THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2020 DIET
SKILLS LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Marking Guides

and

Examiner's Reports

FOREWARD

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

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

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

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

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

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

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

NOTES

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

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2020

FINANCIAL REPORTING

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

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

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

a. The financial statements of Orobo, Lepa and Opeke as at December 31, 2018 are as follows:

Statement of financial position as at December 31, 2018

	Orobo Plc	Lepa Limited	Opeke Limited
Non-current assets:	**₦'000**	**₦'000**	**₦'000**
Freehold property	48,750	31,250	12,500
Plant and equipment	19,875	9,375	7,125
Investment	37,500	--	--
	106,125	40,625	19,625
Current assets			
Inventory	14,375	7,500	6,625
Trade receivables	8,250	7,250	9,250
Bank and cash	1,250	3,000	500
	23,875	17,750	16,375
Total assets	130,000	58,375	36,000
Equity and liabilities:			
Equity:			
Ordinary share capital – ₦1 each	50,000	25,000	18,750
Retained earnings	36,500	22,125	9,750
	86,500	47,125	28,500
Non-current liabilities			
12% loan notes	12,500	2,500	-
Current liabilities			
Trade payables	17,000	8,750	7,500
Bank overdraft	14,000	-	-
	31,000	8,750	7,500
Total equity and liabilities	130,000	58,375	36,000

Additional information:

(i) Orobo Plc acquired 15million ordinary shares in Lepa Limited in January 2013 for ₦25million when the retained earnings of Lepa Limited were ₦5million.

(ii) At the date of acquisition of Lepa Limited, the fair value of its freehold property was considered to be ₦10million greater than its value in Lepa Limited's statement of financial position. Lepa Limited had acquired the property in January 2013 and the building element (comprising of 50% of the total value) is depreciated on cost over 40 years.

(iii) Orobo Plc acquired 5.625million ordinary shares in Opeke Limited on January 1, 2017 for ₦12.5million when the retained earnings of Opeke Limited were ₦3.75 million.

(iv) Lepa Limited manufactures components used by both Orobo Plc and Opeke Limited. Transfers were made by Lepa Limited at cost plus 25%. Orobo Plc held ₦2.5million inventory of these components at December 31, 2018. In the same period Orobo plc sold goods to Opeke Limited of which Opeke Limited had ₦2million in inventory as at December 31, 2018. Orobo plc had marked these goods up by 25%.

(v) The goodwill of Lepa Limited is impaired and should be fully written off. An impairment loss of ₦2.3million is to be recognised on the investment in Opeke Limited.

(vi) Non-controlling interest is valued at full fair value, Lepa Limited shares were trading at ₦1.60 just prior to the acquisition by Orobo Plc.

Required:

Prepare the consolidated statement of financial position of Orobo group for the year ended December 31, 2018. (25 Marks)

b. Ikoko Plc started business 3 years ago following a research breakthrough that motivated large scale customers to order the company's new product.

Extracts from the financial statements recently published are as follows:

Statement of profit or loss for the year ended December 31, 2014

	2014	2013
	₦'m	₦'m
Revenue	360	20
Cost of sales	(150)	(12)
Gross profit	210	8
Operating expenses	(50)	(3)
Operating profit	160	5
Interest expense	(10)	-
Tax expense	(60)	(2)
Profit for the year	90	3

Statement of financial position as at December 31, 2014

	2014 ₦'m	2013 ₦'m
Non-current assets:		
Property, plant & equipment	80	20
Current assets:		
Inventory	200	40
Trade receivables	70	25
Bank	(50)	30
Total assets	**300**	**115**
Equity and liabilities		
Equity:		
Ordinary shares of ₦1 each	60	40
Current liabilities:		
Trade payables	190	60
Current tax	50	15
	300	**115**

Required:

i. Discuss **THREE** signs which show that Ikoko Plc is suffering from overtrading during the year ended December 31, 2014 from the published financial statements. (5 marks)

ii Identify any **FIVE** possible causes of the problem from the published financial statements. (5 marks)

iii Recommend any **FIVE** possible solutions to the problem. (5 marks)

(Total 40 Marks)

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

QUESTION 2

Non-accounting professionals usually wonder why an entity's general purpose financial reporting should be regulated without allowing users to be free from choice of presentations.

In order to give clarity on this subject to the non-accounting professionals in your workplace,

You are required to:

a. Explain **FOUR** reasons why financial reporting should be regulated in Nigeria. (4 Marks)

b. Identify and explain **TWO** sources of accounting regulations in Nigeria. (3 Marks)

c. Highlight **THREE** objectives of the International Accounting Standard Boards (IASB). (3 Marks)

d. Eko Transport Company (ETC) limited is preparing its financial statements for publication for the year ended August 31, 2019. The draft statement of changes in equity is presented as follows:

	Share Capital ₦'Million	Share Premium ₦' Million	Retained Earnings ₦' Million	Total ₦' ₦'Million
Balance: 31/8/2018	750	75	135	960
Profit for the year end	0	0	803	803
	750	75	938	1,763
Dividend paid	0	0	(150)	(150)
Balance: 31/8/2019	750	75	788	1,613
Retained earnings (August 31, 2017)			(90)	

Additional information:

(1) On January 10, 2020, ETC Limited discovered that inventory was overstated by ₦105,000,000 as at August 31, 2019 and by ₦90,000,000 as at August 31, 2018.

(2) There was transposition error in reporting dividend payments in the statement of changes in equity, the correct figure as at August 31, 2019 was ₦105,000,000.

(3) The company income tax rate is 30% in each year.

(4) On August 31, 2019; additional shares of 50,000,000 were issued at ₦1.25 kobo. The par value of ETC Limited share is ₦1.00 per share. This was inadvertently omitted in the record of ETC Limited.

You are required to prepare:

i. Revised Comparative Income Statements after necessary adjustments for the years ended August 31, 2018 and 2019. (3 Marks)

ii. Adjusted Statement of Changes in Equity as at August 31, 2019. (5 Marks)

iii. The journal entries to correct the errors in (2) and (4) above (2 Marks)

(Total 20 Marks)

QUESTION 3

a. IAS 10 on events after reporting period has two main objectives:
- To specify when a company should adjust its financial statements for events that occur after the end of the reporting period; and
- To specify the disclosure that should be given about events that have occurred after the end of the operating period but before the financial statements were authorised for issue.

Required:

Discuss the following key concepts under IAS 10:
i. Event after reporting period
ii. Adjusting events
iii. Non-adjusting events (6 Marks)

b. The following events took place in Chakachaka Company Nig. Limited:

(i) Shortly after the financial year ended on June 30, 2018 but before the financial statements were authorised for issue, Chakachaka Nigeria Limited's inventory was destroyed by a fire outbreak which resulted in a loss of ₦200 million.

(ii) The company's financial year that ended June 30, 2018 shows an amount of ₦60million that is due from one of its debtors, Mr. Onigbese. Chakachaka Nigeria Limited provided for impairment at June 30, 2018 of ₦15million against the gross value of ₦60million due from Mr. Onigbese. On July 31, 2018 before the financial statements were authorised for issue, Mr. Onigbese was declared bankrupt and unable to pay the debt.

(iii) Chakachaka Nigeria Limited was sued on June 30, 2018 but the judgment was only handed down on July 21, 2018. The Company was found liable for damages and cost amounting to ₦31million were awarded against it. On July 22, 2018, Chakachaka Nigeria Limited filed a claim with its insurers and on July 29, 2018, it was notified that the insurer would only cover ₦26 million of the loss.

Required:

Prepare a brief memorandum advising the directors of Chakachaka Nigeria Limited. on the accounting treatment and/or disclosure required as a result of the events in (i) to (iii) after the reporting date. (14 Marks)

(Total 20 Marks)

QUESTION 4

Gbenga Nigeria Plc trial balance as at December 31, 2019 is shown below:

	₦	₦
Revenue		2,290,125
Administration expenses	237,150	
Selling and distribution expenses	175,200	
Legal and professional expenses	81,150	
Allowance for receivables		8,625
Inventories – finished goods – 31/12/18	276,750	
Work-in-progress – 31/12/18	49,125	
Inventories – raw materials at cost – 31/12/18	162,600	
Purchases – raw materials	1,125,900	
Carriage inwards – raw materials	15,750	
Manufacturing wages	375,000	
Manufacturing overheads	187,500	
Authorised and issued 900,000 ordinary share of 50 kobo each fully paid		450,000
150,000 8.4% cumulative preference shares of ₦1 each fully paid		150,000
Revaluation surplus		65,000
Share premium		150,000
General reserve		85,000
Retained earnings – 31/12/18		425,250
Patents and trademarks	323,250	
Motor vehicle at cost	112,500	
Freehold property at cost	375,000	
Leasehold property at cost	112,500	
Plant and equipment at cost	225,000	
Furniture and fittings at cost	75,000	
Amortisation of leasehold property – 31/12/18		22,500
Accumulated depreciation @ 31/12/2018:		
Plant and equipment		102,750
Furniture and fittings		23,625
Motor vehicles		37,500
10% loan notes		150,000
Trade payables		146,250
Trade receivables	266,445	
Bank overdraft		76,875
Cash	7,680	
	4,183,500	**4,183,500**

(i) A gain of ₦20,000 made on the revaluation of old freehold property during the year is yet to be accounted for.

(ii) Inventories at December 31, 2019 were:

	₦
Raw materials	168,900
Finished goods	413,025
Work-in-progress	56,700

(iii) Legal and professional expenses include solicitor's fees for purchase of new freehold land during the year of ₦7,500.

(iv) Provision is to be made for full year's interest on the loan notes.

(v) The leasehold land and buildings are held on 50 years lease, with 40 years unexpired life left as at the end of December 31, 2018.

(vi) Depreciation for the year is to be charged as follows:
- Plant and equipment 8% on cost – charged to production
- Furniture and fittings 10% on cost – charged to administration
- Motor vehicles 20% on carrying amount – charged -25% to administration and 75% to selling and distribution.

(vii) Income tax on the profit for the year is estimated at ₦68,900 and is due for payment on February 28, 2020.

Required:

Prepare the statement of profit or loss and other comprehensive income for the year ended December 31, 2019. **(Total 20 Marks)**

QUESTION 5

International Financial Reporting Standards (IFRS) may either be **premised on principle or rule based concepts.**

You are required to:

a. Explain the principle and rule based concepts. (7 Marks)

b. Highlight the **THREE** basic steps/processes necessary for developing a new accounting standard. (3 Marks)

c. The Board of directors of Adamu Limited has decided to dispose off a group of held-for-sale-assets. The extracts of carrying amounts of the assets immediately before classification as held-for-sale were stated as follow:

	₦'000
Goodwill	80,000
PPE at revalued amounts	208,000
PPE at cost	320,000
Inventory	84,000
Financial asset	68,000
	760,000

The Board estimated that the fair value of the disposal group is ₦650,000,000 gross with selling costs amounting to ₦10,000,000.

Required:

i. Explain what is meant by disposal group and the rules of recognition under IFRS 5 – Non-current assets held for sale and discontinued operations. (2 Marks)

ii. Determine and allocate the impairments on the disposed off asset under IFRS 5. (4 Marks)

iii. Prepare necessary journal entries to record the transactions. (1 Mark)

iv. Identify **THREE** applicable criteria under IFRS 5 for classifying an asset or disposal group as held for sale in the financial statements. (3 Marks)

(Total 20 Marks)

QUESTION 6

Noodles Nigeria Limited **(NNL)** manufactures various type of noodles in Oluyole for sale across the states in Nigeria. Recently, to continue to sustain leadership of the company in the Nigerian market, on September 1 2015; a brand new machine was bought from a supplier under the following conditions:

	₦' 000
Supplier's invoice price	500,000
Trade discount applicable to invoice price 25%	
Discount applicable on invoice price for early settlements 5%	
Freight and shipment cost	100,000
Stevedore expenses	20,000
Initial operating losses	10,000
Handling cost	15,000
Electrical and installation cost	25,000
Interest on loan to the point of usage	12,000
Interest on loan after the usage	18,000
Pre-operation expenses	5,000
Staff training in use of the machine	4,000
Professional and consultancy fee on advice to buy the machine	30,000
Purchase of a four-year maintenance contract	120,000
Pre-production testing cost	13,000
Estimated residual value	90,000

Estimated useful life in machine output/units 5,000,000

Actual Outputs:	**Y/E 31/8/2016 '000**	**Y/E 31/8/2017 '000**	**Y/E 31/8/2018 '000**	**Y/E 31/8/2019 '000**
Outputs/Units	1,000	1,200	1,400	800

On September 1, 2016, **NNL** Limited decided to upgrade the machine by adding new major components at a cost of ₦300,000,000. As a result of the new upgrade, there was an increase in the remaining useful life of the output to 8,000,000 units on September 1, 2016 and the residual value of the machine was revised to ₦114,000,000.

You are required to:

a. Describe what is meant by depreciable amount within the context of IAS 16 on property, plant and equipment (PPE). (1 Mark)

b. Highlight **THREE** characteristics of depreciable assets under IAS 16. (3 Marks)

c. Describe the **TWO** models of accounting for cost of property, plant and equipment (PPE) under IAS 16. (3 Marks)

Calculate the following:

i. Machine cost. (3 Marks)

ii. Revenue expenditure over the years in the statement of profit or loss. (5 Marks)

iii. Carrying amounts of the machine over the years. (5 Marks)

(Total 20 Marks)

SOLUTION 1

(a) OROBO GROUP PLC

Consolidated statement of financial position as at December 31, 2018

Non-current assets	**N'000**
Free hold property (w2)	89,250
Plant and equipment (19,875 + 9,375)	29,250
Investment in associates (w3)	11,880
	130,380
Current assets:	
Inventory (w4)	21,375
Trade receivable (8,250 + 7,250)	15,500
Bank and cash (1,250 + 3,000)	4,250
	41,125
Total assets	171,505
Equity and liabilities:	**N'000**
Equity	
Ordinary share capital	50,000
Retained earnings (w5)	44,805
	94,805
Non-controlling interest (w6)	21,950
	116,755
Non-current liabilities	
12% loan notes (12,500 + 2,500)	15,000
Current liabilities	
Trade payables (17,000 + 8,750)	25,750
Bank overdraft	14,000
	39,750
	171,505

Working Notes:

(w1) Control

$\frac{15}{25} \times \frac{100}{1} =$

Orobo Plc

60% Lepa Ltd

30% Opeke Ltd $= \frac{5625}{18750} \times 100$

(w2) Freehold property:

	₦'000
Orobo Plc	48,750
Lepa Ltd	31,250
Fair value adjustment (w9)	10,000
Additional depreciation [10,000 x 50% ÷ 40] x 6 years (2013 – 2018)	(750)
	89,250

(w3) Investment in associates

	₦'000
Cost of investment	12,500
Share of post-acquisition profits (9,750 – 3,750) x 30%	1,800
Less: Unrealised Profits (UR) (w8)	(120)
Impairment	(2,300)
	11,880

(w4) Inventory

	₦'000
Orobo Plc	14,375
Lepa Ltd	7,500
UR profit (2,500 x 25/125) (w8)	(500)
	21,375

(w5) Retained earnings

	OroboPlc	**Lepa Ltd.**	**Opeke Ltd.**
	₦'000	**₦'000**	**₦'000**
Retained earnings per question	36,500	22,125	9,750
Adjustments:			
Unrealised profit (w3&w4)	(120)	(500)	--
Fair value adjustment (w2)	--	(750)	--
Impairment loss (w7)	--	(1,000)	--
	--	19,875	9,750
Less: Pre-acquisition reserve	--	(5,000)	(3,750)
	36,380	14,875	6,000
Post-acquisition profit:-			
Lepa Ltd. (14,875 x 60%)	8,925		
Opeke Ltd. (6,000 x 30%)	1,800		
Impairment loss Opeke Ltd	(2,300)		
	44,805		

(w6) Non-controlling interest (NCI)

	₦'000
NCI at acquisition (10,000 x N1.60) (w7)	16,000
Share of post-acquisition retained earnings (14,875 x 40%)	5,950
	21,950

(w7) Goodwill

	₦'000	₦'000
Lepa Ltd		
Consideration transferred		25,000
Non-controlling interest (10,000 x ₦1.60)		16,000
Less:		41,000
Net asset acquired:		
Share capital	25,000	
Retained earnings (pre)	5,000	
Fair value adjustment	10,000	(40,000)
Goodwill at acquisition		1,000
Less: Impairment (full impairment)		(1,000)
		Nil

(w8) UR profit

On Sale by Lepa Ltd to OroboPlc (Parent)	2,500 x 25/125	= 500
On sale by Orobo Plc to Opeke Ltd. (Associates) 2,000 x 25/125 x 30%		= 120

(w9) Fair value adjustments

	Difference at acquisition ₦'000	Difference now ₦'000
Property	10,000	10,000
Additional depreciation (5,000 x 6/40)	-	(750)
	10,000	9,250

(b i) To fully identify the financial problems Ikoko Plc suffered, there is the need to match revenue with production cycles on the one hand and assess the cash on the other hand.

- There was an increase in revenue base from ₦20m to ₦360m in 2014, there was a revenue growth of ₦340m. This is a clear case of a large volume of business which requires large working capital to be able to meet orders which the company did not have.
- Ikoko Plc's working capital deteriorated deeply from ₦20m positive (₦95m – ₦75m) in 2013 to ₦20m negative (₦270m – ₦290m) in 2014, which is a symptom of inefficient working capital management.
- There was interest expense of ₦10m in 2014 as against zero expense in 2013 as a result of heavy borrowing. This impacted negatively on the company's net profit.

- The company has a positive bank balance of ₦30m in 2013 and has overdraft of ₦50m in 2014 which is an indication of illiquidity in the company's cash position.
- The company had delay in meeting obligations to suppliers and vendors as trade payables increased from ₦60m to ₦190m. Also the current tax liability increased from ₦15m to ₦50m.

(ii) **Possible causes of over-trading**

- Fall in liquidity ratios (current and acid test ratios)
- Rapid increase in revenue.
- Sharp increase in sales to non-current assets ratio.
- Increase in inventory in relation to revenue.
- Increase in the accounts payable period.
- Increase in short-term borrowing and/or a decline in cash balance.
- Increase in gearing.
- Decrease in the profit margin.
- Decline in current and acid test ratios.
- Increase in receivables in the current year relative to the preceding year.
- High incidence of taxation.

(iii) **Possible remedies of over-trading**

- Speed up collection from customers.
- Slow down payment to suppliers.
- Maintain lower inventory levels.
- Increase the capital through equity.
- Increase cash sales.
- Rectify mismatch between non-current and current assets.
- Increase bank funding.
- Reduce business funding.
- Raise long-term debt capital.
- Speed up work-in-progress into finished goods and sell to reduce the working capital needed.
- Acquire non current assets by lease or hire purchase

Marking Guide

		Marks	Marks
(a)	Consolidated statement of financial position:		
	Title of financial statement	¾	
	Determination and presentation of non current assets	3¾	
	Determinations of goodwill on consolidation	2¾	
	Calculation of investment in associates	2½	
	Determination and presentation of current assets	3½	
	Determination of equity	5¾	

	Calculation of non-controlling interest	1½	
	Determination of non-current liabilities	¾	
	Determination of current liabilities	1½	
	Workings for group structure and URP and fair value adjustments	2½	25
(bi)	Signs of overtrading:		
	Points on revenue expansion	2	
	Points on weak working capital	2	
	Any other point on overtrading	1	5
(bii)	Possible cause of overtrading		
	Any five possible causes	5	5
(biii)	Any five remedies	5	5
	Total		**40**

Examiner's Report

The question tests candidates' knowledge of preparation of consolidated statement of financial position in part (a) while part (b) is on interpretation of financial statement with particular emphasis on over trading including possible causes and solutions to the problems.

All the candidates attempted the question and their performance was average. The commonest pitfalls were the inability of the candidates to properly account for investments in associates and correctly calculate the fair value adjustments. Also, most candidates could be justify why Ikoko Plc Company was suffering from over trading using the information provided in the company's financial statement.

Candidates are advised to pay more attention to group accounts, as well as, interpretation of financial statements as these are important sections of syllabus at the skills level of the Institute's examination.

SOLUTION 2

(a) (i) The needs for regulatory framework:

- Regulations ensure that external users of financial statements are provided with information relevant for their decision making.
- They ensure that users get reliable information.
- Regulations ensure that entities adopt similar accounting treatments of similar items and account for similar transactions in the same way.
- They enable comparison of financial statements of different entities and comparison of entity's performance of current year with those of previous years.
- Without regulations, management could deliberately engage accounting methods to prepare financial statements to mislead users.

(b) **Accounting standards**

Accounting standards are authoritative statements of how particular issues are reflected or reported in the financial statements, e.g. IFRS in Nigeria

Company law

The company law varies from one country to another. It typically sets out rules for determining profits available for distribution, issuing and redeeming share capital, the reserves that an entity must have and use to which they can be put.

Listing rules for listed companies

Listing rules set out the information which entities must supply when their shares are traded on a major stock market. They must comply with these rules to maintain their listing.

(c) **Objectives of IASB is to:**

- Develop, in the public interest, a set of high-quality global financial standards;
- Promote the use and application of those standards;
- Take account of the special needs of small and medium size entities and emerging economies; and
- Promote and facilitate the adoption of IFRS through convergence of national and international accounting standards.

(d) (i) **Revised comparative income statements**

	2018 ₦'m	2019 ₦'m	
Retained/profit for the year (135 + 90)	225	578	(803-225)
Add/less:			
Overstatement of closing inventory	(90)	(15)	(105 – 90)
Tax effect at 30%	27	4.5	
	(63)	(10.5)	
Revised profit	162	567.5	

Adjusted

(ii) **statement of changes in equity for the year ended August 31, 2019**

	Share Capital	Share Premium	Retained Earnings	Total
	₦'million	₦'million	₦'million	₦'million
Balance as at 31/08/2018	750	75	135	960
Adjustments	-	-	(63)	(63)
Restated balance	750	75	72	897
Profit for the year	_	_	567.5	567.5
Dividend paid	-	-	(105)	(105)
New shares issued	50	12.5	-	62.5
Balance as at 31/08/2019	800	87.5	534.5	1,422

(iii) **Journal entries for correction of errors**

	Dr. ₦'million	Cr. ₦'million
Suspense account	45	
Retained earnings account		45
Being transposition error of dividend paid now corrected		
Bank account	62.5	
Ordinary share capital account		50
Share premium account		12.5
Being proceeds from issue of shares completely omitted.		

Marking Guide

		Marks	Marks
(a)	Reasons for financial reporting regulation in Nigeria:		
	Any four (4) correct points		4
(b)	Sources of accounting regulation in Nigeria:		
	Identification of any 2 sources	2	
	Explanation of the 2 sources	1	3
(c)	Objectives IASB:		
	Any three (3) correct points		3
(di)	Preparation of revised income statement		
	Determination of retained profits	1	
	Adjustment of over-statement of inventory/ tax effects	2	3
(ii)	Correct title	1	
	Correct posting in statement of changes in equity	3	
	Correct balance as at August 31, 2019	1	5
(iii)	Journal entries to correct errors		2
	Total		20

Examiner's Report

The question tests candidates' knowledge of regulatory framework on financial reporting as well as preparation of statement of changes in equity which, reflects prior year adjustments.

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

Some candidates could not correctly explain the sources of accounting regulations in Nigeria while others could not correctly reflect the effects of prior year adjustments, in a statement of changes in equity, and which led to loss of valuable marks.

Candidates are advised to pay more attention to all the sections of the syllabus for better performance in future examinations of the Institute.

SOLUTION 3

(a)

(i) **Events after reporting period:** These are events favourable or unfavourable which occur between the end of the reporting date and the date the financial statements are authorised for issue.

(ii) **Adjusting event:**
An adjusting event is an event which provides further evidence of a condition existing at the reporting date. An entity shall adjust the amounts recognised in its financial statements for the period just ended to reflect adjusting event after the reporting period.

(iii) **Non –adjusting event**

- An entity shall not adjust the amount recognised in its financial statement to reflect non-adjusting event after the reporting date. In this case, there was no condition existing at the reporting date, so no adjustment should be made.

- Disclosure should be made in note form in the financial statement for significant non-adjusting event after reporting date.
- If a non-adjusting event means the going concern concept no long applies to the entity, then the event should be treated as an adjusting event i.e. the financial statement should not be prepared on going concern basis.

(b) **To: Directors of Chakachaka Nig. Ltd.**

From: Consultants

Subjects: Event after reporting period

The following accounting treatments and disclosures are recommended for the events highlighted:

(i) **Inventory destroyed by fire outbreak**

- This event is a 'non-adjusting event' as it is indicative of a condition (fire) that arose after the end of the reporting period.

- As this is a non-adjusting event, no adjustment will be made to the amount recognised in the financial statement of your company for the year ended June 30, 2018.

- However, if the loss of ₦200million is consequential enough that its non-disclosure would influence the economic decision of the users of the financial statements, disclosure of the nature of the event, the estimate of its financial effects or a statement if such an estimate cannot be made would be required.

(ii) **Bankrupt Debtor – Mr. Onigbese**

This is an adjusting event and Chakachaka Nig. Ltd. should impair the amount receivable (₦60 million) from Mr. Onigbese as at June 30, 2018.

His bankruptcy after the end of the reporting period provides evidence of the fact that the amount receivable from the debtor was impaired at the end of the reporting period.

(iii) **Judgement debt**

- This is an 'Adjusting event' – This is because the liability existed at the reporting date, but confirmation of the amount was only received on July 21, 2018.
- The financial statement should be adjusted to reflect the information received subsequently. Accordingly, provisions should be made for the entire amount of the judgement debt.
- The filing of the insurance claim only took place following the reporting date; hence no account should be taken of this at June 30, 2018. As confirmation of the success of the claim was received prior to the signing off date this should be disclosed in the notes to the financial statements of Chakachaka Nig. Ltd.

Conclusion

You should not hesitate to contact me if you need further explanation.
Thank you.

Consultant

Marking Guide

		Marks	Marks
(a)	Discussion of key concepts:		
	Explanation of events after reporting date	2	
	Explanation of adjusting events	2	
	Explanation of non-adjusting events	2	6
(b)	Memorandum to Directors of Chakachaka Ltd		
	Presentation in memo format paragraph	½	
	Opening/Introduction	½	
	Discussion on accounting treatment and disclosure in respect of the fire incident (3 points)	4½	
	Discussion on accounting treatment disclosure in respect of Bankrupt Debtor:		
	Any two (2) points	3	
	Discussion on accounting treatment and disclosure in respect of judgement debt		
	Any three (3) points	4½	
	Conclusion of memo	½	
	Closing/Name/Signature	½	14
	Total		**20**

Examiner's Report

The question tests candidates' knowledge of IAS 10 – Events After Reporting Period, and the application of the provisions of the standard to practical situations.

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

Majority of the candidates could not correctly define some of the basic terminologies in the standard, while others were unable to apply the provisions of the standards to the practical situations.

Candidates are advised to pay more attention to all relevant international accounting standards at this level of the Institute's examination for better performance in future.

SOLUTION 4

Gbenga Nigeria Plc
Statement of profit or loss and other comprehensive income for the year ended December 31, 2019

	₦
Revenue	2,290,125
Cost of sales (Wk 1)	(1,572,000)
Gross profit	718,125
Administrative expenses (Wk 2)	(250,650)
Selling and distribution expenses (Wk 3)	(186,450)
Legal and professional expenses (Wk 4)	(73,650)
Operating profit	207,375
Finance cost (Wk 5)	(27,600)
Profit before tax	179,775
Income tax expense	(68,900)
Profit for the year	110,875
Other comprehensive income	
Revaluation surplus (Wk 6)	20,000
Total Comprehensive income	130,875

Workings Notes

1. Cost of sales:

	₦	₦
Opening inventory:		
Raw materials	162,600	
Work-in-progress	49,125	
Finished goods	276,750	488,475
Purchases-raw materials		1,125,900
Carriage inwards		15,750
Less: Closing Inventory:		
Raw materials	168,900	
Work-in-progress	56,700	
Finished goods	413,025	(638,625)
Manufacturing wages		375,000
Manufacturing overhead		187,500
Depreciation-plant and equipment		18,000
		1,572,000

2. Administrative expenses

As per trial balance	237,150
Depreciation:	
Leasehold (112,500 - 22,500) ÷ 40	2,250
Furniture and fittings (10% × 75,000)	7,500
Motor vehicle (112,500 - 37,500) × 20%) × 25%	3,750
	250,650

3. Selling and distribution expenses

As per trial balance	175,200
Depreciation-motor vehicle	11,250

	186,450
4. Legal and professional	
As per trial balance	81,150
Amount relating to acquiring land	(7,500)
	73,650
5. Finance cost	
Loan notes (10% × 150,0000)	15,000
Cumulative preference shares	12,600
	27,600
6. Revaluation surplus	
As per trial balance	65,000
Gain on revaluation	20,000
	85,000

Marking Guide

	Marks
Preparation of statement of profit or loss and other comprehensive income:	
Title of the statement	½
Determination of gross profit	8½
Determination of profit before taxation	9
Determination of profit for the year	1
Determination of total comprehensive profit	1
Total	**20**

Examiner's Report

The question tests candidates' knowledge of preparation of statement of profit or loss and other comprehensive income.

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

The commonest pitfall was that some candidates recognised revaluation surplus in the statement of profit or loss, instead of other comprehensive income.

Candidates are advised to pay attention to all sections of the syllabus for improved performance in future.

SOLUTION 5

(a) **Principle and rule based concepts**

- A rule-base financial reporting system is a list of detailed rules that must be followed when preparing financial statements.
- A principle-based system relies on generally accepted accounting principles that are conceptually based and are normally underpinned by a set of key objectives.
- Company law consists of detailed rules. Accounting standards may be rule-based or principle-based. IASs and IFRSs are mainly principles based, though some would argue that in practice they are a mixture of rules and principles.
- It is possible for rules and principles to complement each other. Many countries (including Nigeria, the UK, Canada and Australia) have a regulatory system in which company law deals only with a few specific matters. Detailed financial reporting practice is developed by the accounting profession through accounting standards.
- Accounting standards are generally (though not always) principle based.
- When accounting standards are principle based they allow reporting practice to develop over time in response to the needs of users and changes in the business environment.
- Accounting standards usually allow preparers to exercise judgement in developing accounting policies that are appropriate to the circumstances of a particular entity.
- In other countries the content of financial statements and accounting practice may be prescribed in great detail by company law with little scope for individual judgement. Because the existing framework is based on detailed rules, users of the financial statements tend to view principles-based accounting as insufficiently rigorous.

(b) **Basic Steps/Processes for developing a new standard**

- Identification of the need for new accounting standard or the revision of an existing accounting standard.
- Issuing of discussion document for public comments with the aim of issuing an exposure draft after taking into consideration various opinions and comments.
- Issuing and publishing the new or the revised accounting standard.

(c) (i) **Disposal group** is a group of assets to be disposed of by sale or otherwise, together as a group in a single transaction and any liabilities directly associated with those assets that will be transferred in the transaction. A disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit. Some disposal groups might fall into the definition of a discontinued operation.

Rule of recognition of disposal group under IFRS 5

A non-current asset (or disposal group) must be classified as held for sale when its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

(ii) Determination/allocation of impairment loss on the disposal group asset

	₦'000	₦'000
Carrying amount		760,000
Less:		
Fair value of the disposal group	650,000	
Cost to sale	(10,000)	
Fair value less cost to sales		(640,000)
Impairment losses		120,000

Allocation of impairment loss on the disposal group assets

	Carrying Value ₦'000	Impairment Loss ₦'000	Workings	Balance ₦'000
Goodwill	80,000	(80,000)		-
PPE at revalued amount	208,000	(13,595)	208/612 x 40,000	194,405
PPE at cost	320,000	(20,915)	320/612 x 40,000	299,085
Inventories	84,000	(5,490)	84/612 x 40,000	78,510
Financial assets	68,000	-		68,000
	760,000	(120,000)		640,000

(iii) Journal entries

	DR ₦'000	CR ₦'000
Impairment loss (profit or loss and other comprehensive)	120,000	
Goodwill		80,000
PPE at revalued amount		13,595
PPE at cost		20,915
Inventories		5,490

Being impairment loss allocated to the disposed assets.

(iv) **Criteria**

The following conditions must apply at the reporting date for an asset (or disposal group) to be classified as held for sale:

- It must be available for immediate sale in its present condition subject only to terms that are usual and customary for sale of such assets (or disposal groups);

- The sale must be highly probable, i.e.:
  - the appropriate level of management must be committed to a plan to sell the asset (or disposal group);
  - an active programme to locate a buyer and complete the plan must have been initiated; and
  - the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value;

- The sale must be expected to be completed within one year from the date of classification (except in limited circumstances) and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Marking Guide

		Marks	Marks
(a)	Principle or rule based concepts:		
	Explanation of principle and rule based concepts:		
	Any 7 points		7
(b)	Basic Steps/Processes for developing new standards:		
	Three (3) points		3
(c) (i)	Explanation of disposal group and rules of recognition under IFRS 5:		
	Explanation of disposal group	1	
	Stating the rule of recognition of disposal group	1	2
(ii)	Determination and allocation of impairment loss:		
	Determination of impairment loss on disposal group	1	
	Allocation of impairment loss	3	4
(iii)	Preparation of journal entries to record allocation of impairment loss		1
(iv)	Criteria for classification of disposal group of an asset held for sale		
	Three (3) correct criteria		3
	Total		**20**

Examiner's Report

The question tests candidates' knowledge of the principles and application of IFRS 5 Non-Current Assets held for Sales and Discontinue Operations.

Only few candidates attempted the question and performance was poor.

Most of the candidates could not correctly allocate the impairments on the disposal of assets under IFRS 5.

Candidates are advised to pay more attention to the provisions and application of international accounting standards that are relevant at this level of the Institute examinations.

SOLUTION 6

a. **The Depreciable amount** is the cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value i.e. Cost less residual value.

b. **Characteristics of depreciable assets**

   i) It must have a limited useful life.
   ii) The useful life must be more than 1 year.
   iii) It must be acquired for production of goods and services of the entity.
   iv) Must not have intention of selling it in the ordinary course of business.

c. **Models of accounting for cost of PPE**

   IAS 16 allows a choice of accounting treatments after initial recognition. All items of property, plant and equipment in a class can be accounted for using one of two models:

   - **Cost model:** Under this model, property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.
   - **Revaluation model:** Under this model, property, plant and equipment is carried at a revalued amount. This is the fair value at the date of the revaluation less any subsequent accumulated depreciation and any accumulated impairment losses.

(d) (i) **Computation of cost of the machine as at:**

September 1, 2015.	**₦'000**
Supplier's Invoice price	500,000
Trade discount to invoice price at 25%	(125,000)
Freight and shipment cost	100,000
Stevedore expenses	20,000
Handling cost	15,000
Electrical and installation cost	25,000
Professional and consultancy fee	30,000
Pre-production testing cost	13,000
	578,000

Subsequent measurement as at September 1, 2016	**₦'000**
Carrying Value after year 1 (i.e. 31/08/2016)	480,400
Upgrade expenditure	300,000
	780,400

(ii) **Revenue expenditure over the years in the financial statement**

	2016	**2017**	**2018**	**2019**
	₦'000	**₦'000**	**₦'000**	**₦'000**
Depreciation	97,600	199,920	233,240	133,280
Initial operating losses	10,000			
Interest on loan to the point of usage	12,000			
Interest on loan after usage	18,000			
Pre-operational expenses	5,000			
Staff training	40,000			
Maintenance contract	30,000	30,000	30,000	30,000
	212,600	**229,920**	**263,240**	**163,280**

(iii) **Computation of carrying amount of the machine over the Years**

	Depreciable Amount	**Output**	**Workings**	**Depr.**	**Carrying Amount**
	₦'000	**₦'000**		**₦'000**	**₦'000**
Depreciable amount 578m - 90m	488,000				
Total output		5,000			
Year 1 – 2016		1,000	1000/5000*488m	97,600	570,400
Depreciable amount = 780.4m - 114m	666,400				
Total output		8,000			
Year 2 – 2017		2,400	2400/8000*666.4m	199,920	580,400
Year 3 – 2018		2,800	2800/8000*666.4m	233,240	347,240
Year 4 – 2019		1,600	1600/8000*666.4m	133,280	213,960
Year 5 - 2020		1,200	1200/8000*666.4m	99,960	114,000

Marking Guide

		Marks	Marks
(a)	Description of depreciable amount:		
	- Correct description		1
(b)	Characteristics of depreciable assets		
	- Any three (3) points		3
(c)	Models of accounting for cost of ppe		
	- Description of cost model	1½	
	- Description of revaluation model	1½	3
(i)	Calculation of machine cost		3
(ii)	Calculation of revenue expenditure over the years in the statement of profit or loss		
	- 2016 revenue expenditure	2	
	- 2017 revenue expenditure	1	
	- 2018 revenue expenditure	1	
	- 2019 revenue expenditure	1	5
(iii)	Determination of carrying amount of the machine over the years		
	- 2016 Carrying amount	1½	
	- 2017 Carrying amount	1	
	- 2018 Carrying amount	1	
	- 2019 Carrying amount	1	
	- 2020 Carrying amount	½	5
	Total		**20**

Examiner's Report

The question tests the principles and applications of the provisions of International Accounting Standards, IAS 16 – property, plant and equipments.

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

Most candidates were able to describe the terminologies of the standards, however, they could not correctly apply it to determine the cost of machinery as well as their carrying amount machinery over the years.

Candidates are advised to pay more attention to practical application of International Financial Reporting Standards for better performance in future examinations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2020

AUDIT AND ASSURANCE

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

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

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

Aladdin Insurance Nigeria Limited is a private company that provides life and non-life insurance services. The company has annual gross premium of ₦15 billion. Ordinarily, the underwriting process is manual and is initiated when a customer walks into a branch and fills a proposal form requesting for an insurance policy (or an agent fills in the form at the request of the customer). The proposal form requires information relating to the subject matter of the insurance policy/cover required by the customer as this will aid the company in assessing the risks attached and will also help the underwriter to quote a reasonable premium amount. The prospective insured must disclose all material and relevant information. The policy proposal form requires important information, such as:

- The name and address of the customer;
- Occupation of the customer;
- Details of the property being proposed for insurance. This could be vehicle details (for motor insurance) property (for burglary or fire) or other details relating to life insurance, etc;
- Value of the property being proposed for insurance; and
- Previous insurance history of the client.

The underwriter reviews the information in the proposal form and assesses the risks inherent in the contract with a view to making a recommendation as to whether to accept or reject the proposal; if the recommendation is to accept, how much premium should be charged. For external and complex risks, external inspectors are engaged. After inspection, the report is sent to the underwriter to review and consider if any risk recommendations should be made to the customer (usually on how to properly manage risks) or if an amendment to the policy wordings is required. The proposal form and the recommendation of the underwriter is passed on to an approving authority based on the approval limits.

On approval of the policy, the policy terms are communicated to the customer for review and acceptance. On acceptance, the customer signs the proposal form and pays the premium. Payment method includes cash, cheques, bank transfers. The details of the policy are recorded in the system by the underwriters who also act as the accountants. Based on NAICOM's requirements, premium should be paid before the insurance cover starts.

However, due to the COVID 19 pandemic, the Federal Government announced a lock down of Lagos, thereby imposing a restriction on movement of goods and persons in the state. In response to this, the company bought a new underwriting system and automated its entire underwriting process.

Required:

a. List **FIVE** control areas for General Information Technology (IT) Controls and examples of controls that can be found in each area. (20 Marks)
b. Identify the weaknesses in the process and a control that might address each weakness. (10 Marks)
c. Explain the limitations of internal controls. (4 Marks)
d. List and explain the type of audit procedures that might be appropriate in the audit of gross premium income. (6 Marks)

(Total 40 Marks)

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

QUESTION 2

In a bid to increase the interest of students in auditing, your audit firm has instituted a program in conjunction with universities in Nigeria, whereby the universities provide the firm with an opportunity to speak to students about the audit profession and what it means to be an auditor with a view to getting them interested in pursuing a career in audit when they graduate. During the program, audit personnel interact one on one with the students. As an audit senior in the firm, you have been asked to attend one of such programs and present a paper.

Required:
Explain the following in relation to the contents of your papers:

a. The definition and objective of an audit (2 Marks)
b. The concepts of accountability, stewardship and agency (3 Marks)
c. Independence of the auditor (1 Mark)
d. True and fair view (2 Marks)
e. Materiality (2 Marks)
f. The rights and duties of an external auditor (6 Marks)
g. The responsibilities of management (4 Marks)

(Total 20 Marks)

QUESTION 3

Adetutu Company Limited obtained a loan from a bank in the previous year. The bank has requested an independent review of the company's compliance with the loan covenants, hence, the Finance Controller has contacted your partner and asked that your firm carry out this assurance engagement.

Required:

a. Discuss the elements of an assurance engagement. (10 Marks)
b. Explain the different levels of assurance. (4 Marks)
c. Explain the categories of threats to the professional ethics of an auditor. (6 Marks)

(Total 20 Marks)

QUESTION 4

Range Nigeria Limited is a large private company, with a financial year end of March 31, 2020, and has been an audit client of your firm for several years. The board of directors has asked your firm if they would be able to provide internal audit services to the company.

Required:

a. Differentiate between internal and external audits. (6 Marks)
b. List the activities of internal auditors. (4 Marks)
c. Justify the need for internal audits. (4 Marks)
d. Explain the measures that can be taken to protect the independence of auditors given that auditors are expected to be independent including internal audit. (6 Marks)

(Total 20 Marks)

QUESTION 5

Below is a workpaper prepared and reviewed by members of an audit engagement team.

Client:

Subject: Trade Payables
Period end:

Objectives To ensure trade payables is fairly stated

Work performed: Selected a sample of 5 trade payables balances as at 31 March and reconciled the supplier statements to the year end trade payables ledger. Reconciling items were vouched to source documentation.

Results

Customers	Payables ledger	Suppliers statement	Difference	Agreed
	₦	₦	₦	₦
A Ltd	1,000	1,000	-	√
B Ltd	2,500	2,500	-	√
C Ltd	23,000	24,000	(1,000)	Note 1
D Ltd	10,000	10,000	-	√
E Ltd	4,000	8,000	(4,000)	Note 2
	40,500	45,500		

Required:

a. Review the above work paper and comment on the missing items. (8 Marks)

b. An accounts personnel at the client office requested that you give him your audit working papers. Explain the ownership, custody and confidentiality of audit working papers. (3 Marks)

c. Explain sampling and sampling risk. (3 Marks)

d. In order to reduce sampling risk appropriately, ISA 530 requires the auditor to make certain considerations in designing a sample. Explain these considerations. (2 Marks)

e. Explain the advantages and disadvantages of statistical sampling. (4 Marks)

(Total 20 Marks)

QUESTION 6

You are the audit senior at a firm of chartered accountants. An inexperienced personnel was hired by the firm and assigned to work with you on the audit of Hiram Nigeria Limited. You have been asked to coach this inexperienced personnel in the audit of balances with local banks and property, plant and equipment.

Required:

a. Explain the term "assertions" in the context of the audit. (2 Marks)

b. List the relevant assertions in the audit of balances with banks and property, plant and equipment. (6 Marks)

c. List the appropriate procedures required to audit tangible non-current assets and link them to the appropriate assertion that they seek to address. (12 Marks)

(Total 20 Marks)

SECTION A

SOLUTION 1

ALLADIN INSURANCE COMPANY LIMITED

General Information Technology (IT) controls are policies and procedures that relate to many different applications (such as revenue, purchases and payroll). They support the effective functioning of application controls by ensuring the complete and accurate processing of individual applications and thus continued proper operation of the IT system.

General IT controls apply to most or all of the entity's IT applications. Consequently, if general IT controls of Alladin Insurance Nigeria Limited are weak, it is unlikely that the processing undertaken by the system will be complete and accurate.

(a) Five control areas of General IT controls.

The main categories of general controls that an auditor would expect to find in a computer-based information system are:

i. **Controls over the development of new computer information systems and applications**
New computer systems may be designed and developed for a 'computer user' (the client company) by an in-house IT department or by an external software company. The controls include:

- Appropriate IT standards should be used when designing, developing, programming and documenting a new computer system;
- There should be controls to ensure that tests are carried out on new systems before they are introduced operationally;
- A new computer system design should be formally approved by the system 'user;
- There should be segregation of duties between the designers and testers of systems; and
- Relevant staff should be given training in the use of a new system before they use it for 'live' operations.

ii. **Controls over the documentation and testing of changes to programs**
When a computer system is operational, it may be necessary to update and amend some of the programs in the system. There should be suitable general controls over the development of new versions of programs. These include:

- There should be controls to ensure that formal testing procedures on new program versions are applied before they are used for 'live' operations;
- All new versions of programs must be authorised at an appropriate level of management; and

- Staff should be given adequate training, where appropriate, in the use of a new program version before they use it for 'live' operations.

iii. **Controls over the prevention or detection of unauthorised changes to programs- for example, by an employee committing fraud or by a 'hacker' accessing the system**

There is a risk that new programs will be introduced without proper authorisation. The risks are particularly serious in entities that have large purpose-written computer systems, and where the computer systems are operated on large computers (mainframe computers or minicomputers) in a centralised computer centre. The controls include:

- There should be a segregation between the tasks of programmers who write new programs and computer operators who use the programs;
- There should be full documentation of all program changes;
- There should be restricted access to programs in the program files, and only authorised programmers should have access to them;
- Program logs should be maintained, to record which programs and which versions are used; and
- There should be virus protection for programs using anti-virus software and there should be back-up copies of all programs (in the event of any 'malicious' changes to programs used in operations).

iv. **Controls to prevent the use of incorrect data files or programs**

In large computer systems, there may be several versions of a program at any time, not just one 'current version'. For example, when a new version is written, the 'old' version may be kept. It is important to ensure that the correct version of the program is used. These include:

- Computer operating staff should be suitably trained, and should follow standard operating procedures for checking the version of the program they are using;
- Job scheduling. There should be formal job scheduling in large computer centres, and a job schedule should specify the version of the program to be used;
- Supervision. Supervisors should monitor the activities of operating staff; and
- Reviews by management. Management should carry out periodic reviews, to make sure that the correct versions of programs are being used.

v. **Controls to prevent unauthorised amendments to data files**

In addition to the risk that there may be unauthorised access to program files and unauthorised amendment of programs, there is also a risk that data files will be accessed without authorisation (by an employee or an external 'hacker'). The controls include:

- Physical access to computer terminals may be restricted to authorised personnel;
- Access to programs and data files may be restricted using passwords. There should be rigorous checks by management to ensure that a password system is being used effectively by employees so that passwords are not easy to 'guess'; and
- Firewalls (software and hardware) can be used to prevent unauthorised external access via the internet.

vi. **Controls to ensure that there will be continuity in computer operations (and that the system will not 'break down' and cease to be operational)**

When problems occur in a computer system, the system may be at risk of ceasing to function. This could happen if there is physical damage to computer equipment or files, or if program files or data files are 'corrupted' or altered without authorisation. These controls include:

- There should be controls over maintaining secure second copies of all programs and data files ('back-up copies'). The back-up copies can be used if the original copies are damaged or corrupted;
- There should be measures for the protection of equipment against fire, power failure and other hazards;
- The company should have disaster recovery plans, such as an agreement with another entity to make use of its computer centre in the event of a disaster such as a fire or flood;
- The company should make suitable maintenance and service agreements with software companies, to provide 'technical support' in the event of operating difficulties with the system; and
- There should be adequate safety provision for the physical structure or facility where the system is located.

(b) Weaknesses and types of controls to address them in Alladin Insurance Limited.

Weakness	**Type of control to address weakness**
i. Underwriting process is manual and only initiated when a customer comes to fill a form	The newly bought fully automated underwriting system should be brought to full use and documented especially because of the high profile of premium earnings occasioning high turnover figure
ii. Agent fills proposal forms at the request of customer.	Customer should fill the proposal forms but where he or she is unable to do so, the agent engaged to fill the forms must explain the contents of the forms in detail to the customer.

iii. Policy terms are communicated to the customer after policy approval by the approving authority.	Policy terms must be communicated to the customer before processing approval from the approving authority to avoid a situation of approval of policy only to be rejected by the customer
iv. Payment of premium in cash by customers after approval of policy	Cash payment of premium must be discouraged as much as possible. Only cheque payments and bank transfers should be allowed
v. The details of the policy are recorded in the system by the underwriter who also acts as the accountant.	There should be segregation of duties in the recording of policy details and the accountant's role. The underwriter should not be the one to record the policy details in the system and while the accounting functions should be performed by another staff not involved in the underwriting process
vi. Based on NAICOM's requirements, premium should be paid before the insurance starts.	Where premium payments are made through cheques or bank transfers, cheques should clear to the company's account before commencement of insurance cover while bank transfers should be confirmed.

(c) **Limitations of internal controls**

Internal controls do not guarantee complete absence of errors and fraud but should guarantee reduction to the barest minimum. The limitations of internal controls, include:

i. Human error may result in incomplete or inaccurate processing which may not be detected by control systems;
ii. It may not be cost-effective to establish certain types of controls within an organisation;
iii. Controls may be in place, but they may be ignored or overrideen by employees or management; and
iv. Collusion may mean that segregation of duties is ineffective. Collusion means that two or more people work together to bypass a control, possibly for the purpose of committing fraud.

(d) **Audit procedures on gross premium income**

These include:

i. Obtain a schedule of gross premium income from the company or make a schedule of gross premium income;
ii. Cast the schedule for accuracy and agree to the gross premium ledger of the company;
iii. Review the company's internal controls on premium to ensure Compliance;

iv. Review a sample of policy files and ensure accuracy of gross premium;
v. Trace sample of premium through the books of the underwriter and bank statements;
vi. Ensure compliance with the Insurance Act, NAICOM regulations and
Nigeria Insurance Association on premium recognition;
vii. Obtain direct confirmation from policy holders on suspicious premiums
or material premiums through circularization;
viii. Review minutes of directors meetings for issues relating to material Premiums;
ix. Obtain a letter of representation from the management on the accuracy of gross premium income; and
x. Ensure compliance with the relevant standards as to adequacy of disclosure of premiums to show a true and fair view.

Marking Guide

		Marks
a.	2 marks each for general control and 2 marks for two examples subject to a maximum of 5 control categories.	20
b.	1 mark for each control weakness and 1 mark for type of control subject to a maximum of 5 weaknesses and types of control respectively	10
c.	1 mark for each limitation subject to maximum of four limitations	4
d.	1 mark for each audit procedure subject to maximum of six audit Procedures	6
	Total	**40**

Examiner's Report

The question, a compulsory one, tests candidates' knowledge on internal controls with emphasis on general information technology (IT) controls.

About 100% of the candidates attempted the question and the performance was generally poor.

The major pitfall of the candidates was the poor understanding of general IT controls ostensibly due to poor coverage of this important area of the auditing syllabus.

Candidates are advised to cover the syllabus adequately in the area of IT which is definitely relevant and believably indispensable in modern day auditing. They should also make use of the Institute's Study Text.

SOLUTION 2

a. **Definition and objective of audit**

An audit is an official examination of the accounts or accounting systems of an entity by an auditor.

The main objective of an audit is to enable an auditor to convey an opinion as to whether or not the financial statements of an entity are prepared according to an applicable financial framework.

The applicable financial reporting framework is decided by: legislation within each individual country (in Nigeria, for example, CAMA Cap C20 LFN 2004 (as amended) , BOFIA CAP B3 LFN 2004, Insurance Act 2003, FRCN Act 2011), and accounting standards, for example, International Accounting Standards/ International Financial Reporting Standards.

b. **Concepts of accountability, stewardship and agency**

The audit of an entity's accounts is needed because, in companies for example, the owners of the business are often not the same persons as the individuals who manage and control that business.

The owners of the company are members/shareholders.
The company is managed and controlled by its directors. The directors have a stewardship role. They look after the assets of the company and manage them on behalf of the shareholders. In small companies, the shareholders may be the same people as the directors. However, in most large companies, the two groups are different.

The relationship between the shareholders of a company and the board of directors is also an application of the general legal principle of agency. The concept of agency applies whenever one person or group of individuals acts as an agent on behalf of someone else (the principal). The agent has a legal duty to act in the best interests of the principal, and should be accountable to the principal for everything that he does as agent.

As agents for the shareholders, the board of directors should be accountable to the shareholders. In order for the directors to show their accountability to the shareholders, it is a general principle of company law that the directors are required to prepare annual financial statements, which are presented to the shareholders or members for their approval.

c. **Independence of the auditor**

The external auditor must be independent from the directors; otherwise his report will have little value. If he is not independent, his opinion is likely to be influenced by the directors but the independence of the internal auditor is less assured than that of the external auditor because the internal auditor reports to the management.

d. **True and fair view**

The auditor reports on whether the financial statements give a true and fair view of the position of the entity as at the end of the financial period and the performance of the entity during the period. The auditor does not certify or guarantee that the financial statements are correct.

Although the phrase 'true and fair view' has no legal definition, the term 'true' implies free from error, and 'fair' implies that there is no undue bias in the financial statements or the way in which they have been presented.

In preparing the financial statements, a large amount of judgement is exercised by the directors. Similarly, judgement is exercised by the auditor in reaching his opinion. The phrases 'true and fair view' indicate that a judgement is being given that the financial statements can be relied upon and have been properly prepared in accordance with an appropriate financial reporting framework.

e. **Materiality concept**

The auditor reports in accordance with the concept of materiality. He gives an opinion on whether the financial statements present fairly in all material respects the financial position and performance of the entity. Information is material if, on the basis of the financial statements, it could influence the economic decisions of users should it be omitted or misstated.

Applying the concept of materiality means that the auditor will not aim to examine every number in the financial statements. He will concentrate his efforts on the more significant items in the financial statements, either because of their high value, or because there is a greater risk that they could be stated incorrectly.

f. **Rights and duties of an external auditor**

(i) **Rights of an external auditor**

The main statutory rights of the auditor per enabling legislations like companies legislation and other establishment laws include the following:

- The right of access to all accounting books and records at all times;
- The right to all information and explanations from management necessary for the proper conduct of the audit;
- The right to receive notice of all meetings of the shareholders (such as the annual general meeting) and to attend those meetings;

- The right to speak at shareholders' meetings on matters affecting the audit or the auditor. This can be important when the auditors are in disagreement with the directors of the client entity and are unable to communicate with the shareholders effectively by any other method; and If the company uses written resolutions, the auditors should have a right to receive a copy of all such resolutions.

(ii) **Duties of an external auditor**

The primary duty of the external auditor is to:

- examine the financial statements; and
- issue an auditor's report on the financial statements, which is then presented to the members of an entity together with the financial statements. This auditor's report will set out the auditor's opinion as to whether the financial statements give a true and fair view (or "present fairly") the financial position and performance of the company, and have been prepared in accordance with the applicable financial reporting framework.

g. **Responsibilities of management**

With respect to an audit, management or those charged with governance are responsible for:

i. Prevention and detection of fraud;
ii. Preparation of the financial statements;
iii. Design and implementation of effective internal controls;
iv. Providing the auditor with relevant financial information necessary for the audit; and
v. Providing written representations to the auditor at the end of the audit.

Marking Guide

		Marks	Marks
(a)	1 mark each for definition and objective of an audit subject to maximum of 2 points		2
(b)	1 mark each for accountability, stewardship and agency subject to a maximum of 3 points		3
(c)	Explanation of the independence of auditor		1
(d)	Explanation of "true and fair view"		2
(e)	Explanation of materiality		2
(f)	2 marks for right of the auditor subject to a maximum of 2 points	4	
	2 marks for duties	2	6
(g)	1 mark each for correct identification of responsibilities of management subject to a maximum of 4 points		4
	Total		20

Examiner's Report

The question, in seven parts, tests candidates' knowledge on the fundamental concept of auditing.

About 98% of the candidates attempted the question and the performance of the candidates was good.

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

SOLUTION 3

a. Elements of an assurance engagement
These include:

i. **A three party relationship**
   - **Practitioner** – the individual providing professional services that will review the subject matter and provide the assurance. e.g. the audit firm in a statutory audit.
   - **Responsible party** – the person(s) responsible for the subject matter. e.g. the Directors are responsible for preparing the financial statements to be audited.
   - **Intended users** – the person or class of persons for whom the practitioner prepares the assurance report. e.g the shareholders in a statutory audit;

ii. **Subject matter**: This is the data such as the financial statements that have been prepared by the responsible party for the practitioner to evaluate. Another example might be a cash flow forecast to be reviewed by the practitioner;

iii. **Suitable criteria**: This can be thought of as 'the rules' against which the subject matter is evaluated in order to reach an opinion. In a statutory audit this would be the applicable reporting framework. (IFRS and Company law);

iv. **Evidence**: Information used by the practitioner in arriving at the conclusion on which their opinion is based. This must be sufficient and appropriate; and

v. **Assurance report**: The report, normally written, containing the practitioner's opinion. This is issued to the intended user following the collection of evidence.

b. **Levels of assurance**

These include:

i. **Reasonable assurance** – A high (but not absolute) level of assurance provided by the practitioner's conclusion expressed in a positive form. e.g. "In our opinion the accounts give a true and fair" view. The objective of a statutory audit is to provide reasonable assurance; and

ii. **Limited assurance** – A moderate level of assurance provided by the practitioner's conclusion expressed in a negative form. e.g. "Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view". The objective of a review engagement is often to provide limited assurance.

(c) **The five categories of threats to the professional ethics of an auditor are:**

i. **Advocacy threat**: Promoting the position of a client or representing them in some way would mean the audit firm is seen to be 'taking sides' with the client; examples include representing the client in court or in any dispute where the matter is material to the financial statements;

ii. **Familiarity threat**: When the auditor becomes too sympathetic or too trusting of a client and loses professional skepticism, or where the relationship between the auditor and client goes beyond professional boundaries;

iii. **Intimidation threat**: Actual or perceived pressures from the client, or attempts to exercise undue influence over the assurance provider create an intimidation threat, e.g. actual or threatened litigation between the auditor and audit client (in which case it may be necessary to resign from the engagement). Intimidation can arise from some of the same situations mentioned above, for example: Fee dependency, wherein the particular client is the major provider of the total fees earned by the practitioner. Personal relationships - Audit partner joining the client;

iv. **Self-interest threat**: Where the auditor has a financial or other interest that will inappropriately influence their judgment or behavior; and

v. **Self-review threat**: Where non-audit assignment is provided to an audit client and is then subject to audit, the auditor will be unlikely to admit or identify the errors in their own work.

Marking Guide

		Marks
(a)	2 marks for each element of an Assurance Engagement subject to maximum of 5 elements	10
(b)	2 marks for each explanation of the different levels of assurance	4
(c)	2 marks each for explanation of threat to the professional ethics of the auditor subject to a maximum of 3 points.	6
	Total	**20**

Examiner's Report

The question tests candidates' knowledge on principles of an assurance engagement.

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

Candidates are advised to make use of the Institute's Study Text and other relevant materials for their examinations.

SOLUTION 4

RANGE NIGERIA LIMITED

(a) **Differences between internal and external audits**

BASIS	INTERNAL AUDIT	EXTERNAL AUDIT
i. Role and work	To examine systems and controls and assess risks in order to make recommendations to management for improvement. The internal audit work programme will therefore to a large extent be dictated by management.	To express an opinion on the truth and fairness of the annual financial statements. The external audit will therefore involve carrying out whatever work deemed necessary to express that opinion.
ii. Qualification to act	No statutory requirements – management select a suitably competent person to perform the internal audit function.	Set out by statute. The relevant legislations determines who to perform the external audit function.
iii. Independence	In internal audits. Internal auditors are members of management and hence cannot claim total independence of the management	In external audits, the auditors are expected to be independent of management.

iv. Duties	In internal audits, the duties of internal auditors are specified by the management and may vary as management deems fit	The duties of auditors in external audits are specified in Companies and Allied Matters Act (CAMA) and other applicable legislations
v. Approach	The internal audit approach aims at 100% level of transaction test hence they are involved in pre and post transaction audits.	In external audit, the audit approach is to test sample of transactions and not 100% of company's transactions
vi. Reporting	Internal audit reports go to management or those charged with governance based on assignments undertaken.	The external audit reports go to members of the entity.

(b) **Activities of internal auditors.**

The activities of internal auditors include:

i. **Monitoring of internal control**. The establishment of an adequate internal control system is a responsibility of management and is an important aspect of good corporate governance. Because the internal control system needs to be monitored on a continuous basis, large companies are likely to establish an internal audit function to assist management in this role;

ii. **Examination of financial and operating information.** This may include review of the means used to identify, measure, classify and report such information or specific inquiry into individual items including detailed testing of transactions, balances and procedures;

iii. **Review of the economy, efficiency and effectiveness of operations.** This could include a review of non-financial controls;

iv. **Review of compliance with laws, regulations and other external requirements** and with internal requirements such as management policies and directives; and

v. **Special investigations into particular areas such as suspected fraud.** The majority of these activities will be classified as operational internal audit assignments.

(c) **The need for internal audit**

These include:

i. Monitoring and improvement in financial controls or operational controls within the entity;

ii. Improvements in compliance with key laws and regulations, thereby reducing the risk of legal action or action by the regulators against the entity;

iii. Improvements in the economy, efficiency or effectiveness of operations;

iv. Examination of financial and operating information including specific enquiry into individual balances and procedures;

v. If the internal auditors carry out checks into the effectiveness of financial controls within the entity, the external auditors may decide that they can rely to some extent on the work done by internal audit. This would save time and effort when carrying out their own audit work. If the external auditors do rely to some extent on the work of internal audit, there may be a reduction in the external audit fee; and

vi. The existence of an internal audit department may enhance the reputation of the entity for sound corporate governance in the opinion of customers and investors.

(d) **Measures that can be taken to protect the independence of auditors.**
Auditors must be independent (actual independence), and also must be seen to be independent (perceived independence). Independence of a statutory auditor is a matter of public confidence in the assurance or audit process. Any threats to independence may be reduced by safeguards put in place by an assurance firm. Specific guidance is provided in a number of key areas where independence may be under threats. The main areas to avoid include:

(i) **Fees and pricing:** Where the total fees generated by an assurance client represent a large proportion of more than 25% an assurance firm's total fees, the dependence on that client and concern about the possibility of losing that client may create a self-interest threat;

(ii) **Family and personal relationships:** Family and personal relationships between a member of the assurance team and a director, officer or certain employees of the client may create self-interest, family or intimidation threats;

(iii) **Close Business relationship:** A commercial or common financial interest between an assurance firm or a member of the assurance team and a client or its management may create self-interest and intimidation threats;

(iv) **Financial Interest:** A financial interest in an assurance client exists where shares or debt instruments are held either directly or indirectly;

(v) **Loans and guarantees**: If the assurance client is a bank or similar institution, no threat to independence is created where the loan is made on normal terms to the assurance firm or a member of the assurance team;

(vi) **Employment or former employment with assurance client.** Individuals who have previously been on the assurance team could leave the assurance firm to work for the assurance client;

(vii) **Long association of senior personnel with assurance clients**: Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat;

(viii) **Provision of non-assurance services:** The independence of an assurance firm may be threatened where the firm carries out a large amount of non-assurance work for an entity that is also its assurance client;

(ix) **Gifts and hospitality**: Accepting gifts and hospitality from an assurance client may create self-interest and familiarity threats; and

(x) **Actual and threatened litigation**: In some cases, a client entity (or some of its members) may threaten the audit firm with litigation as a result of something the audit firm or a member of the audit team, has (or has not) done. Actual or threatened litigation could create self-interest or intimidation threats.

However, Internal Auditor must also be independent, but the following measures can be taken to protect the independence of internal auditors:

i. **Reporting lines:** Head, Internal Audit Department (HIAD) may report to the audit committee and not to the Finance Director or Chief Accountant;

ii. **Deciding the scope of internal audit work:** The scope of work carried out by the internal auditor should not be decided by the finance director or line management responsible for the operations that might be subjected to audit. This is to avoid the risk that the internal auditor might be assigned to investigations of non-contentious areas of the business. The scope of internal audit work should be decided by the HIAD or by the audit committee;

iii. **Rotation of internal audit staff:** Internal auditors should not be allowed to become too familiar with the operations that they audit or the management responsible for them. To reduce the familiarity threat, internal auditors should be rotated regularly, say every three to five years, and at the end of this time they should be assigned to other jobs within the entity;

iv. **Appointment of the HIAD:** The HIAD should not be appointed by a senior executive who may have some self-interest in wishing to appoint a 'yes man' who will not cause trouble'. Instead, the audit committee should be responsible for appointing a new HIAD, subject perhaps to approval by the board of directors;

v. **Designing internal controls**: The internal auditors should not be responsible for the design of internal controls within the entity. If they did, they would be required to audit their own work, which is unacceptable.

Senior management in accounting and finance or line management should have responsibility for the design and implementation of internal controls, taking advice where appropriate from the external auditors when control weaknesses are identified during the external audit.

Marking Guide

		Marks
(a)	2 marks for each explained difference between external and internal audit subject to a maximum of 3 differences	6
(b)	1 mark for each activity subject to a maximum of 4 activities	4
(c)	2 marks for each justification for the need of internal auditors subject to a maximum of 2 points	4
(d)	2 marks for each measure to protect auditors independence subject to a maximum of 3 points	6
	Total	**20**

Examiner's Report

The question tests knowledge of the candidates' knowledge on differences between internal and external audits, the activities of the internal auditors and auditors' independence.

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

Candidates are advised to make use of the Institute's Study Text, Pathfinder and other relevant study materials for better performance in their examinations.

SOLUTION 5

(a) The missing items in the reflected work paper include:

i. The name of the client is not stated, as a basic requirement;
ii. The accounting period and date of review is not stated;
iii. The reference to files on payable is missing;
iv. The name of the person preparing the work paper is not stated;
v. The date the paper was prepared is not stated;
vi. The name of any person reviewing the work and the extent of such review are not stated;
vii. Notes of any errors or omissions identified;

viii. A conclusion on the area; and
ix. Relevant keys to the tick marks.

(b) **Ownership of the audit documentation rests with the auditor:** The working papers do not form part of the accounting records of the client, and do not belong to the client. The auditor needs to decide how long to keep the audit files. ISA 230 requires a minimum period of five years from the date of the audit report (or group audit report if later). Auditing standards require the auditor to ensure that working papers are kept safe and their contents are kept confidential. Information should only be made available to third parties in accordance with ethical guidelines.

(c) **Sampling** is the application of audit procedures to less than 100% of items within a population, in order to draw conclusions about the population as a whole.

Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion had he tested the entire population. This will happen if the sample is not representative of the population as a whole. If an auditor uses a sample that is not representative of the entire population, he will reach a conclusion about the accuracy of the client's financial statements that may be unjustified and incorrect. In order to decrease sampling risk, the auditor could select a larger sample. By the laws of probability, sampling risk should be lower when a larger sample is taken.

(d) **Considerations of ISA 530 in designing a sample** – if sampling risk is to be reduced and therefore detection risk reduced, the sample must be designed in an appropriate way. When designing a sample, the auditor is required by ISA 530 to:

i. Consider the purpose of the audit procedure and the population from which the sample will be drawn
ii. Determine a sample size sufficient to reduce sampling risk to an acceptable low level
iii. Select items for the sample in such a way that each sampling unit in the population has an equal chance of selection.

(e) The advantages of statistical sampling techniques are as follows:

i. Statistical sampling provides an objective, mathematically precise basis for the sampling process;
ii. It required sample size can be calculated precisely (using statistical probability techniques); and
iii. There may be circumstances where statistical sampling is the only means of auditing efficiently (for example, in the case of very large 'populations' of items).

The disadvantages of statistical sampling techniques are as follows:

i. A degree of training and technical expertise is required if auditors are to use statistical sampling techniques effectively;
ii. It requires an investment in the necessary training for audit staff;
iii. Sample sizes may be larger than under a judgmental approach, thus increasing the time (and the cost) involved in the audit.
iv. Some auditors take the view that it is preferable to rely on the skill, experience and judgment of the auditor, rather than on mathematical/statistical models.

Marking Guide

		Marks	Marks
(a)	1 mark for each review and comments on any 8 missing items on the work paper subject to a maximum of 8 points		8
(b)	1 mark for each of ownership, custody and confidentiality		3
(c)	1 mark for sampling	1	
	2 mark for sampling risk	2	3
(d)	1 mark for any two considerations in designing a sample subject to a maximum of 2 points		2
(e)	1 mark each for 2 advantages	2	
	1 mark each for 2 disadvantages	2	4
	Total		**20**

Examiner's Report

The question is in five parts. Parts (a) and (b) required candidates to review a practical audit documentation template, while parts (c) to (e) test candidates' knowledge on sampling as it relates to audit.

About 10% of the candidates attempted the question and their performance was generally poor.

The commonest pitfall was their inability to assess and review practical audit documentation, as given in a scenario.

The candidates should cover all areas of the syllabus and be able to relate and adapt their knowledge to practical situations and scenarios. They should make use of the Institute's Study Text.

SOLUTION 6

a. **Assertions**- Representations by management, explicit or otherwise, that are embodied in the financial statements as used by the auditors to consider the different type of potential misstatements that may occur.

b. Assertions in the audit of balances with banks and property, plant and equipment include:
   i. Existence
   ii. Rights and obligations
   iii. Completeness
   iv. Valuation
   v. Classification and understandability
   vi. Accuracy and valuation.
   vii. Presentation and disclosures

c. The appropriate procedures required to audit tangible non-current assets linking them to the appropriate assertive are:

   i, Completeness
   - Obtain or prepare a schedule of tangible non-current assets, showing cost or valuation, depreciation and carrying amounts.
   - Reconcile this list with the corresponding opening balances.
   - Select a sample of assets that physically exist (and whose existence has been verified, possibly by means of inspection by the auditor) and trace these assets to the asset register.
   - Obtain or prepare a reconciliation of ledger balances for tangible non-current assets with the asset register and investigate any differences.

   ii. Existence
   - Select a sample of assets from the non-current asset register and physically inspect them. During the inspection, note whether the asset is in use and the condition that it is in. For an asset register held on an IT system, audit software could be used to assist in the selection of a sample.
   - Establish and investigate the reasons for any assets in the sample that are not found by the auditor.

   Cost
   - Land and buildings: Confirm the figures for cost with the purchase contract for the asset and the invoices for associated costs (such as professional fees). Check that the purchase expenditure is analysed reasonably between land, buildings.

- Equipment and vehicles: Check the cost in the financial statements against the purchase invoices for the assets.

- Review the allocation of total expenditure on non-current assets between capital and revenue amounts.

At valuation
- Verify amounts in the financial statements with the valuer's report.
- Consider the reasonableness of the valuation.
- Check that valuations are regularly updated.
- Check the accounting for the rise or fall in value on revaluation.

Depreciation and impairment
- Review depreciation rates for reasonableness in the light of the nature of the asset, its estimated useful life and residual value.
- Ensure that consistent depreciation methods are in use.
- Review gains or losses on sale /disposal (and the accumulated depreciation and impairment at the time of disposal).
- Consider the possibility that assets are obsolete or suffering impairment. This matter may have to be discussed with the directors of the client company.

iii. **Rights and obligations (ownership)**
- Land and buildings: Verify legal title to the assets by inspecting appropriate documents (such as legal documents of ownership, or lease agreements).
- Vehicles: Examine vehicle registration documents or similar documentation giving evidence of title.
- Other assets: Examine invoices or other documents transferring title.
- Ensure that documents are in the name of the entity (the client company).
- Review legal documents, bank documents and other documents for evidence of any loans that are secured by charges on assets.
- Confirm that the entity has adequate insurance cover for its property, plant and equipment.

iv. **Presentation and disclosures**
- Review the disclosures in the financial statements and ensure they are correct and clear.
- Ensure the schedule of tangible non-current assets agrees to the figures in the financial statements.
- Confirm that adequate impairment provision is made as relevant for property, plant and equipment in the financial statements.

Marking Guide

		Marks	Marks
(a)	Explanation of Assertions in the context of audit		**2**
(b)	1 mark for relevant assertion subject to a maximum of 6 points		6
(c)	Each listing of appropriate procedures	1	
	Each linkage to appropriate assertions	2	
	Subject to a maximum of 4 points	**3**	**12**
	Total		**20**

Examiner's Report

The question tests candidates' knowledge on substantive audit procedures.

About 5% of the candidates attempted the question and the performance was poor.

The commonest pitfall of the candidates was their inability to correctly state the audit procedures in the audit of tangible non-current assets and link the procedures to appropriate "assertions".

Candidates should cover the syllabus very well and make good use of the Institute's Study Text.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2020

PERFORMANCE MANAGEMENT

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

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

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

Adeco Nigeria plc is a large and diversified company with several factories. One of its factories that produces "Apex" has not been able to meet its sales target for over two years. The board has mandated the company's management to take a decisive step on what to do with the factory.

The management therefore set up a committee of three, the factory manager, marketing manager and the management accountant to analyse the situation and come up with a report on what they feel the management should do. The marketing manager submitted two proposals to the committee, these are:

- a sales volume of 25,000 units can be achieved with a selling price of ₦13.50 per unit and an advertising campaign of ₦37,500; or

- a sales volume of 35,000 units can be achieved at a selling price of ₦11.25 with an advertising campaign costing ₦52,500.

The management accountant is to work on these proposals with the information provided by the factory manager and come up with calculations that will help the committee to know which of the proposals to be recommended to management. The management accountant is also required to prepare a third scenario that would reflect the factory closure.

The factory manager submitted the following information to the management accountant:

Budgeted sales and production of Apex (units)	50,000
	₦000
Sales	750.0
Less production costs:	
Material A – 1 kg per unit	75.0
Material B – 1 litre per unit	37.5
Labour – 1 hour per unit	187.5
Variable overhead	150.0
Fixed overhead	75.0
Non-production costs	75.0
Total cost	600.0
Budgeted profit	150.0

The following additional information has also been made available:

(i) There are 50,000 kg of material A in inventory. This originally cost ₦1.5 per kg.

Material A has no other use and unless it is used by the division, it would have to be disposed off at a cost of ₦750 for every 5,000 kg.

(ii) There are 30,000 litres of material B in inventory. Any unused material can be used by another department to substitute for an equivalent amount of a material, which currently costs ₦1.875 per litre. The original cost of material B was ₦0.75 per litre and it can be replaced at a cost of ₦2.25 per litre.

(iii) All production labour hours are paid on an hourly basis. Rumours of the closure of the department have led to a large proportion of the department's employees leaving the organisation. Uncertainty over its closure has also resulted in management not replacing these employees. The department is therefore short of labour hours but has sufficient man hour to produce 25,000 units. Output in excess of 25,000 units would require the department to hire contract labour at a cost of ₦5.625 per hour. If the department is shut down, the present labour force will be deployed within the organisation.

(iv) Included in the variable overhead is the depreciation of the only machine used in the department. The original cost of the machine was ₦300,000 and it is estimated to have a life span of 10 years. Depreciation is calculated on a straight-line basis. The machine has a current resale value of ₦37,500. If the machinery is used for production, it is estimated that the resale value of the machinery will fall at the rate of ₦150 per 1,000 units produced. All other costs included in variable overhead vary with the number of units produced.

(v) Included in the fixed production overhead is the salary of the factory manager which amounts to ₦30,000. If the department were to shut down, the manager would be made redundant with a redundancy pay of ₦37,500. All other costs included in the fixed production overhead are general factory overheads and will not be affected by any decision concerning the factory.

(vi) The non-production cost charged to the factory is an apportionment of the total on-production costs incurred by the factory.

The committee will be meeting in a week's time to prepare its report to the management on what course of action the management should take, either one of the marketing manager's proposals or to close down the factory.

Required:

As the management accountant of Adeco Plc, you are to:

a. Prepare detail calculations to support the committee's recommendation to the management whether to:

   i. reduce production to 25,000 units

   ii. reduce production to 35,000 units

   iii. shut down the factory. (20 Marks)

b. A customer has just placed a special order for 25,000 of Apex and the customer is willing to pay ₦12.00 per unit. Advise management whether to accept or reject the order. Assume that for any shortfall in material "A" required to produce the order, it can be bought at a price of ₦2.00 per kg. (10 Marks)

c. Discuss the management accounting techniques and principles that a management accountant will apply in preparing calculations to support management decision in such a circumstance as above. (10 Marks)

(Total 40 Marks)

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

QUESTION 2

Ideal Nigeria Limited manufactures two products, Light and Medium, on the same machines. Sales demand for the products exceeds the machine capacity of the company's production department. The potential sales demand in each period is for 10,000 units of Light and 15,000 units of Medium. Sales prices cannot be increased due to competition from other producers in the market. The maximum machine capacity in the production department is 40,000 hours in each period.

The following cost and profitability estimates have been prepared:

	Light	Medium
	₦	₦
Sales price	110	135
Direct materials	(50)	(45)
Direct labour and variable overhead	(30)	(55)
Contribution per unit	30	35
Machine hours per unit	1.5 hours	2 hours

Fixed costs in each period are ₦450,000.

Required:

a. Using marginal costing principles, calculate the profit-maximising output in each period, and the amount of profit. (4 Marks)

b. Explain how throughput accounting differs from marginal costing in its approach to maximising profit. (4 Marks)

c. Using throughput accounting, calculate the throughput accounting ratio for Light and Medium. (8 Marks)

d. Using throughput accounting principles, calculate the profit maximising output in each period, and the amount of profit. (4 Marks)

(Total 20 Marks)

QUESTION 3

Toma Paste Nigeria Limited produces tomatoe paste which serves as an alternative for an immediate stew for working mothers instead of looking for fresh tomatoes.

For the forthcoming period, the company's budgeted fixed costs were ₦600,000 and budgeted production and sales were 13,000 units.

The product has the following standard cost:

	₦
Selling price	500
Materials 5kg × ₦40/kg	200
Labour 3hrs × ₦40/hr	120
Variable overheads 3hrs × ₦30/hr	90

Actual results for the period were as follows:
11,000 units were made and sold, earning revenue of ₦5,720,000.

66,000kg of materials were bought at a cost of ₦2,970,000 but only 63,000 kg were used. 36,000 hours of labour were paid for at a cost of ₦1,422,000. The total cost for variable overheads was ₦1,170,700 and fixed costs were ₦400,000.

The company uses marginal costing and values all inventory at standard cost.

Required:

a. Prepare a statement reconciling actual and budgeted profit using appropriate variances. (12 Marks)

b. Recalculate the fixed production overhead variances, assuming the company uses absorption costing. (4 Marks)

c. Discuss possible causes for the labour variances you have calculated. (4 Marks)

(Total 20 Marks)

QUESTION 4

Adeb Nigeria Limited has two divisions, Eastern and Northern divisions. Eastern division makes materials that are used to manufacture special blocks. It transfers some of these materials to the Northern division and sells some of the materials externally to other block manufacturers. Northern division makes special blocks from the materials and sells them to traders in building materials.

The production capacity of Eastern division is 10,000 tonnes per month. At present, sales are limited to 5,000 tonnes to external customers and 3,000 tonnes to Northern division.

The transfer price was agreed at ₦200 per tonne in line with the external sales trade price at 1st July which was the beginning of the budget year. From 1st December, however, strong competition in the market has reduced the market price for the materials to ₦180 per tonne.

The manager of the Northern division has suggested that the transfer price for the materials from Eastern division should be the same as for external customers. The manager of Eastern division rejected this suggestion on the basis that the original budget established the transfer price for the entire financial year.

From each tonne of materials, Northern division produces 10 blocks, which it sells at ₦40 per blocks. It would sell a further 20,000 blocks if the price were reduced to ₦32 per block.

Other relevant data are given below:

	Eastern division	**Northern division**
	₦	**₦**
Variable cost per tonne	70	60
Fixed cost per month	150,000	60,000

The variable costs of Northern division exclude the transfer price of materials from Eastern division.

Required:

a. Prepare estimated profit statements for the month of December for each division and for Adeb Nigeria Limited as a whole, based on transfer prices of ₦200 per tonne and of ₦180 per tonne, when producing at

   i. 80% capacity

   ii. 100% capacity, on the assumption that Northern division reduces the selling price to ₦32. (10 Marks)

b. Comment on the effect that might result from a change in the transfer price from ₦200 to ₦180. (5 Marks)

c. Suggest an alternative transfer price that would provide an incentive for Northern division to reduce the selling price and increase sales by 20,000 blocks a month. (5 Marks)

(Total 20 Marks)

QUESTION 5

Dat Air was founded in January 2010 by Dr. Daniel Taiwo and the airline has been branded as a low-cost airline in Nigeria. Dat Air's strategy is to operate as a low-cost and highly efficient airline, and it does this by:

(i) Operating mostly in cities where other airlines do not fly to reduce landing cost;
(ii) Using only one aircraft model in order to reduce maintenance and operational costs. These planes are leased rather than bought outright;
(iii) Having only one category of seat class; there is no pre-allocated seats or in-flight entertainment; and to
(iv) Focus on e-commerce with customers both booking tickets and checking in for flights online. Customers who booked well in advance before the flight date enjoy substantial discount.

The airline was given an 'on time arrival' ranking of second best by the Nigerian aviation authority, who rank all 20 airlines operating locally in the country based on the number of flights which arrive on time at their destinations. 48 Dat Air flights were cancelled in 2018 compared to 35 in 2017. This increase was due to an increase in the staff absentee rate at Dat Air from 5 days per staff member per year to 7 days.

The average 'ground turnaround time' for airlines in Nigeria is 2 hours, meaning that, on average, planes are on the ground for cleaning, refuelling, etc for 2 hours before departing again. Customer satisfaction surveys have shown that 90% of customers are happy with the standard of cleanliness on Dat Air's planes.

The number of passengers carried by the airline has grown from 200,000 passengers on a total of 2,107 flights in 2010 to 650,000 passengers on 5,320 flights in 2018. The overall growth of the airline has been helped by the limited route licensing policy of the Nigerian government, which has given DAT Air almost monopoly status on some of its routes. However, the government is now set to change this policy with almost immediate effect, and it has become more important than ever to monitor performance effectively.

This has necessitated the management of Dat Air to examine the airline's performance using the balanced scorecard model. This will enable the management to discover areas where improvement is needed in its operations.

Required:

a. Describe each of the **FOUR** perspectives of the balanced scorecard. (6 Marks)

b. For each perspective of the balanced scorecard, identify **ONE** goal together with a corresponding performance measure which could be used by DAT Air to measure the company's performance. The goals and performance measures should be specifically relevant to Dat Air. For each pair of goals and performance measures, explain why you have chosen them. (9 Marks)

c. Appraise the usefulness of the balanced scorecard as a performance evaluation technique. (5 Marks)

(Total 20 Marks)

QUESTION 6

Lapez operates a chain of health and fitness clubs, located in state capitals in Nigeria. For easy administration, the clubs are structured into two divisions, the Northern and the Southern divisions. Each division has a General manager who is responsible for revenue, cost and investment decisions at their clubs. A bonus is awarded each year to the General manager that generates the higher return on capital employed (ROCE).

The following summary information shows the results of the divisions for the past two years:

Year ending 31st December	2018		2017	
	Northern	**Southern**	**Northern**	**Southern**
	₦000	**₦000**	**₦000**	**₦000**
Revenue	2,700	3,720	2,850	3,375
Staff costs	1,725	2,145	1,770	1,965
Others operating cost	690	1,012	750	930
Operating profit	285	563	330	480
Capital employed	750	1,350	1,125	1,800
Average number of members	6,880	9,425	7,050	8,320

Notes:

(i) Revenue is comprised largely of income from membership fees.

(ii) Lapez uses net book value of non-current assets as the capital employed. The capital employed figures in the above table are the net book value of the non-current assets of each division at the end of the year.

(iii) Non-current assets are depreciated on a straight-line basis over a period of five years and are assumed to have no residual value. There were no additions nor disposals of non-current assets during the years 2017 and 2018.

(iv) Both divisions have a cost of capital of 15%.

(v) Ignore taxation and inflation.

However, investigations by Lapez's management revealed that at the end of 2017 the General manager of the Southern division rejected the opportunity to acquire a new building and equipment to set up a new fitness club at a total cost of ₦1,200,000. The building could have been purchased for ₦525,000 and for the purpose of this evaluation, it is assumed that it would have held that value for five years and that no depreciation would have been charged on the building. The new equipment would have cost ₦675,000 and would have been depreciated in accordance with Lapez's policy over five years. The investment would have taken place on 1 January 2018.

The forecast annual profit and number of members for the proposed new club were as follows:

	₦000
Revenue	1,012.5
Staff costs	(556.5)
Other operating costs (including depreciation of the equipment)	(240.0)
Operating profit	216.0
Average number of members	2,100

It is Lapez's policy that investments of this type should be appraised over five years using net present value.

Required:

a. Discuss the relative performance of the two divisions using Return on Capital Employed and **TWO** other performance measures that you think are appropriate. (15 Marks)

b. Calculate the net present value of the investment. Ignore taxation and inflation. (5 Marks)

(Total 20 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)

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

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)

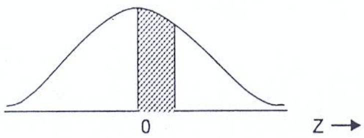
Periods

(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

ADECO NIGERIA PLC.

(a)

Relevant savings and revenue

	25,000 units	35,000 units	Shut down
	₦	₦	₦
Sales revenue	337,500	393,750	–
Material B	9,375	–	56,250
Sale of machinery	33,750	32,250	37,500
Total revenue/savings	380,625	426,000	93,750
Relevant costs			
Material A disposal	3,750	2,250	7,500
Purchase material B	–	11,250	–
Labour	93,750	150,000	–
Variable overhead			
(excl. depreciation)	60,000	84,000	–
	37,500	52,500	–
Advertising campaign			
Manager's salary	30,000	30,000	–
Redundancy pay	–	–	37,500
Total relevant costs	225,000	330,000	45,000
Net savings	155,625	96,000	48,750

Workings

	25,000 units	35,000 units	Shut down
1. Sales revenue			
No. of units	25,000	35,000	
Selling price	₦13.50	₦11.25	
Sales revenue	₦337,500	₦393,750	
2. Savings made on material B			
Surplus available	5,000	_	30,000
Saving per litre	₦1.875	₦1.875	₦1.875
Total saving	₦9,375	–	₦56,250
3. Sale of machinery			
Current market price	₦37,500	₦37,500	₦37,500
Reduction in value	₦3,750	₦5,250	_
Sale proceeds	₦33,750	₦32,250	₦37,500
4. Disposal cost of material A			
Quantity to be disposed of	25,000	15,000	50,000
Cost of disposal	₦3,750	₦2,250	₦7,500
5. **Purchase cost of material B**			
Production requirement	25,000	35,000	
No. of litres to be Purchased	_	5,000	

Purchase cost		₦11,250
6. Labour costs		
Normal labour costs	₦93,750	₦93,750
Contract labour	–	₦56,250
	₦93,750	₦150,000
7. Variable overhead		
@ ₦2.40 per unit*	₦60,000	₦84,000

*Variable overhead/unit

		₦
Total variable overhead		150,000
less depreciation		30,000
		120,000
Variable overhead/unit	=	$\frac{₦120,000}{50,000}$
	=	₦2.40 per unit

8. Manager's salary – relevant
9. Redundancy pay – relevant
10. General fixed overheads and non-production overheads – not relevant

(b) **Special order**

From the calculations in (a), the decision will be to produce 25,000 units at a price of ₦13.50. This means that the special order of 25,000 units could be produced, with the following relevant revenues and costs:

		₦
Revenue:		
Sales	(25,000 × ₦12.0)	300,000
Savings made on material A disposal	$\{\frac{250,000\ X\ ₦750}{5000}\}$	3,750
		303,750
Costs:		
Material B (20,000 x ₦1.875)		37,500
Labour (25,000 × ₦ 5.625)		140,625
Variable overhead (25,000 × ₦2.40)		60,000
		238,125
Additional contribution		65,625

Decision: Adeco is advised to accept the special order as it will produce additional contribution of ₦65,625.

(c) The cost accounting technique normally used by the management accountant to Assist management in decision making is the marginal costing technique, while the cost accounting principle is the relevant costs and relevant revenue principle.

Marginal costing might be used for decision-making. For example, marginal costing is used for limiting factor analysis, linear programming and contribution techniques.

It is appropriate to use marginal costing for decision-making when it can be assumed that future fixed costs will be the same, no matter what decision is taken, and that all variable costs represent future cash flows that will be incurred as a consequence of any decision that is taken.

These assumptions about fixed and variable costs are not always valid. When they are not valid, relevant costs should be used to evaluate the economic/financial consequences of a decision.

Relevant costs should be used for assessing the economic or financial consequences of any decision by management. Only relevant costs and benefits should be taken into consideration when evaluating the financial consequences of a decision.
A relevant cost is a future cash flow that will occur as a direct consequence of making a particular decision.

The key concepts in this definition of relevant costs are as follows:

- Relevant costs are costs that will occur in the future. They cannot include any costs that have already occurred in the past.
- Relevant costs of a decision are costs that will occur as a direct consequence of making the decision. Costs that will occur anyway, no matter what decision is taken, cannot be relevant to the decision.
- Relevant costs are cash flows. Notional costs, such as depreciation charges, notional interest costs and absorbed fixed costs, cannot be relevant to a decision.

Marking Guide

	Marks	Marks	Marks
a. (i) Production of 25000 units (½ x 13)	6.5		
(ii) Production of 35000 units (½ mark x 13 ticks)	6.5		
(iii) Shutdown of factory (½ mark x 13ticks)	6.5		
Headline	0.5	20.0	
b. Management Accounting Technique (Any 4 points @ 2½marks)		10.0	
c. Accept or reject decision on special order (10ticks @ 1 mark)		10.0	40.0

Examiner's Report

The question tests candidates' understanding of marginal costing as well as relevant costing techniques.

Being a compulsory question, all candidates attempted the question.

The performance of student was just above average.

The major pitfall was candidate lack of understanding of the subject area especially in situation that has to do with savings, replacement costs and cost incurred in situation of shutdowns.

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

SOLUTION 2

IDEAL NIGERIA LIMITED

(a) **Marginal costing approach**

Profit will be maximised by producing output to maximise the contribution per machine hour (contribution per unit of limiting factor).

	Light	Medium
Contribution per unit	₦30	₦35
Machine hours per unit	1.5 hours	2 hours
Contribution per machine hour	₦20	₦17.50
Ranking for manufacture	1st	2nd

Profit will be maximised by making and selling 10,000 units of Light in each period (maximum sales demand). This will require 15,000 machine hours. The remaining 25,000 machine hours should be used to make and sell 12,500 units of Medium.

	₦
Contribution from Light: 10,000 ×₦30	300,000
Contribution from Medium: 12,500 ×₦35	437,500
Total contribution	737,500
Fixed costs	450,000
Profit	287,500

(b) Throughput Accounting recognises material costs and its components as the only variable costs while the variable costs under marginal costing consist of direct materials costs, direct labour costs and variable overhead costs.

Under throughput accounting, direct labour costs are treated as fixed costs under other operational costs while marginal costing treats direct labour costs as relevant or variable costs relevant for decision making.

The Net profit of throughput accounting differs from that of the marginal costing because the components of their costs of sales vary.

The main difference between throughput accounting and marginal costing is in the treatment of direct labour and variable overhead costs as a 'fixed cost' in the short-term. In throughput accounting, fixed costs are referred to as 'factory cost'.

(c) Throughput accounting ratio =

Return per bottleneck unit / Factory cost per bottleneck unit

Here, the bottleneck resource is machine time.

	Light	Medium
	₦	₦
Sales price	110	135
Materials cost	50	45
Throughput	60	90
Machine hours per unit	1.5 hours	2 hours
Throughput/return per machine hour	₦40	₦45

To calculate the cost per factory hour, we need to make an assumption about direct labour cost and variable overhead costs. It is assumed that the direct labour cost and variable overhead cost in the answer to part (a) is fixed in the short-term.

	₦
Direct labour and variable overhead costs:	
Light: 10,000 ×₦30	300,000
Medium: 15,000 ×₦55	825,000
Total Direct labour/Variable Overhead	1,125,000
Fixed costs	450,000
Factory cost in each period	1,575,000

Factory cost per machine hour = ₦1,575,000/40,000 hours = ₦39.375.

	Light	Medium
Return per machine hour	₦40	₦45
Factory cost per machine hour	₦39.375	₦39.375
Machine hours per unit	1.5 hours	2 hours
Throughput accounting ratio	1.02 (102%)	1.14 (114%)
Ranking for manufacture	2nd	1st

Note: The aim should be to maximise the throughput accounting ratio, and to ensure that the ratio is higher than 1.0.

(d) Profit will be maximised by making and selling 15,000 units of Medium (maximum sales demand). This will use up 30,000 machine hours. The remaining 10,000 machine hours should be used to make 6,666.67 units of Light.

	₦
Return from Medium: 15,000 ×₦90	1,350,000
Return from Light: 6,666.67×₦60	400,000
Total return/throughput	1,750,000
Fixed costs	1,575,000
Profit	₦175,500

Marking Guide	**Marks**	**Marks**	**Marks**
a. - Profit maximizing output using Marginal Costing principles (8 ticks @ 1 tick = ¼ mark)	2.0		
- Maximising output (2 ticks @ ½mark)	1.0		
- Maximum profit (4ticks @ ¼mark)	1.0	4.0	
b. Throughput accounting Vs Marginal Costing (2 points @ 2 marks per tick)		4.0	
c. Calculation of Throughput Accounting ratio			
- Throughput returns/per Machine hour (8 ticks @ ¼ mark)	2.0		
- Computation of Factory Cost/Machine hour (8 ticks @ ¼ mark)	2.0		
- Computation of Throughput Accounting ratio (4ticks @ 1 mark)	4.0	8.0	
d. Profit Maximisation/output using Throughput Accounting:			
- Computation of output (2 ticks @ 1 tick)	2.0		
- Computation of Profit (4 ticks @ ½ mark)	2.0	4.0	20.0

Examiner's Report

The question tests candidates' understanding of application of marginal costing and throughput accounting principles.

The performance of candidates was just average.

The major pitfall was candidates' poor understanding of marginal costing and throughput accounting techniques.

Candidates are encouraged to read the Institute's study text when preparing for future examinations of the Institute.

SOLUTION 3

(a) Reconciliation Statement between Budgeted and Actual Profit

			₦'000	
Budgeted contribution			1170.0	
Sales volume variance			180.0	(A)
Sales price variance			220.0	(F)
Standard Contribution			1,210.0	
Cost variances				
	F	A		
	₦.	₦.		
Materials price		330.0		
Materials usage		320.0		
Labour rate	18.0			
Labour efficiency		120.0		
Variable overhead rate		90.7		
Variable overhead efficiency		90.0		
Total	18.0	950.7		
Total cost variances			932.7	(A)
Actual contribution			277.3	
Less Fixed cost			400.0	
Actual loss			(122.7)	

Workings

TOMA PASTE NIGERIA LIMITED

Materials price variance: based on quantities purchased since inventories are valued at standard cost.

	₦'000	
66,000 kg of materials should cost (×₦40)	2,640	
They did cost	2,970	
Material price variance	330	(A)

	kg	
11,000 units produced should use (× 5kg)	55,000	
They did use	63,000	
Usage variance in kg	8,000	(A)
Standard price per kg	₦40	
Usage variance in ₦	₦320,000	(A)

Labour rate variance

	₦'000	
36,000 hours of labour should cost (×₦40)	1,440	
They did cost	1,422	
Labour rate variance	18	(F)

Labour efficiency variance

	hours	
11,000 units produced should take (× 3 hours)	33,000	
They did take	36,000	
Efficiency variance in hours	3,000	(A)
Standard rate per hour	₦40	
Efficiency variance (in ₦)	₦120,000(A)	

Variable Overhead Variances:

	₦'000	
36,000 hours should cost (×₦30)	1,080.0	
They did cost	1,170.7	
Variable overhead expenditure variance	90.7	(A)

Variable overhead efficiency variance

(36,000hrs – 33,000hrs) =3,000 hours (A) ×₦30 per hour = <u>₦90,000</u> (A)

Sales price variance

	₦'000	
11,000 units should sell for (x ₦500)	5,500	
They did sell for	5,720	
Sales price variance	220	(F)

Sales volume (contribution margin) variance

Budgeted sales volume in units	13,000	
Actual sales volume in units	11,000	
Sales volume variance in units	2,000	(A)
× Standard contribution per unit	₦90	
Sales volume variance in ₦.contribution	₦180,000	(A)

N/B = Standard Contribution = (₦500 – ₦410)

ALTERNATIVE TO COMPUTING VARIANCES

- Material price Variance = Actual Cost less Standard Cost

= Actual Quantity Purchased x Actual Cost Per kg

less

= Actual Quantity Purchased x Standard Cost per kg

= (AQ x AC) – (AQ x SC)

$= \left\{66{,}000 \times \frac{2{,}970{,}000}{66{,}000}\right\} - (66{,}000 \times ₦40)$

= ₦2,970,000 – ₦2,640,000

= ₦330,000 Adverse

- Material Usage Variance = Standard Cost less Standard Cost of Actual Production

= Actual Quantity Used x Standard Cost Per kg

less

= Standard Cost of material per unit x Actual Production

= (AQ x SC) – (SC x AP)

= (63,000 x 40) – (₦200 x 11,000)

= ₦2,520,000 – ₦2,200,000

= ₦320,000 Adverse

- Labour Rate Variance = Actual Cost less Standard Cost

= (Actual hours used x Actual hour rate

less

= (Actual hours used x Standard labour rate per hour)

= $(36{,}000 \text{ x } \frac{₦1{,}422{,}000}{36{,}000}) - (36{,}000 \text{ x } ₦40)$

= ₦1,422,000 – ₦1,440,000

= ₦18,000 Favourable

- Labour Efficiency Variance= Standard Cost - Standard Cost of Actual Production

= (Actual hours x Standard labour rate per hour) - (Standard labour rate per unit x Actual Production)

= (36,000 x ₦40) – (₦120 x 11,000)

= ₦1,440,000 – ₦1,320,000

= ₦120,000 Adverse

- Variable Overhead Efficiency Variance = Standard Cost – Standard Cost of Actual Production

= (Actual Hours x Standard variable overhead per hour)-(Standard variable overhead per unit x Actual Production)

= (36,000 x ₦30) – (₦90 x 11,000)

= ₦1,080,000 – ₦990,000

= ₦90,000 Adverse

- Variable Overhead Expenditure Variance = (Actual Cost – Standard Cost)

= (Actual Hours x Actual Variable Overhead per hour) – (Actual Hours x Standard Variable overhead per hour)

$$= (AH \text{ x } AVOH) - (AH - SVOH)$$

$$= (36{,}000 \text{ x } (\frac{₦1{,}170{,}700}{36{,}000}) - (36{,}000 \text{ x } ₦30)$$

$$= ₦1{,}170{,}700 - ₦1{,}080{,}000$$

$$= ₦90{,}700 \text{ Adverse}$$

$$= (SSP - ASP)\ AQS$$

$$= \left\{₦500 - (\frac{₦5{,}720{,}000}{11{,}000})\right\} \text{ x } 11{,}000$$

- Sales Volume Variance = (Standard Sales – Budgeted Sales)

= (Actual Sales Volume x Standard Sales Price) - (Budgeted Quantity x Standard Sales Price)

$$= (AQS \text{ x } SSP) - (BQS - SSP)$$

$$= (11{,}000 \text{ x } ₦500) - (13{,}000 \text{ x } ₦500)$$

$$= ₦5{,}500{,}000 - ₦6{,}500{,}000$$

$$= ₦1{,}000{,}000 \text{ Adverse}$$

- Standard Margin = (Standard Sales Price – Standard Cost per unit)

$$= ₦500 - ₦410 \qquad = ₦90$$

- Sales Volume Variance $= \frac{₦90}{₦500} \text{ x } \frac{₦1{,}000{,}000}{1} = ₦180{,}000$ Adverse

Working Notes

		₦'000
Budgeted contribution	₦90.00 × 13,000 units	1,170.0
Budgeted fixed costs		(600.0)
Budgeted profit		
		570.0

Actual profit

	₦'000	₦'000
Sales		5,720.0
Materials	2,970.0	
Less closing inventory (3,000kg ×₦40.00)	(120.0)	
	2,850.0	
Labour	1,422.0	
Variable overheads	1,170.7	
Fixed costs	400.0	
Total		(5,842.7)
Actual loss in the period		(122.7)

b) If the company uses absorption costing with a direct labour hour absorption rate, we can calculate an expenditure, capacity and efficiency variance for fixed production overheads.

Budgeted absorption rate per hour:

Budgeted labour hours: 13,000 × 3 = 39,000 hrs

Budgeted fixed cost ₦600,000

Budgeted absorption rate: ₦600,000 /39,000 = ₦15.38

Fixed overhead expenditure variance

	₦'000	
Budgeted fixed overhead costs	600	
Actual fixed overhead costs	400	
Fixed overhead expenditure variance	200	(F)

Fixed overhead capacity variance

	hours	
Budgeted hours of work	39,000	
Actual hours worked	36,000	
Capacity variance in hours	3,000	(A)
Standard fixed overhead rate per hour	₦15.38	
Fixed overhead capacity variance in ₦.	₦46,140 (A)	

Fixed overhead efficiency variance

Efficiency variance in hours = 3,000 hours (A) – see answer to (a).

Fixed overhead efficiency variance = 3,000 hours (A) ×₦15.38 = ₦46,140(A).

ALTERNATIVE SOLUTION

- Fixed Overhead Expenditure Variance = Actual Cost – Budgeted Cost
  = ₦400,000 – ₦600,000
  = ₦200,000 Favourable

- Fixed Overhead Capacity Variance = (Budgeted Cost – Standard Cost)

= (Budgeted Hours x Standard Cost per hour) – (Actual Hours x Standard Cost per hour)

= (BH x SC) – (AH x SC)

$$=(13{,}000 \times 3\left\{\frac{₦600{,}000}{13{,}000 \times 3}\right\} - (36{,}000 \times (\frac{₦600{,}000}{39{,}000})$$

= ₦600,000 – ₦553,846

= ₦46,154 Adverse

- Fixed Overhead Efficiency Variance =

= (Standard Cost - Standard Cost of Actual Production)

= (AH x SC) – (SCAP)

$$= (36{,}000 \times (\frac{₦600{,}000}{39{,}000}) - (11{,}000 \times (\frac{₦600{,}000 \times 3}{39{,}000})$$

= ₦553,846 - ₦507,692

= ₦46,154 Adverse

N/B: Due to round-off or, any answer between ₦46,140 (A) to ₦46,154 (A) will be accepted.

(c) **Labour rate**

The labour rate variance is favourable indicating a lower rate per hour was paid than expected. This is perhaps because lower grade of labour were used during production. Though less likely, it is possible that staff had a pay cut imposed upon them/decrease in buy rate. Finally, an incorrect or outdated standard could have been used.

Labour efficiency

This is significantly adverse, indicating staff took much longer than expected to complete the output. This may relate to the favourable labour rate variance, reflecting employment of less skilled or experienced staff. Staff demotivated by a pay cut are also less likely to work efficiently.

It may also relate to the reliability of machinery as staff may have been prevented from reaching full efficiency by unreliable equipment. Others include:

- Decrease in machine set up time
- Idle time
- Lack of motivation
- Faulty equipment/Machine breakdown

Marking Guide	**Marks**	**Marks**	**Marks**
a. Reconciliation Statement (16 ticks @ ½ mark)	8.0		
- Workings (8 ticks @ ½ mark)	4.0	12.0	
b. Recalculation of Fixed overhead variances			
- 3 fixed overhead variances (1 mark each)	3.0		
- Working (2 ticks @ ½ mark each)	1.0	4.0	
c. Labour rate variance			
(Any 2 points at 1 point = 1 mark)	2.0		
Labour efficiency Variance			
(Any 2 points @ 1 point = 1 mark)	2.0	4.0	20.0

Examiner's Report

The question tests candidates' understanding of application of standard costing and variance analysis.
Majority of the candidates attempted the question.

The performance of candidates was above average.

The major pitfall was candidates inability to understand the application of standard costing using marginal costing as well as treatment of fixed overhead under absorption costing approach. Another pitfall was candidates' failure to understand the treatment of inventory under standard costing principle.
Candidates are encouraged to read the Institute's study text when preparing for future examination of the Institute.

SOLUTION 4

ADEB NIGERIA LIMITED

(a) **Profit statements in December**

(i) **Operating at 80% capacity**

	Transfer price ₦200			Transfer price ₦180		
	Eastern division	**Northern division**	**Total**	**Eastern division**	**Northern division**	**Total**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Sales:						
External (₦180x5000)	900	1,200	2,100	900	1,200	2,100
Transfers (₦200x3000)	600	-	0	540	-	0
Total	1,500	1,200	2,100	1,440	1,200	2,100
Costs						
Transfers	-	(600)	0	-	(540)	0
Variable (₦70x8000)	(560)	(180)	(740)	(560)	(180)	(740)
Fixed	(150)	(60)	(210)	(150)	(60)	(210)
Total	(710)	(840)	(950)	(710)	(780)	(950)
Profit	790	360	1,150	730	420	1,150

(ii) **Operating at 100% capacity**

	Transfer price ₦200			Transfer price ₦180		
	Eastern division	**Northern division**	**Total**	**Eastern division**	**Northern division**	**Total**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Sales:						
External (₦180x5000)	900	1,600	2,500	900	1,600	2,500
Transfers (₦200x5000)	1,000	-	0	900	-	0
Total	1,900	1,600	2,500	1,800	1,600	2,500
Costs						
Transfers	-	(1,000)	0	-	(900)	0
Variable	(700)	(300)	(1,000)	(700)	(300)	(1,000)
Fixed	(150)	(60)	(210)	(150)	(60)	(210)
Total	(850)	(1,360)	(1,210)	(850)	(1,260)	(1,210)
Profit	1,050	240	1,290	950	340	1,290

N/B: Under the Northern Div. External Sales = ((₦32x5000x10 blocks) = ₦1,600,000
Under the Northern Div. Variable Costs = ((₦60x5000) = ₦300,000

(b) The effect of a change in the transfer price from ₦200 to ₦180 will result in lower profit for Eastern division and higher profit for Northern division, but the total profit for the company as a whole will be unaffected.

A reduction in the transfer price to ₦180 (or possibly lower) is recommended, because this is the price at which Northern division can buy the materials externally. At any price above ₦180, Northern division will want to buy externally, and this would not be in the interests of the company as a whole. Significantly, at a transfer price of both ₦200 and ₦180, Northern division would suffer a fall in its divisional profit if it reduced the selling price of blocks to ₦32 and increased capacity by 20,000 blocks each month. A reduction in price would be in the best interests of the company as a whole, because total profit would rise from ₦1,150,000 per month to ₦1,290,000.

(c) Ignoring the transfer price, the effect on Northern division of reducing the sale price of blocks to ₦32 would be to increase external sales by ₦640,000 and variable costs in Northern division by ₦120,000 (2,000 tonnes × ₦60). Cash flows would therefore improve by ₦520,000 per month (₦640,000 less ₦120,000). To persuade Northern division to take the extra 2,000 tonnes, the transfer price should not exceed ₦260 (₦520,000/2,000). This is above the current external market price which is ₦180 although there is strong price competition in the market.

The transfer price for Eastern division should not be less than the variable cost of production in Eastern division, which is ₦70 per tonne.

In the final analysis, an optimal transfer price suggested should be between ₦70 to ₦180.

Marking Guide	Marks	Marks	Marks
a. (i) Profit Statement @ 80% capacity			
(50 ticks @ 1 mark for 10 ticks)	5.0		
(ii) Profit Statement @ 100% capacity			
(50 ticks @ 1 mark for 10 ticks)	5.0	10.0	
b. Comments on effect on transfer price change			
(2 points @ 2½ marks per point)		5.0	
c. Other transfer price to provide incentive			
(2 points @ 2½ marks per point)		5.0	20.0

Examiner's Report

The question tests candidates' understanding of transfer pricing technique.

The attempt on this question by candidates was moderate.

The performance of candidates is above average.

The major pitfall was candidates poor understanding of the requirements of the question especially in areas of varying capacity for production and sales as well as determination of optimum transfer price.

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

SOLUTION 5

DAT AIR

(a) The four perspectives

Financial perspective – this perspective is concerned with how a company looks to its shareholders. How can it create value for them? Kaplan and Norton identified three core financial themes which will drive the business strategy: revenue growth and mix, cost reduction and asset utilisation

Customer perspective – this considers how the organisation appears to customers. The organisation should ask itself: 'to achieve our vision, how should we appear to our customers?' The customer perspective should identify the customer and market segments in which the business will compete. There is a strong link between the customer perspective and the revenue objectives in the financial perspective. If customer objectives are achieved, revenue objectives should be too.

Internal perspective – this requires the organisation to ask itself: 'what must we excel at to achieve our financial and customer objectives?' It must identify the internal business processes which are critical to the implementation of the organisation's strategy. These will include the innovation process, the operations process and the post-sales process.

Learning and growth perspective – this requires the organisation to ask itself whether it can continue to improve and create value. The organisation must continue to invest in its infrastructure – i.e. people, systems and organisational procedures – in order to improve the capabilities which will help the other three perspectives to be achieved.

(b) **Goals and Measures:**

Perspective	**Goal**	**Performance Measure**	**Comments/Remarks**
Customer	To improve on the existing level of cleaningness of Airplanes	Rating of the cleaning by the customers.	This constitute a major factor adding value to customers.
Customer	To ensure that flights are on time. To reduce the number of flight cancelled	"On time arrival" ranking from the aviation authority. The number of flights cancelled.	DAT Air is currently No. 2 in the ranking and customers are more likely to use it. If flights are frequently cancelled, customers will not use it as it will be received as unreliable.
Internal	Extending operations to other cities where no airline fly to currently	The number of customer base and fights in a year	This represents area where the airline has been excelling
Internal	To improve turnaround time on the ground. To improve the cleaningness of DAT's Planes. To develop the online booking system.	On the ground time % of customers happy with the standards of the planes (customer satisfaction) percentage downtime	Less time spent on ground means fewer planes are needed, reduce leasing costs. About 85% of customers are happy meaning 15% can result in loss of revenue. Since the company relies on booking system. It is critical in situation of growing number of customers.

Financial	(a) To continue to use one model of aircraft	The extent reduction in maintenance and operational costs when compared with increase in customers' base and revenue.	This will help to make superior returns to the shareholders of the company.
Financial	(b) To use fewer planes to transport customers. (c) To increase set revenue per plane	Cost of lease of plane per customer Revenue per available passenger	Operating efficiency will be driven by getting more customers on fewer planes. This measures the cost side. This covers the first part of achieving operating efficiency by having fewer empty seats on planes
Innovation & Learning	To reduce the employee absentee rate. To increase ground crew training on cleaning and refuelling procedures	The number of days absent per employee. Number of days' training per ground crew members	It is critical to the company that its workforce are reliable as absentee staff will lead to flight cancellation. If ground crew are better trained, they reduce the time the place stays on the ground, resulting in fewer planes being required and thus lowers costs. Cleaning results in customer satisfactory and retention will increase
Innovation & Learning	Taking advantage of new developments in the e-commerce to improve business operations	The increase in number of customers who book online in advance	This area will help the airline to maintain its competitive position in the industry

c. APPRAISAL OF THE USEFULNESS OF THE BALANCED SCORECARD AS A PERFORMANCE EVALUATION TECHNIQUE

- **Better Strategic Planning**
  The Balanced Scorecard provides a powerful framework for building and communicating strategy. The business model is visualised in a Strategy Map which helps managers to think about cause-and-effect relationships between the different strategic objectives. The process of creating a Strategy Map ensures that consensus is reached over a set of interrelated strategic objectives. It means that performance outcomes as well as key enablers or drivers of future performance are identified to create a complete picture of the strategy.

- **Improved Strategy Communication & Execution**
  Having a one-page picture of the strategy allows companies to easily communicate strategy internally and externally. We have known for a long time that a picture is worth a thousand words. This 'plan on a page' facilitates the understanding of the strategy and helps to engage staff and external stakeholders in the delivery and review of the strategy. The thing to remember is that it is difficult for people to help execute a strategy which they don't fully understand.

- **Better Alignment of Projects and Initiatives**
  The Balanced Scorecard helps organisations map their projects and initiatives to the different strategic objectives, which in turn ensures that the projects and initiatives are tightly focused on delivering the most strategic objectives.

- **Better Management Information**
  The Balanced Scorecard approach helps organisations design key performance indicators for their various strategic objectives. This ensures that companies are measuring what actually matters. Research shows that companies with a BSC approach tend to report higher quality management information and better decision-making.

- **Better Process Alignment**
  Well implemented Balanced Scorecards also help to align organisational processes such as budgeting, risk management and analytics with the strategic priorities. This will help to create a truly strategy focused organisation.

Marking Guide	**Marks**	**Marks**	**Marks**
a. (i) Listing of each perspective (1 mark each)	4.0		
(ii) Discussing each perspective (½ mark each)	2.0	6.0	
b. Goods/Performance measures of the perspectives			
- Any 3 of the perspective goals	3.0		
- Any 3 corresponding measures	3.0		
- Any 3 corresponding explanations	3.0	9.0	
c. Usefulness of Balance Scorecard			
(2 points @ 2½ marks per point)		5.0	20.0

Examiner's Report

The question tests candidate knowledge of the concept of balance scorecard as an instrument of identifying corporate goals and associated performance measures.

The performance of students is below average.

The major pitfall was candidates' inability to identify the corporate goals and the associated measures.

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

SOLUTION 6

LAPEZ

(a)

	2018		**2017**	
	Northern	**Southern**	**Northern**	**Southern**
ROCE %	38.0	41.7	29.3	26.7
Staff costs/revenue %	63.9	57.7	62.1	58.2
Other operating costs/revenue %	25.6	27.2	26.3	27.6
Asset turnover	3.6	2.8	2.5	1.9
Operating profit/revenue %	10.6	15.1	11.6	14.2
Depreciation ₦'000	375.0	450.0	375.0	450.0
Op costs-depreciation ₦'000	315.0	562.0	375.0	480.0
Op costs-depreciation/revenue %	11.7	15.1	13.2	14.2
Revenue per member ₦	392	395	404	406
Staff costs per member ₦	251	228	251	236
Residual Income	172.50	360.50	161.25	210.00
Absolute Profit	₦ 285	₦ 563	₦ 330	₦ 480

In 2017 the Northern division generated the higher ROCE and the General manager of that division would have received the bonus. The revenue for the Northern division was lower than that of the southern division but so was its capital employed. This is because it had a lower investment in non-current assets and its assets are older (assuming that all assets in each particular division were acquired at the same date).

Revenue at the Northern division has fallen by 5.3% between 2017 and 2018. Also. revenue per member slightly fell from ₦404 in 2017 to ₦392 in 2018. Therefore, it can be concluded that the decline in revenue is due to the fall in number of members. The opposite is true for the Southern division, as revenue has increased by 10.2% over the period. Revenues per member are in line with the Northern division at ₦395 and have been maintained over the period.

The operating profit has fallen over the period at the Northern division due to a fall in revenue and also less effective cost management with operating profit margins decreasing from 11.6% to 10.6%.

Conversely, in the Southern division, the operating profit margin has increased from 14.2% to 15.1%. However further information can be obtained from a deeper analysis of the figures:

- Staff expenses as a percentage of revenue have increased for the Northern division but decreased for the Southern division. Given that revenue is almost directly linked to the number of members, it could be argued that this is to be expected given that it is highly likely that many of the staff costs are fixed.
- Operating costs as a percentage of revenue have fallen for both divisions but if depreciation is excluded it can be seen that they have increased for the Southern division.

The General manager of the southern division would earn the bonus in 2018.

b.

	Year	**₦'000**	**Disc factor**	**PV ₦**
Investment	0	-1,200	1.000	-1,200
Cash inflow	1-5	351	3.352	1,177
Sales of assets	5	525	0.497	<u>261</u>
NPV				**<u>238</u>**

The NPV of the project is ₦238,000. This NPV is positive.

<u>**Workings**</u>

Calculation of Depreciation for each year = $\frac{₦675,000}{5\ year}$ = ₦135,000

Calculation of Adjusted Annual Cashflows	=
Operating Profit	= ₦ 216,000
Add: Depreciation	= ₦ <u>135,000</u>
	= ₦ <u>351,000</u>

The NPV of the investment is positive and therefore this investment should have been made.

Marking Guide	**Marks**	**Marks**	**Marks**
a. Computation/discussion of ROCE and two other performance measures for 2017/2018:			
- Computation of ROCE @ 1 mark	4.0		
- Discussion of relative performance for ROCE	1.0		
- Computation of any other two measures @ 1 mark	8.0		
- Discussion of relative performance	2.0	15.0	
b. Computation/Appraisal of Investment (5 ticks @ 1 mark)		5.0	20.0

Examiner's Report

The question tests candidates knowledge of company divisional performance and the use of appropriate parameters when financial data are provided on divisional basis. The question also test's candidates' ability in investment appraisal technique.

Majority of the candidates attempted the question.

The performance of candidates is above average.

The major pitfall was inability of candidates to carry out thorough and relevant appraisal of the ratios computed. Also, candidates inability to apply the annuity table since the cash flow is regular for the duration of the investment is a major pitfall.

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

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2020

PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: $3^{1}/_{4}$ hours (including 15 minutes reading time)

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

SECTION A: COMPULSORY QUESTION (40 MARKS)

QUESTION 1

IPSAS 33, gives a transition relief (exemption) of up to three years within which to develop models for transiting to IPSAS accrual. However, the government of Nigeria adopted accrual IPSAS on revenue from exchange transactions effective January 1, 2016.
Oranta State Government mandated the Accountant-General of the State to implement the IPSAS accrual in the preparation of their financial statements with effect from January 2018 which was complied with accordingly.

For the smooth implementation of IPSAS accrual, the State Executive Council approved the following:

(i) Asset valuation committee to be chaired by the Deputy Governor with the Commissioner of Finance, Commissioner of Budget and Planning, Chairman State Internal Revenue Service, Accountant-General of the State and Head of Service as members while a Director in the Office of the Secretary to the State Government was appointed as the Secretary.
(ii) The Committee was mandated to value all the State assets and liabilities on or before the implementation of IPSAS accrual.
(iii) The Committee was allowed to engage the services of competent valuers for the job.
(iv) The valuation of the assets and liabilities should be on continuous basis and any value agreed and approved by the State Executive Council should be brought into the books in the year of valuation.
(v) All assets and liabilities incurred after implementation of IPSAS accrual should be recognised in the year they occurred.

The consolidated trial balance for the year ended December 31, 2017 based on IPSAS cash is as follows:

	Dr ₦'million	Cr ₦'million
Liquid assets:		
CRF Bank balance	55,000.00	
Investments:		
Treasury bills	100,000.00	
Advances	95,000.00	
Revolving loans granted	250,000.00	
Fund balance:		
Consolidated Revenue Fund (CRF)		75,000.00
Loans:		
External loans		150,000.00
State bonds		275,000.00
Total	**500,000.00**	**500,000.00**

Extracted consolidated cashbook for the year 2018:

	Dr ₦'million	Cr ₦'million
Receipts:		
Share of federation account allocation	324,000	
Value added tax allocation	234,000	
Tax revenue - Personal income tax	185,000	
Non- Tax Revenue:		
- Fees	35,000	
- Fines	36,000	
- Penalty	33,000	
Revolving loan repayment including interest of ₦2billion	52,000	
Interest on treasury bills	10,000	
Aids and grants	51,800	
	960,800	
Payments:		
Salaries and wages		750,000
Motor vehicles		25,000
Building		23,000
Plant & machinery		15,000
Equipment		7,000
Loan repayment- Bonds and interest		13,000
- Foreign and Interest		32,000
Transport and Travelling		1,900
Hotel accommodation		2,600
Office consumables		750

Rent expenses	1,200
General repairs and maintenance	800
Utilities	3050
Consultancy	6,700
Other overheads	2,100
Pension and gratuity	35,000
Finance charge- Insurance	350
Revolving loan	500
Miscellaneous expenses	450
	920,400

The following information is relevant:

(i) The employees' salaries and wages bill for the month of December 2018 amounting to ₦6.5billion was outstanding at the end of the year.

(ii) The following information was extracted from the unit in charge of accounting for property, plant and equipment (PPE): 100 sets of HP computers were received from Koko Computers Limited to assist the State government to eradicate ghost workers from the payroll- the HP series P1120, 2016 model. Based on this information, a call was made to three of their computer suppliers to find out the current price of the HP P1120. Two of the suppliers quoted ₦450,000 each, while one quoted ₦500,500 each. Based on this information, the fair value of the computers, were taken as ₦500,000 each.

(iii) The government during the year received an asset valuation report from the Asset Valuation Committee that was set up to carry out the valuation of the old assets and liabilities of the State.

(iv) The following values were recommended and approved by the State Executive Council respectively:

Details	**Committee valuation**	**State Executive Council approval**
	₦'million	**₦'million**
Vacant land	116,000	95,000
Land and building (Cost of land ₦30billion)	150,000	135,000
Plant and machinery	75,000	75,000
Motor vehicle	20,000	15,000
Equipment	55,000	50,000
Furniture and fittings	85,000	80,000
Total	**501,000**	**450,000**

(v) Pension and gratuity of ₦15 billion was outstanding at the end of the year

(vi) Some of the accounting policies adopted by the government for depreciation include the following rates;

	% p.a.
Motor vehicle	20
Building	2
Furniture	10
Equipment	15
Plant & machinery	15
Investment property	5

(vii) During the year, one of the contractors took the State to court for breach of contract. The case was still in court as at the end of the year and from all indications, judgment will eventually be in his favour. The legal adviser estimated the judgment debt to be ₦50million.

(viii) Value of office consumables based on inventory sheet as at December 31, 2018 was ₦550million.

(ix) The following expenses were incurred but not settled as at end of the year.

	₦'million
Consultancy	150
Utility	28
Repairs & maintenance	20

(x) An extract from the foreign loan amortisation schedule indicates that a total sum of ₦32billion comprising principal and interest of ₦2billion was due and paid during the year. Also domestic loan of ₦13billion comprising principal and interest of ₦1billion was paid during the year. The interest payable on domestic and external loans at the end of the year amounted to ₦3billion and ₦5 billion respectively.

(xi) The investment of 10% treasury bills for 360 days was due to mature on January 1, 2018 and reinvested immediately for another term.

(xii) The revolving loan attracts interest of 4% per annum and it is paid along with the principal.

Required:

a. In line with the provisions of IPSAS 33, explain how the following revenue from exchange transactions should be recognised:

i. Aid and grants receivable as at December 31, 2015 (2 Marks)

ii. Debt forgiveness approved on or after January 1, 2016 (2 Marks)

iii. Personal income tax on or after January 1, 2016 (2 Marks)

b. Prepare in vertical form:

i. Statement of financial performance for the year December 31, 2018. (17 Marks)

ii. Statement of financial position for the year December 31, 2018. (17 Marks)

(Total 40 Marks)

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

QUESTION 2

a. An internal audit is an independent appraisal activity within an organisation for the review of accounting, financial and other operations with the objective of assisting members of the organisation to discharge their responsibilities effectively. It is a sound policy to establish constructive working relationships with internal audit units in order to foster the development, promote coordinated coverage and avoid duplication.

Required:

Explain the **FIVE** criteria employed by the external auditors to assess the likely effectiveness and relevance of the internal audit functions and **FIVE** areas where the internal audit functions can be of assistance to the external audit. (10 Marks)

b. Globally, there has been steady increase in the level of government expenditure in different areas of activities. In Nigeria there is steady growth of expenditure over the years which requires explanation.

Required:

Identify and explain **FIVE** reasons for rising public expenditure over the years in Nigeria. (10 Marks)

(Total 20 Marks)

QUESTION 3

a. The budgeting process is a cycle of events which occur sequentially every year and which results in the approved budgets in ministries and extra-ministerial departments.

Required:
Explain **FIVE** factors militating against the budgeting system in the public sector. (10 Marks)

b. There are various instruments that can be employed for the purpose of raising capital within the domestic economy by government.

Required:
Discuss **FIVE** of these instruments. (10 Marks)

(Total 20 Marks)

QUESTION 4

a. The Chairman of Okoko Local Government set up ponds farming in order to meet one of the promises he made to the electorates when he was campaigning. The Chairman of the Local Government is however apprehensive about the viability of the project and its ability to finance itself in view of the increasing production cost. The expected cash-in-hand as at January1, 2020 is ₦3,300,000.

The following information concerns the budgeted sales and purchases of the fish farm.

	Sales budget ₦'000	**Purchases budget ₦'000**
November, 2019	55,000	35,000
December, 2019	100,000	55,000
January, 2020	114,000	75,000
February, 2020	142,000	95,000
March, 2020	145,000	80,000

Analysis of records shows that debtors settle according to the following pattern.

70% within the month of sale

30% in following month

All purchases are on credit. Past experience shows that 80% of the purchase costs are settled in the month of transaction and the balance in the subsequent month. Overhead costs of 65% of the purchases of the month will have to be paid monthly. The Local Government will be given monthly allocation of ₦15million

Required:

Prepare for the Chairman of the Okoko Local Government a monthly cash budget of the fish pond for the first quarter (January to March) of the year 2020. (10 Marks)

b. The growth of the grant system is an important factor in the development of fiscal federalism. The grant system is concerned not only with the level of grants and the programme areas, which should be supported, but also the form in which the grants are to be given.

You are **required** to explain **FIVE** principles that should guide grant design. (10 Marks)

(Total 20 Marks)

QUESTION 5

a. Odeda Agricultural Corporation, a parastatal under Waso State Ministry of Agriculture operates its business with plant and equipment that qualified under IPSAS 17 on property, plant and equipment. On January 1, 2020 the cost of the corporation plant was ₦100,000,000 and the accumulated depreciation was ₦40,000,000. On January 2, 2020, the corporation bought a new equipment at the cost of ₦100,000,000 and the equipment supplier accepted an old equipment owned by Odeda Agricultural Corporation in part exchange for a value of ₦2,500,000. The equipment originally cost ₦8,000,000 and its accumulated depreciation was ₦5,500,000.

Required:

i. Calculate the gain or loss on the disposal of the old equipment. (5 Marks)

ii. Explain **FIVE** disclosures requirements of property, plant and equipment stated at revalued amount in accordance with IPSAS 17. (5 Marks)

b. Investment appraisal is a technique aimed at finding out the least possible costs of an investment and the maximum economic benefits, which may accrue from the commitment of resources into it. Cost Benefit Analysis and Cost Effectiveness Analysis are among the techniques used for investment appraisal in public sector.

Required:
Explain the **FIVE** steps to be followed in conducting Cost Benefit Analysis and Cost Effectiveness Analysis. (10 Marks)

(Total 20 Marks)

QUESTION 6

a. In July 2003, the Federal Government commenced the implementation of deliberate policies, programmes and projects aimed at strengthening the economy, governance and fighting corruption.

This led to the first Economic Reform and Governance Project (ERGP) initiative, which was approved in December 2004, in line with FGN goal to strengthen governance, accountability, reduce corruption and deliver services more effectively. This brought about the reforms in public sector of the economy. The Government Integrated Financial Management Information System (GIFMIS) and Integrated Personnel and Payroll Information System (IPPIS) are parts of the Public Financial Management (PFM) reforms approved in 2004

Required:
Identify **FIVE** objectives each of Government Integrated Financial Management Information System (GIFMIS) and Integrated Personnel and Payroll Information System (IPPIS). (10 Marks)

b. Economic cycle also known as business cycle refers to the upward and downward movements (fluctuations) as shown in the national gross domestic product during a given period.

Required:
Explain **FIVE** phases of an economic cycle (10 Marks)

(Total 20 Marks)

SOLUTION 1

a. Revenue from exchange transactions

i. **Aid and grants receivable as at December 31, 2015**

If on or before December 31, 2015, a public sector entity is entitled to an un-conditional aid/grants and funds have not been received as at January 1, 2016, the amount due to that entity and not yet received shall be recognised as receivable in the opening statement of financial position.

ii. **Debt forgiveness approved on or after January 1, 2016**

Debt forgiven on or after January 1, 2016 shall be immediately recognised as revenue in the books of the recipient when both the grantor and the recipient have approved a debt forgiveness agreement/MoU and no conditions are attached.

Where there are conditions attached to the debt forgiven to the extent that if not met the amount will be repayable, and there is a possibility of failure to meet such condition(s), the amount forgiven (or portion with conditions) will remain a liability until such conditions are met.

iii. **Personal income on or after January 1, 2016**

The personal income tax is recognised at the point when the taxpayer has earned assessable income. In Nigeria, the recognition of personal income tax is to be considered in two-folds:

- At the point of collection in the books of Relevant Tax Authority (RTA), personal income tax is recognised when taxpayer or employer has submitted returns.
- In the books of the government (Federal/State treasury), personal income tax is recognised upon remittance of tax by RTA to Consolidated Revenue Fund (CRF) of the respective treasury.

b. **Oranta State Government**

Statement of financial performance for the year ended December 31 2018

	Working notes	₦' million	₦' million
Revenue:			
Share of federation account allocation			324,000.00
Value added tax allocation			234,000.00
Tax revenue - Personal income tax			185,000.00
Non- tax revenue			
- Fees.			35,000.00
- Fines.			36,000.00
- Penalty			33,000.00
Revolving loan interest	iii.		2,020.00
Interest on treasury bills			10,000.00
Aids and grants			51,800.00
Donation of computers			50.00
Total revenue			**910,870.00**
Expenditures:			
Salaries & wages	ii.	756,500.00	
Bonds interest	iii.	4,000.00	
External loan interest	iii.	7,000.00	
Transport and travelling		1,900.00	
Hotel accommodation		2,600.00	
Office consumables	ii.	200.00	
Rent expenses		1,200.00	
General repairs and maintenance	ii.	820.00	
Utilities	ii.	3,078.00	
Consultancy	ii.	6,850.00	
Other overheads		2,100.00	
Pension and gratuity	ii.	50,000.00	
Finance charge- Insurance		350.00	
Miscellaneous expenses		450.00	
Contingency - Judgement debt		50.00	
Depreciation:			
- Motor vehicles	i.	5,000.00	
- Building	i.	460.00	
- Plant and machinery	i.	2,250.00	
- Equipment	i.	1,057.50	**845,865.50**
Surplus for the year			**65,004.50**

Working Notes

i. Depreciation on new PPE

	Land & building	Equipment	Motor vehicles	Furniture and fittings	Plant and machinery
Rate	2%	15%	20%	10%	15%
	₦' million	**₦' million**	**₦' million**	**₦' million**	**₦' million**
Depreciation to be charged	**₦460.00**	**1,057.50**	**5,000.00**	**00**	**2,250.00**

ii. Analysis of expenses

	Salaries and wages ₦' million	Pension and gratuity ₦' million	Consultancy ₦' million	Utility ₦' million	Repairs and maintenance ₦' million	Office consumables ₦' million
Bank	750,000	35,000	6,700	3,050	800	750
Value of consumable b/f	--	--	--	--	--	--
Accrued c/f	6,500	15,000	150	28	20	--
Prepaid c/f	--	--	--	--	--	-550
Amount charged	**756,500**	**50,000**	**6,850**	**3,078**	**820**	**200**

iii. Interest credited and charged on revolving/ domestic and external loans

	Revolving loan ₦' million	Bonds ₦' million	External loan ₦' million
Bank	2,000	(1,000)	(2,000)
Interest receivable/payable	20	(3,000)	(5,000)
Credited/(charged)	**2,020**	**(4,000)**	**(7,000)**

Oranta State Government

Statement of financial position as at December 31 2018

Non-current assets:	Working notes	Cost/ valuation	Accumulated depreciation	Carrying amount
		₦' million	₦' million	₦' million
Land & buildings	iv.	253,000.00	460.00	252,540.00
Motor vehicles	iv.	40,000.00	5,000.00	35,000.00
Furniture and fittings	iv.	80,000.00	00	80,000.00
Equipment	iv.	57,050.00	1,057.50	55,992.50
Plant & machinery	iv.	90,000.00	2,250.00	87,750.00
Total non- current assets		**520,050.00**	**8,767.50**	**511,282.50**
Current assets:				
Office consumables	ii.		550.00	
Cash and cash equivalents	v.		95,400.00	
Investment: Treasury Bills			100,000.00	
Advances			95,000.00	
Revolving loan	vi.		200,500.00	
Revolving loan interest (4% of 500)	iii.		20.00	
Total current assets				491,470.00
Total assets				**1,002,752.50**
Non- current liabilities:				
Long term borrowing - Bonds	vi.	263,000.00		
- Foreign	vi.	120,000.00		
Total non- current liabilities:			383,000.00	
Current liabilities				
Salaries & wages	ii.	6,500.00		
Consultancy	ii.	150.00		
Utility	ii.	28.00		
Repairs & maintenance	ii.	20.00		
Pensions & gratuity	ii.	15,000.00		
Contingent liability		50.00		
Interest payable - Domestic	iii.	3,000.00		
- External	iii.	5,000.00		
Total current liabilities			29,748.00	
Total liabilities				**412,748.00**
Net assets				**590,004.50**
Equity				
Reserves	vii & viii			525,000.00
Surplus for the year				65,004.50
Total equity				**590,004.50**

Working notes:

iv. Property, plant & equipment.

New property, plant & equipment	Land and building ₦' million	Equipment ₦' million	Motor vehicles ₦' million	Furniture and Fittings ₦' million	Plant and machinery ₦' million
Bank	23,000	7,000	25,000	--	15,000
Donation of computers	--	50	--	--	--
Valuation of old assets	230,000	50,000	15,000	80,000	75,000
Balance as at December 31 2018	**253,000**	**57,050**	**40,000**	**80,000**	**90,000**

v. Calculation of cash and its equivalents as at December 31, 2018

	₦' million
Balance b/f	55,000
Total receipts	960,800
	1,015,800
Total payments	-920,400
Balance c/f	**95,400**

vi. **Revolving/domestic and external loans**

	Revolving loan receivable ₦' million	Bonds payable ₦' million	External loan payable ₦' million
Balance b/f	250,000	275,000	150,000
Repayment	-50,000	-12,000	-30,000
Additions	500	-	-
Balance c/f	**200,500**	**263,000**	**120,000**

vii. **Revaluation surplus**

Old property plant & equipment	Land and building ₦' million	Equipment ₦' million	Motor vehicles. ₦' million	Furniture and Fittings ₦' million	Plant and machinery ₦' million
Valuation	135,000	50,000	15,000	80,000	75,000
Vacant Land Valuation	95,000	-	-	-	-
Revaluation surplus	**230,000**	**50,000**	**15,000**	**80,000**	**75,000**

viii Reserves

Revaluation	**₦' million**
Land and building	230,000.00
Equipment	50,000.00
Motor vehicles.	15,000.00
Furniture and fittings	80,000.00
Plant and machinery	75,000.00
Sub-total	**450,000.00**
CRF balance	75,000.00
Total	**525,000.00**

Marking Guide

		Marks	**Marks**
a.	Revenue from exchange transactions:		
	Aid and grants receivable as at December 31, 2015	2	
	Debt forgiveness approved on or after January 1, 2016	2	
	Personal income on or after January 1 2016	2	6
b.	Statement of financial performance:		
	Correct title	½	
	Calculation of total revenue	3	
	Calculation of total expenditure	5	
	Calculation of net surplus for the year	1½	10
	Workings:		
i.	Property, plant and equipment:		
	Calculation of depreciation charges for the year on PPE	2½	
ii.	Analysis of expenses:		
	Calculation of expenses to be charged during the year	3	
iii.	Interest on revolving credited/domestic and external loans interests charged		
	Calculation of interest on revolving credited/domestic and external loans interests charged	1½	7
	Sub-total		17
	Statement of financial position:		
	Correct title	½	
	Calculation of total non-current assets	4½	
	Calculation of total current assets	1¾	
	Calculation of total assets	¼	
	Calculation of non- current liabilities	¾	
	Calculation of total current liabilities	2¼	
	Calculation of total liabilities	¼	
	Calculation of total net assets	¼	
	Calculation of total net assets/equity	1½	12

	Workings		
iv.	Property, plant and equipment:		
	Calculation of the cost of PPE at the end of the year	1¼	
v.	Cash and its equivalents c/f:		
	Calculation of cash & its equivalents	1	
vi.	Revolving receivable/domestic and external loans payable:		
	Calculation of revolving/domestic and external loans c/f	¾	
vii.	Calculation of revaluation surplus	1¼	
viii.	Calculation of reserves	¾	5
	Sub- Total		**17**
	Total		**40**

Examiner's Report

The question tests candidates' knowledge of recognition of revenue on exchange transactions under IPSAS 33 First-Time Adoption of Accrual Basis in part (a) of the question, while part (b) tests candidates' knowledge on the preparation of statement of financial performance and statement of financial position using vertical format.

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

The commonest pitfalls was the inability of the candidates to understand the treatment aids and grant; debt forgiveness; and personal income tax under IPSAS 33. Candidates were unable to incorporate the additional information given in the notes to the question in the preparation of financial statement.

Candidates are advised to acquire adequate knowledge of relevant provisions of International Public Sector Accounting Standards (IPSAS) for better performance in the Institute's future examinations.

SOLUTION 2

a.i. Reliance of the external auditors on the internal auditors' work

Before external auditors could rely on the work of the internal auditors, the former would have made the following assessments:

- The degree of independence of the internal auditors;
- The scope and objectives of the internal audit functions as defined by the management;
- Due professional care, that is, whether or not the internal audit work is properly planned, recorded and reviewed;

- The technical competence of the internal auditors. This raises the question as to whether the internal auditors belong to any reputable professional accounting body or has relevant practical experience in internal audit work;
- The quality of the internal audit reports and to what extent they are being acted upon by the management are of interest to the external auditors; and
- The quality and standard of internal audit working papers are of significance, showing the extent of work done.

ii. **Areas where the internal auditors can assist the external auditors**

Some the areas where external auditors may rely on the work of internal auditors are as follows:

- Attendance at inventory taking and cash counts of an organisation where external auditors is not able to do them himself;
- Conducting pay parade of the staff of the organisation;
- Where the internal auditors have special knowledge in the particular areas of business of the organisation;
- Strengthening relationship between the external and internal auditors, thereby resulting in identifying accounting and auditing issues that are of importance to the external auditors;
- Checking the underlying audit evidence for some of the work performed by the internal auditors;
- With the knowledge of the internal auditors, the external auditors can gain additional insights into the entity;
- Conducting compliance tests on accounting controls, on a continuous basis to provide assurance that such controls have operated satisfactorily throughout the period under review;
- Testing transactions and balances such as payables, receivables, non-current assets, etc.;
- Documentation of the accounting and internal control systems; and
- Assisting by making his work plans, programmes, working papers, etc. available to the external auditors in confidence.

b. **Reasons for rising public expenditure**

The reasons for rising in public expenditure over the years in Nigeria are as follows:

- **Traditional function**
  The traditional responsibilities of government such as defence, maintenance of law and order, as well as general administration are becoming extensive and cumbersome. Defence is becoming expensive more than ever. Within the country, administrative set up is increasing both in coverage and intensity, that is, professionals in different fields have to be recruited to handle government machinery (operations). In addition, various complexities of economic and social

measures emerge which may cause government to increase expenditure in this area;

- **Additional responsibility**
  Besides the traditional functions of the State, there is growing awareness of additional responsibilities. Embarking on welfare measures which include measures to enrich the cultural life of the society and those designed to provide social securities to the people such as pensions, old peoples' homes, etc. Furthermore, government involvement in organisation of various socio-cultural and sporting activities also has the consequence of causing increase in government expenditure;
- **Population**
  Increasing population may also be an important determinant of public expenditure growth. As the population is rising, there will be changes in the demand structure of the society which will evoke some changes in the provision of public goods and services. The volume of various public goods and services has to rise in conformity with the growth of population;
- **Urbanisation**
  It has been argued that urbanisation and the resulting congestion has increased the need for more infrastructure and public goods and services. For example, a number of incidental services like those connected with traffic, roads, sanitation, pollution and so on have to be provided. In some states in Nigeria, street managers sweeping on regular basis to ensure cleanliness of the environment are now visible.
- **Inflation**
  The tendency for prices to go up has equally contributed to the growth of public expenditure. The increase in prices of input and other goods purchased by public sector has resulted in an increase in public expenditure;
- **Debt servicing**
  Increasing public expenditure can also be explained in terms of increasing cost of debt servicing. Incremental provisions made yearly in the national budget for debt servicing confirms the effect of debt service on expenditure growth;
- **Unforeseen occurrences**
  Any unanticipated occurrence(s) that exert(s) pressure on government finance might contribute to increase in public expenditure. The reason being that government would be committed to restoring normalcy to the environment in addition to providing palliative measures to reduce pain and suffering. This is usually the case for the victims of flood, earthquake and other disasters both natural and man-made;
- **Political instability**
  The instability in the economic and political terrain of most developing countries may be a potent factor to explaining increase in public expenditure. Such instability will always lead to destruction by

each succeeding regime, or structures put in place by the preceding regimes. The lack of continuity in government programmes and policies result in wasteful use of public resources; and

- **Corruption/leakages**
  Corrupt practices lead to over invoicing and over bloating of contract bidding. These give rise to increase in public expenditures. Leakages within the system should be discouraged in order to reduce expenditure

Marking Guide

		Marks	Marks
a.	Reliance of the external auditors on the internal auditors' work and areas of assistance:		
	Any five criteria to assess reliance	5	
	Any five areas of assistant	<u>5</u>	10
b.	Reasons for rising public expenditure:		
	Identification of five reasons for rising public expenditure	5 <u>5</u>	
	Explanation of five reasons for rising public expenditure.		<u>10</u>
	Total		**<u>20</u>**

Examiner's Report

Part (a) of the question requires candidates to explain the criteria employed by the external auditors to assess the likely effectiveness and relevance of internal audit functions; and areas where the internal audit functions can be of assistance to the external audit. Part (b) of the question tests the reasons for increase in public expenditure over the years.

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

The commonest pitfall was the inability of the candidates to explain the areas where the internal audit functions can be of assistance to the external auditors. They also lack the knowledge of reasons for increase in public expenditure over the years.

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

SOLUTION 3

a. **Factors militating against effective budgeting system in the public sector**
The key factors, militating against efficient and effective budget implementation in the public sector are as follows:

(i) **Human element**
Top management members see budgeting as restraining and challenging. They tend to develop a lot of apathy towards its adoption and implementation. The lack of probity and accountability of some operatives affect successful budgeting;

(ii) **Uncertainties underlying data inputs**
There are a lot of uncertainties in the data used for the budget preparation. The projections in revenue accruing from oil may not be forthcoming in view of the vagaries in the world market. Lack of efficient database also hamstrings reliable forecasts;

(iii) **The type of project for which budget is prepared**
How successful a budget will be, depends on the type of project to which it relates. Some projects are popular while others are not. Those that are not popular, may face stiff implementation problems;

(iv) **The problem of inflation**
Inflation tends to reduce the purchasing power. When the value of money is falling, budget implementation may run into problems. The revenue available will not be able to cover the expenditure;

(v) **Political, social and cultural elements**
Each segment of the nation has its own cultural beliefs and taboos, which may take time to change. Introducing innovation may be met with stiff opposition. For example, a section of the country may not be willing to provide land for development purposes. Secondly, where there is political instability, budget implementation is at risk.

(vi) **Changing government policies**
To implement a budget, a lot depends on the policy of government. For effective budget implementation, government policies have to be harmonised and consistent. Frequent changes in government policies affect budget implementation;

(vii) **The problem of debt management and optimal use of limited resources**
There is the challenge of striking a balance between which parts of the nation's resources should be used for servicing debts and the amount that should be utilised for economic development;

(viii) **Low agricultural output**
Agricultural output is fast dwindling because the method of farming is outdated and the younger population is not attracted. The resources that should be used for economic development are therefore being diverted to the importation of food items; and

(ix) **Fiscal indiscipline**
Most government officers are always maximising their budget. Under the incremental budgeting system, they tend to expend the last naira available in a year's budget in order to justify the demand for increased allocation in the subsequent year, with little or nothing to show under the current year.

b. **Domestic borrowing instruments**

The following are the domestic borrowing instruments:

(i) **Treasury bills**
These are highly liquid financial instruments issued by the Central Bank on behalf of the federal government. They are issued in multiples of ₦1,000 for 91 days maturity, with a minimum investment of ₦10,000. Treasury bills are issued and traded at discount. The income is the difference between the purchase price and the maturity value;

(ii) **Treasury certificates**
These are interest paying obligations of the federal government issued by the Central Bank for maturities ranging from one to two years. Treasury certificate rate is usually higher than that of treasury bills because of its longer tenure and hence higher risk to investors. As with the treasury bills, the major investors in treasury certificates are the Central Bank, commercial banks, discount houses and to a lesser extent merchant banks;

(iii) **FGN bonds**
These are debt securities (liabilities) issued by the Debt Management Office (DMO) for and on behalf of the Federal Government of Nigeria (FGN). The FGN has an obligation to pay the bondholders the principal and agreed interest as and when due. FGN bonds have minimum tenor of two (2) years while there are bonds with maturities of 3, 5, 7

and 10 years in issue and for the future there may be bonds with maturities of 15, 20,30 years or more;

(iv) **FGN Savings Bond (FGNSB)**

The Debt Management Office (DMO), on behalf of the Federal Government of Nigeria (FGN) issues FGN Savings Bonds. The bonds are issued for the following objectives:

- To deepen the national savings culture;
- To provide opportunity to all citizens irrespective of income level to contribute to national development; and
- To enable all citizens participate in and benefit from the favourable returns available in the capital market.

They are issued monthly in tenors of 2 and 3 years, with quarterly payment of interest to the investors. They are offered to the investing public through offer for subscription at an interest rate announced by the DMO. The offer is usually opened for 5 days from the date of announcement. The minimum subscription amount is ₦5,000 with additions in multiples of ₦1,000, subject to a maximum of ₦50,000,000. The bonds are backed by the full faith and credit of the Federal Government of Nigeria. The bonds are acceptable as collateral for loans by banks and can be sold for cash in the secondary market;

(v) **Government development stocks**

Development stocks are either medium or long-term securities usually issued to finance development projects or for lending to lower levels of government. The longer the maturity of these stocks, the higher their yields. The principal investors in development stocks are insurance companies, which are required to invest in them by the virtue of insurance act, commercial and merchant banks, Central Bank, and other savings institutions;

(vi) **FGN sovereign Sukuk**

This is an Islamic investment certificate that represents ownership interest of the holder in an asset or pool of assets. It entitles the holder to receive income from the use of the assets. The Federal Government of Nigeria issues Sukuk bond for the purpose of:

- Funding the construction/rehabilitation of key critical infrastructure projects like roads;
- Diversifying the sources of government funding;
- Offering ethical investors an opportunity to invest in government issued securities;

- Achieving higher level of financial inclusion; and
- Serving as a reference pricing of Sukuk for other issuers especially private sector issuers.

  Like other government debt securities, FGN sovereign Sukuk is issued in multiples of ₦1,000 with a minimum investment of ₦10,000. It is backed by the full faith and credit of the Federal Government of Nigeria;

(vi) **General obligation bonds**

A general obligation bond is a common type of municipal bond that is secured by government's pledge to use legally available resources including tax revenues, to repay the bondholders. These types of bonds are backed by the full faith and credit of the issuer, in addition to the power of the issuer to introduce tax and take any other steps necessary to repay the bondholders. They are frequently used to pay for the construction of roads, schools, prisons and other public infrastructures;

(vii) **Revenue bonds**

These are municipal bonds issued on the premise that both principal and interest will be repaid from the revenue generated from the facilities to be constructed with the proceeds of the issue. In other words, an authority that has constructed physical assets would charge customers for the use of the assets and then dedicate the revenue to servicing of the associated debt; and

(viii) **Special assessment bonds**

These are types of bond for which the payment of interest and principal will be made from a special tax assessed upon the beneficiaries of the facility to be constructed. These types are popular for development of public utilities and service programmes.

Marking Guide

		Marks	Marks
a.	Factors militating against the budgeting system:		
	Any identification of five factors militating against the budgeting system	5	
	Explanation of factors identify	5	10
b.	Domestic borrowing instruments:		
	Identification of five instruments	5	
	Explanation of domestic borrowing instruments identify	5	10
	Total		**20**

Examiner's Report

Part (a) of the question tests the candidates' knowledge of the factors militating against the budgeting system in the public sector, while part (b) examines the candidates' knowledge on instruments that can be employed for the purpose of raising capital within the domestic economy by government.

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

The commonest pitfalls were the inability of the candidates to identify the factors militating against the budgeting system in the public sector and instruments that can be employed for the purpose of raising capital within the domestic economy by government.

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

SOLUTION 4

Okoko Local Government

Cash budget for the months of January to March, 2020

	January	**February**	**March**
	₦ '000	**₦ '000**	**₦ '000**
Receipts			
Sales	109,800	133,600	144,100
Allocation	15,000	15,000	15,000
Total receipts- A	**124,800**	**148,600**	**159,100**
Payments			
Payment for purchases	71,000	91,000	83,000
Overhead cost	48,750	61,750	52,000
Total payments- B	**119,750**	**152,750**	**135,000**
Balance b/f.	3,300	8,350	4,200
Total receipts – Total payments (A-B)	5,050	-4,150	24,100
Bal. c/f.	**8,350**	**4,200**	**28,300**

Workings

Analysis of sales receipt	**January**	**February**	**March**
	₦ '000	**₦ '000**	**₦ '000**
30% of December sales	30,000.00	--	--
70 % January sales	79,800.00	--	--
30% of January sales	--	34,200.00	--
70 % February sales	--	99,400.00	--
30% of February sales	--	--	42,600.00
70 % March sales	--	--	101,500.00
Total	**109,800.00**	**133,600.00**	**144,100.00**

Analysis of payment on purchases	**₦ '000**	**₦ '000**	**₦ '000**
20% of December purchases	11,000.00	--	--
80% of January purchases	60,000.00	--	--
20% of January purchases	--	15,000.00	--
80% of February purchases	--	76,000.00	--
20% of February purchases	--	--	19,000.00
80% of March purchases	--	--	64,000.00
Total	**71,000.00**	**91,000.00**	**83,000.00**

b. Principles that should guide grant design

The following principles should guide grant design:

i. **Clarity in grant objectives**
Grant objectives should be specified clearly and precisely;

ii. **Autonomy**
Sub-national governments should have complete independence and flexibility in setting priorities. They should not be constrained by the categorical structure of programmes and uncertainty associated with decision-making by national officials. Tax-base sharing allows sub-national governments to introduce their own tax rates on national bases and formula-based revenue sharing, or block grants are also consistent with this objective;

iii. **Revenue adequacy**
Sub-national governments should have adequate revenue to discharge designated responsibilities;

iv. **Responsiveness**
The grant programme should be flexible enough to accommodate unforeseen changes in the fiscal condition of the recipients;

v. **Equity (fairness)**
Allocated funds should vary directly with fiscal-need factors and inversely with the tax capacity of each jurisdiction;

vi. **Predictability**
The grant mechanism should ensure predictability of sub-national governments' shares by publishing five-year projections of funding availability. The grant formula should specify ceilings and floors for yearly fluctuations. Hold harmless or grandfathering provisions should accompany any major changes in the formula;

vii. **Transparency**
Both the formula and the allocations should be disseminated widely in order to achieve as much as a broad consensus as possible on the objectives and operation of the programme;

viii. **Efficiency**
The grant design should be neutral with respect to sub-national governments' choices of resource allocation to different sectors or types of activity;

ix. **Incentive**
The design should provide incentives for sound fiscal management and should discourage inefficient practices. Specific transfers should not be made to finance sub-national government deficits; and

x. **Accountability for results**
The grantor must be accountable for the design and operation of the programme. The recipient must be accountable to the grantor and its citizens for financial integrity and results (i.e., improvements in service delivery performance). Citizens' voice and exit options in grant design can help advance bottom-up accountability objectives.

Marking Guide

		Marks	Marks
a.	Cash budget:		
	Correct title	¼	
	Calculation of total receipts	2¼	
	Calculation of total payments	2¼	
	Calculation of balance c/f	2¼	
	Workings		
	Analysis of sales receipt	1½	
	Analysis of payment on creditors	1½	10
b.	Principles that should guide grant design:		
	Identification of five principles	5	
	Explanation of five principles	5	10
	Total		20

Examiner's Report

Part (a) of the question tests candidates' knowledge on the preparation of cash budget, while part (b) tests the principles that should guide grant design.

Few candidates attempted the question and performance was below average
The commonest pitfalls was the inability of the candidates to identify the principles that should guide grant design.

Candidates are advised to pay more attention to this area of the syllabus for better performance in the Institute's future examinations.

SOLUTION 5

a. i. Calculation of gain/loss on disposal of the old equipment

	₦ '000	₦ '000
Sales proceed on disposal		2,500
Less		
Old equipment at cost	8,000	
Accumulated depreciation	5,500	
Carrying amount as at disposal date Jan 2, 2016		2,500
Profit on disposal of equipment		Nil

ii. **Disclosure requirements of revalued property, plant and equipment as per IPSAS 17**

If a class of property, plant and equipment is stated at revalued amounts, the following shall be disclosed:

- The effective date of the revaluation;
- Whether an independent valuer was involved;
- The methods and significant assumptions applied in estimating the assets fair values;
- The extent to which the assets' fair values were determined directly by reference to observable prices in an active market or recent market transaction on arm's length terms or were estimated using other valuation techniques;
- The revaluation surplus, indicating the changes for the period and any restrictions on the distribution of the balance to shareholders or other equity holders;
- The sum of all revaluation surpluses for individual items of property, plant and equipment within that classes; and
- The sum of all revaluation deficits for individual items of property, plant and equipment within that classes

bi. **Procedures for conducting cost-benefit analysis**

The steps involved in conducting a cost benefit analysis are as follows:

- Examine the problem with the proper definition of the objectives of the analysis in focus;
- Consider alternative courses of actions, which would achieve the defined objectives in (a) above;
- Enumerate the costs involved and the benefits, which would accrue from the particular courses of action, to the establishment and the society;
- Evaluate the costs and benefits;
- Draw conclusions as to the economic and social effects of a particular choice; and
- Re-examine the problem and the chosen objectives to determine accomplishment.

ii. **Procedures for conducting cost effectiveness analysis**

The steps involved in conducting a cost effectiveness analysis are as follows:

- Objective definition is to determine what actual target is;
- 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;
- Selection of measure to be adopted: What types of approaches will enable management to achieve the set objectives within a reasonable period of time will be determined;
- Development of cost estimates: Cost estimates have to be collated, addressing the issues of what to include and how to measure them; and
- 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.

Marking Guide

		Marks	Marks
a.	Calculation of gain/loss on the disposal of the old equipment calculation of gain/loss	5	
b.	Disclosure requirements as per IPSAS 17: Any five disclosures	5	10
c	Steps to be followed for conducting Cost Benefit Analysis and Cost Effectiveness Analysis:		
	Explanation of steps to be followed for conducting Cost Benefit Analysis.	5	
	Explanation of steps to be followed for conducting Cost Effectiveness Analysis	5	10
	Total		**20**

Examiner's Report

Part (a) of the question tests candidates' knowledge on the calculation of gain or loss on the disposal of old equipment and disclosure requirements of revalued amount of property, plant and equipment under IPSAS 17. Part (b) tests candidates' knowledge on steps to be followed for conducting Cost Benefit Analysis and Cost Effectiveness Analysis.

Few candidates attempted the question and performance was below average. The commonest pitfalls was the inability of the candidates to state the disclosure requirements of property, plant and equipment stated at revalued amount under IPSAS 17. Also they were unable to identify steps to be followed for conducting Cost Benefit Analysis and Cost Effectiveness Analysis. Candidates are advised to acquire adequate knowledge of the relevant provisions of IPSAS.

SOLUTION 6

ai. **Objectives of GIFMIS**

The overall objective is to implement a computerised financial management information system for the FGN, which is efficient, effective, and user friendly. Other specific objectives are as follows:

- Increases the ability of FGN to undertake central control and monitoring of expenditure and receipts in the MDAs;
- Increases the ability to access information on financial and operational performance;
- Increases internal control system to prevent and detect potential and actual fraud;
- Increases the ability to access information on government's cash position and economic performance;
- Improves medium term planning through a Medium Term Expenditure Framework (MTEF);
- Provides the ability to understand the costs of groups of activities and tasks; and
- Increases the ability to demonstrate accountability and transparency to the public and cooperating partners.

ii. Objectives of IPPIS

The objectives of Integrated Personnel and Payroll Information Systems (IPPIS) are as follows:

- Facilitates planning: Having all the civil service records in a centralised database will aid man power planning as well as assist in providing information for decision- making;
- Aids budgeting: An accurate recurrent expenditure budget on emolument could be planned and budgeted for on a yearly basis;
- Monitors the monthly payment of staff emolument against what was provided for in the budget;
- Ensures data base integrity so that personnel information is correct and intact;
- Eliminates payroll fraud such as ghost workers syndrome; and
- Facilitates easy storage, updating and retrieval of personnel records for administrative and pension processes.

b. Phases of economic cycle

The following are the phases of economic cycle:

(i) **Expansion**

In the expansion phase, there is an increase in various economic factors, such as employment, output, wages, profits, demand and supply of products and sales. In addition, the prices of factors of production and output increase simultaneously. In this phase, borrowers are generally in good financial condition to repay their debts, therefore, lenders lend money at higher interest rates. This leads to an increase in the flow of money. Due to increase in investment opportunities, idle funds of organisations or individuals are utilised for various investment purposes. Consequently, the cash inflows and outflows of businesses equilibrate. This expansion continues till the economic conditions become favourable;

(ii) **Peak**

This phase refers to the point at which the increase in growth rate of business activities attains its maximum limit. In the peak phase, the economic factors, such as output, profit, sales, income and employment, are higher but do not increase further. There is a gradual decrease in the demand of various products due to increase in the prices of input. The increase in the prices of input leads to an increase in the prices of final products, while the income of individuals remain constant. This causes consumers to restructure their monthly budgets. Consequently, the demand for products such as jewelries, homes, automobiles, refrigerators and other durables starts falling;

(iii) **Recession**

As discussed in the peak phase, there is a gradual decrease in the demand of various products due to increase in the prices of input and budget adjustment by consumers. When the decline in the demand for products becomes rapid and steady, recession phase sets in. In this phase, all the economic factors such as output, prices, savings and investment, start declining. Generally, producers are unaware of decrease in the demand for products and they continue to produce goods and services. In such a case, the supply of products exceeds the demand.

Depression

Over time, producers realise the surplus of supply when the cost of manufacturing of a product is more than revenue generated. This condition is firstly experienced by few industries, but slowly spreads to all industries. This situation is firstly considered as a small fluctuation in the market, but as the problem persists for a longer period, producers start noticing it. Consequently, producers cut down on further investment in factors of production such as labour, machinery and furniture. This leads to the reduction in the prices of factors, which results in the decline of demand of inputs as well as output;

(iv) **Trough**

During the trough phase, economic activities of a country decline below the normal level. In this phase, the growth rate of an economy becomes persistently negative. In addition, there is a rapid decline in national income and expenditure, which it becomes difficult for debtors to pay off their debts. As a result, the rate of interest decreases; therefore, banks reduce lending. Consequently, banks face the situation of increase in their cash balances. Apart from this, the level of economic output of the country becomes low and unemployment becomes high. In addition, in trough phase, investors do not invest in stock markets and many weak organisations leave the industries or they liquidate. At this point, an economy reaches the lowest level of shrinking; and

(v) **Recovery**

Once the economy touches the lowest level, it happens to be the end of negativism and beginning of positivism. In this phase, there is a turnaround at the trough and the economy starts recovering from the negative growth rate. Demand starts to pick up due to the lowest prices and consequently, supply starts reacting too. The economy develops a positive attitude towards investment and employment, hence, production starts rising. Employment also begins to rise and due to the accumulated cash balances with bankers, lending also shows positive signals. This will also lead to new investment in production processes and replacement of depreciated capital. Recovery continues until the economy returns to steady growth levels. This completes one full business cycle of boom and contraction. The extreme points are the peak and the trough.

Marking Guide

		Marks	Marks
a.	Objectives of GIFMIS:		
	Any five objectives:	5	
	Objectives of IPPIS		
	Any five objectives	5	10
b.	Phases of economic cycle:		
	Identification of five phases	2½	
	Explanation	7½	10
	Total		**20**

Examiner's Report

Part (a) of the question tests candidates' knowledge of objectives of Government Integrated Financial Management Information Systems (GIFMIS) and Integrated Personnel and Payroll Information Systems (IPPIS), while part (b) asks the candidates to explain the phases of economic cycle as shown in the national gross domestic product during a given period.

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

The commonest pitfalls were the inability of the candidates to identify objectives of Government Integrated Financial Management Information Systems (GIFMIS) and Integrated Personnel and Payroll Information Systems (IPPIS), while other candidates mixed up their objectives. Also, some candidates could not explain the phases of economic cycle.

Candidates are advised to have adequate knowledge of relevant regulations relating to public sector account for better performance in the Institute's future examinations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2020

CORPORATE STRATEGIC MANAGEMENT & ETHICS

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

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

COMPULSORY QUESTION (40 MARKS)

QUESTION 1

Dumbura Republic is reputed for its high population density and the consequent availability of cheap labour. Surprisingly, due to the high premium placed on qualitative education in science and technology-based disciplines, the country has an abundance of highly skilled workforce suited for manufacturing industries. Other features of Dumbura Republic include adequate, accessible and reliable social infrastructure such as electricity, potable water, road and rail network, and an effective security network. Besides, the country also has a variety of tax incentives designed to attract foreign investments. These positive features of the socio-economic environment in Dumbura have attracted a lot of foreign investors, including several computer and mobile phones hardware production companies.

Indeed, the socio-economic environment in Dumbura is very business friendly. Hence, it is not surprising that a lot of foreign companies have located their industrial plants in the country. Effects of this development include increased employment opportunities, influx of people in search of employment from the neighbouring countries, spiralling rent rates for all categories of accommodation, worsening environmental pollution and a spiking population growth rate, which is beginning to take its toll on available social infrastructure. Besides, the hitherto peaceful country is beginning to experience an increased rate of crimes such as burglary, robbery, cyber theft and kidnap that target expatriates particularly. The local population is becoming increasingly hostile to the expatriates and workers from neighbouring countries, accusing them of denying the local population access to good job opportunities.

You have been employed as a consultant to a computer and mobile phone hardware company, Cells Incorporated, which is considering relocating its major manufacturing plant from an Asian country to Dumbura Republic. This is hoped to bring down cost of production and provide a ready market for about 20% of its products.

You are required to:

a. With the aid of Johnson, Scholes and Whittington's position on strategic management, advise Cells Incorporated on the elements of strategic management that must be taken into consideration in reaching a decision on whether to relocate its manufacturing plants to Dumbura Republic. Ensure that you make adequate references to the scenario above as might be relevant. (30 Marks)

b. Clarify the nature and objectives of a mission statement. (10 Marks)

(Total 40 Marks)

QUESTION 2

Global Masters Plc. is a multinational corporation operating in numerous industries in many jurisdictions. The company had adopted different frameworks for managing risks in different jurisdictions over the years. This had made reporting on risk management difficult.

The board of Global Masters Plc. resolved to harmonise these various frameworks into a framework which has universal acceptance. The board therefore engaged your firm of risk experts to carry out the harmonisation process.

Required:

a. Recommend a universally acceptable framework which is also applicable in the various industries in which Global Masters Plc. operate. Justify your recommendation. (3 Marks)

b. Discuss the elements of the framework. (6 Marks)

c. Discuss the techniques to be adopted in implementing the framework. (11 Marks)

(Total 20 Marks)

QUESTION 3

Effective corporate governance requires adequate understanding of the basic concepts and theories of corporate governance.
You are required to discuss **FIVE** theories of corporate governance in a way that will assist a newly appointed director to understand and apply them.

(Total 20 Marks)

QUESTION 4

As a professional accountant, it is important that you are ethical in carrying out your professional responsibilities. This requires, among other qualities, a good ethical foundation consisting of clear understanding of what ethics is all about.

You are required to:

a. Clarify the relationship between ethics and law. (3 Marks)
b. With the aid of an appropriate example, explain the nature of moral dilemma. (5 Marks)
c. Present a critique of consequentialist theories of ethics in relation to **TWO** of its general criticisms and the profit-making objective in business.
(12 Marks)
(Total 20 Marks)

QUESTION 5

a. In an effort to increase shareholders' value, companies are often faced with risks.

Required:

i. Explain the term 'risk'. (2 Marks)
ii. Differentiate between the **TWO** broad categories of risk, with examples. (8 Marks)

(Total 10 Marks)

b. The Chairman of Imperial Oil Services Limited, a company which prides itself as a leader in corporate social responsibility, has just returned from a training programme on '*Efficient Board Management'*. He stated that during the programme, Sustainability Reporting was identified as one of the key responsibilities of the Board of Directors by the Nigerian Code of Corporate Governance, 2018.

As the Chief Compliance Officer of the company, the Chairman requests for a paper discussing the relevant principles and issues to be covered by the company's policies on sustainability as required by the code.

Required:

Present a paper discussing the relevant principles and issues to be covered by the company's policies on sustainability as required by the code.
(10 Marks)
(Total 20 Marks)

QUESTION 6

The ICAN Professional Code of Conduct and Guide for Members requires every member or student of the Institute to always 'act professionally' and in 'the public interest' in the discharge of their responsibilities.

Required:

a. Explain 'act professionally' in relation to the ICAN code. (1 Mark)

b. Discuss the behavioural attributes that will enable an ICAN student to act professionally. (6 Marks)

c. Discuss briefly 'acting in the public interest'. (7 Marks)

d. Differentiate between a trade and a profession. (6 Marks)

(Total 20 Marks)

SOLUTIONS

SOLUTION 1

a. Johnson, Scholes and Whittington identified three elements of strategic management that Cells Incorporated must consider in deciding whether to relocate to Dumbura. These are:

- Strategic position
- Strategic choices
- Strategy into action.

Each of these will be examined in some detail

(i) **Strategic Position**

This is arrived at through an analysis of the position of the company in its markets. It involves determining the ways a company performs or can perform better than its competitors and vice versa.

It also requires an understanding of the factors in the 'business environment' that affect their company, and how the company will be affected by changes that are likely to happen in the environment in the future. Could the company be affected by changes in technology, the state of the economy or new laws? Even more important, perhaps, will there be changes in what customers want to buy, because of changes in society or lifestyles? If so, how might this affect what the company produces and sells? Hence, Cells Incorporated need to take into consideration the facts presented in respect of the socio-economic environment of Dumbura.

Based on Johnson, Scholes and Whittington suggestions, there are three aspects of strategic position that Cells Incorporated needs to consider:

- The environment
- Strategic capability of the entity
- Expectations and purposes.

Environment (threats and opportunities)

The business environment consists of the threats and opportunities that exist, and it is important for Cells Incorporated to assess their significance. Threats are occurrences in the environment that could adversely affect the ability of the entity to achieve its objectives. Opportunities on the other hand are factors that might be exploited, to improve the ability of the entity to achieve its objectives. Generally, both threats and opportunities are made up of variables outside of the firm's control
The existing threats and opportunities in Dumbura that should be considered by Cells Incorporated include:

- Spiking rents, environmental pollution, growing hostility and increasing crime rates in Dumbura; and
- Availability of cheap labour, social infrastructure and tax incentives in Dumbara.

Strategic capability of the entity (strengths and weaknesses)

Cells Incorporated need to assess its strategic capability to understand what it can achieve. This involves an analysis of its strengths and weaknesses. This includes:

- Identification of what Cells Incorporated is good at doing and what can be done to improve on these; and
- Identification of areas of deficiencies of Cells Incorporated where its rivals seem to be better and what can be done to improve in these areas of deficiencies.

Expectations and purposes

- An analysis of the strategic position of Cells Incorporated requires its management to take a decision on the purpose of the entity and its objectives. The purpose of Cells Incorporated includes reduction of the cost of production and exploitation of the local market.
- Cells Incorporated also expects to take full advantage of available social infrastructure in Dumbura e.g. electricity, water, road and rail network etc.

(ii) **Strategic choices**

This involves identifying different possible strategies that Cells Incorporated might adopt and making a choice of the preferred strategies from the different alternatives that are available. There are three levels involved in the process of identifying alternative strategies and making strategic choices:

- Corporate level and international;
- Business level strategies; and

- Development directions and methods.

Corporate level and international

Strategic choices are made at the corporate strategy level in respect of what the entity should be doing. For companies, this means making decisions about which products or services it should be selling, and what markets it should be selling them in. In the case on hand, it is a decision about where to locate the manufacturing plant: in Dumbura
There is an international aspect to the strategic choice to be made by Cells Incorporated at this level because the company needs to decide whether it should relocate its operations from an Asian country to Dumbura

Business level strategies

Choices must also be made at the business level strategy. For companies, a major strategic choice is between a strategy of cost leadership and a strategy of differentiation. If a company chooses a strategy of differentiation, it must decide how it intends to make its products or services different from those of its competitors, so that the company will have a competitive advantage over rival companies. It is noted that there are several computer and phone hardware companies already located in Dumbura. Hence, Cells Incorporated has to decide on the business level strategy to adopt to contend with these competitors that already have a head start in Dumbura.

Development directions and methods

A choice must be made about the direction or directions in which the business should go.
If a company's management decides on a strategy of growth, to make the business bigger, decisions have to be made about how the company will grow. Will it have a strategy of internal growth, and developing the business gradually using the company's own internal resources (organic growth strategy)? Or will it seek to grow by making acquisitions of other companies (inorganic growth strategy)? Or will it seek to grow by making strategic alliances with other companies, so that all the companies in the alliance help each other to grow their businesses?

The case of Cells Incorporated obviously involves an attempt to develop new markets in Dumbara thus pursuing organic growth strategy

(iii) Strategy into action

The third element in the Johnson, Scholes and Whittington model of strategic management is 'strategy into action'. This means implementing the chosen strategies. There are three aspects to strategy implementation:

- Organising;
- Enabling; and
- Managing change.

Organising

An organisation structure must be established in ways that will help the entity to implement its strategies effectively in order to achieve its strategic targets. 'Organising' means putting into place a management structure and delegating authority. Individuals should be made responsible and accountable for different aspects of the chosen strategies. Decision-making processes must be established. In the case of Cells Incorporated, structures and procedures will have to be determined to facilitate the implementation of the decision to relocate to Dumbura, if this choice is made.

Enabling

The term 'Enabling' means making the entity to achieve success through the effective use of its resources.

- Each resource must be used to support the achievement of strategic objectives. This calls for efficient management of resources such as people (and labour skills), information, finance and technology.
- Strategies should be based on making full use of the resource strengths of the entity to achieve competitive advantage.
- The resource available in Dumbura should be fully exploited by Cells Incorporated to achieve its objectives e.g. availability of social infrastructure, effective security network etc.

Managing change

Most entities exist in a rapidly-changing environment and they need to adapt and change to survive and succeed. Implementing strategy always means having to make changes in response to changes in the environment. Managing change successfully is therefore an important aspect of strategic management. Cells Incorporated will have to decide on how to manage the exigencies of relocating to Dumbura. For instance, how to deal with challenges identified in Dumbura such as burglary, cyber theft, kidnapping etc.

b. **Nature and objectives of Mission statement**

'A mission statement describes the basic objectives of an organisation in society in terms of the products and services it produces for its customers'. It defines the present state or purpose of an organisation. It should be a clear and short statement. Drucker suggested that it should answer the following fundamental questions:

- What is our business?
- What is our value to the customer?
- What will our business be?
- What should our business be?

Objectives/relevance of a mission statement

A mission statement can have several different purposes which include to:

- provide a basis for consistent strategic planning decisions;
- assist with translating broad intentions and purposes into corporate objectives;
- provide a common purpose for all groups and individuals within the organisation;
- inspire employees;
- establish goals and ethics for the organisation; and
- improve the understanding and support for the organisation from external stakeholder groups and the public in general.

Marking Guide

i	**Strategic position**		½		
	Explanation of strategic position	2 x 1 Mark	2		
	Example of strategic position	1 x ½	½	**3**	
	Identification of environment (Threat and Opportunities)		½		
	Explanation	4 x ½	2		
	Example	1 x ½	½		
	Identification of strategic capabilities		½	**3**	
	Explanation		½		
	Analysis of strength and weakness		**2**	**3**	
	Expectations and purpose:				
	Identification		½		
	Explanation		2		
	Example		½	**3**	**12**
ii	**Strategic Choice:**				
	Identification		½		
	Explanation		1		
	Identification of alternative Strategic	3 x ½	$1^1/_2$	**3**	
	Corporate level and International Explanation	2 x 1	2		
	Business level strategies Explanation	2 x 1	2		
	Development direction and method	2 x 1	2	**6**	**9**
iii	**Strategic into action**		½		
	Identification of organising		½		
	Explanation	1 x 1	1	**3**	
	Relating to case		1		
	Identification of Enabling		½		
	Explanation		1		
	Relating to case	2 x ½	1		
	Example		½		

	Identification of managing change		½		
	Explanation	2 x 1	2		
	Example		½	**3**	9
					30
b.	**Nature and objectives of mission Statement**				
	Definition OR	2 x 1	2		
	Fundamental questions	4 x ½	2	**2**	
	Explanation			**2**	**4**
	Objectives and relevance of mission statement	6 x 1		**6**	**10**
					40

Examiner's Report

Part (a) of this compulsory question tests candidates' ability to apply Johnson, Scholes and Whittington position on Strategic Management to a business scenario. Part (b) of the question tests the nature and objectives of Mission Statement.

Virtually all the candidates attempted this question.

Performance was below average.

Many candidates did not demonstrate full comprehension of the elements of Johnson, Scholes and Whittington position on Strategic Management. Some could not effectively relate the elements to the given scenario. Others could not clearly articulate the objectives of mission statement

Candidates are advised to master principles and concepts fully to enable them apply them to given scenarios.

SOLUTION 2

a. ISO 31000 framework harmonises various frameworks and is thus chosen as the most appropriate.

Justification for the adoption of ISO 31000 framework

- ISO 31000 is universally accepted across jurisdictions.
- ISO 31000 may be used by any organisation in any industry or sector and can be applied to any type of risk. Its purpose is to promote international standardisation in risk management systems.

b. Elements of ISO 31000 framework

ISO 31000 puts forward a framework for risk management that has three main elements:

- **Risk Architecture**: This consists of the roles and responsibilities for risk management within the organisation and the risk reporting structure. For example it consists of the respective roles and responsibilities of the board, the audit committee, the group risk management committee, the risk disclosures committee, the CEO, business unit managers, individual employees, risk managers, specialist risk management functions and internal auditors.

- **Risk Strategy**: There should be a risk management action plan and resources to support risk management activities. The risk strategy of the organisation should be specified, including the risk appetite of the board.

- **Risk Protocols**: These are the rules and procedures for implementing risk management and the risk management methodologies that should be applied. For example, there should be rules, procedures and methodologies for risk assessments, risk responses, and incident reporting; a business continuity plan; and arrangements for auditing the efficiency and effectiveness of controls.

c. Techniques for Implementing ISO 31000 Framework

ISO 31000 uses the '7Rs and 4Ts' of risk management as a framework for the implementation of a risk management system. These are:

- **Recognition/identification of risks**
  This is the process of identifying the risks present in the situation.
- **Ranking or evaluation of risk**
  The identified risks present are evaluated in terms of impact and probability of occurrence. The risks are then ranked in order of their significance
- **Responding to significant risk**
  Designing responses to the risks identified as significant.
- **Resourcing controls**
  Resources to be deployed in risk management are mobilised and monitored for effectiveness.
- **Reaction planning**
  Reaction to each risk situation is planned in line with its return, significance and resources available.
- **Reporting and monitoring risk performance**
  Information are collected on risks. They are continuously monitored and reported to governance and relevant stakeholders.
- **Reviewing the risk management framework**
  The risk management framework is reviewed to improve its efficiency, in the light of the information collected.
- **Risk treatment**
  The treatment given to each risk class is determined.

- Tolerate: accept the exposure to risk, if it is within acceptable limits set, depending on the risk appetite of the company.
- Treat: take measures to control or eliminate the risk. These measures are aimed at making the risks more tolerable or bring them within acceptable limits, depending on the risk appetite of the company.
- Transfer: transfer the risk to someone else.
- Terminate: terminate the activity that gives rise to the risk.

Marking Guide

ai.	Identification of framework		
ii.	Justification of the framework		2
			3
b.	Identification of 3 element	3 x $^1/_2$	
	Explanation of 3 Elements		6
	Examples	3 x $^1/_2$	$1^1/_2$
	Identification of 7 Rs	7 x 1	7
	Identification of 4Ts	4 x 1	4
			11
			20

Examiner's Report

This question tests candidates' ability to identify the universal applicability of ISO 31000 risk management framework, discuss its elements and techniques for its implementation.

About 70% of the candidates attempted this question.

The performance was poor as many of the candidates could not identify ISO 31000 risk management framework as the applicable framework. Others could not adequately discuss the techniques for its implementation

Candidates are advised to take keen interest in this particular risk management framework because of its universal applicability across jurisdictions, different types of risk and industry.

SOLUTION 3

Agency Theory

This theory is based on the premise of the separation of ownership i.e. shareholders (the principals) from the executives i.e. board and management (the agents) in the running of an organisation.

Distinctive features of Agency Theory.

- The principals delegate the running of the organization to the agents with expectation that the agents will run the organization in the best interest of the principal.
- However, the agents have other interests other than those of the principals, leading to some conflict of interest. The theory believes that the principal suffers a loss, called 'agency loss' from this conflict of interest.
- Because of this loss, agency theory suggests award of financial incentives to encourage the agents to maximise the returns to the principals.
- Alternatively, the principals should exercise strict controls over the activities of the agents to ensure that they are in the best interest of the principals.

Transaction cost theory

Transaction cost theory explains companies not just as 'economic units', but as organisations consisting of people with differing views and objectives. A large part of the theory is concerned with questions relating to what makes an organisation grow; how many operations it undertakes 'in house'; and how much it buys in from external suppliers.

The theory explains that a firm's decision about whether to arrange transactions in the open market or whether to do the work 'in-house' (itself) depends on which is cheaper. When a firm does some work 'in-house', it needs a management structure and a hierarchy of authority. Senior management are at the top of this hierarchy. According to the theory of transaction cost economics, the structure of a firm and the relationship between the owners and its management depends on the extent to which transactions are performed internally.

From governance perspective, traditional economic theory assumes that all behaviour is rational, and that profit maximisation is the rational objective of all businesses. However, transaction cost economics changes these assumptions by trying to allow for human behaviour, which is not always rational. Transaction cost theory is based on two assumptions about behaviour:

- Bounded rationality: humans act rationally only within certain limits of understanding. This means, for example, that the managers of a company will in theory act rationally in seeking to maximise the value of the company for its shareholders, but their 'bounded rationality' might make them act differently. There are limits to rational thinking; and

- Opportunism: individuals act in a self-interested way, and 'with guile'. In other words, people will not always be honest and truthful about their intentions and will sometimes be opportunistic. Opportunism is 'an effort to realise individual gains through a lack of candour or honesty in transactions.' An individual might try to take advantage of an opportunity to gain a benefit at the expense of someone else.

This self-interest needs to be controlled. When managers act in their own interests, they act against the interests of the shareholders. For example, managers will often try to increase the size of their company, even though this is not in the best interests of the shareholders, because they benefit personally from growth in the size of the company.

Stewardship theory

In the stewardship theory of corporate governance, it is recognised that the directors of a company have a stewardship role. They look after the assets of the company and manage them on behalf of the shareholders.

As stewards of the company and as agents for the shareholders, the board of directors should be accountable to the shareholders. For the directors to show their accountability to the shareholders, it is a general principle of company law that the directors are required to prepare annual financial statements, which are presented to the shareholders for their approval.

RESOURCE DEPENDENCY THEORY

Resource dependency theory looks at how the resources of an organisation affect its governance and behaviour. The basic argument of resource dependence theory can be summarised as follows:

- Organisations depend on resources (such as materials, labour and capital), many of which are under the control of other organisations;
- Resources are a basis of power;
- Legally independent organisations may therefore depend on other organisations for the resources they need; and
- Power and dependence on resources are directly linked.

Class hegemony theory and managerial hegemony theory

Class hegemony theory is a Marxist-based theory that considers the business elite (the 'upper class') as a group of individuals who control the governance of companies to perpetuate their power base.

Managerial hegemony theory is like class hegemony theory in that the system of governance under the board of directors is seen as the tool of management. It argues that the real power in corporate governance lies with management and that they can take advantage of shareholder weakness to pursue their self-interest.

Psychological and organisational perspective theory

A psychological theory approach takes the view that governance depends largely on informal structures and behaviours within an organisation. Decisions by a board of directors and the performance of the board are influenced by inter-personal tactics and relationships. Outcomes are often the result of a bargaining process between interested parties.

An organisational perspective theory is based on the view that the performance of the board of directors, company ownership and remuneration and other incentives for executives may differ according to the legal system and institutional characteristics in a specific country.

Stakeholder theory
There are different stakeholders in an organisation e.g. shareholders, employees, customers, government, local community etc. The stakeholder theory of corporate governance is that governance depends on the inter-relationships and relative strength of the different stakeholders of a company.
A stakeholder may:

- be affected by what the organisation does;
- affect what the organisation does; or
- be affected by and affect what the organisation does.

System Theory
A system theory approach to governance considers a company as an overall system, consisting of inter-linked sub-systems. Governance depends on how these sub-systems (and sub-sub-systems etc.) interlink with each other.

Marking Guide

Identification of any 5 theories	5 x 1	5
Explanation of 2 points each for 5 theories	2 x 5 x $1^1/_2$	<u>15</u>
		<u>**20**</u>

Examiner's Report
This question examines candidates' knowledge of the theories of corporate governance.

About 80% of the candidates attempted this question.

General performance was just average.

Those candidates who performed poorly discussed the principles of corporate governance rather than its theories.

Candidates are admonished to pay attention to the fine details of concepts and theories of corporate governance.

SOLUTION 4

4a. **Ethics and the law**

Ethics consists of normative standards that guide human actions. These standards are not backed by sanctions. Law on the other hand has the same function as ethics but has sanction attached for their violation.

Generally speaking, it is considered unethical to break the law. However, there are some instances in which people believe that certain laws may be broken on ethical grounds because such laws are considered to be unethical. For example, the law that requires Germans not to assist Jews during the Second World War was widely considered to be unethical or immoral.

Another example is that while it is unethical to lie to one's employer, it might not be illegal to do so under certain circumstances.

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 whilst harming another.

In summary, an ethical dilemma is a situation where guiding moral principles cannot unequivocally resolve the conflict and determine which course of action is right or wrong. It arises when there is a difficulty in determining what the morally right or good course of action is.

c. **CONSEQUENTIAL THEORIES (TELEOLOGICAL THEORIES) OF ETHICS**

Consequential theories of ethics are also known as teleological theories or results-based theory. This is the theory that "of all the things that a person might do at any given moment, the morally right action is the one with the best overall consequences".

According to this view, nothing is inherently 'wrong': it all depends on the outcomes or consequences. Whether something is right or wrong depends only on results. This means that faced with a moral dilemma, an individual should choose the action that will provide the best possible consequences (or the 'least-worst' consequences).

Individuals may not think about the consequences of their decisions or actions every time they are faced with a moral dilemma, because they do not have the time. Instead they might rely on a generally-accepted view of what is right, based on the normal outcomes from similar situations. For example, a person may choose not to tell a lie because there is a generally accepted view that telling lies is 'bad' based on experience that lying usually has bad consequences.

Utilitarianism

A variant of consequential ethics is utilitarianism. Utilitarianism is the view that the morally correct decision in any situation is one that produces the best possible outcomes for people (for 'mankind'). The aim should be to maximise well-being or 'utility' for people.

Ethical egoism

Another variant of ethical consequentialism is ethical egoism. This takes the view that people should always do what is in their own best interests, not what is in the best interests of people generally.

Consequential/teleological ethics and the profit motive

Teleological ethics can be used to justify the profit motive in business. It can be argued that when a business is profitable, many people benefit. Shareholders benefit from higher returns and dividends; employees benefit from the employment that a profitable business provides; customers benefit from the goods and services that a profitable business is able to provide (that it would not be able to provide if it did not make a profit); the general public benefits from the benefits to the economy from profitable businesses and additional economic activity.

Teleological ethics can also be used to justify actions in business that might otherwise seem morally 'dubious' or 'wrong', such as:

- cutting costs (including making employees redundant);
- down-sizing (which involves making people redundant); and
- doing business in a country with a dubious political system, such as a tyrannical government.

Main criticisms of consequential theories

The main criticisms of the consequential theory of ethics are that:

- It is often difficult to predict in advance what the consequences of a decision or action might be; and
- It is a theory that can be used to justify acting in self-interest.

Marking Guide

a.	Explanation of Ethics and Law	3 x $^1/_2$	$1^1/_2$		
	Examples of Ethics and Law	1 x $^1/_2$	$1^1/_2$		
					3
b.	Nature of moral dilemma	5 x 1			5
c i.	Explanation of consequentialist theories	2 x $1^1/_2$	3		
ii.	Consequentialist Teleological ethics and profit motive	4 x 1		4	
	Examples	3 x 1	3		
iii.	Criticisms of consequentialist theories	2 x 1		2	
					12
					20

Examiner's Report

Part (a) of the question requires candidates to clarify the relationship between ethics and law, while Part (b) tests candidates' knowledge of the nature of moral dilemma and Part (c) requires them to critique the consequential list theories of ethics.

About 70% of the candidates attempted this question.

The performance in Part (a) was fair, that in Part (b) was good and that in Part (c) was poor.

Those candidates that performed poorly in Part (a) of the question could not clearly identify the link between law and ethics.

Many candidates performed poorly in Part (c) because of their inability to critically appraise the consequential list theories.

Candidates at the skills level must develop their ability to appraise and evaluate issues, in addition to acquiring knowledge of concepts, principles and theories.

SOLUTION 5

ai. Risk is usually associated with the possibility that things might go wrong, that events might turn out worse than expected or that something bad might happen.

Risk has a broader meaning. Risk exists whenever a future outcome or future event cannot be predicted with certainty, and a range of different possible outcomes or events might occur.

ii. Risks can be divided into two categories:

- Pure risks

- Speculative risks.

Pure risk (downside risk)

Pure risk, also called downside risk, is a risk where there is a possibility that an adverse event might occur. Events might turn out to be worse than expected, but they cannot be better than expected.

For example, there might be a safety risk that employees could be injured by a machine. This is a pure risk, because the expectation is that no one will be injured but a possibility does exist.

Similarly, there might be a risk for a company that key workers will go on strike and the company will be unable to provide its goods or services to customers. This is a pure risk, because the expected outcome is 'no strike' but the possibility of a strike does exist.

Another example of pure risk is that the company factory may catch fire.

Speculative risk (two-way risk)

Speculative risk, also called two-way risk, exists when the actual future event or outcome might be either better or worse than expected.

- An investor in shares is exposed to a speculative risk, because the market price of the shares might go up or down. The investor will gain if prices go up and suffer a loss if prices go down.

- An individual might ask his bank for a loan to buy a house, and the bank might offer him a 10-year loan at a fixed rate of interest or at a rate of interest that varies with changes in the official bank rate. The individual takes a risk with his choice of loan. If he chooses a fixed interest loan, there is a risk that interest rates will go up in the next 10 years, in which case he will benefit from the fixed rate on his loan. On the other hand, interest rates might go down, and he might find that he is paying more in interest than he would have done if he had arranged a loan at a variable rate of interest.

- Companies face two-way risk whenever they make business investment decisions. For example, a company might invest in the development of a new product, on the basis of sales and profit forecasts. Actual sales and profits might turn out to be higher or lower than forecast, and the investment might provide a high return, moderate return or low return (or even a loss).

b. Part E of the Nigerian code of Corporate governance deals with Sustainability.

The relevant principle that deals with Sustainability is **Principle 26**. It states inter alia: Paying adequate attention to sustainability issues including environment, social, occupational and community health and safety ensures successful long-term business performance and projects the company as a responsible corporate citizen contributing to economic development.

The recommended practices are as follows:

The Board should establish policies and practices regarding its social, ethical, safety, working conditions, health and environmental responsibilities as well as policies addressing corruption.

The policies should include the following:

- The company's business principles, practices and efforts towards achieving sustainability;
- The management of safety issues including workplace accidents, fatalities, occupational and safety incidents;
- Plans and strategy for addressing and managing the impact of serious diseases on the company's employees and their families;
- The most environmentally beneficial options particularly for companies operating in disadvantaged regions or in regions with delicate ecology, in order to minimise environmental impact of the company's operations;
- The nature and extent of employment equity and diversity (gender and other issues);
- Training initiatives, employee development and the associated financial investment;
- Opportunities created for physically challenged persons or disadvantaged individuals;
- The environmental, social and governance principles and practices of the Company; and
- Corruption and related issues.

The Board should monitor the implementation of sustainability policies and report on the extent of compliance with the policies.

Marking Guide

ai.	Definition of risk	1 x 2	2	
ii.	identification of categories of risk	2 x 1		2
	Explanation of 2 categories of risk	2 x 1		2
	Examples of 2 categories of risk	4 x 1	4	
				10
b.	Explanation of principle	1 x 2	2	
	Recommended practices of the board	1 x 2	2	
	Any 6 policies	6 x 1	6	10
				20

Examiner's Report

Part (a) of the question tests candidates' ability to define risk and differentiate between the broad categories of risk. Part (b) tests candidates' ability to discuss sustainability principles and issues as required by the Nigerian Code of Corporate Governance 2018.

About 90% of the candidates attempted this question.

Performance in Part (a) was good, while that in Part (b) was poor.

The poor performance in Part (b) was due to candidates discussing sustainability in general terms, rather than in accordance with the Nigerian Code of Corporate Governance 2018.

Candidates are advised to study those materials referred to in the ICAN Study Text.

SOLUTION 6

a. **Acting Professionally**
Professionals are expected to act in a professional way. Professional behaviour means complying with relevant laws and obligations, including compliance with the code of conduct (including the code of ethics) of the relevant professional body.

b. The behavioural attributes required to act professionally include:
- acting with integrity;
- being honest and straight-dealing;
- providing objective opinions and advice, free from bias, influence or conflicts of interest using specialist knowledge and skill at an appropriate level for the work;
- Confidentiality: respecting the confidentiality of information provided by clients avoiding any action that brings the profession into disrepute. It also includes compliance with all relevant laws and regulations.

c. Acting in the public interest: an aspect of professional bodies, which separates a profession from a trade, is that members of the profession are expected to act in the public interest. it is therefore a responsibility of the accountancy profession 'not to act exclusively to satisfy the needs of a particular client or employer'. when the demands or needs of a client or employer appear to be contrary to the public interest, accountants should consider the public interest first. It is usual to associate the public interest with matters such as: detecting and reporting any serious misdemeanour or crime, protecting health and public safety, preventing the public from being misled by a statement or action by an individual or an organisation; and exposing the misuse of public funds and corruption in government and revealing the existence of any conflict of interests of those individuals who are in a position of power or influence.

d. **Differences between a Trade and a Profession**

A trade is a skilled job typically requiring manual or mechanical skills and special training

While a Profession is:
Occupation, practice, or vocation requiring mastery of a complex set of knowledge and skills through formal education and/or practical experience.

OR

An occupation founded upon specialised educational training, the purpose of which is to supply disinterested objective counsel and service to others, for a direct and definite compensation.

Difference between Trade and Profession are shown in the table below:

	TRADE	**PROFESSION**
TRAINING	Less rigorous, less formal	Very rigorous and highly structured
STANDARD REQUIRED	Vary within the trade in the same jurisdiction	Usually universal within a profession and jurisdiction
CODE OF CONDUCT	Less rigorous	Very rigourous
INTEREST SERVED	Only clients/employers	Public interest very important over those of clients/employers
REGULATED BY	Guilds	Professional bodies

Marking Guide

a.	Definition of accounting profession			1
b.	Behavioural attribute	6 x 1		6
ci.	Definition of acting in public interest	2 x 1	2	
ii.	Explanation of public interest	5 x 1	<u>5</u>	
				7
d.	Definition of Trade			1
	Definition of profession			1
	Differences between trade and profession	4 x 1		<u>4</u>
				<u>20</u>

Examiner's Report

Part (a) of the question requires candidates to explain to 'act professionally' in accordance with the ICAN Code of Professional Conduct. Part (b) tests candidates' ability to discuss the behavioural attributes that enables ICAN students to act professionally. Part (c) tests candidates' understanding of 'acting in public interest'. Part (d) requires candidates to differentiate between a Trade and a Profession.

About 90% of the candidates attempted this question.

Performance was above average.

Candidates who did not perform well in this question did not realise that ICAN students are held to the same code of conduct as members of the Institute. Some others could not distinguish between a trade and a profession.

Skills level candidates must realise that they would be required to apply the knowledge they had acquired to practical situations in the examination at this level. They are also admonished to study the ICAN Code of Professional Conduct.