THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

MAY 2022 DIET
SKILLS LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Marking Guides

and

Examiners' 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

SKILLS LEVEL EXAMINATION – MAY 2022

FINANCIAL REPORTING

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

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN IN THIS QUESTIONS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Endtime PLC is a company based in Benin with the following trial balance for the year ended December 31, 2020:

	₦'Million	₦'Million
Depreciation: Plant and equipment 1/1/2020		13,875
Revenue		226,625
Administrative costs	26,200	
Plant held for sale	7,500	
Cost of sales	140,000	
Finance costs	5,500	
Multi-Users S&P and SAGE accounting software	5,700	
Inventory at 31/12/2020	10,000	
Distribution expenses	12,300	
Plant and equipment 1/1/2020	50,000	
Ordinary share capital of 50 kobo each		40,000
Allowances for doubtful debts		2,000
Investment property at valuation 1/1/2020	15,000	
Trade receivables/payables	10,000	3,000
Rental income from investment property		2,500
Bank balance		3,500
Land and buildings 1/1/2020	62,000	
15% preference shares of ₦1 each		13,000
Deferred taxation		4,200
Revaluation reserves on land and buildings		20,000
Retained earnings		16,500
Discounts	3,000	2,000
	347,200	347,200

Additional Information:

(i) Finance costs include full year dividends on preference shares and ordinary share dividends of 2½ kobo paid at the end of the year. Allowances for doubtful debts are no longer necessary as customers paid as at when due from time to time in the past 2 years.

(ii) Severely damaged inventories, which cost ₦790,000,000 were included in the inventories in the trial balance. This will need to be repaired at a cost of ₦440,000,000 before a knowledgeable buyer will be interested to pay ₦940,000,000 at arm's length transaction.

(iii) As at December 31, 2020, a valuer based in Victoria Island in Lagos was contacted by the company to review its land and buildings. The land and buildings was revalued upward by ₦13,000,000,000 and a certificate was issued to this effect. The board of directors approved the valuation but it has not yet been accounted for in the trial balance. The valuer advised that the remaining useful life of the asset is reasonably and reliably estimated to be 20 years. Depreciation is on straight-line basis.

(iv) Depreciation on plant and equipment is charged at 15% on reducing balance basis. The multi-users S&P and Sage was bought on September 30, 2020. The amortisation is at the rate of 12.5% annually. The amortisation is evenly distributed over the year. Besides, software installation, customisation and handling cost of ₦800,000,000, training costs of ₦900,000,000, consultancy fee of ₦600,000,000 and other general overheads of ₦850,000,000 on the new software were included in administrative expenses. All depreciations are treated as administrative costs.

(v) On December 30, 2020, a chartered surveyor valued investment property at ₦14,000,000,000 and the company uses fair value model in IAS 40 - Investment Property.

(vi) Current income tax has been estimated for the year ended December 31, 2020 at ₦9,000,000,000 and deferred tax provision as at December 31, 2020 is to be adjusted in the income statement to reflect the tax base of the company's net assets of ₦12,000,000,000 less than the carrying amounts. The current company income tax rate is 30%.

(vii) The plant held for sale is valued in the trial balance at its carrying amount. A broker is readily available to buy the plant for ₦6,000,000,000 at a fee of 6% of sales proceed. The sale would take place in January, 2021. Any necessary adjustment is to be treated as cost of sales.

You are required to prepare:

a. Statement of profit or loss and other comprehensive income for the year ended December 31, 2020. (13 Marks)

b. Statement of changes in equity for the year ended December 31, 2020. (4 Marks)

c. Statement of financial position as at December 31, 2020. (13 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

QUESTION 2

a. The aim of IAS 8- Accounting Policies, Changes in Accounting Estimates and Errors is to enhance compatibility of the entity's financial statements to previous periods and to the financial statements of other entities.

Required:
Explain the terms, "accounting polices and accounting estimates". (3 Marks)

b. In an in-house training for newly recruited trainee accountants in your organisation, a disagreement arose on the distinction between change in accounting policies and change in accounting estimates. Consequent upon the above the finance director requested you as the head of accounting department to make a presentation on the subject matter.

Required:
Write a memo addressed to the finance director distinguishing changes in accounting policies and changes in accounting estimates, highlighting also the accounting treatment of the changes in accounting estimates. (8 Marks)

c. An extract from the non-current assets register of Eze Nigeria Limited at July 1, 2019 were as follows:

	Freehold property	Office equipment	Computer software licence
	₦'000	**₦'000**	**₦'000**
Cost/valuation	995,000	525,000	1,100,000
Accumulated depreciation/ amortisation	(100,000)	(334,000)	(110,000)
Carrying amount	895,000	191,000	990,000

Other relevant information:

(i) The computer software licence was acquired from Microsoft Zap Incorporated, USA on July 1, 2018 and has 10 years lifespan. In June 2020, a review of the sales of the computer software showed a very big decline in patronage. As a result of the review, estimated recoverable amount of the licence as at June 30, 2020 was ₦333million. The license is amortised on a straight-line basis.

(ii) The freehold property consisted of land and buildings which were revalued few years ago for ₦395million attributable to the land and ₦600million to the buildings. On that date, the estimated remaining useful life of the buildings was 24 years. However, a second revaluation of the freehold property on July 1, 2019 attributed ₦410million to land, ₦560million to buildings and 20 years as the estimated remaining useful life for buildings.

(iii) On Jan 1, 2020 an item of office equipment was purchased for ₦128million and a further ₦22million was spent on commission and installation of the equipment. Annual depreciation is charged at the rate of 18½% on cost and is appropriately apportioned on time basis as situation demands. There were no disposals of non-current assets during the year to June 30, 2020.

Required:

Prepare with comparative figures, statement of financial position extracts of Eze Nigeria Limited as at June 30, 2020. Show relevant notes for PPE and intangible assets. (9 Marks)

(Total 20 Marks)

QUESTION 3

Daddy PLC is a first-tier entity quoted on the Nigeria Stock Exchange (NSE). The entity acquired 640 billion equity shares in Mummy PLC on January 1, 2020. The purchase consideration comprised the following:

(i) Issue of one ordinary share of Daddy PLC in exchange for every two shares in Mummy PLC.

(ii) Issue of ₦100 12% loan notes in Daddy PLC in exchange for every 400 shares in Mummy PLC; and

(iii) A cash payment of 15 kobo per share for every share acquired in Mummy PLC on January 1, 2020.

At the date of acquisition, the market price of Daddy PLC's shares was 75k each. The cost incurred by banks when a fixed rate loan is paid out early, is assumed to be nil. Also, Daddy PLC has recorded the 12% loan notes in the purchase consideration in the accounts. The statements of financial position of the two (2) companies as at December 31, 2020 are presented below:

Assets	Daddy PLC ₦'billion	Mummy PLC ₦'billion
Non-current assets:		
Property, plant and equipment (PPE)	650	350
Investments	160	0
Intangible assets	0	40
	810	390
Current assets:		
Inventories	100	25
Trade receivables	190	70
Bank	0	35
	290	130
Total assets	1,100	520
Equity and liabilities:		
Ordinary shares at 25 kobo each	350	200
Retained earnings 1/1/2020	220	120
Retained earnings 31/12/2020	100	50
	670	370
Non-current liabilities:		
12% Loan notes	160	40
Current liabilities:		
Trade payables	150	60
Other accrued expenses	40	20
Current taxation	50	30
Bank	30	0
	270	110
Total equity and liabilities	1,100	520

Additional information:

(i) As at the date of acquisition, the carrying amount of the net assets of Mummy PLC was equal to their fair value except for an item of property, which had a fair value of ₦50 billion in excess of its carrying amount with additional depreciation of ₦5 billion in the post-acquisition period to March 31, 2020. This has not been reflected in Mummy's PLC statement of financial position.

(ii) The intangible asset was a television programme designed to promote the business activities of Mummy PLC. However, as a result of new government legislation on security matters on banditry and criminalities, such television programmes have now been pronounced illegal in the country. The appropriate government security agency advised the company to immediately stop the television programme and ₦12 billion compensation is to be received from the Television Authority. As a result of the new legislation, the governing board of Daddy PLC was of the opinion that goodwill on consolidation has been severely impaired by ₦30 billion.

(iii) It is the group's policy to value non-controlling interest at full fair value. The fair value of non-controlling interests as at the date of acquisition was ₦100 billion.

(iv) Mummy PLC sold goods worth ₦20 billion to Daddy PLC during the post-acquisition period, ₦5billion of these goods were included in the inventory of Daddy PLC as at December 31, 2020. Mummy PLC made a profit of ₦8 billion on the sales.

(v) Mummy PLC trade payables of ₦9 billion did not agree with Daddy PLC's trade receivables as a result of cash in transit of ₦5 billion.

You are required to:
Prepare the consolidated statement of financial position as at December 31, 2020.
(Total 20 Marks)

QUESTION 4

a. The following financial statements were extracted from the 2021 annual report and accounts recently published by Odibeze Nigeria PLC.

Statement of profit or loss and other comprehensive income for the year ended April 30, 2021

	₦'000
Revenue	849,940
Cost of sales	(564,200)
Gross profit	285,740
Investment income	18,000
Operating expenses	(192,400)
Finance costs	(26,000)
Profit before taxation	85,340
Income tax expense	(28,340)
Profit for the year	57,000
Other comprehensive income:	
Gain on revaluation of property	15,000
Total comprehensive income	72,000

Statement of financial position as at April 30, 2021

	2021	2020
Non-current assets:	**₦'000**	**₦'000**
Freehold properties	350,000	385,000
Plant and machinery	220,000	242,000
Trade investments	120,000	88,000
Goodwill	-	38,500
Current assets:		
Inventories	325,700	265,000
Trade receivable	203,050	190,000
Cash and bank	64,000	10,200
	1,282,750	1,218,700
Equity and liabilities:	**₦'000**	**₦'000**
Ordinary shares of ₦1.20k each	120,000	72,000
Share premium	21,000	-
Revaluation reserves	15,000	5,000
Retained earnings	679,000	654,000
Non-current liabilities:		
8½% Redeemable preference shares	32,000	-
Current liabilities:		
Trade payables	260,500	350,200
Taxation	65,200	107,400
Bank overdraft	90,050	30,100
	1,282,750	1,218,700

Additional information

(i) During the financial year the company made a bonus issue of one share for every six shares held and a cash issue at ₦1.90kobo per share to provide funds for its anticipated expansion.

(ii) It is the company's policy to revalue its freehold properties annually with any resulting surplus transferred to revaluation reserves account. There was no disposal of freehold properties during the year.

(iii) A plant with a carrying amount of ₦20,000,000 was disposed on September 30, 2020 for ₦11,200,000 while the depreciation charge for the year on the remaining plant and machinery of ₦24,000,000 was included in the operating expenses.

(iv) The investment income represents interest received on the trade investment during the year. The trade investment suffered impairment loss of ₦10,000,000 by the year end.

(v) The company paid an interim dividend of ₦25,000,000 and proposed a final dividend of ₦45,000,000.

Required:

a. Prepare the statement of cash flows of Odibeze Nigeria PLC for the year ended April 30, 2021 in accordance with IAS 7, using indirect method. (17 Marks)

b. In the context of IAS-7 – Statement of Cashflows, explain the term cash and cash equivalent. List **THREE** examples. (3 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

QUESTION 5

IFRS 15 - Revenue from Contract with Customers, defines contract as an agreement between two or more parties that create enforceable rights and obligations.

Required:

a. Compare with an example, where necessary:
   i. Contract liabilities versus contract assets
   ii. Stand-alone-selling price versus transaction price (5 Marks)

b. Under IFRS 15, highlight **SIX** criteria to assess a contract (6 Marks)

c. Explain what is meant by contract modification and state **TWO** ways in which it can be accounted for. (4 Marks)

(Total 15 Marks)

QUESTION 6

a. The IASB Conceptual Framework for Financial Reporting gives much detail about the qualitative characteristics of financial statements which make them useful.

   Required:

   Discuss the qualitative characteristics, which make information useful to users of financial statements. (10 Marks)

b. The Financial Reporting Council of Nigeria (FRCoN) is a Federal Government parastatal under the supervision of the Federal Ministry of Industry, Trade and Investment.

Required:
Identify **FOUR** main objectives of FRCoN as defined in the Act establishing the Institution. (2 Marks)

c. The conceptual framework of IASB states that there are two concepts of capital maintenance.

Required:
Explain the term financial capital maintenance and physical capital maintenance concepts. (3 Marks)

(Total 15 Marks)

QUESTION 7

The Board of Directors of Owerri PLC is planning to acquire controlling interest in Warri Health PLC, a vaccine producing company to expand the profitability of the group. Both companies were quoted on the Nigerian Stock Exchange (NSE). The Chief Accountant of Owerri PLC has been given the industrial average and the financial statements of Owerri PLC and Warri Health PLC for the year ended December 31, 2020. This was done to enable the Chief Accountant compute the relevant ratios and to evaluate the inherent potentials of the acquisition of the controlling interest in the company. As the Senior Accountant of Owerri PLC, the Chief Accountant gave you the financial statements of the two companies from which you computed the following ratios.

Comparative ratios of Warri Health PLC and Owerri PLC with the industrial average

	Owerri PLC	Warri Health PLC	Industrial Average
Profitability:			
Gross profit margin	32.6%	38.5%	34%
Expenses margin	12.6%	5.0%	15%
Net profit after tax margin	18%	9%	20%
Liquidity:			
Current ratio	2:1	5:1	2:1
Quick ratio	1:1	3:1	1:1
Gearing/stability ratios:			
Debt equity ratio	15%	65%	25%
Interest cover	10 times	0.05 times	8 times
Investment ratio:			
Earnings per share (EPS)	30 kobo	12 kobo	10 kobo
Price earnings ratio	5.6 times	2.5 times	2.40 times

In addition to the above ratios computed and submitted to your boss, he has asked you to compute the cost of sales ratio and earnings yield (EY). The industrial average for both ratios are 60% and 12% respectively.

You are required to:

a. Compute the **TWO** additional ratios of the companies for the year ended December 31, 2020. (2 Marks)
b. Draft a technical report to the Chief Accountant of Owerri PLC to evaluate and advise on the desirability of the acquisition of controlling interest in Warri Health PLC. (13 Marks)

(Total Marks 15)

SECTION A

SOLUTION 1

Endtime PLC

a) Statement of profit or loss and other Comprehensive income for the year ended December 31, 2020

	Note	₦'Million
Revenue		226,625
Cost of sales	1	142,150
Gross profit		84,475
Other incomes	2	6,500
Administrative expenses	3	(34,541)
Distribution cost	4	(15,300)
Operating profit		41,134
Finance cost	5	(3,500)
Profit before taxation		37,634
Income tax expense	6	(8,400)
Profit for the year		29,234
Other comprehensive income:		
Gain on revaluation of land and buildings		13,000
Total comprehensive income		42,234

Endtime PLC

b) **Statement of changes in equity for the year ended December 31, 2020**

	Ordinary shares ₦'million	Revaluation reserve ₦'million	Retained earnings ₦'million	Total equity ₦'million
Balance b/f	40,000	20,000	16,500	76,500
Profit for the year			29,234	29,234
Gain on revaluation	-	13,000	-	13,000
Ordinary dividend	-	-	(2,000)	(2,000)
	40,000	33,000	43,734	116,734

c) **Endtime PLC**

Statement of financial position as at December 31, 2020

	Note	₦'million
Non-current assets:		
Property, plant and equipment	7 & 8	102,606
Investment property	9	14,000
Intangible assets:		
Multi-Users S&P and Sage Accounting Software	10	6,878
Total non-current assets		123,484
Current assets:		
Inventory	11	9,710
Trade receivables		10,000
Plant held for sales	12	5,640
Total current asset		25,350
Total assets		148,834
Equity and liabilities:		
Equity:		
Ordinary shares of ₦0.50 each		40,000
Revaluation reserves on land and buildings		33,000
Retained earnings		43,734
Equity		116,734
Non-current liabilities:		
15% preference shares		13,000
Deferred tax liabilities	13	3,600
		16,600
Current liabilities:		
Trade payables		3,000
Bank Overdraft		3,500
Current tax payables		9,000
Total current liabilities		15,500
Total equity and liabilities		148,834

Notes to the Accounts

Wk 1: Cost of sales	₦'million
Balance per trial balance	140,000
Closing inventory written down	290
Impairment of plant held for sales	1,860
Statement of profit or loss (SOPL)	142,150

Wk 2: Other income	₦'Million
Reversal of allowance for doubtful debt	2,000
Rental income from investment property	2,500
Discount received	2,000
SOPL	6,500

Wk 3: Administrative expenses	₦'million
Balance per trial balance	26,200
Customisation and handling cost	(800)
Consultancy fees	(600)
Depreciation on land & building (Wk 7)	3,100
Depreciation on plant & equipment (Wk 8)	5,419
Loss on revaluation of investment property	1,000
Amortisation of Multi-Users S&P and Sage	222
SOPL	34,541

Wk 4: Distribution cost	₦'Million
Balance per trial balance	12,300
Discount allowed	3,000
SOPL	15,300

Wk 5: Finance cost	₦'Million
Balance per trial balance	5,500
Less: Ord. div. (2.5k x 40,000/0.50)	(2,000)
SOPL	3,500

Wk 6: Income tax expense	₦'Million
Current year tax	9,000
Decrease in deferred tax (Wk 13)	(600)
SOPL	8,400

Wk 7: Land and buildings	₦'Million
Opening balance	62,000
Depreciation for the year (₦62,000/20years)	(3,100)
Carrying amount	58,900
Gain on revaluation	13,000
Revalued amount	71,900

Wk 8: Plant and equipment

	₦'Million
Cost b/f	50,000
Accumulated depreciation b/f	(13,875)
Carrying amount b/f	36,125
Depreciation for the year (15% x 36,125)	(5,419)
Revalued amount	30,706

Wk 9: Investment property

	₦'Million
Cost b/f	15,000
Revalued amount (SOFP)	(14,000)
Loss on revaluation (SOPL)	1,000

Wk 10: Multi-Users S&P and Sage Acc

	₦'Million
Purchase cost	5,700
Customisation and handling cost	800
Consultancy fees	600
Total cost	7,100
Amortisation (12.5% x 7,100 x 3/12)	(222)
Carrying amount (SOFP)	6,878

Wk 11: Closing inventory

	₦'Million	₦'Million
Balance b/f		10,000
Less Written down:		
Cost of damaged inventory	(790)	
Net realisable value:		
Expected selling price	940	
Further cost to enable sales	(440)	
		(290)
Revised closing inventory		9,710

Wk 12: Plant held for sale

	₦'Million
Carrying amount	7,500
Recoverable amount:	
Fair value	6,000
Cost to sales (6% x 6,000)	(360)
	5,640

The Plant held for sales should be recognised at ₦5,640 million (being the lower of the carrying amount and the recoverable amount) while the difference between them
₦7,500 million – ₦5,640 million (₦1,860 million) will be recognised in the SOPL.

Wk 13: Deferred taxation	**₦'Million**
Opening balance	4,200
Closing balance (12,000 x 30%)	3,600
Decrease in deferred tax	(600)

Examiner's report

The question tests candidates' knowledge of preparation of final accounts in accordance with the provisions of relevant accounting standards.

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

The common pitfalls of the candidates were their inability to determine the cost of software to be capitalised as well as the amount of property held for sale to be disclosed in the statement of financial position. Also, some candidates showed preference shares as part of equity instead of non-current liabilities.

Candidates are advised to pay more attention to the preparation of final accounts and the application of relevant accounting standards required for such preparations for better performance in future examination of the Institute.

Marking guide

		Marks	**Marks**
a)	Preparation of statement of profit or loss and other comprehensive income		
	- Title of the statement	½	
	- Determination of gross profit	2½	
	- Determination of profit before taxation	7	
	- Determination of profit for the year	2	
	- Determination of total comprehensive income	1	13
b)	Preparation of statement of changes in equity		
	- Title of the statement	¼	
	- Determination of ordinary share capital	¾	
	- Determination of revaluation reserve	1	
	- Determination of retained earnings	1	
	- Determination of total equity	1	4
c)	Preparation of statement of financial position		
	- Title of the statement	¼	
	- Determination of non-current assets	6	
	- Determination of current assets	4	
	- Determination of equity	1	
	- Determination of non-current liabilities	¾	
	- Determination of current liabilities	1	13
	Total		**30**

SOLUTION 2

(a) **Accounting policies** are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting its financial statements. These include any accounting methods, measurement systems and procedures for presenting disclosures. Accounting policies differ from accounting principles in that the principles are the accounting rules and the policies are a company's way of adhering to those rules. e.g. depreciation policies, inventory policies, etc.

Accounting estimates on the other hand are “approximation of the amount of a business transaction for which there are no precise means of measurement.” Estimates are used in accrual basis accounting to make the financial statements more complete, usually to anticipate events that have not yet occurred but are considered probable. These estimates may be subsequently revised as more information becomes available.

Accounting estimates arise from inherent uncertainties in business activities which mean that many items in financial statements cannot be measured with precision but can only be estimated. Estimates are formed using judgements based on the latest available and reliable information. Common examples of estimates in the financial statements include:

i. Allowances for bad debts;
ii. Allowances for inventory obsolescence;
iii. The fair value of financial assets or financial liabilities;
iv. The useful lives of, or the expected pattern of consumption of the future economic benefits embodied in depreciable assets; and
v. Warranty obligations.

b) **INTERNAL MEMORANDUM**

From: Head-Accounting Department Date: May 18th, 2022

To: Finance Director

Subject: **Presentation on distinction between changes in accounting policies and changes in accounting estimates**

Further to your request on the subject matter, this presentation aims at highlighting the distinguishing features between changes in accounting policies and changes in accounting estimates in accordance with IAS 8-Changes in Accounting Policies, Changes in Accounting Estimates and Errors.

Changes in accounting policies

i. An entity must apply consistent accounting policies in a period to deal with similar transactions, other events and circumstances so that they can identify trends in its financial performance or financial position.

ii. A change in accounting policies entails a deviation from the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting its financial statements. Frequent changes in accounting policies are therefore undesirable because they make comparisons with previous periods more difficult.

iii. A change in accounting policy can be established where there is a change in recognition, measurement or presentation criteria of transactions and other events in the financial statement. For example, an entity which previously used the cost model to measure investment properties but decided to use fair value model instead in the current accounting year, has changed its accounting policy. Changes in accounting policies most times require retrospective application.

Changes in accounting estimates

i. A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.

ii. A change in accounting estimate may be needed if changes occur in the circumstances on which the estimate was based, or if new information becomes available. Therefore, change in accounting estimates is not the result of discovering an error in the way an item has been accounted for in the past and it is not a correction of an error.

iii. Any change in the estimated useful life of a non-current asset would result in a change in the amount of annual depreciation charged on the asset and this is a change in accounting estimate.

Accounting treatment of changes in accounting estimates

i. A change in accounting estimate is accounted for prospectively not retrospectively. This means that the effect of the change is recognised in the current period and the future periods affected by the change. That is, it is recognised by including it:

ii. In statement of profit or loss for the period in which the change is made, if the change affects that period only, or

iii. In statement of profit or loss for the period of change and future periods, if the change affects both.

iv. To the extent that a change in estimate results in change in assets and liabilities, it should be recognised by adjusting the carrying amount of the affected assets or liabilities in the period of change.

Hope the above explanation would be found useful for the purpose required.

Thank you.

Signed
XYZ

(c) **Eze Nigeria Limited**

Comparative statement of financial position (extract) as at June 30,

Assets:	**Notes**	**2020**	**2019**
Non-current assets:		**₦'000**	**₦'000**
Property, plant and equipment	1	1,172,000	1,086,000
Intangible assets	2	333,000	990,000

Notes to the accounts

1. **Schedule of movement in PPE for the year ended June 30, 2020**

	FHP - land	FHP - building	Office equipment	Total
Cost:	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Balance as at July 1, 2019	395,000	600,000	525,000	1,520,000
Additions	-	-	150,000	150,000
Gain on revaluation	15,000	60,000	-	75,000
Balance as at June 30, 2020	410,000	660,000	675,000	1,745,000
Accm. depreciation:				
Balance as at July 1, 2019	-	100,000	334,000	434,000
Depreciation for the year	-	28,000	111,000	139,000
Balance as at June 30, 2020	-	128,000	445,000	573,000
Carrying amount:				
Balance as at June 30, 2020	410,000	532,000	230,000	1,172,000
Balance as at July 1, 2019	395,000	500,000	191,000	1,086,000

2. **Schedule of movement in intangible assets for the year ended June 30, 2020**

	Computer Software
Cost:	**₦'000**
Balance as at July 1, 2019	1,100,000
Additions	-
Balance as at June 30, 2020	1,100,000
Accm. amortisation and impairment:	
Balance as at July 1, 2019	110,000
Amortisation for the year	110,000
Impairment loss recognised	547,000
Balance as at June 30, 2020	767,000
Carrying amount:	
Balance as at June 30, 2020	333,000
Balance as at July 1, 2019	990,000

Examiner's report

The question tests candidates' knowledge of the provisions of IAS 8 - Accounting policies, changes in accounting estimate and errors. Candidates' are required to explain accounting policies and accounting estimates in part (a), differences between accounting policies and accounting estimates in part (b), while part (c) requires the preparation of schedule of movement of PPE and statement of financial position extracts.

Few candidates attempted the question and their performance was below average.

The common pitfalls were inability of the candidates to correctly explain and differentiate between accounting policies and accounting estimates, while others could not prepare the schedule of movement of PPE.

Candidates are advised to pay more attention to relevant provisions of international financial reporting standards that are relevant to skills level of the Institute of Chartered Accountants of Nigeria for better performance in future examinations.

Marking guide

		Marks	Marks
a)	Explanation of accounting policies and estimates		
	- Definition of accounting policies	½	
	- Correct explanation of accounting policies	½	
	- One (1) correct example of accounting policies	½	
	- Definition of accounting estimates	½	
	- Correct explanation of accounting estimates	½	
	- One (1) correct example of accounting estimates	½	3
b)	Memo on the difference between accounting policies and accounting estimates		
	- Memo format	½	
	- Introduction/preamble	½	
	- Two correct points on accounting policies at 1 mark each	2	
	- Two correct points on accounting estimates at 1 mark each	2	
	- Two correct points on accounting treatments for changes in accounting estimates at 1 mark each	2	
	- Concluding remarks	½	
	- Closing/signature	½	8
c)	Preparation of statement of financial position		
	- Presentation of extract of statement of financial position	¼	
	- Schedule of movement in PPE	$5^3/_4$	
	- Schedule of movement in intangibles	3	9
	Total		**20**

SOLUTION 3

Daddy PLC
Consolidated statement of financial position as at December 31, 2020

Non-current asset:	**Notes**	**₦'billion**
Property, plant and equipment (650+350+50-20)		1,030
Intangible (40-40)		-
Goodwill	3	196
Total non-current assets		1,226
Current asset:		
Inventories (100+25-2)		123
Trade receivables (190+70-14)		246
Bank (0+35+5)		40
Contingent assets		12
Total current assets		421
Total assets		1,647
Equity:		
Ordinary shares (350+80)		430
Share premium	8	160
Retained earnings	6	296
		886
Non-controlling interest (NCI)	5	94
Total equity		980
Non-current liabilities:		
12% Loan notes (160+40)		200
Current liabilities:		
Payables (150+60-9)		201
Other accrued expenses (40+20)		60
Current tax (50+30)		80
Bank (30+0+96)		126
Total current liabilities		467
Total liabilities		667
Total equity and liabilities		1,647

Working notes

Wk 1: Group structure

Daddy PLC ---------------80% (640/(200/0.25)--------------- Mummy PLC

NCI = 20%

Wk 2: Net asset of subsidiary	At reporting date ₦'billion	At acq. date ₦'billion	Post-acq. ₦'billion
Ordinary share	200	200	-
Retained earnings	170	120	50
Fair value adjustment:			
Property	50	50	-
Depreciation	(20)	-	(20)
Intangibles	(40)	-	(40)
Contingent assets	12	-	12
	372	370	2

Wk 3: Determination of goodwill on acquisition

	₦'billion	₦'billion
Fair value of consideration transfer:		
Share exchange (1/2 x 640 x 0.75)	240	
Loan note (640/400 x N100)	160	
Cash (0.15 x 640)	96	496
NCI at fair value		100
		596
Less: Net assets of subsidiary at acquisition		(370)
Goodwill at acquisition		226
Impairment		(30)
Goodwill at reporting		196

Wk 4: Unrealised profit (URP)	**₦'billion**
URP = 5 x 8/20 =	2.00
Dr - NCI (20% x 2)	0.40
Dr - Retained earnings (80% x 2)	1.60
Cr – Inventory	2.00

Wk 5: Valuation of NCI	**₦'billion**
NCI at acquisition (Wk 3)	100.0
Add: Share of post-acquisition profit (20% x 2)	0.4
Unrealised profit (20% x 2)	(0.4)
Impairment of goodwill (20% x 30)	(6.0)
	94.0

Wk 6: Consolidated retained earnings	**₦'billion**
Daddy PLC (220 + 100)	320
Add: Share of post-acquisition profit (80% x 2)	1.6
Unrealised profit (80% x 2)	(1.6)
Impairment of goodwill (80% x 30)	(24.0)
Consolidated retained earnings	296

Wk 7: Cash consideration	**₦'billion**
Dr - Cost of investment	96
Cr – Cash	96

Wk 8: Share exchange	**₦'billion**
Ordinary share (1/2 x 640 x 0.25)	80
Share premium (1/2 x 640 x 0.50)	160

Wk 9: Additional depreciation	**₦'billion**
₦5 x 4 quarters	20

Examiner's report

The question is on preparation of consolidated statement of financial position.

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

The pitfall of the candidates was their inability to correctly calculate the goodwill arising from consolidation and determination of consolidated retained earnings.

Candidates are advised to note that question on group accounts are regular features at this level of the Institute's examinations hence, they are advised to pay more attention to this area of the syllabus for better performance in future examinations.

Marking guide

	Marks
Preparation of consolidated statement of financial position	
- Title of the statement	¼
- Determination of group structure	½
- Determination of goodwill on acquisition	3
- Determination of non-current assets	2
- Determination of current assets	3
- Determination of equity	2
- Calculation of non-controlling interest	2¼
- Determination of non-current liabilities	½
- Determination of current liabilities	2
- Workings of unrealised profit	1
- Workings of subsidiary's net assets	1½
- Workings of consolidated retained earnings	1½
- Workings of additional depreciation	½
Total	**20**

SOLUTION 4

Odibeze Nigeria PLC
Statement of cashflows for the year ended April 30, 2021

	Notes	₦'000	₦'000
Cash flows from operating activities			
Profit before taxation			85,340
Adjustments:			
Depreciation charged on freehold	4	50,000	
Depreciation charged on plant and machinery	3	24,000	
Impairment loss		10,000	
Loss on sale of plant (₦20,000 – 11,200)		8,800	
Finance cost		26,000	
Goodwill written-off		38,500	
Interest received		(18.000)	139,300
Changes in operating assets/liabilities:			
Increase in inventories		(60,700)	
Increase in trade receivables		(13,050)	
Decrease in trade payables		(89,700)	(163,450)
Cash generated from operations			61,190
Tax paid	2		(70,540)
Interest paid			(26,000)
Net cash used in operations			(35,350)

Cash flows from investing activities:			
Payment for purchase of plant	3	(22,000)	
Proceed from sale of plant		11,200	
Interest received		18,000	
Payment for purchase of trade investment		(42,000)	
Net cash inflows from investing activities			(34,800)
Cash flows from financing activities:			
Proceed from issue of ordinary shares		57,000	
Proceed from issue of preference shares		32,000	
Dividend paid		(25,000)	
Net cash inflows from financing activities			64,000
Net decrease in cash and cash equivalents			(6,150)
Opening cash and cash equivalents			(19,900)
Closing cash and cash equivalents			26,050

Working notes

Wk 1: Cash and cash equivalents:

	Closing ₦'000	Opening ₦'000	Change ₦'000
Cash and bank	64,000	10,200	53,800
Bank overdraft	(90,050)	(30,100)	(59,950)
	(26,050)	(19,900)	(6,150)

Wk 2: Taxation

	₦'000
Balance b/f	107,400
Per profit or loss	28,340
	135,740
Less: Closing balance c/f	(65,200)
Cash/bank	70,540

Wk 3: Plant and machinery

	₦'000
Opening balance b/f	242,000
Disposal	(20,000)
Depreciation	(24,000)
	198,000
Closing balance c/f	220,000
Cash/bank	22,000

Wk 4: Freehold properties

	₦'000
Opening balance b/f	385,000
Revaluation surplus	15,000
	400,000
Closing balance c/f	(350,000)
Depreciation charged	50,000

Wk 5: Trade investment

	₦'000
Opening balance b/f	88,000
Impairment loss	(10,000)
	78,000
Closing balance c/f	120,000
Cash/bank	42,000

Wk 6: Proceed from issued shares at premium

Opening issued share capital ₦72,000,000

$$\text{Number of shares in issue } = \frac{₦72{,}000{,}000}{₦1.20}$$

= 60,000,000 Shares

$$\text{Bonus issue of 1 for 6 } = \frac{10{,}0000{,}000 \text{ shares}}{70{,}000{,}000 \text{ shares}}$$

Numbers shares in issue at April 30, 2021

$$= \frac{₦120{,}000{,}000}{₦1.20} = \text{ 1000,000,000 shares}$$

No of shares issued for cash (100,000,000 – 70,000,000) = 30,000,000 shares

Value of issue = 30,000,000 at ₦1.90
= ₦57,000,000

b) **Cash and cash equivalents**

Cash comprises cash on hand and demand deposits denominated in naira and foreign currencies. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Examples include cash in hand, cash at bank, bank overdraft, short-term investments like treasury bills and treasury certificates.

Examiner's report

The question tests candidates' knowledge of preparation of statement of cash flows using indirect method and explanation of cash and cash equivalents.

Most candidates attempted the question and performance was average.

The common pitfalls of the candidates were their inability to determine the number of bonus shares issued by the company and the number of shares paid for on cash basis.

Candidates are advised to pay more attention to IAS 7 – statement of cash flows for better performance in future examinations.

Marking guide

		Marks	Marks
a)	Presentation of statement of cash flows:		
	- Title of statement	¼	
	- Stating cash flows from operating activities	6½	
	- Stating cash flows from investing activities	4	
	- Stating cash flows from financing activities	3¼	
	- Stating cash and cash equivalents	3	17
b)	Cash and cash equivalents		
	- Correct explanation of cash and cash equivalents	1½	
	- Three (3) correct examples of cash and cash equivalents	1½	3
	Total		**20**

SOLUTION 5

(a) Differentiate between:

i) Contract liabilities versus contract assets

The contract liability is a supplier's obligation to transfer goods or services to a customer for which it has received consideration (an amount of consideration due) from the customer. This situation normally occurs where the contract require payment in advance or allow the supplier a right to an amount of consideration that is unconditional before it transfers good and service to the customer.

A contract asset on the other hand is a supplier's right to consideration in exchange for goods or services that it has transferred to a customer. A contract asset is reclassified as a receivable when the supplier’s right to consideration becomes unconditional. It usually occurs where a supplier transfer goods and services to a customer before the customer pays consideration or before payment is due.

ii) Stand-alone selling price versus transaction price

Stand-alone selling price is the price at which an entity would sell a promised goods and services separately to a customer. The stand-alone selling price which is determined at the inception of the contract is the basis upon which the transaction price will be allocated to each performance obligations in a contract. The objective of which is to depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

Transaction price on the other hand is the amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract, excluding any amounts collected on behalf of third parties (for example, sales taxe). An entity must consider the terms of the contract and its customary practices in determining the transaction price. The transaction price is adjusted if the entity (e.g. based on its customary business practices) has created a valid expectation that it will enforce its rights for only a portion of the contract price. The transaction price is affected by the nature, timing and amount of consideration promised by a customer.

(b) Criteria for assessing a contract under IFRS 15 are:

i. The parties to the contract have approved the contract;
ii. The parties to the contract are committed to perform the contract obligations;
iii. The entity can identify each party's rights regarding the goods or services to be transferred;
iv. The entity can identify the payment terms for the goods or services to be transferred;
v. The contract has commercial substance in terms of amount of future cash inflows;
vi. The contract has commercial substance in terms of risk assessment and timing of contract obligations; and
vii. It is probable that an entity will collect the consideration in terms of customer's ability and intention to pay.

(c)

(i) **Explanation of contract modification**

- A contract modification is a change in the scope of a contact that is approved by the parties to the contract.
- It exists when the parties to a contract approve a modification that creates new or changes existing enforceable rights and obligations of the parties to the contract.
- It could be approved in writing, by oral or implied by the customary business practices.

(ii) **Methods of accounting for contract modification**

- As a separate contract from the existing contract.
- As a termination of the existing contract.
- As part of the existing contract, that is, as cumulative catch-up adjustments.

Examiner's report

The question tests the candidates' knowledge of basic terminologies of contract and contract price under IFRS 15 - Revenue from contract with customers as well as criteria for assessing contract and way of accounting for contract modifications.

Few candidates attempted the question and performance was poor.

Majority of the candidates were able to state the criteria for assessing contract under IFRS 15, but they could not explain basic terminologies of contract/contract price under the accounting standard.

Candidates are advised to pay more attention to all sections of the syllabus and also all relevant international financial reporting standards at this level of the Institute's examinations.

Marking guide

		Marks	Marks
a)	Comparison IFRS 15 terms		
i)	Contract liabilities versus Contract assets:		
	- Correct definition and explanation	1½	
	- Two (2) correct examples at ½ mark each	1	
ii)	Stand-alone-selling price versus Transaction price		
	- Correct definition and explanation	1½	
	- Two (2) correct examples at ½ mark each	1	5
b)	Criteria for assessment of contract		
	- Stating six (6) correct criteria at 1 mark		6
c)	Contract modification		
	- Correct explanation of contract modification	2	
	- Correct explanation of accounting for contract modification	2	4
	Total		15

SOLUTION 6

a) **Fundamental qualitative characteristics**

i) **Relevance:** Information must be relevant to the decision-making needs of users. Information is relevant if it can be used for predictive and/or confirmatory purposes.

- It has **predictive value** if it helps users to predict what might happen in the future.
- It has **confirmatory value** if it helps users to confirm the assessments and predictions they have made in the past.

The relevance of information is affected by its materiality. Information is material if omitting it or misstating it could reasonably be expected to influence decisions of the users based on the financial statements.

- Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the items to which the information relates in the context of an individual entity's financial report.
- Therefore, it is not possible for the IASB to specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

ii) **Faithful representation:** Financial reports represent economic phenomena (economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims) by depicting them in words and numbers.

To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. A perfectly faithful representation would have three characteristics. It would be:

- Complete – the depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations;
- Neutral – the depiction is without bias in the selection or presentation of financial information; and
- Free from error – where there are no errors or omissions in the description of the phenomenon and the process used to produce the reported information has been selected and applied with no errors in the process.

Enhancing qualitative characteristics

(i) **Comparability:** Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among items. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Consistency is related to comparability, but it is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Consistency helps to achieve the goal of comparability.

(ii) **Verifiability:** This quality helps assure users that information faithfully represents the economic phenomena it purports to represent.

- Verifiability means that different knowledgeable and independent observers could reach consensus that a particular depiction is a faithful representation.
- Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

iii) **Timeliness:** This means having information available to decision-makers in time to be capable of influencing their decisions.

iv) **Understandability:** Information is made understandable by classifying, characterising and presenting it in a clear and concise manner. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently.

b) Main objectives of FRCoN as defined in the Act establishing the institution are:

   i) To protect investors and other stakeholder's interest;
   ii) To give guidance on issues relating to financial reporting and corporate governance to professional, institutional and regulatory bodies in Nigeria;
   iii) To ensure good corporate governance practices in the public and private sectors of the Nigerian economy;
   iv) To ensure accuracy and reliability of financial reports and corporate disclosures, pursuant to the various laws and regulations currently in existence in Nigeria;
   v) To harmonise activities of relevant professional and regulatory bodies as relating to corporate governance and financial reporting;
   vi) To promote the highest standards among auditors and other professionals engaged in the financial reporting process;
   vii) To enhance the credibility of financial reporting; and
   viii) To improve the quality of accountancy and audit services, actuarial, valuation and corporate governance standards.

c) The two concepts of capital maintenance are:

   i. **A financial concept of capital**

   The capital of an entity is measured as its net assets, which is also its equity.

   - Where a financial concept of capital is used, the main concern of users of the financial statements is with the maintenance of the nominal financial capital of the entity.
   - With financial concept of capital maintenance, a profit is not earned during a period unless (excluding new equity capital raised during the period and adding back any distribution of dividends to shareholders) the financial value of equity (net assets) at the end of the period exceeds the financial value of equity at the beginning of the period.

ii. **A physical concept of capital**

The capital of an entity is represented by its productive capacity or operating capability. Where a physical concept of capital is used, the main concern of users of the financial statements is with the maintenance of the operating capability of the entity.

- With a physical concept of capital maintenance, a profit is not earned during a period unless (excluding new equity capital raised during the period and adding back any distribution of dividends to shareholders) the operating capability of the business is greater at the end of the period than at the beginning of the period. Current value accounting reflects the concept of physical capital maintenance.
- In a period of inflation, profits reported using a financial concept of capital will normally be higher than profits reported using a physical concept of capital, such as current value accounting.
- Financial capital maintenance is likely to be the most relevant to investors as they are interested in maximising the return on their investment and therefore, its purchasing power while physical capital maintenance is likely to be most relevant to management and employees as they are interested in assessing an entity's ability to maintain its operating capacity.

Examiner's report

The question tests candidates' knowledge of IASB conceptual frame work of financial reporting in part (a), part (b) requires candidates to state the objective of Financial Reporting Council of Nigeria (FRCoN) and part (c) requires that candidates should explain the term financial capital maintenance and physical capital maintenance.

Most candidates attempted the question and performance was average.

Majority of the candidates were able to explain qualitative characteristics of financial statement. However, many of them could not explain the concepts of financial capital and physical capital maintenance.

Candidates are advised to cover all sections of the syllabus for better performance in future examinations.

Marking guide

		Marks	Marks
a)	Discussion of the qualitative characteristics:		
i)	Fundamental qualitative characteristics:		
	- Correct discussion of relevance	2	
	- Correct discussion of faithful representation	2	
ii)	Three (3) correct discussion of enhancing qualitative characteristics at 2 marks each	6	10
b)	Main objectives of financial reporting council of Nigeria:		
	- Stating four correct objectives at ½ mark each		2
c)	Concepts of capital maintenance		
	- Explanation of financial capital maintenance		
	- Three (3) points at ½ mark each	1½	
	- Explanation of physical capital maintenance		
	- Three (3) points at ½ mark each	1½	3
	Total		15

SOLUTION 7

(a) Computation of additional ratios for the year ended December 31, 2020			
	Owerri PLC	Warri Health PLC	Industrial Average
Cost of sale ratio = Cost of sales / Revenue	Revenue– gross profit margin / revenue = 100% - Gross profit margin = 100% - 32.6% = **67.40%**	Revenue – gross profit margin / revenue = 100% - Gross profit margin = 100% - 38.5% = **61.50%**	**60%**
Earnings yield = Earnings Per Share / Market Price Per Share	Reciprocal of P/E Ratio 1 x 100% / Price Earnings ratio 1 x 100% / 5.6 times = **17.86%**	Reciprocal of P/E Ratio 1 x 100% / Price Earnings ratio 1 x 100% / 2.5 times = **40%**	**12.00%**

(b) **INTERNAL MEMORANDUM**

TO: Chief Accountant

FROM: Senior Accountant

SUBJECT: Financial statements analysis and evaluation of potential acquisition of Warri Health PLC.

DATE: May 10, 2022

The above subject refers.

The Board of our company is in the planning phase of the potential acquisition of Owerri Health PLC, a quoted company like ours on the Nigeria Stock Exchange (NSE), but within the health industry. In aiding the board's decision on the acquisition of the target or not, there is a pivotal role the finance department is professionally required to perform, this includes evaluation of the performance of the target company comparing this with the industry average and with our performance.

First, to advise the Board on the suitability of the acquisition from the historical performance of the company's perspective, I have used financial statements analysis with the aid of financial ratios to carry out the performance measurement. The financial ratios used are in four categories: profitability, liquidity, gearing/stability and investment ratios. The outcome and findings on each category, regarding the target's performance are as stated in the subsequent paragraphs.

Profitability:
The target company's performance, based on gross margin is higher than both the industry average and ours. These show how well the company has been able to increase its revenue in relation to its cost of sales. Similarly, it was also able to control its operating expenses as the expense ratio is hugely lower than both the industry average and that of our company. Surprisingly, this does not translate to good performance or better net profit margin.

A further evaluation of other information and metrics revealed that the company is highly levered (as its gearing ratio is exceptionally excessive and may not able to have sufficient profit that would cover its future interest expenses, resulting in inadequate interest coverage). Also, the tax burden, if not well managed, may contribute to the poor performance of its net profit margin, thereby may not have harnessed a robust and effective tax planning and optimisation strategy.

Liquidity:
The liquidity position of the target is solid and placed the target company in a more advantageous position than its peers in the industry and our company. In terms of liquidity measures, the company is twice as that of the industry average and our company. Though this may look good on the surface, with its excessive leverage by way of borrowing, it may have obtained more borrowings than required for its sustainable capacity and operations as a sustainable business; thereby resulting in the short-term high-positive liquidity it found itself, and this may be at the expense of loss of value to the shareholders as it traded-off for its profitability because of avoidable finance costs that may have been avoided if it has put up sound and efficient working capital and long-term financial management creating a balance between short-term solvency and long-term stability of the business on a sustainable basis.

Gearing/stability:
There is a red flag on the target company's long-term borrowing trajectory. It does not match its capacity and profitability, thereby creating excessive leverage with a potential for future increases in the cost of financing debt and possible replacement. The capital and interest measures of leverage both pointed in the same direction which is a possible setback in its capacity structure and funding strategy.

Investors' returns:
The target company is expect to have very low earnings per share (EPS) because of its low equity mix to its total capital, thereby creating a colossal interest burden that subsumed its high gross and operating margins. The EPS of the target company is just about 40% of the EPS of our Company, though it is higher than industry average. This simply implies that it may not be doing badly in making
returns to investors based on the industry average but is unlikely to meet our Board's return expectation. We currently are more than twice the target's current performance. Similarly, the direction of the Price-Earnings ratio speaks to the value and premium the capital market is placing on the companies within the market based on market information and future expectations.

Secondly, based on the evaluation of the performance based on financial ratios, the company seems not to be doing badly, but if based on other factors, especially qualitative considerations, and the management found the target company is worth acquiring, the Board will have to revisit the under-listed issues.

(i) The capital mix (i.e., the ratio of equity-to-debt) of the target, and develop a robust financial strategy to identify and maintain an optimal capital mix that will reflect the operating capacity and guarantee the sustainability of the business of the target post-acquisition.
(ii) The tax strategy may need to be revisited, thereby developing a tax planning and tax optimisation framework(s) suitable for the target's business.

Recommendation:

The target company may be considered as a good buy based on the analysis of the financial statements as presented above and other essential factors. However, the Board will also have to ensure that observations raised, and probable strategies identified above are adopted on acquisition of the target company in order to achieve the synergy as expected by the Board to expand the company's profitability and growth.

Best regards

____

Senior Accountant

Examiner's report

The question tests candidates' knowledge of using ratios computed for interpretation and decision making purposes.

Most of the candidates attempted the question and performance was fair.

Candidates were able to calculate the cost of sales ratios but others cold not compute earnings yield which is simply the reciprocal of P/E ratios. Majority of the candidates could not write the technical report required for the evaluation and advise the board of directors of the company accordingly.

Candidates should note that interpretation rather than mere computations of ratios is required at this level of Institute's examinations for better performance, hence they should pay more attention to this area.

Marking guide

		Marks	Marks
a)	Computation of ratios		
i)	Computation of cost of sales ratios:		
	- Owerri PLC	½	
	- Warri Health PLC	½	
ii)	Computation of Earnings yield ratio:		
	- Owerri PLC	½	
	- Warri Health PLC	½	2
b)	Preparation of technical report:		
	- Presentation in memo format	1	
	- Introduction/preamble	1	
	- Evaluation of profitability	2	
	- Evaluation of liquidity	2	
	- Evaluation of gearing/stability	2	
	- Evaluation of investors return	2	
	- Correct recommendation	2	
	- Closing and signature	1	13
	Total		15

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2022

AUDIT AND ASSURANCE

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

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Quality Plastic Manufacturing Company Limited has been operating for about a decade. The company is into the production of plastic chairs, bowls, tables and other related products. It was awarded a contract to produce chairs for a pentecostal church that has branches across the 36 states of the country, including Abuja.

The church has its convention ground that occupies large hectares of land along Lagos-Abeokuta expressway. The number of chairs which are in millions would be produced and delivered to the headquarters of the church from where they would be distributed to all the branches and the convention ground. Given the fact that this contract would increase the fortune of the company, Ogbuefi Okafor, the Chairman of the company, saw the need for the company to grow bigger in the future and would require more funding to finance the expansion. He discussed this with his bank manager who advised him to approach a consultant that would prepare a feasibility study for him on the expansion.

Though he agreed with the bank manager, he however now feels that there is need to convert the accounting system of the company from manual to computer-based as a result of the level of expansion envisaged. As a first step before conversion to computer based system, the company set up an internal control system, including an internal audit department. The internal audit department is headed by a partly qualified accountant who has passed the skills level of ICAN Professional Examinations but has a very wide experience in internal audit. Your firm has been the auditors of the company for the past five years.

Required:

a. Explain the computer audit packages that can be used in the audit documentation process and the advantages of these audit packages. (10 Marks)

b. State the commonly used computer-assisted audit techniques (CAATs) and explain why they are essential in the audit process of a computer-based accounting system. (10 Marks)

c. Explain **TEN** threats to Information technology (IT) systems, which the auditor should be aware of. (10 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

There are **FIVE** fundamental principles of ICAN code of conduct for members which auditors must comply with while carrying out their duties as auditors.

Required:

a. Explain the requirements for application of ethics by ICAN members. (5 Marks)

b. Explain the fundamental principles of ICAN codes of ethics. (10 Marks)

c. Under what circumstances may an auditor be required to disclose information to a third party? (5 Marks)

(Total 20 Marks)

QUESTION 3

The objective of the auditor, according to ISA 300 - *Planning an audit of financial statements,* is to plan and perform an audit in an effective manner.

Required:

a. Explain the benefits of audit planning. (5 Marks)

b. Why is it important that audit firms should maintain the quality of their work? (5 Marks)

c. Explain the procedures a firm of auditors should establish internally to maintain the quality of its work. (10 Marks)

(Total 20 Marks)

QUESTION 4

Emerging technologies have potentials to affect or disrupt the auditing process.

Required:

a. State **FIVE** emerging technologies that have potentials to affect or disrupt the auditing process. (5 Marks)

b. Explain how these emerging technologies could affect the work of the statutory auditor. (15 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Garkuwa Nigeria Limited is a newly incorporated company that deals in building materials. The Managing Director is engaged on full time basis in the running of the business. Other employees are: the accounts officer who keeps the books, the cashier and two labourers.

The company does not maintain inventory records and inventory is a material item in the financial statements. The Managing Director wants you to advise him on inventory count procedures with a view to ensuring that the methods used at arriving at the inventory value will be satisfactory. The first financial statements of the company are to be made up for the 12 months to December 31, 2021.

Required:

a. Advise the Managing Director on how he should organise and carry out the physical inventory count. (9 Marks)

b. State the records and information he should retain in connection with the count. (3 Marks)

c. How should he arrive at the individual values for the various inventory items? (3 Marks)

(Total 15 Marks)

QUESTION 6

In the course of carrying out their assignments, the auditors are usually faced with threats created by a broad range of circumstances.

Required:

a. Explain **THREE** types of threats usually faced by auditors. (6 Marks)

b. Explain the circumstances that may give rise to the threats in (a) above. (6 Marks)

c. Highlight **THREE** major categories of safeguards which may mitigate or reduce threats to auditors. (3 Marks)

(Total 15 Marks)

QUESTION 7

Materiality is a fundamental concept in both auditing and accounting. It reflects the fact that the users of financial statements find it useful even if they are not 100% accurate.

Required:

a. What are the factors that an auditor will consider when assessing whether or not an item is material? (5 Marks)

b. State the principles an auditor will apply in the concept of materiality
   i. When planning and performing the audit (5 Marks)
   ii. When evaluating the effect of misstatements on the financial statements (5 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. Computer audit packages are types of audit software that are utilised in the auditing process especially in the audit documentation procedure. They make the preparation of audit documentation process more efficient.

Examples of the computer-audit packages are:

(i) Fast Path Assure;
(ii) Logic Gate Risk Cloud;
(iii) Netwrix Auditor;
(iv) Draftworx; and
(v) Caseware.

The uses to which the computer packages can be put include:

(i) Analysis schedules especially where the firm uses standardised documentation;
(ii) Lead schedules;
(iii) Audit plan;
(iv) Checklists;
(v) Summary of significant findings; and
(vi) Draft financial statements.

The audit documents will be automatically cross referenced and updated during the entire audit process.

The advantages of using computer audit packages include:

i. Neat documentation, easy to read and in a standard format;
ii. Reduction in the risk of avoidable errors in processing adjustments like update, amendment, corrections etc;
iii. Remotely carrying out audit review process without being necessarily done in the client's office or premises;
iv. Automatic processing of adjustments and data may result in significant time and financial saving on the audit assignment; and
v. Suitability for both large and small audit teams, due to easy management of access permissions.

b. Computer Assisted Audit Techniques (CAATs) are specialised techniques of obtaining audit evidence

i. **The commonly used CAATs are:**
Test data
The use of test data involves the auditor processing a sample of data through the client's information technology system and comparing the results achieved with predetermined test data.
Audit software

This is a computer program used by the auditor to extract needed information from a client's computer based accounting system, for audit purposes, they include:

- Interrogation program;
- Interactive software; and
- Embedded software.

ii. **CAATs are very essential in the audit process of computer-based information system for reasons that include:**

- CAATs are very necessary in the audit process because the IT system may not provide adequate audit trail;
- Processing being electronic, is not physically visible. It is necessary for the auditor to have access to inside the computer to check the completeness and accuracy of the processing of the data, CAATs enable the achievement of this objective;
- CAATs allow testing a larger number of transactions in relatively shorter time periods; and
- CAATs allow testing of effectiveness of controls programmed into the computer software.

c. **Information technology (IT) risks**

Generally speaking, risks are events or situations that have potentials for compromising the objectives of a business or a business entity. These risks are derived from internal or external environments and could be man-made or arising from nature's hazards. IT risk involves threats to IT system, including:

i. **Hackers**
These are people who illegally break into computer systems for various reasons which could include extortion of money or just for pride;

ii. **Insider fraud**
Staff could use the employer's computer systems to alter sensitive data for unlawful benefits;

iii. **Password theft**
This could be the target of a malicious hacker or disgruntled employee;

iv. **Denial of service attack**
This is an online attack that prevents the company's authorised users from having access to their websites or other IT resources;

v. **Hardware and software failures**
A computer hardware or software may fail as a result of targeted attacks, including loss of power and corrupted data. For example, a simple internet downtime could lead to loss of purchase orders;

vi. **Virus threat**
Viruses represent computer programs that when executed, can copy itself and spread from one computer to another which often disrupt computer operations;

vii. **Malware threat**
Malware is a malicious software designed to disrupt computer operations. An infected computer system could cripple the entire operations of an organization;

viii. **Spams and phishing attack**
This is an unsolicited email that seeks to fool unsuspecting people into revealing personal details or buying fraudulent goods and services online;

ix. **Natural disaster**
Natural disasters, such as flood and fire outbreak could lead to huge disruptions of computer operations;

x **Human error**
This is a major threat to most organisations. An employee might accidentally delete important data or fails to follow security procedures properly; and

xi. **Privacy violation**
Threats of exposure or illegal conveyance of corporate and private information relating to the enterprise and its employees in violation of principle of confidentiality.

Examiner's report

The question tests candidates' knowledge of computer audit packages, computer-assisted audit techniques (CAATs), and threats to information technology (IT) systems.

Being a compulsory question, about 100% of the candidates attempted it and performance was poor.

The commonest pitfall of the candidates was their inability to explain computer audit packages and threats to IT systems.
Candidates are advised to cover adequately this essential part of the syllabus which is a non-avoidable area in modern-day auditing.

Marking guide

		Marks	Marks
a.	**Explanation of computer packages**		
	Explanation of computer audit packages	1	
	Any one example	1	
	The uses of computer audit packages		
	(1 mark each subject to a maximum of 3 points)	3	
	Advantages of using computer audit package		
	(1 mark each, subject to a maximum of 5 points)	5	10
b.	**Commonly used CAATs**		
	For stating types of CAAT		
	(1 mark each, subject to the 2 points)	2	
	Explanation of the types of CAAT		
	(2 marks each for the 2 points)	4	
	Essentials of CAATs in the audit process		
	(1 mark each, for 4 points)	4	10
c.	**Threats to information technology (IT)**		
	For stating the threats		
	(½ mark each, subject to a maximum of 10 points)	5	
	Explanation of threats to information technology		
	(½ mark each, subject to a maximum of 10 points)	5	10
	Total		**30**

SECTION B

SOLUTION 2

a. All accountants who are members of a professional body, such as ICAN, are required to comply with the regulations of the professional body. Such professional regulations therefore apply to both external auditors, assurance providers and internal auditors. The reason for the wide reach of ethical guidelines is that the accountancy profession accepts that it has a responsibility to act in the public interest.

In providing a code of ethics, ICAN is complying with one of its regulatory functions, which is to ensure that statutory audits are performed only by fit and proper persons who act with professional integrity.

b. **The following are the five fundamental principles in ICAN code of ethics:**

Integrity: Members should be straightforward and honest in all professional and business relationships. Integrity implies not just honesty but also fair dealing and truthfulness;

i. **Objectivity:** Members should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgments;

ii. **Professional competence and due care:** Members have a duty to maintain their professional knowledge and skill at such a level that a client or employer receives a competent service, based on current developments in practice, legislation and techniques. Members should act diligently and in accordance with applicable technical and professional standards;

iii. **Confidentiality:** Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose such information to third parties without authority or unless there is a professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties, even after the cessation of the relationship; and

iv. **Professional behaviour:** members should comply with relevant laws and regulations and should avoid any action which discredits the profession. They should behave with courtesy and consideration towards all with whom they come into contact in a professional capacity.

c. An auditor may disclose a client's information to a third party when:

i. The client has authorised disclosure in writing;
ii. There is a professional duty to disclose;
iii. Disclosure is required by a court in a legal or judicial process;
iv. The disclosure is done in the public interest; and
v. There is a need to protect member's interests, that is, to defend himself as necessary.

Examiner's report

The question tests candidates' knowledge of the fundamental principles of ICAN code of ethics for members.

About 95% of the candidates attempted the question. The candidates showed good understanding of the requirements of the question and the performance was good.

The commonest pitfall of the candidates was their inability to explain the requirements for the application of ethics by members and circumstances whereby an auditor could be required to disclose information to a third party.

Candidates are advised to study well for future examinations and make good use of the Institute's publications.

Marking guide

a	**Requirements for application of ethics**	**Marks**	**Marks**
	(2½ marks each for the 2 points on the explanation of requirement for application of ethics by ICAN members)		5
b	**The fundamental principle of the ICAN code**		
	(1 mark each for the explanation of the fundamental principle (5 points)	5	
	(1 mark each for the explanation of the fundamental principle (5 points)	5	10
c	**Disclosure of information to a third party**		
	(1 mark each for the circumstance where the auditor is required to disclose to a third party - confidentiality exception rule (5 points)		5
	Total		**20**

SOLUTION 3

a. Benefits of audit planning include:

i. Helping the auditor to devote appropriate attention to important areas of the audit;
ii. Helping the auditor to identify and resolve potential problems;
iii. Helping the auditor to organise and manage the audit engagements so that it is performed in an effective and efficient manner;
iv. Assisting in the selection of staff with appropriate experience and the proper assignment of work to them; and
v. Allowing for the direction, supervision of staff and review of their work.

b. It is important that audit firms maintain the quality of their work so as to:

i. Give them reasonable assurance that the expression of audit opinion reflects observance of approved auditing standards, contractual or statutory requirements and professional standards;
ii. Promote observance of standards relevant to his work as described in statements published by accountancy bodies;
iii. Maintain audit quality which is essential to acceptance of the audit firms' services and reputation;
iv. Improve stakeholders' and investor's confidence in the audited financial statements; and
v. Avoid future litigations or assist future litigation process.

c. The nature and extent of a firm's quality control procedure will depend on the firm's size and nature of its practice, the number of offices and the way in which the firm is organised. Some of the main considerations in relation to such procedures, as recognised in the auditing guidelines on quality control are:

i. **Acceptance of appointment and re-appointment as auditors**: The auditor should ensure that in making a decision to accept an appointment or re-appointment as auditors, consideration is given to:

- The firm's own independence;
- The ability to provide an adequate service to the client; and
- The integrity of client's management;

ii. **Professional ethics:** There should be procedure within the firm to ensure that all partners and professional staff adhere to the principles of independence, objectivity, integrity and confidentiality as set out in the ethical statements issued by the accountancy bodies;

iii. **Skills and competence**: It is essential that the firm's partners and staff should have attained the skills and competence required to fulfil their responsibilities. This will involve procedures relating to recruitment, updating of technical skills, on-the-job training, and professional development;

iv. **Review of the firm's procedures**: The firm should monitor the effectiveness of its quality control procedures. This monitoring process should provide reasonable assurance that measures to maintain the professional standards of the firm are being properly and effectively carried out;

v. Review of audit process which might include occasional review of a sample of the firms audit files by independent reviewers from within or outside the firm;

vi. Identifying root cause of weaknesses discovered from the reviews and audit inspections; and

vii. Developing and implementing action plans to address those weaknesses, monitoring and revising these action plans to ensure that they are effective.

Examiner's report

This question tests candidates' knowledge on audit planning.

About 60% of the candidates attempted the question and the performance was average.

The major pitfall of the candidates was their inability to state the procedures for maintaining the quality of the work of the auditors.

Candidates should prepare well for future examinations making use of the Institute's Study Text and the Pathfinders.

Marking guide

		Marks
a	**Benefits of audit planning** (1 mark each for benefit of audit planning subject to a maximum of 5 points)	5
b	**Why audit firms should maintain quality of their work** (1 mark each for importance for maintenance of quality of work by audit firms subject to a maximum of 5 points)	5
c	**The procedures a firm of auditors should introduce internally to maintain the quality of their work** (2 marks each for each procedure subject to a maximum of 5 points)	10
	Total	**20**

SOLUTION 4

a. **Emerging technologies that have potentials to affect or disrupt the auditing process include:**

i. Cloud-based accounting system;
ii. Big data and analytics;
iii. Social media;
iv. Block chain technology;
v. Artificial intelligence and robotics;
vi. Machine learning;
vii. Smart spaces; and
viii. Modern Apps for predictive analysis.

With these digital technologies, it is estimated that some professions will disappear completely, some will experience growth and new areas of specialisation of professions that were never known will emerge. As a result, it is inevitable that these systems will affect the auditing profession.

b. **Some areas of audit and assurance that are likely to be affected by the emerging technologies are:**

i. Audit engagement planning which involves:

- Identifying the areas to be audited;
- Selecting members of the audit team;
- Assigning responsibilities to each audit staff;
- Allocating time for the audit; and
- Establishing the materiality threshold.

There are many aspects of these activities that could be automated and made more efficient with the use of technology. Most available off-the-shelf audit software have capabilities and in-built tools to enhance audit planning activities.

ii. **Audit risk assessment:** Modern audit software and advanced data analytic solutions can be used to conduct audit risk assessment – both qualitative and quantitative risk assessments. For instance, in conducting quantitative risk assessment all that is required is to upload the financial information of the client into the audit software and use existing functions to select and compute the relevant ratios, percentages and trend analysis for the auditor to interpret. In some cases, the results from the computations are given interpretation by the software and made available for the auditor to review and exercise human judgement.

iii. **Evaluation of internal controls:** After planning and risk assessment, the external auditor is expected to evaluate the operating effectiveness of internal controls which would most likely include computer controls. The only viable means to evaluate computer or IT controls is through the use of Computer Assisted Audit Tools. Many audit software are built with the capability to test IT controls to ascertain their level of adequacy and operating effectiveness.

iv. **Audit substantive testing:** Substantive testing involves the use of analytical procedures and test of details to confirm the completeness, accuracy and validity of financial statements amounts and disclosures. Ratios and trend analysis can easily be carried out by the auditor using a software. Also, automated audit solutions could be used to prepare and serve circularisation letters to obtain third party confirmations.

v. **Audit reporting:** Auditors have been using word processors and spreadsheets to compile their reports at the end of the audit exercise. Most modern audit software have embedded reporting modules that could be used by the auditor to put together all kinds of relevant reports to users. With the help of the reporting modules of these applications, the auditor could convert certain aspects of his findings into diagrams and pictures which are easier to understand by the client's executives.

Examiner's report

The question tests candidates' knowledge of the potential effects of emerging technologies on an auditing process.

About 30% of the candidates attempted the question and the performance was poor.

The commonest pitfall of the candidates was their inability to state the emerging technology and their effects on the work of an auditor.

Candidates should be advised to always update their knowledge on current developments in auditing and make use of the Institute's Study Text and publications.

Marking guide

		Marks	Marks
A	**Emerging technologies that could affect auditing process**		
	(1 mark each for emerging technology (maximum of 5 points)		5
B	**How the emerging technology will affect the work of the statutory auditors**		
	(1 mark each for stating audit and assurance areas)	5	
	(2 marks each for explaining the audit and assurance stated above subject to a maximum of 5 points)	10	15
	Total		**20**

SOLUTION 5

a. The Managing Director will be advised to:

i. Introduce the use of inventory records – inventory ledgers, kardex, inventory or bin cards as these records will be the basis of comparison and confirmation of correctness or otherwise of physical inventory quantity balances any time inventory count is conducted;

ii. Prepare inventory count sheets containing this list of all items of inventory normally held in the stores or warehouse. The inventory sheets should be serially numbered to ensure that control is exercised over the sheets before, during and after the inventory count;

iii. Prepare and distribute inventory count instructions to participants in the inventory count exercise. Also, have a briefing session with the participants to ensure understanding and compliance with inventory count procedures;

iv. Schedule actual inventory count period to be as close as possible to the end of the financial year, for example, December 31 year end. If there is inventory movement (in and out) between date of inventory count and December 31, a comprehensive list of such inventory movement should be made for necessary adjustments;

v. Ensure that prior to inventory count date, warehouse/store must be well laid out. All inventory items must be properly arranged and racks, bins and other containers should be clearly labeled to ease identification;

vi. Ensure that after counting of each item, relevant rack bins and other containers should be clearly marked to avoid double counting or omission;

vii. Ensure that where large quantities of small items are held, sampling procedures may have to be incorporated within the counting instructions;

viii. Note that it is important that the Managing Director takes full responsibility for supervision to ensure that inventory count procedures are strictly followed;

ix. Ensure that cut-off information is generated to take care of goods inwards and goods outwards;

x. Ensure that third party goods held in the warehouse must be separated from own inventory. This could arise from sales yet to be delivered to customers or recently purchased goods found to be defective but are to be returned to suppliers. Similarly, slow-moving, damaged, defective and obsolete goods must be separated and separately listed; and

xi. Send a copy of the inventory count instruction, to the company's auditors who should be invited for inventory count observation. The Managing Director should note that actual inventory count is not the responsibility of the auditors.

b. **The following documents should be retained to satisfy statutory requirements:**

i. All inventory count sheets both neat and rough copies;
ii. A note of inventory issued and used;
iii. Inventory summary schedules;
iv. Notes of adjustment relating to slow moving, defective, damaged or obsolete items;
v. Any useful information to assist in the checking of prices; and
vi. Summary of values of inventory count sheets.

c. **Valuation of Individual inventory items are carried out as follows:**

i. Each item of inventory should be valued for balance sheet/statement of financial position purposes at the lower of cost or net realisable value;
ii. Such determination of individual costs should be related to actual supplier invoice prices. The latest invoice prices should be used to value the components of the actual physical inventory balances where the first in first out method of inventory valuation is adopted;
iii. In all cases, company policy in relation to inventory valuation should consistently be adhered to. A common policy is as mentioned in (i) above, that inventories are valued at lower of cost or net realisable value; and
iv. The company should also consider the provisions of IAS 2.

Examiner's report

This question tests candidates' knowledge of how physical inventory counts are organised and carried out, records and information to be required with the inventory count, and how individual prices/values are arrived at for the inventory items.

About 60% of the candidates attempted the question. The understanding of the question was surprisingly poor, hence the performance was poor.

The major pitfall of the candidates was their inability to state the procedures for physical count but this was misconstrued as substantive procedures on inventory.

Candidates should understand the requirements of questions before answering them to enhance their performance in future examinations.

Marking guide

		Marks
a	**Advice to the Managing Director in carrying out of physical inventory count**	
	(1 mark each for each point maximum of 9 points)	9
b	**Records to be retained in connection with the inventory count**	
	(1 mark each for each record subject to maximum 3 points)	3
c	**Determination of values of individual inventory items**	
	(1 mark each for the procedure subject to maximum of 3 points)	3
	Total	**15**

SOLUTION 6

a. **Threats faced by auditors include:**

i. **Self-interest threat** - These are threats arising from auditors acting in their own interest, for example, if the auditor earns a large proportion of his revenue from a particular client, he might be unwilling to upset that client by issuing an unfavorable audit report. Also, If the auditor has direct or indirect interest in the proprietary capital;

ii. **Self-review threat** - This may occur when a previous judgement needs to be re-evaluated by the chartered accountant responsible for the judgement, for example, if the auditor performs accountancy work for a client in addition to the audit, he may find himself in a situation where he is reviewing his own work and may, therefore, not be as critical of it as he might be if he was reviewing someone else's work;

iii. **Advocacy threat** – This exists if the auditor is intimidated by management or its directors to the point that they are objectively promoting and supporting the client in a legal case, may lead to perceived loss of independence;

iv. **Familiarity threat** - The threat that may occur if an auditor has some kind of familiarity with the client which could alter his opinion about his financial statements, for example, acting for a client for a long period of time may mean that the auditor becomes less critical of that client's reporting practices; and

v. **Intimidation threat** - The threat that a member will promote a client's interest or position to the point that his or her objectivity or independence is compromised, for example, a strong Finance Director may intimidate junior members of the audit team and persuade them not to report errors found during their audit assignments.

b. Circumstances which may give rise to threats for members:

i. **Self-interest**

- Financial interests, loans and guarantees.
- Incentive-based fee arrangements.
- Concern over employment security.
- Commercial pressure from outside the employing organization.
- Inappropriate personal use of corporate assets.
- Close personal or business relationships.
- Holding a financial interest in a client or jointly holding a financial interest with a client.
- Undue dependence on fees income from a client.

ii. **Self-review**

- Business decision or data being reviewed by the same person who made those decisions or prepared the data.
- Being in the position to exert direct and significant influence over any entity's financial reports.
- The discovery of a significant error during re-evaluation of the work undertaken by the member.
- Reporting on the operation of financial systems after being involved in their design or implementation.
- A member of the assurance team being, or having recently been, employed by the client in a position to exert direct or significant influence over the subject matter of the engagement.
- Performing a service for a client that directly affects the subject matter of an assurance engagement.

iii. **Advocacy**

- Commenting publicly on future events.
- Situations whereby information is incomplete or where the argument being supported is against the law.
- Promoting shares in a listed company which is also an audit client.
- Acting as an advocate for an assurance client in litigation or dispute with third parties.

iii. **Familiarity**

- Where a member in a position to influence financial or non-financial reporting or business decisions has an immediate family member who could benefit from those decisions.
- Long association with business contacts influencing business decisions.
- Acceptance of gifts or preferential treatment, unless the value is clearly insignificant.
- Over familiarity with the management of the organization such that professional judgment could be compromised.
- A former partner of the firm being a director or officer of the client or an employee being in the position to exert direct or significant influence over the subject matter of the engagement.

v. **Intimidation**

- Threat of dismissal or replacement of the member, or a close family over a disagreement about the application of an accounting principle or the way in which information is to be reported.
- A dominant personality attempting to influence the members decisions.
- Being threatened with litigation.
- Being pressured to inappropriately reduce the amount of work performed in order to reduce fees.

c. **Safeguards which may remove or reduce threats to auditors fall into three categories, These are:**

i. Safeguards created by the profession, legislation or regulation;
ii. Safeguards in the work environment; and
iii. Safeguards created by the individual.

Examiner's report

This question tests the candidates' knowledge of threats auditors face in the course of their assignments.

About 95% of the candidates attempted the question and the performance was good.

The commonest pitfall was the candidates' inability to explain the circumstances that may give rise to the threats usually faced by auditors.

Candidates are advised to follow strictly the instructions of questions and prepare well for future examinations.

Marking guide

		Marks	Marks
a	**Types of threats faced by auditors**		
	(1 mark for each listed type of threats subject to a maximum of 3 points)	3	
	(1 mark each for explaining each type of threat stated subject to a maximum of 3 points)	3	6
b	**Circumstances that may give rise to threats to members**		
	(½ mark each for each circumstance subject to a maximum of 4 circumstances in a point and maximizing of 3 points)		6
c	**Major categories of safeguards which may mitigate or reduce threats**		
	(1 mark for each type of safeguard subject to a maximum of 3 points)		3
	Total		**15**

SOLUTION 7

a) The auditor's determination of materiality is a matter of professional judgement and is affected by the auditor's perception of the financial information needs of the users of financial statements. It is, therefore, reasonable for the auditor to assume that users:

(i) Have a reasonable knowledge of business and economic activities and are willing to study the information in the financial statements with reasonable diligence;

(ii) Understanding that financial statements are prepared, presented and audited to levels of materiality;

(iii) Recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgements and the consideration of future errors; and

(iv) Make reasonable economic decisions based on the information on the financial statements.

b)

(i) The principles an auditor will apply in the concept of materiality at the planning and performing stage of audit are as follows:

- In line with ISA 320 requirements, at the planning stage, the auditor must determine materiality for the financial statements as a whole. This is often referred to as the materiality level or materiality threshold. If lower thresholds are required for some areas these must also be set at this stage;

- The auditor must also set what ISA 320 refers to as performance materiality. Performance materiality recognises the fact that if all areas of the audit are carried out to detect all errors/omissions under the (overall) materiality level, that objective could be achieved, but when all the individual immaterial errors/omissions are added together, overall materiality could in fact be breached. Performance materiality is a way of taking this risk into account and will be set at a lower figure than overall materiality. There may be one or more performance materiality levels, as the level could vary by area;

- As the audit progresses, the auditor must revise materiality and, if appropriate, materiality for particular areas and performance materiality, if he becomes aware of information which could have caused him to have initially set different levels, had that information been known to him at the time; and

- Setting materiality levels are often based on 'quantitative' factors, and expressed as a percentage of revenue, profit or asset values, such as 1% of revenue or 5% of pre-tax profit.

ii) The principles an auditor will apply in the concept of materiality when evaluating the effect of misstatements on the financial statements include:

- Understanding the areas where risk of misstatements (error) appear to exist, and the nature of the risk;
- Deciding when an error should be considered material, and when it may be Ignored;
- Ascertaining what aspects of the audit will be the most difficult to plan because of the high risk of misstatement;
- Assessing inherent risks and control risks, and the identification of significant audit areas;
- Setting materiality levels;
- Ascertaining the possibility of material misstatements, including those arising because of fraud (rather than unintentional error); and
- Identifying complex accounting areas, particularly those involving accounting estimates.

Examiner's report

This question tests the candidates' knowledge of threats auditors face in the course of their assignments.

About 95% of the candidates attempted the question and the performance was good.

The commonest pitfall was the candidates' inability to explain the circumstances that may give rise to the threats usually faced by auditors.

Candidates are advised to follow strictly the instructions of questions and prepare well for future examinations.

Marking guide

			Marks	Marks
a	**Factors an auditor considers when assessing whether or not an item is material**			
	(2 marks for stating the main factor of judgment of the auditor in determining materiality of an item)		2	
	(1 mark each for other factors maximum of 3 points)		3	5
b	**The guidelines the auditor will apply in the concept of materiality**			
	(i)	(1 mark each for the guidelines the auditor will apply on materiality when planning and performing an audit subject to a maximum of 5 points)	5	
	(ii)	1 mark each for any principle the auditor will apply in the concept of materiality when evaluating the effect of misstatements on the financial statements	5	10
	Total			**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2022

PERFORMANCE MANAGEMENT

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

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

a. You are the Management Accountant of Dankoli Nigeria Limited which specialises in the production of 3 products: Product 1, Product 2 and Product 3.

The following information is available for the first quarter of 2021:

Particulars	**Product 1**	**Product 2**	**Product 3**
Sales units ('000)	225	376	190
	₦	₦	₦
Selling Price per unit	15.0	13.00	10.00
Variable costs per unit	7.80	6.00	5.00
Attributable fixed costs	275,000.00	337,000.00	296,000.00

General fixed overhead is apportioned on the basis of sales value. The budgeted general fixed overhead is ₦1,668,000.

Required:

i. Calculate the budgeted contribution and profit of the Products and Company. (5 Marks)

ii. Calculate the budgeted profits on the assumption that Product 3 is discontinued with no effect on sales of the other products. (5 Marks)

iii. Calculate the extra sales in units and value required to cover the additional cost of advertising of ₦80,000 if such cost is treated as general fixed overhead. (5 Marks)

b. The company is considering the viability of investing in a one-off order outside its normal budgeted routine operation. The Management Accountant is requested to appraise the procurement and sale of some useful medical equipment. The following cost estimate has been prepared by a junior accountant:

Particulars	Quantity used	Notes	₦
Direct material:			
Steel	40 sq. meters at ₦50 per sq/MM	1	2,000
Brass fittings		2	800
Direct labour:			
Skilled	100 hours at ₦80 per hour	3	8,000
Semi-skilled	40 hours at ₦50 per hour	4	2,000
Overhead	140 hours at ₦100 per hour	5	14,000
Estimating time		6	4,000
			30,800
Administrative overhead	This is 20% of production cost	7	6,160
			36,960
Profit at 25% of total cost		8	9,240
Selling Price			46,200

Explanation on the notes are:

(1) The steel is regularly used and has a current stock value of ₦50 per square meter. There are currently 400sq. meters in stock. The steel is readily available at a price of ₦55 per square meter.

(2) The brass fittings would have to be bought specifically for the job. A supplier has quoted ₦800 for the fittings required.

(3) The skilled labour is currently employed by the company and paid at the rate ₦80 per hour. If this job were undertaken, it will be necessary to either work 100 hours overtime which would be paid at time plus one half or reduce production of another product which earns a contribution of ₦130 per hour.

(4) The semi-skilled labour to complete the job currently has sufficiently been paid idle time to be able to complete this work.

(5) The overhead absorption rate includes power cost which is directly related to machine usage. If this job were undertaken, it is estimated that the machine time required would be 40 hours. The machine incurs power costs of ₦7.50 per hour. There are no other overhead costs which can be specifically identified with this job.

(6) The cost of the estimation time is that attributable to the 4 hours taken by the engineers to analyse the drawings and determine the cost estimate given above.

(7) It is the company's policy to add 20% to the production cost as an allowance against administrative costs associated with the jobs accepted.
(8) This is the standard profit added by the company as part of its pricing strategy.

Required:

i. Prepare on a relevant cost basis, the lowest cost estimate that could be used as the basis for a quotation. Explain briefly, your reasons for using each of the values in your estimates. (6 Marks)

ii. There may be a possibility of repeat orders from your company which would occupy part of normal production capacity. What factors need to be considered before quoting for this order? (4 Marks)

c. Explain the following concepts:

i. Incremental cost;
ii. Differential cost;
iii. Committed cost;
iv. Sunk cost; and
v. Opportunity cost.

(5 Marks)
(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

Mega Laboratories plc is a successful manufacturing company in the pharmaceutical industry. The company manufactures a number of household drugs. Since the advent of the Covid-2019 pandemic, its products have been in high demand. One of its newest products is known as ***vacineDcovid.*** In order to manufacture the product, a single raw material, **Zithromax** is used.

Budgets are to be prepared for the quarter ending 30 June 2021 and the following information is available for this purpose:

(i) At 31 March 2021 various balances were as follows:

Receivables	₦500,700
Creditors (suppliers of Zithromix)	₦153,000
Inventory of **vacineDcovid**	20,300 units
Inventory of Zithromix	200,000 kg

(ii) Extracts from the 'standard cost card' – ***vacineDcovid*** are as follows:

	₦/unit
Direct material Zithromax, 10kg at ₦5.00 per kg	₦50.00
Direct labour, 2 hours at ₦6.00 per hour	₦12.00

(iii) Suppliers of Zithromax give two months credit to the company, whereas customers take one month's credit.

(iv) Sales expectations for the quarter ending 30th June 2021 are as follows: 25,000 units of ***vacineDcovid*** at a selling price of ₦95.00 per unit.

(v) Assume that sales of ***vacineDcovid*** and purchases of Zithromix will be evenly spread over the three months to 30 June 2021.

(vi) Depreciation relating to plant and machinery is ₦55,000 for the quarter ending 30th June 2021.

(vii) 'Other expenses' are paid immediately in cash, and are estimated to be ₦200,000 for the quarter ending 30th June 2021.

(viii) The anticipated inventory levels at 30 June 2021 are as follows:

Inventory of ***vacineDcovid***	15,000 units
Inventory of Zithromix	150,500 kgs

(ix) Assume there is no work-in-progress and that stocks of ***vacineDcovid*** and Zithromix are valued at standard direct cost – see (ii) above.

Required:

For the quarter ending 30th June 2021 prepare:

a. A cash budget (amounts for each separate month are not required). (8 Marks)

b. Income Statement budget. (clearly state any assumptions you have made) (5 Marks)

c. Briefly state the benefits of a Cash Budget to Mega Laboratories plc. (3 Marks)

d. Sales are often considered to be a principal budget factor of an organisation.

Required:

Explain the meaning of a 'principal budget factor' and assuming that is sales, explain how sales may be forecast, making appropriate reference to the use of statistical techniques and the use of computers. (4 Marks)

(Total 20 Marks)

QUESTION 3

Uzochuks Nigeria Limited is a company established four years ago to produce medical equipment. The income statement and statement of financial position for 2019 and 2020 are as follows:

Income Statement

Particulars	2019	2020
	₦M	₦M
Sales	250	280
Operating costs	(180)	(200)
Operating Profit	70	80
Finance charges	(10)	(14)
Profit before tax	60	66
Tax at 25%	(15)	(18)
Profit after tax	45	48

Statement of Financial Position

Particulars	2019	2020
	₦M	₦M
Non- Current Asset	350	440
Current Asset	190	260
Total	540	700
Shareholders' fund	400	445
Long-term and medium term debts	100	100
Current Liabilities	40	155
Total	540	700

Other information are given as follows:

(3) Operating costs include the following:

Particulars	2019	2020
	₦'M	₦'M
Depreciation	25.0	28.0
Provision for doubtful debts	2.8	1.2
Research and development	5.0	-
Other non-cash items	4.0	3.0

(ii) Economic depreciation is assessed to be ₦50.5million in 2020. Economic depreciation includes any appropriate amortisation adjustments. In previous years, it can be assumed that economic and accounting depreciation were the same.

(iii) Tax is the cash paid in the current year (₦16 million) and an adjustment of ₦2 million for deferred tax provisions. There was no deferred tax balance prior to 2020.

(iv) The provision for doubtful debts was ₦2.5million on the 2020 statement of financial position.

(v) Research and development is not capitalised in the accounts. It relates to a new project that will be developed over five years and is expected to be of long-term benefit to the company. 2020 is the first year of this project.

(vi) The company had a non-capitalised leased assets of ₦18million in January 2020. These assets are not subjected to depreciation.

(vii) Cost of capital of Uzochuks:

Equity	18%
Debt (pre-tax)	6%

(viii) Capital structure of Uzochuks:

Equity	60%
Debt	40%

(ix) The company had the opportunity to invest in a solar project that will require the procurement of an equipment worth ₦3million in January 2020 and run for a period of 5 years with a salvage value of ₦0.50million, generating a stable net cash flow of ₦0.85 million. The applicable cost of capital is the associated weighted average cost of capital of the company.

Required:

a. i. Compute and evaluate the company's performance using average rate of return (ARR). (4 Marks)

ii. Compute and evaluate the Company's performance using economic value added (EVA) parameter. (9 Marks)

b. Calculate the net present value of the solar project for the life of the investment. (7 Marks)

(Total 20 Marks)

QUESTION 4

Large service organisations, such as banks and hospitals, used to be noted for their lack of management accounting techniques and their relatively unsophisticated budgeting and control systems compared with large manufacturing organisations. But this is changing and many large service organisations are now revising their use of management accounting techniques, especially as it relates to activity-based approach.

Required:

a. Explain which features of large-scale service organisations encourage the application of activity-based approaches to the analysis of cost information. (5 Marks)

b. Explain which features of service organisations may create problems for the application of activity-based costing. (5 Marks)

c. Explain the uses for activity-based cost information in service industries. (5 Marks)

d. Many large service organisations were at one time state-owned, but have been privatised. Examples in some countries include electricity supply and telecommunications. They are often regulated. Similar systems of regulation of prices by an independent authority exist in many countries, and are designed to act as a surrogate for market competition in industries where it is difficult to ensure a genuinely competitive market. Explain which aspects of cost information and systems in service organisations would particularly interest a regulator, and why these features would be of interest. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Abayomi Plc produces and sells two major products, A and B. The budgeted income statement for the year to December 31, 2022 is given below:

Products	A	B	Total
	₦'000	**₦'000**	**₦'000**
Sales	8,400	25,200	33,600
Production costs:			
Materials	2,240	5,040	7,280
Direct labour	1,120	3,360	4,480
Variable overheads	1,120	2,240	3,360
Fixed overheads	560	1,680	2,240
Total	5,040	12,320	17,360
Gross Profit	3,360	12,880	16,240
Fixed selling and Adm.			(8,320)
Net profit before tax			7,920

The budgeted selling prices of the products are:

A	₦120
B	₦180

Required:

a. Determine the breakeven sales in units for each of the products, using the budgeted data. (6 Marks)

Now assume that the following changes are made to the budget:

(i) Unit selling price of product B is reduced to ₦160

(ii) Direct material cost is expected to drop by 10% for product A and 20% product B.

(iii) Direct labour costs for each product will increase by 10%.

(iv) Additional ₦456,000 will be spent on advertising.

(v) 80% of total revenue will be derived from product B.

b. Calculate how much sales revenue must be made to earn an after tax rate of return of 12% of the revenue? Assume tax rate of 40%. (5 Marks)

c. Assuming all the facts in (b) (i) – (v) above but with the original budgeted revenue of ₦33,600,000. Compute the revised breakeven sales in units for each of the products. (4 Marks)

(Total 15 Marks)

QUESTION 6

Ezenwa Nigeria Limited is a company which produces a single product on an assembly line. The budget personnel has been availed with the following information which represents the extremes of high and low volumes of production which the company will achieve over a three month period.

	Production of 80,000 units	Production of 160,000 units
	₦	₦
Direct materials	3,200,000	6,400,000
Indirect materials	480,000	800,000
Direct labour	2,000,000	4,000,000
Power	720,000	960,000
Repairs	800,000	1,200,000
Supervision	800,000	1,440,000
Rent, insurance and rates	360,000	360,000

Additional Information:

Supervision is a "step function". To this end, one supervisor is employed for all production levels up to and including 100,000 units. For higher levels of production, an assistant supervisor whose remuneration is ₦640,000 will be added.

Required:

a. Prepare a set of flexible budgets for presentation to the Production Director to cover the following levels of production over a period of three months:

i. 80,000 Units
ii. 100,000 Units
iii. 120,000 Units
iv. 140,000 Units
v. 160,000 Units (9 Marks)

b. During the three months July to September 2021, 100,000 units were produced. Actual costs incurred during this period were as follows:

	₦
Direct materials	4,150,000
Indirect materials	580,000
Direct labour	2,700,000
Power	760,000
Repairs	885,000
Supervision	850,000
Rent, insurance and rates	320,000

Required:

i. Prepare a budget report for presentation to the Production Director displaying all relevant variances. (3 Marks)

ii. For each variance, suggest any further investigations which might be required and the necessary actions required to be taken by the Director. (3 Marks)

(Total 15 Marks)

QUESTION 7

Eko Limited is a small manufacturing company producing two high quality products called 'Kay' and 'Lay'. Both products use a raw material Tee (costing ₦30 per kg) in their manufacture. The Directors are reviewing the company's stock management policies for the forthcoming year as part of the annual budget preparation cycle.

Due to the product specification, quality is an important factor and a quality control inspection takes place immediately after the production cycle has ended. At this point, any inferior products are rejected and only good production becomes available for sale. In addition to these losses, a certain quantity of waste is unavoidable from material Tee due to the cutting process for both products.

The following forecast information has been extracted from departmental estimates for the year ending 31st December 2020 (the budget period).

	Product Kay	Product Lay
Sales (quality approved units)	23,000	10,000
Finished goods stock increase by year-end	275	185
Post-production rejection rate (%)	2	3
Material Tee usage (per completed unit, net of wastage)	2kg	3kg
Material Tee wastage (%)	5	10

Additional information:

- Usage of raw material Tee is expected to be at a constant rate over the period.
- Annual cost of holding one unit of raw material in stock is 17% of the material cost.
- The cost of placing orders is ₦30 per order.
- Eko Limited maintains a constant 1,000 kg of safety/buffer stock of material Tee regardless of the quantity ordered each time.

Required:

a. Prepare operational budgets for the year ending 31st December 2020 under the following headings: (Show your workings clearly)
   i. Production budget for Products Kay and Lay (in units). (5 Marks)
   ii. Purchases budget for Material Tee (in kgs and value). (5 Marks)

b, Calculate the Economic Order Quantity for Material Tee (in kgs). (5 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

Where Y = cumulative average time per unit to produce x units

a = the time taken for the first unit of output

x = the cumulative number of units produced

b = the index of learning (log LR/log2)

LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

$$b = \frac{\text{change in price}}{\text{change in quantity}}$$

a = price when Q = 0

$MR = a - 2bQ$

The linear regression equation of Y on X is given by:

$$Y = a + bX$$

where

$$b = \frac{n\sum XY - (\sum X)(\sum Y)}{n\sum X^2 - (\sum X)^2}$$

$$a = \frac{\sum y}{n} - \frac{b\sum x}{n}$$

Coefficient of determination (r^2)

$$r^2 = \frac{(n\sum XY - \sum x \sum Y1)^2}{(n\sum X^2 - (\sum X)^2\ (n\sum y^2 - (\sum X)^2}$$

The Miller-Orr Model

$$Spread = 3 \text{ x} \left(\frac{\frac{3}{4} \text{x Transaction Cost x Variance of Cash flows}}{\text{Interest rate (as a proportion)}} \right)^{\frac{1}{3}}$$

Annuity Table

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

Where r = discount rate

n = number of periods

Discount rate (r)

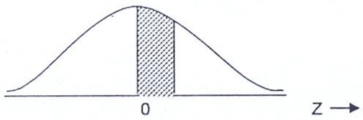
Periods

(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.



$Z=\frac{(x-\mu)}{\sigma}$	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) **Contribution and profit of product/company**

	Product 1	Product 2	Product 3	Company
Sales (₦)	3,375,000	4,888,000	1,900,000	10,163,000
VC	1,755,000	2,256,000	950,000	4,961,000
Contribution	1,620,000	2,632,000	950,000	5,202,000
Less Fixed Cost:				
Attributable	275,000	337,000	296,000	908,000
General	553,921	802,242	311,837	1,668,000
Total Fixed Cost	828,921	1,139,242	607,837	2,576,000
Net Profit	791,079	1,492,758	342,163	2,626,000

ii) **Budget profit if product 3 is discontinued with no effect on other products sales**

	Product 1	Product 2	Product 3	Company
Sales (₦)	3,375,000	4,888,000	-	8,263,000
VC	1,755,000	2,256,000	-	4,011,000
Contribution	1,620,000	2,632,000	-	4,252,000
Less Fixed Cost:				
Attributable	275,000	337,000	-	612,000
General	681,290	986,710	-	1,668,000
Total Fixed Cost	956,290	1,323,710	-	2,280,700
Net Profit	663,710	1,308,290	-	1,972,000

iii) **Extra sales to cover advertising cost of ₦80,000**

	1	2	3	Company
Old contribution	1,620,000	2,632,000	950,000	5,202,000
Additional Contr.	26,567	38,477	14,956	80,000
Total Contribution	1,646,567	2,670,477	964,956	5,282,000
Contribution/unit	7.20	7.00	5.00	
New units sold	228,690	381,497	192,991	
Old unit sold	225,000	376,000	190,000	
Extra units sold	3,690 units	5,497 units	2,991units	
Selling price (₦)	15	13	10	
Sale value (₦)	55,350	71,461	29,910	156,721

(b) i) **Computation of minimum selling price using a relevant costing approach**

Particular	Workings	Amount	Reasons
Direct material: Steel Brass Fittings	55 x ₦40	₦2,200 ₦800	Future cash flow Future cash flow
Direct labour: Skilled Semi-skilled	100 x 1,50 x ₦80	₦12,000 -	Incremental cash flow No incremental costs
Overhead	40 x ₦7.50	₦300	Only power cost is relevant
Estimating cost		-	Sunk cost
Administrative overhead		-	No incremental cost
Relevant cost of order		₦15,300	

ii) Factors that need to be considered in making this quotation

- Time period of repeated order, number (frequency of repeat order) and the demand
- Cash flow from alternative use of the capacity
- Existence of complaints
- Price to be quoted by competitors
- If there will be need for hiring special equipment
- The ability to deliver as at when required to the customer

c. i) **Incremental Cost**
Incremental cost is an additional cost that will occur if a particular decision is taken. Provided this additional cost will result in a cash flow, it is a relevant cost.

ii) **Differential Cost**
It is the amount by which future costs will be different depending on which cause of action is taken. It is thus an amount by which future cost will be higher or lower, if a particular course of action is chosen. It is a relevant cost if it involves additional cash flow.

iii) **Committed Cost**
It is a category of unavoidable costs. It is thus a cost that a company has already committed to or an obligation already made, that it cannot avoid by any means.

iv) **Sunk Cost**
A sunk cost is a cost that has already been committed by an earlier decision. They are not relevant cost in decision making.

v) **Opportunity Cost**
An opportunity cost is a benefit that will be lost by taking one course of action instead of the next most profitable course of action. It is not an actual cost in

the real sense of an amount paid out as an expense. It is a comparative cost resulting from making once choice over another.

Examiner's report

The question tests students' understanding of Marginal Cost for Decision Making. Majority of the students attempted the question being a compulsory question. The performance was average. The major pitfall was the inability of students to identify relevant cost and compute extra sales in units to cover additional cost of advertising.

Candidates are advised to read ICAN study text when preparing for the future examination of the Institute.

Marking guide

		Marks	Marks
a (i)	25 ticks at 1/5 mark	5	
(ii)	20 ticks at ¼ mark	5	
(iii)	20 ticks at ¼ mark	5	15
b (i)	8 ticks at ½ mark	4	
	Any 4 correct reasons at ½ mark	2	
(ii)	Any 4 ticks at 1 mark	4	10
c	5 points at 1 mark		5
	Total		**20**

SOLUTION 2

MEGA LABORATORIES PLC

(a) CASH BUDGET FOR QUARTER ENDING 30TH JUNE 2021

	₦
Cash inflow	
Collection from customers	2,084,033
Total cash inflow (A)	2,084,033
Cash Outflow	
Payment to suppliers	398,833
Other expenses	200,000
Labour cost	236,400
Total cash outflow (B)	835,233
Net cashflow (A-B)	1,248,800
Opening Cash balance	-
Closing cash balance	1,248,800

(b) Income statement for Quarter Ending 30 June 2021

		₦	₦
			2,375,000
Sales			
Cost of sales:			
Opening inventory	(20,300 x 62)	1,258,600	
Production	(19,700 x 62)	1,221,400	
		2,480,000	
Closing inventory (15,000 x 62)		(930,000)	(1,550,000)
Gross Profit			825,000
Other expenses		200,000	
Depreciation		55,000	(255,000)
Net profit			570,000

c. **Benefits of Cash Budget**

(i) It can help to regulate expenses.

(ii) It will clearly show a business has more cash than expected (surplus) or less cost than expected (deficit).

(iii) it is useful in liquidity management and planning.

d. Principal budget factor is the resource or activity which is limited and which forms the base for the preparation of the budgets.

Sales are often regarded as a major budget factor to be considered in preparing company budget since all company operation take bearing from what level of revenue that will be expended in the operation. Thus, this factor is known as the principal budget factor or limiting factor. In the majority of organisations, this factor is sales demand or revenue expectation although it can also be shortage of materials or inadequate plant capacity.

Examiner's report

The question examines candidates on Cash Budget. It was attempted by the majority of the candidates. The performance was average. The main pitfall was the inability to compute correct purchase cost of raw materials used.

Candidates are encouraged to read the Institute's text when preparing for the examination of the Institute.

Marking guide

		Marks	Marks
a	8 ticks at 1 mark		8
b	10 ticks at ½ mark		5
c	Any 2 points at ½ mark		3
			16
d	Definition	2	
	Explanation	2	4
	Total		**20**

SOLUTION 3

a. i. **Average Rate of Return (ARR)**

Average Profit = (2019 Profit before interest/tax + 2020 Profit before interest Tax)/2

Average Capital Employed = (Beginning Capital employed + Closing capital employed)/2

$$\text{ARR} = \frac{\text{Average profit before interest and tax}}{\text{Average capital employed}}$$

Net Profit	2019	2020
Profit	₦70 million	₦80million
Net capital employed	₦500 million	₦545million

$$\text{ARR} = \frac{(70 + 80)/2}{(500 + 545)/2} = \frac{75}{522.52} \times \frac{100}{1}$$

ARR = 14.354%

ii. Computation of Economic Value Added (EVA)

Computing 2020 Net operating Profit after tax (NOPAT)

				₦'million
		Profit after Tax		48.00
Add	(1)	Finance change (1- 0.25) x 14		10.50
	(2)	Non cash items	3.00	
	(3)	Deprecation	28.00	
	(4)	Provision for doubtful debts	1,20	
	(5)	Deferred Tax	2.00	
	(6)	Research/Development	-	34.20
				92.70
less	(1)	Economic depreciation	50.50	
	(2)	Research/development	1.00	51.50
		Adjusted NOPAT		41.20

Computation of opening Capital Employed for 2020:			**₦'million**
2019 capital employed			
(₦540million – ₦40million)			500.00
Add:			
1	Non-capitalised lease assets	-	18.00
2	Non cash item	-	3.00
3	Provision for doubtful debt	-	1.30
			522.30

Computation of Weighted average cost of capital (WACC)

= (0.18 x 0.60) + (0.06 x (1-0.25) x 0.4

= 10.80 + 1.80

= 12.60%

Computation of EVA

Adjusted NOPAT	=	41.20
Less capital charge = (0.126 x 522.30)	=	(65.81)
Negative EVA	=	(24.61)

b. The business is not creating adequate values for the owners

Net Present Value (NPV) of Investment

Year	Cashflow	Dcf@ 12.6%	PV
0	(3,000,000)	1.000	(3,000,000)
1	850,000	0.8881	754,885
2	850,000	0.7887	670,395
3	850,000	0.7000	595,000
4	850,000	0.6221	528,785
5	850,000	0.5525	469,625
6	500,000	0.5525	276,250

The project is profitable since the NPV is positive

Alternative Solution

Year	Cashflow ₦	Dcf@12.(	PV ₦
0	(3,000,000)	1.0000	(3,000,000)
1-5	850,000	3.5518	3,019,030
5	500,000	0.5525	276,250
			295,280

The project is profitable since the NPV is positive

Examiner's report

The question tests students' understanding of Performance Evaluation and Capital Budgeting. Few students attempted the question and the performance was poor. Majority that attempted the questions could not identify the variables to use to arrive at Net Operating Profit After Tax (NOPAT).

Candidates are advised to read the study text for future examination of the Institute.

Marking guide

			Marks	Marks
(a)	(i)	8 ticks at ½ mark	4	
	(ii)	27 ticks at 1/3 mark	9	13
(b)		14 ticks at ½ mark		7
		Total		20

SOLUTION 4

a) Large-scale service organisations have a number of features that have been identified as being necessary to derive significant benefits from the introduction of ABC:

i) They operate in a highly competitive environment;
ii) They incur a large proportion of indirect costs;
iii) Products and customers differ significantly in terms of consuming overhead resources;
iv) They market many different products and services.
v) Their activities are not based on volume such as direct labour hours;
vi) Their overhead costs are driven by specific activities

b) The following may create problems for the application of ABC:

i) Facility sustaining costs (such as property rents etc.) represent a significant proportion of total costs and may only be avoidable if the organisation ceases business. It may be impossible to establish appropriate cost drivers;
ii) It is often difficult to define products where they are of an intangible nature. Cost objects can therefore be difficult to specify;
iii) Many service organisations have not previously had a costing system and much of the information required to set up an ABC system will be non-existent.
Therefore introducing ABC is likely to be expensive;
iv) The choice of both activities and cost drivers might be inappropriate;
v) The benefits from ABC might not justify the costs. In some cases, it does not provide different information from traditional absorption costing.

c) The uses for ABC information for service industries are similar to those for manufacturing organisations:
   i) It leads to more accurate product costs as a basis for pricing decisions when cost-plus pricing methods are used;
   ii) It results in more accurate product and customer profitability analysis statements that provide a more appropriate basis for decision-making;
   iii) ABC attaches costs to activities and identifies the cost drivers that cause the costs. Thus ABC provides a better understanding of what causes costs and highlights ways of performing activities more effectively by reducing cost driver transactions. Costs are managed more effectively in the long term.
   iv) It enables resources and other related costs to be more accurately attributed to the services which they use.
   v) It provides understanding into the fastest growing and least visible element of cost-overhead.
   vi) It encourages continuous improvement and total quality control because control and planning are directed at the process level and it links the corporate strategy to operational decision making.
   vii) It eliminates waste by providing visibility of non-value added activities.

d) The following aspects would be of most interest to a regulator:
   i) The costing method used (e.g. marginal, traditional full cost or ABC). This is of particular importance to verify whether or not reasonable prices are being set and that the organisation is not taking advantage of its monopolistic situation. Costing information is also necessary to ascertain whether joint costs are fairly allocated so that cross-subsidisation from one service to another does not apply;
   ii) Consistency in costing methods from period to period so that changes in costing methods are not used to distort pricing and profitability analysis;
   iii) In many situations a regulator may be interested in the ROI of the different services in order to ensure that excessive returns are not being obtained. A regulator will therefore be interested in the methods and depreciation policy used to value assets and how the costs of assets that are common to several services (e.g. corporate headquarters) are allocated. The methods used will influence the ROI of the different services.

Examiner's report

The question examines candidates on the application of Activity Based Costing (ABC) in service organisations. Majority of the students attempted the question. The performance was above average.

Candidates are encouraged to read ICAN text when preparing for future examinations of the Institute.

Marking guide

		Marks	Marks
a	Any 5 points at 1mark	5	
b	Any 5 points at 1mark	5	
c	Any 5 points at 1mark	5	
d	Any 5 points at 1mark	5	
	Total		**20**

SOLUTION 5

a) When dealing with multi-products, the breakeven point in units is given by:

$$\text{BEP (Units)} = \frac{\text{FC}}{\text{WC}}\text{, where}$$

WC = Weighted Contribution per unit and FC = Total fixed costs

The WC is calculated using units sold and not sales revenue. The budgeted sales in units are:

			Units	Ratio
Product A:	₦8,400,000 ÷ ₦120	=	70,000	1
B:	₦25,200,000 ÷ ₦180	=	140,000	2
			210,000	3

This weighted contribution per unit is computed as follows:

	A	B
	₦	₦
Selling price	120	180
Less variable costs	64	76
Contribution per unit	56	104
Weight	1/3	2/3

$$\text{WC/unit} = \frac{56}{3} + \frac{104 \times 2}{3} = 88$$

Fixed costs:	₦	
Production overheads	2,240,000	
Selling and adm. overheads	8,320,000	
Total fixed costs (FC)	10,560,000	

$$\text{BEP (units)} = \frac{\text{FC}}{\text{WC}} = \frac{10{,}560{,}000}{88} = 120{,}000 \text{ units, made up of:}$$

Product A $1/3 \times 120{,}000 = 40{,}000$ units
B $2/3 \times 120{,}000 = 80{,}000$ units

Alternative Method

There are other methods of generating the above results.

For example, we can first compute the BEP in naira value as detailed below.

$$BEP\ (₦) = \frac{\text{FC}}{\text{WCMR}}$$

The weighted contribution margin ratio (WCMR = weighted contribution margin ratio) (WCMR) must be based on sales revenue as detailed below:

Product A 8,400/33,600 = 0.25
B 25,200/33,600 = 0.75

$$\text{WCMR} = \left(\frac{56}{120} \times 0.25\right) + \left(\frac{104}{180} \times 0.75\right) = 0.55$$

$$\text{BEP (₦)} = \frac{₦10{,}560{,}000}{0.55} = ₦19{,}200{,}000$$

This made up as follows:

Product	Weight	Sales (₦)	Price	Qty
A	0.25	4,800,000	₦120	40,000
B	0.75	14,400,000	₦180	80,000

b) We first determine the revised weighted contribution margin ratio (WCMR)

	A	B
Direct materials*	₦28.80	₦28.80
Direct labour	17.60	26.40
Variable overheads	16.00	16.00
Total variable costs per unit	62.40	71.20
Selling price	120.00	160.00
Contribution per unit	57.60	88.80
CMR	0.48	0.555

WCMR = (0.2 × 0.48) + (0.8 × 0.555)= 0.54

* The direct material cost per unit is computed as follows:

$$\text{Product A} \quad \frac{₦2{,}240{,}000}{70{,}000} \times 90\% = ₦28.80$$

$$\text{B} \quad \frac{₦5{,}040{,}000}{140{,}000} \times 80\% = ₦28.80$$

The revised fixed costs = ₦10,560,000 + 456,000 = ₦11,016,000

Profit after tax, as a percentage of revenue = 12% × (1 – 0.40) = 20%

Let ₦x = the required revenue.

Profit after tax = 20% of x = ₦0.20x

Using:

$$\text{Sales (₦)} = \frac{\text{Total fixed cost+ Profit}}{\text{WCMR}}, \text{or} \quad x = \frac{11{,}016{,}000+0.20x}{0.54}$$

0.54 x	=	11,016,000 + 0.20x
0.34x	=	11,016,000
x	=	₦32,400,000
Product A	=	20% of ₦32,400,000 = ₦6,480,000
B	=	80% of ₦32,400,000 = ₦25,920,000

c)

Total sales
₦33,600,000

Ratio of revenue	20%	80%
Value	₦6,720,000	₦26,880,000
Selling price	₦120	₦160
Quantity	56,000	168,000
Ratio based on units	0.25	0.75
Contribution per unit	₦57.60	₦88.80

WC/Unit = (₦57.60 × 0.25) + (₦88.80 × 0.75) = ₦81

$$\text{BEP (units)} = \frac{\text{FC}}{\text{WC}} = \frac{₦11{,}016{,}000}{₦81} = 136{,}000 \text{ units}$$

Product A: 0.25 × 136,000	=	34,000 units
B: 0.75 × 136,000	=	<u>102,000 units</u>
Total	=	<u>136,000 units</u>

Alternative Method

$$\text{BEP (₦)} = \frac{₦11,016,000}{0.54} = ₦20,400,000$$

	Product A	Product B
Ratio – Value weighted	20%	80%
Value	₦4,080,000	₦16,320,000
Selling price	₦120	₦160
Quantity	34,000	102,000

Examiner's report

The question tests the candidates' understanding of Cost-Volume-Profit-Analysis. Majority attempted the questions and the performance was below average.

The major pitfall was the inability to compute combined contribution margin.

Students are advised to read the Institute's text when preparing for the Institute's examination in future.

Marking guide

		Marks	Marks
a	18 ticks at 1/3 mark	6	
b	20 ticks at 1/4 mark	5	
c	8 ticks at 1/2 mark	4	
	Total		**15**

SOLUTION 6

Flexible Budget for 3 months

Particulars	80,000	100,000	120,000	140,000	160,000
	'000	'000	'000	'000	'000
Variable Costs:					
Direct materials	3,200	4,000	4,800	5,600	6,400
Indirect materials	320	400	480	560	640
Direct labour	2,000	2,500	3,000	3,500	4,000
Power	240	300	360	420	480
Repairs	400	500	600	700	800
Total (A)	6,160	7,700	9,240	10,780	12,320

Fixed Costs:

Indirect material	160	160	160	160	160
Power	480	480	480	480	480
Repairs	400	400	400	400	400
Supervision	800	800	1,440	1,400	1,440
Rent, rates & Insurance	360	360	360	360	360
Total fixed costs (B)	2,200	2,200	2,840	2,840	2,840
Production Cost (A+B)	8,360	9,900	12,080	13,620	15,160

Working

Particulars	**80,000**	**100,000**	**120,000**	**140,000**	**160,000**	**Cost analysis**
	₦'000	₦'000	₦'000	₦'000	₦'000	
Direct material	3,200	4,000	4,800	5,600	6,400	Variable cost
Indirect material	480				800	Semi-variable cost
Direct Labour	2,000	2,500	3,000	3,500	4,000	Variable cost
Power	720				960	Semi-variable cost
Repairs	800				1,200	Semi-variable cost
Supervision	800	800	1,440	1,440	1,440	Step cost
Rent/insurance/ rates	360	360	360	360	360	Fixed cost

Using High – Low method analysis of semi-variable costs:

Indirect Material Variable cost Per unit $= \dfrac{800{,}000 - 480{,}000}{160{,}000 - 80{,}000} = \dfrac{320{,}000}{80{,}000}$

= ₦4 per unit

Fixed Cost = (800,000 – 640,000) = ₦160,000

Power variable cost per unit $= \dfrac{₦960{,}000 - ₦720{,}000}{80{,}000} = \dfrac{240{,}000}{80{,}000}$ = ₦3

Fixed cost = 960,000 – (3 x 160,000) = ₦480,000

Supervision (variable cost) $= \dfrac{1{,}440{,}000 - 800{,}000}{80{,}000} = \dfrac{640{,}000}{80{,}000}$ = ₦8

Fixed cost = 1,440,000 – 8 (160,000)

1,440,000 – 1.280,000 = ₦160,000

Repair Variable cost $= \dfrac{1{,}200{,}000 - 800{,}000}{80{,}000} = \dfrac{400{,}000}{80{,}000}$ = ₦5

Fixed cost = ₦1,200,000 – 5 x (160,000) = ₦400,000

b. i. Budget report from July to Sept 2021 at 100,000 units showing variances:

S/N	Particulars	Variable Cost ₦'000	Fixed Cost ₦'000	Total Cost ₦'000	Actual Cost ₦'000	Variance ₦'000
1.	Direct material	4,000	-	4,000	4,150	150 A
2.	Indirect material	400	160	560	580	20 A
3.	Direct labour	2,500	-	2,500	2,700	200 A
4.	Power	300	480	780	760	20 F
5.	Repairs	500	400	900	885	15 F
6.	Supervision	-	800	800	850	50 A
7.	Rent, Insurance/Rates	-	360	360	320	40 F

Where A = Adverse variance and F = favourable variance

iii. Further investigations on the variances and measures/actions needed to be taken by director.

S/N	Variance	Variance amount	Investigations and measures to be taken on the variances
1	**Direct material cost variance**	**₦150,000A**	There exists a ₦150,000 adverse variance which could be as a result of price and usage of materials. High actual direct material price, wastage, poor quality of materials, and loss in production. Management is expected to conduct price and market survey, ensure high quality low priced materials are procured and used, handling of materials to reduce wastage to be improved.
2	**Indirect material cost variance**	**₦20,000 A**	There is ₦20,000 adverse variance for indirect material which could be as a result of price and usage of such materials, wastage, poor quality of such materials Management is expected to conduct price and market survey, ensure high quality low priced materials are procured and used, handling of such materials to reduce wastage.
3	**Direct Labour cost variance**	**₦200,000 A**	An adverse variance of ₦200,000 was observed. This could arise from direct labour rate and efficiency variances. The variance could be attributable to high labour rates, inefficient operations and excessive overtime.

			Management can control same through appropriate labour pricing, effective job evaluation and manpower planning.
4	**Power overhead cost variance**	**₦20,000F**	There is a favourable variance of ₦20,000 which could be due to decrease in power rates. There is a need for investigation to ensure appropriate and realistic figure is used for budgeting purposes in future.
5	**Repairs expenses cost variance**	**₦15,000F**	A favourable variance of ₦15,000 was noticed. It may mean that maintenance programme of equipment was not only adhered to but surpassed. A favourable variance of ₦15,000 means that there is a need for investigation to ensure appropriate figure (realistic figures) are used for budgeting purposes in future.
6	**Supervision cost variance**	**₦50,000A**	There is an adverse variance of ₦50,000 which could be due to increase in cost of supervision. There is need for investigation to ensure appropriate figure is used for budgeting purposes in future.
7	**Rent, insurance and Rates cost Variances**	**₦40,000F**	purposes in future. There is a favourable variance of ₦40,000 which could be due to decrease in rates. There is a need for investigation to ensure appropriate figure is used for budgeting.

Examiner's report

The question examines candidates on Flexible Budget. Majority of the students attempted the question. The performance is above average.
Candidates are advised to study the Institute's text for future Institute's examination.

Marking guide

		Marks	Marks
a	63 ticks at 1/7 mark		9
b (i)	Any 6 ticks at 1/2 mark	3	
(ii)	Any 6 ticks at ½ mark	3	6
	Total		**15**

SOLUTION 7

a. i) Production Budget

	Kay	Lay
Unit needed for sales	23,000	10,000
Units needed to increase closing stock	275	185
Total good units needed	23,275	10,185
Normal loss: 2/98 x 23,275	475	
3/97 x 10,185		315
	23,750	10,500

ii) Raw Material Purchase Budget

	23,750	10,500
Usage of Material Tee	2kg	3kg
Material Tee needed for production, net of wastage	47,500	31,500
Normal wastage: 5/95 x 47,500 =	2,500	
10/90 x31,500		3,500
Material purchase (gross)	50,000	35,000

Total raw material to be purchased is 85,000 kgs of material Tee at a price of ₦30 per kg gives a total purchasing budget of ₦2,550,000 for the period.

b. **Economic Order Quantity (EOQ)**

$$\text{EOQ} = \sqrt{\frac{2DK}{H}}\text{, where}$$

D = annual demand in units = 85,000 units
K = cost per order = ₦30
H= holding cost per unit per unit = ₦30 x 17% = ₦5.10

$$\text{EOQ} = \sqrt{\frac{2 \text{ x } 85{,}000 \text{ x ₦}30}{\text{₦}5.10}} = 1{,}000 \text{ units}$$

Examiner's report

The question tests candidates' understanding on preparation of Operational Budget. The major pitfall was the inability to adjust for wastages.

The performance was below average. Candidates are encouraged to read the study text of the Institute for future examination.

Marking guide

		Marks	Marks
a (i)	10 ticks at ½ mark	5	
(ii)	10 ticks at ½ mark	5	
			10
b	5 ticks at 1 mark		5
	Total		**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
SKILLS LEVEL EXAMINATION – MAY 2022

PUBLIC SECTOR ACCOUNTING & FINANCE

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

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

The ministry of finance of Ojaja Republic prepared the aggregate Medium-Term Expenditure-Framework (MTEF) budget for consideration by the National Assembly as contained in the country's Constitution. The following are the MTEF actual budget estimates and the approved budget estimates by various sectors have been thoroughly screened by the Budget Committees of the Senate and House of Representatives:

Ojaja Federal Republic
Summary of total budgeted expenditure by sector for 2020

Sector code	Sector name	Actual estimates 2020 ₦'m	Approved estimates 2020 ₦'m
01	**Administrative sector:**		
	Personnel cost	40,000	34,000
	Overhead cost	25,000	21,250
	Consolidated revenue charges	18,600	15,810
	Capital expenditure	62,400	53,040
	Sub-total	**146,000**	**124,100**
02	**Economic sector:**		
	Personnel cost	22,500	20,250
	Overhead cost	12,600	11,340
	Consolidated revenue charges	28,600	25,740
	Capital expenditure	41,300	37,170
	Sub total	**105,000**	**94,500**
03	**Law and justice sector:**		
	Personnel cost	15,800	15,800
	Overhead cost	20,200	20,200
	Consolidated revenue charges	17,500	17,500
	Capital expenditure	38,500	38,500
	Sub total	**92,000**	**92,000**

04	**Regional sector:**		
	Personnel cost	40,800	38,760
	Overhead cost	22,200	21,090
	Consolidated revenue charges	16,700	15,865
	Capital expenditure	32,300	30,685
	Sub total	**112,000**	**106,400**
	Summary of total expenditure by sectors:		
	Personnel cost	119,100	108,810
	Overhead cost	80,000	73,880
	Consolidated revenue charges	81,400	74,915
	Capital expenditure	174,500	159,395
	Total	**455,000**	**417,000**

Additional information

(i) Administrative sector - all costs at incremental basis of 15%, except for capital expenditure which will increase by 10%.

(ii) Economic sector - all costs at incremental basis of 25%, except for overhead cost which will decrease by 5%.

(iii) Law and justice sector - all costs at declining basis of 5%, except for personnel cost which will increase by 10%.

(iv) Regional sector - all cost at incremental basis of 10%, except for consolidated revenue charges which will decrease by 15%.

Required:

a. Prepare proposed budget estimates, for 2021, 2022 and 2023 based on the approved estimates for year 2020. **(20 Marks)**

b. Explain the following in relation to National Chart of Accounts (NCOA) structure for budgeting:

i. Functional segment (2 Marks)
ii. Programme segment (2 Marks)
iii. Geographical segment (2 Marks)

c. Enumerate **FOUR** steps require for budgeting with the National Chart of Accounts. (4 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

Transparency International is committed to advancing accountability, integrity and transparency. The mission is to stop corruption and promote transparency, accountability and integrity at all levels and across all sectors of society, while the vision is a world in which government, politics, business, civil society and the daily lives of people are free of corruption.

Required:

a. Discuss **FIVE** measures that are needed to ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption. (10 Marks)

b. Explain **TWO** ways by which procurement officers can detect bid rigging. (5 Marks)

c. Explain **FIVE** powers of the Code of Conduct Bureau. (5 Marks)

(Total 20 Marks)

QUESTION 3

Revenue generation is an important role carried out by some agencies of government with a view to meeting the expenditure of government, required for taking care of the welfare of the citizens. Revenue Mobilisation, Allocation and Fiscal Commission Act 1989 specifically mentioned some powers and functions of the Commission.

Required:

a. Identify **FOUR** powers and responsibilities of State Board of Internal Revenue Service in Nigeria. (4 Marks)

b. Explain **FOUR** specific functions of the Department of Petroleum Resources (DPR). (4 Marks)

c. Highlight **SIX** powers entrusted to the Revenue Mobilisation, Allocation and Fiscal Commission. (6 Marks)

d. Explain **THREE** sources of revenue payable to federation account in Nigeria. (6 Marks)

(Total 20 Marks)

QUESTION 4

a. The following information relates to Koki Event Center which is owned and managed by Ogbonge Local Government.

Koki Event Centre
Statement of financial position as at September 30, 2021 (Extract)

Assets	**2021**	**2020**
Current assets	**₦**	**₦**
Cash and cash equivalents	2,713,337	3,053,277
Investments	1,324,922	980,248
Current pledges receivables–(net)	2,056,445	1,349,314
Contribution receivables for rent	193,357	45,369
Contract receivables	252,784	99,030
Inventories	239,615	296,017
Trust deposits	86,007	46,725
Prepaid expenses	131,529	32,589
Total current assets	6,997,996	5,902,569
Non-current assets		
Long-term portion of receivables, less current portion		
Pledges receivables(net)	1,061,300	1,410,876
Contribution receivables for rent (net)	240,946	-
Furniture and equipment (net)	468,397	53,867
Endowment investments	3,444,637	3,683,988
Other investments	401,134	423,764
Total non-current assets	5,616,414	5,572,495
Liabilities		
Current liabilities		
Accounts payables	48,975	37,053
Accrued salaries and related costs	418,486	348,719
Total current liabilities	467,461	385,772
Non-current liabilities:		
Long-term debt	5,255,411	4,549,404
Long-term deferred tax liabilities	3,446,901	2,855,900

Required:

a. Compute the following relevant ratios for the event centre and comment on your results:
   i. Current ratio (3 Marks)
   ii. Acid test ratio (3 Marks)
   iii. Working capital/Total assets ratio (3 Marks)
   iv. Total debts/Total assets (3 Marks)
   v. Long-term debts/Total assets (3 Marks)

b. Highlight **THREE** ways by which analytical review can be conducted. (3 Marks)

c. Explain **TWO** ways the performance appraisal of a profit-oriented entity would differ from that of a public-oriented entity. (2 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Rescheduling is the rearrangement of payment terms of debt with respect to new maturities, grace period and readjustment of the interest rate. The essence is to facilitate convenience in debt repayment.

Required:

a. Identify and explain **TWO** main principles of debt rescheduling. (5 Marks)
b. Discuss **FIVE** forms of debt conversion. (10 Marks)

(Total 15 Marks)

QUESTION 6

Public expenditure is an important segment of the budgetary activities. It refers to the expenses incurred by government in the course of its activities.

Required:

a. Discuss **TWO** effects of public expenditure on the economy. (5 Marks)

b. Identify and explain **FIVE** principles of public expenditure. (10 Marks)

(Total 15 Marks)

QUESTION 7

Investment appraisal is a process of finding out the least possible costs of an investment and the maximum economic benefits, which may accrue from the commitment of resources.

Required:

a. Highlight **FOUR** reasons for divergence between private and public appraisal of project. (4 Marks)

b. How does cost-benefit analysis (CBA) differ from cost-effectiveness analysis (CEA)? (5 Marks)

c. Identify **THREE** procedures and **THREE** limitations of cost-effectiveness analysis. (6 Marks)

(Total 15 Marks)

SOLUTION 1

Ojaja Federal Republic
Preparation of proposed budgeted estimates for 2021 to 2023

Sector code	Sector name	2020 Actual estimates ₦'000	2020 Approved estimates ₦'000	2021 Proposed estimates ₦'000	2022 Proposed estimates ₦'000	2023 Proposed estimates ₦'000
01	**Administrative sector**					
	Personnel cost	40,000.00	34,000.00	39,100.00	44,965.00	51,709.75
	Overhead cost	25,000.00	21,250.00	24,437.50	28,103.13	32,318.60
	Consolidated revenue charges	18,600.00	15,810.00	18,181.50	20,908.73	24,045.04
	Capital expenditure	62,400.00	53,040.00	58,344.00	64,178.40	70,596.24
	Sub-total	**146,000.00**	**124,100.00**	**140,063.00**	**158,155.26**	**178,669.63**
02	**Economic sector**					
	Personnel cost	22,500.00	20,250.00	25,312.50	31,640.63	39,550.78
	Overhead cost	12,600.00	11,340.00	10,773.00	10,234.35	9,722.63
	Consolidated revenue charges	28,600.00	25,740.00	32,175.00	40,218.75	50,273.44
	Capital expenditure	41,300.00	37,170.00	46,462.50	58,078.13	72,597.66

	Sub total	**105,000.00**	**94,500.00**	**114,723.00**	**140,171.85**	**172,144.51**
03	**Law and justice sector**					
	Personnel cost	15,800.00	15,800.00	17,380.00	19,118.00	21,029.80
	Overhead cost	20,200.00	20,200.00	19,190.00	18,230.50	17,318.98
	Consolidated revenue charges	17,500.00	17,500.00	16,625.00	15,793.75	15,004.63
	Capital expenditure	38,500.00	38,500.00	36,575.00	34,746.25	33,008.94
	Sub total	**92,000.00**	**92,000.00**	**89,770.00**	**87,888.00**	**86,362.34**
04	**Sub total**					
	Personnel cost	40,800.00	38,760.00	42,636.00	46,899.60	51,589.56
	Overhead cost	22,200.00	21,090.00	23,199.00	25,518.90	28,070.79
	Consolidated revenue charges	16,700.00	15,865.00	13,485.25	11,462.46	9,743.09
	Capital expenditure	32,300.00	30,685.00	33,753.50	37,128.85	40,841.74
	Sub total	**112,000.00**	**106,400.00**	**113,073.75**	**121,009.81**	**130,245.18**
	Summary of total expenditure by sectors					
	Personnel cost	119,100.00	108,810.00	124,428.50	142,623.23	163,879.89
	Overhead cost	80,000.00	73,880.00	77,599.50	82,086.88	87,431.00
	Consolidated revenue charges	81,400.00	74,915.00	80,466.75	88,383.69	99,066.20
	Capital expenditure	174,500.00	159,395.00	175,135.00	194,131.63	217,044.57
	Total	**455,000.00**	**417,000.00**	**457,629.75**	**507,225.42**	**567,421.66**

(b) **Explanation of National Chart of Accounts (NCOA) in relation to budget structure**

i. **Functional segment:** The functional classification or classification by functions of government is a detailed classification of the functions or a socio-economic objective, that government unit aims to achieve through various outlays. It therefore, organises government activities according to their broad objectives or purposes.

ii. **Programme segment:** The programme classification identifies various set of activities to meet specific policy objectives of the government e.g. Pre-primary education, poverty alleviation and food security.

iii. **Geographical segment:** The geographical classification is used to identify the geographical location of an entity (MDAs)or a project so that an analysis of government budget along various zones, states and local government areas in the country can be done.

(c) **Steps required for budgeting with the National Chart of Accounts**

i. Identify the government institutions (cost and revenue centres) from the hierarchy of administrative list and codes provided in the chart of accounts.
ii. Identify the economic items that would be executed during the fiscal year.
iii. Identify the functions intended to be performed by government institutions (revenue and cost centres).
iv. Identify the programmes intended to be carried out by the government institutions.
v. Determine the sources of financing the budgeted amount for each budget line.
vi. Identify the planned location for the economic transactions or government institutions.

Examiner's report

The question tests candidates' knowledge on the preparation of budget estimates using Medium-Term Expenditure Framework (MTEF) as well as IPSAS 24 in part (a) of the question, while parts (b) and (c) test candidates' knowledge on the explanation of functional, programme and geographical segments in relation to structure of National Chart of Account (NCOA) for budgeting purposes.

All the candidates attempted the question and their performance was average.

The commonest pitfalls were the inability of the candidates to explain the functional, programme and geographical segments in relation to structure National Chart of Account (NCOA) for budgeting purposes. Also candidates were unable to incorporate the additional information given in the notes to the question in the preparation of budget estimates using Medium-Term Expenditure Framework (MTEF).

Candidates are advised to pay more attention to the relevant provisions ofbudget estimates using Medium-Term Expenditure Framework (MTEF) and also to make use of Pathfinder and Study Text for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a	**Preparation of proposed budget estimates**		
	Title	½	
	Calculation of total:		
	Administrative sector budget estimates	3¾	
	Economic sector budget estimates	3¾	
	Law and justice sector budget estimates	3¾	
	Regional sector budget estimates	3¾	
	Summary of expenditure budget estimates by sectors	4½	20
b.	**Explanation of National Chart of Accounts (NCOA) in relation to budget structure**		
	Explanation of the segments identified		6
c	Steps required for budgeting with the National Chart of Accounts		4
	Total		30

SOLUTION 2

(a) The following measures that are needed to ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption are as follows:

i. **The existence of bodies that include within their competence the fight against corruption.**

The bodies must have the necessary independence and autonomy to perform their functions, subject to checks and balances to prevent abuse, and sufficient human and financial resources to effectively apply and enforce laws and regulations on anti-corruption.

Where more than one body is involved in the fight against corruption, procedures should exist for information sharing and cooperation. Inter-agency communication is vital. Examples are the Economic and Financial Commission (EFCC) and Nigeria Financial Intelligence Unit(NFIU).

ii. **The establishment of codes of conducts for public officials and subsequent dissemination and related training.**

These codes of conduct should be clear and transparent and be combined with strict sanctions against public officials involved in corruption.

Public sector managers should likewise receive clear guidance and training on the manner in which allegations of corruption should be dealt with, including referral mechanisms to law enforcement authorities, procedures for the protection of informants and the means of dealing with an official against whom allegations have been made.

Codes of conduct might take the form of government-wide documents or involve a series of subject-specific codes. In either case, the content of these codes should take into account areas of public service which are particularly at risk of receiving or soliciting bribes or of resorting to extortion, including law enforcement, public procurement, export credit, development assistance, and customs and tax administration. Examples are the Code of Conduct Bureau(CCB) and the Public Service Rules.

iii. **The reporting by domestic officials to superiors, prosecutors or other public authorities**

- Where officials have been promised, offered or given a bribe, there should be smooth and unhindered reporting process.
- Officials should know, for example, how to report on such occurrences and how this will be dealt with.
- Where the bribe involves another official, sufficient safeguard should be put in place (such as whistleblowing and witness protection programmes) to ensure that reporting is not discouraged by the prospect of the reporting person being penalised in some way.
- Procedures must be put in place that will enable officials and public employees to provide anonymous information to those responsible for investigating corruption and integrity matters. Steps to treat communications as confidential need to take into account the rights of the accused person, and the possibility that disclosure of the information might be necessary to conduct an investigation and/or prosecution.
- Indicators of the success of these mechanisms and of codes of conduct and public sector training can include instances of such reporting by domestic officials.

iv. **Reporting of promises, offers and bribes by competitors, employees or other private individuals, including the media, should also be facilitated.**

- Procedures might include, for example, both formal mechanisms for reporting and anonymous hot lines.
- Procedures should guard against malicious false reporting by competitors such as by obtaining independent verification of allegations before taking further action.

v. **The existence of adequate accounting procedures, independent auditing, and internal company controls are also essential for detecting and preventing corrupt practices.**

Companies should be prohibited from making off-the-books transactions or keeping off-the-books accounts, and they should be required to maintain adequate records of the sums and the means by which money is received and spent.

Likewise, auditors who discover indications of a possible illegal act of bribery should be required to report this to management and, as appropriate, to corporate monitoring bodies. Consideration should also be given to imposing a duty to report to law-enforcement authorities.

vi. **Sharing of information received from public officials, companies or individuals with other concerned countries that contributes to the international framework of combating corruption.**
In complex or large-scale corruption cases, information sharing can be essential and hence should be facilitated either by direct mechanisms or by allowing sufficient flexibility within the existing system.

vii. Effective public awareness and assistance programmes are essential to the successful detection and reporting of corruption and practices lacking in integrity.
These include activities (e.g. public campaigns) and information (e.g. easily accessible websites).
Private sector awareness of laws and regulations on anti-corruption is essential and it may be desirable to establish, or assist professional bodies in carrying out training programmes for lawyers, accountants, auditors and others.

viii. As part of private sector awareness, individuals and companies might be permitted to submit a request for an opinion (based on the facts of a prospective transaction) as to whether the transaction would constitute an offence of bribing a public official.
Such assistance should not create undue exceptions to corruption offences or otherwise undermine anti-corruption and integrity laws and regulations.

(b) **Ways by which procurement officers can detect bid rigging**

Procurement officers can detect bid rigging through the following measures:

i. **Check for warning signs and patterns when businesses are submitting bids**
Certain bidding patterns and practices seem at odds with a competitive market and suggest the possibility of bid rigging. Search for odd patterns in the ways that firms bid and the frequency with which they win or lose tender offers. Subcontracting and undisclosed joint venture practices can also raise suspicions;

ii. **Look for warning signs in all documents submitted**
Telltale signs of a bid-rigging conspiracy can be found in the various documents that companies submit. Although companies that are part of the bid-rigging agreement will try to keep it secret: carelessness, or boastfulness or guilt on the part of the conspirators, may result in clues that ultimately lead to its discovery. Carefully compare all documents for evidence that

suggests that the bids were prepared by the same person or were prepared jointly;

iii. **Observe warning signs and patterns related to pricing**
Bid prices can be used to help uncover collusion. Look for patterns that suggest that companies may be coordinating their efforts such as price increases that cannot be explained by cost increases. When losing bids are much higher than the winner's bid, conspirators may be using a cover-bidding scheme. A common practice in cover schemes is for the provider of the cover price to add 10% or more to the lowest bid. Bid prices that are higher than the engineering cost estimates or higher than prior bids for similar tenders may also indicate collusion;

iv. **Check for suspicious statements at all times**
When working with vendors, watch carefully for suspicious statements that suggest that companies may have reached an agreement or coordinated their prices or selling practices; and

v. **Look for suspicious behaviour at all times**
Look for references to meetings or events at which suppliers may have an opportunity to discuss prices, or behaviour that suggests a company is taking certain actions that only benefit other firms.

(c) **Powers of the Code of Conduct Bureau (CCB)**
The Code of Conduct Bureau was set up to:

i. Receive declarations by the public officers made under paragraph 12 of Part 1 of the Fifth Schedule of the 1999 Constitution;
ii. Examine the declarations in accordance with the requirements of the Code of Conduct or any law;
iii. Retain custody of such declarations and make them available for inspection by any citizen of Nigeria on such terms and conditions as the National Assembly may prescribe;
iv. Ensure compliance with and, where appropriate, enforce the provisions of the Code of Conduct or any law relating thereto;
v. Receive complaints about non-compliance with or breach of the provisions of the Code of Conduct or any law in relation thereto, investigate the complaint and, where appropriate, refer such matters to the Code of Conduct Tribunal; and
vi. Carry out any other functions as may be conferred upon it by the National Assembly.

Examiner's report

Part (a) of the question requires candidates to discuss the measures that are needed to ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption, while part (b) tests candidates' knowledge of how procurement officers can detect bid-rigging, and part (c) of the question is on powers of the Code of Conduct Bureau.

Few candidates attempted the question and performance was below average. The commonest pitfalls were the inability of the candidates to identify the measures that are needed to ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption, while others could not explain the ways by which procurement officers can detect bid-rigging.

Candidates are advised to have adequate knowledge of relevant provisions of Procurement Act 2007 and other laws or regulations for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a	Measures that are needed to ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption		
	Identification of measures	5	
	Explanation of measures identified	5	10
b	Ways by which procurement officers can detect bid rigging		
	Identification of ways to detect bid rigging	2	
	Explanation of ways identified	3	5
c	Powers of the Code of Conduct Bureau (CCB)		5
	Total		**20**

SOLUTION 3

(a) **Powers of State Board of Internal Revenue Service**

The state Board of Inland Revenue Service has the power and responsible for:

i. Assessing, collecting and accounting for all taxes, fees, and levies in the state. The Commissioner of Finance is to prescribe the manner the Board is to account for the taxes, fees and levies collected;
ii. Supervise the collection of all revenues due to the State Government with other ministries, extra-ministerial department, parastatals and government companies;

iii. Revise all obsolete rates collectable by the Board and initiate review and advice the Governor on it;
iv. Liaise on tax and revenue matters with the Federal Government directly through the Joint Tax Board and make recommendations where appropriate to the Joint Tax Board on Tax policy, tax reform, tax registration, tax treaties and exemption as may be required from time to time;
v. To administer the provisions of the Personal Income Tax Act 2004 as amended and relevant tax laws in the State; and
vi. To generally control the management of the service on matters of policy subject to the provisions of the edicts and imposing discipline on employees of the State Internal Revenue Service.

(b) **Functions of Department of Petroleum Resources (DPR)**

i. DPR has the statutory responsibility of ensuring compliance to petroleum laws, regulations and guidelines in the oil and gas industry.

ii. Supervising all petroleum industry operations being carried out under licences and leases in the country.

iii. Monitoring the petroleum industry operations to ensure that they are in line with national goals and aspirations including those relating to flare down and domestic gas supply obligations.

iv. Ensuring that health safety and environmental regulations conform to national and international best oil field practices.

v. Maintaining records on petroleum industry operations, particularly on matters relating to petroleum reserves, production/exports, licences and leases.

vi. Advising government and relevant government agencies on technical matters and public policies that may have impact on the administration and petroleum activities.

vii. Processing industry applications for leases, licences and permits;

viii. Ensuring timely and accurate payments of rents, royalties and other revenues due to government.

ix. Maintaining and administering the National Data Repository (NDR).

x. Ensuring responsibility for the collection of royalty on crude oil and gas, rentals, penalty on gas flared, signature bonus and miscellaneous income into federation account.

(c) **Powers of the Revenue Mobilisation, Allocation and Fiscal Commission (RMAFC)**

The Commission shall have power to:

i. Monitor the accruals to and the disbursements of revenue from the federation account;

ii. Review, from time to time, the revenue allocation formulae and principles in operation to ensure conformity with changing realities;

iii. Advise the federal, state and local governments on fiscal efficiency and methods by which their revenue is to be increased;

iv. Determine the remuneration appropriate to the holders of the offices as specified in Parts A and B of the First Schedule to this Act;

v. Make recommendations and submit its finding by a report thereto to the government of the federation or of the state, as the case may be, regarding the formula for the distribution of the federation accounts and the local government accounts;

vi. Discharge such other functions as may be conferred on the Commission by the Constitution of the Federal Republic of Nigeria, this Act, or any other Act of the National Assembly;

vii. Be a statutory member of each of the following government agencies:
- The Federation Account Allocation Committee;
- The Local Government Joint Account Allocation Committee;
- The Joint Tax Board;
- The Niger-Delta Development Commission; and
- The Commission on Ecological Fund;

viii. Have the power to demand and obtain regular and relevant information, data or returns from any Government agencies including the following:
- The Nigerian National Petroleum Corporation;
- The Nigerian Customs Service;
- The Federal Board of Inland Revenue;
- The Central Bank of Nigeria; and
- The Federal Ministry of Finance.

(d) **Sources of revenue payable to the federation account**

i. **Direct taxes:** These are payable by the individuals and firms such as company income tax, hydrocarbon tax, petroleum profit tax, capital gain tax, back duty assessment, and personal income tax of foreigners residing in Nigeria.

ii. **Indirect taxes:** These are taxes on goods and services in the form of custom and excise duties, forfeiture penalties, VAT, etc.

iii. **Mining:** These are oil pipeline licence fees, rents of mining rights, mining fees, royalties on minerals, NNPC earnings from direct sales, penalties for gas flared, and rent of oil wells.

Examiner's report

The question tests the candidates' knowledge of the powers and responsibilities of State Board of Internal Revenue Service in part (a), while part (b) requires candidates to explain the specific functions of the Department of Petroleum Resources (DPR). Part (c) is on powers entrusted with the Revenue Mobilisation, Allocation and Fiscal Commission.

Most of the candidates attempted the question and performance was average.

The commonest pitfalls were the inability of the candidates to differentiate between the powers and responsibilities of State Board of Internal Revenue Service and Federal Inland Revenue Service (FIRS).

Candidates are advised to make use of Pathfinder and Study Text of the Institute for better performance in future examinations.

Marking guide

		Marks	Marks
a	Powers of State Board of Internal Revenue Service		4
b	Functions of Department of Petroleum Resources (DPR)		4
c	Powers of Revenue Mobilisation, Allocation and Fiscal Commission (RMAFC)		6
d	**Sources of revenue payable to the federation account**		
	Identification of revenue payable	1½	
	Explanation of the identified revenue payable	4½	6
	Total		20

SOLUTION 4

a. **Computation of relevant ratios for Koki Event Center**

S/N	Details	Formulae	2021	2020
i.	Current ratio	Current assets / Current Liabilities	6,997.996 / 467,461 = 14.97 : 1	5,902,569 / 385,772 = 15.30 : 1
ii.	Quick asset ratio	Current assets- Inventories / Current liabilities	6,997,996-239,615 / 467,461 = 14.46 : 1	5,902,569-296,017 / 385,772 = 14.53 : 1
iii.	Working capital/Total assets ratio	Current assets- Current liabilities / Total assets	6,997,996-467,461 / 12,614,410 0.52: 1	5,902,569-385,772 / 11,475,064 0.48 : 1
iv.	Total debts to Total assets ratio	Total debts / Total assets	9,169,773 / 12,614,410 = 0.73 : 1	7,791,076 / 11,475,064 = 0.68 : 1
v.	Long-term debts/Total assets ratio	Long-term debts / Total assets	8,702,312 / 12,614,410 = 0.69 : 1	7,405,304 / 11,475,064 = 0.65 : 1

Interpretation of the accounting ratios

i. **Current ratio**

In the two years, the company carried too much liquid capital than necessary. The best ratio here is 2:1. However, the result for 2021 is better than 2020. Therefore, the company is tying down too much fund that could have been invested in some other investments or start another event centre.

ii. **Acid test ratio**

The company also carried too much cash, based on acid test ratio in both years which this means that there was idle cash in the business. This means that the company is tying down too much fund that could have been invested in some other investments or start another event centre.

iii. **Working capital/Total assets ratio**

This ratio is appropriate for both years. However, the best could have been ratio 1:2. This capital structure ratio is of high benefit to the growth of the company.

iv. **Total debts /Total assets ratio**

The result of this ratio is permissible, however, it is better to finance the company with more debts than cash because of tax benefits. For example interest payable on loan is tax-exempt.

v. **Long-term debts/Total assets ratio**

The ratio is still permissible, however, it would be better if it is 2:1. Additionally, it is better to obtain more loans to finance the business because of the tax benefit of using loan to finance a business because of tax relief.

(b) Ways of conducting analytical review are as follows:

(i) Developing an independent expectation;
(ii) Identify differences between expected and reported amount;
(iii) Investigate the reasons for the differences; and
(iv) Evaluate the differences and draw conclusion.

(c) **Ways the performance appraisal of a profit-oriented entity differ from a local government public-oriented entity**

According to IPSAS 24 on presentation of budget information in financial statements, public sector entities, including local governments are required to present a comparison of the budgeted amount for which it is held publicly accountable and actual amount, either as a separate additional financial statement or as an additional budget columns in the financial statements, currently presented in accordance with IPSASs. The comparison of budgeted and actual amounts shall be presented separately as:

(i) The original and final budget amounts;
(ii) The actual amounts on a comparable basis; and
(iii) By way of the note disclosure, an explanation of material differences (variances) between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements and a cross reference to those documents is made in the notes.

A profit-oriented entity performance appraisal is in form of revenue growth, revenue per client, profit margin, client retention rate and customer satisfaction.

Examiner's report

Part (a) of the question tests candidates' knowledge of computation of relevant ratios, while part (b) requires the candidates to state the ways by which analytical review can be conducted. Part (c) also requires the candidates to state the ways the performance appraisal of a profit-oriented entity would differ from that of a push oriented entity.

Majority of the candidates attempted the question and performance was good.

The commonest pitfalls were the inability of the candidates to state the ways by which analytical review can be conducted and the ways the performance appraisal of a profit-oriented entity would differ from that of a public-oriented entity.

Candidates are advised to cover all sections of the syllabus for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a	**Computation of relevant ratios**		
	Identification of the formula	2½	
	Calculation of the ratios	7½	
	Interpretation	5	15
b	Ways of conduction analytical review		3
c	Ways the performance appraisal of a profit-oriented entity differ from public-oriented entity		2
	Total		**20**

SOLUTION 5

(a) Principles of debt rescheduling

There are three main principles that guide the rescheduling process. These principles are discussed below:

(i) Imminent default

This principle applies to the debtor country and requires the debtor nation to prove that it will not be able to meet its external debt service obligations unless granted relief. This proof can be shown through accumulation of debt service arrears. The IMF balance of payments projections of the country also serve the purpose, as these projections always provide an indication of the country's economic position.

This requirement is very important, as a debtor country will be denied access to the rescheduling process without the Club being satisfied that this condition has been fulfilled.

(ii) Burden sharing

The principle of burden sharing applies to the creditor countries. It requires the Creditor to be prepared to share fairly and equitably the burden of the rescheduling in the proportion of their individual exposure to the debtor countries. In effect, the creditor must agree to provide the debtor country with relief that is commensurate with their exposure. The counterpart, from the point of view of debtors, is the principle of comparability of treatment, which extols the need for debtors to treat creditors equitably in meeting the debt service obligations.

iii) **Conditionality**
This principle, which is generally regarded as the "golden rule" of the Paris Club of Creditors also, applies to the debtor countries. It requires the debtor nation to put in place an IMF structural adjustment programmes before approaching the Club for rescheduling process. Sometimes such programmes determine the type of agreement, which the official creditors would be prepared to reach with the debtor country.

(b) **Forms of debt conversion**

(i) **Debt for equity conversion**. This is the exchange of a country's foreign denominated debt for local currency, which can be, used either for the establishment of new enterprise or for the purchase of equity share in an existing private sector concerns.

(ii) **Debt for debt conversion.** This involves the exchange of foreign currency debt for domestic currency denominated debt e.g. Government Development Stock (GDS) that can be sold or traded in the domestic secondary market.

(iii) **Debt for cash conversion**. It entails the exchange of foreign currency denominated debt for local currency which can be used for local working capital, loan repayments and local tax payments.

(iv) **Debt for export conversion**. Under this arrangement, exports are paid for in a combination of cash that is, foreign currency and debts conversion proceeds.

(v) **Debt for nature.** This arises when the domestic currency proceeds of debt conversion are applied for development of conservation, promoting wildlife tourism and other natural resources. Another variant is a situation whereby the foreign currency denominated debt is exchanged for a particular natural resource for a given period.

(vi) **Debt for development**. In this case, the proceeds of debt conversion are employed for development activities of non-governmental private voluntary organisations such as foundations, trusts and multi-national aid organisations

(vii) **Relending**. Under this category, the proceeds of debt conversion are given out as fresh loan(s) to non-governmental private economic entity mostly multinational corporations. This practice is usually employed whenever the Central Bank does not have adequate foreign exchanges to pay the beneficiaries of debt conversion.

Examiner's report

The question tests candidates' knowledge on the main principles of debt rescheduling and forms of debt conversion.

Majority of the candidates attempted the question and performance was average The commonest pitfalls were the inability of the candidates to discuss the forms of debt conversion.

Candidates are advised to make use of the Institute's Pathfinder and Study Texts for better performance in future examinations.

Marking guide

		Marks	Marks
a	**Principles of debt rescheduling process**		
	Identification of main principles	2	
	Explanation of main principles identified	<u>3</u>	5
b	**Forms of debt conversions**		
	Identification of forms of debt conversions	2½	
	Explanation of forms of debt conversion identified	<u>7½</u>	<u>10</u>
	Total		<u>15</u>

SOLUTION 6

(a) **Effects of public expenditure**

The effects of public expenditure on the economy can be examined by reference to its impacts on a number of macroeconomic and socio-political activities as discussed below:

(i) **Public expenditure and economic stabilisation**

The philosophy of laissez-faire does not always guarantee automatic achievement of economic objectives of full employment, general price stability, equitable distribution of income, socially desired growth rate as well as soundness of foreign accounts. In fact, the more advanced and free the market economy, the greater the tendency of fluctuations in macroeconomic variables such as income, employment and general price level. Public expenditure as an anti-cyclical tool can be designed in such a manner as to create effective demand thereby stimulating investment activities. Stimulation of investment will lead to increase in employment, output and reduction in price, other things being equal. It must be emphasised however, that the total demand should be regulated so that the demand flows would match the supply flows, otherwise the stimulating effect would result into inflationary pressure.

(ii) **Public expenditure and production**

Public expenditure can help the economy to attain a higher level of production. Through stimulation of investment activities, it can help to create conditions favourable for market forces to push up production. It can be used to create human skills through education and training and maintenance of social overheads. Expenditure on education and health promotes human capital development and also promotes physical stock of capital for growth. Expenditure on education, health, communication, increases people's productivity at work and hence their incomes. With rise in income, savings also increase and this in turn has a beneficial effect on capital formation and investment. Through research and development, new and effective methods of production can be invented whereby local resources are used.

(iii) **Public expenditure and economic growth**

The goals of planning are growth and social welfare, which can be realised only through government expenditure. Consequently, the government allocates funds to various sectors like agriculture, industry, transport, communications, education, energy, health, exports, and the likes with a view to achieve impressive growth. Government expenditure has been very helpful in maintaining balanced economic growth in the country. In furtherance of this, government takes keen interest in allocating more resources for development of backward regions. Such efforts reduce regional inequality and promote balanced economic growth. The government propels the growth in an industry by either increasing its spending in it or supporting it in the forms of subsidies, lower interest rate for investments etc. For example, the government through Central Bank had created various funds with differential interest rates to be disbursed to perceived users with the aim of correcting market failure thereby growing the economy.

(iv) **Public expenditure and distribution**

An important aspect of the market mechanism is the inequalities of income and wealth, which arise on account of nature endowment and get widened through the institutions of private property and inheritance. Welfare consideration favours an equitable distribution of income and wealth since the purpose of economic policy is to attain the maximum level of social benefits possible. A shift towards equality may be achieved through various forms of public expenditure, especially those that are meant to help the poorer sector of the society. For instance, items of common consumption may be subsidised and production of those, which are in short supply, can be taken up by public sector. Public expenditure on social security and subsidies to the poor are aimed at increasing their real income and purchasing power. Expenditure on education, communication and health has a positive impact on productivity of the weaker section of society, thereby increasing their income earning capacity.

(b) **Principles of public expenditure on the economy**

(i) **Principle of economy**: The resources of the economy are limited relative to need. Public expenditure is the financial counterpart of the limited resources, which the government uses directly, or places at the disposal of certain sections of the society for the purpose of achieving specific objectives. According to this principle, the use of public expenditure must not be more than what is just necessary. Utmost care must be taken to avoid waste of public funds.

(ii) **Principle of sanction**: According to this principle, no public funds must be used without proper authorisation and that funds must be applied only for the purpose for which they have been sanctioned. In a democratic setting, it is the responsibility of the legislature to sanction expenditure on demand by the executive authorities. The essence of such a measure is to prevent unscrupulous and unwanted use of public expenditure, and hence a check on misappropriation of public fund.

(iii) **Principle of benefit:** This is a most fundamental principle of public spending. According to this principle, money is to be spent to promote maximum social advantage (MSA) to the economy. Any public expenditure is to be viewed against the benefit that would accrue from it. Public expenditure is to be incurred, if only it will be beneficial to the society. The beneficial nature of public expenditure can manifest itself in terms of its effects on employment, consumption, savings, investment, output, price, income distribution, and so on.

(iv) **Principle of surplus:** This is completely opposed to the practice of deficit budgeting. According to this principle, government should be more prudent in the utilisation of resources and aim at meeting its current expenditure needs out of its current revenue. It should not overspend and run into debt. All efforts should be directed at achieving a moderate surplus. Such moderate surpluses recorded in the past should be used to meet some reasonable but unavoidable deficits during other periods.

(v) **Principle of elasticity:** The principle of elasticity requires that public expenditure should not in any way be rigidly fixed at all times. Rather, it should be fairly elastic. Public authorities should be in a position to adjust the expenditure as the situation demands. During the period of depression, it should be possible for government to increase expenditure so that the economy is lifted from low level of employment. During boom period, the state should be in a position to curtail expenditure without causing any distress to the people.

Examiner's report

Part (a) of the question tests candidates' knowledge of the effects of public expenditure on the economy, while part (b) requires the candidates to identify and explain the principles of public expenditure.

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

The commonest pitfalls were the inability of the candidates to identify the effects of public expenditure on the economy and they were also unable to explain the principles of public expenditure.

Candidates are advised to make use pay more attention to both the public sector accounting and public finance sections of the syllabus for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a	**Effects of public expenditure**		
	Identification of principles of public expenditure	2	
	Explanation of principles of public expenditure identified	3	**5**
b	**Principles of public expenditure on the economy**		
	Identification of effects of public expenditure	5	
	Explanation of effects of public expenditure identified	5	10
	Total		**15**

SOLUTION 7

(a) **Reasons for divergence between private and public appraisal of project**

There are many reasons for the divergence between the two systems of appraisal. These are:

(i) The structure of income distribution in the society may cause a divergence between private and social appraisal. Since the market prices are essentially determined by income distribution, then it will not reflect the society's evaluation except the income distribution in the society is made equal;

(ii) The existence of externalities, which may be positive or negative, are not considered at all by the commercial or private enterprise analysis of project;

(iii) Neglect of consumers surplus in the commercial evaluation of project. This will result in under-estimation of the benefit from the society's view point; and

(iv) Price distortion through price control, wage control and interest rate regulations by government influence the price system.

(b) **Difference between Cost-Benefit Analysis (CBA and Cost-Effectiveness Analysis - (CEA)**

i. The cost effectiveness analysis (CEA) approach identifies either the least cost method of realising an objective or the maximum output attainable at a given cost. In contrast to cost-benefit analysis (CBA), focus on cost and benefit. Cost effectiveness analysis does not attempt to supply information on the benefits of achieving goals. Rather, the emphasis is on the least or minimal cost of achieving the specific objective of a public sector project.

ii. The CEA compares the relative cost and outcomes (effects) of a project, whereas CBA assigns a monetary value to the measure of the effect of a project.

iii. CEA is a mixed (qualitative and quantitative) project evaluation technique, whereas the CBA is a quantitative project evaluation technique.

iv. CEA generally does not consider opportunity costs, whereas opportunity cost should be taken into account in CBA.

(c) **Procedure and limitations of cost effectiveness analysis**

Procedures of cost-effectiveness analysis are as follows:

(i) Objective definition: This is meant to determine what actual target is. That is, what are the projects?

(ii) Sourcing and assessment of alternatives: After the public project has been determined, what are the cost alternatives that are available? The information in this regard have to be collated;

(ii) Selection of measure to be adopted: It has to be determined what types of approaches will enable management to achieve the set objectives within a reasonable period of time;

(iv) Development of cost estimates: Cost estimates have to be collated, addressing the issues of what to include and how to measure them; and

(v) Taking the final decision: Having ascertained the adequacy of cost effectiveness measures and relying on the information on cost estimates, the public sector organisation evolves the final decision, based on the principle of least cost.

(d) **Limitations of cost-effectiveness analysis**

(i) Procedures are subjective, since they are based on the personal judgment of the decision-maker.
(ii) What is an appropriate measure of effectiveness cannot be easily resolved.
(iii) It may lead to wrong decisions resulting from imperfect information on which costs are based and benefits derived.

Examiner's report

Part (a) of the question requires the candidates to highlight reasons for divergence between private and public appraisal of project, while part (b) asks the candidates to differentiate between Cost-Benefit Analysis (CBA) and Cost –Effectiveness Analysis (CEA). Part (c) asks the candidates to identify the procedures and limitations of Cost-Effectiveness Analysis.

Few candidates attempted the question and their performance was poor.

The commonest pitfalls were the inability of the candidates to differentiate between the Cost-Benefit Analysis (CBA) and Cost –Effectiveness Analysis (CEA). Also candidates could not identify the procedures and limitations of Cost-Effectiveness Analysis.

Candidates are advise to make use of Pathfinder and Study Texts of the Institute for better performance in future examinations.

Marking guide

		Marks	Marks
a	Reasons for divergence between private and public appraisal project		4
b	Difference between Cost-Benefit Analysis (CBA) and Cost - Effectiveness Analysis - (CEA)		5
c	Procedures of Cost-Effectiveness Analysis	3	
	Limitations of Cost-Effectiveness Analysis	3	6
	Total		15

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2022

CORPORATE STRATEGIC MANAGEMENT & ETHICS

Time Allowed: 3¼ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Abiodun Farms Limited is a company established to engage in poultry farming. Currently, it owns and runs a poultry farm located at Ota, Ogun State. With five years experience in egg production, the company currently produces 700 crates of egg per day, all of which are sold in Ota. The current demand for eggs in Ota is estimated at 2,000 crates per day. The company's vision is to become the country's biggest egg producer within the next ten years.

As a growth strategy, Abiodun Farms Limited plans to expand production to 10,000 crates of eggs per day through the installation of more cages and pens on its premises at Ota, acquisition of more chicken and other required inputs. The focus is to serve the market for eggs in selected towns in Southwestern Nigeria all of which have an estimated daily demand of 50,000 crates of egg. Production capacity of all competitors of Abiodun Farms Limited in the market for eggs in the Southwest was estimated at 32,000 crates per day. The company hopes to take advantage of this demand gap through the establishment of distribution outlets across major cities in the region for effective marketing. Aggressive advertisement campaign to stimulate demand for its products will also be embarked upon.

The establishment of a new poultry or expansion of the production capacity of an existing one has no legal requirements except for making adequate arrangement for waste management. Capital requirement is high. However, the Central Bank of Nigeria (CBN) recently approved the release of soft loans to all interested poultry farmers as part of the government's agri-loan scheme aimed at promoting farming. Abiodun Farms Limited intends to fund 60% of its growth plan through the agri-loans scheme which the CBN has approved and is currently awaiting disbursement. For the success of the proposed growth strategy, it hopes to leverage on the following:

- Knowledge and experience of poultry business acquired in the company's 5 years of operation;
- Size of land owned by the company where current production takes place is adequate for the proposed expansion;

- Strong business relationship with the biggest and most reliable suppliers of poultry inputs, such as point-of-lay chicken, cages, feeds, medicines, egg crates, etc;

- Growth rate of demand for eggs is currently in tandem with that of the population of the country which is estimated at 3%;

- The company has access to current technology in eggs production which has not changed in decades. It hopes to install automatic solid chicken waste flushers, egg pickers and sorters. There are also plans to employ 2 in-house veterinarians;

- The problem of kidnapping has become worrisome in the area where the company operates. Recently, it had to pay a huge ransom to kidnappers for the release of one of its kidnapped marketers. To mitigate this risk, the company plans to engage 5 local hunters to provide security for its employees in addition to those securing the farm premises currently;

- There is currently no public water supply to the farm location. Hence, the company provides its own water, using a huge borehole it drilled 3 years ago which has the capacity to generate adequate water to meet current and future needs. In the same vein, the company relies mostly on its generating sets for its electricity needs. This is because of the unreliable and epileptic public electricity supply;

- With increase in production of eggs comes an increase in solid waste generation and air pollution. Therefore, it is envisaged that the increased air pollution could attract some negative reactions from people in the Ota community. The company however has an existing waste disposal system which it hopes to expand to properly dispose all poultry waste; and

- Required human resources are available within the Ota community.

Required:

From the given scenario:

a. Use the SOAR model to analyse the strategic position of Abiodun Farms Limited. (12 Marks)

b. Using the PESTEL analysis, assess the business environment of Abiodun Farms Limited explaining how each component will impact on the success of the company's growth strategy. (12 Marks)

c. Suggest to Abiodun Farms Limited strategies to employ to achieve its goal of being the biggest poultry products producer and seller in the country under the following strategic directions:

i. Market development (2 Marks)
ii. Market penetration (2 Marks)
iii. Diversification ` (2 Marks)

(Total 30 Marks)

SECTION B: (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

A supermarket chain recently established more outlets in the city. Due to increased risk exposure occasioned by heightened insecurity in the country, the company saw the need to implement an effective management strategy aimed at minimising attendant risks. The need is made even more apparent due to the introduction of more stringent regulatory requirements on handling perishable food items by the National Agency for Food and Drugs Administration and Control (NAFDAC). To this end, you have been engaged to provide advice to the company on risk management.

Required:

a. i. Using the ALARP principle, advise the management on how to effectively manage the company's risks. (2 Marks)

ii. Advise the company on the need to engage a risk manager. (2 Marks)

iii. Enumerate the roles of a risk manager. (5 Marks)

b. i. What is risk audit? Should the firm engage internal or external auditors (or consultants) to conduct risk audit? Justify your position. (7 Marks)

ii. Illustrate to the management of the company the stages involved in conducting a risk audit. (4 Marks)

(Total 20 Marks)

QUESTION 3

There is a growing concern that organisations should act in a responsible manner to ensure sustainability of their environment. To this end, environmental reporting has become an important part of the reporting obligation of firms. Hence, you have been approached for advice by a manufacturing company that seeks to incorporate environmental reporting into its annual reports. You are to present to the management a report detailing the following:

a. Nature and benefits of environmental reporting. (5 Marks)

b. i. Key elements of Sustainability Balanced Scorecard (SBSC) as a measure of a firm's performance. (2 Marks)
   ii. Elements of an environmental audit. (4 Marks)

c. Nature and use of Environmental Management Accounting (EMA) (9 Marks)

(Total 20 Marks)

QUESTION 4

Chief Etido has recently increased his shareholdings in Food Plc, a leading manufacturer of some fast-moving consumer goods (FMCG) in the country, to over 51%. As his close friend, he recently approached you for advice on how to actualise his ambition of becoming both Chief Executive Officer and Chairman of Food Plc as he is in several other private limited liability companies.

Required:
Advise Chief Etido on:

a. The possibility of becoming both the CEO and Chairman of a public limited liability company like Food Plc., as provided for by the Code of Corporate Governance. (2 Marks)

b. The roles of the following in a public limited liability company
   i. The CEO (5 Marks)
   ii. The Chairman (5 Marks)

c. His responsibilities in the board of directors, if he chooses to become a non-executive member instead. (8 Marks)

(Total 20 Marks)

SECTION C: (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

a. A friend of yours who recently lost his job came to you for advice on how to invest his life savings in a way that will minimise the risk of loss of capital.

i. Advise him on how risk of losses could be minimised using the following:

   i. Risk Diversification (1 Mark)
   ii. Risk Transfer (1 Mark)
   iii. Risk Sharing (1 Mark)
   iv. Risk Hedging (1 Mark)
   v. Risk Avoidance (1 Mark)

ii. Explain to your friend when risk diversification is the best option for him. (4 Marks)

b. What is risk appetite? Explain **THREE** factors that determine the risk appetite of a company. (6 Marks)

(Total 15 Marks)

QUESTION 6

At the Annual General Meeting of TAIMAKO Nigeria Limited, shareholders expressed displeasure about what they considered to be excessively high remuneration paid to members of the company's board of directors. Some shareholders believed that board remunerations should be tied to the company's financial performance. Consequently, a group of shareholders has asked you to advise them on the position of the Code of Corporate Governance on remuneration of directors.

Required:

Advise them on:

a. The purpose and structure of remuneration package for board members. (5 Marks)

b. The role of remuneration committee. (5 Marks)

c. The problems of linking board members reward with company's performance. (5 Marks)

(Total 15 Marks)

QUESTION 7

a. All accountants are expected to act ethically in the discharge of their respective duties. In the light of this, evaluate the following concepts as it applies to professional accountancy practice:

   i. Personal Ethics. (1 Mark)
   ii. Business Ethics. (1 Mark)
   iii. Professional Ethics. (1 Mark)

b. With the aid of a clear example, explain the term 'ethical/moral dilemma: (2 Marks)

c. Explain the Kolberg's stages of moral development. (10 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. SOAR stands for the following:

S: Strength
O: Opportunities
A: Aspirations
R: Results

i. Strength: This answers the following question: what are those qualities inherent in the firm that can be leveraged on to deliver competitive advantage? From the given scenario, the strengths are:

- Knowledge and experience of poultry business acquired in the company's 5 years of operation;
- Size of land of the firm where current production takes place is adequate for the proposed expansion;
- Strong business relationship with biggest and most reliable suppliers of poultry inputs such as point-of-lay chicken, cages, feeds, medicines, egg crates etc. This hopefully will ensure reliable supply of all inputs;
- The company has access to current technology in eggs production which has not changed in decades. It hopes to install automatic waste flushers and egg pickers and sorters; and
- Availability of privately owned water, waste management and electricity supply system.

ii. Opportunities: These are positive features of the business environment capable of delivering competitive advantage to the firm.
They include:

- The existence of a huge gap in the supply of eggs in the Southwest;
- Availability of CBN approved soft loans targeted at agriculture businesses provides funding opportunity for the firm's growth strategy;
- Eggs market growth rate is currently in tandem with that of the population of the country which is estimated at 3%; and
- Needed labour is available within the host community.

iii. Aspirations: This represents the firm's vision and the strategic initiatives to achieve them.
From the scenario:

- The vision of being the largest egg producer in the country; and

- The current growth strategy which could be one of the phases towards achieving the longer-term goal.

iv. Results: These are indicators that measure progress towards achieving the organisation's goals.

- Current capacity and market share indicate progress towards achieving the long-term goal

b. PESTEL is a tool used for assessing the key element of the external (macro) environment and their impact on firm competitive advantage

- P: Political Environment: This is made up of government policies, political climate, tax policies, labour laws, trade restrictions and similar externalities that impact competitive advantage. From the given scenario, the following are elements of the political environment:
- Security challenges posed by threat of bandits and kidnappers; and
- Availability of soft CBN disbursed soft loans for agri-businesses to encourage agriculture.
- E: Economic Environment: These are macroeconomic indices that affect competitive advantage such as GDP, economic growth, interest rate unemployment rate, inflation rate, market growth rate, etc. From the scenario, the following can be extracted:
- Market for eggs is large and is growing at the rate of 3% per annum
- Needed manpower is locally available; and
- There is excess demand for eggs waiting to be exploited
- S: Socio-cultural Environment: This is concerned with social attributes such as population figures, population structure, cultural and religious beliefs, health concerns, etc.

  The following can be deduced from the scenario:
- Population growth is at 3%;
- No religious or cultural constraints to producing, selling, buying and consuming eggs;
- No indication that eggs consumption is hazardous to health; and
- No cultural barrier to rearing chicken.
- T: Technological Environment: This includes level of innovativeness, availability of technology and changes in technology in the business environment.

  From the scenario, the following can be deduced:
- Technology of egg production has changed very slowly; and
- The most up to date technology is available to the firm.
- E: Ecological Environment: This is concerned with the weather, climate, level of pollution etc. From the given scenario, the following can be noted:

- The absence of environmental factors that could inhibit the production of eggs is evident.

- L: Legal Environment: This is concerned with the existence of laws which have influence of the running of business. Such laws could include labour laws, minimum wage regulations, regulatory requirements etc. From the given scenario. There are no regulatory or legal requirements for setting up a new or expanding an existing poultry except for proper waste management.

c. i. **Market Development:** Involves selling the firm's products in another geographical area. For Abiodun Farms to achieve its objective of being the largest seller of eggs in the country, it must try to sell its eggs in other geopolitical zones of the country. This might involve opening distribution outlets and/or sell to existing distributors in these areas

ii. **Market Penetration:** This strategic direction aims at increasing the market share of existing market. To achieve the strategic objectives, Abiodun Farms Limited should try to increase its market share of Ota and the South West.

iii. **Diversification:** Involves going into new line of business that may be related or unrelated to the current poultry business. Abiodun farms should also consider diversifying into other poultry products such as frozen fresh chicken, day old chicks, ducks, turkey, etc. Other alternatives might include production of feeds, cages and farm management consulting.

Examiner's report

This compulsory question on strategic management tests:

a) Application of SOAR model to analyse strategic position;
b) Use of PESTEL model to assess a business environment; and
c) Strategies to achieve goals under the following directions; market development, market penetration and diversification.

Virtually all the candidates attempted this question. Performance was above average.

Those candidates who performed poorly in this question could not identify the components of SOAR and PESTEL. Many candidates could not identify strategies to accomplish market development, market penetration and diversification.

Candidates and admonished to master new concepts such as SOAR and cover the syllabus.

Marking guide

	Description	**Marks**	**Marks**
a	$^1/_4$ for each full meaning of SOAR	1	
	Definition of strength	1	
	Components of strength: 1 mark each for any three points	3	
	Definition of opportunities	1	
	Components of opportunities:1 mark each for any two points	2	
	Definition of aspiration	1	
	Components: 1 mark each for any one point	1	
	Definition of results	1	
	Components: 1 mark for ant one point	1	
			12
b	Definition of political environment	1	
	Component: 1 mark each for any one point	1	
	Definition of economic environment	1	
	Component: 1 mark each for any one point	1	
	Definition of social environment	1	
	Component: 1 mark each for any one point	1	
	Definition of technology environment	1	
	Component: 1 mark each for any one point	1	
	Definition of ecology environment	1	
	Component: 1 mark each for any one point	1	
	Definition of legal environment	1	
	Component: 1 mark each for any one point	1	
			12
ci	Market Development: Definition	1	
	Explanation	1	
ii	Market penetration: Definition	1	
	Explanation	1	
iii	Diversification: Definition	1	
	Explanation	1	
			6
	Total		**30**

SECTION B

SOLUTION 2

i. ALARP is the acronym for As Low as Reasonably Practicable
- The ALARP principle is that it is usually impossible (or if it is possible, it is grossly expensive) to eliminate all risk but that any residual risk should be as low as reasonably practicable.
- A risk is said to be ALARP when the cost involved in reducing it further would be grossly disproportionate to the benefit gained.

ii. The company should consider engaging a risk manager to handle the entire firm's business risk by providing information, assistance, and advice, and to improve risk awareness within the entity and encourage the adoption of sound risk management practice.

iii. The role of a risk manager might therefore include:
- Identification of risks;
- Establishing 'tools' to help with the identification of risks;
- Establishing modelling methods for the assessment and measurement of risks;
- Collecting risk incident reports (for example, health and safety incident reports);
- Assisting heads of departments and other line managers in the review of reports by the internal auditors;
- Preparing regular risk management reports for senior managers or risk which committees; and
- Monitoring 'best practice' in risk management and encouraging the adoption of best practices within the entity.

b. **i. Risk Audit is a**
- process by which an attempt is made to identify, verify, record, measure, analyse and report the range of risks that may be present in each situation.
- It can also be defined as a systematic way of understanding the risk which an organisation faces.

Advantages of risk audit being conducted by internal auditors are:

- Risk auditing requires knowledge of the processes, systems, procedures, and culture of the organisation to be audited. This requirement is best met by those working within the organisation. This gives internal auditors advantage over external auditors because they are in a better position to write risk audit reports in a manner that can easily be understood by management;

- Risk audit is essentially a management tool used for effective risk management. Therefore, it should be carried out internally; and
- The tendency for many external auditors and consultants to use generic 'one size fits all' solution to risk management often weaken their ability to provide company specific solutions to managing risks.

The use of external auditors to audit risk has the following advantages:

- Due to familiarity with the way things work and are done in the firm, internal auditors may fail to identify some risks faced by the entity. This can be mitigated with the use of a neutral individual;
- External auditors and consultants may have broader industry-wide experience, knowledge and skills in risk audit and assessment thus putting them in a better position to identify risks which internal auditors may not see; and
- External auditors or consultants will likely be more independent in their auditing and assessment of risks.

Justification

Candidate may adopt any one of the following:

- Internal auditors are better because of their understanding of the processes, systems, procedures culture of the firm;
- External auditors are better because they tend to be more independent and objective and have wider experience; and
- A combination of both internal and external auditors is better.

ii. There are four stages in a risk audit.

- **Stage 1: Identification**. The first step in a risk audit is to identify what the risks are in a situation, strategy, procedure or system. Risks change continually in nature.

- **Stage 2: Assessment**. When the risks have been identified, the next step is to assess them by evaluating the probability and impact of an adverse event or outcome occurring.

- **Stage 3: Review**. The auditor should look at the controls that are in place to manage the risk if an adverse outcome happens.

- **Stage 4: Report**. The risk audit should lead to a report to the board of directors or to management, depending on who commissioned the audit

Examiner's report

This Risk Management question tests ALARP principle, role of risk manager and risk audit.

About 70% of the candidates attempted this question and performance was good.

Some candidates could not present the stages of risk audit nor justify the use of internal or external auditors to conduct risk audit.

Candidates at the skills level should learn the application of knowledge to simple scenarios.

Marking guide

	Description	Marks	Marks
a. i	Full meaning of ALARP	1	
	Meaning of ALARP	1	
			2
ii	Need for ALARP	2	
			2
iii	Role of risk manager (1 mark each for five points)	5	
			5
b. i	Definition of risk audit	1	
	Advantages of engaging internal risk auditors: 1 mark each for any 2 points	2	
	Advantages of engaging external risk auditors: 1 mark each for any two points	2	
	Justification	2	
			7
ii	1 mark for each of the four stages	4	
			4
			20

SOLUTION 3

a. "Environmental reporting" is the preparation, presentation and communication of information relating to an organisation's interactions with the natural environment.

Benefits of environmental reporting are:

- Enables reporting companies to discharge their accountabilities to society and future generations;

- Strengthens accountability to shareholders and reduces the agency gap between directors and shareholders through wider information disclosure;
- Enables companies respond to certain issues that may threaten the perception of their ethics and/or competence (for example oil companies).
- Companies manage their exposure to environmental risk better and make more informed decisions; and
- Companies use the process and output of environmental reporting as a lever to save costs, increase operational efficiency and reduce waste.

b. (i) Key elements of Sustainable Balanced Scorecard (SBSC) are:

a. Financial perspective;
b. Customer perspective;
c. Internal operations;
d. Innovation and learning perspective; and
e. Non-market perspective.

(ii) An environmental audit typically has three elements:

- Metrics. These are agreed aspects of performance that are measured (quantified);
- Setting targets for achievement and measuring actual performance. Performance should be measured in terms of the agreed metrics; a
- Reporting on achievement of targets or variances/non-compliance with targets, with reasons for any non-compliance.

c. i.

- Environmental Management Accounting (EMA) provides information that support the operation of an environmental management system.
- It provides managers with financial and non-financial information to support their environmental management decision making
- Environmental Management Accounting complements other conventional management accounting methods and does not replace them.

ii. The purposes of environmental management accounting are:

- Estimating annual environmental costs (for example, costs of waste control);
- Budgeting and setting targets for improvements in environmental performance;
- Product pricing;

- Investment appraisal (for example, estimating clean-up costs at the end of a project life and assessing the environmental costs of a project);
- Identifying opportunities for cost savings; and
- Estimating savings from environmental projects.

Examiner's report

This question tests nature and benefits of environmental reporting, elements of sustainability balanced score card, and nature and use of environmental management accounting (EMA).

Very few candidates attempted this question. Performance was poor.
Many of the candidates could not state the nature and benefits of environmental reporting.

Another common pitfall was inability of candidates to distinguish between sustainability Balanced Score card and balanced score card. Some candidates could not state the nature and use of Environmental Management Accounting (EMA).

Sustainability reporting and environmental reporting are very current issue which candidates should get conversant with.

Marking guide

		Marks	Marks
a	Nature of environmental reporting	1	
	Benefits of environmental reporting	4	
			5
bi	Elements of SBSC	2	
ii	Elements of environmental audit (2 marks each for points)	4	6
c.	Nature of Environmental Management Accounting (EMA)	3	
	Purpose of EMA	6	
			9
	Total		**20**

SOLUTION 4

a. The roles of the Chairman and Chief Executive Officer are essential in organisation and the Code of Corporate Governance does not allow both posts to be occupied by the same person at the same time.
This mostly applies to companies listed on the Nigeria Exchange Group (NGX).
This is for the following reasons:

- To avoid the risk of one individual dominating board decision making

- To enable CEO focus on short term priorities while the chairman focuses on the long-term organisational needs;
- It enables distinction between management authority and board authority;
- Empowers the chairman and CEO to pursue their respective duties without any concerns that one position might negatively influence the other; and
- A major role of the board is to supervise management. It will amount to self-supervision and conflict of interest if the Chairman supervises himself as the CEO (the CEO is the head of management).

b. The role of the CEO varies from one organisation to another depending on the organisational structure and the size of the company.

- For small companies, the CEO may take up such roles as recruitment and
- other lower-level decisions. For bigger organisations, the CEO takes higher level strategy and major company decisions.
- Communicating, on behalf of the company, with shareholders, government entities and the public.
- Leading the development of the company's short term and long-term strategy
- Creating and implementing the entity's vision and mission.
- Evaluating the work of other executive directors and management team.
- Maintaining awareness of the company's competitive landscape, expansion of opportunities, industry development, etc.
- Ensuring that the company maintains high social responsibility wherever it does business.
- Assessing risks of the company and ensuring they are monitored and minimised.
- Setting strategic goals and making sure they are measurable and describable.

ii. Roles of the board chairman:

- Run the board and set its agenda. The agenda should be mainly forward looking and should concentrate on strategic matters.
- Ensure that all members of the board receive accurate, timely and clear information 'to help them reach well-informed and well-considered decisions.
- Ensure effective communication with the shareholders. The chairman should make sure that the other directors are aware of the views of the major shareholders.
- Manage the board, and make sure that enough time is allowed for the full discussion of complex or controversial issues.
- With the assistance of the company secretary, arrange for the induction of new directors after their appointment, and the continuing training and development of all the board directors.

- Organise the performance evaluation of the board, its main committees, and its individual directors.
- Encourage the active participation in the board's affairs by all the directors.
- Playing a leading role in ensuring that the board and its committees are composed of the relevant skills, competencies, and experience.
- Acting as the main link between the board and the CEO; advising the CEO in the effective discharge of his/her duties.

c. Responsibilities of board of directors:
- **Strategy:** The board is responsible for the overall management of the company or group. This involves:
  - Approving the long-term objectives and commercial strategy;
  - Approving the annual budget and capital expenditure budget;
  - Oversight of operations; and
  - Review of the performance of the company or group decisions about expanding operations into new product areas or new markets, and decisions about closing any significant part of operations.

- **Structure and capital:** Changes relating to the capital structure of the group, or its management and control structure. Also, decisions about any change in the company's status, such as going from private company to public company status.
- **Financial reporting and controls:** Approval of financial statements and results. Approval of dividend policy.
- Approval of treasury policies, such as foreign currency exposures and the use of financial derivatives.
- **Internal controls:** Ensuring that there is a sound system of internal control and risk management, by monitoring the systems that are in place.
- **Contracts:** Approval of major capital projects and strategically significant contracts. Approval of loans or foreign currency transactions above a stated amount. Approval of all major acquisitions and disposals.
- **Communication:** Approval of all communications to shareholders and the stock market, and all major press releases.
- **Board membership and other appointments:** Decisions about appointments to the board, appointment of the company secretary and the appointment of the company's auditors.
- **Remuneration:** Decisions about the remuneration of all directors and senior managers, including the approval of major share incentive schemes (which may also require approval by the shareholders).
- **Delegation of authority:** The board is responsible for deciding what responsibilities should be delegated to board committees, and should decide on the division of responsibilities between the chief executive officer and the board chairman.

- **Corporate governance matters:** The board is responsible for corporate governance matters such as communications with the company's shareholders, deciding the balance of interests between the shareholders and other stakeholders and ensuring that independent non-executive directors continue to be independent.
- **Policies:** Approval of company policies, such as health and safety policy and environmental policy.
- **Other issues:** There will probably be several other issues that the board should reserve for its own decision making, such as decisions affecting the company's contributions to its employees' pension fund, the appointment of the company's main professional advisers, and decisions to prosecute, defend or settle major litigation disputes involving costs or payments above a specified amount.

Examiner's report

This Corporate Governance question test.

Separation of positions of Board chairman from that of CEO; Roles of Board Chairman and CEO; and the responsibilities of the Board of Directors.
About 90% of the candidates attempted this question and performance was very good.

Only a few candidates could not clearly distinguish between the roles of Board Chairman and Chief Executive officer.

Marking guide

	Description	Marks	Marks
a	Conclusion	1	
	Reasons	1	
			2
bi	Role of CEO		5
ii	Role of Chairman		5
c	Responsibilities of BOD		8
	Total		**20**

SECTION C

SOLUTION 5

a i. **Risk Diversification:** Also called risk spreading, involves investing in a range of different business activities with the expectation that returns from the good performers will offset those of the poor performers.

ii. **Risk Transfer:** This involves passing on some or all the risks inherent in a business activity to someone else. A good example of risk transfer is insurance.

iii. **Risk Sharing:** This involves collaboration with other persons. In so doing, risks are shared jointly. Example of a risk sharing strategy is partnerships and joint venture agreements with other investors.

iv. **Risk Hedging:** Hedging is a risk management strategy employed to offset losses in investments by taking an opposite position in a related asset. For example, if a company has an exposure to currency risk, and will lose money, if the US dollar falls in value against the euro, a hedge can be created whereby the company will make a profit if the US dollar falls in value against the euro. The loss on the original risk exposure will be offset by a gain on the hedge position.

v. **Risk Avoidance:** This means not having any exposure to a risk. A business risk can only be avoided by not investing in the business. Risk avoidance therefore means staying out of a business, or leaving a business and pulling out of the market.

ii. Risk diversification is the best option when the following conditions are met:

- Where the experience, knowledge and skill of the investor spreads across several businesses.

- It is riskier for the investor to invest in a portfolio of unrelated businesses especially when it takes the investor away from his area of expertise; and

- Business activities with similar risks will make the entire business portfolio risker. For example, a downturn in the housing market will likely affect the market for all kinds of building materials.

b. Risk appetite is the amount of risk that an entity is willing to accept by investing in business activities, in order to obtain the expected returns from the business. Risk appetite varies from one company to another. Some companies are willing to take fairly large risks whereas others are risk averse. In general, companies expect higher returns from taking larger risks.

Risk appetite varies across different companies on the basis of size and structure of the company and market conditions.

- **Size:** Small companies are often more entrepreneurial than larger companies and are willing to take bigger risks in order to succeed and grow. Entrepreneurial business leaders are associated with risk-taking. On the other hand, large companies can afford to take bigger risks than small companies when they are well-diversified.

  - **Structure:** As companies become larger, with a hierarchical management structure, they might become more bureaucratic. Bureaucracies are often the opposite of entrepreneurial businesses, because they are risk averse. Managers are unwilling to take on risk, and because of the hierarchical nature of the management structure, it might be difficult to promote a culture of risk awareness and embed risk within the management processes.

  - **Market Conditions:** Business risk is often higher in markets where conditions are volatile and subject to continual and unpredictable change. When a new market emerges, risks are high. Companies investing in the new market must have an appetite for taking on the high risk because they expect the potential benefits to be large. As a market matures, it becomes more stable and more predictable. Volatility declines and there is less risk. Consequently, the risk appetite of companies operating in a developed and mature market could be low.

Examiner's report

This question tests risk minimisation techniques risk diversification and risk appetite.

About 90% of the candidates attempted this question.

General performance was good. Only a few candidates could not explain factors that determine risk appetite.

Marking guide

	Description	Marks	Marks
ai			
i	Risk Diversification		1
ii	Risk Transfer		1
iii	Risk Sharing		1
iv	Risk Hedging		1
v	Risk Avoidance		1
aii	Conditions that must be satisfied before adopting risk diversification 2 marks each for two points		4
b	Definition of risk appetite	$1^1/_2$	
	Determinants of risk appetite of a company	$4^1/_2$	
			6
	Total		**15**

SOLUTION 6

a. Purpose of board remuneration

i) Remuneration is used as a tool for attracting needed talents. This also applies to board members' remuneration. To ensure that the board is equipped with needed talents, remunerations must be competitive.

ii) Remunerations also serve as a tool for building employee commitment and motivation among employees. Same also applies with board members.

iii) Motivation and commitment for achieving performance targets are built through competitive remuneration packages.

iv) Remunerations are also used for retention of needed skills and talents.

Structure of board remuneration

- The structure of remuneration of board members varies across different organisations as determined by their respective remunerations' committees. However, the following are commonly used:

  - Basic salary;
  - One or more annual cash bonuses linked to the achievement of specific performance targets.
  - Free shares in the company or share options; and
  - Pension rights or a contribution to a pension fund for the director.

b. Roles of remuneration committee are as follows:

- Review of framework for remuneration and terms and conditions of employment of the chairman of the board and executive directors;
- Monitoring of the level and structure of remuneration of senior managers;
- Determining the detailed remuneration package of the executive directors and chairman including termination payments;
- Ensuring that executive directors are fairly rewarded for their contribution to the performance of the company; and
- Assuring stakeholders of transparency in the process of determining the remuneration of the executive directors. This is achieved by ensuring that individual who have no personal interest determine the remuneration in question.

c. Problems that may arise from linking board remuneration to company's performance include the following:

- During a period of economic downturn, many firms need fresh injection of talents in many cases at the board and senior management levels. However, when remuneration is linked to firm performance, the ability to attract needed talent at such critical time may be hampered;
- The ability to retain needed talents could also be impaired especially when competitors are constantly seeking to poach people needed skills currently working for the company;
- Where current firms' performance falls below shareholders with expectation, performance targets may be set. However, meeting these targets require some level of motivation. Competitive remuneration is a tool for achieving the needed motivation.
- Executives may be rewarded with a large bonus for meeting an annual profit target. This will almost certainly motivate the director to achieve the target. However, a consequence of maximising the current year's profit might be that long-term profits will be lower;
- Executives may have expectations that they will receive rewards, even when the company does not perform particularly well. The effect of an incentive scheme might therefore be to discouraged a director when the bonus is less than expected, rather than give him an incentive to improve performance; and
- The remuneration committee should consider the consequences for the company's pension costs of awarding any basic salary increase to directors, especially directors who are approaching their retirement.

Examiner's report

This Corporate Governance question tests purpose and structure of board remuneration, role of remuneration committee; and problems of linking board members reward with company performance.

About 65% of candidates attempted this question. Performance was average.

Common pitfalls were inability of some candidates to explain the role of the remuneration committee and identify the problems associated with linking board members' reward with company performance.

Candidates at this level must endeavour to master concepts and apply them to simple scenarios.

Marking guide

	Description	Marks	Marks
a	Purpose of board remuneration	3	
	Structure of board remuneration	2	
			5
b	Role of board remunerations committee		5
c	Problems of linking board members reward with company's performance		5
	Total		**15**

SOLUTION 7

a i. **Personal ethics** refers to:

- the ethics that a person identifies with in respect to people and situations that they deal with in everyday life. It describes the intrinsic moral principles and values that govern an individual's interactions with others;
- Personal ethics reflects one's inner views on morality;
- Personal ethics are typically influenced by family members, religion, experience and culture; and
- Personal ethics form the basis for compliance with business and professional ethics. As such, professional accountants are expected to display a high standard of personal ethics.

ii. **Business ethics** consists of:

- the moral principles that guard the way a business conducts itself and its transactions.
- Business ethics describes the moral principles and values that guide how people and institutions behave in the world of commerce; and

- Business ethics considers how the pursuit of self-interest (e.g., profits) impacts others through the actions of individuals or firms within business.

iii. **Professional Ethics**

- Describes the moral principles and values that govern behaviour in the context of a particular profession such as lawyers, doctors, architects, and accountants.

- Professional ethics is normally specified in a professional code of conduct that all members (and students) professing to be part of that profession must abide by.

- Adherence to an Institute's professional code of conduct such as ICAN's Code of Professional Conduct is normally a requirement of membership and remains relevant throughout the professional's life, not just in the work environment.

b. An ethical (moral) dilemma involves a conflict between two moral principles whereby it can be argued that both perspectives are fair and reasonable. Ethical dilemmas typically arise in situations whereby a particular action is likely to benefit one stakeholder and harm another

c. **Stage 1: Obedience and punishment orientation**: At Stage 1, individuals judge right and what is right or wrong based on the direct consequences for them from the actions they take. An action is considered bad if the individual's believes that he (or she) will be punished for it. The worse the punishment, the greater the moral wrong.
An action is good if the individual knows that he will receive some benefit.
The individual believes that there are powerful authorities who can give rewards and punishments for behaviour.

Stage 2: Individualism and exchange: The individual (often a child) recognises that there is no single view of what is right or wrong. Different individuals have different points of view. Everyone is also free to pursue their own personal interests and will therefore want to do what is in their own best interest. When faced with a moral dilemma, the individual's decision is based on personal interest. The individual might show an interest in other people, but only to the extent that other people might help to further his own interests.

Stage 3: Good interpersonal relationships: Individuals relate in society and understand morality to be beyond personal benefit. They believe that they should live up to the expectations of family, friends, and the community. They are aware of the approval or disapproval that they receive from other people and try to live up to their expectations.

Stage 4: Maintaining social order: Here the individual is concerned with society, and the need to maintain social order. The focus is on respect for social conventions, authority and obeying the law.

Stage 5: Social contract orientation: At this stage, individuals think about society differently from the conventional way. They take the view that a good society is one in which there is a 'social contract' in which everyone works towards the common benefit of society. They recognize that people should have certain basic rights that the society will protect.

Stage 6: Universal ethical principles: Kohlberg suggested that individuals very rarely reach Stage 6 of moral development. At this stage, moral reasoning is based on abstract 'universal' ethical principles. The individual queries the validity of laws and considers that laws are only valid if they are based on justice. Individuals have an obligation to disobey unjust laws.

Examiner's report

This question tests the concepts of personals, business and professional ethics, ethical/moral dilemma, and Kohlberg's stages of moral development.

About 70% of the candidates attempted this question and most of them performed well.

The few candidates who performed poorly in their question could not explain the stages of Kohlberg's moral development.

Candidates are admonished to cover the syllabus fully.

Marking guide

a	**Description**	**Marks**
i	Personal Ethics	1
ii	Business Ethics	1
iii	Professional Ethics	1
b	Ethical/Moral dilemma (1 mark for definition and 1 mark for example)	2
c	Kolberg stages of moral development	10
	Total	**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2022

TAXATION

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

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Mr. Danko Chinyere who has worked in a neighbouring African country for many years, returned to Nigeria in August 2018. He incorporated a private limited liability company known as ChiDan Limited located in Lagos on October 30, 2018. The company deals in processing and packaging of plantain chips for local consumption.

The directors of the company opened a business bank account with one of the leading commercial banks in November 2018. The company commenced full operations on January 2, 2019.

Your firm, Adama & Co. was appointed as the tax consultant to ChiDan Limited in January 2021. At the first engagement meeting with the company, you discovered that the company was yet to register with the Federal Inland Revenue Service (FIRS). Relevant taxes, including value added tax were not remitted to FIRS.

An extract of the company's first set of financial statements made up to December 31, 2020 are as follows:

	₦'000	₦'000
Gross turnover		**860,250**
Gross profit		307,734
Profit on disposal of plant, property and equipment		7,860
		315,594
Administrative and other expenses:		
Salaries and wages	62,810	
Directors' remuneration	9,000	
Electricity and generator running expenses	4,815	
Rents and rates	36,270	
Repairs and renewal	10,230	
Motor vehicle expenses	32,535	
Donations and subscriptions	9,300	
Interest and bank charges	6,780	

Bad and doubtful debts	8,870	
Miscellaneous expenses	20,770	
Loss of fund	12,800	
Audit fees	8,600	
Legal and professional charges	7,725	
Depreciation	42,825	(273,330)
Net profit		42,264

The following additional information is provided:

(i) **Donations and subscriptions include:**

	₦'000
Lagos Chamber of Commerce	750
Motor Boat Club	300
Polo Club	250
Political parties	7,500
Approved National Relief Fund	500
	9,300

(ii) **Bad and doubtful debts consist of :**

	₦'000
Allowance for doubtful debts	3,000
Specific provision	4,245
Bad debts written off	1,625
	8,870

(iii) **Miscellaneous expenses include:**

	₦'000
Court fine	600
Exchange loss on remittances and balances	7,910
Allowable office expenses	12,260
	20,770

(iv) **Loss of fund**

A director defrauded the company to the tune of ₦9,800,000.

(v) **Legal and professional charges include:**

	₦'000
Debt collection and retainership fees	3,975
Land acquisition	3,750
	7,725

(vi) Capital allowances as agreed with the Revenue amounted to ₦30,380,000.

Required:

Advise management of the company on the following:

a. Due date for submission of audited financial statements to the tax office. (2 Marks)

b. Requirements for filing of VAT returns and remittance of VAT liabilities - Section 16 of VAT Act (as amended). (4 Marks)

c. Basis of assessment on commencement of business - Section 29 (3) of CITA (as amended) (6 Marks)

d. The income tax liabilities payable for the relevant year of assessment (18 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

You attended an interview for employment as Assistant Manager (Tax) in a professional firm. The following were presented to you to proffer solutions:

Mariam, Ola, Jude and Co., a firm of quantity surveyors makes up its accounts to December 31, of each year. The following details were extracted from the firm's accounting books in respect of the year ended December 31, 2019:

		₦
(i)	Net profit for the year	1,540,000
(ii)	Legal expenses for successfully defending one of the partners for alleged professional misconduct formed part of legal fees in the accounts	100,000
(iii)	Depreciation	360,000
(iv)	Profit on sale of property, plant and equipment	4,220
(v)	Balancing charge	10,400
(vi)	Balancing allowance	6,900
(vii)	Capital allowances for the year	300,000

Additional information available is:

(i) Profit sharing ratio agreed by the partners:
Mariam 2, Ola 3, Jude 5

(ii) Mariam, Ola and Jude received ₦7,400 each per annum as interest on loan to the firm.

(iii) Salaries paid to each of the partners are:
Mariam - ₦240,000, Ola - ₦200,000 and Jude - ₦220,000

Required:

Compute the personal income tax assessable for each partner for the relevant year of assessment. **(Total 20 Marks)**

QUESTION 3

The Federal Government of Nigeria expanded the taxes and levies which the tiers of government can impose through the Schedule to the Taxes and Levies (Approved List for Collection) Act (Amendment) Order, 2015. In this Order made by the Minister of Finance, several new tax/levy heads, such as infrastructure maintenance/development levy, wharf landing charge/fee, consumption tax, the National information technology development levy, etc., were introduced.

However, on May 8, 2020, the Federal High Court sitting in Lagos, delivered judgment in suit number: FHC/L/CS/1082/2019 between The Registered Trustees of Hotel Owners and Managers Association of Lagos (suing for itself and on behalf of all its members) Vs The Attorney – General of the Federation and Others, and held that the Ministerial Order of 2015 is unconstitutional, null and void.

The Court submitted that the Constitution vests the legislature with the power to make laws. The Court further stated that schedules to a law are part and parcel of that law and as such, only the legislature can amend schedules to a law. The implication of this ruling is that all the taxes that were added to those ones in the Taxes and Levies (Approved List for Collection) Act Cap. T2 LFN 2004, via the Ministerial Order 2015, are illegal and cannot be enforced.

Since the judgment, your firm has been faced with series of enquires from taxpayers on the taxes/levies they are now expected to pay.

Required:

State the following:

a. **FIVE** taxes collectible by the Federal Government (5 Marks)
b. **FIVE** taxes/levies collectible by the State Governments (5 Marks)
c. **TEN** taxes/levies collectible by the Local Governments (10 Marks)

(Total 20 Marks)

QUESTION 4

Bakosa Insurance Co. Plc. is a company engaged in both life and other insurance businesses.

You were appointed as the tax consultant of the company on June 30, 2021. The Managing Director of the company invited you to a meeting of the directors with a view to intimating them of the recent changes introduced by the Finance Acts 2019 and 2020, relating to insurance business.

Required:

Explain the following to the management of the company:

a. Recent changes introduced by Finance Acts 2019 and 2020, that relate to the computation of tax liabilities of insurance companies. (16 Marks)

b. Additional documents/information to be filed by insurance companies. (4 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Withholding tax is a tax deducted at source from proceeds made to a taxable person for the supply of goods and services.

It is not another form of tax, but simply an advance payment of tax, as the withholding tax deducted at source is off-set against any subsequent tax liability that may be due in respect of the income.

Required:

a. State the contents of withholding tax returns/payment schedule. (5 Marks)

b. State the time frame for compliance with withholding tax returns. (5 Marks)

c. Explain the merits and demerits of withholding tax scheme. (5 Marks)

(Total 15 Marks)

QUESTION 6

a. The difficulty in determining what constitutes a trade has led to many litigations and the huge number of tax cases that exist on the issue. The problem from the decided cases is that of finding an absolute test for identifying a trade.

The conclusion had always been that there are no fixed rules but that each case could be examined on its own facts.

Required:

State **FOUR** considerations that influence the identification of badges of trade. (8 Marks)

b. Ndakogi Nigeria Limited commenced business in 2007. The extract of the statement of profit or loss of the company for the year ended December 31, 2021, has revealed the following:

	₦'000	₦'000
Gross turnover from core business activities		26,000
Revenue from closed operations	4,000	
Expenses on closed operations	(2,600)	
Profit on closed operations	1,400	1,400
Dividend received (gross)		1,800
Rent received (gross)		850
Revenue from other operating activities	8,000	
Expenses on other operating activities	2,600	
Profit from other operating activities	5,400	5,400

Required:

Compute the minimum tax payable (7 Marks)

(Total 15 Marks)

QUESTION 7

The tax system in Nigeria has been reviewed in recent times with a view to ensuring ease of doing business in Nigeria, among other things. With the enactments of Finance Acts 2019 and 2020, many enabling Acts were amended.

The tax system usually involves a tripartite aspect, namely, the tax policy, tax law and tax administration.

Required:

a. Explain tax policy. (5 Marks)

b. State notable tax legislations. (5 Marks)

c. State the bodies charged with the administration of taxes in Nigeria. (5 Marks)

(Total 15 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	25
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 and 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 consolidated relief allowance and tax exemption items had been granted, the balance of income shall be taxed as specified in the tax table above.

4. COMPANIES INCOME TAX RATE 30%; 20%; and 0%

5. TERTIARY EDUCATION TAX (2½% of Assessable Profit)

6. CAPITAL GAINS TAX 10%

7. VALUE ADDED TAX 7.5%

SOLUTION 1

XZB & Co.
The Managing Director
ChiDan Limited
Lagos

Dear Sir,

RE: TAX MATTERS

Further to our verbal discussions in respect of the above subject matter, we wish to respond to your requests as follows:

a) Due date for submission of audited financial statements to the tax office

Section 55 (3), CITA (as amended) specifies the statutory timeline for filing of audited accounts and income tax returns by all companies (new or existing). Section 55 (3) provides as follows:

(i) In the case of a company that has been in business for more than eighteen months, the due date for filing tax returns is not more than six months after the end of the company's accounting year; and
(ii) In the case of a newly incorporated company, the due date for filing tax returns is within eighteen months from the date of its incorporation or not later than six months after the end of its first accounting period, whichever is earlier.

b) Requirements for filing of VAT returns and remittance of VAT liability – Section 16 of VAT Act (as amended)

A taxable person shall render to the FIRS, on or before the 21st day of the month following that in which the purchase or supply was made, a return of all taxable goods and services purchased or supplied by him during the preceding month in such manner, as the Federal Inland Revenue Service (FIRS) may, from time to time determine. A person who imports taxable goods into Nigeria shall render returns on all the taxable goods imported by him into Nigeria.

A taxable person shall, on rendering a return:

(i) If the output tax exceeds the input tax, remit the excess to the FIRS; or
(ii) If the input tax exceeds the output tax, be entitled to a refund of the excess tax from the FIRS, on production of such documents, as may be required of him from time to time. An importer of taxable goods shall, before clearing those goods, pay to the FIRS the tax due on those goods.

The Nigerian Customs Service shall, before releasing taxable goods to its importer, demand the Value Added Tax Compliance Certificate issued by the FIRS on those goods.

Limitation of the scope of input tax

The input tax allowed as deduction from output tax is limited to the tax on goods purchased or imported directly for resale and goods which form the stock-in-trade used for the direct production of any new product, on which the output tax is charged.

Consequently, input tax:

(i) On any overhead relating to service, and general administration of any business which otherwise can be expended through the statement of profit or loss; and

(ii) On any capital item and asset, which is to be capitalized along with cost of the capital item and asset, is not allowed as a deduction from output tax.

Every Ministry, statutory body or any other agency of government and oil and gas companies shall, at the time of making payment to a contractor, remit the tax charged on the contract to the FIRS. The remission shall be accompanied with a schedule, showing the name and address of the contractor, invoice number, gross amount of invoice, amount of tax and the month of return.

c) Basis of assessment on commencement of business - section 29 (3) of CITA (as amended)

Section 29 (3) of CITA (as amended) provides that “the assessable profits of any company from any trade or business (or in the case of a company other than a Nigerian company) for its first year of assessment and the two following years of assessment (which years are in this subsection respectively referred to as “the first year”, “the second year” and “the third year”) shall be ascertained in accordance with the following:

i) For the first year, the assessable profits shall be the profits from the date in which it commenced to carry on such trade or business in Nigeria to the end of its first accounting period;
ii) For the second year, the assessable profits shall be the profits from the first day after its first accounting period to the end of its second accounting period; and
iii) For the third year and for each subsequent year, the assessable profits shall be the profits from the day after the accounting period just ended.

d) The income tax liabilities payable for the relevant assessment year

The tax liabilities have been computed thus:

ChiDan Limited
Computation of income tax liabilities
For 2021 assessment year

	₦'000	₦'000
Net profit per accounts		42,264
Add:		
Donations and subscriptions:		
- Motor Boat Club	300	
- Polo Club	250	
- Political parties	7,500	
Allowance for doubtful debts	3,000	
Miscellaneous expenses – court fine	600	
Loss of fund – director	9,800	
Legal expenses – land acquisition	3,750	
Depreciation	42,825	68,025
		110,289
Deduct:		
Profit on sale of property, plant and equipment		(7,860)
Adjusted profit		102,429
Capital allowances		(30,380)
Total profit		72,049
Companies income tax (30% of total profit)		₦21,614,700
Tertiary education tax (2% of assessable profit)		₦2,048,580
Minimum tax liability (0.25% of gross turnover)		₦2,150,625

Whist thanking you for the confidence reposed in us, it is hoped that our comments adequately captured your requests.

Yours faithfully,
For: XZB & Co.

J. A. Yusuf
Managing Consultant

Tutorial notes

i. Loss of fund by a director amounting to ₦9,800,000 is not allowed for tax purposes on the assumption that defalcation by a director is not covered by insurance or contract of indemnity as provided for under section 22 of Companies Income Tax Act Cap C21 LFN 2004 (as amended), therefore, fraud committed by the director of ₦9,800,000 will be disallowed.

ii. Exchange loss on transaction of inter-company balances represents loss on exchange resulting from conversion of foreign liabilities at rates existing as at the statement of financial position date, whilst exchange loss on remittance is the difference between the book value of a foreign liability on the date of settlement and the actual amount at which the foreign liability is eventually settled. The difference between the two is that the first loss is unrealized while the second is realised.

iii. Effective January 1, 2022, the Finance Act 2021, increased the tertiary education tax rate from 2% to 2½%. However, based on FIRS circular, companies which have their accounting years ending between July 1, 2021 and December 2021, must provide for tertiary education tax at the rate of 2½ %.

Examiner's report

The question tests candidates' knowledge of the due dates of filing of audited financial statements to the tax office, filing of VAT returns and remittance of VAT liabilities, basis of assessment on commencement of business, and the computation of tax liabilities.

This being a compulsory question, almost 100% of the candidates attempted the question. The performance of the candidates was fair.

The commonest pitfalls of the candidates were their inability to identify allowable and non allowable expenses and state the due dates for filing of audited financial statements to the tax office for new and existing companies. Additionally, some of the candidates could not explain the basis of assessment for commencement of business and were unable to compute income tax liabilities.

Candidates should ensure that they are abreast of changes in tax laws when preparing for ICAN examinations.

Marking guide

		Marks	Marks
(a)	**Due for submission of audited financial statements to the tax office**		
	- A company that has been in business for more	½	
	- than eighteen months		
	- Due date for filing tax returns is not more than six months after the end of the company's accounting year	½	
	- Newly incorporated company, filing is within eighteen months from the date of incorporation	½	
	- Not later than six months after the end of it's first accounting period	½	**2**
(b)	**Requirements for filing of VAT returns' and remittance of VAT liabilities**		
	- On or before the 21st day of the month following that in which the purchase or supply was made	2	
	- A return of all taxable goods and services purchased or supplied by him	1	
	- Shall render returns on all the taxable goods imported into Nigeria	1	**4**
(c)	**Basis of assessment on commencement of business**		
	- First year – from the date of commencement of business to the end of the first accounting period	2	
	- Second year – from the first day after the first accounting period to the end of the second accounting period	2	
	- Subsequent years- profits from the day after the accounting period just ended	2	**6**
(d)	**Computation of income tax liabilities**		
	- Name of the company	1	
	- Year of assessment	1	
	- Net profit per accounts	1	
	- Add: Donations and subscriptions:		
	- Motor Boat Club	1	
	- Polo Club	1	
	- Political parties	1	
	- Allowance for doubtful debts	1	
	- Miscellaneous expenses – court fine	1	
	- Loss of fund - director	1	
	- Legal expenses – land acquisition	1	
	- Depreciation	1	

Deduct:		
- Profit on sale of property, plant and	½	
equipment	½	
- Capital allowances	1	
- Total profit	1	
- Companies income tax (30% of total profit)		
- Tertiary education tax (2% of assessable	1	
profit)		
- Minimum tax liability (0.25% of gross	1	
turnover)	1	
- Closing paragraph of the letter	1	
- Signature		18
Total		**30**

SOLUTION 2

Mariam, Ola, Jude and Mosaku
Computation of the computed income of the partnership
For 2020 assessment year

	₦	₦
Net profit as per accounts		1,540,000
Add: Legal expenses		100,000
Depreciation		360,000
		2,000,000
Deduct: Profit on sale of property, plant and equipment		4,220
Adjusted profit		1,995,780
Add: Balancing charge		10,400
		2,006,180
Deduct: Balancing allowance	6,900	
Capital allowance	300,000	306,900
Computed income		**1,699,280**

Computation of assessable income of the partners
For 2020 assessment year

	Mariam	Ola	Jude	Total
	₦	₦	₦	₦
Share of profit	339,856	509,784	849,640	1,699,280
Salaries	240,000	200,000	220,000	660,000
Interest on loan	7,400	7,400	7,400	22,200
Gross income	**587,256**	**717,184**	**1,077,040**	**2,381,480**
Consolidated relief allowance:				
₦200,000 + 20% of gross income	(317,451.20)	(343,436.80)	(415,408)	
Chargeable income	269,804.80	373,747.20	661,632	

Computation of personal Income tax payable

	₦	₦	₦
First ₦300,000 @ 7%	18,886.34	21,000.00	21,000.00
Next ₦300,000 @ 7%	-	-	-
Next ₦73,728 @ 11%	-	8,112.19	-
Next ₦300,000 @ 11%	-	-	33,000.00
Next ₦61,600 @ 15%	-	-	9,244.80
Personal income tax payable	18,886.34	29,112.19	63,244.80

Examiner's report

The question tests candidates' knowledge of the taxation of partners.

Over 75% of the candidates attempted the question and the performance was average.

The commonest pitfalls of the candidates were their inability to compute consolidated relief allowance and properly reflect balancing charge and balancing allowance in the income tax computations.

Candidates are advised to pay attention to relevant amendments to tax laws and their effects on tax computations in their preparations for future examinations.

Marking guide

	Marks	Marks
Heading:		
- Name of the partnership	½	
- Computation of assessable income	½	
Net profit as per accounts:	½	
- Add: Legal expenses	½	
- Depreciation	½	
Deduct: Profit on sale of property, etc	½	
Add: Balancing charge	½	
Deduct : Balancing allowance	½	
Capital allowances	½	4½
Computation of assessable income of the partners:		
- Share of profit (½ mark for each partner and total)	2	
- Salaries (½ mark for each partner and total)	2	
- Interest on loan (½ mark for each partner and total)	2	
- Gross income (½ mark for each partner and total)	2	
- Consolidated relief allowance (½ mark for each partner)	1½	
- Chargeable income (½ mark for each partner)	1½	11
Computation of personal income tax payable:		
- First ₦300,000 @ 7%	1½	
- Next ₦73,728 @ 11%	½	
- Next ₦300,000 @ 11% (½ mark for Ola)	½	
- Next N61,000 @ 15% for Jude	½	
- Personal income tax payable (½ mark for each partner)	1½	4½
Total		**20**

SOLUTION 3

(a) **Taxes to be collected by the Federal Government are:**

(i) Companies income tax;
(ii) Withholding tax on companies and non-resident individuals;
(iii) Petroleum profits tax;
(iv) Value added tax;
(v) Tertiary education tax;
(vi) Capital gains tax on companies and non-resident individuals;
(vii) Stamp duties on corporate bodies; and
(viii) Personal income tax on:

- Members of the armed forces of the Federation of Nigeria;
- Members of the Nigeria Police Force; and
- Staff of the Ministry of External Affairs and non-resident individuals.

(b) Taxes and levies to be collected by a state government are:

(i) Personal income tax in respect of:-
- Pay-As-You-Earn (PAYE); and
- Direct taxation (Self-assessment)

(ii) Withholding tax on individuals;
(iii) Capital gains tax on individuals;
(iv) Stamp duties on instruments executed by individuals;
(v) Pools betting and lotteries, gaming and casino taxes
(vi) Road taxes;
(vii) Business premises registration fees, for:-
- Urban areas as defined by each state:
  - ₦10,000 (maximum) for registration; and
  - ₦5,000 per annum for renewal of registration;
- Rural areas as defined by each state:
  - ₦2,000 for registration; and
  - ₦1,000 for annual renewal of registration;

(viii) Development levy (individuals only) not more than ₦100 per annum on all taxable individuals;
(ix) Naming of street registration fees in the state capital
(x) Right of occupancy fees on lands owned by the state in urban cities of the state; and
(xi) Market taxes and levies where state finance is involved.

With the enactment of Federal Capital Territory Internal Revenue Service (FCT-IRS) Act 2015, the FCT-IRS is now responsible for the collection of the following taxes:

(i) Personal income tax:
- Pay-As-You-Earn (PAYE) in respect of all individuals resident in FCT under employment in both public and private sectors; and
- Direct assessment in respect of self-employed individuals and enterprises.

(ii) FCT property tax;
(iii) Stamp duties in respect of individuals and enterprises resident in FCT;
(iv) Withholding tax in respect of individuals and enterprises in FCT; and
(v) Capital gains tax in respect of individuals and enterprises resident in FCT.

(c.) Taxes and levies to be collected by a local government are:

i. Shops and kiosks rates;
ii. Tenement rates;
iii. Marriage, birth and death registration fees;
iv. Slaughter slab fees;
v. On and off liquor license fees;
vi. Street naming registration fee except in the state capital;
vii. Right of occupancy fees on lands in rural areas (exclusive of those collectable by the Federal and state governments);

viii. Market taxes and levies excluding any market where State finance is involved;
ix. Motor park fees;
x. Domestic animal license fees;
xi. Bicycle, truck, canoe, wheel barrow and cart fees, other than a mechanically propelled truck;
xii. Cattle tax payable by cattle farmers only;
xiii. Road closure levy;
xiv. Radio and television licence fees (other than radio and television transmitter);
xv. Radio license fees (to be imposed by the local government of the state in which the car is registered);
xvi. Illegal parking fees;
xvii. Public convenience, sewage and refuse disposal fees;
xviii. Customary burial ground permit fees;
xix. Religious places establishment permit fees; and
xx. Signboard and advertisement permit fees.

Tutorial note

It is pertinent to note that the Federal government expanded the taxes and Levies which the tiers of government can impose through the Schedule to the Taxes and Levies (Approved List for Collection) Act (Amendment) Order, 2015.

In this order made by Minister of Finance, several new tax/levy heads, such as infrastructure maintenance/development levy, wharf landing charge/fee, consumption tax, the National information Technology Development levy, etc were introduced.

However, on May 8, 2020, the Federal High Court sitting in Lagos, delivered judgement in suit number: FHC/L/CS/1082/2019, in a case between the Registered Trustees of Hotel Owners and Managers Association of Lagos (Suing for itself and or behalf of all its members) vs The Attorney-General of the Federation and others, held that the Ministerial Order 2015 is unconstitutional, null and void.

The Court submitted that the Constitution vests the legislature with the power to make laws. The Court further stated that the schedules to a law are part and parcel of the law and as such, only the legislature can amend schedules to a law. The implication of the ruling is that all the taxes and levies that were added to those ones in the Taxes and Levies (Approved List for Collection) Act Cap. T2 LFN 2004, via the Ministerial Order 2015, are illegal and cannot be enforced.

Examiner's report
The question tests candidates' knowledge of the taxes and levies collectible by the Federal Government, state governments and local governments.

About 90% of the candidates attempted the question and the performance was good.

The commonest pitfall of the candidates was that some of the candidates could not distinguish between taxes and levies collectible by the three tiers of government.

Candidates are advised to familiarize themselves with the provisions of the Taxes and Levies (Approved List for Collection) Act Cap. T2 LFN 2004.

Marking guide

		Marks
(a)	Taxes to be collected by the Federal Government (1mark each for any 5 correct points)	5
(b)	Taxes and levies to be collected by a state government (1 mark each for any 5 correct points)	5
(c)	Taxes and levies to be collected by a local government (1 mark each for any 10 correct points)	10
	Total	**20**

SOLUTION 4

Bakosa Insurance Company Plc

a) Recent changes introduced by Finance Acts 2019 and 2020 are:

i. **Definitions**

- Investment income - section 16(6) of CITA (as amended) "Investment income" for the purpose of taxation of a life insurance company means "income derived from investment of shareholders' funds".
- **Gross premium and gross income – section 16(13) of CITA (as amended)** For the purpose of section 16(12) – minimum tax computation:

- “Gross premium” means the total premiums written, received and receivable excluding unearned premium and premiums returned to the insured; and

- “Gross income” means total income earned by a life insurance business including all investment income (excluding franked investment income), fees, commission and income from other assets but excluding premium received and claims paid by reinsurers.

- Gross income may also include other incomes, such as annuities, commission received, rent, as well as surplus arising from actuarial revaluation of the reserve for the unexpired risk account or life fund account transferred to profit or loss account for distribution.

ii. **Minimum tax payable**
Section 16(12) of CITA (as amended), provides that the tax payable by any insurance company for any year of assessment shall not be less than:
- 0.5% of the gross premium for non-life insurance business; and
- 0.5% of gross income for life insurance businesses.

Provided, that all applicable minimum tax under this section shall be reduced to 0.25% for tax returns prepared and filed for any year of assessment falling due on any date between January 1, 2020 and December 31, 2021, both days inclusive.

iii. **Losses can be carried forward indefinitely**
Insurance companies can now carry forward their losses indefinitely.

iv. **Others**

- Based on section 16(8) of CITA (as amended), any insurance company other than a life insurance company shall be allowed for deductions from its premium, the following reserves for tax purposes:
  - Reserve for unexpired risks calculated on a time apportionment basis of the risks accepted in the year instead of the old basis determined on a percentage consistently adopted by the company; and
  - Outstanding claims and outgoings, an amount equal to the total estimated amount of all outstanding claims and outgoings, provided that any amount not utilised towards settlement of claims and outgoings shall be added to the total profits of the following year instead of the old provision which was based on a percentage (25%) of total premium.

- Based on section 16(9)(c) of CITA (as amended), a life Insurance business shall now deduct all normal allowable business outgoings from its investment income and other incomes, and no restriction on a certain percentage (20%) of gross income shall be available as total profit of the company for tax purposes.

b) **Additional documents/information to be filed by insurance business**
An insurance company that engages the services of an insurance agent, a loss adjuster and an insurance broker, shall include in its annual tax returns, a schedule showing the names and addresses of the insurance agent, loss adjuster and an insurance broker, the date their services were employed and terminated, and payments made to them.

An insurance company is expected to maintain the details and schedule of policies and risks accepted in a given year, and the computation of unexpired risks associated with them. The schedule should comprise the name of the policy holder, type of policy, period of the policy, amount of the premium and expired risk computed therefrom.

A schedule detailing the specific items making up the estimated amount of outstanding claims and outgoings shall be prepared, by insurance companies.

Insurance companies shall maintain a schedule of estimated claims and outgoings that constitute the amount deducted every year.

Examiner's report

The question tests candidates' knowledge of the recent changes introduced by the Finance Acts 2019 and 2020 in relation to income tax computations of insurance companies and additional documents / information to be filed by them.

Less than 5% of the candidates attempted the question. Candidates demonstrated a poor understanding of the question, hence performance was poor.

The commonest pitfall was the inability of some of the candidates to explain the effects of the recent changes introduced by Finance Acts 2019 and 2020 on the income tax computations of insurance companies and the additional documents/ information to be filed by them.

Candidates are advised to read ICAN Study Text, Pathfinder and the relevant Finance Acts when preparing for subsequent examinations to ensure better performance in future.

Marking guide

		Marks	Marks
(a)	**Recent changes introduced by finances Act, 2019 and 2020:**		
	(i) **Definitions:**		
	- Investment income	1	
	- Income derived from investment of shareholders fund	1	
	- Gross premium	1	
	- The total premiums written, received and receivable excluding unearned premium and premiums returned to the insured	1	
	- Gross income	1	
	- Total income earned by a life insurance business including all investment income	1	
	(ii) **Minimum tax payable**		
	- 0.5% of the gross premium for non-life insurance business	1	
	- 0.5% of gross income for life insurance business	1	
	- Minimum tax shall be reduced to 0.25% for tax returns prepared and filed between Jan. 1, 2020 and Dec. 31, 2021	1	
	(iii) **Losses carried forward**		
	Insurance companies can now carry forward losses indefinitely	2	
	(iv) **Others**		
	- Reserve for unexpired risks calculated on a time apportionment basis	2	
	- Outstanding claims and outgoing amount equal to the total estimated amount of all outstanding claims and outgoings	2	
	- Life insurance business shall now deduct all normal allowable business outgoings from investment income and other income without restriction	1	16
(b)	**Additional documents/information to be filed by insurance business that engages services of agents, loss adjusters and brokers**		
	- A schedule showing names and addresses of the agents, loss adjusters and brokers	½	
	- Date their services where employed and terminated	½	

-	Details and schedule of policies and risks accepted in a given year	½	
-	Computation of unexpired risk associated with them	½	
-	A schedule detailing the specific items making up the estimated amount of outstanding claims and outgoings	1	
-	A schedule of estimated claims and outgoings that constitute the amount deducted every year	1	4
Total			**20**

SOLUTION 5

a. Contents of WHT returns/payment schedule

Each withholding tax cheque being paid to the Revenue must be accompanied with a payment schedule, which is a list of those who suffered the deductions that make up the cheque. The payment schedule must contain the following particulars:

i. Names of the taxpayers who suffered the deductions;
ii. Their addresses;
iii. The nature of their activities/services and period covered;
iv. Their tax file numbers [now tax identification number (TIN)];
v. The total amount payable;
vi. The rate of tax applied;
vii. The amount of tax withheld;
viii. The balance paid to the taxpayer;
ix. The tax contract for which returns were being made;
x. The date of payment; and
xi. The cheque number and date.

b. Time frame for compliance with WHT returns

For WHT deducted from companies, this should be remitted to Federal Inland Revenue Service, whilst those deducted from individuals should be remitted to the State Internal Revenue Service where the recipient is resident.

The time frame for compliance with WHT returns in respect to companies and individuals is 21 days and 30 days, respectively, from the date the duty to deduct WHT arose or when it was deducted, whichever is earlier.

c. Merits and demerits of WHT scheme

Merits

The following are some of the merits of withholding tax scheme:

(i) Source of government revenue;
(ii) It helps in expanding the tax net by bringing into the tax net persons who were previously unknown to the tax authorities;
(iii) It helps in determining a person's turnover and thus ascertaining the correct income for tax purposes;
(iv) It makes tax payment less cumbersome to the taxpayer who may not have to bother himself going to the tax office to pay his tax;
(v) It reduces incidence of tax evasion;
(vi) It involves little or no cost of collection as it is self accounting in nature; and
(vii) It saves time for the revenue officers to attend to other duties.

Demerits

The demerits of the withholding tax scheme are:

(i) A high rate of withholding tax is likely to affect the operational performance of most businesses;
(ii) The application of withholding tax affects the cash flow of most businesses as they receive amounts less than what they have estimated or budgeted for per the invoices they have issued; and
(iii) It is likely to discourage hard work by Revenue Officers since it is self accounting in nature.

Examiner's report

The question tests candidates' understanding of the contents of withholding tax returns, due dates of filings, and merits and demerits of withholding tax scheme.

About 80% of the candidates attempted the question and performance was above average.

The commonest pitfalls of some of the candidates were their inability to state the time frame for compliance with withholding tax returns.

Candidates are advised to read widely before sitting for the Institute's examinations.

Marking guide

		Marks	Marks
(a)	Contents of WHT returns/payment schedule		
	(1 mark each for maximum of 5 correct points)		5
(b)	Time frame for compliance with WHT returns:		
	- 21 days for companies	2	
	- 30 days for individuals	2	
	- From the date the duty arose or when it was deducted, whichever is earlier	1	5
(c)	Merits of WHT scheme		
	(1 mark each for any 3 correct points)	3	
	Demerits of WHT Scheme		
	(1 mark each for any two correct points)	2	5
	Total		**15**

SOLUTION 6

a. **Badges of trade**

The Royal Commission on the taxation of profit and income gave a summary of considerations that influence the identification of the badges of trade and they include:

(i) The subject- matter of the realisation;
(ii) The length of period of ownership;
(iii) The frequency or number of similar transactions;
(iv) Supplementary work on or in connection with the property realised;
(v) The circumstances that were responsible for the realisation;
(vi) The profit-seeking motive;
(vii) The source of finance;
(viii) Method of acquisition; and
(ix) Existence of similar trading transactions or interest.

Example of cases used to provide justification for the definition of badges of trade is:

Trustees of Methodist Church Mission v FBIR – An assessment was raised on the income from Wesley House, a property developed by the trustees and leased out to tenants. Objection to the assessment was based on the status of the owners (Methodist Church) which enjoys exemption under the Act as being engaged in ecclesiastical activities.

The Federal Revenue court held that the company is doing precisely what it was formed to do, namely, carrying on the business of a company dealing in real estate. Therefore, it cannot claim to be exempted from the incidence of taxation because it is established that the relevant income is derived from a trade or business.

b. Ndakogi Nigeria Limited
Computation of minimum tax payable
For 2020 assessment year

	₦'000
Gross turnover from core business activities	26,000
Revenue from closed operations	4,000
Dividend received (gross)	1,800
Rent received (gross)	850
Revenue from other operating activities	8,000
Total revenue/turnover	40,650
Dividend received (gross)	(1,800)
Gross turnover for computation of minimum tax	38,850

The minimum tax payable is 0.5% of ₦38,850,000 = ₦194,250

Given the fact that a taxpayer has the prerogative to apply the reduced rate of 0.25% in any relevant two assessment years, coupled with the fact that the company commenced business in 2007, it was assumed that the rate of 0.25% must have been applied in the past, hence the application of 0.5%.

Examiner's report

The question tests the candidates' knowledge of the considerations that influence the identification of badges of trade and the computation of a company's minimum tax payable.

Over 70% of the candidates attempted the question and they demonstrated a fair understanding of the question, hence performance was average.
The commonest pitfall was the candidates' poor understanding of badges of trade and their inability to compute minimum tax liability.

Candidates are advised to read relevant study materials in order to perform well in future examinations.

Marking guide

		Marks	Marks
(a)	**Identification of badges of trade**		
	(2marks each for any correct 4 points)		8
(b)	**Computation of minimum tax liability**		
	- Name of the company	½	
	- For 2020 assessment year	½	
	- Gross turnover from core business activities	½	
	- Revenue from closed operations	½	
	- Dividend received (gross)	½	
	- Rent received (gross)	½	
	- Revenue from other operating activities	½	
	- Dividend received (gross)	½	
	- Gross turnover for computation of minimum tax	1	
	- Minimum tax payable @ 0.5%	2	7
	Total		**15**

SOLUTION 7

The tax system usually involves a tripartite aspect, namely the tax policy, the tax laws, and the tax administration.

(a) Tax policy - The tax policies are general statements of intention, which guide the thinking and the action of all concerned towards the realization of the set goals. They usually include:

(i) Movement of emphasis from income tax to consumption tax that is less prone to tax evasion;
(ii) Pursuance of a tax law regime with the aim of reducing individual tax burden, widening the tax net and encouraging savings and investments;
(iii) Introduction of the self-assessment scheme to encourage taxpayer participation in the tax assessment process, which is considered to be realistic in approach. The policy can also include movement from coercive method of taxation to voluntary compliance as in the case of Nigeria in recent time.
(iv) Movement from traditional coercive method of taxation to voluntary compliance;
(v) Engagement in education of taxpayers through public enlightment and tax drive; and
(vi) Using the due process of law and mechanism of an efficient tax administration to curb tax evasion.

(b) **Tax laws**: The tax laws include the following notable tax legislations in Nigeria:

(i) Personal Income Tax Act Cap P8 LFN 2004 (as amended);
(ii) Companies Income Tax Act Cap C21 LFN 2004 (as amended);
(iii) Petroleum Profits Tax Act Cap P13 LFN 2004 (as amended);
(iv) Capital Gains Tax Act Cap C1 LFN 2004 (as amended);
(v) Value Added Tax Act Cap V1 LFN 2004 (as amended);
(vi) Tertiary Education Trust Fund (Establishment, Etc) Act, 2011;
(vii) Stamp Duties Act Cap S8 LFN 2004 (as amended); and
(viii) Petroleum Industry Act 2021.

In Nigeria, the Constitution vests the legislation of income tax, whether personal or corporate on the Federal Government in order to promote uniformity. However, the three tiers of government share the administration of the various taxes. Tax laws are reviewed periodically in line with the changes in social, political and economic conditions of the country.

The power to impose tax in Nigeria is within the exclusive legislative authority of the Federal Government. There are various machineries set up by the government to ensure strict compliance of these laws; non-compliance attracts penalties and fines.

(c) **Tax administration**: This involves practical interpretations and application of the tax laws. The bodies charged with the administration of tax in Nigeria are the Federal, the State and Local governments. The tax authorities of these tiers of government derive their formation from the relevant laws which include:
(i) The Federal Inland Revenue Service (FIRS);
(ii) The State Internal Revenue Service (SIRS);
(iii) The Local Government Revenue Committee;
(iv) Joint Tax Board; and
(v) Joint State Revenue Committee.

Examiner's report

The question tests the candidates' knowledge of tax policy, tax legislations and the bodies charged with the administration of taxes in Nigeria.

About 75% of the candidates attempted the question and the performance was above average.

The commonest pitfall was the candidates' poor understanding of Nigeria tax system.

Candidates are advised to pay attention to this particular aspect of the syllabus.

Marking guide

		Marks	Marks
a	**Tax policy**		
	- As general statement of intention	2	
	- Considerations (1 mark each for any example subject to a maximum of 3 points)	3	5
b	**Tax laws**		
	- (1 mark each subject to a maximum of 5points)		5
C	**Tax administration**		
	(1 mark each for each correct point)		5
	Total		**15**