THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2020 DIET
PROFESSIONAL LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Marking Guides

and

Examiner's Reports

FOREWARD

This issue of the **PATHFINDER** is published principally, in response to a growing demand for an aid to:

(i) Candidates preparing to write future examinations of the Institute of Chartered Accountants of Nigeria (ICAN);

(ii) Unsuccessful candidates in the identification of those areas in which they lost marks and need to improve their knowledge and presentation;

(iii) Lecturers and students interested in acquisition of knowledge in the relevant subject contained herein; and

(iv) The professional; in improving pre-examinations and screening processes, and thus the professional performance of candidates.

The answers provided in this publication do not exhaust all possible alternative approaches to solving these questions. Efforts had been made to use the methods, which will save much of the scarce examination time. Also, in order to facilitate teaching, questions may be edited so that some principles or their application may be more clearly demonstrated.

It is hoped that the suggested answers will prove to be of tremendous assistance to students and those who assist them in their preparations for the Institute's Examinations.

NOTES

Although these suggested solutions have been published under the Institute's name, they do not represent the views of the Council of the Institute. The suggested solutions are entirely the responsibility of their authors and the Institute will not enter into any correspondence on them.

TABLE OF CONTENTS

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2020

CORPORATE REPORTING

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ANSWER FOUR OUT OF SIX QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

Statements of financial position as at December 31, 2019

	Haba	Suka	Zara
	₦'000	**₦'000**	**₦'000**
Assets			
Non-current assets			
Property, plant and equipment	32,000	25,000	20,000
Investments	33,500	-	-
	65,500	25,000	20,000
Current assets			
Cash at bank and in hand	9,500	2,000	4,000
Trade receivables	20,000	8,000	17,000
Inventory	30,000	18,000	18,000
	125,000	**53,000**	**59,000**
Equity and liabilities			
Equity			
Share capital	40,000	10,000	15,000
Share premium account	6,500	–	–
Retained earnings	55,000	37,000	27,000
	101,500	47,000	42,000
Current liabilities	23,500	6,000	17,000
	125,000	53,000	59,000

Statement of profit or loss for the year ended December 31, 2019

	Haba	Suka	Zara
	₦'000	**₦'000**	**₦'000**
Revenue	125,000	117,000	82,000
Cost of sales	(65,000)	(64,000)	(42,000)
Gross profit	60,000	53,000	40,000
Distribution costs	(21,000)	(14,000)	(16,000)
Administrative expenses	(14,000)	(8,000)	(7,000)
Profit before taxation	25,000	31,000	17,000
Income tax expense	(10,000)	(9,000)	(5,000)
Profit after tax	**15,000**	**22,000**	**12,000**

Statement of changes in equity (extract) for the year ended December 31, 2019

	Haba	Suka	Zara
	₦'000	**₦'000**	**₦'000**
Retained earnings brought forward	40,000	15,000	15,000
Retained profit for the year	15,000	22,000	12,000
Retained earnings carried forward	55,000	37,000	27,000

You are given the following additional information:

(i) Haba owns 80% of Suka's shares. These were purchased in 2016 for ₦20.5 million cash, when the balance on Suka's retained earnings stood at ₦7million.

(ii) In 2014, Haba purchased 60% of the shares of Zara by the issue of shares with a nominal value of ₦6.5 million. These shares were issued at a premium of ₦6.5 million. At that date the retained earnings of Zara stood at ₦3 million and the fair value of the net assets of Zara was ₦24 million. It was agreed that any undervaluation of the net assets should be attributed to land. This land was still held at December 31, 2019.

iii) Included in the inventory of Zara and Suka at December 31, 2019 are goods purchased from Haba for ₦5.2 million and ₦3.9 million respectively. Haba aims to earn a profit of 30% on cost. Total sales from Haba to Zara and to Suka were ₦8 million and ₦6 million respectively.

Iv) Haba and Suka each proposed a dividend before the year-end of ₦2 million and ₦2.5 million respectively. No accounting entries have yet been made for these.

(v) Haba has carried out annual impairment tests on goodwill in accordance with IFRS 3 and IAS 36. The estimated recoverable amount of goodwill at December 31, 2016 was ₦5 million and at December 31, 2019 was ₦4.5 million.

You are required to prepare:

a. Consolidated statement of profit or loss for the year ended December 31, 2019. (10 Marks)

b. Consolidated statement of financial position as at December 31, 2019. (10 Marks)

c. Explain why external users of consolidated financial statements benefits from inclusion of statement of group cashflows in the annual report of companies. (10 Marks)

d. At December 31, 2019, Hard plc owned 90% of the shares in Spark Limited. At this date the carrying amount of the net assets of Spark in the consolidated financial statements of the Hard Group was ₦800 million. None of the assets of Spark are re-valued.

On January 1, 2020, Hard sold 80% of the equity of Spark for ₦960 million in cash.

The remaining shares in Spark held by Hard are estimated to have a fair value of ₦100 million.

Required:

Explain how the disposal of the shares in Spark should be accounted for in the consolidated financial statements of the Hard Group.

(10 Marks)

(Total 40 Marks)

SECTION B: YOU ARE REQUIRED TO ANSWER ANY THREE OUT OF FIVE QUESTIONS IN THIS SECTION (60 MARKS)

QUESTION 2

Goodwin plc
Statement of profit or loss extract for the year ended December 31, 2019

	₦	₦
Profit before tax		121,900
Less: Taxation		(52,900)
		69,000
Less: Transfer to general reserve	5,750	
Dividends:		
Preference shares	1,380	
Ordinary shares	2,070	
		(9,200)
Retained profit		59,800

As at January 1, 2019, the issued share capital of Goodwin plc was 23,000 6% preference shares of ₦1 each and 20,700 ordinary shares of ₦1 each.

Required:

Calculate the basic and diluted earnings per share for the year ended December 31, 2019 under the following circumstances:

a. Where there is no change in the issued share capital. (5 Marks)

b. The company made a bonus issue of one ordinary share for every four shares in issue at September 30, 2019. (3 Marks)

c. The company made a rights issue of shares on October 1, 2019 in the proportion of 1 for every 5 shares held at a price of ₦1.20. The middle market price for the shares on the last day of quotation cum rights was ₦1.80 per share. (8 Marks)

d. Briefly discuss how investors use EPS ratio in investment decision and give **TWO** examples of potential ordinary shares under IAS 33. (4 Marks)

(Total 20 Marks)

QUESTION 3

Tupe Print plc has just recently acquired 18% of the shareholding in Adowa plc making it the second largest single shareholder. The majority shareholder has 58% voting shares while the remainder of the shares are held by ten other shareholders with none holding more than 5% voting shares. The board of directors of Adowa is made up of 12 members with TupePrint having 3 members and the majority shareholder having 7 members. TupePrint was able to negotiate its representation on the board due to its strategic importance in Adowa's operations and expansion plans. The directors of TupePrint have accounted for its investment in Adowa as an equity instrument investment. The directors feel Adowa should not be accounted for as an associate because TupePrint does not have 20% of the voting interest and thus does not exercise significant influence over Adowa.

Adowa has been making losses for the past three years and has only returned a taxable profit once in the last five years. The projection is that Adowa will return to making taxable profits in another five years. As part of the acquisition of shares in Adowa, deferred tax assets for deductible temporary differences arose. The directors of TupePrint are unsure of how to account for this deferred tax asset.

TupePrint has an item of equipment which costs ₦56 million. This item of plant and equipment currently has a carrying value in the financial statements of ₦39.2 million. TupePrint expects the operation of the equipment to generate undiscounted cash flows of ₦7 million per year for the next five years. TupePrint could generate immediate cash flow of ₦40 million if the equipment is disposed today. However, if the disposal is carried out, it will have to pay a sales commission of 8.5%. The directors of TupePrint are performing an annual impairment review and understand that determining the recoverable amount is an important part of this exercise.

Required:

a. Discuss how the investment in Adowa plc should be accounted for in the financial statements of TupePrint plc. (7 Marks)

b. Advise the directors of TupePrint how the deferred tax asset that has arisen should be accounted for. (7 Marks)

c. Assist the directors of TupePrint to determine the recoverable amount of the equipment. You may assume a discount rate of 10% or five year annuity rate of 3.791, (if relevant). (6 Marks)

(Total 20 Marks)

QUESTION 4

a. There have been many developments in Nigeria that increasingly put pressure on listed companies to embrace sustainability reporting.

Required:

Discuss any **THREE** of such developments. (7 Marks)

b. The directors of BETA Company Plc sought your opinion on sustainability strategies to be included in the company's sustainability report in order to advance their sustainability development in the country.

Required:

Advise the Board of Directors on areas to focus in order to deliver their sustainable development commitments. (7 Marks)

c. The objective of IAS 24 – Related party disclosure, is to ensure that an entity's financial statements contain sufficient disclosures to draw attention to the possibility that the entity's financial position or profit or loss may have been affected by the existence of related parties.

Required:

Identify and discuss **THREE** key areas of disclosures required by a group companies in their financial statements. (6 Marks)

(Total 20 Marks)

QUESTION 5

Muzana Limited owns tractors used for farming purposes and sometimes enters into lease arrangements with other agricultural companies. A particular tractor when leased out by Muzana is for 8 years. The useful economic life of each tractor is estimated at 10 years while the fair value of each tractor is estimated at ₦26 million. The present value of minimum lease payments in the lease arrangement is ₦28 million. Lease payments are made to Muzana by the lessee on a monthly basis and has purchase option at the end of the lease term to acquire the machine for ₦2.2 million. A similar fairly used machine in the market will cost the buyer ₦2.5 million. Following the transition to IFRS 16, the management of Muzana have classified this lease as an operating lease in its year-end financial statements.

In order to expand its operations, Muzana accessed the Agricultural Loan Credit Programme set up by the government of Nigeria. In the year 2016, Muzana was granted a 5-year interest free loan of ₦100 million. At year end September 30, 2019, Muzana had been able to set aside ₦100 million in a special trust to be used for no other purpose than to pay off the loan in full on its due date in 2020. The management of Muzana are currently preparing their year-end 2019 financial statements and have derecognised the loan liability due to the fact that funds have been set aside in full to satisfy the loan payment in 2020.

Muzana Limited have just concluded a meeting with its tax consultant. The amounts due to the state tax authorities in the current year is ₦2.3 million. Muzana also has a tax credit of ₦1.8 million due from the Federal government in the current year. The tax consultant has advised Muzana that these amounts can be offset in their year-end financial statements to show only a tax liability of ₦500,000.

Required:

a. Explain how the lease arrangement should be classified in Muzana's 2018 year-end financial statements? (7 Marks)

b. Advise the management of Muzana, based on IFRS 9 derecognition rules, if the loan liability can be recognised in their year-end September 30, 2019 financial statements. (7 Marks)

c. Explain if the advise provided by the tax consultant is consistent with the offsetting rules under IAS 12 Income Taxes? (6 Marks)

(Total 20 Marks)

QUESTION 6

a. KutuKutu plc has a policy in place to pay its employees a performance bonus. This bonus is to be paid in cash and is unrelated to the movement in its share price. KutuKutu plc has the choice of settling the bonus in cash or in equity shares to the value of the cash bonus. Based on bonuses paid in prior years, KutuKutu has always settled the bonuses to employees that qualify in shares.

b. KutuKutu plc grants one share option to each of its 50 employees on January 1, 2016. The share options will vest at the end of the 2 years provided that:

(i) The employees remain in KutuKutu plc's employment at that date; and

(ii) The earnings before interest, tax depreciation and amortisation (EBITDA) of KutuKutu plc for the 2nd year achieves a specified target.

At the grant date, each recipient is required to make a non-refundable cash payment of ₦2,000 to KutuKutu plc. This payment amount is based on the estimated fair value (FV) of the share option which reflects the probability that the target EBITDA will be achieved in the 2nd year. FV of each option would be ₦250 (excluding the effect of the EBITDA condition).

If KutuKutu plc does not achieve the target EBITDA or if an employee leaves the employment of KutuKutu plc, no shares will be issued and the employee will not be entitled to a repayment. Accordingly, both service and non-market vesting condition are deemed to be substantive

Required:

i. Do the transactions entered into under (a) above meet the definition of equity-settled share based payment transactions within the scope of IFRS-2? (8 Marks)

ii. How should the transaction in (b) above be accounted for? (12 Marks)

(Total 20 Marks)

SOLUTION 1

a.

Haba Group
Consolidated statement of profit or loss and other comprehensive income for the year ended December 31, 2019

	₦'m
Revenue	310.0
cost of sales	(159.1)
	150.9
Distribution cost	(51.0)
Admin expenses	(29.0)
	70.9
Less: Impairment loss	(0.5)
Profit before tax	70.4
Income tax expense	(24.0)
Profit after tax	46.4

b.

Haba Group
Consolidated statement of financial position as at December 31, 2019

	₦'m	₦'m
Assets		
Non – current assets		
Property, plant and equipment (32 + 25 + 20 + 6)		83
Goodwill (wk3)		4.5
Total non-current assets		87.5
Current assets		
Cash at bank and in hand (9.5 + 2 + 4)	15.5	
Trade receivables (20 + 8 + 17)	45.0	
Inventory (30 + 18 + 18 – 1.2)	63.9	124.4
Total assets		211.9
Equity and liabilities		
Equity:		
Share capital		40
Share premium		6.5
Retained earnings (wk4)		90.3
Non-controlling interest (NCI) (wk6)		28.6
		165.4
Current liabilities (23.5 + 6 + 17)		46.5
Total equity and liabilities		211.9

Workings

Wk 1

Haba group structure

80% 60%

Suka Zara

NCI 20% 40%

Wk 2 - Consolidated schedule

				Adjustment			
	Haba	**Suka**	**Zara**	**Haba**	**Suka**	**Zara**	**P&L**
	₦'m	**₦'m**	**₦'m**	**₦'m**	**₦'m**	**₦'m**	**₦'m**
Revenue	125	117	82	-	(8)	(6)	310
Cost of sales	(65)	(64)	(42)		8	6	(157)
Unrealised profit (W 4)	-	-	-	-	(1.2)	(0.9)	(2.1)
Gross profit	60	53	40	-	(1.2)	(0.9)	150.9
Distribution costs	(21)	(14)	(16)				(51)
Admin expenses	(14)	(8)	(7)				(29)
							70.9
Less: Goodwill impairments		(0.5)					(0.5)
Profit before tax							70.4
Income tax expense	(10)	(9)	(5)				24.0)
Profit after tax		21.5	12				46.4
Profit attributable to:	**Haba**	**Suka**	**Zara**				
Parent (Balancing figure)							37.30
Non-controlling Interest	20%	4.3	-				
	40%	-	4.8				9.1
							46.4

Wk 3 – Calculation of goodwill

			Suka	**Zara**
			₦'m	**₦'m**
Purchase consideration			20.5	13
Net assets at acquisition	80%	(₦17m)	13.6	-
	60%	(₦24m)	-	(14.4)
Goodwill at acquisition date			6.9	(1.4)
Impairments:	2016	1.9		
	2019	0.5	2.4	-
Goodwill at reporting date			4.5	(1.4)

Wk 4 – Consolidated retained earnings (Group)

	₦'m
Parent	55
Gain on bargain purchase (Goodwill – Zara)	1.4
Share of profit – Suka	24
Share of profit – Zara	14.4
Unrealised profit (0.9 + 1.2)	(2.1)
Impairment	(2.4)
	90.3

Wk 5 – Post acquisition profits of subsidiaries

		Suka ₦'m	Zara ₦'m
Retained earnings at acquisition date		7	3
at reporting date		37	27
		30	24
Parent	Suka 80% (30)	24	
	NCI 20% (30)	6	
		30	
	Zara 60% (24)		14.4
	NCI 40% (24)		9.6
			24.0

Wk 6 – Non-controlling interest

	Suka ₦'m	Zara ₦'m
At acquisition - 20% (17)	3.4	-
At acquisition - 40% (24)	-	9.6
Share of profit (Wk 5)	6	9.6
	9.4	19.2
Total NCI (9.4 + 19.2)	**₦28.6m**	

Wk 7 – Net assets of subsidiaries

	Suka ₦'m	Zara ₦'m
At acquisition		
Share capital	10	15
Share premium	-	-
Retained earnings	7	3
Fair value adjustment – Land	-	6
	17	24
At reporting date		
Share capital	10	15
Share premium	-	-
Retained earnings	37	27
Fair value adjustment – Land	-	6
	47	48
Post – acquisition profit	30	24

c. **Benefits of cash flow statement**

i. Cash flow statement refers to a financial statement that provides details about the amount of cash and cash equivalents of a business.

ii. It is a key report that highlights the changes in a company's cash flow over a specified period.

iii. Investors consider the cash flow statement as a valuable tool because it helps them to understand how much money an entity is making and spending, where the money is coming from; and how it is being spent.

iv. Cash flow statement also helps the investors to know the liquidity/actual cash position of the company which P or L will not show.

v. It provides insights about the liquidity and solvency of an entity, which is vital for the survival and growth of any organisation.

vi. With a clear liquidity position, cash-flow helps the entity to arrange for any shortfall or surplus for the growth of the business and even helps in cash flow forecasting for investment decisions.

vii. Where the company has long-term debt obligations, a cash flow statement helps the investors to determine the possibility of repayment.

viii. Cash flows can be used to easily predict the timing, amounts, and uncertainty of future cash flows.

ix. Cash flow assists investors to determine actual cash generated from operation and understand the working capital management of the entity.

x. Cash flow statement clarifies cash inflows and outflows into operating activities, investing activities and financing activities.

d. **Disposal**

		₦'m
Purchases consideration		
Fair value of retained shares in Spark		960
		100
		1060
Net assets of Spark at carrying value	800	
Less: NCI 10% ₦800m	(80)	(720)
Gain on sale of shares		340

i. The standard gives guidance on how entity should account for disposal of equity interest in a subsidiary where control is lost or retained.

ii. In line with the question, this is a step disposal where parent lost control.

iii. The standard requires that the fair value of the disposal consideration should be added to the fair value of the remaining equity interest and compared with the parent's percentage shareholding of the subsidiary's consolidated net assets, which include any fair value adjustment and unimpaired goodwill if any, at the date of disposal.

iv. Any gain or loss arising from the disposal should be credited/debited to profit or loss if control is lost, otherwise, it should be charged to other component of equity assuming parent retained control.

v. The total gain of ₦340 million on disposals of the shares should be recognised in profit or loss for the period.

vi. Hard Plc will recognise the investment in Spark in its statement of financial position in accordance with the requirements of IAS 39. At initial recognition, this investment should be valued at ₦100 million.

Marking Guide

		Marks	Marks
a.	Consolidated statement of profit or loss	4	
	Group structure	1	
	Consolidated schedule	<u>5</u>	10
b.	Consolidated statement of financial position	4	
	Computation of goodwill	1	
	Value of net assets	2	
	Non-controlling interest in Suka and Zara	1	
	Group retained earnings	1	
	Post-acquisition profits of subsidiaries	<u>1</u>	10
c.	Benefits to users of inclusion of group cash flows in annual reports of companies (any correct 10 points)		10
d.	Accounting for disposal of shares in the consolidated financial statements	6	
	Explanation of step disposal of Hard plc. (any correct 4 points)	<u>4</u>	<u>10</u>
	Total		**<u>40</u>**

Examiner's Report

Parts (a) and (b) of the question test candidates' knowledge of group structure, preparation of consolidated statement of profit or loss and statement of financial position. Part (c) of the question tests candidates' knowledge of the benefits accrued to external users on inclusion of group cash flows in the annual reports of companies. Part (d) of the question tests how the disposal of shares are accounted for in the group consolidated financial statements.

All the candidates attempted the question and their performance was above average. The commonest pitfalls of the candidates were their inability to calculate correctly group retained earnings, goodwill, post-acquisition profit of subsidiaries, computation of the non-controlling interest (NCI) and accounting for disposal of shares.

Candidates are advised to do in-depth study to understand the basic principles of consolidating financial statements, practise more questions and use ICAN study texts for better performance in future examinations.

SOLUTION 2

(a) This question requires the calculation of basic and diluted earnings per share which are the main requirements of IAS 33.

IAS 33 requires entities to calculate:

- the basic earnings per share on its continuing operations
- the diluted earnings per share on its continuing operations.

Diluted EPS and basic EPS will usually differ when there are potential ordinary shares in existence.

Without a change in the issued share capital and no potential ordinary shares, Basic and Diluted EPS will be the same.

The Formula is:

$$\textbf{Basic EPS} = \frac{\text{Net profit (or loss)attributable to ordinary shareholders during a period}}{\text{Weighted average number of shares in issue during the period (WANOS)}}$$

$$\text{Or Simply Basic EPS} = \frac{\text{Total earnings}}{\text{(WANOS)}}$$

The total earnings to use will be the profit or loss from continuing operations after deducting tax and preference dividends (and in the case of consolidated financial statements, after excluding the earnings attributable to non-controlling interests or minority interests). Total earnings include any income from associates (i.e. any share of profits or losses of associates).

$$\text{Calculation for Godwin Plc Basic EPS} = \frac{\text{PAT} - \text{Preference dividend}}{\text{(WANOS)}} = \frac{₦69{,}000 - ₦1{,}380}{20{,}700)}$$

= ₦327k or ₦3.27k

(b) With bonus issue on September 30, 2019, WANOS will change but no potential ordinary shares and so Basic and Diluted EPS are still the same.

Existing number of shares before bonus issue = 20,700
Bonus issue is 20,700/4 (1 for every 4) = 5,175
Total Shares = 25,875

$$\text{Basic EPS} = \frac{₦69{,}000 - ₦1{,}380}{25{,}875} = 261\text{k or } ₦2{,}61\text{k}$$

(c) With right issue on October 1, 2019

$$\text{Basic EPS} = \frac{₦69{,}000 - ₦1{,}380}{22{,}648} = 299\text{k or } ₦2.99$$

Calculation of WANOS

Theoretical ex-right price (TERP) will be calculated to derive the new WANOS.
Theoretical ex-right price (TERP) is the weighted average price of the share immediately after the right issue. With the middle market price of ₦1.8 and right issue price of ₦1.2, TERP will be calculated thus:

Existing shares	5 x 1.8 = 9		
Right issue	1 x 1.2 = 1.2		
	6	10.2	TERP = 10.2/6 = 1.7

Calculation of WANOS

Bonus element of issue increases shares to	20,700 x 1.8/1.7	= 21,918
Full price element of issue increases shares to	20,700 x 6/5	= 24,840

WANOS is therefore: 21,918 x 9/12 = 16,438
plus 24,840 x 3/12 = 6,210
22, 648

(d) **Uses of EPS ratio by investors**

i. Investors use EPS as a measure of performance to assess the companies in which they invest or might possibly invest.
ii. These investors are usually interested in changes in a company's EPS over time (trends)
iii. They are also interested in the size of EPS relative to the current market price of the company's shares which is referred to as the Price earnings ratio (P/E)
iv. They use calculated EPS to reliably compare different companies through evaluation of the EPS and P/E ratios of different companies.

Examples of potential ordinary shares under IAS 33

A potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares at some time in the future.

IAS 33 gives the following examples of potential ordinary shares:

- financial liabilities or equity instruments that are convertible into new ordinary shares at some time in the future (convertible debentures, convertible preference shares);
- share options and warrants. Options and warrants are financial instruments

that give the holder the right (but not the obligation) to purchase new ordinary shares at some time in the future, at a fixed price;

- shares that will be issued if certain contractual conditions are met, such as contractual conditions relating to the purchase of a business.

Marking Guide

		Marks	Marks
a.	General requirement of IAS 33	1	
	Reasons why there is no difference between basic and diluted EPS	1	
	Formula for basic EPS	1	
	Definition of total earnings	1	
	Calculation of basic EPS for Goodwin Plc.	1	5
b.	No difference between basic and diluted EPS	1	
	Calculation of new total no of shares with Bonus issue	1	
	Calculation of new basic EPS with bonus issue	1	3
c.	Calculation of basic EPS	1	
	Calculation of TERP	2½	
	Calculation of WANOS	4½	8
d.	Uses of EPS ratio by investors	2	
	Examples of potential ordinary shares	2	4
	Total		**20**

Examiner's Report

The question tests candidates' knowledge of calculation of basic and diluted earnings per share (EPS) in accordance with the requirement of IAS 33- Earnings Per Share.

Majority of the candidates attempted the question and their performance was above average.

The commonest pitfall of the candidates was their inability to differentiate between calculation of basic and diluted earnings per share.

Candidates are advised to improve their level of preparation to cover all areas of the syllabus and to pay more attention to relevant accounting standards at this level of the Institute's examinations.

SOLUTION 3

a. The standard gives guidance on when an investor is said to have gained significant influence. If an entity holds 20% - 50% of the equity interest in an investee, it will be presumed the investor has significant influence unless it can be clearly proved that this is not the case. If the holding is less than 20%, the entity will be presumed not to have significant influence unless such influence can be clearly demonstrated.

The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

- Acquisition of 20% - 50% of the share capital of an investee;
- Material transactions between the two entities;
- An inter-change of management personnel between the two entities; or
- The provision of essential technical information by one entity to the other;
- Representation on the board of directors or equivalent governing body of the investee; and
- Participation in the policy-making process, including participation in decisions about dividends or other distributions.

Since Tupeprint has three (3) board members out of twelve (12) representing 25% and the majority shareholder have seven (7) members representing 58%, this qualifies Tupeprint to participate in the policy-making process thus gain significant influence.

Consequently, the investment in Adowa should be accounted for in line with IAS 28 using the equity method as follows:

	₦
Cost of investment	X
Plus/(minus) parent's share of profit/(loss)	X
Plus/(minus) parent's share of OCI	X
Minus share of impairment	(x)
Less Dividend	(x)
Cost of investment in Associate	(x)

The director should be aware that percentage of interest is not the only basis of determining associate or subsidiary other factors stated above should always be considered.

b. Deferred tax assets are Items on a company's statement of financial position that may be used to reduce taxable income in the future. They are created by deductible temporary difference (Deferred Tax Asset (DTA).

(DTA = Deductible temporary different x Tax rate).
The standard requires that DTA can only be recognised as a non-current asset if the following conditions are satisfied;

(i) If it is recalculated and reconfirmed;
(ii) If the entity can proof that there will be future profit where it intends to utilise it; and
(iii) If the amount can be reliably measured and are not to be discounted.

Supposed the above mentioned conditions are met, then the Directors of Tupeprint should account for the DTA as follows:

DR Deferred tax asset
CR Profit or loss

Based on constant loss in the past, current year profit may not demonstrate or serves as basis for future profits except if certain projections and conditions that will enhance future profits existed.

c. In line with the relevant standard, an asset is said to be impaired if the carrying amount (CA) of the asset or cash generating unit is higher than the recoverable amount (RA).

Recoverable amount is the higher of the fair value less cost to sell and value in use.

Value in use is the present value of all the net future cash flows associated with the use of the assets including the residual value discounted at the cost of capital.

Impairment is the amount by which the carrying amount is higher than the recoverable amount.

This is applied in the determination of the recoverable amount of the asset as follows:

	₦'m
Cost	56
Acc. Depreciation	16.8
Carrying amount	39.2

Value in use (V.I.U)

Year	Cashflow	Annuity factor at 10%	Present value
1-5	₦7m	3.791	₦26.537m

Fair value less cost to sell (FVLCTS)		**₦'m**
Fair value		40
Cost to sell	8.5% x 40	(3.4)
FVLCTS		36.8

The Recoverable amount (RA) is 36.6 (the higher of V.I.U of 26.537 and FVLCTS of 36.6)

The impairment:	**₦'m**
Carrying amount	39.2
Recoverable amount	36.6
Impairment	2.6

TupePrint should recognise the impairment by passing below accounting entry

Dr Profit or loss	₦2.6 million	
Cr Plant and equipment		₦2.6 million

Marking Guide

		Marks	**Marks**
a.	Introduction of the guidance of the accounting standard	1	
	Points to illustrate existence of significance influence (any correct 4 points)	2	
	Explanation of Tupeprint significance influence	2	
	Investment in Adowa using equity method	2	7
b.	Definition of deferred tax asset	1	
	Recognition of deferred tax asset	4	
	Advise to the Directors of Tupeprint	2	7
c.	Determination of the recoverable amount	3	
	Computation of value in use	2	
	Calculation and accounting treatment of impairment	1	6
	Total		**20**

Examiner's Report

Parts (a) and (b) of the question test candidates' understanding of the principle of significance influence on entity's financial statement, while part (c) tests candidates' knowledge of computation of recoverable amount of a non-current asset.

Few candidates attempted the question and their performance was poor.

The commonest pitfall of the candidates was their inability to deduce that significant influence is not limited to percentage of shares holdings alone, but on the basis of some other factors enunciated under IAS 28- Associates and Joint Ventures.

Candidates should pay special attention to this area of the syllabus for better performance in the Institute's future examinations.

SOLUTION 4

a. Listed companies in Nigeria just like their counterparts across the World embrace and develop more interest in sustainability reporting. Increased interest in sustainable reporting has come from several sources and based on recent developments such as:

   (i) A broader understanding and acceptance of the links between economic activities and global sustainability issues by companies and other stakeholders;

   (ii) A recognition of the risk-management and economic benefits that organisations can gain from integrating sustainability into their strategies;

   (iii) A growing demand from stakeholders, including investors, customers, employees and NGOs, for organisations to manage their operations in a more sustainable manner;

   (iv) Government's concerned about the implications for society of environmental damage and loss of natural resources. This has led some governments and regulators to request companies to report on their environmental and social impacts;

   (v) Investors, many of whom now consider the ethical, social and environmental implications of the investments they make (socially responsible investment (SRI);

   (vi) Companies themselves, who may identify business opportunities – developing new products or reducing costs, in environmental friendly initiatives; and

   (vii) Companies have come to realise that they can enhance their value by developing an understanding about the connections between sustainability and business and communicating this to their stakeholders. Thus, driving improvement and innovation.

(b) <u>Sustainability Reporting</u> is the disclosure and communication of environmental, social, and governance (ESG) goals as well as a company's progress towards them.

   There are many ways to build sustainability reporting into corporate social responsibility programme. Sustainability indexes provide corporate organisations with typical sustainability strategies and areas to focus in order to achieve whatever sustainability development commitments an organisation may seek to achieve.

Sustainability indexes are based on analysis of economic; environmental; and social performance generally and specifically assessing the following issues:

- corporate governance;
- risk management;
- branding,;
- climate change mitigation;
- supply chain standards;
- labor practices; and
- industry-specific sustainability criteria

Therefore, BETA Company Plc is advised to consider any of the areas above to include them in the Company's sustainability report.

(c) **Disclosure requirements on related party transactions**

IAS 24 is a disclosure standard calling for specified disclosures of:

i. related party relationships; and
ii. related party transactions.

Provisions and requirements of IAS 24 are:

i. IAS 24 requires disclosure in the notes to the financial statements of the following, whether or not transactions have taken place between those related parties;
    - the name of the entity's parent; and
    - if different, the name of the ultimate controlling entity.
ii. Where transactions have taken place between the related parties, irrespective of whether a price was charged, the following should be disclosed:
    - the nature of the related party relationship;
    - the amount of the transactions;
    - in respect of outstanding balances;
        - the amount;
        - their terms and conditions;
        - any guarantees given or received; and
        - any provision for doubtful/irrecoverable debts.
    - The expense recognised in the period in respect of irrecoverable debts due from related parties.

    The above disclosures should be given separately for each of the following
    categories of related party:
    - the parent;
    - entities with joint control or significant influence over the entity
    - subsidiaries;
    - associates;
    - joint ventures in which the entity is a venture;
    - key management personnel of the entity or its parent; and

- other related parties

iii. In addition, IAS 24 requires disclosure of compensation to key management personnel, in total, and for each of the following categories:
   - short-term employee benefits;
   - post-employment benefits;
   - other long-term benefits;
   - termination benefits; and
   - share-based payments

Marking Guide

		Marks	Marks
a.	Introduction	1	
	Identification of the developments	3	
	Discussion on each for maximum of 3 points	3	7
b.	Any seven (7) areas of focus for sustainability reporting		7
c.	Identification of the disclosure requirements of IAS 24	3	
	Discussion on any 3 of the disclosure areas	3	6
	Total		**20**

Examiner's Report

Parts (a) and (b) of the question test candidates' knowledge of the current development in sustainability reporting, while part (c) of the question tests the objectives of IAS 24- Related Party Disclosures on group companies financial statements.

Majority of the candidates attempted the question and their performance was above average. They also displayed good understanding of the question using local environment in parts (a) and (b). However, their performance in part (c) was poor.

The commonest pitfall of the candidates in part (c) of the question was their inability to separately identify the disclosure requirements of the parent, subsidiaries, associates and joint ventures.

Candidates are advised to have adequate knowledge of contemporary issues beyond financial reporting as well as the basic principles of disclosures relating to group financial statements for better performance in future examinations

SOLUTION 5

a. Classification of lease arrangement

According to IFRS 16 Leases, the lessor must classify all lease contracts into finance lease or operating lease.

The lessor should classify the lease as a finance lease if:

i. the lessor substantially transfers the risks and rewards associated with leased asset to the lessee;
ii. the lessor will likely transfers ownership of the leased asset to lessee after the end of the lease period;
iii. the lessee is responsible for the maintenance and servicing of the leased asset;
iv. the present value of minimum lease payment is greater or substantially equal to the fair value of the leased assets;
v. the lease term or period forms a substantial part of the useful life of the leased assets even if title is not transferred;
vi. the lease contract is a non-cancellable lease agreement; and
vii. the lease contract contains a bargain purchase option.

The lessor should classify the lease as an operating lease if:

i. the lessor substantially retains the risks and rewards associated with leased assets;
ii. the lessor is responsible for the maintenance and servicing of the leased asset;
iii. the present value of minimum lease payment forms an insignificant part of the fair value of the leased assets;
iv. the lease term or period forms an insignificant part of the useful life of the leased assets even if the title is not transferred;
v. the lease contract is a cancellable lease agreement; and
vi. the lease contract does not contain a bargain purchase option.

Based on the above position of IFRS 16, Muzana should classify the lease arrangement as a finance lease in the financial statement for 2018 year-end for the following reasons:

- the present value of minimum lease payment of ₦28 million is greater than the fair value of the leased asset of ₦26 million;
- the lease term of 8 years forms a substantial part of the useful life of the leased asset of 10 years even if the title is not transferred;
- the lease contract is a non-cancellable lease agreement; and
- the lease contract gives the lessee an option to purchase the leased asset at the end of the lease period and the option, is under condition,

favourable to the lessee. The lessee will be required to pay ₦2.2 million while a similar asset actually cost ₦2.5 million.

A contract contains a lease, if it conveys the right to control the use of an asset for a period of time in exchange for consideration. Control is conveyed where the customer has both the right to direct the identified assets use and to obtain subsequently all the economic benefits from the use of the assets.

In the case under review, all the aforementioned conditions are met, hence the lease assets and corresponding liability of the same amount would be recognised at the inception of the lease.

An operating lease would still have been capitalised by the lessee under IFRS 16, if it conveys the right to control the use of an asset. Invariably, almost all form of lease are classified under IFRS 16, however, where a supplier has a substantive right of substitution throughout the period of use, a lessee does not have a right to use an identified assets, hence it is not capitalised.

b.

i. IFRS 9 -Financial Instruments, Recognition and measurement is the relevant standard that deals with the derecognition of financial liability.

ii. Derecognition is the removal of previously recognised financial liability from an entity's statement of financial position.

iii. A financial liability is derecognised when and only when, it is extinguished.

iv. By extinguishment of financial liability, it means the financial liability has been discharged, cancelled or expired.

v. This is when the obligation specified in the contract is fully discharged.

Based on the foregoing, Muzana limited loan is still effective and running as at year-end 2019

- Though full provision have been made for the repayment of the loan, this will not become due until year-end 2020.
- We have no information that Musana Limited was contemplating or ready to discharged the loan before its maturity in 2020.
- Therefore, the management of Muzana Limited cannot derecognised the loan until it is fully discharged at its maturity in 2020.

c. **Offsetting of current tax asset and current tax liability**

The advice provided by the tax consultant is not consistent with the offsetting rules under IAS 12-Income taxes. According to IAS 12, an entity can only offset current tax asset and current tax liability if the following two conditions are met:

i. The entity has a legally enforceable right to offset the recognised amount; and
ii. The entity intend to settle the amount on net basis (or intend to realise the current tax asset and settle the current tax liability at the same time).

Based on the above position of IAS 12, the management of Muzana should not offset the current tax asset and the current tax liability. That is, the current tax asset should be separately recognised under current assets while the current tax liability should also be recognised separately under current liabilities.

Marking Guide

		Marks	Marks
a.	Explanation on classification of lease arrangement in the financial statement	5	
	Classification of Muzana lease based on IFRS 16	2	7
b.	IFRS 9 derecognition rules as stated in the standard	3	
	Advice to the management of Muzana limited on their loan liability	4	7
c.	Offsetting rules under IAS 12- Income taxes	3	
	Explanation of the advice to the management of Muzana limited by the tax consultant	3	6
	Total		**20**

Examiner's Report

Part (a) of the question tests candidates' knowledge of the application of IFRS 16-Leases on classification of lease arrangement and conditions thereto. The (b) part of the question tests candidates' knowledge of the derecognition rules of financial liability under IFRS 9 on financial instruments, while the (c) part of the question examines the application of the offsetting rules of current tax asset and current tax liability under IAS 12-Income Taxes.

Majority of the candidates attempted the question and their performance was average in parts (a) and (b) but very poor in part (c) of the question.

The commonest pitfall of the candidates was lack of understanding of the provisions of IFRS 16 to solve practical problems.

Candidates are advised to pay more attention to the application of the provisions of various accounting standards to real life situations for better performance in future examinations.

SOLUTION 6

a.

i. The relevant standard is IFRS 2-Share-Based Payment.
A share-based payment is a transaction in which the entity:

- receives goods or services as consideration for its equity instruments; or
- incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity.

ii. IFRS 2 identifies two types of share-based payment transactions:

- Equity-settled share-based payment transactions. This is where the entity pays for goods or services by issuing the entity instruments including shares and share options.
- Cash-settled Share-Based Payment Transaction. This is where the entity's receives goods or services as consideration for cash payment that is based on the share price.

iii. Since Kutukutu pays its employees a performance bonus in cash which is unrelated to the movement in its share price, and has always been settled to employees that qualified in shares; these transactions meet the definition of equity-settled share-based payment and therefore fall under IFRS 2.

b. The relevant standard is IFRS 2 Share-Based Payment as described above.

The standard requires that full provision based on the number of staff that will remain at the vesting date should be made, even if it is not probable that the conditions attached will be met. The provision should be spread over the vesting period using the fair value of share option at grant date. However, the provision will be based on the movement in the share price if share appreciation rights (SARS) are granted.

The accounting requirement for Initial recognition will be:

For equity-settled share-based Payment
DR Profit or Loss
CR Share option

For cash-settled – share based payment
DR Profit or Loss
CR Liability

Subsequently, only the incremental provision is accounted for.

This is applied as follows:

Number of staff remaining x share option x share price at grant date x year/vesting period

	₦	Equity
2016 (Year 1)		
Expected outcome (at grant date value)		
50 x 1 x 250 x ½		6,250
2017(Year 2)		
Expected outcome		
50 x 1 x 250 x $^{2}/_{2}$	12,500	
	(6,250)	
		6,250
Accumulated equity for the 2 years		12,500

Journal entries

2016 (Year 1)

Dr.	Profit or loss	6,250	
Cr.	Equity		6,250

Share – based equity expended in Year 1

2017 (Year 2)

Dr.	Profit or Loss	6,250	
Cr.	Equity		6,250

Share – based equity expended in Year 2

Non – refundable cash payment
50 staff x ₦2,000 = ₦100,000

Dr.	Other receivables	100,000	
Cr.	Profit or loss		100,000

Non – refundable cash payment in respect of share-based equity for staff

Marking Guide

		Marks	Marks
a.	Definition of equity-settled share based payment transactions according to IFRS 2	2	
	Identification of types of share-based payments transaction	2	
	Explanation on the policy of Kutukutu to meet definition of equity-settled share based payment	4	8
b.	Accounting for transactions in Kutukutu plc.	2	
	Accounting requirements for initial recognition	2	
	Accounting for subsequent incremental provisions	4½	
	Journal entries to record the transactions for 2 years	3½	12
	Total		**20**

Examiner's Report

The question tests candidates' knowledge of IFRS 2- Share-Based Payment on application of the standard to a case study, types, recognition, treatment, presentation and accounting for transactions under the standard.
Few candidates attempted the question and their performance was below average.

The commonest pitfall of the candidates was their inability to correctly apply the provisions of the standard to the scenario presented in the question.

Candidates are advised not only to concentrate on the provisions of accounting standards but to also understand their applications to real life situations for better performance in future examinations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2020

ADVANCED TAXATION

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ANSWER FOUR OUT OF SIX QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

The recent trade tariff war on goods exported between United States and China, has opened vista for corporate players in the two countries and their allies to venture into new areas considered to be business-friendly.

Sunchi Limited, Shanghai, is a computer accessories company that was incorporated in China in 2003. The company established its subsidiary outlet, Sunchi West Africa Holdings, in Ibadan, Nigeria, on January 1, 2018. The Nigerian company adopted December 31, annually (same as the parent company) as its end of financial year.

The first set of consolidated accounts was audited by a reputable audit firm based in China. Taxes for both business operations were also paid in China.

The Nigerian tax inspectors from the Federal Inland Revenue Service demanded for annual returns and tax computations from the subsidiary company but the General Manager of the company claimed that the company had paid personal income tax of its employees and directors, value added tax on imported equipment and relevant custom duties. Furthermore, since the parent company is not registered in Nigeria, there is no reason why it should be liable to companies income tax. The issue is yet to be resolved.

The Managing Director of the subsidiary company in Nigeria, with the permission of the head office in China, appointed you as the company's tax consultant to help unravel the issue of payment of companies income tax by resident and non-resident companies operating in Nigeria. He also submitted to you the statement of profit or loss for the year ended December 31, 2018, after conversion of the transactions in head office's Chinese currency (Yuan) to Nigerian Naira.

	China	Nigeria	Total
	₦'000	**₦'000**	**₦'000**
Turnover	1,982,210	455,600	2,437,810
Miscellaneous income	36,010	8,200	44,210
Total income	2,018,220	463,800	2,482,020
Less: Direct cost of production	777,190	120,700	897,890
Gross profit	1,241,030	343,100	1,584,130
Expenses:			
Personnel costs	288,650	101,220	389,870
Electricity and rates	3,550	6,830	10,380
Legal expenses	12,000	4,200	16,200
Share of head office expenses	50,000	25,000	75,000
Depreciation	26,300	9,900	36,200
Allowance for doubtful debts	18,240	10,650	28,890
Income tax paid in China	55,880	-	55,880
Value added tax on essentials	-	2,500	2,500
Entertainment	2,400	3,400	5,800
Transport and travelling	10,200	1,340	11,540
Printing and stationery	15,770	2,640	18,410
Telephone, telex and postage	3,890	1,730	5,620
Motor vehicle running expenses	18,520	900	19,420
Foreign exchange loss provision	-	1,750	1,750
Debenture interests	-	1,000	1,000
Loss on revaluation of non-current assets	-	1,490	1,490
Repairs and maintenance	90,600	3,440	94,040
Audit and accountancy fees	12,250	-	12,250
Administrative expenses	125,100	44,600	169,700
Total expenses	733,350	222,590	955,940
Net profit	**507,680**	**120,510**	**628,190**

For the Nigerian company, the following additional information is also relevant:

(i) Miscellaneous income:
This consists of income realised from sale of component parts to head office. The transaction was made at open market price.

(ii) Legal expenses comprise:

	₦'000
Debt collection	800
Preliminary expenses	2,100
Land acquisition	550
Retainership fee	750
	4,200

(iii) **Allowance for doubtful debts are made up of:**

	₦'000
Allowance for doubtful debts	5,820
Specific allowance for doubtful debts	3,300
Bad debts written off during the year	1,530
	10,650

(iv) **Repairs and maintenance include:**

	₦'000
Improvement to office building	2,250
Repairs of plant and machinery	1,190
	3,440

(v) **Administrative expenses include:**

	₦'000
Court fine	600
Office expenses	42,750
Subscription to Nigeria-China Trade Mission	250
Provision of Chinese books to public secondary school in Oyo State	1,000
	44,600

(vi) **Schedule of qualifying capital expenditure is as follows:**

Item	Date of acquisition	Amount ₦'000
Factory building	January 1, 2018	20,200
Office building	January 1, 2018	12,450
Plant and machinery	February 3, 2018	25,000
Motor vehicles	March 10, 2018	16,120
Furniture and fittings	January 1, 2018	4,700
Office equipment	February 13, 2018	4,000

Required:

As the company's tax consultant, you are to prepare a report to management of Sunchi Limited taking into consideration the following:

a. Resident and non-resident companies (4 Marks)

b. Circumstances under which profit of a non-resident company will be liable to tax in Nigeria. (10 Marks)

c. Relationship between a:
- Nigeria branch and the parent company (3 Marks)
- Nigeria subsidiary and the parent company (3 Marks)

d. Overseas branch of a Nigerian company (3 Marks)

e. Overseas subsidiary of a Nigerian company (3 Marks)

f. Advise on, if any, the companies income tax payable by the two business operations in Nigeria. (14 Marks)

(Total 40 Marks)

SECTION B: YOU ARE REQUIRED TO ANSWER ANY THREE OUT OF FIVE QUESTIONS IN THIS SECTION (60 MARKS)

QUESTION 2

Sunny Oil Producing Nigeria Limited is engaged in petroleum exploration in the deep sea off the coast of Bight of Benin in the Niger delta region since 2005. It is involved in a production sharing contract with the Nigerian National Petroleum Corporation. In order to consolidate its position in the Nigerian oil and gas sector, the company intends to diversify its operations into the ocean going oil tanker transportation business in the next few months.

The company submitted its annual returns and statement of tax computation in respect of the year ended December 31, 2018 to the Federal Inland Revenue Service office in April 2019 but there was a disagreement between the amount raised by the tax office and that of the company. A check by the financial accountant of the company revealed that capital allowances on plant and equipment acquired for ₦120.5 million during the year as well as donation of ₦50 million made to an institution of higher learning were not taken into consideration in the determination of assessable profit. A letter explaining this discrepancy was written by the Managing Director to the FIRS but instead of the issue to be resolved, a notice, giving the company, date and time for hearing before the Tax Appeal Tribunal was received.

In order for the company to be properly guided in the pursuit of the case before the tribunal, it was resolved that a competent firm of Chartered Accountants with bias in oil and gas accounting and taxation should be engaged.

Your firm has been appointed as the company's tax consultants with the mandate of representing the company at the sittings of the Tax Appeal Tribunal. Relevant documents in respect of the acquisition of the plant and equipment and donation were made available to you.

The extract from the books of accounts of the company for the year ended December 31, 2018 revealed the following:

(i) Export sales:

Bonny light	150,000 barrels exported at 37^0API
Forcados	100,000 barrels exported at 36^0API
Bonny medium	90,000 barrels exported at 35^0API

Price per barrel at 36^0API:

Bonny Light	$63.03
Forcados	$65.00
Bonny medium	$64.53

(ii) Actual realised price is arrived at after adjusting for the variance in API. For every API, $0.03 is the variance in price at 36^0.

(iii) Domestic sales: 80,000 barrels at ₦720 per barrel.

(iv) Expenses incurred include:

	₦'000
Operating expenses	255,000
Production and exploration	1,100,600
Intangible drilling cost	420,800
Administrative expenses	225,500
Non-productive rent	80,700
Bad debts written off	20,150
Repairs and renewals	92,600
Transportation and traveling	73,200
Royalties	222,900
Miscellaneous expenses	63,800
Salaries and wages	830,700
Pension fund contribution	74,450
Customs duty (non-essentials)	10,400
Habour dues	3,300
Stamp duties on debenture	2,500
Interest on loan	52,350
Cost of 3 appraisal wells	120,000
Income tax provision	750,000
Transfer to special reserves	255,000

Additional information:

(i) Production and exploration include ₦80 million incurred on tangible drilling operation and depreciation of ₦200.2 million.

(ii) Royalties include amount of ₦22.5 million in respect of royalties on domestic sales.

(iii) Miscellaneous expenses include, among others, ₦12.75 million spent on obtaining information on the existence of oil in the Middle-Belt and ₦50 million donation to a public university in one of the states in the Niger delta region.

(iv) The Joint Tax Board gave approval for the operation of pension fund contribution in the company.

(v) Interest on loan includes ₦12.3 million paid to a subsidiary company. The transaction was made at the prevailing market rate.

(vi) The company entered into a gas contract with the following:

Company	**Load factor**	**Amount ₦'000**
Akin Gas Limited	66^0	220,000
Bollah Limited	71^0	350,000

(vii) **Schedule of qualifying capital expenditure:**

Asset	Date of acquisition	Location	Amount ₦'000
Plant	February 28, 2018	Off-shore operation in territorial waters and continental shelf area of 80 metres water depth	120,500
Pipeline and storage tank	May 1, 2018	Off-shore operation in territorial waters and continental shelf area of 120 metres water depth	85,300
Motor vehicle	March 30, 2017	On-shore operation	40,600
Building	February 13, 2016	On-shore operation	50,800

(viii) Unutilised capital allowance and loss brought forward from the previous year were ₦12.5 million and ₦750 million, respectively.

(ix) Capital allowance as agreed with the relevant tax authority was ₦130.25 million.

(x) The amount stated in respect of transfer to special reserves was approved by the company's Board of Directors to be utilised for future investment opportunities.

(xi) Assume ₦305 is equivalent to US $1.

(xii) Profits from petroleum exported or sold domestically are taxable at 85%.

Required:

a. As the company's tax consultant, you are to draft a report to the Managing Director explaining the following:

i. The preparation which you and the company should make before the commencement of the proceedings at the tribunal. (2 Marks)

ii. Steps to be taken by the company if the decision of the tribunal is not acceptable to it. (2 Marks)

iii. The tax implication of the company's proposed transportation business. (1 Mark)

b. Re-computing the following:

i. Assessable profit (8 Marks)
ii. Chargeable profit (3 Marks)
iii. Assessable tax (1 Mark)
iv. Chargeable tax (1 Mark)
v. Total tax payable (2 Marks)

(Total 20 Marks)

QUESTION 3

Larry Limited, Lagos, is a manufacturing company that has been producing household utensils successfully for several years. The company is planning to enter the international market but the management team has little or no information in respect of regional economic integration and trade blocs around the world.

The Managing Director of the company has just engaged your professional accounting firm to provide advice on some salient issues in this respect.

Required:
As the Desk Officer in charge of international tax matters in the professional accounting firm, you are to present a report to your principal partner, for his review before sending it to the firm's client. Your report should cover the following areas:

a. Distinction between regional economic integration and trade blocs. (4 Marks)

b. Objectives of regional integration. (5 Marks)

c. Benefits of regional economic integration and trade blocs. (4 Marks)

d. Disadvantages of regional economic integration and trade blocs. (3 Marks)

e. Common market and economic union as major types of regional economic integration. (4 Marks)

(Total 20 Marks)

QUESTION 4

The quest by various governments in Nigeria since 1990s to use tax incentives to change the narrative of being a mono-product foreign exchange earner has attracted interests from both local and foreign investors to the hitherto forgotten non-oil sector. However, some of the foreign investors are not conversant with these tax incentives available to investors in the manufacturing, mining and telecommunication industries.

You have been appointed as a tax consultant to a Mexican billionaire through his agent in Nigeria, IBK Associates, with interests in many sectors such as agriculture, aviation, manufacturing and telecommunication in the Latin American region. He intends to explore the Nigerian business environment within the next six months.

Required:
You are to write a report to the Mexican through his agent in Nigeria highlighting the following areas:

a. Objectives of Nigerian tax incentives (4 Marks)

b. Forms of tax incentives (2 Marks)

c. Various tax incentives available to operators in the:

   i. Manufacturing sector (6 Marks)

ii. Agriculture (2 Marks)

iii. Telecommunications (2 Marks)

d. Other non-tax factors foreign investors consider in determining a jurisdiction as investment destination. (4 Marks)

(Total 20 Marks)

QUESTION 5

Tax haven is a state, country or territory where certain taxes are levied at a low rate or not at all. This has created problems for other countries as their products and services are no longer competitive in international markets. However, various international organisations, governments and other stakeholders are still handicapped in mitigating or totally eliminating this malaise that is threatening competitive global market.

You have been invited by a manufacturing outfit to help explain certain issues regarding tax haven in practice.

Required:

a. From the perspective of the Organisation for Economic Co-operation and Development (OECD), explain **THREE** key factors in deciding whether a jurisdiction is a tax haven or not. (6 Marks)

b. How can a country use its tax jurisdiction to address the issue of competition from a tax haven? (5 Marks)

c. Explain the advantages of and provide the criticisms against tax haven. (9 Marks)

(Total 20 Marks)

QUESTION 6

a. Ms. Lilian Abu is a Nigerian born with a British mother. She grew up and schooled in the UK after which she took up a job with Her Majesty Revenue and Customs (HMRC) as a revenue officer. She has been selected to join a team of international reviewers visiting Nigeria in the coming months under a project funded by the World Bank.

Lilian has contacted you as part of her initial research to understand the tax system in Nigeria ahead of her visit.

Required:

i. Discuss the structure of the tax administration system in Nigeria. (4 Marks)

ii. Discuss the functions of any **TWO** organs of tax administration in Nigeria. (8 Marks)

b. Lilian informed you that based on her Google searches, she had seen a lot of concerns being expressed by Nigerian taxpayers over multiple taxation.

Required:

Explain the concerns by Nigerian taxpayers over multiple taxation and outline the causes and possible solutions of multiple taxation in Nigeria. (8 Marks)

(Total 20 Marks)

NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

	Initial %	Annual %
Building Expenditure	15	10
Industrial Building Expenditure	15	10
Mining Expenditure	95	Nil
Plant Expenditure (excluding Furniture & Fittings)	50	25
Manufacturing Industrial Plant Expenditure	50	Nil
Construction Plant expenditure (excluding Furniture and Fittings)	50	Nil
Public Transportation Motor Vehicle	95	Nil
Ranching and Plantation Expenditure	30	50
Plantation Equipment Expenditure	95	Nil
Research and Development Expenditure	95	Nil
Housing Estate Expenditure	50	25
Motor Vehicle Expenditure	50	25
Agricultural Plant Expenditure	95	Nil
Furniture and Fittings Expenditure	25	20

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

Graduated tax rates with consolidated relief allowance of ₦200,000 or 1% of Gross Income whichever is higher + 20% of Gross Income.

	Taxable Income (₦)	Rate of Tax (%)
First	300,000	7
Next	300,000	11
Next	500,000	15
Next	500,000	19
Next	1,600,000	21
Over	3,200,000	24

After the relief allowance and exemption had been granted, the balance of income shall be taxed as specified in the tax table above.

4.	COMPANIES INCOME TAX RATE	30%
5.	TERTIARY EDUCATION TAX	(2% of Assessable Profit)
6.	CAPITAL GAINS TAX	10%
7.	VALUE ADDED TAX	5%

SOLUTION 1

ABC & CO. (Tax Consultants)

ABC Avenue, Lagos.

April 10, 2020

The Managing Director
Sunchi West Africa Holdings
Ibadan

Dear Sir,

RE: TAXATION OF RESIDENT AND NON-RESIDENT COMPANIES IN NIGERIA

I refer to your mail of April 5, 2020 on the above subject, requesting us to unravel the issue of payment of companies income tax by resident and non-resident companies operating in Nigeria.

Please find below relevant issues that will facilitate your understanding of the situation:

a) **Resident company**

A company is resident in Nigeria under the extant law, if it is incorporated or registered in Nigeria. This means that the taxpayer is liable to tax on the income or profits accruing in, derived from, brought into, or received in Nigeria

Non-resident company

This is a company that is not registered or incorporated in Nigeria, but which derives income or profits from Nigeria.

A non-resident corporation or individual is liable to tax only on the profit or income deemed to be derived from Nigeria.

b) **Circumstances under which a non-resident company will be liable to tax in Nigeria**

These include:

- **Fixed base of business:** If a non-resident company has a "fixed base" from which it carries on its business or trade in Nigeria, the profits from such activities would be deemed to be derived from Nigeria;

- **Agency operation:** Where a non-resident company does not have a fixed base but habitually operates a trade or business through a person in Nigeria who:

  - is authorised to conclude contracts on its behalf or on behalf of some other companies controlled by it or which has controlling interest in them or

  - habitually maintains a stock or goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of the company, then an agency arrangement is deemed to have arisen.

  The profit deemed to have been derived from Nigeria is the profit attributable to the business or trade or activities carried on through the agent.

- **Turnkey projects:** This is a trade or business or activity which involves a single contract for the surveys, deliveries, installations or construction. For Nigerian income tax purposes, the profit from such a tunkey project is considered as derived from Nigeria and this will be liable to tax.

- Income derived by non-resident company from professional consultancy, management and technical services rendered in Nigeria.

- Income derived from supervisory activity that lasts more than three (3) months.

- Income derived by a non-resident company from investment, such as dividend, interest, rent and royalties. The withholding tax deducted from these incomes is taken as the final tax.

- Income derived from a contract awarded to a Nigerian company, but sub-contracted to a non-resident company.

c i) **Relationship between a Nigerian branch and a foreign parent company**

- Under the Companies Income Tax Act Cap C21 LFN 2004 (as amended) citizens of other countries, that are foreign nationals can incorporate a company or corporation (other than a corporation sole). This is regarded as a resident company that is a Nigerian company.
- However, a Nigerian branch of a foreign company is treated as a corporate entity. Income or profits derived by such company in Nigeria is taxable in Nigeria.

  The conditions under which such a Nigerian company will not be liable to Nigerian tax are where:

  - The branch of the foreign company is used solely for the storage or display of goods or merchandise; and
  - The branch is used for collection of information.

c ii) **Nigerian subsidiary and a foreign parent company**

- Under the Nigerian tax laws, the subsidiary of the foreign parent company must be incorporated in Nigeria.
- The foreign equity participation may be 100% (wholly-owned) or less than 100% (partly owned), this will not affect the residence status in Nigeria.
- Dividends distributed by the Nigerian subsidiary of the parent company is a franked investment income and shall be exempted from tax in the hands of the parent company. But it will be subjected to withholding tax of 7.5% in Nigeria.

d) **Overseas branch of a Nigerian company**

- For tax purposes, the profit of an overseas branch of a Nigerian company is deemed to be derived in Nigeria and is therefore fully liable to tax in Nigeria.
- It is essential to know that the foreign tax suffered is allowable as a deduction in determining the overseas profits.
- Assets in such a branch are eligible for capital allowances claim in Nigeria.
- Losses incurred can be set off against profit in Nigeria provided such losses were incurred from the same source.
- Double Taxation Relief (DTA) is available for any foreign tax suffered.

e) **Overseas subsidiary of a Nigerian company**

- For tax purposes, the profit of an overseas subsidiary is not deemed to be derived in Nigeria and will therefore not be liable to tax in Nigeria.
- It is only dividend received from such overseas subsidiary that will be considered for Nigerian tax purposes.
- Technical and management fees paid to the Nigerian company by the overseas subsidiary will be subjected to tax in Nigeria.
- Capital allowances will not be claimable on the assets of the overseas subsidiary.

f) **Computation of companies income tax payable by the Nigerian subsidiary**

The companies income tax payable by the Nigerian subsidiary is **₦31,415,100,** while the tertiary education tax is **₦2,899,400** (See Appendix I). The China operation is not liable to Nigerian tax, hence no computation of adjusted/assessable profit.

We have commented on areas deemed necessary. Nevertheless, if you should still need further clarification(s), please do not hesitate to contact us.

Yours faithfully,

Chukwu, A. O
Senior Consultant

APPENDIX I

Sunchi West Africa Holdings

Computation of adjusted profit

For the year ended December 31, 2018

	₦'000	₦'000
Net profit as per accounts		120,510
Add back: Disallowable expenses:		
Depreciation	9,900	
Loss on revaluation of non-current assets	1,490	
Legal expenses:		
Preliminary expenses	2,100	
Land acquisition	550	
Allowance for doubtful debts (General prov)	5,820	
Repairs and maintenance:		
Improvement on office building	2,250	
Administrative expenses (court fine)	600	
Foreign exchange loss provision	1,750	24,460
Adjusted profit/Assessable profit		144,970

Computation of companies income tax for 2018 year of assessment

	₦'000
Adjusted/assessable profit	144,970
Deduct: Capital allowances (w1)	40,253
Total profit	104,717
Companies income tax @ 30% of total profit	31,415.1
Tertiary Education Tax @ 2% of assessable profit	2,899.4
Total tax payable	**34,314.5**

Workings

(1) Capital allowances computation

	Factory Building	Office Building	Plant Machinery	Motor Vehicle	Furniture Fittings	Office Equip.	Total Capital Allow.
1A	15	15	50	50	25	50	
AA	10	10	25	25	20	25	
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
2018 Y/A							
Cost	20,200	12.450	25,000	16,120	4,700	4,000	
1A	(3,030)	(1,868)	(12,500)	(8,060)	(1,175)	(2,000)	28,633
AA	(1,717)	(1,058)	(3,125)	(2,015)	(705)	(500)	9,120
Inv. All.			(2,500)				2,500
							40,253
2019 Y/A							
TWDV c/f to 2019 Y/A	15,453	9,524	9,635	6,381	2,820	1,542	

(2) Annual allowances for 2018 in N'000

Factory building

$$AA = \frac{₦20,200 - ₦3,030}{10}$$

$$= \underline{₦1.717}$$

Office building

$$AA = \frac{₦12,450 - ₦1,868}{10}$$

$$= ₦1,058.25$$

$$= \underline{\underline{₦1.058}}$$

Plant & machinery

$$AA = \frac{₦25,000 - ₦12,500}{4}$$

$$= \underline{\underline{₦3,125}}$$

Motor vehicle

$$AA = \frac{₦16,120 - ₦8,060}{4}$$

$$= \underline{\underline{₦2,015}}$$

Furniture & fittings

$$AA = \frac{₦4,700 - ₦1,175}{4}$$

$$= \underline{\underline{₦705}}$$

Office equipment

$$AA = \frac{₦4,000 - ₦2,000}{4}$$

$$= \underline{\underline{₦500}}$$

Marking Guide

		Marks	Marks
a)	Heading	½	
	Address	½	
	Correct definition of resident company	1	
	Tax implication of resident company	½	
	Correct definition of non-resident company	1	
	Tax implication of non-resident company	½	4
b)	2 marks for each description of circumstances which income or profit of a non-resident company will be assessable to tax subject to a maximum 5 points		10
c i)	1 mark for each correct description of the relationship between a Nigerian branch and a foreign parent company subject to a maximum of 3 points		3
ii)	1 mark for each correct description of the relationship between Nigerian subsidiary and a foreign parent company subject to a maximum of 3 points		3
d)	1 mark for each correct description of overseas branch of a Nigerian company subject to a maximum of 3 points		3
e)	1 mark for each correct description of overseas subsidiary of a Nigerian company subject to a maximum of 3 points		3
f)	Heading	½	
	Net profit as per accounts	½	

Depreciation	½	
Loss on revaluation of asset	½	
Preliminary expenses	½	
Land acquisition	½	
General provision for doubtful debt	½	
Improvement to office building	½	
Court fine	½	
Foreign exchange loss provision	½	
Adjusted profit	½	
Tax liability:		
Adjusted profit	½	
Capital allowance	½	
Total profit	½	
Companies income tax	½	
Tertiary education tax	½	
Total tax payable	½	
	8½	
Capital allowances (18 ticks x $^1/_4$ mark each)	4½	
That is:		
2018 Y/A (1 tick)		
IA (6 ticks)		
AA (6 ticks)		
Investment allowance (1 tick)		
Total capital allowance (4 ticks)		
Conclusion (memo)	1	14
Total		**40**

Examiner's Report

The question tests the candidates' understanding of the principles relating to taxation of resident and non-resident companies.

Being a compulsory question, almost all the candidates attempted the question. Candidates demonstrated a fair understanding of the question, especially in companies income tax computations; and performance was average.

The commonest pitfall was the inability of the candidates to differentiate between overseas branch and a Nigerian company.

Candidates should endeavour to read extensively the Institute's Study Text and other relevant textbooks.

SOLUTION 2

XYZ & Co (Chartered Accountants)

Port Harcourt

Date ----

The Managing Director
Sunny Oil Producing Nigeria Limited
Niger Delta Region

Dear Sir,

RE: TAX APPEALS AND THE TAX IMPLICATION OF THE COMPANY'S PROPOSED TRANSPORTATION BUSINESS

Having concluded our assignment, we are pleased to report as follows:

ai. Preparation to be made before the commencement of the proceedings at the tribunal

These include:

- All the relevant documents for the plant and equipment acquired and donation made would be collated and reviewed;
- All such documents would be photocopied and marked for easy reference; and
- Adequate provisions of the law that back the claim of capital allowances on the plant and equipment and donation as allowable expenses would be documented.

ii. Steps to be taken by the company if the decision of the Tribunal is not acceptable to it

These include:

- Any person dissatisfied with a decision of the Tribunal may appeal against such decision on a point of law to the Federal High Court;
- The appeal must be in writing to the Secretary to the Tribunal within 30 days after the date on which such decision was given;
- A notice of appeal shall be filed which will set out all the grounds of law on which the appellant's case is based; and
- Upon receipt of a notice of appeal, the secretary to the Tribunal shall cause the notice to be given to the Chief Registrar of the Federal High Court along with all the exhibits tendered at the hearing before the Tribunal.

iii. The tax implication of the company's proposed transportation business

The profit of oil producing companies that are involved in transportation business shall not be assessable to tax under the Petroleum Profits Tax Act or put differently, the business is covered under the Companies Income Tax Act 2004 (as amended).

We hope that this report adequately represents the mandate assigned to us. Should you need any further clarification on this, we will be glad to address it.

Yours faithfully,

Debby Made
Principal Consultant

(b) **Sunny Oil Producing Nigeria Limited**

Petroleum Profit Tax

For 2018 Year of Assessment

	₦'000	₦'000
Export sales (W1):		
Bonny light ($63.06 x ₦305 x 150,000)		2,884,995
Forcados ($65 x ₦305 x 100,000)		1,982,500
Bonny medium ($64.50 x ₦305 x 90,000)		1,770,525
Domestic sales (₦720 x 80,000)		57,600
Natural gas (W2)		487,679
		7,183,299
Deduct: Allowable expenditure:		
Operating expenses	255,000	
Tangible drilling cost	80,000	
Production & exploration		
(₦1,100,600 – ₦80,000 – ₦200,200)	820,400	
Intangible drilling cost	420,800	
Admin expenses	225,500	
Non-productive rent	80,700	
Bad debts	20,150	
Repairs and renewals	92,600	
Transport & traveling	73,200	
Royalties or domestic sales	22,500	
Royalties others	200,400	
Miscellaneous expenses		
(₦63,800 - ₦12,750 - ₦50,000)	1,050	
Salaries and wages	830,700	
Pension fund contribution	74,450	
Customs duty	10,400	

Habour dues	3,300	
Interest on loan	52,350	
Appraisal wells (₦120,000 x 2/3)	80,000	
Tertiary education tax (2/102 x ₦3,089,799)	60,584	3,404,084
Adjusted profit		3,779,215
Deduct: unrelieved loss b/f		750,000
(i) Assessable profit		3,029,215
Less: Capital allowances		
Lower of:		
Actual capital allowances for the year	130,250	
Unutilised capital allowance b/f	12,500	
	142,750	
Petroleum investment allowance (w3)	24,845	
	167,595	
Or		
85% of assessable profit (85% of ₦ 3,029,215)	2,574,833	
Less 170% of PIA (1.7 x ₦24,845)	42,237	
	2,532,596	
		167,595
ii. Chargeable profit		2,861,620
iii. Assessable tax @ 85% of ₦2,861,620		2,432,377
Less MOU		-
iv. Chargeable tax		2,432,377
Tertiary education tax		60,584
Chargeable tax		2,432,377
v Total tax payable		2,492,961

Workings

(1) Export sales

	Bonny	Light	Forcados		Bonny	medium
	API	$	API	$	API	$
Standard	36^0	63.03	36^0	65.00	36^0	64.53
Actual	37^0		36^0		35^0	
	1^0x 0.03	0.03	0^0x 0.03	(0.00)	(1^0)x 0.03	(0.03)
		63.06		65.00		64.50

(2) Natural gas sales

Akin Gas Limited $$\frac{60-66}{60-70} = \frac{15.5-x}{15.5-14.3}$$

$$\frac{-6}{-10} = \frac{15.5-x}{1.2}$$

$$= \mathbf{x\ 14.78}\%$$

	₦'000
Gross sales	220,000
Less: G-factor allowance	
(14.78% of ₦220,000,000)	(32,516)
Net sales	187,484

Bollah Limited

$$= \frac{70-71}{70-80} = \frac{14.3-x}{14.3-13.6}$$

$$= \frac{-1}{10} = \frac{14.3-x}{0.7}$$

$$= \mathbf{x\ 14.23}\%$$

	₦'000
Gross sales	350,000
Less: G-factor allowance	
(14.23% of N350,000)	49,805
Net sales	300,195

Total net sales = ₦187,484,000 + 300,195,000 = **₦487,679,000**

(3) Petroleum investment allowance (PIA)

		₦'000
Plant:	₦ 120,500,000 x 10% =	12,050
Pipeline & storage tank:	₦ 85,300,000 x 15% =	12,795
Total		24,845

Marking Guide

		Marks	Marks
a i)	1 mark for each of the points on preparations to be made by the consultant and the company subject to a maximum of 2 points		2
a ii)	1 mark for each of the points on the steps to be taken by the company if the decision is not favourable to it subject to a maximum of 2 points		2
a iii)	½ mark for each of the points on the tax implication of the company's proposed transportation business subject to a maximum of 2 points		1
bi.	Heading	¼	
	Export sales :		
	Bonny light	¼	
	Forcados	¼	
	Bonny medium	¼	
	Domestic sales	¼	
	Natural gas	¼	
	Operating expenses	¼	
	Tangible drilling cost	¼	
	Production & exploration	¼	
	Intangible drilling cost	¼	
	Admin expenses	¼	
	Non-productive rent	¼	
	Bad debts	¼	
	Repairs and renewals	¼	
	Transport and traveling	¼	
	Royalties (domestic sales)	¼	
	Royalties (others)	¼	
	Miscellaneous expenses	¼	
	Salaries and wages	¼	
	Pension fund contribution	¼	
	Customs duty	¼	
	Habour dues	¼	
	Interest on loan	¼	
	Appraisal wells	¼	
	Tertiary Education tax	¼	
	Adjusted profit	¼	
	Unrelieved loss b/f	¼	

Workings:

Export sales (Bonny light) (Forcados) Bonny medium	½	
Natural gas (Akin Ltd)	¼	
(Bollah Ltd)	¼	
i. Assessable profit	¼	8
Actual capital allowances for the year	¼	
Unutilized capital allowance b/f	¼	
Petroleum investment allowance	¼	
Total value	¼	
85% of assessable profit	¼	
Less 170% of PIA	¼	
Total value	¼	
Capital allowance figure (₦ 167,595)	¼	
Workings on PIA (Total value)	½	
ii. Chargeable profit	½	3
iii. Assessable tax @ 85% of chargeable profit		1
iv. Chargeable tax		1
v. Total tax payable:		
Tertiary education tax	½	
Chargeable tax	½	
Total tax payable	1	2
Total		**20**

Examiner's Report

The question tests the candidates' knowledge on assessment and appeal procedures and petroleum profits tax computations.

Majority of the candidates attempted the question and they exhibited a clear understanding of the requirements of the question and performance was satisfactory.

The commonest pitfall was the inability of the candidates to correctly treat the loss relief brought forward and donation in the determination of assessable profit.

Candidates are advised to cover the specific areas of the syllabus which relates to the topic by using the Institute's Study Text, other relevant textbooks and tax laws.

SOLUTION 3

PQR & CO. CHARTERED ACCOUNTANTS, LAGOS

INTERNAL MEMORANDUM

Date: November 25, 2020

From: Desk Officer (International Tax Matters)

To: The Principal Partner

RE: REPORT ON LARRY LIMITED'S REQUEST ABOUT REGIONAL ECONOMIC INTEGRATION AND TRADE BLOC

I refer to our client's request on regional integration and trade bloc and hereby present a report for your review before same is presented to the client.

a) Regional integration

This is a process in which neighbouring states enter into an agreement in order to upgrade cooperation through common institutions and rules.

The objectives of the agreement could range from economic to political and environmental. Although, it has typically taken the form of a political economy initiative where commercial interests are the focus for achieving broader socio-political and security objectives, as defined by national governments.

Regional integration has been organised either via supranational institutional structures or through inter-governmental decision-making, or a combination of both.

Past efforts at regional integration have often focused on removing barriers to free trade in the region, increasing the free movement of people, labour, goods, and capital across national borders, reducing the possibility of regional armed conflict (for example, through confidence and security building measures), and adopting cohesive regional stances on policy issues, such as the environment, climate change and migration.

The examples include North American Free Trade Agreement (NAFTA), Asian Pacific Economic Cooperation Forum (APECF).

Trade blocs

A trade bloc is basically a free-trade or near-free-trade formed by one or more tax, tariff, and trade agreement between two or more countries.

Some trading blocs have resulted in agreements that have been more substantive than others in creating economic cooperation. Of course, there are pros and cons for creating regional agreements.

In the past decade, there has been an increase in these trading blocs with more than one hundred agreements in place and more in discussion.

Some of the examples include European Union (EU), ECOWAS, Africa Continentila Free Trade Area (ACFTA).

b) **Objectives of regional integration**

Regional integration is the joining of individual states within a region into a larger whole. The degree of integration depends upon the willingness and commitment of independent sovereign states to share their sovereignty. Regional integration initiatives should fulfill at least the following eight important objectives:

i) The strengthening of trade integration in the region;
ii) The creation of an appropriate enabling environment for private sector development;
iii) The development of infrastructure programmes in support of economic growth and regional integration;
iv) The development of strong public sector institutions and good governance;
v) The reduction of social exclusion and the development of an inclusive civil society;
vi) Contribution to peace and security in the region;
vii) The building of environmental programmes at the regional level; and
viii) The strengthening of the region's interaction with other regions of the world.

c) **Benefits of regional economic integration and trade blocs**

The benefits derivable from regional economic integration and trade blocs agreement include the following:

i) **Trade creation:** These agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developed countries;

ii) **Employment opportunities:** By removing restrictions on labour movement, economic integration can help expand job opportunities;

iii) **Consensus and cooperation:** Member nations may find it easier to agree with smaller numbers of countries. Regional understanding and similarities may also facilitate closer political cooperation;

iv) **Impetus for private sector planning and investment:** Regional economic integration can serve a useful economic purpose beyond the direct gains from trade liberalisation, by reducing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest; and

v) **Other non-economic benefits:** Regional economic integration may allow a member country to reap other non-economic benefits, such as peace and security.

d) Disadvantages of regional economic integration and trade blocs

These include:

i) **Trade diversion:** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with non-member nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, inefficient companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the trading bloc.

ii) **Employment shifts and reductions:** Countries may move production to cheaper labour markets in member countries. Similarly, workers may move to gain access to better jobs and wages. Sudden shifts in employments can distort the resources of member countries.

iii) **Loss of national sovereignty:** With each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economic rights.

iv) **Regional integration and trade blocs** are forms of trade barriers with countries which are not members of the trading bloc.

v) **Investment diversion:** One of the problems facing many smaller economies is lack of foreign investment. Investment decision is a potential economic disadvantage of regional economic integration programme. Foreign investors from non-member countries may see a member country as less attractive place to invest due to higher burden of tariffs and regulations against non-member states.

e) **Common market and Economic Union**

Regional economic integration has enabled countries to focus on issues that are relevant to their stage of development as well as encourage trade between neighbours. Common market and Economic Union are types of regional economic integration.

Common market allows for the creation of economically integrated markets among member countries.

Trade barriers and any restrictions on the movement of labour and capital between member countries are removed.

Like customs unions, there is a common trade policy for trade with non-member nations. The primary advantage to workers is that they no longer need a visa or work permit to work in another member country of a common market. An example is the Common Market for Eastern and Southern Africa (COMESA).

Economic Union: This is created when countries enter into an economic agreement to remove barriers to trade and adopt common economic policies.

An example is the European Union (EU).

Economic Union requires the integration of monetary and fiscal policies such as use of common currencies and fixed exchange rates.

It is hoped that the matters discussed above will meet your expectations.

Mrs Charity Kay

Marking Guide

		Marks	Marks
Heading/Address		1	
a)	½ mark each for correct description of regional Integration subject to a maximum of 3 points	1½	
	½ mark each for correct description of trade blocs subject to a maximum of 3 points	1½	4
b)	1 mark for each objective of regional integration subject to a maximum of 5 points		5
c)	1 mark for each benefit of economic integration and trade blocs subject to a maximum of 4 points		4

d)	1 mark for each disadvantage of economic integration and trade blocs subject to a maximum of 3 points	3
e)	1 mark each for correct description of common market subject to a maximum of 2 points	2
	1 mark each for correct description of economic union subject to a maximum of 2 points	2
	Total	**20**

Examiner's Report

The question tests candidates' understanding of the principles of economic regional integration and trade bloc.

Many candidates' attempted the question but sizeable number of them lacked understanding of the question and performance was poor.

The major pitfall of the candidates was their inability to differentiate common market from economic union.

Candidates are advised to read the relevant laws and textbooks on economic regional integration and trade bloc.

SOLUTION 4

LMN & Co (Tax Consultants)

Kaduna

March 6, 2020

The Managing Director
Able Associates
Kano

Dear Sir,

RE: NIGERIAN TAX INCENTIVES

I refer to your letter with Reference Number Able/03/20 dated February 25, 2020 engaging our firm to provide professional advice on the above subject. Our comments are as follows:

a) Objectives of tax incentives

Tax incentives in Nigeria are meant to:

(i) Encourage voluntary tax compliance;

(ii) Attract domestic and foreign investments into Nigeria;

(iii) Encourage businessmen to invest in certain preferred sectors of the economy;

(iv) Encourage investment to develop rural areas and export processing (EPZ);

(v) Promote export activities;

(vi) Encourage repatriation of foreign earnings to Nigeria;

(vii) Encourage research and development activities;

(viii) Encourage and accelerate the growth of small scale businesses; and

(ix) Encourage businesses to make financial contributions to activities which the government considers socially desirable.

b) **Forms of tax incentives**

The incentives may be granted based on industry or type of tax and may include:

(i) Exemption from payment of taxes;

(ii) Reduction in rate of tax to be paid;

(iii) Grant of allowances and deductions from profits subject to tax, etc; and

(iv) Claiming of reliefs such as loss relief and double taxation relief.

c i) **Manufacturing sector**

Fiscal measures have been drawn to provide for deductions and allowances in the determination of taxable income of manufacturing enterprises. They include:

- **Pioneer status**
  This is a concession to pioneer companies located in economically disadvantaged areas by providing a tax holiday period of three to five years. These industries must be considered by the government to be beneficial to the country's economy and in the interest of the public.

  Companies that are involved in local raw material development; local value added; labour intensive processing; export–oriented activities; in-plant training; are also qualified for additional concessions;

- **Tax relief for research and development (R&D)**
  Up to 120% of expenses on R&D are tax deductible provided that such R&D activities are carried out in Nigeria and are connected with businesses to which allowances are granted. The result of such research could be patented and protected in accordance with internationally accepted industrial property rights;

- **Small business income tax rate of 20%** if the business is within its first 5 years and turnover of ₦1 million or below (Prior to Finance Act 2019);

- Based on the provisions of the Finance Act 2019, any business with less than ₦25 million turnover is exempted from companies income tax. While, any company with turnover from ₦25 million to less than ₦100 million attracts income tax rate of 20% on total profit;

- **Local raw materials utilization;**

  30% tax concession for five years to industries that attain minimum local raw materials utilisation as follows: agro – 80%; agro allied – 70%; engineering – 65%; chemical – 60%; and petro-chemical – 70%;

- **Labour intensive mode of production**
  15% tax concession for five years. The rate is graduated in such a way that an industry employing one thousand persons or more will enjoy 15% tax concession while an industry employing one hundred will enjoy only 6%, while those employing two hundred will enjoy 7% and so on;

- **Local value added**
  10% tax concession for five years. This applies essentially to engineering industries, while some finished imported products serve as inputs. This is aimed at encouraging local fabrication rather than the mere assembly of completely knocked down parts;

- **In-plant training**
  2% tax concession for five years, of the cost of the facilities for training;

- **Export oriented industries**
  10% tax concession for five years. This concession will apply to industries that export not less than 6% of their products;

- **Rural investment allowance**
  This is an allowance given to a company which incurs capital expenditure or the provision of facilities, such as electricity, water and tarred road. The rates are as follows:

  No facilities at all (100%); no electricity (50%); no water (30%) and no tarred road (15%).

- **Investment in economically disadvantaged areas**
  100% tax holiday for seven years and additional 5% depreciation over and above the initial capital depreciation; and

- **Excise duty**
  Excise duty is the money paid to the government by manufacturing concerns for goods purchased. It is a production tax. The tax can also be levied on intangible items such as internet data and telecommunication fees.

c ii. **Agriculture**

Incentives include;

General incentive-pioneer status;

- Tax relief for research and development;
- 30% tax credit for 5 years for agro-allied form that attains maximum level of local raw material utilization of 70%;
- Effective 2012 YOA, agricultural machinery and equipment attracts no duty;
- No restriction on the amount of capital allowance claimable in any year of assessment;
- Agricultural business is exempted from minimum tax provision;
- Interest on loans granted to agricultural business is exempted from tax provided the moratorium period is not less than 18 months and the interest is not more than the base lending rate at the time it was granted;
- Agro-allied plants and equipment enjoy enhanced capital allowance of up to 50%; and
- Application of small business income tax rate of 20% if the business is within its first 5 years and turnover is ₦ 1 million or below.

c iii. **Telecommunications**

These include:

- Provision of non-fiscal incentives to private investors in addition to a tariff structure that ensures that investors recover their investment over a reasonable period of time, bearing in mind the need for differential tariffs between urban and rural areas; and
- Rebate and tax relief are provided for the local manufacture of telecommunications equipment and provision of telecommunication services.

d. Non-tax factors considered by foreign investors in locational determinants, will differ from one business to another, depending on the objectives of the investment.

The more important non-tax factors include:

- Economic and political stability;
- Adequate physical, business, accounting and legal infrastructure;
- The absence (or limited presence) of bureaucratic obstacles;
- Adequate communication channels;
- Ability to negotiate profit freely;
- Effective banking system; and
- The availability of an adequate dispute resolution mechanism.

Please do not hesitate to contact us if you require any further clarification on the above subject.

Yours faithfully,

Victor Aminu
Principal Consultant

Marking Guide

			Mark
a.	Heading/address	1	
	½ mark for each objective of tax incentives subject to a maximum of 6 points	3	4
b.	1 mark for each form of tax incentives mentioned subject to a maximum of 2 points		2
c. i	1 mark each for tax incentives available to the manufacturing sector subject to a maximum of 6 points		6
ii	½ mark each for tax incentives available to the agricultural sector subject to a maximum of 4 points		2
iii	1 mark each for tax incentives available to the telecommunications sector subject to a maximum of 2 points		2
d.	1 mark each for correct discussion on non-tax factors subject to a maximum of 4 points		4
	Total		**20**

Examiner's Report

The question tests candidates' understanding of tax incentives available to specific sectors in the Nigerian business environment.

Many candidates attempted the question and they showed fair understanding of it and performance was above average.

The commonest pitfall was the candidates' inability to identify the various incentives available to agricultural and telecommunication sectors.

The candidates are encouraged to read widely before sitting for examinations in order to perform well.

SOLUTION 5

a. Organisation for Economic Co-operation and Development (OECD) identifies three key factors in deciding whether a jurisdiction is a tax haven or not. These are:

i) **Nil or only nominal taxes**
Tax havens impose nil or only nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a piece to be used by non-residents to escape high taxes in their countries of residence;

ii) **Protection of personal financial information**
Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefitting from the low tax jurisdiction; and

iii) **Lack of transparency**
A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available.

Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. Secret rulings, negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records is a contributing factor.

b. To avoid tax competition, many high tax jurisdictions have enacted legislation to counter the tax sheltering potential of tax havens. Generally, such legislation tends to operate in the following ways:

i) Attributing the income and gains of the company or trust in the tax haven to a taxpayer in the high-tax jurisdiction on an arising basis. Controlled foreign corporation legislation is an example of this;

ii) Transfer pricing rules, standardization of which has been greatly helped by the promulgation of OECD guidelines

iii) Restrictions on deductibility or imposition of a withholding tax when payments are made to offshore recipients;

iv) Taxation of receipts from the entity in the tax haven, sometimes enhanced by notional interest to reflect the element of deferred payment. The EU withholding tax is probably the best example of this.

v) Exit charges or taxing of unrealized capital gains when an individual, trust or company emigrates;

vi) Many jurisdictions employ blunter rules. For example, in France, securities regulations are such that it is not possible to have a public bond issue through a company incorporated in a tax haven; and

vii) Usage of "forced disclosure" of tax mitigation schemes. These involve the revenue authorities compelling tax advisors to reveal details of the scheme, so that the loopholes can be closed during the following tax year, usually by one of the methods highlighted above. Although not specifically aimed at tax havens, given that so many tax mitigation schemes involve the use of offshore structures, the effect is much the same.

d. Advantages of tax havens

These include:

i) Personal residency

Since the early 20th century, wealthy individuals from high- tax jurisdictions have sought to relocate themselves to low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation. Almost no tax haven assesses any kind of capital gains tax or inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles;

ii) Corporate residency

Corporate persons, in contrast to natural persons, can own subsidiary corporations in many countries. That allows them to take advantage of the variety of laws, regulations and conventions in multiple countries, without overtly engaging in any questionable activities. Only in extreme cases will they move their formal corporate headquarters; and

iii) Asset holding

This involves utilizing an offshore trust or offshore company or a trust owning a company. The company or trust will be formed in one tax haven and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into an entity which is not tax resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction.

Criticism of tax havens

These are:

i) Tax havens have been criticised because they often result in the accumulation of idle cash which is expensive and inefficient for companies to repatriate;

ii) The tax shelter benefits result in a tax incidence disadvantaging the poor;

iii) Many tax havens are thought to have connections with fraud, money laundering and terrorism;

iv) Investigations of illegal tax haven abuse have been ongoing, there have been few convictions;

v) Lobbying pertaining to tax havens and associated transfer pricing has also been criticized; and

vi) Activities in tax havens facilitate practice of base erosion and profit shifting (BEPS).

Marking Guide

		Marks	Marks
a	2 marks for each of the OECD's perspectives subject to a maximum of 3 points		6
b	1 mark for each method of coping with the issue of tax Have subject to a maximum of 5 points		5
c	2 marks for correct discussion on advantages of tax haven, maximum of 3 points	6	
	1 mark each for criticism subject to a maximum of 3 points	3	9
	Total		**20**

Examiner's Report

The question tests candidates' knowledge on issues relating to tax haven.

Many candidates did not attempt the question. The performance of the candidates in part (a) of the question was poor, whilst that of parts (b) and (c) was average.

The major pitfall was the inability of the candidates to explain the key factors in deciding whether or not a jurisdiction is a tax haven from the perspective of the OECD.

Candidates are advised to read widely the Institute's Study Text, Pathfinder and other relevant textbooks, as this will go a long way in assisting them to pass future examinations.

SOLUTION 6

a) (i) Structure and taxing rights of different levels of government

For tax purposes and in accordance with its constitutional provision, Nigeria is divided into three constituencies – The Federal, State and Local Governments. The taxing right for each of the three tiers of government is contained in the Taxes and Levies (Approved List for collection) Act Cap T2 LFN 2004 (as amended).

Federal Government

The Federal Government is responsible for the administration and collection of taxes due from all taxable corporate bodies, personnel of the Nigerian Armed Forces and those employed in Nigeria's foreign missions through the Federal Inland Revenue Service (FIRS).

Examples of taxes collected by Federal Government are Companies income tax, Petroleum profits tax, Value added tax, Personal income tax from members of armed forces personnel, police force, Capital gains tax for companies and non-residents, withholding tax from companies, etc.

NOTE: With the enactment of the FCT-IRS Act 2015, taxes payable by residents of the FCT are now due to the FCT-IRS.

State Government

Each state government is responsible for administration, assessment and collection of the taxes due from all taxable persons resident in the state with the exception of the Nigerian Armed Forces and employees of the Nigeria foreign missions through each State's Internal Revenue Service (SIRS).

Examples of taxes collected by State Government are Personal income tax, withholding tax from individuals and unincorporated entities, Capital gains tax for individuals and unincorporated entities, road taxes, pools betting and lotteries, gaming and casino taxes, development levy, etc.

Local Government

Local government is responsible for collecting levies such as shop and kiosk rates, tenement rates, on and off liquor licenses fees, slaughter slab fees, marriage, birth and death registration fees, motor park levies, road closure levy, etc.

Local government taxes/levies are collected by the Local Government Revenue Committee in each state.

(a) **(ii) Functions of organs of tax administration in Nigeria are as follows:**

Federal Inland Revenue Service Board (FIRSB)

The FIRSB shall be responsible to:

- Provide the general policy guidelines relating to the functions of the Service;
- Manage and superintend the policies of the Service, on matters relating to the administration of the revenue assessment, collection and accounting system under this Act or any enactment or law;
- Review and approve the strategic plans of the Service;
- Employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service;
- Stipulate remuneration, allowances, benefits and pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission; and
- Do such other things, which in its opinion, are necessary to ensure the efficient performance of the functions of the Service under the Act.

State Board of Internal Revenue Service (SBIRS)

The SBIRS shall be responsible for:

- Ensuring the effectiveness and optimum collection of all taxes and penalties due to the Government under the relevant laws;
- Doing all such things as may be deemed necessary and expedient, for the assessment and collection of the tax and shall account for all sums so collected, in a manner to be prescribed by the Commissioner;
- Making recommendations, where appropriate, to the JTB on tax policy, tax reform, tax legislation, tax treaties and exemptions as may be required from time to time;

- Generally controlling the management of the State Service on matters of policy, subject to the provisions of the law setting up the State Internal Revenue Service; and
- Appointing, promoting, transferring and imposing discipline on employees of the State Internal Revenue Service.

Local Government Revenue Committee (LGRC)

The LGRC shall be:

- Responsible for the assessment and collection of all taxes, fines and rates, under its jurisdiction and shall account for all amounts so collected, in a manner to be prescribed by the Chairman of the Local Government;
- Autonomous of the local Government Treasury department and shall be responsible for the day-to-day administration of the Department, which forms its operational arm;
- Responsible for tax payer education; and
- Responsible for collection of data and information to develop and reform tax policies legislation and administration.

(b) **Multiple taxation**

Multiple taxation is a tax regime under which various and similar types of taxes are imposed on taxpayers by different tiers of government. For instance, while the Federal Government imposed the Value added tax on consumption and made it applicable throughout the Federation, some notably, Lagos State, introduced the sales tax based on the same principle as the former and made it applicable in Lagos State.

i) Causes of multiple taxation in Nigeria

The possible causes of multiple taxation in Nigeria are:

- The number of taxes which local government has constitutional right to collect;
- Lack of funding, particularly, for most States may result to multiple taxation where the Board attempts to source for fund through levying of tax notwithstanding whether such tax had already been levied either by the Federal or Local Governments;
- Some of the state governments deliberately deny their local governments the revenue due to them, consequently the local government as a way of

survival desperately and aggressively focus on anything that will generate revenue to them;

- Lack of tax education and awareness;
- Inability of all the tiers of government adequately fund their departments and agencies;
- Multiplicity of revenue agencies;
- Overlapping taxing rights as contained in the Constitution and the taxed and levies (approved list for collection); and
- Manual tax administration system and unauthodox tax collection mechanism.

ii) Possible solutions to multiple taxation in Nigeria include:

- Streamlining the number of taxes in Nigeria in view of the low yields of many of the taxes, This will involve the review of current statutory provisions in Nigeria;
- Reviewing all the existing taxes in Nigeria and harmonise where necessary, as recommended by various study groups;
- Reviewing of the Constitution to address the overlap in taxing rights and limit the number of taxes that can be imposed by different levels;
- Abolishing unauthodox method of tax collection and implement technology for tax administration; and
- Limiting the number of revenue agencies.

Marking Guide

		Marks	Marks
a.i	1 mark on general comments/introduction to structure and taxing rights	1	
	1 mark each for discussions on Federal Government, State State Government and Local Government	<u>3</u>	4
ii	1 mark each on functions of two organs of the administration in Nigeria subject to a maximum of 4 points per organ		8
b.	1 mark each on causes of multiple taxation in Nigeria subject to a maximum of 4 points	4	
	1 mark each on possible solutions to multiple taxation in Nigeria subject to a maximum of 4 points	<u>4</u>	<u>8</u>
			<u>20</u>

Examiner's Report

The question tests candidates' knowledge on tax administration and fiscal policy in Nigeria.

Many candidates attempted the question and they showed mixed understanding of the question. The performance of the candidates in part (a) of the question was above average while it was fair in part (b).

The major pitfall was the candidates' poor understanding of the causes and solutions to multiple taxation in Nigeria.

Candidates are advised to pay attention to the specific areas of the syllabus relating to the topic as this will enable them to perform very well in future examinations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2020

STRATEGIC FINANCIAL MANAGEMENT

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ANSWER FOUR OUT OF SIX QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

Assume today is November 20, 2019. In 2018, the Oyin Division of Aba plc successfully launched a new premium wine- 'Aladun', in Nigeria. The Divisional Board of Oyin Division is now considering plans put forward by the Divisional Marketing Manager to launch the full range of Aladun in another country ''Linder''. Linder has Linderian dollar (L$) as currency and the launch is planned for January 1, 2020.

It is well known within the industry that it can be very difficult for a foreign company to break into the Linderian market for fruit wine because there is significant loyalty towards local Linderian brands and imported South African brands. Initial market research based on free tasting sessions has met an encouraging response but there is still some uncertainty over the success of the launch. However, the greatest danger to the success of Aladun in Linder is considered to be the risk that a Nigerian competitor might launch a similar range of products in the same market.

Financial data for the project

To date, ₦5 million has been spent on initial market research for the Linderian market. If the project is approved, an additional ₦20 million will be required for detailed market research and packaging design. The cost of the launch itself includes an expensive radio and television advertising, campaign in Linder and it is expected to cost about ₦10 million. Both of these costs are tax deductible in Nigeria. In addition, L$84 million will be spent on a distribution centre in Linder. All of these one-off costs are payable on January 1, 2020.

Estimates of net operating cash flows for the project vary considerably according to assumptions made regarding consumer and competitor reaction to the launch of 'Aladun' in Linder. Forecast cash flow figures for sales revenue and associated costs for the project for the year ending December 31, 2020 have been estimated based on two possible outcomes, known as Scenario A and Scenario B. The forecasts are:

Forecast operating cash flow figures for the year ending December 31, 2020.

Scenario A:	Sales revenue	L$100 million
	Costs	L$10 million plus ₦20 million
Scenario B:	Sales revenue	L$55 million
	Costs	L$10 million plus ₦15 million

All operating cash flows shown above are expected to grow by 5% per annum in subsequent years for the duration of the project.

It can be assumed that if Scenario A occurs in 2020, it will also occur in all subsequent years. The same is true for Scenario B. It is estimated that there is a 70% probability of occurrence of Scenario A and a 30% probability of Scenario B.

Other relevant financial information:

- Oyin Division evaluates projects of this nature at a risk-adjusted after-tax discount rate of 15% over a 4 year period.
- The proposed new distribution centre to be built in Linder is expected to have a residual value of L$52 million after 4 years.
- Corporate income tax is charged in Nigeria at 35% on taxable profits and is paid at the end of the year in which the taxable profit arises. No separate tax is charged in Linder. Tax depreciation allowances are available in Nigeria on all capital expenditure (incurred both in Nigeria and Linder) at a rate of 100%. Balancing charges will arise on any residual value. There are sufficient profits elsewhere in the group to be able to take advantage of these tax benefits or any taxable losses that occur.
- Operating cash flows should be assumed to arise at the end of the year to which they relate.
- The exchange rate is expected to be ₦1 = L$1.2000 on January 1, 2020 and the naira is expected to strengthen against the L$ by 2% a year in each of the next 4 years.
- The project could be abandoned on January 1, 2021 and the distribution centre sold for an estimated L$70 million. If the project were abandoned on January 1, 2021, no further cash inflows or outflows would arise from then onwards and there would be no penalties for pulling out of the market.

Required:

a. Ignoring the abandonment option:

i. Calculate the NPV for the project as at January 1, 2020 for Scenarios A and B individually as well as the overall total expected NPV. (17 Marks)

ii. Calculate the payback period for the project for each of Scenarios A and B. (4 Marks)

iii. Interpret your results from (a)(i) and (a)(ii) (4 Marks)

b. Evaluate whether or not the project should be abandoned on January 1, 2021 if Scenario B occurs. (7 Marks)

c. Advise how real options and other strategic financial issues might influence the initial investment decision. (8 Marks)

(Total 40 Marks)

SECTION B: YOU ARE REQUIRED TO ANSWER ANY THREE OUT OF FIVE QUESTIONS IN THIS SECTION (60 MARKS)

QUESTION 2

Peter John plc (PJP) is considering a takeover bid for Yekin plc (YP).
PJP's board of directors has issued the following statement:
'Our superior P/E ratio and synergistic effects of the acquisition will lead to a post-acquisition increase in earnings per share and in the combined market value of the companies'.

Summarised financial data for the companies:

	₦ Million	
	PJP	**YP**
Sales	480.0	353.0
Profit before tax	63.0	41.0
Tax	(18.9)	(12.3)
Profit after tax	44.1	28.7
Dividends	20.0	11.0
Non-current assets (net)	284.0	265.0
Current assets	226.4	173.0
Total assets	510.4	438.0
Equity and liabilities		
Ordinary shares (10 kobo par value)	40.0	30.0
Reserves	211.2	192.0
Medium and long term borrowing	86.0	114.0
Current liabilities	173.2	102.0
	510.4	438.0

Notes:

(i) After tax saving in cash operating costs of ₦7,500,000 per year indefinitely are expected as a result of the acquisition

(ii) Initial redundancy costs will be ₦ 10 million before tax

(iii) PJP's cost of capital is 12%

iv) Current shares prices are: PJP ₦29, YP ₦18

(v) The proposed terms of the takeover are payment of 2 PJP shares for every 3 YP shares.

Required:

a. Calculate the current P/E ratios of PJP and YP (2 Marks)

b. Estimate the expected post acquisition earnings per share and comment upon the importance of increasing the earnings per share. (4 Marks)

c. Estimate the effect on the combined market value as a result of the takeover using:

   i. P/E based valuation

   ii. Cash flow based valuation
   State clearly any assumptions that you make (5 Marks)

d. Discuss the limitations of your estimates in (c) above (3 Marks)

e. Evaluate the strategic implications of making a hostile bid for a company compared with an aggressive investment programme of organic growth. (6 Marks)

(Total 20 Marks)

QUESTION 3

a. What are the main responsibilities faced by companies when developing an ethical framework, and in what ways can these responsibilities be addressed? (10 Marks)

b. Discuss how ethical considerations impact on each of the main functional areas of a firm. (10 Marks)

(Total 20 Marks)

QUESTION 4

a. What risks might an industrial company face as a result of interest movements? (8 Marks)

b. A plc wants to borrow ₦200 million for five years with interest payable at six-monthly intervals. It can borrow from a bank at a floating rate of NIBOR plus 1% but wants to obtain a fixed rate for the full five-year period. A swap bank has indicated that it will be willing to receive a fixed rate of 8.5% in exchange for payments of six-month NIBOR.

Required:

Calculate the fixed interest six-monthly payment with the swap in place.
(4 Marks)

c. **Calculate:**

i. The interest payments if NIBOR is 10% (4 Marks)

ii. The interest payments if NIBOR is 7.5% (4 Marks)

(Total 20 Marks)

QUESTION 5

Yinko plc operates in the hospitality and leisure industry. The board of directors met recently to discuss a number of financial proposals.

Proposal 1
To increase the company's level of debt by borrowing a further ₦100 million and use the funds raised to buy back its shares.

Proposal 2
To increase the company's level of debt by borrowing a further ₦100 million and use these funds to invest in additional non-current assets in the form of expansion in available rooms in one of their hotels.

Proposal 3
To sell excess non-current assets in another hotel. The net book value of the assets is ₦100 million and they will be sold for ₦135 million. This will enable the company to focus on the other high-performing hotel units. These other hotel units will require no additional investment in non-current assets. All the funds raised from the sale of the non-current assets will be used to reduce the company's debt.

Yinko plc Financial Information

Extracts from the Forecast Financial Position for the coming Year

	₦million
Non-current assets	1,410
Current assets	330
Total assets	1,740
Equity and liability:	
Share capital (40 kobo per share par value)	240
Retained earnings	615
Total equity	855
Non-current liabilities	700
Current liabilities	185
Total liabilities	885
Total liabilities and capital	1,740

Yinko's forecast after tax profit for the coming year (in the absence of the above proposals) is expected to be ₦130 million. The current share price is ₦3.20 per share.
The non-current liabilities consist solely of a 6% medium term loan redeemable within seven years. The term of the loan contract stipulates that an increase in borrowing will result in an increase in the coupon payable of 25 basis points on the total amount borrowed, while a reduction in borrowing will lower the coupon payable by 15 basis points on the total amount borrowed.

Yinko's effective tax rate is 20%. The company's estimated after tax rate of return on investment is expected to be 15% on any new investment. It is expected that any reduction in investment would suffer the same rate of return.

Required:

a. Estimate the impact of each of the three proposals on the forecast statement of financial position, the earnings per share, and the financial gearing (Total Debt/Total Assets) of Yinko Plc.

Show your workings. (16 Marks)

b. Discuss your results. (4 Marks)

(Total 20 Marks)

QUESTION 6

Binko Industrial Services plc is an all equity financed and a Stock Exchange listed company. Over recent years the company's management has adopted a fairly cautious and conservative policy of not seeking expansion, but has been contented to earn a steady level of profits, most of which have been distributed as dividends.

Recently there have been some personnel changes at board level with the result that the company has more actively been seeking new investment opportunities. In the financial year which has just ended the company reported profits of ₦50 million, a similar figure to that of recent years.

It has been estimated that the company's cost of equity is 15% per annum.
Four investment projects have been identified, all of which could commence immediately. The estimated cash flows and timings of these projects are as follows.

Project	A	B	C	D
	₦m	**₦m**	**₦m**	**₦m**
Year 0	(20)	(20)	(30)	(10.0)
1	7.5	6.5	8.0	5.0
2	7.5	6.5	8.0	5.0
3	7.5	6.5	8.0	5.0
4		6.5	8.0	
5		6.5	8.0	

Each of these projects is in the same risk class as the company's existing projects.

You have been asked by the board to give your advice on dividend policy at next week's board meeting.

Required:

a. Calculate how much Binko Industrial Services plc should pay to shareholders as dividend in respect of the company's financial year which has just ended, assuming that Modigliani and Miller were correct in their original 1961 proposition on dividend policy.

You should ignore taxation in this calculation. (5 Marks)

b. Prepare notes on which you will base your contribution to the board meeting. These should include a brief explanation of the Modigliani and Miller proposition on dividend policy and reasons why the company's board may decide not to pay the level of dividend which you indicated in (a). You should bear in mind the fact that most members of the board have little or no accounting or financial knowledge. Your comments must relate to the particular circumstances of Binko Industrial Services plc

Ignore inflation.

Work to the nearest ₦1,000 (15 Marks)

(Total 20 Marks)

Formulae

Modigliani and Miller Proposition 2 (with tax)

$$K_{EG} = K_{EU} + (K_{EU} - K_D)\frac{V_D}{V_{EG}}(1-t)$$

Asset Beta

$$\beta_A = \left[\frac{V_E}{(V_E + V_D(1-T))}\beta_E\right] + \left[\frac{V_D(1-T)}{(V_E + V_D(1-T))}\beta_D\right]$$

Equity Beta

$$\beta_E = \beta_A + (\beta_A - \beta_D)\left(\frac{V_D}{V_E}\right)(1-t)$$

Growing Annuity

$$PV = \frac{A_1}{r-g}\left(1 - \left(\frac{1+g}{1+r}\right)^n\right)$$

Modified Internal Rate of Return

$$MIRR = \left[\frac{PV_R}{PV_I}\right]^{\frac{1}{n}}(1+r_e) - 1$$

The Black-Scholes Option Pricing Model

$$C_0 = S_0N(d_1) - Ee^{-rt}\,N(d_2)$$

$$d_1 = \frac{In\left(\frac{S_0}{E}\right) + (r + 0.5\sigma^2)T}{\sigma\sqrt{T}}$$

$$d_2 = d_1 - \sigma\sqrt{T}$$

The Put Call Parity

$$C + Ee^{-rt} = S + P$$

Binomial Option Pricing

$$u = e^{\sigma \times \sqrt{T}/n}$$

$$d = 1/u$$

$$a = e^{rT/n}$$

$$\pi = \frac{a-d}{u-d}$$

The discount factor per step is given by $= e^{-rT/n}$

Annuity Table

Present value of an annuity of 1 i.e. $\dfrac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate

n = number of periods

Discount rate (r)

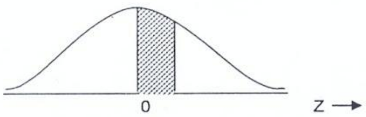
Periods

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2.487	3
4	3·902	3·808	3.717	3·630	3.546	3.465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3.890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4.486	4·355	6
7	6·728	6.472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7.435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6.418	6·145	10
11	10·368	9·787	9·253	8·760	8·306	7·887	7.499	7·139	6·805	6.495	11
12	11·255	10·575	9·954	9·385	8·863	8·384	7·943	7·536	7'161	6·814	12
13	12·134	11·348	10·635	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·004	12·106	11·296	10·563	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·865	12·849	11·938	11·118	10·380	9·712	9·108	8·559	8·061	7·606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2.444	2.402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2.690	2·639	2.589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3.498	3.410	3·326	6
7	4·712	4·564	4.423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4.799	4·639	4.487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4.451	4·303	4·163	4·031	9
10	5·889	5·650	5.426	5·216	5·019	4·833	4·659	4.494	4·339	4·192	10
11	6·207	5·938	5·687	5.453	5·234	5·029	4·836	4·656	4.486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4.439	12
13	6·750	6.424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5.468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6.462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

NORMAL DISTRIBUTION

This table gives the area under the normal curve between the mean and a point Z standard deviations above the mean. The corresponding area for deviations below the mean can be found by symmetry.



$Z=\dfrac{(x-\mu)}{\sigma}$	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	.0000	.0040	.0080	.0120	.0159	.0199	.0239	.0279	.0319	.0359
0.1	.0398	.0438	.0478	.0517	.0557	.0596	.0636	.0675	.0714	.0753
0.2	.0793	.0832	.0871	.0910	.0948	.0987	.1026	.1064	.1103	.1141
0.3	.1179	.1217	.1255	.1293	.1331	.1368	.1406	.1443	.1408	.1517
0.4	.1554	.1591	.1628	.1664	.1700	.1736	.1772	.1808	.1844	.1879
0.5	.1915	.1950	.1985	.2019	.2054	.2088	.2123	.2157	.2190	.2224
0.6	.2257	.2291	.2324	.2357	.2389	.2422	.2454	.2486	.2518	.2549
0.7	.2580	.2611	.2642	.2673	.2704	.2734	.2764	.2794	.2823	.2852
0.8	.2881	.2910	.2939	.2967	.2995	.3023	.3051	.3078	.3106	.3133
0.9	.3159	.3186	.3212	.3238	.3264	.3289	.3315	.3340	.3365	.3389
1.0	.3413	.3438	.3461	.3485	.3508	.3531	.3554	.3577	.3599	.3621
1.1	.3643	.3665	.3686	.3708	.3729	.3749	.3770	.3790	.3810	.3830
1.2	.3849	.3869	.3888	.3907	.3925	.3944	.3962	.3980	.3997	.4015
1.3	.4032	.4049	.4066	.4082	4099	.4115	.4131	.4147	.4162	.4177
1.4	.4192	.4207	.4222	.4236	.4251	.4265	.4279	.4292	.4306	.4319
1.5	.4332	.4345	.4357	.4370	.4382	.4394	.4406	.4418	.4430	.4441
1.6	.4452	.4463	.4474	.4485	.4495	.4505	.4515	.4525	.4535	.4545
1.7	.4554	.4564	.4573	.4582	.4591	.4599	.4608	.4616	.4625	.4633
1.8	.4641	.4649	.4656	.4664	.4671	.4678	.4686	.4693	.4699	.4706
1.9	.4713	.4719	.4726	.4732	.4738	.4744	.4750	.4756	.4762	.4767
2.0	.4772	.4778	.4783	.4788	.4793	.4798	.4803	.4808	.4812	.4817
2.1	.4821	.4826	.4830	.4834	.4838	.4842	.4846	.4850	.4854	.4857
2.2	.4861	.4865	.4868	.4871	.4875	.4878	.4881	.4884	.4887	.4890
2.3	.4893	.4896	.4898	.4901	.4904	.4906	.4909	.4911	.4913	.4916
2.4	.4918	.4920	.4922	.4925	.4927	.4929	.4931	.4932	.4934	.4936
2.5	.4938	.4940	.4941	.4943	.4945	.4946	.4948	.4949	.4951	.4952
2.6	.4953	.4955	.4956	.4957	.4959	.4960	.4961	.4962	4963	.4964
2.7	.4965	.4966	.4967	.4968	.4969	.4970	.4971	.4972	.4973	.4974
2.8	.4974	.4975	.4976	.4977	.4977	.4978	.4979	.4980	.4980	.4981
2.9	.4981	.4982	.4983	.4983	.4984	.4984	.4985	.4985	.4986	.4986
3.0	**.49865**	.4987	.4987	.4988	.4988	.4989	.4989	.4989	.4990	.4990
3.1	**.49903**	.4991	.4991	.4991	.4992	.4992	.4992	.4992	.4993	.4993
3.2	**.49931**	.4993	.4994	.4994	.4994	.4994	.4994	.4995	.4995	.4995
3.3	**.49952**	.4995	.4995	.4996	.4996	.4996	.4996	.4996	.4996	.4997
3.4	**.49966**	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4998
3.5	**.49977**									

SOLUTION 1

a.(i). Scenario A

Year	0	1	2	3	4
Distribution centre (L$ million)	(84)				52
Net L$ cash flows growing at 5% (L$ million)	0	90	94.50	99.23	104.19
Exchange rate	1.200	1.2240	1.2485	1.2734	1.2989
Naira equivalent cash flows (₦million)	(70)	73.53	75.69	77.93	120.25
Market research/launch	(30)				
Naira cash outflows, growing at 5% (₦million)	0	(20)	(21)	(22.05)	(23.15)
Net	(100)	53.53	54.69	55.88	97.10
Tax relief on distribution centre (₦m) (w1)	0	24.02			(14.01)
Tax relief on market research/launch(₦m)	0	10.50			
Tax payable on NCF excluding residual (₦m)	0	(18.74)	(19.14)	(19.56)	(19.97)
NCF	(100)	69.31	35.55	36.32	63.12
PVF at 15%	1.000	0.870	0.756	0.658	0.572
PV (₦m)	(100)	60.30	26.88	23.90	36.10

Total NPV=₦47.18 million.

Scenario B

Year	0	1	2	3	4
Distribution centre (L$ million)	(84)				52
Net L$ CF growing at 5% (L$ million)		45	47.25	49.61	52.09
Exchange rate	1.2000	1.2240	1.2485	1.2734	1.2989
Naira equivalent CF (₦million)	(70)	36.76	37.85	38.96	80.14
Market research/launch (₦ million)	(30)				
Naira cash outflows growing at 5% (₦million)		(15)	(15.75)	(16.54)	(17.36)
NCF (₦m)	(100)	21.76	22.10	22.42	62.78
Tax impact of capital allowances (w1) (₦million)	0	24.02			(14.01)
Tax relief on market research/launch(₦million)	0	10.50			
Tax payable on NCF excluding residual (₦million)	0	(7.62)	(7.74)	(7.85)	(7.96)
Naira NCF	(100)	48.66	14.36	14.57	40.81
PVF at 15%	1	0.870	0.756	0.658	0.572
PV (₦million)	(100)	42.33	10.86	9.59	23.34

Total NPV = - ₦13.88million.

Expected Values

Scenario	NPV	Prob	ENPV ₦m
A	47.18	0.70	33.03
B	-13.88	0.30	-4.16
ENPV			28.87

Working Notes

Tax relief on distribution centre

- On cost = 84m/1.2240 × 35% = ₦24.02m

(Tax savings due in year 1)

- On scrap value:

52m/1.2989 × 35% = ₦14.01m

(Tax liability due in year 4)

ii) **Payback**

Scenario A

Year	NCF (₦m)	Cumulative NCF (₦m)
0	(100)	(100.00)
1	69.31	(30.69)
2	35.55	4.86

Payback = 1 + 30.69/35.55 = 1.86 years

Scenario B

Year	NCF (₦m)	Cumulative NCF (₦m)
0	(100)	(100.00)
1	48.66	(51.34)
2	14.36	(36.98)
3	14.57	(22.41)
4	40.81	18.40

Payback = 3 + 22.41/40.81 = 3.55years

iii) **Interpretation of results**

The results of the NPV and payback investment appraisal exercise can be summarized in the following table:

	Scenario A	Scenario B	Expected result
NPV (₦m)	47.18	Loss of 13.88	28.8
Payback	1.86 years	3.55 years	-

The expected NPV of the project is ₦28.8 million and therefore we might conclude that the project should go ahead on basis of a positive NPV.

However, it is dangerous to make decisions on the basis of expected values in the case of one-off projects. Such action implies a risk-neutral attitude to the possibilities. An assessment of the risk appetite and risk capacity of the company is important when looking at the implications of a loss under Scenario B.

Expected value is a more useful tool where there are a large number of repeated projects with independent results. There is some indication that the company may be undertaking a number of product launches at the same time, but details are not available for analysis here.

The payback results also reinforce the conclusion that the project is risky under Scenario B. Payback is not achieved until mid-way through year 4 (toward the end of the project) under Scenario B, indicating that the project struggles to pay back the funds invested at all, let alone show a profit.

In this case, it is important to consider the results for each of the two Scenarios separately. Under Scenario A, there are strong positive results for both NPV and Payback. However, the results are poor under Scenario B, with a negative NPV for the project. This is telling us therefore that there is a chance that the Linderian launch will not be successful (and we have estimated this chance at 30%). Whether the project will be accepted or not will therefore depend on the risk attitude of the Board and whether it is willing to accept the possibility of such losses.

b. Evaluation of the abandonment option

We know that it would be possible to abandon the project at the end of the first year without penalty and retain the ability to realise a residual value of L$70 million on the investment in the distribution centre. This would however be subject to a balancing charge in respect of tax depreciation allowances already claimed. Given that 'if the project were abandoned', the L$70 million would be received on the first day of the financial year, this balancing charge would not crystalise into a cash flow until the end of the financial year – ie: 31 December 2021.

All costs incurred prior to 1 January 2021 such as the marketing, and launch costs and the investment in the distribution centre should be ignored as they would have become sunk costs. The net operating cash flows for the year ending 31 December 2020 should also be ignored, although the net operating cash flows for the years ending 31 December 2021, 2022 and 2023 are still relevant.

Net present value calculations:

Scenario B – Abandon	**1.1.21**	**31.12.21**
	₦	₦
Distribution centre – sale		
(₦57.19 =L$ 70.00/1.2240)	57.190	
Balancing charge ₦57.19 million × 35%		(20)
Discount factor	1.000	0.870
PV	57.190	(17.400)

Total NPV: ₦39.79 million,
i.e. appropriately ₦40 million

31Dec:	**2021**	**2022**	**2023**
Scenario B – Do not abandon	₦	₦	₦
Net naira equivalent cash flows	14.360	14.570	40.810
Discount factor	0.870	0.756	0.658
PV	12.490	11.010	26.850

Total NPV: ₦50.35 million i.e. approximately ₦50 million

Examiner's Note: Valid alternative approaches will be given full credit. For example, recalculating Scenario B assuming that the project is abandoned early.

Evaluation:

- The PV of the remaining cash flows is greater if the project is not abandoned at this point (NPV of ₦50 million versus ₦40 million if the project were to be abandoned)
- The ultimate decision will also depend on the sensitivity of the cash flows – is it possible that cash flows could be low in early years but increase in later years once the product has gained acceptance in the market?
- It will also depend on other factors such as the possible loss of reputation as a consequence of early withdrawal from the market or loss of market share to a competitor.
- The development of this new market may be a key element required to meet the company's strategic aim of increased market share in both domestic and overseas markets.

Conclusion:

There are strong arguments for continuing with the project rather than abandoning it on 1 January 2021, even if Scenario B holds true for the remaining term of the project. Based on a financial evaluation of future present values and possibility of other benefits of developing a market presence in the Linderian market at this time.

c) **Advise how real options and other strategic financial issues might influence the initial investment decision.**

Even under the 'worst case' scenario, Scenario B, it is unlikely that the project would be abandoned and therefore the abandonment option has little influence on the investment decision and little value on 1 January 2020. The abandonment option is 'out-of-the-money', on that date. However, it does not follow that the option has no value on 1 January 2020 because there is always a possibility that out-turn results are even worse than predicted by Scenario B and the option would then be exercised. The 'insurance' provided by the abandonment option has some value, linked to the extent of loss that would be avoided and the probability that the option would move to being 'in-the-money' by the end of the year. Depending on the risk appetite of the company, this insurance against an even larger loss may be sufficient to influence the investment decision in favour of proceeding with the investment.

Other real options include 'wait' and 'follow on'.

A 'follow on' would seem to be the most likely to apply in this instance. If, for example, 'Aladun' were to be successful in Linder, it might open up the possibility of the launch of further product lines in Linder. This option could therefore have significant value and should be evaluated and built into the investment appraisal of this project.

A 'wait' option could be dangerous in this case as it could give competitors time to break into the market ahead of us and establish a market lead.

Other strategic financial issues that might be raised in discussion include:

- Availability of finance. What is the company's credit worthiness and credit rating? Is there a refinancing risk? Are sufficient funds available to fund this expansion?
- Do some areas of the business need to be sold in order to release capital for expansion?
- Impact on shareholder returns such as earnings per share. Under Scenario A the project returns more than 15% on the investment on an NPV basis, but under Scenario B the project would damage earnings per share due to its loss making position.
- Impact on gearing. The impact of the project on gearing is likely to be immaterial due to the relatively small size of the project in relation to the group as a whole. However, group gearing is quite high and this could

limit the scope for pursuing aggressive growth in both product range and geographical spread in the near future.

- Risk appetite. What would be the likely response of shareholders of a failure of this project? To what extent could a loss be absorbed by other parts of the group?

Marking Guide

		Mark	Mark
a (i)	**Scenario A**		
-	Recognition of the amount spent on distribution centre and the residual value in years 0 and 4	0.5	
-	Calculation of the growing cash flows-years 1 to 4	1.0	
	Calculation of the exchange rate-years 1 to 4	1.0	
	Conversion of the foreign currency to Naira	0.5	
	Recognition of the cost of market research/launch in year 0	0.5	
	Calculation of the Naira cash out/flows for years 1 to 4	1.0	
	Computation of the tax relief on distribution centre	0.5	
	Computation of the tax relief on market research/launch	0.5	
	Computation of tax payable on net cash flow	1.0	
	Determination of the present value factor for years 0 to 4	0.5	
	Calculation of the present value for years 0 to 4	0.5	
	Computation of the net present value	0.5	
	Scenario B		
-	Recognition of the amount spent on distribution centre and the residual values in years 0 and 4	0.5	
-	Calculation of the growing cash flows for years 1 to 4	1.0	
-	Calculation of the exchange rate for years 1 to 4	1.0	
-	Conversion of the foreign currency to Naira=years 1 to 4	0.5	
-	Recognition of the cost of market research /launch in year O	0.5	
-	Calculations of the Naira cash outflows for years 1 to 4	1.0	
-	Computation of the tax relief on: Distribution centre	0.5	
	: Market Research/launch	0.5	
-	Computation of tax payable on net cash flow	1.0	
-	Determination of the present value factor for years 0 to 4	0.5	
-	Calculations of the present value for years 0 to 4	0.5	
-	Computation of the net present value	0.5	
-	Computations of the expected values for scenarios A & B	1.0	17
ii)	Computation of payback period-Scenario A	2	
	Computation of payback period-Scenario B	2	4
iii)	Summary of the result of calculations of the NPV and payback investment appraisal exercise	0.5	
	Comment on the result of the calculated NPV	1.5	
	Conclusion on the pay back results of Scenarios A and B	0.5	
	Comment on the result of the payback years	1.5	4

b)	Recognition of sunk costs	1.0	
	Computation of the PV in case of Abandonment - Scenerio B	1.5	
	Computation of the PV in case of non-abandonment – Scenerio B	1.5	
	Evaluation of the result of the PV	2.0	
	Conclusion	1.0	7
c)	Advice on how real options and other strategic financial issues might influence the initial investment decision	8	
			40

Examiner's Report

The question tests candidates' knowledge of foreign capital project. They were expected to calculate expected net present value and payback period. They were also expected to evaluate an option to abandon the project after the first year.
Being a compulsory question, almost all the candidates attempted the question but the level of performance was very poor.
Common mistakes include:

- Computing capital allowances on advertising costs, cost of market research, etc;
- Adding together figures given in foreign currency and in naira;
- Inability to calculate the appropriate exchange rates;
- Applying the Black-Schole option pricing model to part (b) despite the fact that the key variables needed for model are not available in the question; and
- Producing generic comments in parts (a)(iii) and (c).

We recommend that candidates should supplement their reading with examination-type of questions from time to time.

SOLUTION 2

a) PJP currently has 400 million ordinary shares, and Fader 300 million.
Earnings per share:

PJP

$$\frac{₦44.10}{400\text{m}} = 11.025 \text{ kobo}$$

YP

$$\frac{₦28.70}{300\text{m}} = 9.57 \text{ kobo}$$

P/E ratios

PJP

$$\frac{2{,}900}{₦11.025} = 263.04$$

YP

$$\frac{1{,}800}{₦9.57} = 188.09$$

b) A 2-for-3 share exchange will result in the issue of 300 million x 2/3 new shares, or 200 million shares, giving a total of 600 million shares.

	₦ million
Current combined earnings after tax	72.80
Additional earnings from operating savings	7.50
	80.30

Ignoring the one-off redundancy payments the expected earnings per share is:

$\frac{₦80.30\text{m}}{600\text{m}} = 13.383$kobo

Increasing earnings per share alone is not enough. The effect on the market value is the crucial factor. When a relatively high P/E company acquires a company with a lower P/E, the expected earnings per share will increase, but not necessarily the total market value of the companies.

c) i) The current combined value of the two companies is:

(400m shares x ₦29) + (300m shares x ₦18) = ₦17 billion.

If the market is efficient, ignoring any synergistic or other effects of the takeover, the post-acquisition P/E will be the weighted average (by earnings) of the current P/E ratios.

$$\frac{(263.04 \times ₦44.10\text{m}) + (188.09 \times ₦28.70\text{m})}{₦72.80\text{m}} = 233.50$$

The new EPS takes into account the operating savings.

Multiplying the P/E by the new EPS 233.5 x 13.383 = 3,124.93
3124.93 x 600 million shares gives a market value of ₦18.750billion.

However, this ignores the impact of the redundancy costs, ₦7,000,000 after tax.
When this is included the combined value of the companies is still expected to substantially increase.

ii) Changes in expected cash flows as a result of the takeover are as follows:

PV of operating savings (to infinity)	$= \frac{₦7,500,000}{0.12} =$	₦62,500,000
Redundancy costs, after tax relief		(₦7,000,000)
Net effect on NPV		₦55,500,000

If the market is efficient the market value of the combined company should increase by ₦55,500,000 as a result of the expected increase in NPV, much less than the estimate using P/E based valuation.

d) Both estimates are likely to be inaccurate. Many other factors are likely to affect the post-acquisition share price. For example:

- The effect of the acquisition on corporate growth rates.
- There may be problems integrating the operations and workforce of the two companies.
- PJP's managers may not be able to apply enhanced management skills to YP's operations.
- The effect of the change in risk and capital structure is not known.
- With respect to the P/E estimate:
- P/E ratios use accounting data rather than cash flow data.
- Accurate estimates of future earnings are very difficult, and earnings can rapidly change.

With respect to cash flows:

- The value of all expected cash flows pre and post-acquisition should be compared, not just the changes in a few cash flows. However, post-acquisition cash flows are very difficult to determine.
- Cash flows savings of ₦7,500,000 per year forever are unrealistic.
- The cost of capital of PJP is likely to change as a result of the acquisition of YP.

The implications of making a hostile bid

The board should be clear about the strategic implications of making a hostile bid for a company rather than carrying out an aggressive investment programme of organic growth.

A hostile bid involves:

- A reduction in competition. The company may be buying a competitor who will no longer be competing against it and its competitive position should be improved.
- A much faster speed of growth. It is much quicker to buy an existing company with existing staff and existing contracts.
- Buying an under-performer. The challenge would be to tighten up the company and release its full potential.
- More expense than the organic alternative. A bidding company has to pay a premium to acquire a target company. However, there may be synergistic benefits from the merger that would make paying the premium worthwhile.
- Possible culture clash between ourselves and the target company managers and employees

- The use of cash resources to finance any cash alternative to the paper offer. If cash is tight, then the company should offer an unattractive cash alternative to try and persuade the target shareholders to accept paper rather than cash.

Organic growth involves:

- Less risk. Steady organic growth is a much safer option, where individual problems can be addressed as they arise, rather than having to deal with all the problems in an entire company from day one of ownership.
- Less damage to the stock price in the market. It is traditionally the case that the market will mark down the price of a bidding company's stock/shares on announcement of the bid, recognising the risk inherent in the deal and the fact that managers may concentrate on the deal rather than on running the existing business.
- More choice on precisely where to expand. Organic growth allows a company to choose more carefully the geographical areas and business areas that you wish to operate in.

Marking Guide

a)	Calculations of earning per share (EPS) for PJP & YP	1.0	
	Calculations of price earnings ratios P/E ratios – PJP & YP	1.0	2
b)	Calculation of number of shares after merger	1.0	
	Calculation of total earnings after merger	1.0	
	Computation of the earnings per share after merger	1.0	
	Comment on the importance of increasing EPS	1.0	4
i)	Computation of the current combined value of PJP&YP	1.0	
	Computation of the post- acquisition P/E ratio	0.5	
	Calculation of the post acquisition market value	1.0	
ii)	Calculation of PV of operating savings (to infinity)	1.5	
	Adjustment of redundancy cost, after tax relief, to determine net effect on PV	0.5	
	Comment on the net effect on NPV	0.5	5
c)	½ mark per valid listed limitation factor, max 6 points		3
d)	1 mark per valid point on hostile bid, max 4 points	4	
	1 mark per valid point on organic growth, max 2 points	2	6
			20

Examiner's Report

The question tests candidates' knowledge of take over and some related basic calculations like EPS, pre-and-post-takeover P/E ratios, capitalization of synergies, etc.

Most candidates attempted the question and once again, the level of performance was very poor.

In computing the post-takeover P/E ratio, candidates did not realize the need to make use of the pre-takeover total earnings of each of the two companies to estimate post-takeover weighted average P/E ratio. Furthermore, almost all the candidates could not isolate and capitalize the relevant cashflows required in section (c) (ii).

We recommend that candidates should cover the entire syllabus when preparing for the Institute's examinations and solve past examination questions.

SOLUTION 3

a) The main responsibilities faced by companies when developing an ethical framework are:
   i) Economic
   ii) Legal
   iii) Ethical
   iv) Philanthropic

The ways in which these responsibilities can be addressed are:

Economic

i) Management should always be acting in the best interests of the company's shareholders, and should therefore always be actively making decisions that will increase shareholders' wealth.

ii) Projects that have positive NPVs should be pursued as far as funds will allow, as such projects will increase the value of the company and thus shareholders' wealth.

iii) While management may have a different attitude towards risk than do the shareholders, they should always manage risk according to shareholders' requirements.

iv) Financing - the optimal financing mix between debt and equity should be chosen as far as possible.

v) Dividends - there is no legal obligation to pay dividends to ordinary shareholders, but the reasons for withholding dividends must be in the interests of the company as a whole (for example, maintaining funds within the company in order to finance future investment projects).

Legal

i) Companies must ensure that they are abiding by the rules and regulations that govern how they operate. Company law, health and safety, accounting standards and environmental standards are examples of these boundaries.

ii) Failure to abide by the rules can cost companies dearly. One only has to look at the fate of WorldCom and Enron bosses, as well as Nick Lesson of Barings Bank, for examples of how failure to operate within the legal framework can cause companies to collapse, taking with them the jobs (and often pension funds) of thousands of employees.

Ethical

i) Ethical responsibilities arise from a moral requirement for companies to act in an ethical manner.

ii) Pursuit of ethical behaviour can be governed by such elements as:

- Mission statements
- Ethics managers
- Reporting channels to allow employees to expose unethical behaviour
- Ethics training and education (including ethics manuals)

Philanthropic

i) Anything that improves the welfare of employees, the local community or the wider environment.

ii) Examples: provision of an employees' gym; sponsorship of sporting events; charitable donations.

Alternative relevant points should be rewarded accordingly

b) Main functional areas of a firm include:
   i) Human resources
   ii) Marketing
   iii) Market behaviour
   iv) Product development

Human resources

i) Provision of minimum wage. In recent years, much has been made of 'cheap labour' and 'sweat shops'. The introduction of the minimum wage is designed to show that companies have an ethical approach to how they treat their employees and are prepared to pay them an acceptable amount for the work they do.

ii) Discrimination - whether by age, gender, race or religion. It is no longer acceptable for employers to discriminate against employees for any reason - all employees are deemed to be equal and should not be prevented from progressing within the company for any discriminatory reason.

Marketing

i) Marketing campaigns should be truthful and should not claim that products or services to something that they in fact cannot.

ii) Campaigns should avoid creating artificial wants. This is particularly true with children's toys, as children are very receptive to aggressive advertising.

iii) Do not target vulnerable groups (linked with above) or create a feeling of inferiority. Again, this is particularly true with children and teenagers, who are very easily led by what their peer groups have. The elderly are also vulnerable, particularly when it comes to such things as electricity and gas charges - making false promises regarding cheaper heating for example may cause the elderly to change companies when such action is not necessary and may in fact be detrimental.

Market behaviour

i) Companies should not exploit their dominant market position by charging vastly inflated prices.

ii) Large companies should also avoid exploiting suppliers if these suppliers rely on large company business for survival. Unethical behaviour could include refusing to pay a fair price for the goods and forcing suppliers to provide goods and services at uneconomical prices.

Product development

i) Companies should strive to use ethical means to develop new products - for example, more and more cosmetics companies are not testing on animals, an idea pioneered by such companies as The Body Shop.

ii) Companies should be sympathetic to the potential beliefs of shareholders - for example, there may be large blocks of shareholders who are strongly opposed to animal testing. Managers could of course argue that if potential investors were aware that the company tested their products on animals then they should not have purchased shares.

iii) When developing products, be sympathetic to the public mood on certain issues - the use of real fur is now frowned upon in many countries; dolphin-friendly tuna is now commonplace.

iv) Use of Fairtrade products and services - for example, Green and Blacks Fairtrade chocolate; Marks &.Spencer using Fairtrade cotton in clothing and selling Fairtrade coffee.

Marking Guide		**Mark**	**Mark**
a)	½ mark for each listed point, max 4 points	2	
	2 marks for explaining the listed point	8	10
b)	½ mark for each main functional areas listed, max 4 points	2	
	2 marks for explaining the main functional areas listed	8	10
			20

Examiner's Report

This question tests the candidates' knowledge of ethical issues in finance. Most of the candidates attempted the question but performance was below average.

Candidates were expected to discuss and provide examples of ethical issues in various functional areas of a firm. More than 90% of the candidates who attempted the question could not produce meaningful solution.

It is required that they should make efforts to read widely and apply their work experiences in examination situations.

SOLUTION 4

a) There are a number of different risks facing commercial organisations. All businesses have to contend with the ups and downs of business life, booms and slumps, risky decisions about what to produce, what prices to charge, how and where to market their goods and so on. Firms which have borrowed money, or are about to borrow money in the near future, face the additional risk of exposure to interest rate changes. If a company has a considerable amount of variable rate debt (for example a large overdraft or variable rate bank loan) then it faces the risk that interest rates may rise and its repayments increase.

The effect of this on the business could be dramatic, reducing cashflow and profit and perhaps, if the rise in rates is a large one and the company is highly geared (with a high proportion of debt), bringing the risk of liquidation. Alternatively, a business with a large amount of fixed rate borrowing (for example a fixed rate loan or fixed interest preference shares or bonds) is exposed to a fall in interest rates. If the company has borrowed large sums at 10% fixed, and a short time later rates fall to 8%, it will be paying more for its debt than it needs to. Cashflow and profits could be better if only the debt were not a fixed rate.

Companies thinking about borrowing in the near future also face risk. Should they borrow at a fixed rate now because they are worried about a rise in interest rates or should they wait in the hope that rates may fall shortly? A wrong decision could be costly.

Finally, there are companies with debt capital maturing that will need to be replaced. A company may have issued ₦5million of bonds due to mature between 2024 and 2026. The company itself will have the choice as to exactly when they will repay the holders of the debt. If they think that interest rates are likely to be lower in 2024 than in 2026 they can repay the bond holder early in 2024 and replace the debt with a new issue of bonds then. If they think rates will be lower in 2026 they can wait and replace the debt when it is cheaper to do so. Decisions like this are risky: making the wrong choice could cost millions of naira.

b) A Plc borrows ₦200million with interest rate at 6-month NIBOR plus 1%. This transaction is in the cash market. In the swap market, it receives 6-month NIBOR and pays fixed interest at 8.5%. The net effect is to acquire a fixed rate obligation at 9.5% for the full term of the swap.
(In the following analysis, N stands for NIBOR)

	%
Cash market: borrow at N + 1%	(₦+1)
Swap market: receive (floating)	₦
pay (fixed)	(8.5)
Net payment (fixed)	(9.5%)

A Plc will therefore fix its payments at ₦9.50m – (₦200m × 9.5% × $^6/_{12}$) every six months for the five year.

At each six-monthly fixing (re-setting) date for the swap, the payment due from A to the swaps bank or from the bank to A will depend on the market rate for six-month NIBOR at that date.

c) i) **NIBOR 10%**

Suppose that on the first re-set date for the swap, at the end of month 6 in the first year, 6-month NIBOR is 10%. The payment due to each party to the swap will be as follows:

	₦m
Due from A-8.5% (₦200m × 8.5% ×$^6/_{12}$)	= (8.5)
Due to A-10%(₦200m × 10% × $^6/_{12}$)	= 10
Net amount due to A Plc	1.5

A Plc will receive this amount six months later at the end of 12 months of the first year- rates are fixed in advance and payments made in arrears. A plc will pay interest on its cash market loan at NIBOR + 1% which for this six-month period is 11% (10% + 1%). Taken with the amount received under the swap agreement, the net cost to A Plc is equivalent to interest payable at 9.5%.

		₦m
Interest on loan = (₦200m × 11% × $^6/_{12}$)	=	(11)
Net receipt from swap		1.5
Net interest payment (for 6 months)		(9.50)
Effective annual rate = $^{9.5}/_{200}$ × $^{12}/_6$	=	9.5%

ii) **NIBOR 7.5%**

With the principles set up above, we can speed up the calculations as detailed below:

	₦m
Swap payments:	
- Due from A-at 8.5%	(8.5)
- Due to A -7.5% (₦200m × 7.5% × $^{6}/_{12}$)	7.5
- Net amount (Net Payment from Swap	(1.0)
Cash market:	
Interest on loan – at 8.5% (7.5% + 1%)	
= (₦200m × 8.5% × $^{6}/_{12}$)	(8.5)
Net payment from Swap	(1.0)
Net interest payment	(9.5%)
Effective annual cost (as above)	9.5%

Marking Guide

		Mark	Mark
a)	2 marks per valid risk discussed, max 4 risks		8
b)	Calculation of the fixed interest six monthly payment	3	
	Comment on the result of the calculation	1	4
c)	Calculation of the interest payment when: NIBOR is 10%	4	
	NIBOR is 7.5%	4	8
			20

Examiner's Report

This question tests candidates' knowledge of interest rate risk generally and hedging using interest rate swap in particular. Less than 20% of the candidates attempted the question but performance was very poor.

Candidates were expected to discuss how changes in interest rates affect both lenders and borrowers. They were also expected to illustrate the effect of pre-designed swap arrangement. Most of the candidates that attempted the question demonstrated lack of knowledge of this area of the syllabus.

Candidates are advised to cover every section of the Institute's syllabus when preparing for the examinations

SOLUTION 5

a) **Forecast Financial Position – Yinko Plc**

	Current	Proposal 1	Proposal 2	Proposal 3
	₦m	₦m	₦m	₦m
Non-current assets	1,410.00	1,410.00	1,510.00	1,310.00
Current assets	330.00	323.60	338.60	322.16
Total assets	1,740.00	1,733.60	1,848.60	1,632.16
Current liabilities	185.00	185.00	185.00	185.00
Non-current liabilities	700.00	800.00	800.00	565.00
Total liabilities	885.00	985.00	985.00	750.00
Share capital (40kobo/share)	240.00	227.50	240.00	240.00
Retained earnings	615.00	521.10	623.60	642.16
Total equity	855.00	748.60	863.60	882.16
Total liabilities and capital	1,740.00	1,733.60	1,848.60	1,632.16
Number of shares	600m	568.75m	600m	600m
Profit after tax (adjusted)	₦130m	₦123.60m	₦138.60m	₦157.158m
EPS (kobo)	21.67	21.73	23.10	26.19
Financial leverage	50.9%	56.8%	53.3%	46.8%

Working Notes

Proposal 1

Debt is increased by ₦100million and shareholders fund reduced by the same amount as follows:

	₦000
Share capital-par value*:	
₦100m × $\frac{40kobo}{320kobo}$	12,500
Retained earnings:	
₦100m × $\frac{320-40}{320}$	87,500
	100,000

(* Only the par value can be removed from share capital. This is very important please)

Additional interest net of tax

	₦'000
– On additional borrowing: 100m × 6.25% × (1 – 0.20)	5,000
– Extra coupon on existing debt = 700m × 0.25% × (1 – 0.20)	1,400
	6,400

This is taken from retained earnings.
Balance of retained earnings
= ₦615m – (87.50m + 6.40m) = ₦521.10m
Furthermore, the additional interest of ₦6.40m is taken off current assets because presumably it is paid out of cash.

Balance of current assets = 330m – 6.40m = ₦323.60m
The alternative is to assume that the additional interest has not been paid and therefore taken to interest payable in current liabilities. That leaves current assets constant at ₦330m and increases current liabilities to ₦191.40m.
Adjusted PAT = ₦130m – 6.40m = ₦123.60m

Proposal 2

* Borrowing of ₦100m increases non-current assets and non-current liabilities by the same amount.

* Retained earnings and current assets are impacted as follows

	Retained earnings ₦000	Current assets ₦000
Additional interest as above	(6,400)	(6,400)
Return on additional non-current assets		
= ₦100m × 15%	15,000	15,000*
Net change	8,600	8,600

(* If cash sales, it will be part of cash or bank and if credit sales, it will be in receivables)
Adjusted PAT = ₦130m + ₦8.60m = ₦138.60m

Proposal 3

Non-current assets are reduced by ₦100m (the net book value of the assets sold). The profit on disposal of ₦100m increases retained earnings (through profit and loss account). The net change in retained earnings and current assets are as follows:

	Retained earnings ₦000	Current assets ₦000
Profit on disposal	35,000	
Interest savings on loan paid:		
₦135,000,000 × 0.06 × (1 – 0.2)	6,480	6,480
Reduction of interest on remaining loan		
= ₦565,000,000 × 0.0015 × (1 – 0.2)	678	678
Return lost due to reduction in investment		

= ₦100,000,000 × 0.15	(15,000)	(15,000)
Net change	27,158	(7,842)

Note: If the profit from the sale of the asset is assumed to be ₦28million (₦35m less tax of 20%), then the statement of financial position, EPS and gearing figures will all change to reflect this.

Adjusted PAT = ₦130m + 27.158m = ₦157.158

b) Discussion

Proposals 1 appears to produce opposite results to others. Proposal 1 would lead to a small increase in the earnings per share (EPS) due to reduction in the number of shares. However, the level of gearing would reduce substantially (by about 12%)

With proposal 3, although the overall profits would increase. because of the profit from sale of assets with interest savings is larger than the lost earnings due to downsizing. It has the lowest gearing.
Proposal 2 would give a significant boost in the EPS from 21.67kobo to 23.10kobo. This is mainly due to increase in earnings through extra investment. However, the amount of gearing would increase by more than 4.7%.

Overall proposal 1 appears to be the least attractive option. The choice between proposals 2 and 3 would be between sustainability of earning and less gearing

Proposal 3, may not be sustainable because profit from sales of asset is a one-off transaction.

Other factors to consider are the capital structure of the competitors, the reaction of the equity market to the proposal, the implications of the change in the risk profile of the company and the resultant impact on the cost of capital.

(Note: Credit will be given for alternative relevant comments and suggestions)

Marking Guide	**Mark**	**Mark**
a)		
Proposal 1		
Calculation of change in current asset	0.5	
Adjustment in non-current liabilities	1.0	
Adjustment of share capital	0.5	
Adjustment of retained earnings	0.5	
Calculation of new number of shares	1.0	
Adjustment in profit after tax	0.5	
Calculation of new EPS	1.0	
Computation of new financial leverage	1.0	6

Proposal 2

Adjustment of non-current asset	1.0	
Adjustment of current asset	0.5	
Adjustment of non-current liabilities	0.5	
Adjustment of Retained earnings	0.5	
Calculation of new profit after tax	0.5	
Calculation of EPS	0.5	
Calculation of financial leverage	0.5	4

Proposal 3

Computation of the new balance on non-current assets	1.0	
Adjustment of current assets	0.5	
Calculation of new balance on non-current liabilities	1.0	
Adjustment of retained earnings	0.5	
Adjustment of profit after tax	1.0	
Calculation of the new EPS	1.0	
Calculation of the new financial leverage	1.0	6
b)		
1 mark per acceptable discussion, max 4 points	4	20

Examiner' Report

The question tests candidates' knowledge of financial projection, using given scenarios. Only about 50% of the candidates attempted the question and again the level of performance was poor.

There were numerous calculation errors in candidates' solutions. The various impacts of the given proposals on income, equity, leverage, etc were not well thought out.

It is recommended that candidates should practice with past examination questions.

SOLUTION 6

a) **Net present value of projects**

A	=	-20m + (7.5m × 2.283)	=	–₦2.88m
B	=	-20m + (6.5m × 3.352)	=	₦1.79m
C	=	-30m + (8m × 3.352)	=	–₦3.18m
D	=	-10m + (5m × 2.283)	=	₦1.42m

As there is sufficient capital to undertake all positive NPV projects, the company should invest in Band D and use ₦30m.

The dividend under the Modigliani and Miller policy is the residue, i.e. ₦50m – ₦30m = ₦20m. It could also be argued that under M&M's assumptions any dividend would do,as shortfalls of cash could be replaced by new equity issues.

b) **Notes for board meeting**

i) **Modigliani and Miller proposition**

M&M suggested that, under the assumption of a perfect capital market, the dividend valuation model would give the share price exactly. It followed that if the share price was the present value of future dividends, the actual pattern of those dividends did not matter to the share price as long as the present value of these remained unchanged. For example, shareholders would be indifferent in valuing a share between a constant stream of dividends and a large lump sum dividend paid at some point in the future, if the value in present value terms were the same.

M&M therefore concluded that the only way to enhance the share price was to invest in positive NPV projects, as these would result in a higher present value of dividends reflecting the beneficial project cash flows being paid out as dividends.

The current dividend should be whatever was not needed for investing in Positive NPV projects (residual dividend policy).

M&M suggested that any shareholders who require income (i.e. dividends) and who are unhappy with the level of dividend paid can sell some of their shares. These shares will have increased in value as a result of the company accepting positive NPV projects.

This is in effect the manufacture of 'home-made' dividends.
No loss of wealth would result as in a perfect market there are no transactions costs.

ii) **Reasons the company may not pay ₦20m dividend**

- **Imperfections in the capital market**
  The above analysis assumes a perfect capital market and that any imperfections will impair the conclusion. The major imperfections that may cause Binko Industrial Services Plc. to reconsider its dividend are discussed below.

- **Information content of dividends**
  In a perfect market investors know everything about a company and its intentions, and in particular know that a dividend is reduced only in order to fund attractive projects.

  In reality, information is restricted and many investors may not be aware of the reasons – (information asymmetry).

  The dividend itself is taken as an important indicator of company health, and cutting the dividend from its previous fairly constant level may convince the investors of problems in the company.
  If enough shareholders decide to sell their holding the share price will drop.

- **Tax preferences of shareholders**
  A perfect capital market assumes indifference between income in the form of dividends and capital gains made as the share price rises.
  In reality, however, the different tax positions of investors will mean that some prefer dividend income, while some prefer an increase in share prices.

- **Transaction costs**
  The buying and selling of shares is not costless in the real world.
  Therefore, the 'manufacture' of home-made dividends would cause a loss in the wealth of shareholders, leading to a preference for payouts (dividends) rather than retentions.

- **Clientele theory**
  It follows that Binko Industrial Services Plc. should discover whether its shareholders prefer dividends or capital gains.
  However, as the company has been following a policy of paying out most of its profits as dividends for a number of years, it is likely to have attracted those investors (or the clientele) who prefer this policy.
  A change to one of retaining profits in order to give a capital gain may well be unpopular with these current investors, and may prompt a wide trading of the shares as they are replaced by investors who prefer a policy of retention.

- **Preference for cash now**
  Some investors will prefer to take the dividend now, rather than rely on an increase in future years.
  In a perfect market this will be fully reflected in the discount rate (cost of equity) used and so be compensated in the share price; in real life this may not be so.

- **Other sources of finance**
  While there are arguments for continuing to payout nearly all the profits as dividend, it must be recognised that viable projects need funding, and that using retained earnings is far cheaper than any other source of equity finance.

  However, the company currently has no debt, and finance could be raised with a reasonably cheap redeemable or irredeemable debenture.

  Management, however, normally consider retained earnings to be more convenient than external equity or debt, and it is likely that the company will want to retain some of the ₦50m profit for projects and for unexpected needs.

- **Project estimates**
  The calculation of the dividend depended upon the net present value of the projects, which in turn depended upon estimates of the cash flows and the company's cost of capital.

  Reassessment of any of these estimates may lead to a different dividend, and the company may want to undertake some sensitivity analysis on these net present values.

- **Future fund raising**
  If the firm is about to embark upon a major expansion programme, it is likely to need external equity in the near future. It could therefore be unwise to cut dividends too sharply, as this could undermine shareholder confidence in the new management and make later issues of new equity difficult.

Marking Guide

a)

Calculation of NPV of project	A	1.0	
Calculation of NPV of project	B	1.0	
Calculation of NPV of project	C	1.0	
Calculation of NPV of project	D	1.0	
Comment on the result of the calculations of net interest values of A, B, C, & D		1.0	5

b)

i)	Explanations of Modigliani & Miller proposition) 1 mark per valid point, max 3 points	3.0	
ii)	2 marks for each reason given in support of the company not being able to pay a ₦20m dividend, max 6 reasons	12.0	15
			20

Examiner's Report

The question tests candidates' knowledge of dividend policy, especially the residual theory of dividend.

Candidates were expected to calculate the net present values of a given set of capital projects. This is needed to determine how much is required to finance profitable projects and how much fund is left for the payment of dividend. They were also required to explain other factors that influence payment of dividend. Almost 90% of the candidates attempted the question but only the (a) part was properly answered.

Candidates could not provide acceptable solutions to section (b).

Once again, we recommend complete coverage of the Institute's syllabus when preparing for this examination.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2020

ADVANCED AUDIT AND ASSURANCE

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ANSWER FOUR OUT OF SIX QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

You are a manager in Obuns & Co, a firm of Chartered Accountants, responsible for the audit of Akudre Plc, a listed entity, for the year ended 31 May 2020. The company operates in the textile industry. It manufactures a range of goods including clothing, linen and soft furnishings. The company employs a team of approximately 750 sales staff around the country who sell the company's products to both households and small to medium-sized businesses. Your firm was appointed as auditor in January 2020. Around 75% of Akudre Plc's sales transactions are cash-based and each of the company's sales staff prepares a cash sales report on a monthly basis.

According to Akudre Plc's Chief Executive Officer, Adu Oke, and in order to foster 'an entrepreneurial spirit' amongst his staff, each staff member (including the senior management team) is encouraged to make cash sales on a commission basis to friends and family. Mr. Oke leads the way with this scheme and recently sold products with a value of ₦4,000,000 to his business associates. He transferred these funds directly into an off-shore bank account in the company's name to which he is the sole signatory.

Review of audit working papers

Your review of the audit working papers and an initial meeting with Mr. Oke identified the following potential issues.

The audit engagement letter and the working papers of the taxation section of the audit file, you established that Obuns & Co. performed the taxation computation for Akudre Plc and completed the tax returns for both the company and Mr. Oke. All of the taxation services have been invoiced to Akudre Plc as part of the total fee for the audit and professional services. Mr. Oke's personal tax return includes a significant number of transactions involving the purchase and sale of properties in various international locations.

The taxation working papers include a detailed review of a number of off-shore bank accounts in Mr. Oke's name which identified the transactions on the properties.

Financing

In addition, the audit committee requests that the audit engagement partner attends a meeting with the company's bank officials, which is planned to be held the week after the auditor's report is issued. The purpose of the meeting is for the company to renegotiate its existing lending facility and to extend its loan. The meeting will be attended by the Chief Finance Officer, a representative of the audit committee, as well as the bank manager. The company is hoping that the audit partner will be able to confirm the company's strong financial position at the meeting, and also confirm that the audit included procedures on going concern, specifically the audit of the company's cash flow forecast for the next two years, which the bank has requested as part of their lending decision.

Required:

a. Discuss the policies and procedures which Obuns & Co. should have in place in relation to an anti-money laundering programme. (5 Marks)

b. Evaluate whether there are any indicators of money laundering activities by either Akudre Plc or its staff. (4 Marks)

c. Describe the requirements of ISA 250: Consideration of Laws and Regulations in an Audit of Financial Statements. (5 Marks)

d. Discuss the actions required when an auditor identifies or suspects material instances of non-compliance by a client with the requirements of ISA 250. (5 Marks)

e. Using the information provided in the financing section, identify and evaluate any ethical threats and other professional issues which arise from the requests made by the audit committee. (3 Marks)

f. If it is the view of the auditors that the loan finance is essential to the continued survival of the company and that at the time of reporting the absence of a finalised agreement represents a material uncertainty regarding going concern.

   Evaluate the additional audit procedures that the auditor would carry out to ascertain if a material uncertainty exists. (10 Marks)

g. Evaluate the impact of the following scenarios on the audit report:

i Use of going concern assumption appropriate but a material uncertainty exists

ii. Use of going concern assumption appropriate, a material uncertainty exists and adequate disclosures have been made in the financial statements

iii. Use of going concern assumption appropriate, a material uncertainty exists but disclosures made in the financial statements are inadequate

iv. Use of going concern assumption inappropriate

(8 Marks)

(Total 40 Marks)

SECTION B: YOU ARE REQUIRED TO ANSWER ANY THREE OUT OF FIVE QUESTIONS IN THIS SECTION (60 MARKS)

QUESTION 2

You are the engagement partner on the audit of Uchenna & Associates. The audit senior sent you the schedule of uncorrected misstatements as shown below, including notes to explain each matter included in the schedule.

		Profit or loss		Statement of financial position	
		Debit	**Credit**	**Debit**	**Credit**
A	Litigation provision	20,000,000			20,000,000
b	Restructuring provision		13,000,000	13,000,000	
c	Correction of deprecation	5,000,000			5,000,000

The audited financial statements recognised revenue of ₦250 million and total assets of ₦1.24 billion. The materiality threshold was determined as ₦12.5million. You are holding a meeting with the management tomorrow, at which the uncorrected misstatements will be discussed.

Notes:

(i) The entity was involved in a litigation in respect of a dispute with a customer over the quality of goods shipped. The customer had obtained a court judgement against Uchenna & Associates and was awarded ₦20million in damages. Uchenna & Associates has appealed the judgement and its solicitors are confident that it would win the appeal. Management has not recognised any amount in the financial statements in relation to the litigation, arguing that they are likely to win the appeal. The audit conclusion is that a provision should be included in the financial statements.

(ii) Management had recognised a provision in respect of a restructuring involving the closure of one of its factories. Management approved the closure at a board meeting in April 2019, but no announcement has been made to the employees.

The audit conclusion is that the provision should not be recognised.

(iii) The audit team had recomputed depreciation expense and noted an understatement of ₦5,000,000.

Required:

a. Explain the requirements of ISA 450: Evaluation of Misstatements Identified during the Audit, with regards to uncorrected audit misstatements. (15 Marks)

b. The matters which should be discussed with management in relation to each of the uncorrected misstatements. (5 Marks)

(Total 20 Marks)

QUESTION 3

You are the Audit Manager at HWO, an audit firm. HWO has secured the audit of SIGMA For Africa, a not-for-profit organisation. You have been assigned the audit of SIGMA For Africa. The extract of the unaudited financial statements is as follows:

SIGMA For Africa
Statement of financial position

	Notes		**As at 31 December**	
			2019	2018
			₦'000	₦'000
Non-current assets	3		76,465	90,492
Other assets	4		28,659	1,327
Current Assets:				
Receivables	5		29,636	39,486
Cash and cash equivalents	6		196,546	476,087
Total assets		(A)	**331,306**	**607,392**
Long term liabilities	7		63,908	66,853
Current Liabilities:				
Suppliers and service providers	8		34,509	69,776
Creditors and credit balances	9		92,164	158,985
Total liabilities		(B)	190,581	295,614
Total assets less liabilities:		**(A)-(B)**	**140,725**	**311,778**
Accumulated fund (Unrestricted net assets):				
Used for current activities			50,495	219,959
Used for non-current assets and other assets			90,230	91,819
			140,725	**311,778**

SIGMA for Africa
Statement of activities

	Notes	For the year ended	
		31 Dec 2019	31 Dec 18
		₦'000	**₦'000**
Income from activities	10	2,456,890	2,863,219
Cost of activities	11	(1,245,679)	(1,734,568)
Net income from activities		**1,211,211**	**1,128,651**
General and administrative expenses	12	(1,382,264)	(1,416,036)
Net deficit for the year		**(171,053)**	**(287,385)**

Furthermore, you were assigned an audit senior. Based on preliminary discussions with your audit senior, you noted that the senior had no prior experience with audits of not-for-profit entities.

Required:
To help your audit senior understand how to audit a not-for-profit organisation, prepare a presentation note summarising the key considerations in the audit for the following areas:

a. Planning (4 Marks)
b. Risk analysis (4 Marks)
c. Internal control (4 Marks)
d. Audit evidence (4 Marks)
e. Reporting (4 Marks)

(Total 20 Marks)

QUESTION 4

Holloway Interiors Limited operates a large shop at Garki, Abuja. The company's year end is April 30. The company sells expensive furniture and does interior decoration. Normally, a sale transaction is initiated when a walk-in customer signs off on an invoice duly filled by the sales clerk. The customer pays for the goods using cash, bank transfers or POS. The sales clerk records the sale on the system and prints out a receipt in duplicate. The customer gets a copy and the sales clerk files the second copy. Thereafter, the customer carries the purchased item away or the company delivers the item. However, due to the COVID 19 pandemic, the Federal Government announced a lock down of Abuja, thereby imposing a restriction on movement of goods and persons. In response, the company closed its showrooms and all of its products were showcased online and all sales were made online. Furthermore, the company delivers all purchases by customers and customers are given the choice to pay before or after delivery. Due to the logistics of delivery, sometimes the delivery of items can take a week after the sale was initiated online.

You are the Audit Manager on the audit of Holloway Interiors Limited.

Required:

a. Discuss the general IT controls that you expect to find in Holloway Interiors. (10 Marks)

b. Discuss the **FIVE** steps model of recognising revenue under the requirements of IFRS 15 Revenue from Contracts with Customers. (10 Marks)

(Total 20 Marks)

QUESTION 5

Maideline Nigeria Limited manufactures tyres for use by cars, trucks and trailers. The company is owner-managed, that is, the shareholders are also the directors of the company. On June 1, 2020, the directors made a decision to wind up the company. The high cost of operating in the country, the depreciation of the Naira against the US dollar and the economic impact of COVID 19 has led to harsh operating conditions that had severely impacted the entity's ability to carry on business in the country.

Management notified the employees, suppliers and customers that Maideline would cease all manufacturing activities on September 30. All the factory workers and most of the employees in the accounts and administration departments were terminated, effective September 30. Most of the employees who remained in employment with the company after September 30 will be made redundant on November 30. However, the company retained a small head office operations, consisting of the Company Secretary and a small accounting and administrative support team. This head office unit will continue to operate for a few more years until the company's operations are wound down completely.

Maideline had 20 branches and a head office. 12 of these branches operate from buildings owned by the company. The remaining 8 branches operate from leased buildings. The expiration of the lease terms ranges from three to five years. Under the terms of the lease agreements, none of these premises can be sub-let and the leases cannot be sold.

On the adoption of IFRS 16, the entity had assumed that the lease will be renewed at the end of the lease tenure and had recorded a lease liability and a right-of-use asset. A small head office building will continue to be occupied and used until the lease expires in three years' time. Maideline accounts for all its tangible non-current assets at cost less depreciation. The entity had recognised deferred tax assets in prior years due to unrelieved tax losses and unutilised capital allowances.

All the products sold by Maideline carry a one-year warranty. Until May 31, 2020, the company sold extended two-year and three-year warranties, but extended warranties were not offered on any products sold from March 1, 2020. Maideline sold its products through national and international distributors, under three-year agreements. Maideline also had annual contracts with its major suppliers for the purchase of components. So far, none of the distributors or suppliers has initiated legal proceedings against Maideline for breach of contract. However, some distributors are withholding payments from Maideline on their account balances, awaiting settlement of the penalty payments they claimed are now due to them from Maideline.

Required:
Using the information provided, identify and explain the financial statement risks to be taken into account in planning the final audit of Maideline in respect of the year ended December 31, 2020. (20 Marks)

QUESTION 6

Nash Investigations Limited specialises in conducting investigations for corporate clients. It employs ex-police officers, security consultants, IT and fraud specialists. Nash Investigations recently dropped its firm of auditors and has approached your firm to participate in a tender process for selecting the new auditor. You are a manager in the audit firm and you will be working with a senior auditor on this assignment. The senior auditor has never been involved in a tender process or appointment of new auditor. You have been provided with the following information:

(i) Nash Investigations is a major service provider to your firm, particularly in the provision of IT and fraud consultancy;
(ii) Nash Investigations has acrimoniously dropped their previous auditors and are withholding fees, pending the resolution of a number of issues especially to their accusations on the competence of the auditors;

(iii) Nash Investigations is currently facing a hostile take-over bid from Technical Investigations Group, a company you also audit;
(iv) Media reports of a fraud allegation leveled against one of the directors of the Company; and
(v) One of the partners in the audit firm is also a director in Nash Investigations.

Required:

Prepare briefing notes to explain the following matters to the audit senior:

a. The audit tendering process in terms of the stages that the audit firm will go through should it decide to participate in the tender. (5 Marks)
b. The requirements of the ICAN Code of conduct on advertising and publicity (5 Marks)
c. The requirements of the ICAN code of conduct on fees (5 Marks)
d. The impact of each additional piece of information provided above and how the information would influence your decision to participate in the audit tender for Nash Investigations. (5 Marks)

(Total 20 Marks)

SOLUTION 1

1a. The policies and procedures which Obuns & Co. should have in place in relation to an anti-money laundering programme include the following:

i. Putting in place systems, controls and procedures to ensure that the firm is not used for money laundering purposes;

ii. Appointing a Money Laundering Reporting Officer (MLRO), whose responsibility is to receive reports on suspected money laundering activities from firm's employees and report them to the appropriate authorities;

iii. Establishing and enhancing record-keeping systems for all transactions (which must be kept for at least five years, with controls to ensure that they are not inadvertently destroyed);

iv. Establishing and enhancing record-keeping systems for verifying the identity of clients (by obtaining official documents, such as – for an individual – passport or driving license, supported by recent utilities bills, and for a company – certificate of incorporation and Tax Identification Number (TIN));

v. Establishing procedures within the firm for reporting any suspicion of money laundering by the client; and
vi. Training and educating staff on procedures for detecting and reporting suspicions of money laundering activities.

b. Indicators of possible money laundering activities by both Mr. Oke and the company include the following:

i. The number of staff involved in cash sales and the difficulty in ensuring that all cash takings enter the proper channel;
ii. Mr. Oke's personal tax returns includes a significant number of transactions involving the purchase and sale of properties in various international locations;
iii. The taxation working papers include a detailed review of a number of off-shore bank accounts in Mr. Oke's name which identified the property transactions;
iv. Each staff (including the senior management team) is encouraged to make cash sales and is paid on a commission basis to sell the company's products to friends and family; and
v. When Mr. Oke recently sold products with a value of ₦4,000,000 to his business associate, he transferred the funds directly into an off-shore bank account in the company's name to which he is the sole signatory

c. ISA 250: Consideration of Laws and Regulations in an Audit of Financial Statements requires the auditor to:

i. Obtain a general understanding of the applicable legal and regulatory framework and how the entity is complying with that framework. This is part of obtaining an understanding of the entity and its environment – here, the legal environment – as required by ISA 315 (Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment);
ii. Obtain sufficient appropriate audit evidence in respect of compliance with those laws and regulations which might be expected to have a direct effect on material amounts and disclosures in the financial statements;
iii. Make enquiries of management as to whether or not the entity is complying with the relevant laws and regulations;
iv. Inspect any correspondence with the relevant authorities;
v. During the audit, remain alert to the possibility that other audit procedures might bring instances of non-compliance to the auditor's attention;

vi. Obtain written representations from management that all known instances of non-compliance or suspected non-compliance have been disclosed to the auditor; and
vii. Document all identified or suspected instances of non-compliance and the results of discussions with management and/or other parties.

d. When an auditor identifies or suspects material instances of non-compliance with the requirement of ISA 250, the following actions are required:

i. Obtain an understanding of the nature of the act and the circumstances under which it has occurred;
ii. Evaluate the possible effect of the non-compliance on the financial statements;
iii. For suspected non-compliance, discuss the matter with management. If compliance is not demonstrated, take legal advice;
iv. If there is insufficient evidence of a suspected non-compliance, consider the impact on the audit report;
v. Consider whether or not the non-compliance impacts on other areas of the audit (for example, on the overall risk assessment); and
vi. Consider how to report the non-compliance – to those charged with governance and/or to shareholders and/or to the authorities.

e. Ethical threats and professional issues arising from the request made by the audit committee include the following:

i. The audit committee has asked the audit engagement partner to attend a meeting with the bank, the objective of the meeting being the renegotiation of the company's loan. This is an advocacy threat to objectivity, as the audit partner will be supporting the client in its renegotiation and may be perceived as supporting or confirming the company's financial position;

ii. If the partner were to attend the meeting and confirm the strength of the company's financial position, or confirm any work performed on the cash flow forecast, there could be legal implications;

iii. Partner attending the meeting and confirming the company's strong position would potentially expose the audit firm to liability; it could be perceived that the audit firm is in some ways guaranteeing the loan or guaranteeing that the company is in a position to service the debt;

iv. The partner's attendance at the meeting could be seen as supporting the company in its attempt to raise further finance; and

v. These ethical issues should be discussed with the audit committee, with an explanation provided as to why the audit firm should not attend the meeting with the bank.

f. The following are additional audit procedures which the auditor would carry out to ascertain whether a material uncertainty exists:

i. **Discussions with management:** Inquire of management as to the validity of its going concern assumptions and implications of these assumptions and also future plans for the business.

Where management has not yet performed an assessment of the entity's ability to continue as a going concern, a request should be made that an assessment be carried out by management;

ii. **Evaluation of management's future plans and actions:** The auditor should carry out an evaluation of management's future plans and actions with regards to its going concern assessment. The auditor should also assess whether the outcome of these plans would improve the situation and the feasibility of these plans;

iii. **Obtain a cashflow forecast**: Where the entity has prepared a cashflow forecast, the auditor should discuss with management, evaluate the reliability of the underlying data generated to prepare the forecast and determine whether there is adequate support for the assumptions underlying the forecast.

The auditor should consider whether any additional facts or information have become available since the date on which management made its assessment;

iv. **Information from the client's bank**: If the client is expecting to rely on continuing financial support from its bank (for example, a continuation of its bank overdraft facility) the bank should be asked to confirm that the finance will be available;

v. **Requesting management representation:** The auditor should obtain written representations from management and where appropriate, those charged with governance, regarding their plan for future action and the feasibility of these plans; and

vi. **Management's assumptions**: Where management assumptions include continued financial support by third parties, and such support is important to the ability of the entity to continue as a going concern, the auditor may need to request written confirmations, including terms and conditions from those third parties and to obtain evidence about their ability to provide support.

g. i. Use of going concern assumption appropriate but a material uncertainty exists.

If the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

- Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
- Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

ii. Use of going concern assumption appropriate, a material uncertainty exists and adequate disclosures have been made in the financial statements.

If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an emphasis of matter paragraph in the auditor's report to:

- Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and
- Draw attention to the note in the financial statements that discloses the relevant matters.

iii. Use of going concern assumption appropriate, a material uncertainty exists but disclosures made in the financial statements are inadequate

- If adequate disclosure is not made in the financial statements, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with ISA 705

(Modifications to the Opinion in the Independent Auditor's Reports).

- The auditor shall state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.

iii. **Use of going concern assumption inappropriate**

- If the financial statements have been prepared on a going concern basis, but in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, the auditor shall express an adverse opinion.
- The auditor may give an unmodified opinion if the financial statements have been prepared on an alternative acceptable basis (for example, a break-up basis) and there is adequate disclosure of this basis. An emphasis of matter paragraph may be required in the auditor's report to highlight the alternative acceptable basis.

Marking Guide

		Marks
a)	1 mark each for any 5 points	5
b)	1 mark each for any 4 points	4
c)	1 mark each for any 5 points	5
d)	1 mark each for any 5 points	5
e)	1 mark each for any 3 points	3
f)	2 marks each for any point subject to a maximum of five (5) points	10
g)	1 mark each for any 2 points in the four (4) solutions	8
		40

Examiner's Report

The question tests candidates' knowledge of the regulations that need to be complied with by companies and the extent of such compliance. It also tests ethical threats and going concern assumptions on auditors' reports.

This being a compulsory question, about 90% of the candidates attempted it but the performance was below average.

The commonest pitfalls of the candidates were the lack of essential knowledge of the regulatory frameworks and the difficulty in the identifying the indicators of money laundering activities.

Candidates are advised to familiarize themselves with the various regulatory frameworks and study the Institute's Study Text and Pathfinders.

SOLUTION 2

a. ISA 450: Evaluation of Misstatements Identified during the Audit requires the following from the auditor with regards to uncorrected misstatements:

   i. Communication with management: The auditor should communicate on a timely basis all audit misstatements with the appropriate level of management unless prohibited by law or regulations from doing so.

      If management refuses to correct all or some of the misstatements communicated by the auditor, he shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatements;

   ii. Evaluate the effect of uncorrected misstatements: Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with ISA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.

      The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

      - The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and

      - The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole;

   iii. Communication with those charged with governance:
      - The auditor shall communicate with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.

- The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

- The auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole;

iv. Audit documentation: The auditor shall include in the audit documentation the following matters:
   - The amount below which misstatements would be regarded as clearly trivial;
   - All misstatements accumulated during the audit and whether they have been corrected; and
   - The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion;

v. Accumulate all misstatements found during the audit unless they are clearly trivial;

vi. Prior to evaluating the effect of uncorrected misstatements, reassessing materiality;

vii. If the total of misstatements identified during the audit approach (or could approach) materiality, decide if the overall audit strategy and audit plan need to be revised;

viii. Communicate all misstatements found during the audit to an appropriate level of management and request that the misstatements be corrected; and

ix. Written representations: The auditor shall request a written representation from management or those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

b. The following matters should be discussed with management in relation to each of the uncorrected misstatements:

i. **Litigation provision**

- The amount of ₦20m exceeds the materiality threshold of ₦12.5m. The item is clearly material.

- The precarious nature of litigation is such that the outcome cannot be determined while litigation is still in progress. The opinion of the company's lawyers cannot be relied upon as a basis to exclude the provision in the financial statements.

- The fact that the customer won the case against Uchenna & Associates tilts the case in favour of the customer, although the result of the Appeal is yet to be ascertained.

ii. **Restructuring provision**

- The adjustment in relation to the provision is material to profit. The provision appears to have been recognised too early.

- IAS 37: Provisions, Contingent Liabilities and Contingent Assets, requires that for a restructuring provision to be recognised, there must be a present obligation as a result of a past event, and that is only when a detailed formal plan is in place and the entity has started to implement the plan, or announced its main features to those affected.

- A board decision is insufficient to create a present obligation as a result of a past event. The provision should be recognised when the announcement is made to the employees .

- Management should be asked to explain why they have included the provision in the financial statements, for example, there may have been an earlier announcement of which the auditor is unaware.

- In the absence of any such further information, management should be informed that the accounting treatment of the provision is a material misstatement, which if it remains unadjusted will have implications for the auditor's opinion.

iii. **Depreciation**

- The understatement to depreciation expense is not material on an individual basis to either the statement of profit or loss or the statement of financial position.

- Despite the amount being immaterial, it should not be disregarded, as the auditor should consider the aggregate effect of misstatements on the financial statements.
- ISA 450 does state that the auditor need not accumulate balances which are 'clearly trivial', by which it means that the accumulation of such amounts clearly would not have a material effect on the financial statements.
- If this amount remains unadjusted by management, it will not on an individual basis result in material misstatement to the financial statements.

Marking Guide

	Marks	Marks
a.(i) 1 mark for each of the 2 points	2	
(ii) 1 mark for each of the 3 points	3	
(iii) 1 mark for each of the 2 points	2	
(iv) 2 marks for specific points	2	
(v) 1 mark each for any two points	3	
(vi – viii) 1 mark for each of the points	3	15
b. (i) 1 mark for any of the correct points	1	
(ii) 1 mark each for any 2 points	2	
(iii) 1 mark each for any 2 points	2	5
Total		20

Examiner's Report

The question tests the candidates' knowledge on the evaluation and treatment of misstatements identified during audit according to the requirements of ISA 450. It also tests the candidates understanding of guidance to management in that regard.

Less than 50% of the candidates attempted the question and the performance was average.

The commonest pitfall of the candidates was the lack of adequate knowledge of the process of treatment of misstatements in the audit process.

Candidates are advised to take seriously the practical work experience embedded in the Institute's students training programme.

SOLUTION 3

The audit senior should recognise the specific features of the not-for-profit organisation (NFPO). However, it is important to realise that the auditor is still performing an audit, and the overall structure of the audit of an NFPO will be similar to the audit of a commercial organisation. However, the detail of the audit will probably differ. The main points to bear in mind with the audit of an NFPO are summarised below. These are general principles. They should be modified as appropriate to reflect the circumstances of each particular NFPO.

a. **Planning**

Consider:

i) The objectives and scope of the audit work;
ii) Any local regulations that apply;
iii) The environment in which the organisation operates;
iv) The form and content of the final financial statements and the audit opinion; and
v) Key audit areas, including risk.

b. **Risk analysis**

Carry out an audit risk analysis under the usual headings of inherent risk, control risk and detection risk in respect of the following:

i. Inherent risk (reflecting the nature of the entity's activities and the environment);
ii. Control risk (internal controls, and the risk that these may be inadequate: controls over cash collection and cash payments may be a key area for an NFPO such as a charity, because large amounts of cash may be collected from the public by volunteers)
iii. Detection risk (the risk that the auditor will fail to identify any material error or misstatement in performing the audit).

c. **Internal control**

Key areas of internal control in an NFPO include:

i. Segregation of duties (although this may be difficult in a small NFPO with only a few employees);
ii. Cash controls;
iii. Controls over income (donations, cash collections, membership fees, grants); and

iv. The use of funds only for authorised purposes.

d. **Audit evidence**

A substantive testing approach (rather than a systems-based approach) is likely to be necessary in a small NFPO, because of weaknesses in its internal control system.

Key areas may include:

i. The completeness of recording transactions, assets and liabilities;
ii. The possibility of misuse of funds;
iii. Analytical procedures may be used to 'make sense' of the reported figures; and
iv. There should be a review of the final financial statements, including a review of the appropriateness of the accounting policies.

e. **Reporting**

The key areas in reporting include:

i. If a report on an NFPO is required by law, the standard external audit report should be used; and
ii. If the audit is performed on a voluntary basis, the report needs to reflect the agreed objective of the audit.

However, it is good practice for the report to follow the general structure laid down by ISA 700: Forming an Opinion and Reporting on Financial Statements

i. Title;
ii. Addressee;
iii. Responsibilities of auditors versus the responsibilities of directors;
iv. Responsibility for financial statements;
v. Other reporting responsibilities;
vi. Basis for opinion;
vii. Going concern and key audit matters (if applicable);
viii. The audit opinion; and
ix. Date, name and address of auditor.

Marking Guide

		Mark	Mark
a.	1 mark each for any 4 points		4
b.	2 marks each for any 2 points		4
c.	1 mark each for any 4 points		4
d.	1 mark each for any 4 points		4
e.	1 mark each for any 2 points	2	
f.	½ mark each for any 4 titles of sections of the report	2	4
	Total		**20**

Examiner's Report

The question tests candidates' knowledge on the procedures and some of the stages involved in carrying out the audit of an entity.

About 60 % of the candidates attempted the question and the performance was above average.

The commonest pitfall of the candidates was the lack of understanding processes of executing an audit engagement.

Candidates are advised to endeavour to read widely for improved performance in subsequent examinations.

SOLUTION 4

a. The general IT controls that are expected to be found in Holloway Interiors Limited are discussed below:

Control area	Controls required
Development of computer-based information systems and applications	▪ Appropriate standards should be established and enforced for designing, developing, programming and documenting each new system. ▪ Suitable testing procedures should be carried out on each new system. ▪ The design of a new system should be approved formally by the management of the system user. ▪ There should be a segregation of duties between system designers and system testers (to reduce the risk of error or fraud) ▪ There should be suitable staff training in the design and testing of systems.

Documentation and testing of programme changes	▪ Formal testing procedures should be applied for any change to a current programme. ▪ There should be formal authorisation procedures for programme changes. ▪ There should be suitable staff training in making and testing programme changes.
Prevention or detection of unauthorised programme changes	• There should be a segregation of duties between programmers and computer system operators. • All programme changes must be fully documented • Access to programme files must be restricted • Programme logs should be used to record access to program files and programmes • There should be anti-virus software and back-up copies of programme files should be kept, to prevent or detect or deal with 'malicious' changes to programmes.
Prevention of the use of incorrect programmes or data files	• Standard operating procedures should be established, and operations should be performed by suitably-trained staff • The scheduling of 'jobs' for a computer centre should specify the programme files and data files to be used. • There should be effective supervision of computer centre operations. • Reviews of operations should be carried out regularly by management.
Prevention of unauthorised amendments to data files	• There must be restricted access to data files, limited to authorised personnel because transaction are processed immediately by the online system and access controls need to be strong. ▪ Transaction logs should be kept of all uses of data files,to provide an audit trail and these should be reviewed by management. ▪ Fire walls (hardware and software) should be used to prevent unauthorised access through internet.
Ensuring continuity of operations	▪ Secure back-up copies should be kept of programme files and data files. ▪ Measures should be implemented for the protection of equipment against fire, power failure and other hazards. ▪ Disaster recovery programmes should be in place, in the event of a major disaster that puts the main computer system out of action. ▪ There should be suitable maintenance and service agreements for all major externally-acquired software.

b. The five step model is as outlined as follows:

Step 1: Identify the contract

i. IFRS 15 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations and specifies that enforceability is a matter of law.

ii. Contracts can be written, oral or implied by an entity's customary business practices.

iii. A contract with a customer exists if collection of consideration is probable, rights to goods or services and payment terms can be identified, it has commercial substance and it is approved and the parties are committed to their obligations.

Step 2: Identify the performance obligations

i. Entities are to identify each promise to deliver a good or provide a service to a customer.

ii. A promise constitutes a performance obligation if the promised good or service is distinct.

iii. A promised good or service is distinct if it meets both of the following criteria.

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and

- the entity's promise to transfer the good or service to the customer separately identifiable from other promises in the contract.

Step 3: Determine the transaction price

i. The transaction price is the amount of the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

ii. To determine this amount, an entity considers factors like the risk of revenue reversal when determining how much variable consideration to include in the transaction price, the consideration payable to the customer, non cash consideration and the significant financing component.

Step 4: Allocate the transaction price

i. Entities will generally allocate the transaction price to each performance obligation in proportion to its stand-alone selling price.

ii. The best evidence of the stand-alone price is an observable price from a stand alone sales of that good or service to a customer. However, if the stand-alone price is not directly observable, then an entity can estimate it by either evaluating the market in which it sells its goods or services and estimating the price that customers are willing to pay, forecasting expected costs plus an appropriate margin or in limited circumstances, subtracting the sum of observable stand-alone selling prices of other goods or services in the contract from the total transaction price.

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

i. An entity recognises revenue when (or as) it satisfies a performance obligation by transferring control of the goods or service to a customer. Control may be transferred either at a point in time or over time.

ii. The indicators that control has passed include a customer having a present obligation to pay, physical possession, legal title, risks and rewards of ownership or having accepted the asset.

Marking Guide

		Marks
a.	½ mark each for each point subject to a maximum 20 points	10
b.	1 mark each for mentioning each of 5 steps	5
	1 mark each for the explanation of 5 steps	5
		10

Examiner's Report

The part (a) of the question tests candidates' knowledge on general information technology (IT) controls, whilst part (b) tests candidates' knowledge on the recognition of revenue from contracts in accordance with IFRS 15: Revenue from Contracts with Customers.

Almost 80% of the candidates attempted the question because of the popular nature of the IT and the performance was good.

The commonest pitfall of the candidates' was the lack of detailed knowledge of the requirement of the respective segments of the IT programme, while in part (b), candidates displayed poor knowledge in itemizing the steps in the model.

Candidates are advised to devote time to their studies and to go through ICAN Study Texts and Pathfinders.

SOLUTION 5

The financial statement risks to take into account in planning the final audit are as follows:

a. Basis of preparation of the financial statements: The financial statements should not be prepared on a going concern basis. The directors need to include a note in the financial statements explaining the basis of the conclusion and the accounting policies applied in drawing up financial statements on a non-going concern basis;

b. Termination expenses: Management needs to determine the amount of termination expenses required. If termination expenses has not been paid at year end, provisions for termination payments will be needed in the financial statements;

c. Internal control: The use of a small accounting team may increase errors in processing accounting transactions towards the end of the year. Segregation of duties (as an internal control) might have been adversely affected;

d. Accounting policy of own buildings: The accounting policy of the 12 buildings owned by the entity will be changed from depreciated cost to fair value because there is an expectation that they might be sold;

e. Impairment of right-of-use assets: It is expected that the right-of-use assets will have a component on amounts prepaid with regards to the leased buildings and the assumed renewal of the lease. There will be a need to assess the right-of-use asset for impairment in the light of the decision to wind down the company's operations;

f. Provision for warranties: Warranty provisions will be recognised for goods sold to customers which are still under warranty;

g. Agreements with suppliers and distributors: Management needs to review the contracts with distributors and suppliers to identify any breaches as a result of the decision to wind down the company, the financial impact of these breaches needs to be determined and potentially recognized in the financial statements;

h. Lease liability: The lease liability for the assumed lease renewal should be derecognised since the company is no longer likely to renew its lease agreements when they end;

i. Companies income tax liability: The tax liability will be determined based on the requirement of the relevant tax laws;

j. Inventory valuation: The company operates in auto industries and tyres have expiring dates or period and inventories might be subject to obsolescence. Therefore, inventories in the financial statements might be overstated; and

k. Deferred tax asset: Considering that the entity is on the verge of ceasing operations, it is unlikely that there would be future taxable profit for the recoverability of the deferred tax asset and so this has to be derecognised.

Marking Guide

	Marks
1 mark each for identifying the risk	10
1 mark each for the explanation of risk identifying	10
Total	**20**

Examiner's Report
The question test candidates' knowledge on financial risks inherent in planning for a final audit.

About 60% of the candidates attempted the question and overall performance was average.

The commonest pitfall of the candidates was their inability to identify the financial statement risks to be considered in planning a final audit.

Candidates are advised to link the theoretical issues in the study text to practical situation when given in a scenario.

SOLUTION 6

a. Tendering is a commercial process widely-used by companies (especially larger companies) when they wish to change auditors. The invitation may or may not include the existing auditor. Tendering involves two or more audit firms being invited by a company to submit a proposal for its audit work, which include:

   i. Tendering should commence only when a firm has been approached by a prospective client. In any case, a firm should not submit a tender for the work unless it can give satisfactory answers to the following questions:

- Does the firm have the expertise to carry out this audit?
- Does the firm have (or could it have) sufficient staff available at the appropriate time?
- Are there any ethical reasons why the firm could not act (for example, a problem with independence, or a conflict of interest)?
- Are there any problems, of which the firm is aware, with the current audit or auditors?

ii. Collect background information about the possible new client. (This is necessary when evaluating any new client, whether the fee is to be set by tender or by any other method);

iii. Establish the precise scope of the work to be performed and the specific requirements of the prospective client;

iv. Carry out a preliminary audit risk assessment and prepare a preliminary plan for the audit. The plan must cover the staffing requirements and the time requirements for the work;

v. Estimate a fee;

vi. Prepare a submission document for the potential client. The contents of this document will typically include:

- An outline of the key characteristics of the firm;
- Clarification of the nature of the audit work or other non-audit work to be performed;
- A statement of the requirements of the client and how the firm will comply with them;
- An outline of how the work will be performed;
- The proposed fee and the basis of its calculation;
- The range of other services which the firm could offer to the client; and

vii. If required, prepare and give a presentation to the potential client.

b. When a professional accountant in public practice solicits new work through advertising or other forms of marketing, there may be a threat to compliance with the fundamental ethical principles.

The main requirements for marketing professional services are that the advertising and publicity material used by any firm:

i) Must not bring into disrepute the professional body, the firm or the profession as a whole;
ii) Should not make exaggerated claims for services offered, qualifications possessed or experience gained – it should be honest and truthful and not mislead;
iii) Must not discredit the services provided by other firms or make disparaging references or unsubstantiated comparisons to the work of another Chartered Accountant;
iv) Must not break any locally-recognised codes of advertising practice;
v) In addition, it is recommended that advertising and publicity material should avoid any reference to fees. If fees are mentioned, there should be a statement of the basis on which the fees are to be charged;
vi) Comments about fees:
   - Must not be misleading;
   - Must not offer discounts; and
   - Must not make comparison with the fees of other service providers; and
vii) ICAN's professional code of conduct and guide for members states that if a Chartered Accountant in public practice is in doubt whether a proposed form of advertising or marketing is appropriate, he/she should consult through the Registrar/Chief Executive of ICAN.

c. ICAN's code of conduct provides specific guidance regarding fees as follows:
i) ICAN advises minimum charge-out rates in respect of fees for professional services which are intended to set a benchmark below which members are not ordinarily expected to charge;

ii) A member should inform a client in writing prior to commencement of any engagement the basis upon which any fee he proposes to charge for his services will be calculated and, on request and where practicable, the level of fees likely to be charged for any assignment;

iii) The member should discuss and explain the basis on which fees will be calculated, including the estimated initial fee, at the earliest opportunity. This discussion should be confirmed in writing, normally in an engagement letter;

iv) Firms should not quote a level of fees for new audit work which is lower than that charged by an existing auditor. Firms should also not quote by tender a level of fees which they have reason to believe is significantly lower than those quoted by other tendering firms. In both instances the firm's objectivity could be threatened;

v) When performing audit work, firms should ensure that their work complies with auditing standards and guidelines and, in particular, quality control procedures. In the event of a complaint being made to the Institute (which might have arisen as a result of a Professional Practice Monitoring Committee's inspection), where fees were a feature in obtaining or retaining the work, firms should be prepared to demonstrate that:
- The work done was in accordance with auditing standards; and
- The client was not misled as to the basis on which fees for the current and subsequent years were to be determined;

vi) A member whose fees have not been paid may be entitled to retain certain books and papers of a client upon which he has been working by exercising a lien and may refuse to pass on information to the client or his successor Chartered Accountant, until those fees are paid. However, a member who so acts should be prepared to take reasonable steps to resolve any dispute relating to the amount of that fee. The incoming auditor has a duty to assist in the recovery of such fees within a reasonable time; and

vii) Fees should generally not be based on a percentage or on contingency calculations for audit work, reporting assignments and similar non-audit roles.

d. **The impact of the five additional information are as follows:**

i) Since Nash Investigation is a major service provider to our firm, the issue of a possible threat to our independence arises and we may not be able to submit a tender for the audit;

ii) Also there should be professional clearance when a firm of auditor is taking up a job which has been previously handled by a professional colleague, and we were told that Nash Investigation is withholding fess of her previous auditor, hence, our firm will not participate in the tendering process;

iii) As a firm of auditors, there is professional requirement which stipulates that one should not act for two opposing parties in any negotiation or claim unless one is appointed as an arbitrator due to process of law and tendering process is not arbitration process, hence, our firm will not be able to participate in the audit tender. It is of note that Nash Investigations is currently facing a hostile takeover bid from Technical Investigations Group. Hence our Firm will not be able to participate in the audit tender;

iv) If we confirm that the reason for parting ways with the old audit firm is incompetence and there is no independence issue; then we can take up the audit and press for the payment of the withheld fees on behalf of the previous auditors. It is of note that Nash investigation is currently facing a hostile takeover bid from Technical Investigations Group. Hence our firm will not be able to participate in the audit tender; and

v) Having one of our partners as a director in an audit client is a threat to our independence which will amount to conflict of interest and if we are to submit a tender for the audit, the partner needs to either resign as partner or as a member of the board of directors.

Marking Guide

		Marks
a.	1 mark for any point (max 5)	5
b.	1 mark for any point (max 5)	5
c.	1 mark for any point (max 5)	5
d.	1 mark each for the 5 points	5
		20

Examiner's Report

The question tests candidates' knowledge on various issues on professional code of conduct and professional ethics.

About 60% of the percentage of candidates that attempted the question and the performance was poor.

The commonest pitfall of the candidates was their inability to explain the requirements of the professional code of conduct of members as regards advertising and publicity, and fees

Candidates are advised to go through ICAN Study Text and other relevant reading materials.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2020

CASE STUDY

Time Allowed: 4 hours (including reading time)

INSTRUCTION: YOU ARE TO USE THE CASE STUDY ANSWER BOOKLET FOR THIS PAPER

Pre-seen

This material is issued prior to the examination date to enable candidates familiarise themselves with the case scenario so as to undertake any research and analyses they think fit. This pre-seen part of the Case Study examination is also published on the Institute's website: www.ican.org/students.

You **MUST NOT** bring this material with you to the Examination Hall. On receipt of the material, you are to spend the few days to the examination date to familiarise yourself with the information provided, carry out additional research and analyses about the industry and analyse the financials provided in preparation for the examination. Candidates should note that the use of pre-seen part of the Case Study will not significantly help them in their preparation for this examination. It is essential that they carry out sufficient analyses on their own in order to have a good understanding of the pre-seen part of the case scenario.

At the start of the examination, candidates will receive the complete case scenario which will include both the pre-seen and the unseen which includes the requirements. You must use the answer paper provided by the Institute in the Examination Hall. Any solution presented with other papers **WILL NOT** be marked.

Assessment of the Case Study

The marks in the Case Study examination are awarded for professional skills and are approximately allocated as follows:

- Assimilating and using information 20%
- Structuring problems and solutions 20%
- Applying judgement 20%
- Drawing conclusions and making recommendations 20%

- Demonstrating integrative and multidisciplinary skills
  10%
- Presenting appropriate appendices
  10%

Of the total marks available, 20% is awarded for the executive summary and approximately 10% for the relevant discussion of ethical issues within your answers to the requirements. Although ethical issues do not form a specific requirement, as this is deemed to have been tested in other subjects of the ICAN professional examination, but will be tested within a requirement which may include the following areas:

- Lack of professional independence or objectivity;
- Conflicts of interest among stakeholders;
- Doubtful accounting and or creative accounting practice;
- Unethical business/commercial practice; and
- Inappropriate pressure to achieve a reported result.

Candidates should note that marks are not awarded for just simply restating facts from the case scenario but are awarded for demonstrating professional skills and technical depth. Therefore, to succeed, candidates are required to:

- Show sufficient evidence of knowledge of the case scenario;
- Be able to carry out appropriate analyses of the issues involved and suggest feasible solutions to the problems identified;
- Demonstrate ability to make informed judgement on the basis of analyses carried out; and
- Generate reasoned conclusions upon which relevant recommendations are made.

Any candidate that omits any one of these will have a slim chance of success in the examination.

November 2020 Case Study: Dotmak Nigeria Limited

List of exhibits

1 About you (Ibrahim Danladi) and your employer, Dotmak Nigeria Limited

2 Repositioning Tito shoes in Nigeria

3 Dotmak Nigeria Limited: history, operations, competitors board and management

4 The challenges and opportunities of the shoe industry in Nigeria

5 Dotmak Nigeria Limited management accounts – 2016 to 2018

6 Dotmak Nigeria Limited: Cost/pricing structure

7 Press article

Exhibit 1

About you (Ibrahim Danladi) and your employer (Dotmak Nigeria Limited)

You are Ibrahim Danladi, writing the Professional level of ICAN examination. You are working as a management accountant at the corporate office of Dotmak Nigeria Limited which manufactures and distributes high quality shoes and personal accessories. You report to the finance controller, Joseph Apororo and your responsibilities include:

- Preparing detailed financial analyses and reports on the performance of the company;
- Assessing operational and strategic business proposals to see how each aligns with the corporate objectives and its impact on the company's business and financial risks;
- Assessing the funding gaps and recommending appropriate sources of fund, taking into consideration the company's optimal financial structure;
- Evaluating investment proposals and reporting to the board on their acceptance or rejection based on the company's current financial strategic objectives, ethical and other commercial considerations.

Your responsibilities demand that you keep yourself current with both the company's internal and external operating environments so as to be able to contribute objectively to the company's strategic thrust.

Exhibit 2

Repositioning Tito shoes in Nigeria

To reposition Tito shoes in Nigeria, we have decided to partner with Tito international to build a shoe plant in Abuja. This shoe plant would provide jobs for more than 128 Nigerians. The plant which would be situated at the Idu Industrial Layout in Nigeria's capital, would be fully manned by Nigerians, and would be making the full range of Tito shoes. At the moment, we are sensitising the market for Tito shoes in Nigeria by establishing a retail shop in Abuja that sells the full range of Tito shoes and accessories. The response of the customers has given us more motivation to go into the production of Tito shoes in Nigeria. Everybody working in the retail store is a Nigerian.

At the moment, we have six people undergoing training as supervisors at the Tito factory. The Tito retail outlet is situated at the Silver Entertainment Centre, Central Business District, Abuja. We believe that the return of Tito would improve the country's economy. To have the confidence to partner with us and come back is a good sign also for the country. Government is also trying to attract foreign investment; whether direct or indirect. Nigerians can expect what they have always known about Tito. First of all, its quality and affordability. At present, there are plans to expand to other states in the country by opening a retail shop in each state capital. We are also not losing our tradition. We are bringing the old with the new and we are infusing both to satisfy our customers.

Exhibit 3

Dotmak Nigeria Limited: history, operations, competitors, board and management

History

Dotmak Nigeria Limited (DNL) was established by Mr. Jude Duru. Mr. Duru trained as a mechanical engineer and has worked for several years in Tito factory based in Canada. Mr. Duru returned to Nigeria in January 2014 to establish a shoe factory. In June 2014, Mr Duru established Dotmak Nigeria Limited to manufacture men's, women's and children's shoes. Since inception, DNL has grown rapidly and made an incursion into the production of military and para-military forces' shoes and accessories. Dotmak shoe is renowned for its comfort, quality and durability, which have made it a household name in Nigeria.

Since its incorporation in 2014, Dotmak Nigeria Limited, with its slogan, 'Keep Africa Walking', aims at ensuring that it produces made-in-Nigeria shoes that can compete in the global market at affordable prices. Producing quality foot wears for oil companies, factories, military and para-military organisations, is the company's own way of contributing its quota to the development of the economy and boosting the efficiency and overall productivity of these entities.

The factory, built to the best international standard, has produced boots for the Nigerian Army, Nigeria Police, 'Back to School' shoes for numerous nursery, primary, and secondary schools. The company also produces industrial safety shoes for construction and oil and gas companies; and combat/jungle boots & service shoes for the military and para-military institutions.

Operations

DNL has its factory in Lagos and it is equipped with modern machines and equipment, for shoe production. Dotmak also has well-trained specialists in making handcraft shoes and shoe designers. The factory has capacity to produce 1,000 shoes in a day and working for 260 days in a year.

Staff of Dotmak are not allowed to join the labour union and have been made to sign an agreement that they will not form any union. Conditions of service are not very attractive, but because of the unemployment situation in the country, workers are made to work twelve hours per day without adequate overtime payment. Provision for annual leave is a week for all categories of staff.

All the raw materials of the company are sourced locally and this has made the company's shoes truly Nigerian. Apart from occasional shortages, all the materials are available all the year round.

The company sells mostly to its distributors but also maintains demonstration showrooms in Lagos, Abuja and Port Harcourt, where its shoes are displayed and sold to customers. However, all contract customers, such as schools, the armed forces and para-military agencies, are allowed to deal directly with the company.

One of the problems faced by the company in its factory is power shortage and the company has to depend on alternative electricity at a very high cost. Therefore, the company has made an unwritten agreement with the officials of the power distribution company in the area to provide uninterrupted 8-hour supply of power to the company on a daily basis for a monthly payment to these officials. The company does not ask for receipt for this payment.

Board and management

DNL is run by a board of four directors, with Mr. Jude Duru as the chairman/chief executive, Mrs. Josephine Duru and two independent non-executive directors. Only Mr. Duru works as an executive of DNL and he is assisted by a General manager who is a seasoned cobbler. The management team comprises:

Mr. Jude Duru	Chairman/chief executive
Mr. Taiwo Opeolu	General manager
Mr. Joseph Apororo	Finance Controller
Mallam Sani Tijani	Factory manager
Mrs Mary Arochukwu	Administration/purchasing manager

Exhibit 4

The challenges and opportunities of the shoe industry in Nigeria

The leather industry was a major contributor to the Nigerian economy in the past, however, due to neglect and unfavourable economic climate and little or no encouragement from the government in the area of policy formulation, the industry suffered a decline.

Challenges of the leather industry

Most of the challenges faced by the industry are:

Importation of cheap shoes into the country: With mass-produced shoes flooding the Nigerian market from all over the world in recent time, there is a need for government to arrest the trend through a deliberate action that would help reposition the leather industry. Whereas, if the industry is repositioned, capital flight associated with the importation of foot wears from countries like Taiwan, South Korea, China, Vietnam, India and Indonesia would become a thing of the past.

Changing Consumer Preferences: The 21st-century consumers are more educated and knowledgeable and as a consequence, they become more demanding and inquisitive in their search of information of the product. This presents a serious challenge to shoemakers, as they have to follow and quickly adapt to consumer preferences, which are fundamental in purchasing decisions.

It is not only about adapting to new fashion trends but considering the whole new set of desires and beliefs. For instance, many consumers search for transparency and security. They want to ensure that the footwear they buy is safe and that it was made according to existing regulations. For these consumers, it is important that products are made from good quality materials, feel comfortable and won't bring any hazard to their health. Some consumers also show concern for where and how their products are made. Therefore, footwear companies must then re-think and adapt their products to best-fit consumers' desires.

Poor power supply: Poor power supply reduces productivity considerably and is mentally draining. Using alternatives throws production costs off the charts.

Inconsistent local raw materials: Then, there is the problem of inavailability of raw materials. The quality of materials from local suppliers is inconsistent. Materials and tools can be good one month, and be absolutely terrible the next. This makes planning production schedule extremely frustrating. Accessories which are the main materials in shoe design range could disappear from the market for months, resurfacing later, after hope has been lost and design discarded.

Going further down the long list of problems shared by the community of designers, lack of equipment is repeated a lot. Very creative concepts get trashed because it is impossible to use the available equipment to execute them properly. Some designers of high-heeled or non-regular shoes resort to outsourcing their production to companies in Turkey, Lisbon, Italy or China. This waters down the 'Proudly Nigerian' mantra that got them started in the first place. One would attempt to purchase these machines, but again, there are no skilled operators and that is the next huge problem.

Funding: The cost of importing machinery and equipment, and running the factory is enormous and bank loans are difficult and expensive to source.

Opportunities

Rapid Pace of Urbanisation: Urbanisation is a global phenomenon and one of the main drivers of increasing demand for consumer goods, especially footwears. According to Professor Alberto Castro, from the Catholic University of Portugal in the study –"Footwear Consumer 2030", it is expected that global urbanisation will rise from 51.1% to 60% by 2030. And this is a phenomenon occurring on a much larger scale in developing countries, when compared to developed ones. Therefore, demand for shoes and other related products will continue to increase in the majority of international markets and most especially in developing countries.

E-Commerce: E-Commerce has become a premier platform for sale of shoes. Its strength over traditional brick and mortar modes is that it can offer selection, convenience and value. These three elements are prime factors for the footwear industry. Where the restraints of a physical store limit the amount of styles and sizes available at any given time, e-commerce can virtually make any and every shoe available, often at a better price, without the hassle of shopping in person. In 2012, online shoe sales globally increased to over $7.8 billion, according to Daily Deal Media. As more companies embrace this mode, the opportunity for more revenue is there.

Exhibit 5

Dotmak Nigeria Limited management accounts – 2016 to 2018

Dotmak Nigeria Ltd
Management accounts
Notes

Income statement for the year ended 30 September	**Notes**	**2018**	**2017**	**2016**
		₦000	**₦000**	**₦000**
Revenue	**1**	731,860	622,380	507,800
Factory costs	**2**	(288,840)	(245,580)	(196,320)
Gross profit		**443,020**	**376,800**	**311,480**
Distribution costs	**3**	(52,780)	(43,060)	(33,940)
Selling expenses	**4**	(263,400)	(223,700)	(183,600)
Administrative expenses	**5**	(103,280)	(85,080)	(68,180)
Operating profit		**23,560**	**24,960**	**25,760**
Net finance (expense)/income		(340)	(780)	1,380
Profit before taxation		**23,220**	**24,180**	**27,140**
Taxation		(5,800)	(6,040)	(6,780)
Profit for the year after taxation		**17,420**	**18,140**	**20,360**

Statement of financial position as at 30 September		**2018**	**2017**	**2016**
		₦000	**₦000**	**₦000**
Non-current assets				
Tangible assets	**6**	139,820	104,820	67,220
Current assets				
Inventories	**7**	40,780	36,260	29,420
Accounts receivable	**8**	21,840	20,300	16,240
Cash and cash equivalents		240	-	14,600
		62,860	56,560	60,260
Total assets		**202,680**	**161,380**	**127,480**
Shareholders' equity				
Ordinary share capital		2,000	2,000	2,000
Retained earnings		91,000	73,580	55,440
Total shareholders' equity		**93,000**	**75,580**	**57,440**
Current liabilities				
Accounts payable	**9**	109,680	85,520	70,040
Bank overdraft		-	280	-
Total current liabilities		109,680	85,800	70,040
Total equity and liabilities		202,680	161,380	127,480

Statement of cash flows for the year ended 30 September	**2018**	**2017**	**2016**
	₦000	**₦000**	**₦000**
Profit before tax	23,220	24,180	27,140
Adjustments for:			
Depreciation & loss on disposals	34,560	33,520	19,880
Net finance expense	340	780	(1,380)
	58,120	**58,480**	**45,640**
Changes in inventories	(4,520)	(6,840)	(2,680)
Changes in accounts receivable	(1,540)	(4,060)	(4,040)
Changes in accounts payable	24,400	16,220	7,680
Cash generated from operations	**76,460**	**63,800**	**46,600**
Taxation paid	(6,040)	(6,780)	(6,340)
Net finance expense paid	(340)	(780)	1,380
Net cash from operating activities	**70,080**	**56,240**	**41,640**
Investing activities			
Purchase of non-current assets	(70,680)	(72,820)	(30,260)
Proceeds from disposal of non-current assets	1,120	1,700	1,040
Net cash used in investing activities	**(69,560)**	**(71,120)**	**(29,220)**
Net change in cash and cash equivalents	**520**	**(14,880)**	**12,420**
Cash and cash equivalents at start of year	(280)	14,600	2,180
Cash and cash equivalents at end of year	**240**	**(280)**	**14,600**

Notes to the management accounts

Note 1 Revenue

	2018	**2017**	**2016**
	₦000	**₦000**	**₦000**
Men's shoes	230,840	195,060	172,960
Women's and children's shoes	501,020	427,320	334,840
	731,860	**622,380**	**507,800**

Note 2 Factory costs

Factory wages	102,420	85,720	67,820
Materials	163,560	135,720	108,440
Manufacturing overheads	22,860	24,140	20,060
	288,840	**245,580**	**196,320**

Note 3 Distribution costs

Delivery vehicle running costs (fuel, etc.)	7,220	6,060	5,560
Distribution overheads and salaries	10,300	8,580	5,960
Courier and related delivery services	35,260	28,420	22,420
	52,780	**43,060**	**33,940**

Note 4 Selling expenses

Retail outlets			
Retail outlet costs	115,480	98,500	83,160
Refurbish, depreciation & loss on disposals	13,420	12,040	10,100
Retail outlet wages	85,720	74,840	65,880
	214,620	185,380	159,140
Web and IT			
Web costs	29,780	24,060	14,880
Computer & IT running costs	9,520	7,220	6,920
IT depreciation & loss on disposals	9,480	7,040	2,660
	48,780	38,320	24,460
Total selling expenses	**263,400**	**223,700**	**183,600**

Note 5 Administration expenses

Design office and prototype costs	17,380	12,440	9,960
Marketing, advertising and catalogue	29,040	25,120	17,860
Administration staff salaries	25,560	22,960	19,780
Office costs including training	20,160	16,680	14,420
Legal and professional costs	5,160	3,520	2,720
Other costs	5,980	4,360	3,440
	103,280	**85,080**	**68,180**

Note 6 Non-current assets
Tangible assets

	Plant & Machinery	**IT Equipment & fittings**	**Outlet Refurb.**	**Vehicles**	**Total**
	₦000	**₦000**	**₦000**	**₦000**	**₦000**
Cost					
At 1 October 2015	79,040	21,480	46,160	4,440	**151,120**
Additions	5,840	3,700	17,120	3,600	**30,260**
Disposals	(2,960)	(700)	(7,240)	(2,240)	**(13,140)**
At 30 September 2016	**81,920**	**24,480**	**56,040**	**5,800**	**168,240**
Depreciation					
At 1 October 2015	55,720	11,940	23,340	2,240	**93,240**
On disposals	(2,140)	(460)	(7,240)	(1,240)	**(11,080)**
Charge for the year	5,380	2,500	10,100	880	**18,860**
At 30 September 2016	**58,960**	**13,980**	**26,200**	**1,880**	**101,020**
Carrying amount at 30 September 2016	**22,960**	**10,500**	**29,840**	**3,920**	**67,220**
Cost					
At 1 October 2016	81,920	24,480	56,040	5,800	**168,240**
Additions	30,960	16,820	21,920	3,120	**72,820**
Disposals	(29,720)	(10,700)	(13,440)	(1,640)	**(55,500)**
At 30 September 2017	**83,160**	**30,600**	**64,520**	**7,280**	**185,560**
Depreciation					

At 1 October 2016	58,960	13,980	26,200	1,880	**101,020**
On disposals	(24,140)	(8,160)	(13,440)	(920)	**(46,660)**
Charge for the year	8,340	4,760	12,040	1,240	**26,380**
At 30 September 2017	**43,160**	**10,580**	**24,800**	**2,200**	**80,740**
Carrying amount					
at 30 September 2017	**40,000**	**20,020**	**39,720**	**5,080**	**104,820**
Cost					
At 1 October 2017	83,160	30,600	64,520	7,280	**185,560**
Additions	16,920	26,440	26,640	680	**70,680**
Disposals	(4,720)	(9,340)	(16,720)	(880)	**(31,660)**
At 30 September 2018	**95,360**	**47,700**	**74,440**	**7,080**	**224,580**
Depreciation					
At 1 October 2017	43,160	10,580	24,800	2,200	**80,740**
On disposals	(3,360)	(6,760)	(16,720)	(480)	**(27,320)**
Charge for the year	9,440	7,440	13,420	1,040	**31,340**
At 30 September 2018	**49,240**	**11,260**	**21,500**	**2,760**	**84,760**
Carrying amount					
At 30 September 2018	**46,120**	**36,440**	**52,940**	**4,320**	**139,820**

Notes to the management accounts

Note 7 Inventories

	2018	**2017**	**2016**
	₦000	**₦000**	**₦000**
Raw materials	6,300	4,440	2,140
Work in progress	660	560	320
Finished goods	33,820	31,260	26,960
	40,780	**36,260**	**29,420**

Note 8 Accounts receivable

Trade receivables	14,080	13,040	10,060
Prepayments	5,340	4,980	4,160
Sundry receivables	2,420	2,280	2,020
	21,840	**20,300**	**16,240**

Note 9 Accounts payable

Trade payables	88,300	65,900	51,120
Taxes and social charges	16,040	14,640	14,260
Accruals	5,340	4,980	4,660
	109,680	**85,520**	**70,040**

Exhibit 6

Dotmak Nigeria Limited: Cost/pricing structure

Factory costs per pair of shoes

Note: figures shown are for the year ended 30 September 2019 (approximately 240,000 pairs)

Approximate labour costs per pair of shoes produced and sold in 2019

	Adult	**Children**
	₦	**₦**
Basic wage-employee cost	486.00	69.43
Average wage-employee cost	1,687.50	241.07
Skilled wage-employee cost	1,399.50	199.93
Management add-on-costs	1,332.00	190.28
	4,905.00	700.71
Approximate materials costs per pair of shoes produced	**Adult**	**Children**
	₦	**₦**
Leather for uppers	4,680.00	668.57
Soles	2,025.00	289.28
Insoles/"socks"	585.00	83.57
Laces, fastenings, etc	405.00	57.86
Packaging	135.00	19.29
	7,830.00	1,118.57

Approximate factory overheads per pair of shoes produced

	Adult	**Children**
	₦	**₦**
Rent and rates	220.50	31.50
Power and services charges	153.00	21.86
Depreciation, repairs and maintenance charges	720.00	102.86
	1,093.50	156.22
Average total factory costs per pair of shoes in the year	**13,828.50**	**1,975.50**

For most calculation purposes, DNL uses ₦13,850.00 for adults and ₦2,000 for children as the rounded figure. The cost for a pair of leather slippers is 75% of the cost for a pair of shoes.

It is the practice of Dotmark Nigeria Limited to add 30% mark up for all shoes made.

Exhibit 7

Press article

LEADERSHIP

NIGERIA'S MOST INFLUENTIAL NEWSPAPER

Tito Nigeria To Invest ₦360m On Leather Plant In FCT

April 3, 2019

Tito Nigeria Limited said that it would invest about one million dollars, (₦360 million) in the building of its new leather factory in the Federal Capital Territory (FCT). Speaking during the formal opening of retail outlet in Abuja at the weekend, the spokesperson of the company, Tobe Eze, explained that the new factory, which would be located in Idu Industrial Area, would be ready in June. Eze added that when completed, the factory would offer employment opportunity to many unemployed youths in the FCT.

He maintained that the factory, when completed would be manned by Nigerians, while efforts would also be made to extend the company's operations to other parts of the country. The spokesperson stated that Tito Nigeria Limited is now in the country to continue to offer Nigerians affordable and durable leather and shoe products, which the company is noted for. He continued: "We are also putting in place measures to ensure that the business is sustained. Nigerians should expect a new trend of shoes, which is what Tito is known for. This is because today's youths want to wear new trendy shoes."

UNSEEN

November 2020 Case Study: Dotmak Nigeria Limited (DNL)

List of exhibits

The following exhibits are newly provided and did not form part of the materials provided as Pre-seen:

8. Email from Joseph Apororo to Ibrahim Danladi
9. Dotmak Nigeria Limited: management accounts for the year ended 30 September 2019.
10. Proposed shoe manufacturing plant projections.
11. 3-year supply contract from Faith Group of Schools.

Dotmak Nigeria Limited (DNL): Case Study requirement

You are Ibrahim Danladi, writing the final level of ICAN Professional Examination, working as management accountant with Dotmak Nigeria Limited, a company that produces and distributes men's and women's shoes. You report to Joseph Apororo, the company's financial controller.

Requirement

You are required to prepare a draft report for the DNL board, as set out in the email dated 6 October 2019 from Joseph Apororo to you **(Exhibit 8)**. Your report should comprise the following:

- An executive summary
- Responses to the two detailed requirements set out in exhibit 8, including appropriate appendices.

State clearly any assumptions you have made. All workings should be attached to your answer.

The following time allocation is suggested:

Reading and planning	1 hour
Performing calculations and financial analyses	1 hour
Drafting report	2 hours

Ensure that you address the two requirements in your report or failure to address any requirement including not submitting an executive summary will affect your chances of success. In addition, as indicated in the Pre-seen, all four skills areas will be assessed under each of the four elements of your report. Accordingly, not demonstrating your judgement or failing to include appropriate conclusions and/or recommendations in each of your reports will adversely affect your chances of success.

Exhibit 8

Email from Joseph Apororo to Ibrahim Danladi

EMAIL

From: Joseph Apororo

To: Ibrahim Danladi

Subject: Board meeting

Date: 6 October 2019

As you are aware, the next board meeting, at which our operational and strategic plans for the coming year will be considered, is in two weeks. At this meeting, the board would like to review our performance, to assist the board in taking decision on our business proposals.

Therefore, I will like you to carry out:

i. A detailed review of our management accounts for the last four years under the following headings: profitability; position; and prospect. You are also to comment briefly on the performance and prospect of each of the two revenue streams;

ii. An evaluation of the contract from Faith Group of Schools, to show what impact it will have on our profitability; and

iii. An evaluation of the proposed Tito factory to show whether or not the company would be able to recover its investment on the project.

I attach herewith exhibits 8 to 10 in respect of details of our strategic plan, Faith Group of Schools' business proposal, and management accounts for the year ended 30 September 2019. You can find in your file, the management accounts for the previous three years.

Please draft for my review, a report to be submitted to the board. Your report should comprise:

(1) An evaluation of the company's performance as reflected in its management accounts for the year ended 30 September 2019 as presented in exhibit 8. Your evaluation should comprise an analysis of the key changes in profitability, position and prospect of the company in comparison with the previous three years to 30 September 2018; and

(2) A critical evaluation and assessment of the two business proposals as contained in exhibits 9 and 10. You are to calculate the projected addition to

contribution from the Faith Group of Schools' contract and show if DNL would be able to recover its investment in the proposed Tito Shoe factory. Also, discuss any broader commercial and ethical considerations as well as the risks that may be associated with these business proposals.

I look forward to receiving your draft report.

Joseph

Exhibit 9

Dotmak Nigeria Limited: management accounts for the year ended 30 September 2019

Dotmak Nigeria Limited Management accounts

	Note	
Income statement		
Year ended 30 September		**2019**
		₦000
Revenue	1	777,740
Factory costs	2	(317,460)
Gross profit		**460,280**
Distribution costs	3	(62,140)
Selling expenses	4	(282,120)
Administration expenses	5	(113,640)
Operating profit		**2,380**
Net finance expense		(620)
Profit before taxation		**1,760**
Taxation		(440)
Profit for the year after taxation		**1,320**

Statement of financial position		
As at 30 September		**2019**
		₦000
Non-current assets		
Tangible assets	6	115,540
Current assets		
Inventories	7	46,860
Accounts receivable	8	22,940
Cash and cash equivalents		15,360
		85,160
Total assets		**200,700**
Shareholders' equity		
Ordinary share capital		2,000
Retained earnings		92,320
Total shareholders' equity		94,320
Current liabilities		
Accounts payable	9	106,380
Total current liabilities		106,380
Total equity and liabilities		**200,700**

Dotmak Nigeria Limited	
Year ended 30 September	**2019**
	₦000
statement of cash flows	
Profit before tax	1,760
Adjustments for:	
Depreciation & loss on disposals	36,120

Net finance expense	620
	38,500
Change in inventories	(6,080)
Change in accounts receivable	(1,100)
Change in accounts payable	2,060
Cash generated from operations	**33,380**
Taxation paid	(5,800)
Net finance expense	(620)
Net cash from operating activities	**26,960**
Investing activities	
Purchase of non-current assets	(12,320)
Proceeds from disposal of non-current assets	480
Net cash used in investing activities	**(11,840)**
Net change in cash and cash equivalents	**15,120**
Cash and cash equivalents at start of year	240
Cash and cash equivalents at end of year	**15,360**

Notes to the management accounts

Note 1 Revenue

	2019
	₦000
Men's shoes	237,960
Women's and children's shoes	539,780
Total	**777,740**
Note 2 Factory costs	
Factory wages	112,940
Materials	179,540
Manufacturing overheads	24,980
	317,460
Note 3 Distribution costs	
Delivery vehicle running costs	7,540
Distribution & appropriated overheads	11,580
Courier and related delivery services	43,020
	62,140
Note 4 Selling expenses	
Retail outlets	
Retail outlet costs	124,560
Refurbishment depreciation & losses	17,300
Retail outlet wages	90,320
	232,180
Web and IT	
Web costs	31,960
Computer & IT running costs	9,700
Depreciation & loss on disposals	8,280
	49,940
Total selling expenses	**282,120**

Note 5 Administration expenses

Design office and prototype costs	19,020
Marketing, advertising and catalogue	29,780
Administration staff salaries	27,520
Office costs including training	22,780
Legal and professional	7,860
Other	6,680
	113,640

Note 6 Non-current assets
Tangible assets

	Plant & Machinery ₦000	**Equipment & Fittings ₦000**	**Outlet Refurb ₦000**	**Vehicles ₦000**	**Total ₦000**
Cost					
At 1 October 2018	95,360	47,700	74,440	7,080	**224,580**
Additions	520	4,280	7,080	440	**12,320**
Disposals	(740)	(1,160)	(7,240)	(1,120)	**(10,260)**
At 30 September 2019	95,140	50,820	74,280	6,400	**226,640**
Depreciation					
At 1 October 2018	49,240	11,260	21,500	2,760	**84,760**
On disposals	(420)	(760)	(4,100)	(680)	**(5,960)**
Charge for the year	9,260	8,040	14,160	840	**32,300**
At 30 September 2019	58,080	18,540	31,560	2,920	**111,100**
Carrying amount					
At 30 September 2019	**37,060**	**32,280**	**42,720**	**3,480**	**115,540**

Note 7 Inventories

	2019 ₦000
Raw materials	7,240
Work in progress	840
Finished goods	38,780
Total	**46,860**

Note 8 Accounts receivable

Trade receivables	14,840
Prepayments	5,520
Sundry	2,580
	22,940

Note 9 Accounts payable

Trade payables	82,380
Taxes and social charges	18,220
Accruals	5,780
	106,380

Exhibit 10

Proposed shoe manufacturing plant projections

The following are the projections for the planned Tito factory:

Project cost: 1. The total cost of the project, i. e. factory building, plant and equipment, is ₦360million.

2. There will be ₦40million investment in working capital.

Revenue projection: The plant is projected to be able to produce and sell shoes as follows:

First year – 20,000 pairs
Second to fifth years – 30,000 pairs each.

Contribution per pair of shoes is projected as follows:
₦6,000, with a probability of 20%;
₦5,000, with a probability of 30%; and
₦4,000, with a probability of 50%.

Cost of capital: The cost of capital is projected at 18% per annum.

Note: It is the practice of Dotmak Nigeria Limited to recover its investment on a project like this in five years.

Exhibit 11

3-year supply contract from Faith Group of Schools

Email

From:	Janet Oluwaseye – Faith Group of Schools
To:	Jude Duru – Dotmak Nigeria Limited
Subject:	Special order
Date:	20 September 2019

I am pleased to inform you that our school board is very satisfied with the shoes you supplied to one of our schools during the last school session. The board has therefore, chosen your company's back-to-school shoes for all our schools. This means that your company will be required to produce between 20,000 and 25,000 shoes at the beginning of every school session for distribution to our various schools, nationwide.

Our school board is prepared to enter into a three year contract to start with and this may be renewed based on our continued satisfaction with the level of quality and comfort of shoes supplied.

Details of the contract are:

a. We are asking for a little change in the design of the shoes to reflect Faith Group of Schools' signature on the buckle of each shoe.

b. The colour of the shoes will be as follows:

- Black to be used during classes, for every pupil, approximately 20,000 pairs per session; and
- Brown slippers, after-school-wear by pupils; staying in the hostel; approximately 5,000 pairs per session;

c. The school board is requesting for a quantity discount of 20% off your normal selling prices.

I will be grateful to receive your response to this request, which I believe makes business sense, being an additional revenue to your normal business.

Janet

ICAN CASE STUDY NOVEMBER 2020

DATE			CANDIDATE NO.	

TIME			MARKER NUMBER	

	Exc Summary	Req 1	Req 2	Overall	TOTAL
SA					
CA					
BC					
NC					
V					
Total	5	8	8	4	25

Executive Summary: Dotmak Nigeria Limited

General

- States the purpose of the report
- States the assumptions
- States reservations, e. g. scepticism

V	NC	BC	CA	SA

2. Requirement 1: Conclusions

- Operating expenses is eating into the company's profitability.
- Liquidity has become a problem.
- There has been financial mismatch
- The prospect for future profit is bleak.

-

V	NC	BC	CA	SA

3. **Requirement 1: Recommendations**

- Institute cost control over operating expenses.
- Stop using short term funds for acquisition of long term assets.
- Reduce inventory holding to reduce working capital requirements.
- Look for cheaper sources of raw materials.

V	NC	BC	CA	SA

4. Requirement 2: Conclusions

- Faith Group of School's order will result in additional contribution
- The proposed Tito factory is viable as the company will be able to recover its investment in five years.
- The staff condition of service is poor.
- Not allowing the staff to join labour union is a bad industrial relations practice.

V	NC	BC	CA	SA

5. Requirement 2: Recommendations

- Accept Faith Group of Schools' order if not working currently at full capacity.
- The company should invest in the proposed shoe factory.
- The company should improve the conditions of service.
- Staff should be given freehand to join the labour union, if they wish.

V	NC	BC	CA	SA

V

REQUIREMENT 1 - Dotmak Nigeria Limited's financial statement analysis.

1 **USES DATA AND INFORMATION APPROPRIATELY**

- Uses information on exhibits 5 and 9 - income statement to show trend of DNL operating performance.
- Uses information on exhibits 5 and 9- statement of financial position to calculate relevant ratios.
- Uses information on exhibits 5 and 9 - notes to management accounts to show trend in performance of each revenue stream.
- Uses information on exhibits 5 and 9 to show trend in DNL's trend in working capital

V	NC	BC	CA	SA

2 **USES PROFESSIONAL TOOLS AND KNOWLEDGE**

- Calculates gross margin ratios
- Calculates operating profit ratios
- Calculates net profit ratios.

4 **IDENTIFIES ISSUES AND OPTIONS**

- Identifies that although revenue is increasing, operating profit is decreasing.
- Identifies that gross profit margin is gradually decreasing.
- Identifies that operating expenses have been increasing. .
- Identifies that the company's liquidity is very poor, although it is gradually improving.

V	NC	BC	CA	SA

5 **APPLIES PROFESSIONAL SCEPTICISM AND ETHICS**

- Recognises that unless DNL's management do something, the company may not continue in business for a long time.
- Recognises that the company's liquidity is poor.

- Prepares trend analysis to determine growth in performance of DNL
- Calculates other relevant ratios.
- Shows calculations to explain the performance and prospects of the two revenue streams.

V	NC	BC	CA	SA

3 **USES ANALYTICAL SKILLS (material points) written report**

- Determines trend in DNL's revenue.
- Determines trend in DNL's gross margin
- Determines trend in DNL's operating expenses.
- Determines trend in working capital ratio.
- Determines trend in return of capital employed.
  Determines trend in operating profit margin.

V	NC	BC	CA	SA

- Recognises that with the trend in increase in trade payable, the suppliers may stop supplying to DNL on credit.
- Recognises that debts of the company is more than the equity capital.

V	NC	BC	CA	SA

6 **EVALUATIVE SKILLS AND JUDGEMENT**

- Recognises that revenue has been growing steadily from year to year.
- Recognises that the company' s return on capital employed has reduced from 20.21% in 2016 to 1.19% in 2019
- Recognises that return on equity has dropped from 35.45% in 2016 to 1.40% in 2019.
- Recognises that the company's net after tax profit margin has dropped from 4.01% in 2016 to 0.017% in 2019, a precarious situation.

V	NC	BC	CA	SA

7 **CONCLUSIONS**

(Draws distinct conclusions under a heading)

- Concludes that continous increase in operating expenses is a problem.
- Concludes that the liquidity position of the company is a threat to its future prospect.
- Concludes that the suppliers may stop supplying materials to DNL on credit.
- Concludes that if the trend continues, the company will make losses in the coming years.
- Concludes that women's and children's shoes contribute to the company's revenue better than men's shoes.

V	NC	BC	CA	SA

8 **RECOMMENDATIONS (commercial / relevant)**

- Recommends that DNL should halt using current capital to finance non current assets.
- Recommends that the company should strive to reduce operating expenses through cost control.
- Recommends that the company should explore possibility of sourcing raw materials from cheaper sources.
- Recommends that the company should explore the possibility of reducing its inventory holdings.

V	NC	BC	CA	SA

REQUIREMENT 2 -Appraisal of Faith Group of School's contract proposal and proposed Tito shoe factory

1 **USES DATA AND INFORMATION APPROPRIATELY**

- Uses information in exhibit 6 to determine cost per pair of shoes and slippers.
- Uses additional information in exhibit 11 to determine selling price per pair of shoes and slippers.
- Uses information in exhibit 11 to determine total cost of Faith Group of Schools order
- Uses information in exhibit 11 to determine total sales value of Faith Group of Schools order
- Uses information in exhibit 11 to determine the total contribution from Faith Group of Schools order.
- Uses information in exhibit 10 to evaluate the proposed Tito factory.

V	NC	BC	CA	SA

2 **USES PROFESSIONAL TOOLS AND KNOWLEDGE** (written into report)

- Determines the cost per pair of shoes and slippers.
- Determines the selling price per shoes and slippers for Faith Group of Schools' order.

4 **IDENTIFIES ISSUES AND OPTIONS**

- Identifies that ability to produce and sell the estimated number of pairs of shoes yearly is critical to the viability of the proposed Tito factory.
- Identifies that the achievement of the expected contribution is critical to the viability of the proposed Tito factory.
- Identifies that DNL should inform Faith Group of Schools that if cost of production increases, they will increase their selling price per pair of shoes to Faith Group of Schools.
- Identifies that the contribution from the order from Faith Group of Schools is lower than the normal contribution, therefore, if the company currently has no spare capacity, the order should not be accepted.

V	NC	BC	CA	SA

5 **APPLYING PROFESSIONAL SCEPTICISM AND ETHICS**

- Discusses the veracity of not allowing the staff to join the labour union.
- Discusses the issue of the staff conditions of service in Dotmak Nigeria Limited.

- Determines the total cost of sales of Faith Group of Schools' order.
- Determines the total sales value of Faith Group of Schools' order.
- Determines the net contribution from Faith Group of Schools' order
- Determines the yearly contribution from the proposed Tito. factory.
- Determines the net present value of the yearly contribution of the proposed Tito factory.
- Determines the net present value of the proposed Tito factory

V	NC	BC	CA	SA

3 **USES ANALYTICAL SKILLS (material points)**

- Calculates the selling price to Faith Group of Schools. order.
- Calculates the factory cost per pair of shoes and slippers.
- Calculates the total contribution from Faith Group of Schools'
- Calculates the yearly contribution of the proposed Tito factory.
- Calculated the present values of the yearly contribution from the proposed Tito factory.
- Calculates the net present value of the proposed Tito factory.
- Calculates loss in contribution, if the company is currently working at full capacity, and still accepts the order of Faith Group of Schools.

V	NC	BC	CA	SA

- Discusses the issue of leave for the staff of Dotmak Nigeria Limited.
- Discusses the working hours per day at Dotmak Nigeria Limited
- Discusses that unofficial payment to Nigerian Power Holding's staff is an ethical breach.

V	NC	BC	CA	SA

6 **EVALUATIVE SKILLS AND JUDGEMENT**

(uses analytical headings)

- Evaluates the expected contribution per pair of shoes from the proposed Tito factory.
- Evaluates the net present value of the proposed shoe factory..
- Evaluates the net contribution from Faith Group of Schools' order
- Evaluates the net contribution form Faith Group of Schools if factory overhead is treated as a fixed cost.
- Evaluates the loss in contribution as a result of accepting the order from Group of schools, if the company is currently working at full capacity.

V	NC	BC	CA	SA

7 **CONCLUSIONS**

(Draws distinct conclusions under a heading)

- Concludes that the order from Faith Group of Schools will result in additional contribution

- Concludes that the company will be able to recover its investment in the proposed Tito factory in 5 years.
- Concludes that the company will need to look into the staff conditions of service.

- The management of DNL should allow the staff to join the labour union if they so wish.

- Concludes that the order from Faith Group of Schools is not worthwhile, if the company is currently working at full capacity.

V	NC	BC	CA	SA

8 **RECOMMENDATIONS (commercial / relevant)**

- Recommends that the contract from faith Group of Schools will results in an additional contribution of between ₦2.5m to ₦6.2m
- Recommends that the management of DNL should undertake the proposed Tito factory project as it has a positive NPV of ₦18.6m
- Recommends that the management of DNL should improve on the company's condition of staff.
- Recommends that the staff of DNL should be given freedom to join the labour union if they so wish.
- Recommends that DNL should not accept the order from Faith Group of Schools if the company is currently working at full capacity.

V	NC	BC	CA	SA

Appendices

1 **Appendices R1: Content and style**

- Shows trend of DNL's operating performance-income statement
- Shows appropriate profitability ratios
- Shows appropriate ratios on the company's liquidity and leverage position
- Shows appropriate ratios to evaluate the company's future prospects
- Shows calculations to explain the performance and prospects of the two revenue streams.

V	NC	BC	CA	SA

2 **Appendices R2: Content and style**

- Shows expected contribution per pair of shoe in the proposed Tito plant
- Shows the total expected contribution per annum in the proposed Tito plant
- Shows the NPV of the proposed Tito plant
- Shows the additional contribution from the Faith Group of Schools' contract.
- Shows loss in contribution if the Faith Group of Schools order is accepted when the company is working at full capacity

V	NC	BC	CA	SA

Main Report

3 **Report: Structure**

- Sufficient appropriate headings
- Appropriate use of paragraphs / sentences
- Legible/clear hand writing
- Correctly numbered pages

V	NC	BC	CA	SA

4 **Report: Style and language**

- Relevant disclaimer (external report)
- Suitable language for the board
- Tactful / ethical comments
- Acceptable spelling and punctuation

V	NC	BC	CA	SA

CC	
SC	
IC	
ID	
NA	
Total	

Appendix 1

Financial statement analysis

Dotmak Nigeria Limited

	2016	2017	CHANGE	CHANGE %	2018	CHANGE	CHANGE %	2019	CHANGE	CHANGE %
	₦000	₦000	₦000		₦000	₦000		₦000	₦000	
Revenue	507,800	622,380	114,580	22.6	731,860	109,480	17.6	777,740	45,880	6.27
Factory costs	-196,320	-245,580	-49,260	25.1	-288,840	-43,260	17.6	-317,460	-28,620	9.91
Gross profit	311,480	376,800	65,320	21.0	443,020	66,220	17.6	460,280	17,260	3.90
Distribution expenses	-33,940	-43,060	-9,120	26.9	-52,780	-9,720	22.6	-62,140	-9,360	17.73
Selling espenses	-183,600	-223,700	-40,100	21.8	-263,400	-39,700	17.7	-282,120	-18,720	7.11
Administrative expenses	-68,180	-85,080	-16,900	24.8	-103,280	-18,200	21.4	-113,640	-10,360	10.03
Operating profit	25,760	24,960	-800	-3.1	23,560	-1,400	-5.6	2380	-21,180	-89.90
Finance expenses	1,380	-780	-2,160	-156.5	-340	440	-56.4	-620	-280	82.35
Net profit before tax expenses	27,140	24,180	-2,960	-10.9	23,220	-960	-4.0	1,760	-21,460	-92.42

Ratios analysis	2016	2017	2018	2019
Profitability:				
Gross margin	311,480/507800%	376,800/622,380%	443,020/731,860%	460,280/777,740%
	61.34%	60.54%	60.53%	59.18%
Operating margin	25,760/507800%	24,960/622,380%	23,560/731,860%	2,380/777,740%
	5.07%	4.01%	3.22%	0.31%
Net profit after tax margin	20,360/507,800%	18,140/622,380%	17,420/731,860%	1,320/777,740%
	4.01%	2.91%	2.38%	0.17%
Return on capital employed (ROCE)	25,760/127,480%	24,960/161,380%	23,560/202,680%	2,380/200,700%
	20.21%	15.47%	11.62%	1.19%
Return on equity	20,360/57,440%	18,140/75,580%	17,420/93,000%	1,320/94,320%
	35.45%	24.00%	18.73%	1.40%

Current ratio	60,260:70,040	56,560:85,800	62,860: 109,680	85,160: 106,380
	0.86 : 1.00	0.66 : 1.00	0.57 : 1.00	0.80 : 1.00
Acid test ratio	30,840:70,040	20,300:85,800	22,080: 109,680	38,300: 106,380
	0.44 : 1.00	0.24 : 1.00	0.20 : 1.00	0.36:1
Absolute liquid ratio	14,600: 70,040	0.00:85,800	240: 109,680	15,360: 106,380
	0.21 : 1.00	0.00 : 1.00	00.0 : 1.00	0.14 : 1.00
Debts to total assets	70,040/127,480%	85,800/161,380%	109,680/202,680	106,380/200,700%
	54.94%	53.17%	54.11%	53.00%
Revenue to total assets	507,800/127,480	622,380/161,380	731,860/202,680	777,740/200,700
	3.98times	3.86times	3.61times	3.88times
Nos of days in receivables	10,060/507,800 *365	13,040/622,380*365	14,080/731,860*365	14,840/777,740*365
	7.2days	7.6days	7.0days	7.0days
Nos of days in payables	51,120/108,440*365	65,900/135,720*365	88,300/163,560*365	82,380/179,540*365
	172.1days	177.2days	197.1days	167.5days
No of days in stock	29,420/196,320*365	36,260/245,580*365	40,780/288,840*365	46,860/317,460*354
	54.6days	53.9days	51.5days	53.9days
Return on Assets	25,760/127,480%	24,960/161,380%	23,560/202,680%	2,380/200,700%
	20.21%	15.47%	11.62%	1.19%
Return on Net Asset	27,140/57,440%	24,180/75,580%	23,220/93,000%	1,760/94,320%
	47.25%	31.99%	24.97%	1.87%

Appendix 2

Dotmak Nigeria Limited

Evaluation of Faith Group of Schools' special order

Calcultion of yearly profit from contract

	Black Shoes	Brown slippers	Total
	₦	₦	₦
Price per pair			
Cost	2,000.00	1,500.00	
Mark up - 30%	600.00	450.00	
Normal selling price per pair	2,600.00	1,950.00	
Quantity discount - 20%	520.00	390.00	
Selling price to Faith Group of Schools	2,080.00	1,560.00	
Order Quantities	20,000.00	5,000.00	
Sales value	**41,600,000.00**	**7,800,000.00**	**49,400,000**
Actual cost per pair	1,975.50	1,481.63	
Order quantities	20,000.00	5,000.00	
Total cost	39,510,000.00	7,408,150.00	46,918,150
Net contribution	**2,090,000.00**	**391,850.00**	**2,481,850**

Note: factory overhead has been treated as part of production costs since we have no information about its variability.

An alternative treatment is to treat factory overheads as fixed cost. If this is done, the net contribution will be:

	Black Shoes	Brown slippers	Total
	₦	₦	₦
Sales value, as above	**41,600,000.00**	**7,800,000.00**	**49,400,000**
Actual cost per pair	1,819.28	1,364.46	
Order quantities	20,000.00	5,000.00	
Total costs	36,385,600.00	6,822,300.00	43,207,900
Net contribution	**5,214,400.00**	**977,700.00**	**6,192,100**

Dotmak Nigeria Limited
Calculation of loss in contribution if FGS order is accepted and the company is currently working at full capacity.

	Shoes	slippers	Total
	₦	₦	₦
Normal selling price per pair	2,600	1,950	
20% discount	520.00	390.00	
Order quantities	20,000.00	5,000.00	
Contribution lost	**10,400,000.00**	**1,950,000.00**	**12,350,000**

Dotmak Nigeria Limited

Evaluation of the proposed Tito factory

Calculation of contribution per pair

	Contribution	**Probability**	**Expected contribution**
	₦		**₦**
	6,000	0.20	1,200
	5,000	0.30	1,500
	4,000	0.50	2,000
			4,700

	Year 1	Year 2 - Year 5
No of pairs per annum	20,000	30,000
Contribution per pair	4,700	4,700
Total contribution per annum	**94,000,000**	**141,000,000**

Calculation of net present value

	Year	**Cash flow**	**Disc factor**	**Present value**
		₦million		**₦million**
Project cost	0	-360	1	-360.00
Working capital	0	-40	1	-40.00
Contribution - year 1	1	94	0.8475	79.67
Contribution - year 2 - 5	Year 2 - Year 5	141	2.2797	321.44
Working capital	5	40	0.4371	17.48
NPV				

Performance and Prospect of Revenue Streams

ACTUALS

	2019	2018	2017	2016	2018-2019	2017-2018	2016-2017
Profitability:	N'000	N'000	N'000	N'000	Change%	Change%	Change%
Men's shoes	237,960	230,840	195,060	172,960	3.08	18.34	12.78
Women's and children's shoes	539,780	501,020	427,320	334,840	7.74	17.25	27.62

Examiner's Report

The Case Study is about a shoe-making company that decided to bring an international shoe company that once operated successfully in the country and became a household name, but eventually packed-up, back into the country. As a result, Dotmak Nigeria Limited, the company, proposed to install an ultra-modern shoe factory in Abuja for that purpose.

The company currently has a factory in Lagos that has also been operating successfully and has been producing shoes for the armed forces in Nigeria, men and women shoes and school children shoes.

The case scenario includes four years management accounts with appropriate notes, both in the pre-seen and the unseen. An appendix containing the cost structure of the company is also in the appendices in the pre-seen. In the unseen, we have details of the costs and revenue structure of the proposed factory, and details of contract from Faith Group of Schools that has placed a special order.
As usual, the Case Study has two requirements, as follows:

- A detail financial analysis of the four-year management accounts to reveal the trend in the company's performance, position and prospect together with a review of the performance of the company's two revenue streams – men and women shoes; and
- An evaluation of the contract from Faith Group of Schools showing the contribution from the contract and whether the contract should be accepted or not. And an evaluation of the proposed shoe factory using net present value and advise the board appropriately.

For candidates to perform well in the Case Study, the following appendices must be prepared:

i. Financial analysis which must include the following: trends analysis of the income statement; profitability ratios; efficiency ratios; liquidity ratios; and leverage ratios;
ii. Calculation of the performance and prospect of the two revenue streams (trend analysis);
iii. Calculation of net contribution from Faith Group of Schools contract – two alternatives may be used, first if factory overhead is treated as a fixed cost

and if factory cost is considered as part of the cost in the calculation. Both approaches are to be marked correct;

iv. Calculation of loss in contribution if the company is working at a full capacity and still goes ahead to accept Faith Group of School's contract; and

v. An investment appraisal of the proposed shoe factory.

Candidates' performance was very poor as only very few candidates scored up to 50%.

The commonest pitfalls of the candidates are:

- They did not calculate all the ratios required to explain the future prospect of the company under requirement 1;
- Some of the candidates discussed SWOT analysis under requirement 1. This was not part of the Case requirements;
- Most of the candidates did not calculate net present value to evaluate the proposed shoe project and the few that calculated the net present value forgot that the working capital introduced at the beginning of the project will be recoupled at the end of the project;
- Lack of understanding of how to write a formal report with appropriate headings and subheadings to address issues required in the Case Study requirements; and
- Inability to write a good executive summary.

Candidates are advised to practice and perfect the art of report writing and learn to address the specific requirements of each Case Study in future examination.