

Examiners Comments

Assessment of Professional Competence

November 2016

OBJECTIVES OF THIS REPORT

This report has been compiled from the analysis of examiners on candidates' performance in the Assessment of Professional Competence (APC), which is Part II of the Qualifying Examination and which was written in November 2016. Its objectives are to –

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

To accomplish these objectives, the report provides specific comments on each section of the case study required.

The APC Competence consists of a single integrated case study which is based on a comprehensive real-life scenario and is multi-disciplinary in nature, in that it covers multiple competency areas.

The case study will be assessed within the context of a certain baseline of technical competence (as developed through the academic programme and as assessed in both the academic programme and the ITC). The case study will also be assessed within the context of any industry, including those that are specifically excluded from ITC.

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

- Background and acknowledgement on the setting of APC November 2016
- Statistics and detailed comments by section/required

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

BACKGROUND AND ACKNOWLEDGEMENT ON THE SETTING OF APC NOVEMBER 2016

The Examinations Committee (Examco) constantly strives to improve its ability to determine whether candidates demonstrate a level of professional competence at entry into the CA(SA) profession. This is done by means of an ongoing process of evaluation and improvement of the way in which it commissions an appropriate case study for the assessment and decides on the evaluation of competence.

Source of the questions

Examco is a sub-committee of the SAICA Initial Professional Development Committee (IPD Committee), and takes overall responsibility for the setting of the case study.

The APC Examco will decide on the industry, scenario and topics to be examined and will also commission a separate setting team, who are specialists in their respective competency area(s) and who have a good understanding of the other competency areas, to commission an appropriate case study and solution for the assessment.

The team will consist of academics and members of the profession in public practice and / or in commerce and industry. Case studies will be commissioned from any person the APC Examco deems to have the relevant experience and competence to do so.

In this regard, the following applies:

- Members in practice who are requested to set case studies by the APC Examco may not be involved in any way in preparing candidates for the APC (this includes formal courses and lectures and training programmes and support programmes put in place to prepare students for the APC but excludes members who perform the normal role of a supervisor, manager or partner on a client); and
- Individuals who are in any way involved in preparing students for the professional programme (this includes formal courses and lectures and training programmes and support programmes put in place to prepare students for the APC but excludes members who perform the normal role of a supervisor, manager or partner on a client) are PROHIBITED from preparing or reviewing any aspect of the case study.

Academics, former academics and/or members of the profession in public practice and/or in commerce and industry will also be selected by Examco each year to assist in the external review of the case study. These external reviewers will be selected based on their experience and ability.

Anyone involved in the professional programmes may not be engaged by SAICA to perform the role of external reviewer.

The involvement of such individuals as external reviewers in the assessment setting and review process is crucial for achieving the quality objective of the assessment.

Where appropriate and where possible, external reviewers will be appointed for a period of at least three years as continuity is important.

The external reviewers will have the following tasks:

- Review of the case study for conceptual problems and consistency in the use of terminology;
- Indicate whether the relevant case study is set at an appropriate level;
- Comment on whether the level of competence in accounting and external reporting (underpinned by the pervasive skills) is set at an appropriate level;
- Comment on whether a minimum level of competence in the remaining five specific technical competence areas and communication skills is set at an appropriate level;
- Comment on the provisional mark grid;
- Comment on whether the time limit is appropriate (assessment can reasonably be completed within a six-hour period, including reading time); and
- Comment as to whether the principles of assessment have been met.

In addition, the quality and appropriateness of the case study are also monitored by at least two external sitters, who attempt each APC case study. These external sitters are required to provide the APC Examco with a formal, independent report in which they comment on the overall case study and suggested solution.

SAICA would like to acknowledge and thank all the people involved in the setting process.

An alphabetical list of all the people involved in various roles, including members of the Examinations Committee, setting team, reviewers and external examination sitters, is as follows:

Christo Landman
Ferdinand Mokete
Frans Prinsloo
Glynnis Carthy
Greg Beech
Gregory Plant
Jacques van Rooyen
Janine Claassens
Justin Shein

Mandi Olivier
Marielienne Janeke
Marco Miguel Pinheiro
Nico van der Merwe
Nomonde Holomisa
Richard Warren-Tangney
Sydney Mhlarhi
Terry Moore
Zuleka Jasper

COMMENTARY ON CANDIDATES' PERFORMANCE IN THE APC 2016

The 2016 case study was based on a hypothetical private company involved in the retail apparel industry. This proved to be very topical given the challenges faced by South African clothing and luxury goods retailers in 2016/2017. The feedback received from the professional programme providers and training officers was that the tasks in the case study were well triggered, however, the exact nature of the tasks could not be predicted.

The average results per section are summarised above each task in this report. In summary, candidates generally responded very well to parts (a) and (f), and mostly displayed competence in parts (b), (d) and (g). The majority of the candidate population struggled with parts (c) and (e). A balance of easy, moderate and difficult tasks in the APC is deliberate and assists in the overall evaluation of professional competence.

Set out below we have summarised candidates' general performance for each part of the case study. These should be read in conjunction with the published examples of actual candidates attempts per task, which the mark team deemed to be 'limited competence displayed' (LC), 'competent' (C) and 'highly competent' (HC) attempts.

Part (a)

Competence area	APC 2016 candidate results		
	Not competent	Borderline	Competent
Audit & pervasive	1.2%	14.5%	84.3%

(a)	<p><i>Respond to Harry Mnisi's email request in document F.</i></p> <p style="text-align: center;">DOCUMENT F</p> <p style="text-align: center;">EMAIL TRAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT</p> <div style="background-color: #e0e0e0; padding: 5px; margin-bottom: 10px;"> <p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 05:45 AM To: Financial Accountant CC: Subject: RE: Internal audit</p> </div> <p>Hi</p> <p>Please have a look at the email trail below, as well as the WhatsApp messages I received from Bill Marx which I forwarded to you. I would like you to draft the memorandum requested by Sally Whiteley in her email on my behalf.</p> <p>Thanks Harry</p> <hr/> <div style="margin-bottom: 10px;"> <p>From: Sally Whiteley Sent: Tuesday, 15 November 2016, 03:47 PM To: Harry Mnisi CC: Subject: RE: Internal audit</p> </div> <p>Hi Harry</p> <p>Please refer to the email from Gavin below, as well as my email of 9 November 2016.</p> <p>Could you please prepare a memorandum to be tabled at our next Board meeting dealing with –</p> <ul style="list-style-type: none"> • the key considerations in deciding whether to establish an internal audit function for zinga Fashions within the next couple of months; and • Bill Marx's suitability as a potential candidate as head of internal audit in the event that the Board does decide to appoint one. <p>Regards Sal</p> <hr/> <div style="margin-bottom: 10px;"> <p>From: Gavin Marx Sent: Friday, 11 November 2016, 01:30 PM To: Sally Whiteley CC: Subject: RE: Internal audit</p> </div> <p>Dear Sally</p> <p>I know that you have asked Harry to report on the desirability of establishing an internal audit function for our company.</p> <p>Refer below to the email I received from my nephew, Bill Marx, who has recently qualified as an internal auditor. I took the liberty of providing him with Harry's contact details. I think that Bill may be a good option to be our company's first internal auditor. Not only is Bill suitably qualified, but he has some very good ideas which I believe will be of great benefit to zinga Fashions.</p>
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	<p>In the interests of transparency, I thought that I should inform you of this fact.</p> <p>Regards Gavin</p> <hr/> <p>From: Bill Marx Sent: Friday, 11 November 2016, 11:00 AM To: Gavin Marx CC: Subject: Internal audit</p> <p>Dear Uncle Gav</p> <p>As you are aware, I have now completed my university studies, and I am ready to start my career as an internal auditor. From what you have told me about zinga Fashions (Pty) Ltd, it sounds like an exciting company to work for, and I would now like to take you up on your offer to assist with securing me a job at zinga Fashions.</p> <p>At this stage I have the following internal audit projects in mind:</p> <ul style="list-style-type: none"> - Undertaking work in areas that will contribute to a reduced external audit fee, e.g. by evaluating the effectiveness of your company's internal control systems; and - Detecting fraudulent conduct at zinga Fashions by establishing and rolling out a whistleblower's hotline – which will use my cell phone number, and which I am willing to man on a 24 hours a day basis. I will investigate all reported frauds, and present the findings to the CEO / CFO. <p>But, of course, the exact nature of my work can only be finalised following discussions with your company's executives, and once I have a better understanding of the needs of zinga Fashions.</p> <p>Cheers Bill</p>
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The task required candidates to respond to two elements namely; whether zinga should establish an internal audit department and the suitability of appointing Bill Marx to head this new division. Candidates needed to address both aspects of the task in order to be competent in this section. As previously mentioned, most candidates displayed competence in part (a). These individuals covered the key purpose and benefits of having an internal audit division, touched on the relationship with the external auditors and concluded that Bill Marx was unsuitable to head up the division.

Candidates who did not perform adequately in part (a) generally:

- Competently addressed the first aspect of the task but then reached the conclusion that Bill Marx was suitable to head up the new division; and/or
- Responded to Harry Mnisi covering the key issues but the response was too long (the memorandum to a board of directors on this issue needed to be succinct and not a theoretical dump).

Candidates who displayed a high degree of competence often identified and discussed:

- King III/IV and the potential stock exchange listing of zinga;
- The need for internal audit to report to the (non-existent) audit and risk committee at zinga;
- Practical examples of how internal audit could improve business processes and risk identification/mitigation;
- The need for Gavin Marx to recuse himself from the board discussions re the appointment of his nephew; and
- The inappropriateness of Bill Marx/internal audit being remunerated on a contingency basis.

Part (b)

Competence area	APC 2016 candidate results		
	Not competent	Borderline	Competent
SRMG & Pervasive	10.8%	37.9%	51.2%

(b)	<p><i>Harry Mnisi asked for your opinion on the issues raised in document H. Respond via email.</i></p>
	<p>DOCUMENT H</p> <p>EMAIL FROM HARRY MNISI TO REFILWE MAPOE</p>
	<p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 06:15 AM To: Refilwe Mapoe CC: Financial Accountant Subject: Tweets</p> <p>Hi Refilwe</p> <p>My daughter referred me to some tweets made by Gavin Marx on Twitter recently. I logged onto Twitter and can confirm the following posts were made by Gavin. They are still on Twitter:</p> <p style="padding-left: 40px;">So bored in the board meeting, blah blah ... only interesting thing is the talk of our possible JSE listing and maybe an acquisition before then - Gavin Marx (@Gavzinga) November 7, 2016</p> <p style="padding-left: 40px;">You know you live a boring life if you aren't nervous about others looking at pictures on your phone – I just have photos of models wearing zinga clothes lol - Gavin Marx (@Gavzinga) November 12, 2016</p> <p style="padding-left: 40px;">#FeesMustFall getting boring. It's amazing how often these protests start just before university exams - Gavin Marx (@Gavzinga) November 14, 2016</p> <p>Refilwe, I am not sure these tweets are appropriate? What should we do as a company?</p> <p>Regards Harry</p> <p>PS: I have copied our Financial Accountant on this email as I think the younger generation may provide some different insights into social media.</p>

The majority of candidates identified the issues with the first and third tweets, and the dangers of social media. Candidates who were assessed competent in this task generally:

- Recognised that disclosing a potential acquisition by zinga was a breach of confidentiality;
- Marx has a duty as a director to act in the best interests of zinga; and
- The potential negative consequences for zinga arising from the third tweet.

The mark team was concerned about the negative stance taken by many candidates to the second tweet. Marx is the director of buying and merchandising and would probably be responsible for marketing and advertising campaigns. This tweet is not necessarily offensive and could be fun publicity for zinga.

Candidates who failed to identify the potential negative consequences for zinga of the third tweet were mostly deemed less than competent in part (b). Notwithstanding freedom of speech, this tweet could elicit a major backlash in the traditional and social media sectors and be damaging to zinga.

The mark team noticed isolated instances were candidates suggested that Gavin Marx should be dismissed as an employee. This is a legal matter and beyond the scope of an aspiring CA(SA)'s expertise. Such a recommendation in an email to your boss may be a career-limiting move in practice.

Impressive recommendations and observations made by candidates included:

- The need for zinga to have a social media policy;
- The link between zinga's social media strategy and Marx's tweets;
- Some of the actual social media fiascos in South Africa and globally in the recent past; and/or
- Practical steps to address and mitigate potential damage for zinga (for example, Marx to delete tweets, establishing a bursary fund etc).

Part (c)

Competence area	APC 2016 candidate results		
	Not competent	Borderline	Competent
Fin Acc & Tax	19.4%	44.6%	36.0%

(c)	<p><i>Prepare a document for Harry Mnisi setting out your comments in response to his request to review the draft workings (see document E).</i></p>
	<p>DOCUMENT E</p> <p>EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT</p>
	<p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 05:39 AM To: Financial Accountant CC: Subject: Current and deferred tax: Sale and leaseback</p> <p>Hi</p> <p>I need your assistance please. One of the outstanding matters in the financial statement preparation process is the sale and leaseback transaction and the tax computations. I played around with the deferred tax consequences of the sale and leaseback so that I can incorporate it into the draft deferred tax calculation for the auditors. With all my current work pressures, I do not have time to get it perfect right now, and would appreciate your input. Please also check my calculation of the base cost of the building for CGT purposes – I am not sure if I used the most appropriate basis. I cannot get the deferred tax proof to work yet!</p> <p>In my calculations I've used a lease term of ten years as we are definitely not certain that we will be renewing the lease. We might be moving offices in the long term. I used a discount rate of 5,5% per annum (nominal), as this is a fair estimate of the interest we would have paid on a bank loan to finance this particular transaction.</p> <p>I forgot to mention this to you previously, but there is some additional information that might affect the numbers: before we sold the head office building, its residual value had always been estimated to be equal to the carrying amount, and the auditors agreed based on the information that was reasonably available at the time. However, during the sale and leaseback negotiations we did some market research and it came to light that other office buildings in the same area and the same age as ours will be at the end of the lease term, currently sell for around R58 million. That is in today's money terms, so I think we were lucky to negotiate a guaranteed residual of only R70 million, considering that property prices in the area generally grow by about 2,5% from year to year! I am also aware that the lessor did not incur any costs to secure the lease.</p> <p>I attach my draft workings for your review. Just comment on any errors or omissions – we can finalise the correct workings later.</p> <p>Thanks in advance.</p> <p>Regards Harry</p>

In task (c) , the task at hand was that the financial accountant (represented by the candidate), was required to prepare a document for Harry Mnisi (the CFO), which contains commentary on the draft current and deferred tax workings prepared by the CFO, in connection with a sale and leaseback transaction, which Zinga entered into. The draft current and deferred tax workings in connection with this transaction were provided to the candidates in the information on the day.

In answering this task successfully, the candidates needed not only to demonstrate the technical competence in connection with IAS12 *Income Taxes* and IAS17 *Leases*, but the candidates also required the pervasive skills of being

able to evaluate information (i.e. being able to work through the given draft workings in a systematic, analytical and critical manner) and being able to present their findings in an appropriate manner to the CFO with an appropriate professional tone.

There was a trigger in the pre-released information to research the following:

- Accounting treatment of a sale and lease back transaction as prescribed by IAS 17;
- Value-added tax (VAT) treatment of a sale and leaseback transaction; and
- The basic aspects of a pre-valuation date asset (i.e. acquired prior to 1 October 2001) in terms of the Eighth Schedule of the Income Tax Act.

Although the current and deferred tax implications in connection with a sale and leaseback transaction were not specifically triggered in the pre-released information, candidates are always expected to consider the current and deferred tax implications of any financial accounting matter as current and deferred tax forms an integral part of financial accounting matters.

Candidates who displayed competence showcased not only the ability to evaluate a pre-prepared calculation adequately, but also, addressed several key issues in the draft current and deferred tax workings provided. The latter included the following:

- Identifying the key accounting errors made in the calculation which included the omission of the deferred gain to be recognised on the sale and lease back transaction in terms of IAS17;
- Identifying the incorrect accounting treatment of the VAT on the sale and lease back transaction with supporting arguments;
- Determining the base cost of the building with supporting arguments; and
- Displaying overall deferred tax knowledge by being able to integrate and identify the implications of the above three aspects on the draft current and deferred tax workings provided.

Overall, the majority of the candidates addressed the first three aspects adequately, but lacked the ability to integrate this knowledge and to identify the implications thereof, on the draft current and deferred tax workings provided. The latter resulted in the majority of the candidates not evaluating and not identifying the key issues in the draft current and deferred tax workings adequately and, therefore, the majority of the candidates did not display overall competence in deferred tax.

Candidates who excelled in this task, meticulously worked through the calculations and identified not only the key issues noted earlier, but also other, more technical errors and omissions, in the calculation. The latter was only displayed if the candidate had an in-depth knowledge of the accounting and tax treatment of a sale and leaseback transaction which assisted in identifying the more technical aspects that would affect the current and deferred tax workings provided.

This task is a good example of what candidates would be exposed to, and be required to do, in practice. It integrates knowledge of two key areas of specialism (i.e. financial reporting and tax) which qualified chartered accountants are expected to be competent in.

Part (d)

Competence area	APC 2016 candidate results		
	Not competent	Borderline	Competent
Audit	10.4%	52.0%	37.6%

(d)	<p><i>In response to Harry Mnisi's email (document G) –</i></p> <p>(i) <i>describe the additional reports that you would ask Barbara Byte to extract from the inventory management system; and</i></p> <p>(ii) <i>list the key questions you would ask Belinda Jantjies to enable Harry Mnisi to evaluate the reasonableness of the inventory obsolescence allowance at 30 September 2016 for financial reporting purposes.</i></p>
	<p>DOCUMENT G</p> <p>EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT</p>
	<p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 06:05 AM To: Financial accountant CC: Subject: Inventory obsolescence allowance</p> <p>Hi there</p> <p>I mentioned last week that I needed you to help with the preparations for the discussions with the external auditors regarding the reasonability of the obsolescence allowance for inventories. Belinda Jantjies was responsible for calculating the obsolescence allowance amount – see attached for her notes and the workings that she sent me.</p> <p>Please could you review Belinda's notes and think about what additional reports we should ask Barbara Byte to extract to help us assess the reasonability of the obsolescence allowance. Also, let me know what questions we should ask Belinda when we meet with her to discuss the obsolescence allowance workings – bearing in mind that you and I will have to justify the approach and workings to the external auditors.</p> <p>Thanks in advance.</p> <p>Regards Harry</p>

This task was practical and challenging. Candidates who simply listed potential reports and questions in the hope of these being relevant did not perform well. Inventory obsolescence was strongly triggered in the pre-released information but the exact nature of the task could not be predicted.

Candidates who were assessed as competent in this task generally listed sufficient relevant reports and good questions. Most either listed relevant reports with limited questions or vice versa. It was disappointing to note how many candidates listed generic reports and questions without specific application to zinga's operations.

Candidates who achieved competence in part (d) often:

- Distinguished between slow moving, high risk items and damaged goods in their questions/reports;
- Addressed net realizable value; and
- Questioned the methodology and consistency of the basis for provision.

The mark team noticed that some candidates questioned Jantjies' qualifications and competence to calculate the inventory obsolescence amount. Picture the scene – you forwarded a list of questions including the aforementioned to Jantjies as the newly appointed financial accountant. The response could have been a short career at zinga.

Part (e)

Competence area	APC 2016 candidate results		
	Not competent	Borderline	Competent
Fin Man	15.7%	39.3%	45.1%

(e)	<p><i>Prepare the memorandum for the Board of Directors as requested by Harry Mnisi in document I.</i></p>
	<p>DOCUMENT I</p> <p>EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT</p>
	<p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 07:35 AM To: Financial Accountant CC: Subject: Revenue ratios</p> <p>Hi</p> <p>I need to calculate relevant revenue ratios for FY2016, together with comparatives, and discuss these at our Board meeting later this month. The context is that our directors want to review our historical revenue growth and evaluate where our growth has come from and what strategies to follow to address any issues.</p> <p>You would have seen the revenue breakdown per year in which stores were opened in the PowerPoint presentation to First Regional Investment Bank – see particularly slide 12. I have attached some additional information that I have extracted from our management information system, which may be useful in calculating relevant revenue ratios. Assume that the attached information is accurate – our management information system provides detailed and valid data!</p> <p>Please prepare a memorandum on my behalf that I can distribute to the Board. The Board prefers concise memorandums that summarise the key issues. The memorandum should deal with the most relevant revenue ratios together with commentary on these numbers.</p> <p>Bear in mind that we did not close or renovate any stores in FY2016 and FY2015. Also, we did not open any new stores in FY2013.</p> <p>Regards Harry</p>

This task proved challenging for most candidates for various reasons:

- The memorandum needed to be concise whilst also containing insightful commentary as the board of directors would know the zinga business;
- Additional information provided on the day may have been overwhelming to absorb in an ‘exam’ setting and candidates needed to identify relevant information without spending too much time on the detail; and
- A select, limited number of ratios needed to be included in the memorandum rather than too many.

Candidates who adopted an ITC type approach to part (e) would have been assessed as borderline competent or lower. Calculating ratios and repeating these results in words would not impress the board of directors of zinga. It was disappointing to note how many candidates included non-revenue ratios in their memoranda. This was clearly beyond the scope of the task.

This task provided the opportunity for candidates to reveal evidence of pre-research. This was often apparent where candidates did list revenue ratios of competitors (Mr Price, Truworths etc). Group work during the pre-release period is encouraged and this was one task where it was evident. Unfortunately, simply listing the revenue growth and comparable sales growth ratios of zinga’s listed competitors would not have translated into competence in part (e).

Refer to the published specimen examples of limited competence, competent and highly competent as published by SAICA to gain a better understanding of the performance in part (e). The competent candidates identified the key issue facing zinga and many other retailers namely; historical revenue growth was derived largely through new store openings with limited unit sales growth.

Part (f)

Competence area	APC 2015 candidate results		
	Not competent	Borderline	Competent
SRMG & Pervasive	2.7%	32.8%	64.5%

(f)	<p><i>Draft a memorandum for discussion in response to Harry Mnisi’s email requests in document J.</i></p>
	<p>DOCUMENT J</p> <p>EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT</p>
	<p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 07:45 AM To: Financial Accountant CC: Subject: Growth strategies</p> <p>Hi</p> <p>With regard to that presentation to First Regional Investment Bank which I forwarded to you last week, please go to section 9 (slide 17). I know that I am going to be asked by the other directors which of the growth opportunities we should prioritise. All those initiatives and opportunities look good but we have to focus on those that will deliver the <u>most long-term value</u> to our shareholders and focus on them first.</p> <p>Please prepare a brief memorandum (for my attention only at this point in time). In it, rank the seven growth opportunities per the First Regional presentation from 1 (highest priority) to 7 (lowest priority), together with your reasons for your assessment.</p> <p>We also need to be cognisant of the major trends in consumer behaviour and retailing. What are two of the major trends (apart from those implicit in the seven growth strategies above) that zinga needs to be aware of and adapt to? Please include some brief notes in the memorandum on this aspect.</p> <p>The document does not have to be too formal – feel free to use bullet points to explain your rationale.</p> <p>Thanks Harry</p>

This task proved to be the easiest for candidates. It was meant to allow candidates to demonstrate their pre-research and draw from experience in other tasks. For example, candidates who identified that historical revenue growth was largely from opening new stores in part (e) should have concluded that long-term this may not be a sustainable strategy.

The mark team was very impressed with most candidates’ attempts. It was interesting to read their reasoning for rankings and trends in retailing.

There were no correct or incorrect answers provided the reasoning was valid. Within the mark team there was similarly no consensus on which of the 7 strategies were most likely to deliver long-term value to zinga’s stakeholders. That’s real life!

The few candidates who did not achieve competence in part (f) either failed to rank the 7 strategies but rather listed positives and negatives of each. Alternatively, they omitted to list two major trends and hence, did not complete the task.

Part (g)

Competence area	APC 2016 candidate results		
	Not competent	Borderline	Competent
Fin Acc & MDMC	9.0%	60.8%	30.2%

(g)	<p><i>Respond via email to Harry Mnisi's queries in document K.</i></p> <p style="text-align: center;">DOCUMENT K</p> <p style="text-align: center;">EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT</p> <p>From: Harry Mnisi Sent: Wednesday, 16 November 2016, 07:59 AM To: Financial Accountant CC: Subject: Cost of sales</p> <p>Hi again</p> <p>You will recall our earlier discussion where I mentioned to you that Sally and I are wondering whether our GP% is actually comparable to that of the listed groups, because they might be including certain income and expenses in different line items. I re-read IAS 2 yesterday and I am not sure that I agree with all of the principles from a management decision making and control perspective.</p> <p>I have three specific issues:</p> <p>(a) Storage costs – IAS 2 states that we should exclude these from the cost of inventories. That makes no sense from a management decision making and control perspective. Our business is seasonal and we need to order and store large quantities of products every couple of months. The cost of storage is inextricably linked to the cost of merchandise – to include these costs in other operating costs would not be reflecting the true cost of our merchandise.</p> <p>(b) Inventory write-offs – IAS 2 requires us to include the obsolescence allowance, inventory write-offs and shrinkage in the cost of inventories expensed. To my mind, inventory write-offs are the result of poor planning by the fashion buyers. So why should sales be punished for higher inventory costs when the fashion buyers made the mistake? I would prefer to reflect inventory write-offs as a separate line item in other operating costs in our monthly management accounts. Also, inventory write-offs are so easy to manipulate from year to year – we can vary our procedures for identifying slow moving inventory and achieve a different GP%.</p> <p>(c) Royalties – IAS 2 states that royalties paid to our foreign suppliers (we have numerous licencing agreements with foreign brands) be included in the cost of inventories. Royalties are paid when we sell products and not when we order and store merchandise. If we do not sell the merchandise, we do not pay royalties. I think we should reflect royalties paid as a selling expense in our management accounts.</p> <p>I would like your thoughts on where zinga should reflect the above costs in our monthly management accounts. Obviously we will need to comply with IFRS for our financial reporting purposes but we do not have to manage our business using illogical principles.</p> <p>Please could you double check that I have interpreted IAS 2 correctly for the above three items.</p> <p>Thanks once again! I'm sure things will get quieter as soon as the audit is done.</p> <p>Regards Harry</p>
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Part (g) provided a challenge for many candidates. The financial accounting for storage costs and inventory write-offs was mostly competently handled. IAS 2 provides no clear guidance on whether royalties should be included or excluded from the cost of inventories. The mark team accepted either conclusion (royalties included or excluded), however, the key test was whether candidates could argue their case. Those candidates who stated that IAS 2 expressly stated that royalties should be included in the cost of inventories were treated with great skepticism.

The MDMC aspect of the task was generally poorly attempted and sometimes ignored (at their peril). Part (g) provided an opportunity to test candidates' critical thinking and logical argument. The mark team was disappointed with many responses as these professional skills were not evident.

The task was practical in that many financial managers in the retail industry debate the underlying issues in part (g). There are no absolute correct answers with regards to how to treat all three items for the purposes of management decision making and reporting.