approach. Most candidates confused the two approaches and hence, answers became illogical.

- Certain candidates answered part (c) in part (b). The required section was very clear and this kind of basic mistake should not be encountered in the Qualifying Examination.
- Many candidates omitted to evaluate all options and only covered two alternatives being closing the venue or outsourcing. The possibility of continuing on the current basis was largely ignored by candidates despite the fact that was specifically requested in the required.
- Most candidates failed to grasp the difference between the cost implications of short term and long term decision making. Many candidates made use of techniques to evaluate the options which indicate that were applied without insight and understanding.
- Most mistakes made by candidates tend to indicate that candidates failed to read (and then respond to) what was required of them. This could also have been due to a lack of time and candidates at this level must learn to manage their time effectively in an examination.

**Part (c)**

For 8 marks, part (c) required candidates to evaluate whether the outsourcing of the catering function at the lodge would improve profitability. The majority of candidates failed to identify that retrenchment costs were once off. It follows that they concluded that outsourcing would reduce profitability when the opposite was true. Also, many candidates omitted to make a recommendation and missed out on an easy mark.

**Part (d)**

This section, for 7 marks, required candidates to outline how management should approach the financial feasibility of upgrading the Magaliesberg facilities and list further financial information required for decision making purposes. It was disturbing to note the number of candidates who attempted to perform calculations in answer to the question when this was clearly not required.

Available presentation marks were 3. Overall, the mark plan was very generous with a possible 89 marks available subject to maximum of 50.