THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2021 DIET
SKILLS LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Marking Guides

and

Examiners' Reports

FOREWARD

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

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

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

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

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

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

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

NOTES

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

TABLE OF CONTENTS

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
SKILLS LEVEL EXAMINATION – NOVEMBER 2021

FINANCIAL REPORTING

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

The trial balance for United Nigeria Plc as at December 31, 2020 is given below:

	DR	CR
	₦'000	₦'000
Purchases/ Revenue	300,000	680,000
Inventories 1/1/2020	80,000	
Property, plant and equipment at cost 1/1/2020	950,000	
Property, plant and equipment Accum. depreciation 1/1/2020		390,000
Interest on 10% loan notes as at 30/6/2020	5,000	
Discounts	10,000	8,000
Distribution expenses	80,000	
Retained earnings		252,000
Administrative expenses	75,000	
Bank balance	160,000	
Bad debts written off	12,000	
12% preference shares		120,000
10% loan notes		100,000
Ordinary share capital of 50 kobo each		150,000
Share premium		90,000
Returns	8,000	6,000
Allowances for trade receivables		10,000
Trade receivables and payables	360,000	234,000
	2,040,000	2,040,000

Additional information:

(i) Inventories at the end of the year were ₦120,000,000. Included in the closing inventories was damaged item with a cost of ₦30,000,000 which has a net realisable value of ₦18,000,000.

(ii) Additional ordinary shares of 50,000,000 were issued and fully paid for at 80 kobo per share, this is yet to be recorded in the trial balance.

(iii) Interest on 10% loan notes is outstanding and dividend on 12% preference shares were paid on December 31, 2020. Existing ordinary shareholders were paid dividend of 5 kobo per share on December 31, 2020. These were yet to be recorded in the trial balance.

(iv) Allowances for trade receivables are to be increased to 15% per annum. Deprecation is charged on plant and equipment (PPE) at the rate of 15% on reducing balance basis.

(v) ₦5,000,000 administrative expenses were outstanding and ₦25,000,000 company income tax is estimated for the year. Depreciation is charged to administrative expenses.

You are required to prepare the followings:

a. i. Statement of comprehensive income of United Nigeria PLC for the year ended December 31, 2020. (10 Marks)

ii Statement of changes in equity for the year ended December 31, 2020. (5 Marks)

Iii Statement of financial position as at December 31, 2020. (10 Marks)

b. Under IAS 36 – Impairments of Assets:

Required:

Briefly explain how an entity should identify and account for impairment of assets. (5 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

The statements of profit or loss and other comprehensive income of Okechukwu and its subsidiary, Ogenta Limited for the year ended December 31, 2019 are presented below:

	Okechukwu Plc	Ogenta Ltd
	₦'000	**₦'000**
Revenue	487,500	330,800
Cost of sales	(304,500)	(258,300)
Gross profit	183,000	72,500
Investment income	26,300	10,200
Distribution cost	(24,050)	(13,370)
Administrative expenses	(40,625)	(21,120)
Finance costs	(10,500)	(9,860)
Profit before tax	134,125	38,350
Income tax expense	(33,800)	(13,000)
Profit for the year	100,325	25,350
Other comprehensive income	23,880	10,440
Total comprehensive income	**124,205**	**35,790**

Additional Information:

(i) Okechukwu Plc acquired 300 million of the ordinary shares issued by Ogenta Limited for ₦428 million.

(ii) During the year ended December 31, 2019, Okechukwu Plc invoiced goods worth ₦80million to Ogenta Limited. It has been the policy of Okechukwu Plc to invoice goods at cost plus 33⅓%. Three-quarters of these goods are yet to be sold by Ogenta Limited at the year end.

(iii) Extracts from the books of Ogenta Limited as at the date of acquisition revealed the following capital structure:

	₦'000
Issued ordinary shares of 50 kobo each	200,000
General reserves	80,000
Retained earnings	52,500

(iv) The fair value of the non-controlling interests at the acquisition date amounted to ₦92.5million.

(v) An impairment test on the goodwill of Ogenta Limited carried out on December 31, 2019 showed that the goodwill should be written down by ₦3.2million.

(vi) On the acquisition date, the fair value of net assets of Ogenta Limited were same as their carrying amount except for the land and building and office equipment which had fair values of ₦5million and ₦1.5million respectively in excess of their carrying amounts. The group non-current assets are depreciated at the rate of 10% per annum on straight-line and charged to administration expenses.

(vii) Ogenta Limited paid a total of ₦20million as dividend to all its shareholders for the year ended December 31, 2019. Okechukwu Plc has accounted for the dividend received.

(viii) The finance cost of Ogenta Limited included ₦2million interest paid to Okechukwu Plc as interest on loan granted. Okechukwu Plc has recognised the amount as interest received.

Required:

Prepare the consolidated statement of profit or loss and other comprehensive income of Okechukwu group for the year ended December 31, 2019.

(Total 20 Marks)

QUESTION 3

a. There are three bases of accounting on which transactions are recognised and measured.

Required:
Discuss these **THREE** bases. (6 Marks)

b. IFRS 15-Revenue from Contracts with Customers; sets out principles to be applied in order to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

Required:
i. Explain the core principles upon which IFRS 15 is based (2 Marks)
ii. Briefly explain the **FIVE** steps-model involved in the application of the core principles (5 Marks)

c. IAS 2-Inventories; sets out the requirements to be followed when accounting for inventories.

Required:
Enumerate **SEVEN** disclosure requirements for inventories to be shown in notes to the financial statements. (7 Marks)

(Total 20 Marks)

QUESTION 4

Below are the statements of financial position of Onye Nigeria Plc as at October 31, 2020 and extract from the statement of profit or loss for the year ended on that date.

Onye Nigeria Plc
Statement of financial position as at October 31, 2020

	2020	2019
Non-current assets	**₦'000**	**₦'000**
Property plant and equipment	8,325	6,435
Current assets		
Inventories	2,880	2,205
Trade receivables	5,535	4,860
Cash and bank	360	540
	17,100	14,040
Equity and liabilities:		
Ordinary share capital	3,600	3,600
Retained earnings	5,603	3,938
Non-current liabilities:		
10% loan notes	3,600	2,700
Current liabilities:		
Trade payables	3,375	3,105
Bank overdraft	495	360
Taxation	135	90
Accrued expenses	292	247
	17,100	14,040

Onye Nigeria Plc
Extracts from Statement of profit or loss for the year ended October 31

	2020	2019
	₦'000	₦'000
Revenue	50,400	43,875
Cost of sales	38,070	30,713
Profit before taxation	2,093	1,440

Additional information:

(i) The profit before tax is after charging

	2020	2019
	₦'000	**₦'000**
Depreciation	1,620	1,620
interest on loan note	360	270
Interest on bank overdraft	68	41
Audit fees	54	45

(ii) The latest industry average ratios is as follows:

ROCE (capital employed = equity and loan notes)	18.50%
Net profit margin	4.73%
Gross profit margin	35.23%
Assets turnover	3.91 times
Current ratio	1.90:1
Quick ratio	1.27:1
Trade receivables period	52 days
Trade payables period	49 days
Inventory turnover	18.30 times
Gearing ratio	32.71%

Required:

a. Calculate the above ratios of Onye Nigeria Plc for years 2019 and 2020. (10 Marks)

b. Analyse the performance and liquidity of Onye Nigeria Plc for year 2020. (5 Marks)

c. Comment on the limitation of use of accounting ratios in financial statements analysis. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

Dongo Limited statement of profit or loss for the year ended December 31, 2020

	₦'000
Revenue	420,000
Cost of goods sold	(99,000)
Gross profit	**321,000**
Administrative cost	(140,800)
Operating profit	**180,200**
Investment income	8,100
Interest paid	(17,120)
Profit before taxation	**171,180**
Income tax expense	(37,000)
Profit for the year	**134,180**

Dongo Limited statement of financial position as at December 31,

	2020 ₦'000	2019 ₦'000
Assets		
Non-current assets:		
Property, plant and equipment at cost	370,300	212,000
Less: Accumulated depreciation	152,650	109,340
Carrying amount	**217,650**	**102,660**
Investment at cost	130,000	130,000
	347,650	232,660
Current assets:		
Inventories	96,220	107,430
Bill receivables	92,610	68,100
Prepaid expenses	17,200	17,000
	206,030	**192,530**
Total assets	**553,680**	**425,190**

	2020 ₦'000	2019 ₦'000
Equity and liabilities:		
Ordinary share capital at ₦1.50	135,000	105,000
Retained earnings	200,850	152,540
Equity	**335,850**	**257,540**
Non-current liabilities:		
12% loan notes	85,000	55,000
Current liabilities		
Bill payables	40,290	69,310
Other accrued expenses	20,630	8,250
Taxation	37,000	32,300
Bank balance	34,910	2,790
	132,830	**112,650**
Total equity and liabilities	**553,680**	**425,190**

Additional information:

(i) During the year ended December 31, 2020; other comprehensive income was nil.
(ii) A dividend of ₦85, 870,000 was paid during the year ended December 31, 2020.
(iii) There was no disposal of non-current assets during the year.

You are required to:

a. Prepare statement of cash flows using the indirect method under IAS 7 (10 Marks)
b. Calculate the company's current ratio as at the year ended December 31, 2019 and 2020. (2 Marks)
c. State **THREE** technical reasons which accounted for the company's rise in overdrafts for the **TWO** years. (3 Marks)

(Total Marks 15

QUESTION 6

a. An internally-generated intangible asset is an asset created by a company through its own efforts and by its nature do not exist physically.

Required:

i. Explain the terms: Research and Development and state **TWO** examples each. (4 Marks)
ii. Development costs must be recognised as an intangible asset if only some conditions can be satisfied.
Identify **FIVE** such conditions. (5 Marks)

b. The following information were extracted from the non-current assets register of Olugbenga Nigeria Limited for the year ended March 31, 2021.

	₦'Million
Internally generated development costs	1,595
Software licences at cost	418
Goodwill at cost	4,050

Accumulated amortisation and impairment loss 1/4/2020:

	₦'Million
Development costs	775
Software licences	204
Goodwill	540

During the year, the following acquisitions and disposals of assets were recorded:

		₦'Million
Acquisitions	- Development costs	330
	- Software licences	91
Disposals	- Development costs	160
	- Software licences	12

Also during the year, goodwill acquired from business combination amounted to ₦102 million. The year-end impairment test on the goodwill revealed a loss of ₦82 million.

Annual amortisation charge on the internally generated development costs and software licences are based on their estimated useful life of 10 years and 15 years respectively. The accumulated amortisations on the disposal were ₦110million and ₦40million for development cost and software licences respectively.

Required:
Prepare a schedule for movement in intangibles to be disclosed in the note to the financial statements for the year ended March 31, 2021. (6 Marks)

(Total 15 Marks)

QUESTION 7

a. The Conceptual Framework states the qualitative characteristics of financial information.

Required:
Identify and explain **FIVE** qualitative characteristics of General Purpose Financial Statements (GPFS). (10 Marks)

b. IAS 16 prescribes the principles and models of the valuation in recognising items of property, plant and equipment in the financial statements of an entity.

Required:
Briefly explain the **TWO** methods of valuation recognised in IAS 16 - property, plant and equipment. (5 Marks)

(Total 15 Marks)

SOLUTION 1

(a) **United Nigeria Limited**

(i) **Statement of Comprehensive Income for the year ended December 31, 2020**

	Note	₦'000
Revenue	1	672,000
Cost of sales	2	(266,000)
Gross profit		406,000
Other incomes discount received		8,000
Administrative expenses	3	(164,000)
Distribution cost	4	(146,000)
Operating profit		104,000
Finance cost	5	(10,000)
Profit before taxation		94,000
Income tax expense		(25,000)
Profit for the year		69,000

United Nigeria Limited

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

	Note	Ordinary Share	Share Premium	Retained Earnings	Total
		₦'000	₦'000	₦'000	₦'000
Balance b/f		150,000	90,000	252,000	492,000
Profit for the year		-	-	69,000	69,000
Issues of shares		25,000	15,000	-	40,000
Dividend paid	6	-	-	31,900	(31,900)
		175,000	105,000	289,100	569,100

United Nigeria Limited

(iii) **Statement of Financial Position as at December 31, 2020**

Non-current assets:	**Note**	**₦'000**
Property, plant & equipment	7	476,000
Current assets:		
Inventory	8	108,000
Trade receivables	9	306,000
Bank balance	10	168,100
Total current asset		582,100
Total assets		1,058,100
Equity and liabilities:		
Equity:		
Ordinary shares of ₦0.50 each		175,000
Share premium		105,000
Retained earnings		289,100
Total equity		569,100
Non-current liabilities		100,000
10% loan notes		120,000
12% preference shares		220,000
Current liabilities:		
Trade payables		234,000
Income tax payables		25,000
Interest payables		5,000
Payables for admin expenses		5,000
Total current liabilities		269,000
Total liabilities		48,000
Total equity and liabilities		1,058,100

Workings

Wk 1: Revenue	**₦'000**
Balance as per the trial balance	680,000
Return inward	(8,000)
Balance to SOPL	672,000
WK 2: Cost of sales	₦'000
Opening Inventory	80,000
Purchases	300,000
Returns outwards	(6,000)
Closing inventory	(108,000)
Balance to SOPL	266,000
Wk 3: Administrative expenses	**₦'000**
Balance b/f	75,000
Depreciation on PPE	84,000
Accrued admin expenses	5,000
Balance to SOPL	**164,000**

Wk 4: Distribution Cost		**₦'000**
Discount allowed		10,000
Distribution expenses		80,000
Bad debt written-off		12,000
Increase in allowance for receivables		44,000
Balance to SOPL		146,000
Wk 4.1: Allowance for trade receivables		**₦'000**
Opening balance		10,000
Closing balance (15% x 360,000)		54,000
Increase in Allowance		44,000
Wk 5: Finance Cost		**₦'000**
Balance b/f		5,000
Accrued (100,000 x 10% x 6/12)		5,000
Balance to SOPL		10,000
Wk 6: Dividend paid		₦'000
Preference dividend		14,400
Ordinary dividend		17,500
		31,900
Wk 7: Property, plant and equipment	**₦'000**	**₦'000**
Cost b/f		950,000
Accumulated depreciation:		
Balance b/f	390,000	
Current year	84,000	(474,000)
Carrying Amount (SOPL)		476,000
Wk 8: Closing inventory	₦'000	₦'000
Balance b/f		120,000
Less: Written down:		
Cost of damaged inventory	30,000	
Net Realisable value	18,000	(12,000)
Revised Closing inventory		108,000
Wk 9: Trade receivables		**₦'000**
Balance as per the trial balance		360,000
Allowance for trade receivables		(54,000)
Balance to SOFP		306,000
Wk 10: Bank balance		**₦'000**
Balance as per the trial balance		160,000
Proceeds from shares		40,000
Preference dividend paid		(14,400)
Ordinary dividend paid		(17,500)
Balance to SOFP		168,100

(b) **Identification and accounting for impairment of assets under IAS 36**

An entity must carry out an impairment review when there is evidence or an indication that impairment may have occurred. At the end of each reporting period, an entity should assess whether there is any indication that impairment might have occurred. If such an indication exists, the entity must estimate the recoverable amount of the asset, in order to establish whether impairment has occurred and if so, the amount of the impairment.

The following are given by IAS 36 as possible indicators of impairment. These may be indicators outside the entity itself (external indicators), such as market factors and changes in the market. Alternatively, they may be internal indicators relating to the actual condition of the asset or the conditions of the entity's business operations.

If there is an indication that an asset (or cash-generating unit) is impaired then it is tested for impairment which involves the calculation of the recoverable amount of the item in question and comparing it with its carrying amount.

Accounting

On identifying the amount by which an asset is impaired, this amount will be charged to statement of profit or loss and the value of the affected non-current asset is also reduced by the same amount.

That is-debit statement of profit or loss and credit non-current assets.

Examiner's Report

The question tests candidates' knowledge of preparation of final accounts involving presentation of statement of comprehensive income, statement of changes in equity and statement of financial position as well as accounting for impairment of assets.

Majority of the candidates attempted the question and performance was average. The commonest pitfall was the inability of the candidates to explain how entity should identify impairment of assets.

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

Marking guide

		Marks	Marks
(a)i	Preparation of statements of comprehensive income		
	Correct title of the statement	¼	
	Determination and presentation of revenue	1	
	Determination and presentation of cost of sales	2	
	Determination and presentation of admin expenses	1½	
	Determination and presentation of distribution cost	3	
	Determination and presentation of finance cost	1½	
	Determination and presentation of profit for the year	¾	10
ii	Preparation of statements of changes in equity		
	Correct title of the statement	¼	
	Correctly stating components of equity	1	
	Correctly recording opening balance of equity Components	1	
	Correct recording of profit for the year	½	
	Correct recording of issue of ordinary shares at Premium	¾	
	Correct recording of dividend paid	½	
	Correct recording of closing balance of equity Components	1	5
iii	Preparation of statements of financial position:		
	Correct title of the statement	¼	
	Determination and presentation of non-current Assets	1¾	
	Determination and presentation of current assets	4	
	Determination of total assets	½	
	Correct recording of components of equity	1	
	Correct recording of non-current liabilities	¾	
	Determination and presentation of current liabilities	1¼	
	Determination of total equity and liabilities	½	10
b)	Identification and Accounting for impairment:		
	Three correct points on identification at 1 mark each	3	
	Two correct points on accounting at 1 mark each	2	5
	Total		**30**

SOLUTION 2

Okechukwu Plc

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

	₦'000
Revenue (487,500+330,800-80,000)	738,300
Cost of sales (304,500+258,300-80,000+15,000	(497,800)
Gross profit	240,500
Investment income (26,300+10,200-15,000-2000)	19,500
Distribution cost (24,050+13,370)	(37,420)
Administrative expenses (40,625+21,120+650+3,200	(65,595)
Finance cost (10,500+9,860-2000)	(18,360)
Profit before taxation	138,625
Income tax expense (33,800+13,000)	(46,800)
Profit for the year	91,825
Other Comprehensive Income (23,800+10,440)	34,320
Total Comprehensive Income	126,145
Profit attributable to:	
Owners of parent (Bal. Figure)	86,450
Non-controlling interests	5,375
	91,825
Total comprehensive income attributable to:	
Owners of parent (Bal. Figure)	118,160
Non-controlling interests	7,985
	126,145

OR

Okechukwu Plc Group

Consolidation Schedule

	Okechukwu Plc	Ogenta Ltd	Adjustments		CPL
	₦'000	₦'000	₦'000	₦'000	₦'000
Revenue	487,500	330,800	(80,000)	-	738,300
Cost of sales	(304,500)	(258,300)	(15,000)	8,000	(497,800)
Gross profit	183,000	72,500	(95,000)	80,000	240,500
Investment income	26,300	10,200	(15,000+2,000)	-	19,500
Distribution cost	(24,050)	(13,370)	-	-	(37,420)
Admin. expenses	(40,625)	(21,120)	(650+3200)	-	(65,595)
Finance costs	(10,500)	(9,860)	-	2,000	(18,360)
Profit before taxation	134,125	38,350	(115,850)	82,000	138,625
Income tax expense	(33,800)	(13,000)	-	-	(46,800)
Profit for the year	100,325	25,350	(115,850)	82,000	91,825
Other comprehensive income	23,880	10,440	-	-	34,320
Total comprehensive income	124,205	35,790	(115,850)	82,000	126,145

Profit for the attributable to:	
Equity owners of the parent	86,450
Non-controlling interest (NCI)	5,375
	91,825
Total comprehensive income attributable to:	
Equity owners of the parent	118,160
Non-controlling interest (NCI)	7,985
	126,145

Workings

Wk 1: Group structure

Okechukwu -------- 75% --------- Ogenta

NCI ----------------------25%

Wk 2: Unrealised profit

URP = 80,000 × 1/4 × 3/4 =

Wk 3: Intra-group dividend

20,000 × 75% = ₦15,000

Wk 4: Fair value adjustment	**₦ '000**
Land and building (5,000,000 ×10%)	500
Land & Building (1.5,000,000 x 10%)	150
	650

Wk 5: Share of subsidiary's profit

	PFTY ₦'000	TCI ₦'000
For the year	25,350	35,790
Impairment losses	(3,200)	(3,200)
Fair Value Adjustment	(650)	(650)
	21,500	31,940
NCI @ 25%	5,375	7,985

Examiner's report

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

Most candidates attempted the question but performance was below average. The pitfall of the candidates was their inability to make necessary adjustments to arrive at the figures that should be posted into the consolidated statement of profit or loss and other comprehensive income.

Candidates should be aware that group account is a regular question at the skills level of the Institute examinations, hence they should pay more attention to this section of the syllabus for better performance in future examinations.

Marking guide

		Marks
(a)i	Preparation of consolidated statement of profit or loss:	
	Title of the statement	½
	Determination and presentation of consolidated revenue	2
	Determination and presentation of consolidated cost of sales	2
	Determination and presentation of consolidated investment income	2
	Determination and presentation of consolidated distribution costs	1½
	Determination and presentation of consolidated admin expenses	2
	Determination and presentation of consolidated finance cost	2
	Determination and presentation of consolidated income tax expense	1½
	Determination and presentation of consolidated total comprehensive income	2
	Determination of profit attributable to parents and NCI	1½
	Determination of total comprehensive income attributable to parent and NCI	1½
	Presentation of other relevant workings	1½
	Total	**20**

SOLUTION 3

(a) **Bases of accounting**

i) Accrual basis of accounting:

Accrual basis of accounting or the accrual concept recognises transactions and other events and circumstances in the period in which those events occur, even if the resulting cash receipts and payments occur in a different period.

- Revenue from sales and other income should be reported in the period when the income arises and this might not be the same as the period when the cash is received.
- The cost of sales in the statement of profit or loss and other comprehensive income must be matched with the sales. Income and 'matching' expenses must be reported in the same financial period.
- Other expenses should be charged in the period to which they relate, not the period in which they are paid for.

ii) **Cash basis of accounting:**

Cash basis of accounting recognises transactions in the periods in which cash receipts and payments occur.

- Revenue from sales and other income would be reported in the period when the cash is received and this might be in a later period than when the income arose.
- Expenses are charged in the period to which they are paid not the period in which they are incurred.
- Over time the accrual based accounting and cash based accounting result in recognising the same amounts. However, transactions might be recognised in different periods under each system.

iii) **Break-up basis of accounting**

- Both the accruals basis and the cash basis assume that a business is a going concern. That means that the business is expected to continue into the future. This may not always be the case.
- A business might be brought to an end or wound- up either due to financial difficulty or, less likely, the owners decide that the business has run its course.
- The break-up basis of accounting is used when the business is no longer a going concern. This basis results in all assets and liabilities being measured at the amount of cash that they can be sold for or settled.

(b) **IFRS 15 is based on a core principle that requires an entity to recognise revenue:**

- In a manner that depicts the transfer of goods or services to customers;
- At an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

Applying this core principle involves following a five steps-model as follows:

Step 1: Identify the contract(s) with a customer that is, whether the contract is within the scope of IFRS 15 and what to do if IFRS 15 does not apply.

Step 2: Identify the separate performance obligations in the contract that is, If IFRS 15 applies, whether the contract contains a single performance obligation or separate performance obligations.

Step 3: Determine the transaction price, that is how to identify the transaction price and whether this should be adjusted for time value of money. Also, what to do if the consideration varies depending on circumstance.

Step 4: Allocate the transaction price to the performance obligations that is how the transaction price should be allocated to the separate performance obligations.

Step 5: Recognise revenue when or as an entity satisfies performance obligations that is whether the performance obligation is satisfied over time or at a point in time.

(c) Disclosure requirements for inventory according to IAS 2
IAS 2 requires the following disclosures in notes to the financial statements.

- The accounting policy adopted for measuring inventories, including the cost measurement method used.
- The total carrying amount of inventories, classified appropriately. (For a manufacturer, appropriate classifications will be raw materials, work-in-progress and finished goods.)
- The amount of inventories carried at net realisable value (NRV).
- The amount of inventories written down in value, and so recognised as an expense during the period.
- Details of any circumstances that have led to the write-down of inventories to NRV.

- The amount of any reversal or any write-down value that is recognised as a reduction in the amount of inventories as expense in the period.
- The circumstances or events that led to the reversal of a write-down of inventories.

Examiner's report

This is a theoretical question testing candidates' knowledge of the three bases of accounting IFRS 15 - Revenue from Contracts With Customers and the disclosure requirements for inventories under IAS 2.

More than 50 percent of the candidates attempted the question and performance was above average.

The common pitfalls include the following:

- Inability to explain the core principles upon which IFRS 15 is based;
- Candidates failure to clearly explain the difference between accrual basis of accounting and break up basis; and
- Others could not enumerate seven disclosure requirements for inventories which would be shown in the notes to financial statement.

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

Marking guide

		Marks	Marks
(a)	Bases of accounting:		
	Correct explanation of accrual basis	2	
	Correct explanation of cost basis	2	
	Correct explanation of breakup basis	2	6
(b)	Core principles of IFRS 15:		
	Correct explanation of two core principles	2	
	Correct explanation of five steps-model at 1 mark each	5	7
(c)	Disclosure requirements for Inventory :		
	Correct enumeration of seven disclosure requirements for inventory at 1 mark each		7
	Total		20

SOLUTION 4

(a) Computation of ratios of Onye Nigeria Plc for years 2019 and 2020

		2020	2019
(i)	Return on capital employed (ROCE) = $\frac{\text{Profit before interest and tax x 100}}{\text{Capital employed}}$	$\frac{(2{,}093+360) \times 100}{(3{,}600+5{,}603+3{,}600)}$ = 19.16%	$\frac{(1{,}440+270) \times 100}{(3{,}600+3{,}938+2{,}700)}$ = 16.70%
(ii)	Net profit margin = $\frac{\text{Profit before interest and tax x 100}}{\text{Revenue}}$	$\frac{2{,}453 \times 100}{50{,}400}$ = 4.87%	$\frac{1{,}710 \times 100}{43{,}875}$ = 3.90%
(iii)	Gross profit margin = $\frac{Gross\ profit \times 100}{Revenue}$	$\frac{(50{,}400-38{,}070) \times 100}{50{,}400}$ = 24.46%	$\frac{(43{,}875-30{,}713) \times 100}{43{,}875}$ = 30.00%
(iv)	Asset turnover = $\frac{Revenue}{Equity + Loan\ notes}$	$\frac{50{,}400}{12{,}803}$ = 3.94 times	$\frac{43{,}875}{10{,}238}$ = 4.29 times
(v)	Current ratio = $\frac{Current\ assets}{Current\ Liabilities}$	$\frac{8{,}775}{4{,}297}$ = 2.04 : 1	$\frac{7{,}605}{3{,}802}$ = 2.00 : 1
(vi)	Quick ratio = $\frac{Current\ assets - inventory}{Current\ liabilites}$	$\frac{8{,}775 - 2{,}880}{4{,}297}$ = 1.37 : 1	$\frac{7{,}605 - 2{,}205}{3{,}802}$ = 1.42 : 1
(vii)	Receivables collection period = $\frac{\text{Trade rec. x 365 days}}{\text{Revenue}}$	$\frac{5{,}535 \times 365\text{days}}{50{,}400}$ = 40days	$\frac{4{,}860 \times 365\text{days}}{43{,}875}$ = 40day
(viii)	Payable payments period = $\frac{\text{Trade payable x 365 days}}{\text{Purchases}}$	$\frac{3{,}375 \times 365\text{days}}{38{,}070}$ = 32days	$\frac{3{,}105 \times 365\text{days}}{30{,}713}$ = 37 day
(ix)	Inventory turnover = $\frac{Cost\ of\ sales}{Average\ inventory}$	$\frac{38{,}070}{2{,}880}$ = 13.22 times	$\frac{30{,}713}{2{,}205}$ = 13.93 times
(x)	Gearing Ratios = $\frac{Debt \times 100}{Debt + equity}$	$\frac{3{,}600 \times 100}{12.803}$ = 28.12%	$\frac{2{,}700 \times 100}{10.238}$ = 26.37%

(b) Analysis of performance and liquidity of Onye Nigeria Plc for the year 2020

Profitability performance of the company

- The computed ROCE % and net profit margin of the company in 2020 are above the industrial average and even above that of 2019. This suggests that the company is doing well in terms of profitability. However, the gross profit margin of the company is below the industry average for year 2020 and even declined from 30% in 2019 to 24.4% in 2020. The company needs to look into its cost of sales by ensuring proper control of it in order to improve its gross profit margin in the subsequent years.

- In addition, the company's asset turnover is slightly above the industry average in 2020 but declined from 4.29 times in 2019 to 3.94 times in 2020. The company needs to improve on this by ensuring that it is more efficient in the utilisation of its assets to generate revenue.

Liquidity position of the Company

- The computed current ratio and quick ratio of the company in year 2020 are above the industry average. This suggests that the company is doing well in terms of liquidity. Although the quick ratio of the company declined from 1.42:1 in 2019 to 1.37:1 in 2020, the company needs to look into this trend in order to avoid further deterioration.

- Both the computed trade receivables and payables payment days of the company are shorter than the industry average. This indicates that the company is able to recover quickly from its receivables and also pays its payables quickly.

- Although the company's inventory turnover in 2020 is below the industry average, the company needs to improve on this.

- The computed gearing ratio of the company is below the industry average. This indicates that the company gearing level is within the acceptable range. Although the company's gearing level slightly increased between 2019 and 2020, the company needs to watch out for this. In general, the company is lowly geared and this is a good position for its business.

(c) **The limitation of accounting ratios in financial statement analysis include the following:**

1. Heterogeneity or Homogeneity: A company may have various divisions operating in many different industries. This can make it difficult to find comparative industry ratios to use for comparison purposes.

2. Need to determine whether the results of the ratio analyses are consistent: One set of ratios may indicate a problem, whereas another set may indicate that the potential problem is only short-term in nature.

3. Need to use judgment: Although financial ratios are used to help assess the growth and risk profile of a company, they cannot be used alone; the entire operation of the company must be examined, and the external economic and industry setting in which it is operating must be considered when interpreting financial ratios.

4. The use of alternative accounting methods: Companies frequently have latitude when choosing certain accounting methods. Ratios obtained from financial statements that employ different accounting choices may not be comparable unless adjustments are made.

5. Management assumptions, basis of estimation and judgment: IFRS is principles based; it requires significant judgement from management of entities, this could result in material differences in the financial statements of the entities. It can also further limit the financial analyses of financial statements with accounting ratios unless further adjustments are made to the accounts.

6. Differences in accounting policies: IFRS as a principle-based financial reporting system, allows alternative treatments of transactions via accounting policy choice. This invariably makes comparison of company's performance via accounting ratios more difficult and less meaningful unless alignment of the accounting policies of the entities are considered.

7. Use of historical cost data: Decisions about future expectations are based on historical data, which in some cases, makes it difficult and insensitive to reaching economic decision that are likely to take into consideration changes in underlying variables that determine companies performance.

8. Inflation can distort the financial statements: Inflation can distort the financial statements (particularly the statement of financial position). Any problem in the financials caused by inflation can be passed on to ratios.

9. Difference in ratio definitions: Differences in ratio definitions make it difficult to compare ratios from different sources. There can be many different ways to compute the same ratio. This can cause confusion or different answers.

10. Use of Industrial average: Comparison against industry average may not be subjected to factors that are not common in the industry.

11. Lack of comparative figure for a new entity: In a company's first year of trading, there will be no comparative figures, hence no indicator to compare with.

Examiner's report

The question tests the candidates' knowledge of accounting ratios, its interpretation and limitations of using the ratios.

Majority of the candidates attempted the question and performance was good. Most candidates were able to calculate the ratios correctly but were unable to interprete such ratios. Similarly, others could not list the limitations of the ratios.

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

Marking guide

		Marks	Marks
(a)	Computation of financial ratios:		
	Correct computation of ten ratios at 1 mark each		10
(b)	Analysis of performance and liquidity:		
	Correct analysis of the company's performance for 2020 using calculated ratios	2½	
	Correct analysis of the company's liquidity position for 2020 using relevant ratios	2½	5
(c)	Limitation of accounting ratios in financial statement analysis:		
	Any five correct limitations at 1 mark each		5
	Total		**20**

SOLUTION 5

(a) **Dongo Limited**

Statement of cashflows for the year ended December 31, 2020

Operating activities:	**₦'000**	**₦'000**
Profit before interest and taxation		180,200
Add/Less: Adjustments		
Depreciation charge for the year (152,650 - 109,340)		43,310
Cashflow from operations before working capital		223,510
Working capital changes:		
Decrease in inventory (107,430 - 96,220)	11,210	
Increase in bill receivables (92,610 - 68,100)	(24,510)	
Increase in prepaid expenses (17,200 - 17,000)	(200)	
Decrease in bill payables (69,310 - 40,290)	(29,020)	
Increase in other accrued expenses (20,630 - 8,250)	12,380	(30,140)
Interest paid		(17,120)
Taxation Paid (Wk 1)		(32,300)
Net cashflows from operating activities		**143,950**
Investing activities:		
Investment income	8,100	
Purchase of PPE (370,300 - 212,000)	(158,300)	
Net cashflows from investing activities		**(150,200)**
Financing Activities:		
Proceeds from issue of shares (135,000 - 105,000)	30,000	
Proceeds from issue of loan notes (85,000 - 55,000)	30,000	
Dividend paid	(85,870)	
Net cashflows from financing activities		**(25,870)**
Net increase in cash and cash equivalents for the year		(32,120)
Cash and cash equivalents at the beginning		(2,790)
Cash and cash equivalents at the end		(34,910)

Workings

Wk 1: Taxation Paid	**₦'000**
Opening balance	32,300
Income tax expenses (SOPL)	37,000
Expected closing balance	69,300
Actual closing balance	37,000
Taxation paid	32,300

(b) Computation of current ratio for the year ended December 31,

	2020	2019
$Current\ ratio = \frac{Currentasset}{Currentliabilities} =$	$\frac{206,030}{132,830}$	$\frac{192,530}{112,650}$
	=1,55:1	=1.71:1

(c) The technical reasons which accounted for the company's rise in overdraft for the two years are:

i) Huge payment of dividend to ordinary shareholders.
ii) Excess investment in the purchase of property, plant and equipment using short term fund.
iii) Significant decrease in bills payable.
iv) Payment of previous year tax liability.
v) The bill receivable also rose by ₦24,510,000 and this drastically affected the increase in the bank overdraft in 2020.

Examiner's report

The question tests candidates' knowledge of preparation of statement of cash flow using indirect method, in accordance with the provisions of IAS 7. Majority of the candidate attempted the question and performance was fair.

The commonest pitfall was the inability of the candidates to identify three technical reasons why the company's overdraft increase over the years.

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

Marking guide

		Marks
(a)	Preparation of statement of cash flows: Correct computation and presentation of statement of cash flows	10
(b)	Computation of current ratios: Correct computation of the company's current ratios for 2019 and 2020 at 1 mark each	2
(c)	Technical reasons for rise in overdraft: Correct three points at 1 mark each	3
	Total	**15**

SOLUTION 6

(a)i **Research and Development**

The term research and development is commonly used to describe work on the innovation, design, development and testing of new products, processes and systems.

Research – Research is an original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Examples of research activities include:

- Activities aimed at obtaining new knowledge.
- The search for and evaluation of applications of knowledge obtained from research.
- The search for alternative materials, products or processes.
- The formulation and testing of possible alternatives for new materials, products or processes.

Development: Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

Examples of Development activities include:

(i) The design, construction and testing of pre-production prototypes and models.
(ii) The design of tools involving new technology
(iii) The construction and operation of a pilot plant that is not large enough for economic commercial production.
(iv) The design, construction and testing of new materials, products or processes.

(ii) Conditions for recognising development costs as an intangible asset.

- It is technically feasible to complete the development project.
- The company intends to complete the development of the asset and then use or sell it.
- The asset that is being developed is capable of being used or sold.
- Future economic benefits can be generated. This might be proved by the existence of a market for the asset's output or the usefulness of the asset within the company itself.
- Resources are available to complete the development project.
- The development expenditure can be measured reliably (for example, via costing records).

(b) **Olugbenga Nigeria Limited**

Schedule of movement in intangible assets for the year ended March 31, 2021

	Devt Cost	Software	Goodwill	Total
Cost:	₦'m	₦'m	₦'m	₦'m
Balance as at April 1, 2020	1,595	418	4,050	6,063
Additions	330	91	-	421
Disposal	(160)	(12)	-	(172)
Business combination	-	-	102	102
Balance as at March 31, 2021	1,765	497	4,152	6,414
Acc. amortisation & impairment:				
Balance as at April 1, 2020	775	204	540	1,519
Impairment loss recognised	-	-	82	82
Amortisation for the year	177	33	-	210
Disposal	(110)	(40)	-	(150)
Balance as at March 31, 2021	842	197	622	1,661
Carrying amount:				
Balance as at March 31, 2021	924	300	3,530	4,753
Balance as at April 1, 2020	820	214	3,510	4,544

Examiner's report

The question tests the candidates' knowledge of accounting for internally generated intangible assets in accordance with the provision of IAS 38. Candidates are also required to prepare schedule of movement of intangible assets that are disclosed in notes to the financial statements.

Few of the candidates attempted this question and performance was poor.

Most candidates that attempted the question could not correctly explain the term research and development while others could not give appropriate examples of research and developments expenditure. Also, some candidates could not correctly prepare schedule of movement of intangible assets.

Candidates are advised to pay more attention to this section of the syllabus for better performance in future examinations.

Marking guide

		Marks	Marks
(a)i	Research and development:		
	Correct explanation of the term research	1	
	Two correct examples of research at ½ mark each	1	
	Correct explanation of the term development	1	
	Two correct examples of development at ½ mark each	1	
		4	
(a)ii	Recognition of development costs:		
	Correct identification of five conditions for recognising development costs at 1 mark each	5	9
(b)	Preparation of schedule of movement in intangibles for the year:		
	Correct preparation of schedule for movement in intangibles with subheads for development cost, software, goodwill and total		6
	Total		**15**

SOLUTION 7

(a) **Qualitative characteristics of General Purpose Financial Statements are:**

i) Relevance;
ii) Faithful representation;
iii) Comparability;
iv) Verifiability;
v) Timeliness; and
vi) Understandability

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

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

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

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

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

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

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

ii) Comparability: Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity.

For another period or another date. Consistency is related to comparability but is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Consistency helps to achieve the goal of comparability.

iii) Verifiability: This quality helps assure users that information Faithfully represents the economic phenomena it purports to represent.

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

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

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

(b) Models of valuation recognised in IAS 16 – Property, Plant and Equipment
All items of property, plant and equipment in a class can be accounted for using one of two models:

i) Cost model - Property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.

ii) Revaluation 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.

The same model should be applied to all assets in the same class. For example, a company's policy might be to value all its motor vehicles at cost, but to apply the revaluation model to all its land and buildings.

Examiner's report

The question tests the candidates' knowledge of qualitative characteristics of general purpose financial information and model of valuation of property, plant and equipment (PPE) in accordance with IAS 16.

Most candidates attempted the question and performance was above average. The commonest pitfall was their inability to correctly identify the two models of valuation of PPE.

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

Marking guide

		Marks	Marks
(a)	Qualitative characteristics of financial information:		
	Correct identification of five qualitative characteristics at 1 mark each	5	
	Correct explanation of five qualitative characteristics at 1 mark each	5	10
(b)	Two models of valuation for PPE:		
	Correct explanation of cost model	2½	
	Correct explanation of revaluation model	2½	5
	Total		**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2021

AUDIT AND ASSURANCE

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

INSTRUCTION: YOU ARE REQUIRED TO ANSWER FIVE OUT OF SEVEN IN THIS QUESTION PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Independent Auditor's Report

To The Members Of Fair Deals Limited (Extract)

Key Audit Matters
Key Audit Matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

GoodWill
Goodwill under IFRSs: the company is required to annually test the amount of goodwill for impairment. This annual impairment test was significant to our audit because the balance of ₦3,024,115 as of December 31, 2020 is material to the financial statements. In addition, management's assessment process is complex and highly judgmental and is based on assumptions, specifically achieving projected revenue which are affected by expected future market or economic conditions, particularly those in North East zone.

Our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the company in particular those relating to the forecast revenue growth and profit margins for domestic wares production. We also focused on the adequacy of the company disclosures about those assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill.

Revenue recognition
The amount of revenue and profit recognised in the year on the sale of domestic wares and after-market services is dependent on the appropriate assessment of whether or not each long-term after-market contract for services is linked to or separated from the contract for sale of domestic wares. As the commercial arrangements can be complex, significant judgment is applied in selecting the accounting basis in each case. In our view, revenue recognition is significant to our audit as the company might inappropriately account for sales of domestic wares and long-term service agreements as a single arrangement for accounting purposes and this would usually lead to revenue and profit being recognised too early because the margin in the long-term service agreement is usually higher than the margin in the domestic wares sale agreement.

Our audit procedures to address the risk of material misstatement relating to revenue recognition, which was considered to be a significant risk, included:- testing of controls, assisted by our own IT specialists, including, among others, those over: input of individual advertising campaigns' terms and pricing; comparison of those terms and pricing data against the related overarching contracts with advertising agencies; and linkage to viewer data; and detailed analysis of revenue and the timing of its recognition based on expectations derived from our industry knowledge and external market data, following up variances from our expectations.

Abuja, Nigeria (signed)
Date Chartered Accountants

ISA 701 *Communicating key Audit matters in the Independent Auditors Report* was introduced to make the auditor's report more informative and useful for the intended users.

Required:

a. Explain what is meant by Key Audit Matters (KAMs) as per ISA 701 and how they are communicated in the auditor's report. (10 Marks)

b. The auditor's report is regulated by either the law (CAMA 2020) or regulation (ISA 700).
   i. State the minimum elements of the auditor's report as required by ISA 700. (10 Marks)
   ii. Explain briefly the matters to be expressly stated in the report of the auditors of a company to its members on the accounts examined by them as stated in CAMA 2020. (10 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

ISA 500 on audit evidence sets out the objective of the auditor is to design and perform audit procedures in such a way to enable him to:

(i) Obtain sufficient and appropriate audit evidence
(ii) Draw reasonable conclusions
(iii) Base his audit opinion

Required:

a. Identify **THREE** characteristics of a good audit evidence. (3 Marks)

b. List and explain briefly **FIVE** testing procedures for gathering audit evidence. (10 Marks)

c. What factors will the auditor consider when assessing the reliability of audit evidence? . (7 Marks)

(Total 20 Marks)

QUESTION 3

Youthplus is a Not-for-Profit Organisation (NFPO) established by well meaning Nigerians. The aims and objectives of the NFPO include raising of funds to assist youth corpers who, after their service are unable to secure employment, to start small scale businesses instead of waiting for white collar jobs that are not in existence. NFPO solicits funds from the public, private and foreign organisations. Youthplus has been in existence for five years and your firm has been appointed as their auditors.

Required:

What factors would you put into consideration when carrying out the audit of Youthplus in the following areas?

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

(Total 20 Marks)

QUESTION 4

Your firm audits Sabona Limited, a privately owned company, which is a customer of Oldie Limited another privately owned client company. The managing director of Oldie Limited has asked your firm to supply Sabona Limited bank transactions for the last six months as they are concerned about their ability to honour their financial obligation.

Required:

a. State whether or not you would supply this information and the reasons for your actions. (5 Marks)

b. Explain briefly **FIVE** fundamental principles issued by the Institute of Chartered Accountants of Nigeria (ICAN) as guides to accountants. (10 Marks)

c. Describe **FIVE** matters that could affect the independence and integrity of the auditor. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

One of the audit testing procedures available to the auditor is the Analytical Review Procedure.

a. Explain what is meant by Analytical Review Procedures. (6 Marks)

b. Explain **FOUR** types of general Analytical Review Procedures. (4 Marks)

c. What is the purpose of performing Analytical Review Procedures at the audit planning stage? (5 Marks)

(Total 15 Marks)

QUESTION 6

Ade, Chika, Idris and company is an independent firm of Chartered Accountants. The firm intends to resign its appointment for non-payment of professional fees to it for sometime by the management of Tisco Ventures Limited.

Required:

a. Explain other reasons that may cause a professional firm to resign from an audit engagement. (3 Marks)
b. Explain the procedures for the resignation of current auditors as per provision of company legislations. (10 Marks)
c. State the ethical position as stated in the ICAN code on another auditor taking up the appointment after resignation of the current auditor applicable to this type of situation. (2 Marks)

(Total 15 Marks)

QUESTION 7

The auditor takes a systems-based approach wherever possible and focuses on testing the systems and internal controls that produces the financial reporting figures of an organisation rather than focusing on the figures themselves. Specialised techniques of obtaining audit evidence may be required by the auditors in an organisation where the systems are Information Technology (IT) based.

Required:

a. Explain the **TWO** conditions that are necessary before the auditor can adopt a systems-based approach to audit assignment. (2 Marks)
b. Explain the term Computer-Assisted Audit Techniques (CAATs) and its disadvantages. (7 Marks)
c. Explain the term "Major Transaction Cycles" of an organisation that the auditor should focus much of his audit work. (3 Marks)
d. State the elements of sales system of an organisation that the auditor should apply tests of controls. (3 Marks)

(Total 15 Marks)

SOLUTION 1

a. Key Audit Matters (KAMs) are defined by ISA 701 as:

"Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance".

ISA 701 explains that in determining KAMs, the auditor shall take into account:

i. Areas of higher assessed risk of material misstatement, or **significant** risks .
ii. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty; and
iii. The effect of **significant events or transactions** that occurred during the period.
iv. The auditor determines which of the above matters were **most significant** in the audit, and hence are the key audit matters.
v. KAMs are defined with reference to the auditor, NOT the user – i.e. the areas that required significant auditor attention in **performing the** KAMs are a standard element of all unmodified auditor's reports for listed companies and other entities where required to be presented by law or regulation. KAMs therefore DO NOT represent a modification to the auditor's report and must not be confused with modified audit opinion, emphasis of matter or other matters, all of which are determined with reference to the USER, not the auditor.

Examples include:

- Goodwill impairment;
- Significant fraud risk;
- Valuation of financial instruments;
- Valuation of investment property;
- Fair Values;
- Effects of new accounting standards;
- Revenue recognition;
- Tax; and
- Management override of controls

Communicating key audit matters

b. KAMs are described in a separate section in the auditor's report under the heading '**key audit matters**'.

For each KAM, the description must:

i. Be clear, concise, understandable and entity specific;
ii. State why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter;
iii. State how the matter was addressed in the audit; and
iv. Be a reference to the related disclosure elsewhere in the financial statements.

(i) The minimum elements of the auditor's report as required by ISA 700 include:

s

- Title;
- Addressee;
- An opinion section containing an expression of opinion on the financial statements and reference to the applicable financial reporting framework used;
- An identification of the entity's financial statements that have been audited;
- A statement that the auditor is independent of the entity in accordance with these requirements. The statement shall identify the jurisdiction of origin of the relevant ethical requirements or refer to the IFAC Code of Ethics;
- Where applicable, a section addressing a material uncertainty of going concern in compliance with ISA 570;
- Where applicable, a key audit matters section (in compliance with ISA 701);
- Where applicable, a section addressing 'other information' in compliance with ISA 720 (Revised);
- A description of management's responsibility for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process;
- A reference to ISAs and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements;
- For public interest entities, the name of the engagement partner unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat;
- Auditor's signature;
- Auditor's address/location; and
- Date of the auditor's report.

(ii) Matters to be expressly stated in the auditor's report as stated in Companies and Allied Matters Act 2020. (CAMA) are:

- Whether the auditors have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purpose of their audit;
- Whether, in the auditor's opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them;

- Whether the company's balance sheet (statement of financial position) and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report are in agreement with the books of account and returns.
- Whether, in the auditor's opinion and to the best of their information and according to the explanations given them, the said statements give the information required by this Act (CAMA) in the manner so required and give a true and fair view in the case of the:
  - Balance sheet (statement of financial position), of the state of the company's affairs as at the end of its year; and
  - Profit or loss account, of the profit or loss for its year; or as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which, by virtue of Part 1 of the First Schedule of this Act, are not required to be disclosed; and

- In the case of a holding company submitting group financial statements whether, in their opinion, the group financial statements have been properly prepared in accordance with the provisions of this Act so as to give true and fair view of the state of affairs and profit or loss of the company and its subsidiaries and associates dealt with where it, so far as it concerns members of the company, or the case may show as to give a true and fair view thereof subject to the non-disclosure of any matter to be indicated in the report which by virtue of Part 1 of the First Schedule to this Act are not required to be disclosed.

Examiner's report

This question tests the candidates' knowledge on key audit matters (KAMs) and contents of the auditor's report as required by ISA 700 and CAMA 2020.

This being a compulsory question, all the candidates attempted it but performance was very poor.

The common pitfall of the candidates was their inability to interpret the requirements of the question, thereby proferring wrong solutions.

Candidates are advised to cover the syllabus adequately and make use of the Institute's Study Texts and Pathfinders when preparing for future examinations.

Marking guide

			Marks	Marks
a.		Explain what is meant by key audit matters		
		(Definition of KAMs)	2	
		(1 mark each for what auditor will take into consideration in determining KAMs) (4 Points)	4	
		(1 mark each for consideration of KAMs)	<u>4</u>	**10**
b	i.	Elements in the Auditor's report as per ISA 700 and CAMA 2020		
		(1 mark each for each element of auditor's report (maximum 10 points)	10	
	ii.	(2 marks for each of the FIVE matters to be stated in the report of auditor.)	<u>10</u>	**<u>20</u>**
		Total		**<u>30</u>**

SOLUTION 2

2(a) The qualities of a good audit evidence include:

(i) **Sufficiency**
A good audit evidence must be sufficient, that is having the right quantity of evidence. The factor of whether the audit evidence is sufficient is a matter of judgment of the auditor, the quantity required and also the quality.

(ii) **Relevance**
Relevance deals with the logical connection with or bearing upon the purpose of the audit procedure and the assertion under consideration. For instance, physical inspection of non-current assets is relevant for verifying the existence but not its ownership.

(iii) **Reliability**
The evidence will be reliable if it can be trusted and relied upon to form an opinion. Issues to be considered include relationship with related controls and the form of the evidence – that is whether oral or documentary; original documentation or copy.

(b) Testing procedures for gathering audit evidence.

Procedures	Explanation/application
Inspection	Looking at an item and experiencing it physically.
Observation	Watching a procedure (e.g physical inventory counts, distribution of wages, opening of mails, etc.
Inquiry	i. Seeking information from knowledgeable persons inside or outside the entity. ii. Evaluating responses to those enquiries iii. Corroborating those responses with other audit evidence iv. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and/or those charged with governance to confirm responses to oral inquiries.
External confirmation	A specific type of inquiry – seeking confirmation from a third party like bank, customer, suppliers, lawyers.
Recalculation	Checking the mathematical accuracy of documents or records e.g payroll, schedules, invoices, etc.
Reperformance	Independently carrying out procedures or control, which were originally performed by the client – bank reconciliation.
Analytical procedures	Evaluating and comparing financial and/or non-financial data for plausible relationships and investigating unexpected fluctuations.

c. Factors that the auditor would consider when assessing the reliability of audit evidence include:

(i) Audit evidence is more reliable when it is obtained from independent sources outside entity under audit: ISA 500 requires that the auditor should be satisfied as to the accuracy and reliability of any internal evidence used in reaching a conclusion;
(ii) Internally generated audit evidence is more reliable when the related controls are effective;
(iii) Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference;
(iv) Audit evidence is more reliable when it exists in documentary form: This could be paper, electronic or other medium. For example, a written record of a meeting made at the time is more reliable than a subsequent oral representation of the matters discussed;

(v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies, or documents that have been filmed, or otherwise transformed into electronic form. This is because the reliability of those other forms may depend on the controls over their preparation, maintenance and transmission;

(vi) Corroborated evidence also assuring the same results;

(vii) Evidence by substantive procedures is more reliable;

(viii) Technical procedure used such as sampling techniques;

(ix) Verifiability of evidence such as official receipts, with OR codes, particulars and dates including company names; and

(x) Auditor's knowledge.

Examiner's report

The question tests candidates' knowledge of audit evidence.

About 85% of the candidates attempted the question and performance was good.

Candidates are advised to prepare well for ICAN examinations by reading the Institute's Study Texts and Pathfinders.

Marking guide

		Marks
a.	Characteristics of good audit evidence (1 mark for each characteristic of a good audit evidence 3 points)	3
b.	Testing procedures for gathering audit evidence (2 marks for each testing procedure explained maximum of 5 points))	10
c.	Factors to consider when assessing reliability of auditors (1 mark for each factor to be considered (maximum of 7 points))	7
	Total	**20**

SOLUTION 3

FACTORS TO BE CONSIDERED IN THE AUDIT OF NFPO (YOUTHPLUS)

	Audit area	Comments
a.	**Planning**	(i) The objective and scope of the audit work (ii) Any local regulations that apply (iii) The environment in which the organisation operates. (iv) The form and content of the financial statements and the audit opinion (v) Key audit areas, including risk
b.	**Risk**	(i) The auditor should carry out an audit risk analysis under the usual headings of inherent risk, control risk and detection risk (ii) Inherent risk (reflecting the nature of the entity's activities and the environment) (iii) Control risk (internal controls, and the risk that these may be inadequate: controls over cash collection and cash payments may be a key area for YOUTHPLUS because large amounts of cash may be collected from the public by volunteers) (iv) Detection risk (the risk that the auditor will fail to identify any material error or misstatement in performing the audit)
c.	**Internal control**	Key areas of internal control in YOUTHPLUS might include: (i) Segregation of duties; (ii) Authorisation of spending; (iii) Cash controls; (iv) Controls over income (donation, cash collections, grants); and (v) The use of funds only for authorised purposes.
d.	**Audit evidence**	(i) A substantive testing approach, rather than a systems based approach is likely to be necessary. (ii) Key areas may include: - The completeness of recording transactions, assets and liabilities; and - The possibility of misuse of funds. (iii) Analytical procedures may be used to 'make sense' of the reported figures. (iv) There should be a review of the financial statements. Including a review of the appropriateness of accounting policies.

e. **Reporting** The audit is performed on a voluntary basis therefore the report needs to reflect the agreed objective of the audit. However, it is good practice for the report to follow the general structure laid down by ISA 700: viz

(i) Title;
(ii) Addressee;
(iii) The audit opinion;
(iv) Basis for opinion;
(v) Responsibilities of auditors versus the responsibilities of management;
(vi) Other reporting responsibilities; and
(vii) Date, name, signature and address of auditor.

Examiner's report

This question tests the candidates' knowledge of the conduct of the audit of a not-for-profit organisation (NFPO).

This question was avoided by most candidates, as only about 25% of them attempted it and performance was poor.

Most of the candidates were not able to explain the process of carrying out the audit of a not-for-profit organisation (NFPO).

Candidates should, as a matter of necessity, cover the entire syllabus adequately before sitting ICAN examinations. They should also make use of ICAN Study Texts, Pathfinder and other relevant publications.

Marking guide

		Marks
a.	Factors to consider when auditing Youthplus planning (1 mark for each factor to be considered on planning 4 points)	4
b.	Risk (1 mark for each factor to be considered on risk 4 points)	4
c.	Internal control (1 mark for each factor to be considered on audit evidence 4 points)	4
d.	Audit evidence (1 mark for each factor to be considered on audit evidence 4 points)	4
e.	Reporting (1 mark for each factor to be considered on reporting 4 points)	4
	Total	**20**

SOLUTION 4

a. A fundamental principle of ICAN code of ethics for members states that information obtained in the course of professional work should not be disclosed to any other party, except

(i) Consent has been obtained from the person or entity to which the information relates; or

(ii) There is a legal or professional duty to disclose information gained when acting in a professional capacity should not be disclosed in order to:
- Gain personal advantage; and
- Gain advantage for another party.

A chartered accountant should maintain confidentiality in a social environment on information disclosed by a prospective client and or employer. The duty of confidentiality subsists even after the end of relationship between the chartered accountant and a client or employer. The auditing firm should not disclose the information to Sobona Limited unless the conditions analysed above are fulfilled.

b. The **FIVE fundamental principles** in the ICAN code are:

i. **Integrity**
Members shall be straightforward and honest in all professional and business relationships. Integrity implies not just honestly but also fair dealing and truthfulness.

ii. **Objectivity**
Members are not to compromise professional or business Judgments because of bias, conflict of interest or undue influence of others.

iii. **Professional competence and due care**
Members have a duty to attain and maintain their professional knowledge and skill at the level required to ensue hat a client or employer receives a competent professional service, based on current technical and professional standards and relevant legislation. Members shall act diligently and in accordance with applicable technical and professional standards.

iv. **Confidentiality**
Members shall respect the confidentiality of Information acquired as a result of professional and business relationships and shall not disclose such information to third parties without authority or unless there is a legal or professional right or duty to disclose

Confidential information acquired as a result of professional and business relationships must not be used for the personal advantage of members or third parties.

v. **Professional behaviour**
Members shall comply with relevant laws and regulations and avoid any conduct the professional accountant knows or should know what might discredit the profession.

c. The matters that could affect the independence and integrity of the auditor include:

i. **Fees and pricing**
Where the total fees generated by an assurance client represent a large proportion of an assurance firm's total fees, the dependence on that client and concern about the possibility of losing that client creates a self-interest of intimidation threat.

ii. **Family and personal relationship**
Family and personal relationships between a member of the assurance team and a director, officer or certain employees at the client might create self-interest, familiarity of intimidation threats, depending on the specific circumstances.

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 might create self-interest or intimidation threats.

iv. **Financial Interests**
A financial interest in an assurance client exists where shares or debt instruments are held either directly or indirectly. A direct financial interest is one held by an individual or the assurance firm or by a trust controlled by them. An indirect financial interest is one held by an individual or the assurance firm via a trust not controlled by them. Such a holding might create a self-interest threat.

Neither an assurance team member nor his immediate family or an assurance firm must hold a direct financial interest or a material indirect financial interest in the assurance client.

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

vi. **Employment with assurance clients**
Individuals who have previously been on the assurance team could leave the assurance firm to work for the assurance client. Depending on:

- The seniority of the individual when he was on the assurance team;
- The position he has taken up at the client;
- The amount of future involvement he will have with the assurance team (as a member of the client's staff); and
- The length of time that has passed since he was on the assurance team.

vii. **Long association of senior personnel with assurance clients**
Using the same senior personnel on an assurance engagement over a long period of time might create a familiarity threat. The level of threat will depend upon:

- The length of time that the individual has been on the assurance team;
- The role of the individual on the assurance team;
- The structure of the firm; and
  The nature of the assurance engagement.

viii. **Provision of non-assurance services**
The independence of an assurance firm may be threatened when the firm carries out a large amount of non-assurance work for an entity that is also its assurance client. This is particularly true where an audit firm carries out non-audit services for its audit client.

Examiner's report

This question tests candidates' knowledge on the Institute's code of ethics for members relating to confidentiality of client's information, fundamental ethical issues and matters that affect independence and integrity of an auditor.

About 95% of the candidates attempted this question and they displayed good understanding of its requirements, hence the performance was good.

The candidates' common pitfalls were their inability to give reasons for their decision to supply confidential information to a third party or not and inability to describe the matters that could affect the independence and integrity of the auditor.

Candidates are advised to develop skills to apply their knowledge to scenarios.

Marking guide

		Marks	Marks
a.	Supply of confidential information to a third party (1 mark for each reason why the information will not be disclosed (5 points))		5
b.	Fundamental principles of ICAN (1 mark for each fundamental principle stated 5 points))	5	
	(1 mark for each fundamental principle explained)	5	
			10
c.	Matters that would affect independence and integrity of audit (1 mark for each matter that could affect independence & integrity of the auditor maximum of 5 points))		5
	Total		**20**

SOLUTION 5

a. Analytical Review Procedures is defined as audit procedures which may systematically analyse and compare related figures, trends, ratios and other data with the aim of providing evidence to support the audit opinion on the financial statements.

The data used in such examination may be financial or non-financial and may originate from within or outside the client organization.

Analytical review procedures range from simple comparisons such as current with the prior year figures or accounting ratios to complex analysis using advanced statistical techniques and computer audit programs.

b. **Four types of general Analytical Review Procedures include:**

i. Comparison of current-year account balances to balances for one or more comparison period;
ii. Comparison of the current year account balances to anticipated results found in the company's budget and forecasts;

iii. Comparison of current year account balances and financial relationship (e.g. ratios) with similar information for the industry in which the company operates; and

iv. Study of the relationship of current year account balances with relevant on-financial information (e.g. physical production statistics relating to input and output, energy consumption, etc.

c. **Purposes of performing preliminary Analytical Review Procedures in the audit planning stage are:**

The purposes include to discover any mis-statement in financial statement presentation;
To confirm information supplied;
To apply reasonableness tests, estimates and judgments;
To perform a cursory review of financial statements at the audit planning State; and
The auditor will hope to identify areas of potential risk or new developments so that he can plan his other procedures in these areas.

Examiner's report

This question tests candidates' knowledge of analytical review procedures.

About 70% of the candidates attempted the question, but the performance was poor.

The common pitfalls of the candidates were their inability to explain the types of general analytical review procedures and the purposes of performing them at the audit planning stage.

Candidates are advised to prepare well for the examinations by making use of the Institute's Study Texts extensively.

Marking guide

		Marks
a.	Explanation of Analytical Review Procedures (2 marks for each point defined and explained on analytical review procedures 3 points)	**6**
b.	Four types of general Analytical Review Procedures (1 mark for each general Analytical Review Procedures explained)	4
c.	Purpose of performing Analytical Review Procedures (1 mark for each purpose of analytical review procedures at planning stage 5 points)	5
	Total	**15**

SOLUTION 6

a. Resignation of Auditors as per sections 412 and 413 of Companies and Allied Matters Act 2020

The auditor may choose to resign during his period of office. The reasons for his resignation apart from non-payment of professional fees include:

i. A consistent lack of integrity is demonstrated by management and/or those charged with governance;

ii. The audit firm can no longer maintain its independence (e.g following a corporate action); and

iii. The client is no longer profitable for the firm.

b. Procedures for the resignation of current auditors as per company legislations

i. The resignation should be made to the company (at the registered office) in writing. The company should submit this resignation letter to the appropriate regulatory authority;

ii. The auditor should prepare a statement of the circumstances. This sets out the circumstances for the resignation; and

iii. The company should send this statement to:

- The Corporate Affairs Commission within 14 days of receipt;
- All persons entitled to receive a copy of the company's financial statements (principally the shareholders); and
- The auditors may require the directors to call a meeting of the shareholders in order to discuss the circumstances of the auditors resignation.

c. Changes in professional appointment. The firm should communicate with the current auditors to establish if there are any matters that it should be aware of when deciding whether or not to accept the appointment.

The following points should be noted in connection with communicating with current auditors:

i. When a member is first approached by a prospective client to act or be nominated, he should explain that he has a professional duty to communicate with the existing auditor;

ii. Client permission is required for any such communication. If the client refuses to give its permission, the appointment as auditor should not be accepted;

iii. If the client does not give the current auditor permission to reply to any relevant questions, the appointment as auditor should not be accepted;

iv. If the current auditor does not provide any information relevant to the appointment, the new auditor should accept or reject the engagement based on other available knowledge; and

v. If the current auditor does provide such information the new auditor should assess all the available information and take a decision about whether or not to accept the audit work.

Examiner's report

This question tests the candidates' knowledge on resignation of auditors in line with regulatory and legal provisions.

About 80% of the candidates attempted the question and performance was fair.

Some candidates could not state correctly the ethical position as stated in the ICAN Code of Ethics for Members.

Candidates are advised to understand the contents of ICAN Code of Ethics for Members and read the Institute's Study Texts and Pathfinders.

Marking guide

		Marks
a.	Reasons why a professional firm can resign (1 mark for each reason that may cause resignation of auditor 3 points))	**3**
b.	Procedures for the resignation of auditors per CAMA (2 marks each FIVE procedure for the resignation of auditor)	10
c.	Ethical position of a new auditor after resignation of current auditor (1 mark for each ethical position required for new auditor's acceptance of audit maximum of 2 points))	2
	Total	**15**

SOLUTION 7

a. Two conditions that are necessary before the auditor can adopt a systems-based approach to do his work are:

- The systems and controls in place should be designed to minimize the risks of misstatements. The auditor carries out this check of controls in his procedures for the documentation and evaluation of the controls.

- The systems and controls should actually operate effectively. The auditor gains evidence that the controls operate in practice by performing tests of control.

b. Computer-Assisted Audit Techniques (CAATs) can be explained as follows:

- CAATs can be defined as any technique that enables the auditor to use Information Technology (IT) systems as a source of generating audit evidence. They involve the use of computer techniques by the auditor to obtain audit evidence.

- CAATs are often necessary in the audit of IT systems because These systems may not provide an adequate audit trail.

- Processing of transaction is invisible because it is electronic. therefore, the auditor needs to 'get inside' the computer to check the completeness and accuracy of the processing.

Disadvantages of CAATs: Computer-Assisted Audit Techniques can be expensive. The costs related to the use of CAATs may include the following;

- Purchasing or developing the programs.
- Keeping programs up-to-date for changes in hardware and software.
- Training audit staff in the use of computer systems to run the CAATs.

c. Major transaction cycles of an organization can be explained as follows:

- The three transaction cycles that the auditor will focus are sales, purchases and payroll. These three transaction cycles will have a direct effect on both the statement of financial position and the income statement.
- Test of controls are applied to key statement of financial position headings linking into the main transaction cycles of bank and cash, inventory as well as revenue and capital expenditure.

d. Elements of sales system of an Organization are stated as follows:
- Receiving orders from Customers.
- Dispatching the goods and invoicing Customers.
- Recording of sales and the amounts receivable in the accounts.

Examiner's report

This question tests candidates' knowledge of adoption of a system based approach to an audit assignment, computer-assisted audit techniques (CAATs), major transaction cycles and elements of sales system.

About 40% of the candidates attempted the question and performance was poor.

The major pitfalls of the candidates were their inability to properly explain CAATs and state their advantages.

Candidates are advised to familiarise themselves with computer-based audit techniques.

Marking guide

		Marks	**Marks**
a.	Two necessary condition for adoption a system-based approach (1 mark for each condition necessary for adopting systems- based approach 2 points)		**2**
b.	Computer-Assisted Audit Techniques (CAATS) (2 marks for each explanation given on CAATs 2 points)	4	
	1 mark for each disadvantage of CAATs given 3 Points)	<u>3</u>	**7**
c.	Major transaction cycles of an organisation (3 points for explanation of the three major transaction cycles)		3
d.	Elements of sales system that the auditor should apply test of controls (1 mark for each element of sales system 3 points)		**<u>3</u>**
	Total		**<u>15</u>**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2021

PERFORMANCE MANAGEMENT

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Kikelomo Limited manufactures three products K, T and F, using different quantities of the same resources. Budget information per unit is as follows:

	K	T	F
	₦	₦	₦
Market selling price	1,800	2,520	3,000
Direct labour (₦140/hour)	280	560	700
Material A (₦60/kg)	300	240	420
Material B (₦120/kg)	480	720	600
Variable overhead (₦80/hour)	160	320	400
Fixed overhead	240	140	240
Total cost	1,460	1,980	2,360
Profit	340	540	640
Total budgeted sales units	500	800	1,600

The budgeted sales are for the month of June but do not include an order from a major customer to supply 400 units per month of each of the three products, at a discount of ₦200 per unit from the market selling price.

During June, the management of Kikelomo Ltd anticipated that there will be a shortage of material B, and that only 17,500 kgs will be available. It is not possible for Kikelomo Ltd to hold inventory of any raw materials, work-in-progress or finished products.

Required:

a. State **THREE** factors which may cause input materials to be a budget constraint and identify steps which may be taken to overcome this constraint. (6 Marks)

b. Prepare calculations to show production that will maximise Kikelomo Ltd's profit for June. (9 Marks)

c. Kikelomo Ltd has now realised that the contract with the major customer does not have to be met in full for any of the three products. The customer will accept whatever Kikelomo is prepared to supply at the contracted prices but they will charge a financial penalty if Kikelomo does not supply them in full in June. Based on this additional information:

Calculate: The lowest value of the financial penalty that the major customer would need to insert in the contract to ensure that Kikelomo Ltd meets the order in full in June. (6 Marks)

d. Now assume that the shortage of material B is expected to continue far beyond June and management of Kikelomo Ltd has decided to outsource the production of some of the products, advise the management of Kikelomo Ltd on the advantages and disadvantages of outsourcing.

(9 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

Divine Grace (DG) Limited currently makes as many units of “Part-2011” as it needs. The company has recently received a bid from another company, KK Plc, for making “Part 2011”. The company will supply 1,000 units of “Part 2011” per year at ₦100 a unit. The company can begin the supply and continue for five years, after which time DG Limited will not need the part. KK Plc can accommodate any change in DG Limited’s demand for the part and will supply it for ₦100 regardless of quantity.

Ayo Ayuba, the cost accountant, reports the following costs for manufacturing 1,000 units of “Part 2011”.

	₦
Direct materials	44,000
Direct production labour	22,000
Variable production overhead	14,000
Depreciation on machine	20,000
Product and process engineering	8,000
Rent	4,000
General overheads	10,000
	122,000

The following additional information is available:

(i) "Part 2011" is made on a machine used exclusively for the production of "Part 2011". The machine was acquired on January 1, last year at a cost of ₦120,000. The machine has a useful life of six years and zero terminal disposal price. Depreciation is calculated on the straight-line method.

(ii) The machine could be sold today for ₦30,000.

(iii) Product and process engineering costs are incurred to ensure that the production process for "Part 2011" works smoothly. Although these costs are fixed in the short run, with respect to units of "Part 2011" produced, they can be saved in the long run if "Part 2011" is no longer produced. If "Part 2011" is outsourced, product and process engineering costs of ₦8,000 will be incurred for next year only.

(iv) Rent costs of ₦8,000 are apportioned to products on the basis of the floor space used for manufacturing the product. If "Part 2011" is discontinued, the space currently used to manufacture it would become available. The company could then use the space for storage purposes and save ₦2,000 currently paid for outside storage.

(v) General overheads are apportioned to each department on the basis of direct production labour costs. These costs will not change in total, but no general overhead will be apportioned to "Part 2011" if the part is outsourced.

Assume the required rate of return is 12%.

Required:

a. Should DG Limited outsource "Part 2011"? (10 Marks)

b. What maximum price should KK Limited quote on the 1,000 units to make Divine Grace indifferent between outsourcing and internal production? (5 Marks)

c. What non-financial factors would favour internal production rather than outsourcing? (5 Marks)

(Total 20 Marks)

QUESTION 3

Kahkiri Limited manufactures two products, product X and product Y, on the same machines. Sales demand for the products exceed the machine capacity of the company's production department. The potential sales demand in each period is for 16,000 units of Product X and 24,000 units of Product Y. Sales prices cannot be increased due to competition from other firms in the market. The maximum machine capacity in the production department is 64,000 hours in each period.

The following cost and profitability estimates have been prepared:

	Product X	**Product Y**
	₦	₦
Sales price	44	54
Direct materials	20	18
Direct Labour	6	11
Variable overhead	6	11
Contribution per unit	12	14
Attributable fixed cost	₦10,000	₦10,000
Machine hours per unit	1.5 hours	2 hours
Fixed costs in each period are	₦100,000	

Required:

a. Using marginal costing approach, calculate the profit-maximising output for the period, and the associated profit for each product and company. (4 Marks)

b. What are the advantages of throughput accounting over marginal costing method in profit maximising decisions?. (4 Marks)

c. Calculate the throughput accounting ratio for Product X and for Product Y. (8 Marks)

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

(Total 20 Marks)

QUESTION 4

You work as the assistant to the management accountant for Henry Limited, a medium-sized manufacturing company. One of its products, Product P, has been very successful in recent years, showing a steadily increasing trend in sales volumes. Sales volumes for the four quarters of last year were as follows:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Actual sales volume (units)	420,000	450,000	475,000	475,000

A new assistant has recently joined the marketing department and she has asked you for help in understanding the terminology which is used in preparing sales forecasts and analysing sales trends. She said: "My main problem is that I do not see why my boss is so enthusiastic about the growth in Product P's sales volume. It looks to me as though the rate of growth is really slowing down and has actually stopped in quarter 4. I am told that I should be looking at the deseasonalised or seasonally adjusted sales data, but I do not understand what is meant by this".

You have found that Product P's sales are subject to the following seasonal variations:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Seasonal variation (units)	+25,000	+15,000	0	-40,000

Required:

a.

i. Adjust for the seasonal variations to calculate deseasonalised or seasonally adjusted sales volume (i.e., the trend figures) for each quarter of last year. (5 Marks)

ii. Assuming that the trend and seasonal variations will continue, forecast the sales volumes for each of the four quarters of next year. (4 Marks)

b. Explain what is meant by seasonal variations and deseasonalised or seasonally adjusted data. Indicate how they can be useful in analysing a time series and preparing forecasts. (5 Marks)

c. State the arguments for and challenges arising from managers participating in setting their budget targets. (6 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

Gaskiya Nigeria Limited is considering whether or not to invest in any of the two projects where the initial cash investment would be ₦13,000,000 for A and ₦14,000,000 for B. The project would have a five-year life and the estimated annual cash flows are as follows:

Project A

Year	Cash inflows	Cash outflows
	₦	₦
1	6,000,000	3,000,000
2	8,000,000	4,000,000
3	10,000,000	4,000,000
4	9,000,000	3,000,000
5	6,000,000	3,000,000
Total	**39,000,000**	**17,000,000**

Project B

Year	Cash inflows	Cash outflows
	₦	₦
1	10,000,000	5,000,000
2	9,000,000	4,000,000
3	8,000,000	3,000,000
4	8,000,000	3,000,000
5	4,000,000	2,000,000
Total	**39,000,000**	**17,000,000**

The company's cost of capital is 10%.

The estimates of cash outflows are considered fairly reliable. However, the estimates of cash inflows are much more uncertain. Several factors could make the annual cash flows higher or lower than expected.

Factor 1: There is a 20% probability that government measures to control the Industry will reduce annual cash inflows by 25%.

Factor 2: There is a 30% probability that another competitor will also enter the market: this would reduce the estimated cash inflows by 10%.

Factor 3: There is a 40% probability that demand will be stronger than expected. The company would not be able to supply more products to the market, but it would be able to sell at higher prices and cash inflows would be 5% higher than estimated.

Required:

a. Calculate the expected net present value of the two projects. (13 Marks)

b. Which of the Projects will be more profitable? (2 Marks)

(Total 15 Marks)

QUESTION 6

Mr. Alade, the owner of a business, has been attending a course on scenario planning and decision making. As a result of that advice, the owner has produced, by using cost, volume and profit analysis, 12 scenarios for a new product that the business will launch in the near future. There are four possible marketing packages that could be used (A, B, C, or D) and there are three possible market conditions (poor, average or good) that could be encountered. The Net Present Value of the cash flows resulting from each of the scenarios is shown in the table below.

	Market package			
Market	**A**	**B**	**C**	**D**
conditions	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Poor	180	230	220	190
Average	190	200	210	275
Good	550	260	210	500

Unfortunately, Mr. Alade missed the session on how to deal with risk and uncertainty. He has sent the above table to the tutor for the course and has asked for help. The tutor replied "I will send you some notes. Based on your table, you will need the methods in the section on 'Uncertainty'. If you can estimate the probability of each type of market condition occurring you need 'Risk based methods'. However, whichever method you use, your decision will be influenced by your attitude."

Required:

Note: Calculations are NOT required.

Explain **FOUR** methods that could help Mr. Alade to decide which marketing package to choose. Your answer should include **THREE** methods to deal with uncertainty, **ONE** method to deal with risk, and an explanation of the **attitude** that would be associated with the decision maker using each of the four methods. **(15 Marks)**

QUESTION 7

Garki plc. is a holding company with four divisions, including Alba and Beta Divisions. Alba Division produces a component that it sells externally, and can also transfer to other divisions within the group.

Beta Division uses the components from Alba Division as a raw material for its final product. The division can also obtain the components from external suppliers. The components, when obtained from Alba Division undergoes further processing at a cost of ₦4.50 per unit, before it is sold to the external market.

The Board of Directors, in order to implement a new Appraisal Review, has set up a performance scheme for the divisional managers. A performance target for the next financial year has been set and the following budgeted information relating to the two divisions has been prepared.

	Alba Division	**Beta Division**
Maximum production/		
Sales capacity	900,000 units	
Sales to external customers	700,000 units	(no constraints)
(Selling price)	₦6.80	
Variable Unit Cost	₦4.90	
Divisional fixed cost `	₦160,000	₦140,000
Capital employed	₦4m	₦3m
Residue Income	₦700,000	₦500,000
Divisional cost of capital	12%	10%.

Beta Division has asked Alba Division to quote a transfer price for units of the components.

Required:

a. Calculate the transfer price per unit which Alba Division should quote to Beta division in order that its budgeted residual income target will be achieved. (3 Marks)

b. Calculate the selling price per unit which Beta Division should quote to external market in order that its budgeted residual income target will be achieved, based on the transfer price quotation, (state clearly your assumptions). (3 Marks)

c. Explain why the transfer price calculated in (a) may lead to sub-optimal decision making from the point of view of Garki plc. taken as a whole. (5 Marks)

d. In what circumstances would a negotiated transfer price be used instead of a market based price? (4 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

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

a = the time taken for the first unit of output

x = the cumulative number of units produced

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

LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

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

a = price when Q = 0

$MR = a - 2bQ$

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

$$Y = a + bX$$

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

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

Coefficient of determination (r^2)

$$r^2 = \frac{[n\sum xy - \sum x \sum y 1]^2}{[(n\sum x^2 - (\sum x)^2)(n\sum y^2 - (\sum y)^2)]}$$

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

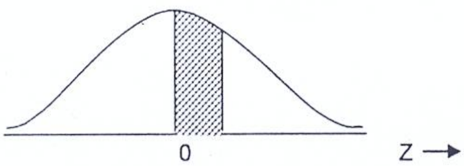
Discount rate (r)

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 poir deviations above the mean. The corresponding area for deviations below the n found by symmetry.



$Z=\dfrac{(x-\mu)}{\sigma}$	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07
0.0	.0000	.0040	.0080	.0120	.0159	.0199	.0239	.0279
0.1	.0398	.0438	.0478	.0517	.0557	.0596	.0636	.0675
0.2	.0793	.0832	.0871	.0910	.0948	.0987	.1026	.1064
0.3	.1179	.1217	.1255	.1293	.1331	.1368	.1406	.1443
0.4	.1554	.1591	.1628	.1664	.1700	.1736	.1772	.1808
0.5	.1915	.1950	.1985	.2019	.2054	.2088	.2123	.2157
0.6	.2257	.2291	.2324	.2357	.2389	.2422	.2454	.2486
0.7	.2580	.2611	.2642	.2673	.2704	.2734	.2764	.2794
0.8	.2881	.2910	.2939	.2967	.2995	.3023	.3051	.3078
0.9	.3159	.3186	.3212	.3238	.3264	.3289	.3315	.3340
1.0	.3413	.3438	.3461	.3485	.3508	.3531	.3554	.3577
1.1	.3643	.3665	.3686	.3708	.3729	.3749	.3770	.3790
1.2	.3849	.3869	.3888	.3907	.3925	.3944	.3962	.3980
1.3	.4032	.4049	.4066	.4082	4099	.4115	.4131	.4147
1.4	.4192	.4207	.4222	.4236	.4251	.4265	.4279	.4292
1.5	.4332	.4345	.4357	.4370	.4382	.4394	.4406	.4418
1.6	.4452	.4463	.4474	.4485	.4495	.4505	.4515	.4525
1.7	.4554	.4564	.4573	.4582	.4591	.4599	.4608	.4616
1.8	.4641	.4649	.4656	.4664	.4671	.4678	.4686	.4693
1.9	.4713	.4719	.4726	.4732	.4738	.4744	.4750	.4756
2.0	.4772	.4778	.4783	.4788	.4793	.4798	.4803	.4808
2.1	.4821	.4826	.4830	.4834	.4838	.4842	.4846	.4850
2.2	.4861	.4865	.4868	.4871	.4875	.4878	.4881	.4884
2.3	.4893	.4896	.4898	.4901	.4904	.4906	.4909	.4911
2.4	.4918	.4920	.4922	.4925	.4927	.4929	.4931	.4932
2.5	.4938	.4940	.4941	.4943	.4945	.4946	.4948	.4949
2.6	.4953	.4955	.4956	.4957	.4959	.4960	.4961	.4962
2.7	.4965	.4966	.4967	.4968	.4969	.4970	.4971	.4972
2.8	.4974	.4975	.4976	.4977	.4977	.4978	.4979	.4980

SOLUTION 1

a) The availability of materials may be a constraint when formulating the budget.

   i) There may be a shortage of supply of materials e.g. where they are Imported and it is known that a bad harvest or political unrest will limit the total quantity available.

   ii) The company may have a limited quantity of specialist storage space available.

   For example raw material may require specially humidified storage or special storage container space where it is toxic or dangerous in nature. Such constraints may limit the overall amount of material which can be made available during the budget period.

   iii) The level of material losses in stores and in the production process may be unacceptably high. This will increase the total input materials required and could lead to a shortfall arising.

   iv) Seasonal material input

   v) Surge in demand

   vi) Storage facility and capacity

   vii) Transport system to move material

   viii) Price of related input material for substitute and complementary goods

The steps:

The company may attempt to minimise the effect of potential shortages by placing forward orders for materials. It may also consider possible substitute materials which are more readily available. Where storage space is a problem, the company may consider the renting of extra storage facilities. It may also wish to negotiate a 'just-in-time' agreement whereby deliveries of material are guaranteed by suppliers to coincide with the forward production plan. In order to reduce the level of material losses, stores layout and control procedures should be reviewed. In the production process additional focus on the efficiency of machinery and the level of training of the work force should help reduce the level of material losses and hence the total material input required.

b) Computation of Production that maximises profit

Product	K	T	F
	₦	₦	₦
Selling Price	1,800	2,520	3,000
Less Variable cost:			
Direct labour	(280)	(560)	(700)
Material A	(300)	(240)	(420)
Material B	(480)	(720)	(600)
Variable overhead	(160)	(320)	(400)
Contribution/Unit	580	680	880

Ranking the products using contribution/kg of material B

Kg of material B	4	6	5
Contribution/kg	₦145	₦113.33	₦176
Ranking	2nd	3rd	1st
Use of material B	3,600kg	3,900kg	10,000kg
Optimal Production	900	650	2,000

c) Producing with no special emphasis on special order

	K	T	F	
Contr./Unit	₦580	₦680	₦880	
Normal Production	500	800	1,600	
Unit of material B	4	6	5	
	2,000	4,800	8,000	= 14,800
Ranking	2nd	3rd	1st	
Bal. to be used for special Order	700kg	0	2,000kg	= 2,700
Units to be produced under special order	175 units			400 units
Normal contribution	580 x 500 =290,000	800 x 680 544,000	1,600 x 880 = 1,408,000	= ₦2,242,000
Special Order	175 x 380 = 66,500	-	400 x 680 = 272,000	₦338,500
	₦356,500	₦544,000	₦1,680,000	= ₦2,580,500

Producing with Emphasis on Special order

Optimal Production (units)	900	650	2,000	₦
Contribution/unit	₦580	₦680	₦880	
Total Contribution	₦522,000	₦442,000	₦1,760,000	
				2,724,000
Less Discount	₦80,000	₦80,000	₦80,000	(240,000)
	₦442,000	₦362,000	₦1,680,000	= 2,484,000
Financial Penalty ₦2,580,500 – ₦2,484,000				= ₦ 96,500

d) **Advantages of outsourcing:**

i. It allows each party to focus on core competences. This should lead to improved quality of the final products produced by Alice. In addition, this should lead to improved efficiency in that part of the overall operations.

ii. It should lead to improved services provided to customers, leading to an increase in customer satisfaction. This will assist in retaining existing customers and achieving repeat sales.

iii. Outsourcing will mean that the amount of capital expenditure is reduced, as the company will no longer be required to invest in the plant and equipment needed to carry out the outsourced activity.

iv. It should lead to less incidence of under-utilisation of assets. This will lead togreater efficiency, and will impact positively on a number of important performance measures (e.g. ROA, asset turnover, ROE, etc).

v. It is possible, but by no means certain, that an activity can be provided by an outsourcer at lower cost than is possible in-house, as a result of the outsourcer's ability to specialise.

Disadvantages of outsourcing:

i. **Staff resistance:** Members of staff, particularly those currently working in the activity to be outsourced, may be resistant, as they will fear that their jobs will be lost.

ii. **Loss of critical skill:** In the medium to long term, the skills associated with the outsourced activity will be lost to the company. It is probable that replacing such skills could prove to be costly. If an inappropriate activity is outsourced, or the outsourcing initiative is unsuccessful, this could prove to be very costly.

Once such skills have been lost, the supplier may seek to increase prices. In such circumstances there would be little option to accept the increased cost, unless an alternative supplier can be identified.

iii. **Quality of the supplier:** The success of an outsourcing initiative will be heavily influenced by the quality of the supplier. It may be difficult to identify a supplier who can provide the correct skills and meet the required specification.
iv. **Loss of confidential data:** When an activity is outsourced, there is a danger that it allows competitors to obtain access to data which otherwise would remain in-house. This may lead to a commercial disadvantage. This is most likely to occur in the case of a product, and competitors may now be able to carry out a tear-down analysis more easily.
v. **Reputational problems:** The most significant potential problem is the damage to reputation which may result if the supplier does not meet the required specification.
vi. Outsourcing firm may turn to a competitor
vii. Loss of managerial control
viii. Failure to meet delivery targets
ix. Selection of vendors may take time and effort

Examiner's report
This is a compulsory question that tests candidates' knowledge on how to handle limiting factor. Being a compulsory question, it was attempted by almost all the candidates.

The candidates recorded an average performance.

The pitfall is that most candidates failed to compute the financial penalty that will be expected when Kikelomo Ltd fails to supply the special order in full as well as failure to treat the discount as an attributable variable costs that only applies to the special order.

Candidates are encouraged to study the Institute's study manual when preparing for ICAN examinations.

Marking guide

			Marks	
a	3 factors that cause material input constraint	3		
	3 Steps to overcome them	3	6	
b	– Contribution per unit	1 ½		
	– Contribution per kg of material B	1 ½		
	– Ranking	1 ½		
	– Optimal Production	4 ½	9	
c	Computation of lowest value of financial penalty (36 ticks at $\frac{1}{6}$ mark)		6	
d	Advantages of outsourcing (2 points at $2^{1}/_{2}$ marks)	5		
	Disadvantage of outsourcing (2 points at 2 marks)	4	9	**30**

SOLUTION 2

a) Outsourcing Cost

Year	Particular	CF	DCF@12%	PV
		₦		₦
1-5	Outsourcing Cost	(100,000)	3.605	(360,500)
0	Sales of machine	30,000	1.000	30,000
1	Engineering cost	(8,000)	0.893	(7143)
1-5	Rent	2,000	3.605	7,210
				330,433

Internal Production Cost

Year	Particular	CF	DCF@12%	PV
		₦		₦
1-5	Direct material	(44,000)	3.605	(158,620)
1-5	Direct Labour	(22,000)	3.605	(79,310)
1-5	Variable O/H	(14,000)	3.605	(50,470)
1-5	Engineering cost	(8,000)	3.605	(28,840)
				317,240

Decision: Produce internally

The company should continue to produce "Part 2011".

Alternative Approach

a) There are two options to evaluate
- Outsource……………………A
- Produce ……………………..B

In the solution that follows, we use incremental approach

		Cash flows (₦)				
Items	**Yr**	**A**	**B**	**A-B**	**PVF@12%**	**PV**
Sales of machine	0	30,000	0	30,000	1	30,000
Outsourcing costs	1-5	(100,000)	0	(100,000)	3.605	(360,500)
Direct materials	1-5	0	(44,000)	44,000	3.605	158,200
Direct labour	1-5	0	(22,000	22,000	3.605	79,310
Variable overhead	1-5	0	(14,000)	14,000	3.605	50,470
Product, etc engineering	1	(8,000)	(8,000)	0	0.893	0
	2-5	0	(8,000)	8,000	2.712	21,696
Rent	1-5	0	(2,000)	2,000	3.606	7,210
NPV if outsourcing						₦(13,614)

The company should continue to produce part 2011.

b) NPV =₦330,433 – ₦317,240= ₦13,193
Sensitivity of the quoted price

$$= \frac{\text{NPV}}{\text{PV of outsourcing cost}} \text{ x } 100$$

$$= \frac{₦13{,}139}{₦360{,}500} \text{ x } 100 = 3.66\%$$

This means that the unit price should not reduce more than
₦100 - (₦100 x 3.66%)

= ₦100 - ₦3.66

= ₦96.34

Alternative Solution:
3.605 x 1000 units x Price =₦360,500 – NPV

= 3,605 P = ₦360,500 – ₦13,193
3,605P = ₦347,307

$$P = \frac{₦347{,}307}{3{,}605}$$

$$P = \underline{\underline{₦96.34}}$$

c) The following are the non-financial factors that would favour internal production:

i) **Labour Union:** If outsourcing leads to laying off operatives who are currently producing the components, labour union may react adversely, if not properly handled.

ii) **Quality:** To maintain high level of quality of the component, it might be better to produce rather than to outsource.

iii) **Ability to meet delivery scheduling:** Internal production should ensure that the components are delivered as and when needed.

iv) **Continuity of supply:** This component will be needed for the next five years. Strategic reasons will demand that the company should keep the supply under its control.

Thus, for harmonious labour relationship, desired level of quality, ability to meet delivery scheduling and continuity of supply, it better to produce rather than outsourcing.

Examiner's report

This is one of the open-ended questions that tests candidates' understanding of relevant cost.

The attempt on this question by candidates was very low.

The candidates recorded below average performance.

The pitfall noticed is candidates' failure to apply the discounting aspect of the question.

Candidates are encouraged to study the Institute's study manual when preparing for ICAN future examinations.

Marking guide

		Marks
A	DG to outsource or not (20 ticks at ½ mark)	10
B	Maximum price to be quoted by KK Ltd	5
C	Non-financial factors that affect internal production (Any 2 points at 2½ marks)	5
		20

SOLUTION 3

a. Using marginal costing principles to calculate the profit maximising output and profit:

Products	X	Y
Sales volume	16,000 units	24,000 units
	₦	₦
Sales Price	44	54
Less variable costs:		
Direct material	20	18
Direct labour	6	11
Variable overheads	6	11
Total variable costs	32	40
Contribution per unit	12	14
Machine hours per product	1.50 hours	2 hours
Contribution per machine hours	₦8	₦7
Ranking	1st	2nd

Hours Required:

Product X = 16,000 x 1.50 = 24,000hours

Product Y = 24,000 x 2 = 48,000 hours

Total hours machine required = 72,000 hours

Available hours: 64,000 hours

Production Mix =

Product X = 16,000 units x 1.50 hours = 24,000 hours

Product Y = 40,000 /2 = 20,000 units = 40,000 Hours

Therefore, profit maximising output = Product X = 16,000 units
Product Y = 20,000 units

Associated Profit

Product	**X**	**Y**	**Total**
			₦
Unit contribution	12	14	
Total contribution	₦192,000	₦280,000	472,000
Less Attributable fixed cost	₦(10,000)	₦(10,000)	(20,000)
Less General Fixed costs			(100,000)
Net Profit	₦182,000	₦270,000	352,000

b. The advantages of throughput accounting over marginal costing method in profit maximising decisions include:

(i) It helps to identify the factors that limit the organisation from realising its goal.
(ii) It helps management to solve organisational crisis and improve business processes to ensure a competitive edge.
(iii) It identifies method which the organisation can use to improve its financial management.

c. Calculation of the throughput accounting ratio for Products X and Y

Computing throughput return per bottleneck

	X	Y
Sales volume	16,000 units	24,000 units
Sales Price	₦44	₦54
Less: Throughput costs:		
Direct material	₦20	₦18
Throughput return	₦24	₦36
Machine hours per unit	1.50 hours	2 hours
Throughput returns per machione hours	₦16	₦18
Ranking	2nd	1st

Factory operating cost per bottleneck

Particulars	X	Y	Total ₦
Units of production	16,000	24,000	
Direct labour	₦96,000	₦264,000	360,000
Variable overhead	₦96,000	₦264,000	360,000
Attributable fixed costs	₦10,000	₦10,000	20,000
Other fixed costs			100,000
Total operating costs			840,000

Factory operating cost per machine hour (Bottleneck)= ₦840,000/64,000 = ₦13.125

Throughput accounting ratio = $\dfrac{\text{Throughput return per bottleneck}}{\text{Factory cost per bottle neck}}$

Product	X	Y
Throughput returns per machione hours	₦16	₦18
Factory operating cost per machine hour	₦13.125	13.125
Throughput Accounting ratio =	16	18
=	13.125	13.125
=	1.22	1.37
Ranking to manufacture	2nd	1st

d.

Product	**X**	**Y**	**Total** ₦
Total machine hours	16000 hours	48,000 hours	
Machine hours/Unit	1.5 hours	2 hours	
Profit maximising output	10,667 units	24,000 units	
Throughput return/hour	₦16	₦18	
Total Return	₦256,000	₦864,000	1,120,000
Total operating cost			840,000
Total operating costs			280,000

Examiner's report

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

The attempt on this question by candidates was very high.

The candidates recorded above average performance.

The pitfall noticed is inability of the candidates to compute throughput accounting ratio.

Candidates are advised to use ICAN study manual intensively when preparing for ICAN future examinations.

Marking guide

			Marks
a	Computation of profit maximising output and profit (20 ticks at $^1/_5$ mark)	4	
b	Advantages of throughput accounting over marginal costing. (2 points at 2 marks)	4	
c	Computation of Throughput accounting ratio. (40 ticks at $^1/_5$ mark)	8	
d	Computation of profit maximising output and profit using throughput Accounting. (16 ticks ¼ mark)	4	
			20

SOLUTION 4

a) **HENRY LIMITED**

(i)

	Quarter 1 units	Quarter 2 units	Quarter 3 units	Quarter 4 units
Actual sales volumes	420,000	450,000	475,000	475,000
Seasonal variation	+ 25,000	+ 15,000	0	40,000
Deasonalised sales volumes	395,000	435,000	475,000	515,000

(ii)

	Quarter 1 units	Quarter 2 units	Quarter 3 units	Quarter 4 units
Trend projection	555,000	595,000	635,000	675,000
Seasonal variation	+25,000	+15,000	-	40,000
Forecast sales volume	580,000	610,000	635,000	635,000

b) **Seasonal variations**

Seasonal variations are short term variations in data that occur due to the time or season of the year. These variations could be due to hourly, daily, weekly, monthly or yearly changes in sales patterns. Due to these variations, forecast data do not always follow the historical trend and hence, the figures have to be adjusted to account for these variations.

Deseasonalised or seasonally adjusted data: Actual data recorded already include seasonal variations. In order to get a clear picture of the trend (i.e. the underlying pattern), the effect of seasonal variations have to be adjusted - a process referred to as deaseasonalising the data.

Observation of the actual data suggests that the rate of increase in sales is declining.

Uses

Provided that the observed trend in deseasonalised data continues, the deseasonalised data can be used to project the trend in future sales. The trend values are adjusted by seasonal variations in each quarter to predict actual sales.

c) **Argument for manager's participation**

i) Managers have experience of the day-to-day running of the business. Their knowledge can help ensure that budget targets are on the one hand: realistic, and on the other hand, a reflection of the full capabilities of the business.

ii) Through manager participation the budgeting process can also become an opportunity for senior management to communicate organisational strategy, policies and expectations. This should encourage subordinate managers to concentrate on corporate goals rather than their own personal goals and will therefore help to achieve goal congruence.

iii) Participation tends to increase motivation since managers feel they are valued. In addition, input to target setting encourages greater commitment to budgets as the budgets are then perceived to be fair. This again leads to improved goal congruence.

iv) Grooming of managers for top posts: The consultation processes involved can be used to access manager potential and help provide training in the skills needed for higher-level management.

Challenges arising from manager participation

i) Since managers are required to implement budgets, they may attempt to set easily achievable targets, over-estimating resource requirements for instance. This can be a particular problem if bonuses depend on achieving such targets. Occasionally, the reverse problem can arise: managers might be over optimistic, thinking an ambitious target will improve their status.

ii) Managers may have different degress of skill in determining an appropriate level of difficulty for budget targets, particularly in a changing business environment. Lack of confidence may also make a manager reluctant to participate.

iii) Although participation is usually perceived to improve motivation, if managers' ideas are rejected, they may feel slighted and have less motivation and commitment to the budget than if it had been imposed from above.

Examiner's report

This is an unpopular question which dwells on trend analysis, seasonal variation and de-seasonalised adjusted data as tools for forecasting and budgeting. The (a) aspect tests candidates ability to compute trend figures using trend and seasonal variation information while the (b) and (c) parts dwelt on theories of seasonal variation, deseasonalised variations and participative budgetary process.

Marking guide

		Marks	Marks	Marks
a	Adjusting for personal variation			
(i)	(20 ticks at ¼ mark)	5		
(ii)	Forecasts for sales volumes (16 ticks at ¼ mark)	4	9	
b	– Explanation of seasonal valuation	1½		
	– Explanation of deseasonalised adjusted data	1½		
	– Uses of time series/Forecast	2	5	
	–			
c	Advantages of participative budgeting (2 points at 1 ½ marks)	3		
	Disadvantages of participative budgeting (2 points at 1½ marks)	3	6	**20**

SOLUTION 5

GASKIYA NIG LTD

a. **Calculation of the expected net present value of the two Projects**

Computation of joint Probability distribution

S/N	Factor 1	Factor 2	Factor 3	Workings	Joint Probability
1	YES	YES	YES	0.2 X 0.3 X 0.4	0.024
2	YES	YES	NO	0.2 X 0.3 X. 0.6	0.036
3	YES	NO	NO	0.2 X 0.7 X 0.6	0.084
4	NO	NO	NO	0.8 X 0.7 X 0.6	0.336
5	NO	NO	YES	0.8 X 0. 7 X 0.4	0.224
6	NO	YES	YES	0.8 X 0.3 X0.4	0.096
7	YES	NO	YES	0.2 X 0.7 X 0.4	0.056
8	NO	YES	NO	0.8 X 0.3 X. 0.6	0.144
				Total	1.000

Impact on inflow

S/N	Joint Probability	Inflow impact	Result	Final expected value
1	0.024	1 - 0.25 -0.10 + 0.05	0.70	0.0168
2	0.036	1 -0.25 – 0.10	0.65	0.0234
3	0.084	1 – 0.25	0.75	0.0630
4	0.336	1-0.0	1.00	0.3360
5	0.224	1 +0.05	1.05	0.2352
6	0.096	1 -0.10+ 0.05	0.95	0.0912
7	0.056	1 – 0.25 + 0.05	0.80	0.0448
8	0.144	1 – 0.10	0.90	0.1296
	1.000			0.9400

Thus the EV of considering the 3 factors is 0.94. Therefore the NPV of Project A and B are:

Project A

Year	Cash inflow	EV of Cash flow	Cash outflow	Net Cash flow	Discount rate 10%	PV of cash flow
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
0	-		(13,000)	(13,000)	1.000	(13,000)
1	6,000 x 0.94	5,640	(3,000)	2,640	0.909	2,399.76
2	8,000 x 0.94	7,520	(4,000)	3,520	0.826	2,907.52
3	10,000 x 0.94	9,400	(4,000)	5,400	0.751	4,055.40
4	9,000 x 0.94	8,460	(3,000)	5,460	0.683	3,729.18
5	6,000 x 0.94	5,640	(3,000)	2,640	0.621	1,639.44
	NPV					+1,731.30

Project B

Year	Cash inflow		EV of Cash flow	Cash outflow	Net Cash flow	Discount rate 10%	PV of cash flow
	₦'000		₦'000	₦'000	₦'000		₦'000
0	-			(14,000)	(14,000)	1.000	(14,000)
1	10,000 0.94	x	9,400	(5,000)	4,400	0.909	3,999.60
2	9,000 0.94	x	8,460	(4,000)	4,460	0.826	3,683.96
3	8,000 0.94	x	7,520	(3,000)	4,520	0.751	3,394.52
4	8,000 0.94	x	7,520	(3,000)	4,520	0.683	3,087.16
5	4,000 0.94	x	3,760	(2,000)	1,760	0.621	1,092.96
	NPV						+1,258.20

b. Project A will be more profitable with a higher NPV of ₦1,731.30

Examiner's report

The question tests candidates' understanding of investment appraisal under situations of uncertainty with sensitivity of variables that affected the investment .

The question was highly attempted by candidates as it was a popular capital investment appraisal question.

The candidates recorded average performance.
The pitfall noticed is the inability of the candidates to decipher the several other factors that affect the annual cash inflows and reflect their effect on the present values of net cash flow.

Candidates are encouraged to study the Institute's study pack when preparing for ICAN future examinations.

Marking guide

	Marks	Marks	Marks
–			
– Company Name	½		
– Computation of joint probability			
– (9 ticks at ¼ mark)	2¼		
– Computation of expected value (9 ticks at ¼ mark)	2¼		
– Expected Net Present value of project A (24 ticks at 1/6 mark)	4		
– Expected Net Present value of Project B (24 ticks at 1/6 mark)	4	13	
– Most profitable project		2	**15**

SOLUTION 6

Mr. Alade could use any of the following three approaches to deal with uncertainty:

(i) **Maximin Decision Rule:** The decision maker will look at the options and choose the one that has the highest minimum return. This type of decision maker is a pessimist and will look at the worst outcome for each of the options and seeks to get the best of the worst.

(ii) **Maximax Decision Rule:** The decision maker will look at the options and choose the one that has the highest return. This type of decision maker is an optimist.

(iii) **Minimax Decision Rule (Regret):** The decision maker will analyse the options and choose an option so that if it is the wrong choice, the regret will not be as much as if the others had been chosen and they were wrong. This type of decision maker seeks to minimise the post-event regret of having made a wrong decision.

(iv) If probabilities can be assigned to the outcomes then "uncertainty" will become "risk". It will then be possible to calculate "expected values". The decision will choose the outcome that has the highest expected value. This assumes that the decision maker is risk neutral.

METHOD OF DEALING WITH RISK

The expected value of an option does not give any indication of the risk associated with the option. The risk, or spread, of the possible outcomes of each option can be measured by calculating the standard deviation. A risk minimiser would choose the option with the lowest standard deviation.

The trade off between risk and return can be evaluated by calculating the coefficient of variation (standard deviation over the expected value).

(v) Decision tree is a flowchart to represent possible solution based on certain conditions

(vi) Simulation method forecasts the outcome of an event using probabilities associated with the events.

(vii) Sensitivity analysis is a method that determines the effect of risk on the expected outcome of a key variable or factor.

Attitude of Decision Makers:

(i) Risk averse: This avoids risk without adequate compensation for the risk

(ii) Risk neutral: This is indifferent about risk taking and hence, ignores it

(iii) Risk seeking: This takes risk without compensation for the risk.

Examiner's report

This question tests candidates theoretical appreciation of decision making under situations of uncertainty and risk.

Many candidates attempted the question.

The candidates recorded average performance.

The major pitfall noticed is the inability of candidates to work in accordance with the examiners' requirements that no computations are required.

Candidates are advised to pay special attention to the requirements of questions as well as use the Institute's study manual when preparing for ICAN future examinations.

Marking guide

	Marks	Marks
– 3 Methods of uncertainty in decisions making. (Any 3 points and explanations)	9	
– 1 Method of risk appraisal in decision making. (Any 1 point and explanation)	3	
– 3 Attitudes associated with decision making under risk/uncertainty. (Any 3 points and explanations)	3	**15**

SOLUTION 7

a) **Garki Plc**

Transfer price per unit for Alba Division:	₦
Residual income	700,000
Notional interest (12% x 4,000,000)	480,000
Net profit	1,180,000
Divisional fixed cost	160,000
Contribution	1,340,000
Variable cost (900,000 x 4.90)	4,410,000
Total revenue	5,750,000
Less: External revenue (700,000 x 6.80)	(4,760,000)
Internal revenue (A)	990,000
Excess/idle capacity (900,000 – 700,000) (B)	200,000 units
Transfer price (A/B)/unit	₦4.95

b)

Selling price of Beta Division	₦
Residual income	500,000
Notional interest (10% x 3,000,000)	300,000
Net profit	800,000
Divisional fixed cost	140,000
Contribution	940,000
Plus Variable cost further of processing cost (200,000 x 4.50)	900,000
Plus Transfer price (200,000 x 4.95) - input cost	990,000
Total revenue (c)	2,830,000
Quantity to sell (D)	200,000
External selling price ($^C/_D$)	₦14.15

Assumption: External offer price from intermediate market from Beta Division is equal to or greater than ₦4.95 transfer price.

c) The transfer price to Beta Division will be sub-optimal to the company as a whole since ₦6.80 is the price to external customers while ₦4.95 is price to the division necessitating a loss of ₦1.85 per unit. The sub-optimal decision making also can be due to the buying division recognising the fixed costs of ₦160,000 and mark-up (Profit – residual income and imputed capital cost) of selling divisions as variable costs of ₦4.95 when it should have been ₦4.90 in setting the transfer price.

d) Negotiated transfer Price Versus Market based Price

A negotiated transfer price is a price that is a product of agreements between the managers of the profit centres. Here, managers are given the autonomy to agree on transfer price. Negotiated transfer prices are appropriate when there is an imperfect market for the goods and services that are bought and sold between divisions.

Market-based transfer pricing is based on the existence of external market. Market-based transfer pricing is perhaps the easiest form of transfer pricing when it comes to determining the price that will be paid between divisions of the same company. It uses the normal market rate that would be paid if the goods were bought on the open market.

Examiner's report

The question is a transfer pricing question that is computed using expected divisional profit and residual income information.

Many candidates attempted the question.

The candidates recorded average performance.

The pitfall noticed is candidates computation of transfer price based on variable costs and opportunity cost without taking into consideration divisional returns expectation in the areas of divisional profit and residual income which are the basis of sub-optimality.

Candidates are advised to pay special attention to the requirements of questions as well as use the Institute's study manual when preparing for ICAN future examinations.

Marking guide

			Marks	Marks
a	Transfer price from Alba divison (12 ticks at ¼ mark)		3	
b	Selling price by Beta division (12 ticks at ¼ mark)		3	
c	Transfer price as sub-optimal decision (2 reasons at 2 ½ marks)		5	
d	– Explanation of Negotiated Transfer price	2		
	– Explanation of market based Transfer Price'	2	4	
	Total			**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2021

PUBLIC SECTOR ACCOUNTING & FINANCE

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

The following information was extracted from the records of the Accountant-General of Harmony State for the year ended December 31, 2020:

	₦'000
Share of statutory allocations:	
FAAC	38,079,795
Value Added Tax (VAT)	10,248,449
Licenses	226,134
Repayment of external loans (including servicing)	463,804
Repayment of FGN Bonds (Restructured commercial loan and salary bailout)	3,004,096
Repayment – General	2,491,424
Re-imbursement	63,000
Direct taxes	7,188,886
Retained earnings of parastatals	10,774,639
Personnel cost (Including salaries on CRF charges)	13,951,945
Overhead charges	15,317,095
Mining rents	14,945
Fees	1,405,392
Other transfers (Deductions from FAAC and others)	1,818,779
Proceeds from aids and grants	14,616,866
CRF charges (Including service wide votes, pension and gratuity)	15,160,307
Parastatals recurrent cost	12,156,294
Fines	15,844
Proceeds of loans from others funds (commercial bank loan)	870,379
Sales	151,707
Earnings	724,019
Rent of government buildings	4,109
Other operating activities (JAAC and LGA bailout)	632,103
Proceeds from external loan	700,000
Rent on lands and others	73,377
Proceeds from internal loan: FGN/State bonds	70,882
Repayment of loans from other funds (commercial bank loan)	2,295,835

The following additional information was made available:

(i) Owing to the inability of the State to fulfill its obligation towards the payment of the salaries of local government staff, a federal government bailout of ₦301,024,000 was received after fulfilling all necessary criteria set for accessing the fund.

(ii) During the year, the state government made claims for the repayment of ₦65,483,000 relating to funds spent on the rehabilitation of federal roads and was granted.

(iii) Details emerging from the Federation Accounts and Allocation Committee (FAAC) showed the following:

	₦'000
Share of the State (Jan. - Dec.)	37,911,897
Deduction at source for loan repayment (Jan. - Dec.)	(5,286,680)
	32,625,217
Sharing of excess petroleum tax by FACC	167,898
	32,793,115

(iv) Capital expenditure funded from aids and grants and external loan amounted to ₦15,387,748,000

(v) During the year, the federal government made a transfer for the refund on reconciliation of Paris Club account amounting to ₦41,310,000

(vi) Refund of bank charges to the Ministry of Finance in the state amounted to ₦51,112,000.

(vii) Cash and cash equivalents as at January 1, 2020 and December 31, 2020 ₦1,546,699 and ₦301,657,000 respectively.

(viii) Other revenue sources of the state government during the year also included an exchange difference amounting to ₦490,575,000.

(ix) Details of capital expenditure are categorised as follows:

	₦'000
General public services	1,249,653
Public order and safety	120,000
Economic affairs	6,345,471
Housing and community amenities	958,396
Social protection	25,091
Environmental protection	27,000
Health	34,522
Recreation, culture and religion	17,862
Education	948,392

Required:

a. Prepare statement of cash flows using direct method for the Harmony State government for the year ended December 31, 2020. (20 Marks)

b. Identify **FOUR** risks associated with reliance on the Medium-Term Expenditure Framework (MTEF) and ways to mitigate the risks. (4 Marks)

c. Discuss **SIX** roles of the Public Accounts Committee (PAC) (6 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

a. IPSAS 5 - Borrowing Cost prescribes the accounting treatment for borrowing costs for general use.

Required:

Identify **FOUR** components and **TWO** types of borrowing costs that are eligible for capitalisation by the standard. (10 Marks)

b. IPSAS 3 - Accounting policies, Changes in Accounting Estimates and Errors outlines criteria for selecting and changing accounting policies among other purposes.

Required:

Outline what constitute changes in accounting policies under the standard and identify **THREE** disclosure requirements, in the standard, under each of the following headings:

i. When initial application of IPSAS 3 is made and has effects on prior, current or future period.

ii. When voluntary changes in accounting policy is made and has effects on current, prior or future period. (10 marks)

(Total 20 Marks)

QUESTION 3

a. The records of research work in the individual countries in the 'third world' are difficult to obtain, unlike in the advanced countries, where research work has been documented and published.

Required:

Discuss **FIVE** observations and **FIVE** features of a good system of public sector accounting in the developing countries as contained in the United Nations Manual on Government Accounting. (10 Marks)

b. The Corrupt Practices and Other Related Offences Act 2000 gave birth to Independent Corrupt Practices and Other Related Offences Commission (ICPC).

Required:

Discuss **FIVE** offences as well as their penalties as contained in the Act. (10 Marks)

(Total 20 Marks)

QUESTION 4

a. Enumerate **THREE** responsibilities for each of the following participants in the smooth operation of the Treasury Single Accounts (TSA)

  i. Central Bank of Nigeria (3 Marks)
  ii. Deposit Money Banks (3 Marks)
  iii. Service Providers (3 Marks)
  iv. Office of the Accountant General of the Federation (3 Marks)

b. Discuss the components of Treasury Single Accounts (3 Marks)

c. Highlight **FIVE** contents of an electronic payment teller (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

Government, like any other economic unit, needs funds which can be raised from various sources for the purpose of financing its activities. Public revenue refers to income generated by government from its activities or operations.

Required:

a. Discuss the **TWO** dimensions or patterns of revenue sharing in a Federation. (5 Marks)

b. Explain **FIVE** principles of revenue allocation. (10 Marks)

(Total 15 Marks)

QUESTION 6

The term externalities refer to economic effects, which may be ***positive*** (gains) or ***negative*** (losses) flowing from ***production*** or ***consumption*** of goods and/or services by one economic unit into the utility function of another economic unit.

Required:

a. Explain **TWO** principal causes of externalities. (6 Marks)

b. Discuss **THREE** measures that government can use to achieve a more efficient allocation of resources in the presence of external benefits. (9 Marks)

(Total 15 Marks)

QUESTION 7

Otunba Local Government wishes to boost its revenue generation and six possible capital investments have been identified. However, the Local Government only has access to a total of ₦6,200,000. The projects may not be postponed until a future period and it is unlikely that similar investment opportunities will occur.

Expected net cashflows are:

	Year					
	0	1	2	3	4	5
Project	**(₦'000)**	**(₦'000)**	**(₦'000)**	**(₦'000)**	**(₦'000)**	**(₦'000)**
A	(2,460)	700	700	700	700	700
B	(1,800)	750	870	640	-	-
C	(1,750)	480	480	630	730	-
D	(1,800)	620	620	620	620	-
E	(1,800)	400	500	600	700	400
F	(1,500)	350	820	820	-	-

Projects A and E are mutually exclusive while all the projects are believed to be of similar risk to the Local Government's existing capital investments. Any surplus funds may be invested in the money market to earn a return of 9% per year. The money market may be assumed to be an efficient market. The Local Government's cost of capital is 12% per year.

Required:

(a) Calculate the expected net present value for each project, and rank the projects. (8 Marks)

(b) Assuming the projects are divisible, calculate the Profitability Index for each project and rank the projects to determine how the money would be best invested. (6 Marks)

(c) State why the rankings in (b) differ from that in (a) above. (1 Mark)

(Total 15 Marks)

SECTION A

SOLUTION 1

(a) **Harmony State Government**

Statement of cashflows for the year ended December 31, 2020

	Notes	₦'000
Operating activities:		
Receipts:		
Statutory allocations:		
- Share from federation (FAAC)	i.	38,079,795
- Value Added Tax (VAT)		10,248,449
Total statutory allocation		**48,328,244**
Independent revenue:		
Direct taxes		7,188,886
Licenses		226,134
Mining rents		14,945
Fees		1,405,392
Fines		15,844
Sales		151,707
Earnings		724,019
Rent of government buildings		4,109
Rent on lands and others		73,377
Repayment – General		2,491,424
Re-imbursement		63,000
Earnings of parastatals		10,774,639
Total independent revenue		**23,133,476**
Other Revenue	ii.	949,,504
Total other revenue		**949,504**
Total receipts		**72,411,224**
Payments:		
Personnel cost (including salaries on CRF charges)		13,951,945
Overhead charges		15,317,095
CRF charges (including service wide votes, pension and gratuity)		15,160,307
Parastatals recurrent cost		12,156,294
Other operating activities (JAAC and LGA bailout)		632,103
Other transfers (Deductions from FAAC and others)		1,818,779
Total payments		**59,036,523**
Net cashflows from operating activities		**13,374,701**
Investing activities:		
Capital expenditure:		
Funding from aids, grants and external loan		15,387,748s
General public services		1,249,653
Public order and safety		120,000

Economic affairs	6,345,471
Housing and community amenities	958,396
Social protection	25,091
Environmental protection	27,000
Health	34,522
Recreation, culture and religion	17,862
Education	948,392
Net cashflows from investing activities	**(25,114,135)**
Financing activities:	
Proceeds from aids and grants	14,616,866
Proceeds from external loan	700,000
Proceeds from internal loan: FGN/State bonds	70,882
Proceeds of loans from others funds (commercial bank loan)	870,379
Repayment of external loans (including servicing)	(463,804)
Repayment of FGN bonds (commercial loan and salary bailout)	(3,004,096)
Repayment of loans from other funds (commercial bank loan)	(2,295,835)
Net cashflows from financing activities	**10,494,392**
Net increase/(decrease) in cash and cash equivalents	**(1,245,042)**
Cash and cash equivalents as at January 1, 2020	1,546,699
Cash and cash equivalents as at December 31, 2020	**301,657**

Workings:

Share from Federal Accounts and Allocation Committee:

		₦'000
i.	Share of the State (Jan. - Dec.)	32,625,217
	Add back: Deduction at source (Jan. - Dec.)	5,286,680
		37,911,897
	Add: Sharing of Excess Petroleum Tax by FACC	167,898
	Total	**38,079,795**
ii.	**Other revenue sources**	
	Exchange difference	490,575
	Refund of road repairs	65,483
	Refund of bank charges	51,112
	Refund from Paris Club	41,310
	LGA bailout	301,024
	Total	**949,504**

(b) **Risks of Medium Term Expenditure Framework (MTEF)**

i. **Global development** risk has led to fragile economic recovery and the emergence of new political risks, which can be mitigated through diplomatic engagements.

ii. **Persistent oil price decline** risk which is expected to remain in the medium term, can be mitigated through diplomatic engagements for oil cuts by producing countries and diversification of the revenue base.

iii. **Oil production and oil sector management** risk which have bedevilled by crude oil theft and oil pipeline vandalism, can be mitigated through engagements with host communities, improved technology in pipeline surveillance, etc.

iv. **Non- oil revenue risks** which are traceable to low remittance into the treasury by government's owned enterprises for lack of transparency. This can be mitigated through improved non-oil revenue drive and capturing of more taxpayers into the tax net.

(c) **Roles of Public Accounts Committee (PAC)**

i. To examine the accounts showing the appropriation of the sum granted by the state house of assembly to meet the public expenditure; together with the Auditor-General's report thereon;

ii. The committee not only ensures that ministries spend money in accordance with state house of assembly approval, it also brings to the notice of the assembly instances of extravagance, loss, unnecessary expenditure and lack of financial integrity in public services;

iii. The committee shall, for the purposes of discharging that duty, have power to send for any person, papers and records and to report from time to time to the state house of assembly and to sit notwithstanding the adjournment of the assembly;

iv. To examine any accounts or report of statutory corporations and boards after they have been presented to the state house of assembly and to report thereon from time to time to the assembly;

v. To enquire into the report of the Auditor General of the state with respect to any pre-payment audit query which had been overruled by the chief executive of the ministry, extra-ministerial department, agency or court of the state government and to report same to the state house of assembly:

vi. The committee has extended its scope of work in recent years to cover the examination of policy issues and accounts that are not part of the appropriation accounts; and

vii. The PAC has no executive power, but it has gained a high reputation in recent years through its active role in interviewing and questioning officials, obtaining and examining records, collecting and screening evidence from witnesses and reporting findings to the state house of assembly.

Examiner's report

This question tests candidates' knowledge on the preparation of statement of cashflows using direct method in part (a) of the question, while part (b) tests candidates' knowledge on the risks associated with reliance on the Medium-Term Expenditure Framework (MTEF) and ways to mitigate the risks. Part (c) of the question also tests candidates' knowledge on the roles of the Public Accounts Committee (PAC).

All the candidates attempted the question, but their performance was below average.

The commonest pitfalls were the inability of the candidates to identify the risks and ways to mitigate the risks associated with reliance on the Medium-Term Expenditure Framework (MTEF) as well as the roles of Public Accounts Committee (PAC). Also some candidates were unable to incorporate the additional information given in the notes to the question in the preparation of statement of cashflows using direct method.

Candidates are advised to have adequate knowledge of relevant provisions of International Public Sector Accounting Standards (IPSAS) and to make use of Pathfinder and Study Texts of the Institute for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	**Preparation of cashflow statement using direct method**		
	Title	½	
	Calculation of net cashflows from operating activities	8¼	
	Calculation of net cashflows from investing activities	3½	
	Calculation of net cashflows from financing activities	2¼	
	Calculation of net increase/(decrease) in cash and cash equivalents for the year	1	
	Calculation of cash and cash equivalents as at December 31, 2020	1¼	
	Working note (i) on share from FAAC	1½	
	Working note (ii) on other revenue sources	1¾	**20**

b.	**Risks associated with reliance on the Medium-term Expenditure Framework (MTEF) and ways to mitigate the risks**		
	Four risks associate with MTEF at ½ mark each	2	
	Four ways to mitigate the risks ½ mark each	2	4
c.	Six roles of the Public Accounts Committee (PAC) at 1 mark each		6
	Total		**30**

SECTION B

SOLUTION 2

(a) Components of borrowing cost:

(i) Interest on bank overdrafts and short-term and long-term borrowings;

(ii) Amortisation of discounts or premium relating to borrowings;

(iii) Amortisation of auxiliary costs incurred in connection with the arrangement of borrowings;

(iv) Finance charges in respect of finance lease; and

(v) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Types of borrowing costs that are eligible for capitalisation

(i) Only borrowing costs incurred that are directly attributable to a qualifying asset can be capitalised to the cost of the asset

(ii) When an entity specifically borrows funds for the purpose of obtaining a particular qualifying assets, the borrowing costs that are eligible for capitalisation should be the actual borrowing costs incurred on such borrowing during the period, less any income earned on the temporary investment of those borrowings.

(iii) Where funds are part of a general pool the eligible amount is determined by applying the capitalisation rate to the expenditure on that asset. The capitalisation rate will be the weighted average of the borrowing cost applicable to the borrowings of the enterprise that are outstanding during the period.

(b) **What constitutes changes in accounting policies under the standard**

i. A change in the accounting treatment, recognition or measurement of a transaction or event within the basis of accounting is a change in accounting policy;

ii. A change in the accounting policy should be made only if required by statute (including mandatory regulation), or by an accounting standard setting body, or if the change will result in more relevant or reliable information about the financial position, financial performance or cashflows of the entity;

iii. An entity shall change an accounting policy only if the change is required by a Public Benefit Entity (PBE) Standard; and

iv. Results in the financial statements providing faithfully representative and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance, or cashflows.

i. Disclosure requirements when initial application of IPSAS is made and has effects on current, prior or future periods are as follows:
- The title of the standard;
- When applicable, that the change in accounting policy is made in accordance with its transitional provisions;
- The nature of the change in accounting policy;
- When applicable, a description of the transitional provisions;
- When applicable, the transitional provisions that might have an effect on future periods;
- For the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected; and

  The amount of the adjustment relating to periods before those presented, to the extent practicable; and *(h) If retrospective application required by paragraph 24(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

ii. Disclosure requirements when voluntary changes in accounting policy is made and has effects on current, prior or future periods are as follows:
- The nature of the change in accounting policy;
- The reasons why applying the new accounting policy provides faithfully representative and more relevant information;
- For the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;
- The amount of the adjustment relating to periods before those presented, to the extent practicable; and
- If retrospective application is impracticable for a particular

prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Examiner's report

Part (a) of the question requires candidates to identify the components and types of borrowing costs that are eligible for capitalisation as required by IPSAS-5: Borrowing Costs, while part (b) tests candidates' knowledge of what constitutes changes in accounting policies and disclosure requirements in accounting with IPSAS-3 Accounting Policies, Changes in Accounting Estimates and Errors.

Few candidates attempted this question and performance was below average. The commonest pitfall was the inability of the candidates to identify the components and types of borrowing costs.

Candidates are advised to have adequate knowledge of relevant provisions of International Public Sector Accounting Standards (IPSAS) and to make use of Pathfinder and Study Texts of the Institute for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	Highlighting components of borrowing cost that are eligible for capitalisation	6	
	Identifying borrowing costs that are eligible for capitalisation	4	10
b.	Explanation of what constitutes changes in accounting policies under the standard	4	
	Disclosure requirements		
i.	When initial application of IPSAS is made and has effects on current, prior or future period	3	
ii.	When voluntary changes in accounting policy is made and has effects on current, prior or future period	3	10
	Total		**20**

SOLUTION 3

(a) **Observations on government accounting system in developing countries**

(i) Relatively little has been given to social government accounting and budgetary control system.

(ii) Accounting procedures in government departments, which reflect complicated systems of checks and balances, tend to hamper the efficacy and timeliness of the accounting information and statistics produced.

(iii) Government accounting is seen mainly as an accountability device for public receipts and expenditure. Efficiency, effectiveness and economy of the operations tend to be neglected.

(iv) Bookkeeping or administrative legal compliance procedures are more common than modern accounting approaches.

(v) Accounting tends to be identified with expenditure control. The fact is that expenditure is subject to multiple checks.

(vi) The amount of paper work is much but no efficiency, accountability or financial control is achieved.

(vii) The accounting data upon which government budgets and plans are based are frequently inaccurate and incomplete.

(viii) Financial reports are delayed and generally in arrears. They consequently become obsolete at the point of implementation.

Features of a good system of public sector accounting as contained in a United Nations Manual on Government Accounting.

The system must:

(i) Comply with constitutional, statutory and other legal requirements of the relevant country;

(ii) Be related to budget classifications. Budgetary financial management must be closely integrated;

(iii) Be maintained in a manner that will clearly identify the objects and purposes for which funds have been received and expended, and the executive authorities who are responsible for custody and use of funds in programme or budget implementation;

(iv) Maintain records in a way that will facilitate audit by external review authorities and readily furnish the information needed for effective audit;

(v) Be developed in a manner that will permit administrative control of funds;

(vi) Be developed so that it effectively discloses the economic and financial results of programme operations, including the sources of revenue, identification of costs and determination of the operating results of government programmes and organisation; and

(vii) Be maintained in a manner that will provide financial data useful for economic analysis and identification of governmental transactions, and also assist in the development of the country's accounts.

(b) Offences as well as their penalties as contained in the Act that established ICPC:

(i) **Offence of accepting gratification:** Any person who corruptly asks for, receives or obtains any property or benefit of any kind for himself or for any other person or agrees or attempts to receive or obtain any property or benefit of any kind for himself or for any other person, is liable to imprisonment for seven (7) years;

(ii) **Offence of giving or accepting gratification through agent:** Any person who accepts or gives gratification through an agent, shall be liable to imprisonment for seven (7) years on conviction.

(iii) **Acceptor or giver of gratification:** The officer will be guilty, notwithstanding that, the purpose was not carried out or matter not in relation to principal's affairs or business; on conviction shall be liable to imprisonment for (seven) 7 years;

(iv) **Fraudulent acquisition of property:** Any person found guilty, shall on conviction, be liable to imprisonment for seven (7) years;

(v) **Fraudulent receipt of property:** Any person who receives anything which has been obtained by means of act constituting a felony or misdemeanour inside or outside Nigeria, which if it had been done in Nigeria would have constituted a felony or misdemeanour and which is an offence under the laws in force in the place where it was done, knowing the same to have been so obtained, is guilty of a felony and the offender shall, on conviction be liable to imprisonment for seven (7) years;

(vi) **Penalty for offences committed through postal system:** If the offence by means of which the thing was obtained is a felony, the offender shall on conviction be liable to imprisonment for three (3) years, except the thing so obtained was a postal matter, or any chattel, money or valuable security contained therein, in which case the offender shall on conviction be liable to imprisonment for seven (7) years;

(vii) **Deliberate frustration of investigation being conducted by the Commission:** Any person who, with intent to defraud or conceal a crime or frustrate the Commission in its investigation of any suspected crime of corruption under the Act or any other law destroys, alters, etc. any document shall on conviction be liable to seven (7) years imprisonment;

(viii) **Making false statements or returns:** Any person who knowingly furnishes any false statement or return in respect of any money or property received by him or entrusted to his care, or of any balance of money or property in his possession or under his control, is guilty of an offence and shall on conviction be liable to seven (7) years imprisonment;

(ix) **Gratification by and through agents:** Any person who corruptly accepts, obtains, gives or agrees to give or knowingly gives to any agent, any gift or consideration as an inducement or reward for doing, fore bearing to do any act or thing, shall on conviction be liable to five (5) years imprisonment;

(x) **Bribery of public officer:** Any person who offers to any public officer, or being a public officer solicits, counsels or accepts any gratification as an inducement or a reward, in the course of official duties shall on conviction be liable to five (5) years imprisonment with hard labour;

(xi) **Using office or position for gratification:** Any public officer who uses his office or position to gratify or confer any corrupt or unfair advantage upon himself or any relation or associate shall be guilty of an offence and shall on conviction be liable to imprisonment for five (5) years without option of fine; and

(xii) **Inflation of contract:** Any public officer who in the course of official duties, inflates the price of any good or service above prevailing market price or professional standards shall be guilty of an offence under this Act and liable on conviction for a term of seven (7) years and a fine of one million naira (₦1,000,000.00).

Examiner's report
Part (a) of the question tests the candidates' knowledge of the features of good system of public sector accounting in the developing countries as contained in the United Nations Manual on Government Accounting. Part (b) tests candidates' knowledge on the offences as well as the penalties contained in the Corrupt Practices and Other Related Offences Act, 2000.

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

The commonest pitfalls were the inability of the candidates to differentiate between developing countries and advanced countries. Most of the observations provided by candidates were for advanced countries as against developing countries.

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

Marking guide

		Marks	Marks
a.	Discussion of five observations of government accounting system in developing countries at 1 mark each	5	
	Discussion of five features of good system of public sector accounting at 1 mark each	<u>5</u>	10
b.	**Offences as well as their penalties as contained in the Act that established ICPC:**	4	
	Identification of five offences at ½ mark each	2½	
	Explanation of the penalties identified at 1½ each	<u>7½</u>	<u>10</u>
	Total		<u>20</u>

SOLUTION 4

(a) **Responsibilities of selected participants for smooth operation of TSA are detailed below:**

Roles of Central Bank of Nigeria (CBN)

i. Deployment of gateway for use by other stakeholders.
ii. Ensures that Remita platform facilitates the transmission of all instructions.
iii. Designs the payment and collection process across all banks based on operational standards.
iv. Maintains the Treasury Single Account (TSA) of the government

v. Ensures maintenance, security and optimum performance of the gateway to meet its obligations.
vi. Issues the guidelines to Deposit Money Banks (DMBs) on the operation of the TSA.
vii. Abides by all terms and conditions for the operation of TSA.

Roles of the Deposit Money Banks (DMBS)

i. Ensures that payments to government are given prompt attention.
ii. Ensures that all collections in favour of FGN are promptly remitted and complains are lodged with Office of the Accountant-General of the Federation (OAGF), CBN and REMITA without delay.
iii. Liaises regularly with OAGF to ensure smooth operation of the TSA.
iv. Liaises with relevant departments of OAGF and CBN on the operations of TSA.
v. Ensures that terms and conditions enshrined in the MoU are effectively discharged.

Roles of service provider

i. Works with CBN, OAGF and other stakeholders to articulate system requirements.
ii. Provides a robust stable and effective integrated processing platform.
iii. Ensures the optimal availability of all relevant systems and platforms.
iv. Provides effective and efficient support to users of the platform.
v. Provides users with relevant reports.
vi. Training of users on the use of the payment gateway.

Roles of Office of Accountant General of the Federation

i. Ensures effective implementation of e-collection reform.
ii. Ensures proper monitoring of the e-collection gateway.
iii. Ensures prompt reconciliation of all collections.
iv. Provides Ministries, Department and Agencies (MDAs) with periodic report of collection.
v. Supports MDAs, banks and payers on the operation of e-collection.
vi. Ensures regular monitoring of all collections to ensure prompt remittance and accounting for collection.
vii. Ensures continuous update of e-collection guidelines and processes.
viii. Abides by the provisions of the MoU with stakeholders

(b) **Components of TSA**

i. **E-Payment** - The Federal Government of Nigeria commenced the implementation of Treasury Single Account (TSA) in April 2012, with the e-payment component. It is a direct payment through electronic transfer to an individual or an organisation using the medium of information and communication technology.

ii. **E-Collection** -The e-collection component of TSA commenced in January 2015. The first Treasury Circular on e-collection was issued on the March 19, 2015 followed by guidelines in September, 2015. It is a comprehensive electronic solution for the remittance, management and reporting of all Federal Government receipts (revenues, donations, transfers, refunds, grants, fees, taxes, duties, tariffs, etc.) into the TSA and sub-accounts maintained and operated at the CBN.

(c) **Contents of E-payment Teller**

i. Account name of the beneficiary
ii. Account number of the beneficiary
iii. Bank and Branch of the beneficiary
iv. Sort code (if not part of Account Number)
v. Amount payable
vi. Purpose of the payment
vii. Signature and thumbprint impression of the account's signatories

Examiner's report

Part (a) of this question tests candidates' knowledge of responsibilities of Central Bank of Nigeria (CBN), Deposit Money Banks (DMBs), Office of the Accountant-General of the Federation and service providers in the smooth operation of the Treasury Single Accounts (TSA). Parts (b) and (c) test the components of TSA and contents of an electronic payment teller, respectively.

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

The commonest pitfalls were the inability of the candidates to understand the role of some agencies in the Treasury Single Accounts (TSA) implementation, as well as its components.

Candidates are advised to have adequate knowledge of relevant provisions of Treasury Single Account (TSA) and other regulations relating to public sector account for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.i.	Roles of Central Bank of Nigeria (CBN) for smooth operation of TSA	3	
ii.	Roles of the Deposit Money Banks (DMBS) for smooth operation of TSA	3	
iii.	Roles of service provider for smooth operation of TSA	3	
iv.	Role of Office of Accountant General of the Federation for smooth operation of TSA	3	12
b	Identification of the components of TSA	1	
	Explanation of the components of TSA	2	3
c.	Contents of e-payment teller		5
	Total		**20**

SECTION C

SOLUTION 5

(a) **Patterns of revenue allocation**

Revenue sharing in a federation involves two distinct strands, namely vertical or horizontal. Vertical allocation refers to revenue sharing among the different tiers of government within a federation based on a given pattern. This implies sharing among the Federal, State and Local governments. Horizontal allocation on the other hand refers to revenue sharing among the component states and local governments on the basis of acceptable principles.

(b) **Principles of revenue allocation**

(i) **Derivation**: This principle was originally applied to the proceeds of export taxes on agricultural produce. The principle asserts that the state from which the bulk of the revenue is obtained should receive extra share over and above what other states receive.

(ii) **Even development:** The objective of government is that the federation itself should grow and develop at an optimum rate and that each of the constituent states should grow and develop at the optimum (not necessarily equal) rate. The principle requires that growth and development should be spread so that serious inequalities or imbalances are reduced in the federation. These may be achieved by sacrificing efficiency in the form of a reduced overall growth.

(iii) **Need:** The rate of growth and development a state is able to achieve depends on the revenue the state is able to generate. It requires financial as well as other resources not only to maintain its existing facilities but also to develop additional capacities. Given a set of these other resources, a state requires funds to enable it realise its potential. When the need of a state is compared with the need of others, it may be necessary to transfer financial resources from one state to another in the interest of efficiency.

(iv) **National interest:** This principle is used residually by the highest level of government to intervene and transfer funds to lower levels or units in the lower levels to serve various considerations. It lies therefore in the sphere of discretionary grants to be administered by the highest tier, that is, government of the federation.

(v) **Independent revenue:** The principle is of the view that each level of government should be able to raise and keep some revenue for its use. The bulk of the revenue of the state revenue comes from what is raised and collected by the federal government. The main sources left to the state governments are those on personal income taxes, capital gains tax and stamp duties, which should be exploited.

(vi) **Continuity of government services**: The principle suggests that each level of government has a certain minimum responsibility and that the level of services provided should not be allowed to fall below a certain standard. Where a state is unable to function effectively due to lack of funds, such a state should be assisted with federally collected revenue.

(vii) **Equality of state**: All men are created equal but are endowed differently. Similarly, states are created equally but they arrive, at creation and through passages of time with different endowments of economic, financial and political power. The principle asserts that revenue sharing among the states should be done on equal basis.

(viii) **Equality of access to development opportunities**: This was introduced to correct unequal endowments of the states. The principle asserts that preferential treatment should be given to those states which by some measures of development lag behind others or fall below certain norms.

(ix) **Absorptive capacity:** It represents the capacity of the state to make proper use of funds. It is on exceptional and efficiency grounds, that is, funds should go to those states that are best able to utilise them.

(x) **Population:** This principle asserts that since government is about people, that development is also about people and that the essence of government should be the welfare of the people. Therefore, states with larger population should receive extra share above others with smaller population.

(xi) **Tax effort:** The principle, which applies in most federation, is designed to encourage states to exploit their tax capacities. The realisation of a state's potential in respect of tax revenues will widen its development possibilities.

(xii) **Fiscal efficiency**: This principle asserts that states should minimise the cost of fiscal administration or obtain maximum revenue from a given cost. Fiscal efficiency reflects not only on the ability to raise taxes and collect them, but it reflects also the structure of the tax base itself as well as the overall administrative machinery of government.

Examiner's report

Part (a) of the question tests candidates' knowledge on the dimensions or patterns of revenue sharing, while part (b) tests candidates' knowledge on principles of revenue allocation.

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

The commonest pitfall was the inability of the candidates to discuss the patterns of revenue sharing.

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

Marking guide

		Marks	Marks
a.	Discussion of patterns of revenue sharing		5
b.	Identification of five principles of revenue allocation at ½ mark each	2½	
	Explanation of two principles of revenue allocation identified at 1½ marks each	7½	10
	Total		15

SOLUTION 6

(a) The two principal causes of externalities are production activities and consumption activities.

Production externalities: It exists where production activities result into gains or losses to the people within a locality without any form of price or compensation paid. For example, oil exploration will generate hazardous effects (losses) and employment and business opportunities (gains) to the people within the precinct of production activities. This shows that the profit that a firm makes does not only depend on its activities but is influenced by the activities of other economic units in the business environment.

Consumption externalities: This occurs when consumption benefit cannot be limited and charged to a particular consumer. This arises when there is interdependence in the consumption activities of individuals within an area without any form of compensation or price paid to the externality generator. This implies that the utility of individual consumption activities will impact on the utility of another within the community.

(b) The following are the devices that government can use to achieve a more efficient allocation of resources in the presence of external benefits

i. **Reduction in industries reserved for the public sector**
In the earlier year government may reserve some industries for the public sector. This meant that only the government could operate in these industries and no private capital would be involved.

While the public sector must be credited with developing these industries, now the private sector is quite capable of taking them forward. Now the private and public sector co-exist and complement each other in these industries, for example, mining and air transportation.

ii. **Disinvestment**

Disinvestment from public sector means to sell equity shares in public companies to the private sector and the public at large. Also, disinvestment allows for the new influx of capital and better efficiency and financial discipline in private hands. It also ensures that the government has additional funds to invest in social programmes such as public health and sanitation.

Disinvestment also shifts the commercial and financial risks to the private sector. It brings the companies under the purview of corporate governance and reduces the amount of public debt. In some cases such as the telecom industries, disinvestment has also benefitted the consumers by lowering prices, through increase competition.

iii. **Closure of uproductive units**

After the change in policies, all public sector units were to be reviewed by a committee put in place by the government. The committee would review the condition of the units and decide whether they were capable of rehabilitation or were to be shut down permanently. But this may upset the workers and employees of the unproductive units that were shut down.

Since the government was not able to sustain such units, they had to be shut down. The workers were provided with a safety net as to prevent loss of income.

iv. **Public provision:**

Under public provision, a public authority that receives payment from the government produces the good or service.

v. **Vouchers:** A voucher is a token that the government provides to households, which they can be used to buy specified goods or services.

vi. **Patents and copyrights:**

Intellectual property rights give the creator of knowledge the property right to the use of that knowledge. The legal device for establishing an intellectual property right is the patent or a copyright. A patent or copyright is a government-sanctioned exclusive right given to an inventor of a good, service or productive process to produce, use and sell the invention for a given number of years.

Examiner's report

Part (a) of this question tests candidates' knowledge of the principal causes of externalities while part (b) requires the candidates to discuss measures that government can use to achieve a more efficient allocation of resources in the presence of external benefits.

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

The commonest pitfalls were the inability of the candidates to identify the two principal causes of externalities and discuss the measures that the government can use to achieve a more efficient allocation of resources.

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

Marking guide

		Marks	Marks
a.	Identification of causes of externalities	1	
	Explanation of causes of externalities indentified	5	6
b.	Identification of three measures to achieve a more efficient allocation of resources in the presence of external benefits	3	
	Explanation of three measures identified	6	9
	Total		**15**

SOLUTION 7

Otunba Local Government

(a) **Calculation of Net Present Value (NPV) for each project**

		Project A		**Project B**		**Project C**		**Project D**		**Project E**		**Project F**	
Year	**DF (12%)**	**CF**	**DCF**	**CF**	**DCF**	**CF**	**DCF**	**CF**	**DCF**	**CF**	**DCF**	**CF**	**DCF**
		₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
0	1	-2,460	-2,460	-1,800	-1,800	-1,750	-1,750	-1,800	-1,800	-1,800	-1,800	-1,500	-1,500
1	0.893	700	625.1	750	669.75	480	428.64	620	553.66	400	357.2	350	312.55
2	0.797	700	557.9	870	693.39	480	382.56	620	494.14	500	398.5	820	653.54
3	0.712	700	498.4	640	455.68	630	448.56	620	441.44	600	427.2	820	583.84
4	0.636	700	445.2	0	0	730	464.28	620	394.32	700	445.2	0	0
5	0.567	700	396.9	0	0	0	0		0	400	226.8	0	0
	NPV		**63.5**		**18.82**		**-25.96**		**83.56**		**54.9**		**49.93**
Ranking			**2**		**5**		**6**		**1**		**3**		**4**

Project to be invested based on NPV

Project	Initial Investment	NPV
	₦'000	**₦'000**
D	1,800.00	83.56
A	2,460.00	63.5
F	1,800.00	49.93
Total	**6,060.00**	**196.99**
Balance	140.00	Money Market
Funds available	**6,200.00**	

NB

Based on NPV criteria projects D, A and F would be selected while the balance of ₦140,000 would be invested in money market at the rate of 9%, because the projects are not divisible. Project E with NPV of ₦53,700 would not be selected because projects A and E are mutually exclusive which means only one of the project could be selected. Since the NPV of A is higher than E, project A is thereby selected.

(b) **Profitability Index (PI)**

Project	**A**	**B**	**C**	**D**	**E**	**F**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Outlay	2,460	1,800	1,750	1,800	1,800	1,500
NPV	63.5	18.82	(25.96	83.56	54.90	49.93
PI = $\frac{\text{NPV}}{\text{Outlay}}$	**0.0258**	**0.0105**	**(0.0148)**	**0.0464**	**0.0305**	**0.0333**
Ranking	**4**	**5**	**6**	**1**	**3**	**2**

Project to be invested based on Profitability Index

Project	Initial Investment	NPV
	₦'000	**₦'000**
D	1,800	83.56
F	1,500	49.93
E	1,800	54.90
Sub-Total	**5,100**	**188.39**
B (Note)	1,100	11.50
Total	**6,200**	**199.89**

NB

Project A, which is the 4th project in ranking will not be selected because it is mutually exclusive with project E which is already selected. We will now select the next project in ranking, which is project B. Only ₦1,100,000 is left for investment in project B. Project B requires a total investment of ₦1,800,000. However, since the projects are said to be divisible, therefore, the available amount of ₦1,100,000 will be invested in project B and the NPV will be a proportion of total NPV for project B. Thus, 1,100/1,800 *18.82 = ₦11,500.

(c) The rankings differ from (a) because NPV is an absolute measure whereas the profitability index is a relative measure that takes into account the different investment cost of each project.

Examiner's report

Part (a) of this question tests candidates' knowledge of the calculation of Net Present Value (NPV) of projects and their rankings while part (b) requires the candidates to calculate the Profitability Index (PI) and rank the projects to determine how the fund available should be best invested. Part (c) requires the candidates to state why the rankings in (b) differ from that in (a).

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

The commonest pitfalls were the inability of the candidates to calculate Profitability Index (PI) and rank the projects accordingly. Also, some candidates could not state the reason why rankings under Net Present Value (NPV) and Profitability Index (PI) differ.

Candidates are advised to make use of pathfinder and study Texts of the Institute for better performance in future examinations.

Marking guide

		Marks	Marks
a.	Calculation of Net Present Value of projects A – F	$6^1/_2$	
	Ranking	$1^1/_2$	8
b.	Calculation of Profitability Index for projects A – F	$1^1/_2$	
	Ranking based profitability index	$1^1/_2$	
	Decision on the projects to invest using profitability index	$1^1/_2$	
	Decision on the mutual exclusive projects to invest on	$^1/_2$	
	Determination of how the balance of the total outlay should be invested	<u>1</u>	6
c.	Explanation the reason why ranking between NPV and PI approach to project appraisal differs.		<u>1</u>
	Total		**<u>15</u>**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2021

CORPORATE STRATEGIC MANAGEMENT & ETHICS

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Bluebird Group Plc is a Nigerian multinational manufacturing company with head office in Nigeria and factories in Nigeria, Ghana, Senegal, Cote d'Ivoire and Mali. The company produces electrical and electronic appliances which include refrigerators, washing machines, pressing irons, television sets and cameras. It controls about 10% of the market for these products in the West African market.

The company hopes to improve on its performance and competitive position over the next ten years. However, with the COVID-19 pandemic came acceleration of developments that heralded the fourth industrial revolution (also known as Industry 4.0) which has reshaped the contemporary business environment. Some of the changes brought about by industry 4.0 include introduction of artificial intelligence, manufacture of smart home appliances, use of robotic and blockchain technology which could enable the head office access all enterprise activities across all locations on real time. Many of the competitors of Bluebird Group have started introducing these changes into their operations to maintain and improve their competitive position.

In order to remain competitive and maintain its leadership position in the industry, the management of Bluebird Group Plc has decided to make requisite changes in all its operations. Its goal is to improve efficiency, effectiveness, competitiveness, innovativeness and ability to respond quickly to rapid changes in the business environment. In order to achieve these, the company hopes to introduce up-to-date cutting edge technology in its entire value chain. It also hopes to commence production of smart home appliances to meet growing consumers' demand. To this end, the company has contracted relevant vendors to supply needed equipment for smart manufacturing and automation. It is anticipated that these changes have to be supported by needed transformation in the company's organisational structure. Also, the company intends to introduce Just-in-time production system and lean manufacturing which will enable it produce bespoke appliances for different groups of consumers. This is more compelling by the need to switch to team-based cross functional approach in carrying out all its operations.

The company also recognises the need for reskilling of its workers as a fall-out of the introduction of industry 4.0 to its operations to combat redundancy and reduce layoffs.

The management of Bluebird Group Plc anticipates that these planned transformations will make it necessary to take the following steps: Firstly, the implementation of an effective enterprise-wide risk management strategy to mitigate the attendant risks that such changes will bring. Secondly, there is the need to implement an effective change management strategy for the anticipated outcomes to be realised. The need for this is more evident with fear of retrenchment being expressed by workers' trade unions.

You have just been engaged as a consultant to the company to advise on effective business process reengineering and change management

Required:

a.

i. Explain briefly suitable organisational structures available to Bluebird Group Plc. and their respective merits and demerits. (10 Marks)

ii. Advise the management of Bluebird Group Plc. on the best organisational structure to adopt to achieve its stated objectives. (2 Marks)

b.

i. Explain **FOUR** Mintzberg's organisational configurations. (4 Marks)

ii. Drawing from the Mintzberg organisational configuration model, advise Bluebird Group on the best organisational configuration to adopt. (3 Marks)

c. From the given scenario, identify the various risks associated with the proposed changes to Bluebird Group Plc. (5 Marks)

d. Using the Gemini 4Rs Model, suggest to Bluebird Group an effective change management strategy. (6 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

XYZ Limited is a company seeking to meet regulatory requirements for listing on the Nigeria Stock Exchange. As such, the company wants to make several changes in its risk management system.

Required:

You have been contracted to provide advice on.

a. The nature and role of risk committee. (8 Marks)

b. The elements of ISO 31000 risk management framework including the 7Rs and 4Ts of implementing an enterprise-wide risk management system. (12 Marks)

(Total 20 Marks)

QUESTION 3

At the last board meeting of a company, there was a heated argument about whether or not the company should have Corporate Social Responsibility (CSR) programmes. Some members of the board see CSR as a waste of resources while others see it as a tool to achieving organisational goals.

Required:

a.i. What is Corporate Social Responsibility (CSR)? (2 Marks)

ii. Explain stakeholders and shareholders theories on CSR. (2 Marks)

b. Explain to the board **FIVE** aspects of CSR. (10 Marks)

c. Advise the company on steps to be taken in implementing a CSR policy. (6 Marks)

(Total 20 Marks)

QUESTION 4

The maker of Nesquake, a popular coffee brand is planning to build a coffee processing plant in Epe, Lagos State. By virtue of production capacity, this will be the biggest coffee plant in Sub-Saharan Africa. This plant has the capacity not only to meet coffee needs of the country, but meet premium and regular coffee demands of West and Central Africa. Generating over one thousand direct and ten thousand indirect jobs in the process. It is anticipated that the plant will provide huge company and personal income tax revenue to the government, while also generating foreign exchange for the country. The company plans to use eco-friendly cutting-edge technology in its production processes. However, as the only available option, the company intends to import 100% of the coffee beans from Katanga, an East African country, notorious for the use of child labour in the production of coffee beans. Recently, Amnesty International called for the boycott of Katanga's coffee beans due to what has been adjudged unethical and inhuman labour practices. Despite this fact, makers of Nesquake have secured all necessary approvals from the Federal Government and have consequently commenced construction of the coffee processing plants.

Required:

Evaluate the morality of government's approval of the project using the following:

a. Tucker's 5 Questions model (10 Marks)

b. American Accounting Association (AAA) model (10 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

a. A friend of yours is planning to establish a company with a board of directors and committees. He hopes the company will have a system to manage its operations and the associated risks.

Required:

Explain:

i. Risk management (2 Marks)

ii. The process and use of risk mapping (4 Marks)

b. Evaluate the roles of the following in risk management:

   i. Board of directors. (4 Marks)

   ii. Risk committees (5 Marks)

(Total 15 Marks)

QUESTION 6

You have been invited to train entry level graduates of your organisation on several topics in soft skills.

Required:

Using the mixed model, prepare a brief presentation on the following:

a. Meaning and characteristics of emotional intelligence. (9 Marks)

b. Uses of emotional intelligence. (6 Marks)

(Total 15 Marks)

QUESTION 7

It has become common practice among organisations to have Corporate Code of Ethics.

Required:

a. Explain Corporate Code of Ethics and its purpose. (5 Marks)

b. Provide an outline of the content of Corporate Code of Ethics. (10 Marks)

(Total 15 Marks)

SOLUTION 1

ai. The following are the various organisation structures from which Bluebird group Plc can choose:

- **Functional Organisation Structure**: involves division of responsibilities between managers of different functions, thus making possible delegation of decision making. Typical example includes the formation of departments according to functions such as production, finance, human resources etc.

  This structure is not suitable for Bluebirds Group because of the complex nature of its operations and what it hopes to achieve

  Advantages of functional organisation structure are:
- Specialisation - departments focus on one area of work;
- Accountability - there are clear lines of responsibility; and
- Clarity - employees understand their specific roles.

  Disadvantages are:
- It could lead to poor communication and coordination across functional units;
- There could be lack of understanding across departments;
- Functional units tend to focus more on their unit objectives goals and neglect the overall company goals;
- There could be slow response to environmental changes;
- It could stifle innovation when challenges arise;
- Autonomy within units might increase with the growth of the company, causing difficulties in management; and
- Specialisation could lead to a narrow viewpoint at the expense of the company's overall goal.

- **Divisional Organisation Structure:** involves structuring organisations according to products, markets, customers or geographical locations
  - A division might also be a strategic business unit of an entity with each division having its own functional departments
  - Authority is delegated from the head office to the divisional management and the responsibility for the implementation of product management strategy is mainly at the divisional level

Advantages are:
- Each division can work as an independent unit;
- Division managers become experts in their areas;
- Separation of strategic and operating controls;
- Good training ground for strategic management;
- Creation of career development opportunities;
- Removal of the need for supervision of divisions by corporate managers;
- Timely and effective decision making;
- Retention of function specialisation within each division;

- Allows chief executive officer to focus on fundamental strategic decision making;
- Quicker response to change in the market environment;
- Delegate authority;
- Effective implementation of strategies;
- Sharp focus on accountability and performance; and
- Facilitates control of product quality and attention to customers' needs.

Disadvantages are that:

- This structure is not suitable for small organisations;
- Headquarters could find it difficult to control each division;
- Duplication of activities might occur in different divisions;
- Could be more expensive to manage compared with other organisation structures;
- Divisional interest could be pursued at the expense of the overall goal of the Organisation;
- Unhealthy competition and rivalry among divisional heads might occur;
- Tendency to focus on short term performance at the expense of long-term results;
- There might be differences in image and quality across divisions;
- Requires an elaborate control system; and
- Could lead to limited sharing of ideas and resources across divisions.

Matrix Structure

- This structure involves employment of a multiple command structure, related support mechanisms and an associated culture and behaviour patterns.
- The matrix structure typically combines both divisional and functional structures.
- The matrix structure is suitable for large organisations that want to remain flexible, innovative, and more responsive to changes in the business environment.
- It also allows for extensive use of work teams.

Advantages

- Allows for collaboration among different departments.
- Combines project and functional management structures.
- Allows for interdepartmental communication.
- Enables employees to develop new skills.
- Allows team members and managers to keep their functional roles.

Disadvantages

- Managerial roles may not be clearly defined.
- Team roles may not be clearly defined.
- Decision-making processes might be slowed down.
- Might be difficult to measure employee performance.

- Multiple chains of command might lead to conflict among managers.

a. ii. Drawing from the scenario given in the case study, Matrix Structure is the best organisational structure to adopt.
This is so because it:

- supports cross functional work team approach which was indicated in the scenario;
- supports organisational innovativeness;
- makes organisations more responsive to changes in the business environment; and
- supports lean manufacturing and Jus-In-Time management philosophy.

b. i. Mintzberg suggested 6 different organisational configurations:

- Simple Structure: Found mostly in entrepreneurial companies, where the strategic apex exercise direct control over the company's operating core. It allows for a high degree of flexibility thus enabling it to respond to changes in the business environment. However, it works well only in simple and relatively small organisations;
- Machine Bureaucracy: Exists where the technostructure is the dominant element of the organisation. The organisation is largely bureaucratic emphasising control through regulations thus making it slow in responding to changes in the environment. This makes the machine bureaucracy structure suitable only for organisations operating in a stable business environment;
- Professional Bureaucracy: The operating core is the dominant element. This structure exists where the operating core is made up of highly skilled professionals such as chartered accountants, lawyers etc;
- Divisionalised Form: This exists where the middle level managers are dominant. There is a large group of powerful executive managers, and the organisational structure is divisionalised led by divisional managers. In some divisionalised structures, divisional managers are very powerful and can restrict the influence of the strategic apex on decision making;
- Adhocracy: This exists where the entity has a complex and disordered structure, making extensive use of teamwork. It is mostly found in complex and dynamic business environments where innovation is essential for success; and
- Missionary Organisations: Members of such organisations share a common set of beliefs and values and there is an unwillingness to compromise or accept change. This configuration is only appropriate for small businesses operating in a static environment.

b ii. The most suitable organisational configuration would be Adhocracy. This is because it:

- Allows for innovation and teamwork;
- Supports just in time management and lean production;
- Allows organisations to respond more quickly to changes in their operating environment; and
- Can blend with the divisionalised form.

c. Categories of risks associated with the proposed changes at Bluebird Group as it affects the following stakeholders are:

- Technology Risk: Risk arising from change in technology. Development of a new technology might make smart electrical appliances obsolete;
- Legal Risk: Risk arising from failure to meet regulatory requirements. This could arise from inability to meet labour laws associated with employment contracts, product standard regulations etc;
- Health, Safety and Environmental Risk: Risk to health and safety of employees, consumers, and members of the public. This could arise from manufacturing process, use of new technologies in the firms' operations such as 5G technology etc;
- Reputational Risk: Damage to the company's reputation with consumers and the public. This risk could arise if the new technologies applied turns out to be unsafe; and
- Market Risk: changes in prices of inputs for instance could lead to losses and therefore failure of the smart home appliances business.

d. The Gemini 4Rs model suggest the following framework for change management at Bluebird Group Plc

i. Reframing

- ➢ Creation of desire for change. From the given scenario, management of Bluebird group Plc has expressed the desire for change in response to changes in the business environment.
- ➢ Creation and clarification of the entity's vision.
- ➢ Creation of measurement indices for progress made towards achieving the corporate vision.

ii. Restructuring

- ➢ Review of existing organisation structure.
- ➢ Review of business model to identify sources of value creation.
- ➢ Process redesign/reengineering to achieve improved efficiency and effectiveness.
- ➢ Identification and removal of hindrances to the realisation of the organisation vision.

iii. Revitalising
  - ➢ Discovery of new products and markets that fit into the changing business environment.
  - ➢ Use of technologies to redefine the rules of the business.

iv. Renewal
  - ➢ Re-skilling of employees to support the change process.
  - ➢ Creation of compensation and reward system that promotes employee motivation and commitment to achieve the corporate vision. Also included here are employee's involvement and collective bargaining system that supports industrial harmony in a unionised business environment.

Examiner's report

This compulsory question tests in parts A, B and D, candidates' understanding of strategic management skills covering organisation structures, Mintzberg's organisational configurations and application of Gemini 4Rs model of change management. Part C of the question examines risks associated with change.
Virtually all the candidates attempted this question, but performance was below average.

Common pitfalls were:

- Inability of some candidates to identify suitable organisation structure for a group. Some included entrepreneurial structure, which is inappropriate for a group which is also a multinational. Many candidates were unable to evaluate each structure, as such, could not identify the most suitable;
- A sizeable number of candidates confused Mintzberg's building blocks with Mintzberg's organisational configurations; and
- Some candidates did not fully understand the Gemini 4Rs model.

It is recommended that candidates should master the skills of applying concepts to scenarios and exercise judgement in decision-making.

Marking guide

a.		Marks	Marks
i.	Mentioning of functional organisation structure		½
	Definition of functional organisation structure		1
	Suitability		1
	Advantages		½
	Disadvantage		½
	Mentioning of divisional organisation structure		½
	Definition		1
	Nature		1
	Advantages		½
	Disadvantages		½
	Mentioning of Matrix Structure		½

	Definition		1
	Nature		½
	Advantages		½
	Disadvantages		½
ii	Choice		**1**
	2 Reasons	½ each	1
b. i	4 Mintzberg organisational configuration	1 each	4
ii	Choice		1
	Suitability: 2 points	1 each	2
c.	5 categories of risk	1 each	5
d.	Gemini 4Rs	1½ each	6
	Total		**30**

SOLUTION 2

a. Nature of risk committees is explained as follow:

i. Might be a committee of the board of directors;
ii. Should be responsible for fulfilling the corporate governance obligations of the board to review the effectiveness of the system of risk management;
iii. Might be an inter-departmental committee responsible for identifying and monitoring specific aspects of risk, such as:

- Strategic/business risks;
- Operational risk (and internal controls);
- Financial risk;
- Compliance risk; and
- Environmental risk.

The roles of risk committees are to:

i. Oversee the risk management infrastructure;
ii. Address risk and strategy simultaneously, including consideration of risk appetite;
iii. Monitor risks;
iv. Oversee risk exposures;
v. Advise the board on risk strategy;
vi. Approve management risk committee charters;
vii. Oversee/support the Risk Officers;
viii. Identity risk; and
ix. Report on the effectiveness of risk management to the board or senior management.

b. **Elements of** ISO31000 are as follows:

   i. **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 Chief Executive Officer, business unit managers, individual employees, risk managers, specialist risk management functions and internal auditors;

   ii. **Risk strategy:** The risk strategy of the organisation should be specified, including the risk appetite of the board. There should be a risk management action plan and resources to support risk management activities; and

   iii. **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.

ISO 31000 uses the '7Rs and 4Ts' of risk management as a framework for the implementation of a risk management system

- Recognition/identification of risks
- Ranking or evaluation of risk
- Responding to significant risk
- Risk treatment:
- Tolerate: accept the exposure to risk
- Treat: take measures to control or eliminate the risk
- Transfer: transfer the risk to someone else
- Terminate: terminate the activity that gives rise to the risk
- Resourcing controls
- Reaction planning
- Reporting and monitoring risk performance
- Reviewing the risk management framework

Examiner's report

Part A of the question tests candidates' knowledge of the nature and role of risk committee while part B tests their understanding of the elements of ISO31000 risk management framework.

Most candidates attempted this question and performance was above average.
The few candidates who performed poorly in this question mistook the nature of risk for nature of risk committee or did not know the elements of ISO 31000 risk management framework.
Candidates are advised to fully cover the syllabus in their preparation for the examination.

Marking guide

		Marks	Marks
a	Nature of risk committee: 4 Points @1each	4	4
	Role of risk committee: 4 points @1each	4	4
			8
b	ISO31000 framework: 6 points @1each	6	
	7Rs and 4Ts: 12 points @½each	6	12
	Total		**20**

SOLUTION 3

a.

i. Corporate Social Responsibility is:

- A management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders;
- A self-regulatory business model that enables a corporation to be socially accountable to its stakeholders and the general public; and
- an obligation that business entities have to refrain from any activity that may be harmful to society or any of its sections as they strive to make or maximise profit.

ii. Shareholder Theory holds that:

- The responsibility of managers is to serve in the best interests of shareholders by using the resources of the corporation to increase the shareholders' wealth by maximising profits; and
- Management should engage in CSR only to the extent that it will enhance the best interest (profit) of shareholders.

Stakeholder Theory on the other hand holds that:

- Businesses have a primary responsibility to build relationships and create value for all its stakeholders; and
- Businesses have responsibilities to local communities, society and other stakeholder groups they must deliver on.

b. The following are aspects of CSR that a business organisation is expected to observe:

- Ethical Responsibility - A company should operate in ethical ways (honest, right, fair). It should have a well-defined code of ethical behaviour and insist that everyone in the company acts in accordance with the ethical guidelines in that code;
- Labour Responsibility - A company should treat its employees fairly and with respect. The fair treatment of employees can be assessed by the

company's employment policies, provision of good working conditions and training for employees;

- Legal Responsibility - A company should demonstrate respect for all legal requirements and basic human rights. For example, it should not tolerate child labour;
- Philanthropic/Social Responsibility - A company should be a responsible citizen in its community by investing in local communities by providing schools, recreational facilities, hospitals, etc. This can be an important aspect of CSR for companies that operate in under-developed countries or regions of the world;
- Economic Responsibility – A company should treat with great care any aspect related to the supply chain of the organisation, the management of customers, consumers or users and the socially responsible development of fiscal activity; and
- Environmental Responsibility - A company should do its best to sustain the environment for future generations. This could take the form of:
    - reducing pollution of the air, land or rivers and seas;
    - developing a sustainable business, whereby all the resources used by the company are replaced;
    - cutting down the use of non-renewable (and polluting) energy resources such as oil and coal and increasing the use of renewable energy sources (water, wind); and
    - re-cycling of waste materials.

e. The following steps should be taken by a company to implement a CSR policy:
- Identify its ethical values and publish these as a Code of Ethics;
- Establish the company's current position with regards to its CSR values and decide on the position it would like to attain in the future. The gap between the current and the target positions provides a basis for developing CSR strategies;
- Develop realistic targets and strategies for implementing its CSR policies;
- Key stakeholders in the company, whose views the company wishes to influence (employees, pressure groups, customers), should be identified;
- The company's CSR achievements should be communicated to the key stakeholders. This is the main purpose of CSR reporting; and
- The company's CSR achievements should be monitored, and actual achievements compared with (1) the targets and (2) the CSR achievements of similar companies (including business competitors).

Examiner's report

This question tests candidates' understanding of corporate social responsibility (CSR), stakeholder and shareholder theories of CSR, aspects of CSR and the process of implementing a CSR policy.

This question was very popular with the candidates. Many of them scored more than 50% of the marks. However, those who performed badly could not distinguish between stakeholder and shareholder theories of CSR.

Candidates are admonished to carefully study the theories underlying the various concepts under study.

Marking guide

		Marks
ai	Definition of 2 each corporate social responsibility: 1 point	2
ii	Meaning of 1 each Shareholder Theory: 1 point	1
	Meaning of 1 each Stakeholder Theory: 1 point	1
b	Aspects of CSR: 2 each 5 points	10
c	Steps for 1 each Implementing CSR policy: 6 points	6
	Total	**20**

SOLUTION 4

a. The following are Tucker's 5 questions and their application to the given scenario:

- **Is it Profitable?** From the given scenario, the project is profitable. It will also generate huge tax revenue for the government while providing the country with foreign exchange;
- **Is it Legal?** There are no indications that production, marketing or exporting of coffee is illegal. Also, even though there are unethical labour practices going on in Katanga, importing coffee beans from there is legal;
- **Is it fair?** Production of coffee is fair. Siting the production facility at Epe is fair. The effect it has on the economy is also positive. However, importing cocoa beans from a country that uses child labour seems unfair because it indirectly supports unfair labour practices. It also provides an impetus for the unfair labour practice to continue in Katanga;
- **Is it right?** It is right in that it will create jobs, provide revenue for government, and return on investment for the company. However, it is not right because it will encourage child labour in Katanga; and

- **Is it sustainable?** Yes, it is sustainable because it makes use of cutting-edge technology which is environmentally friendly.

From the above, one might say that the decision to buy coffee beans from Katanga and the approval by government seems unethical because Katanga makes use of forced child labour.

OR:

From another perspective, given the fact that Katanga provides the only available option of supply of coffee beans, it seems that it might be right for the company to get its supply from Katanga. In view of the other very positive impacts of the proposed business, other means may be sought to improve the labour issues involved in the production of coffee beans from Katanga. These positive impacts include the capacity to meet the coffee needs of the country and regular coffee demands of West and Central Africa, create one thousand direct and ten thousand indirect jobs, provide huge company and personal income tax revenue for the country and generate foreign exchange for the country.

b. The American Accounting Association (AAA) is a 7-step approach to ethical decision making. It seeks to answer 7 questions to determine the ethical value of a decision. The 7 questions are discussed below within the context of the given scenario:

- **What are the facts?** As shown in the scenario:
  - Government has approved the establishment of a coffee processing plant in the country by Nesquake;
  - The plant will increase government revenue through company and personal income taxes and generate both jobs and foreign exchange while meeting domestic coffee demand;
  - The company plans to use eco-friendly cutting-edge technology in its production process;
  - Coffee beans will be sourced from Katanga, a country known for using child labour in its coffee fields;
  - As the only available option, the company intends to import 100% of the coffee beans from Katanga;
  - Amnesty International called for the boycott of Katanga's coffee beans due to what has been adjudged unethical and inhuman labour practices;
  - The plant will be the biggest in Sub-Saharan Africa; and
  - The plant will provide one thousand direct and ten thousand indirect jobs.

- **What are the ethical issues?** The ethical issues are:
  - Should government approve the siting of the plant in the country given the fact that a needed input will be a product of child labour, a practice that is globally believed to be unethical?

- Should the government and Nesquake boycott Katanga's coffee beans as demanded by Amnesty International?

- **What moral principles or values are relevant to the decision?**
  Relevant moral principles include respect for human dignity, right to health, education and protection from work that is hazardous or exploitative (inhuman labour practices).

- **What are the alternative courses of action for the decision maker?**
  There is no alternative since the scenario states that Katanga provides "the only available option".

- **Which course of action (or courses of action) seems best, because it is consistent with the moral principles and values identified in Step 3?**
  - Seek means to discourage the use of unfair child labour in the production of coffee beans
  - Nesquake does not engage in the production of coffee, going by the scenario.
  - **What are the consequences of each alternative course of action?**
    - Cost of coffee beans will likely rise.
    - Loss of job opportunities, revenue, tax and foreign exchange.

- **What is the decision?**
  From the above, one might say that the decision to buy coffee beans from Katanga which employs forced and child labour made the approval by government seems unethical.

  OR:

  From another perspective, given the fact that Katanga provides the only available option of supply of coffee beans, it seems that it might be right for the company to get its supply from Katanga. In view of the other very positive impacts of the proposed business, other means may be sought to improve the labour issues involved in the production of coffee beans from Katanga. These positive impacts include the capacity to meet the coffee needs of the country and regular coffee demands of West and Central Africa, create one thousand direct and ten thousand indirect jobs, provide huge company and personal income tax revenue for the country and generate foreign exchange for the country.

Examiner's report

This question tests candidates' knowledge of practical application of Tucker's 5 Questions model and American Accounting Association (AAA) model to a given scenario.

Most candidates attempted this question. Performance was however, just average.

Most candidates understood the two models well, but some could not apply them to the given scenario to make ethical decisions. Valuable marks were also lost because many candidates failed to apply their professional judgements to reach a conclusion on the project.

Candidates at this level of the examination should expect questions that will require them to express opinions based on their professional judgements and be ready to defend such positions.

Marking guide

		Marks	Marks
a	Tucker 5 questions: 5 points @ $1^1/_2$ each	$7^1/_2$	
	Conclusion: 1 point @$2^1/_2$ each	$2^1/_2$	
			10
b	AAA Model: 6 points @ $1^1/_2$ each	9	
	Decision: 1 point @1 each	1	
			10
	Total		**20**

SOLUTION 5

a. i. Risk management can be defined as

- the process of identifying, evaluating, prioritising, coordinating and applying resources to minimise and control the probability of the occurrence of a risk.
- the process by which executive management, under board supervision, identifies the risk arising from business and establishes the priorities for control and particular objectives

ii. Risk mapping involves taking identified risks and placing them in a map. The map is a 2x2 matrix with:

- One side representing the frequency of an adverse event or the probability that the risk will materialise, and an adverse outcome will occur; and
- The other side representing the losses if adverse events occur, or adverse circumstances arise

The following is a format for a simple risk map

Impact/size of potential loss	Low Probability/Frequency	High Probability/Frequency
High Impact	**High Impact** **Low Probability** *Consider the need for control measures such as insurance*	**High Impact** **High Probability** *Consider immediate action to control risk*
Low Impact	**Low Impact** **Low Probability** *Review Periodically*	**Low Impact** **High Probability** *Consider the need for controlled action*

Probability or frequency of the risk

Risk mapping is a tool used by the management of a company to identify risks that require immediate control measures and areas where review of such measures is needed.

b. i. Board of directors of companies perform oversight role in risk management. They do not get involved in the day-to-day management of risks. Their oversight roles include:

i. Developing policies and procedures around risks that are consistent with the organisation's strategy and risk appetite.
ii. Following up on management's implementation of risk management policies and procedures.
iii. Ensuring that risk management policies and procedures function as they are intended.
iv. Taking steps to foster risk awareness.
v. Encouraging an organisational culture of risk adjusting awareness.
vi. Periodically reviewing the effectiveness of internal control including effectiveness of risk management policies.
vii. Reporting to shareholders on its review of internal controls.

ii. Risk committee might be interdepartmental committees responsible for identifying and monitoring specific kinds of risks.

OR

Board risk committees are made up of mostly board members formed to assist the board in its oversight function of risk management.

According to Delloitte, the roles of board risk committees include to:

- Oversee risk management infrastructure;
- Address risk and strategy simultaneously, including consideration of risk appetite;
- Monitor risks;
- Oversee risk exposures;
- Advise the board on risk strategy;
- Approve management risk committee charters.

Examiner's report

This question tests candidates' knowledge of risk management, the process and use of risk mapping, and evaluation of the roles of board of directors and risk committees in risk management.

More than 60% of the candidates attempted this question. Performance was above average.

The candidates who performed poorly did not understand the use of risk mapping or confused the roles of the board of directors in risk management with those of risk committees. Some could not distinguish between board and management risk committees.

Candidates are advised to take serious interest in risk management, as it is an important component of strategic management.

Marking guide

			Marks	Marks
a.	i.	Definition of risk management: 2 each@ 1 point	2	
				2
b		Definition of risk map: 1 each@ 1 point	1	
	i.	Diagram	2	
		Use of risk map: 1 each @1 Point	<u>1</u>	
	ii.	Role of board of directors: 1 each @4 points	4	
		Role of board risk committees: 1 each @5 points	<u>5</u>	
				9
		Total		**<u>15</u>**

QUESTION 6

a. Meaning and characteristics of Emotional Intelligence

- Emotional intelligence can be described as the ability to grasp and reason correctly with emotional abstractions (emotional concepts) and solve emotional problems.
- Emotional intelligence is conceptualized as a set of abilities pertaining to emotions.
- Emotional intelligence is a form of social intelligence that involves the ability to monitor one's own and other's feelings and emotions, to discriminate among them, and use this information to guide one's thinking and action.
- It is the ability to perceive and express emotion, assimilate emotion in thought, understand and reason with emotion and regulate emotion in the self and others.
- Emotional intelligence also reflects abilities to join intelligence, empathy and emotions to enhance thought and understanding of interpersonal dynamics.
- Within the context of marketing exchanges, EI is the ability to use emotions to facilitate interactions with customers and, by extension, the ability to acquire and apply knowledge from one's emotions and those of others to produce beneficial outcomes.

Characteristics are:

i. Self–awareness: consists in understanding and having firm control over one's own emotions. They are aware of their own strengths and weaknesses;
ii. Self-regulation: this refers to the ability to control one's emotions. They are comfortable with change and do not act before thinking;
iii. Motivation: capacity for long-term focus and determination to achieve set goals;
iv. Empathy: the ability to understand the needs, viewpoints, and wants of others even when these feelings are concealed; and
v. Social skills: ability to work effectively in teams and give adequate consideration to the interests of others.

b. Uses of Emotional Intelligence (EI)

These include:

i. Interpersonal relationship: There is a correlation between EI and the development of positive interpersonal relationship. The former facilitates and promotes the latter;
ii. Job performance: Findings show that EI promotes staff motivation and job performance;
iii. Better working environment: individuals (from interns to managers) with higher EI are better equipped to work cohesively within teams, deal with

change more effectively, and manage stress – thus enabling them to efficiently pursue business objectives;

iv. Leadership: EI plays a positive role in leadership effectiveness;

v. Physical and mental health: Studies have shown that people with higher emotional intelligence enjoy better physical and mental health;

vi. Enhancing business success: the ability to understand and manage emotions is crucial to realizing one's true potential in business. Goleman described EI as being powerful and, at times, more powerful than IQ in predicting success in life. Developing EI can greatly influence our success by contributing to increased morale, motivation and greater co-operation;

vii. Team spirit and bonding: Those who exhibit higher levels of EI also have a greater propensity for empathic perspectives, cooperation with others, developing affectionate and more satisfying relationships as well as greater social skills in general; and

viii. Improved communication: The process of successful communication, especially in conflict situations and successful negotiation, is closely linked to high levels of EI. The ability to identify, manage, and understand emotions help us communicate without resorting to confrontation. A person with high EI is better equipped to manage conflict and build meaningful relationships given their elevated capacity to understand, and therefore address, the needs of those with whom they engage.

Examiner's report

This question tests candidates' knowledge of the meaning, characteristics and uses of Emotional Intelligence using the Mixed Model.

Most candidates did not attempt this basic question. Performance was poor.

Only a few candidates knew the uses of emotional intelligence as a soft skill.

Soft skills were introduced into the syllabus in the last one year. It is obvious that most candidates did not cover this area of the syllabus. Soft skills are essential requirements for future-ready chartered accountants, so all candidates enjoined to fully cover this area of the syllabus.

Marking guide

		Marks	Marks
a.	Meaning of Emotional Intelligence: 1 point		3
	Characteristics of Emotional Intelligence: 3 points @ 2 each	6	
b.	Uses of Emotional Intelligence: 4 points @$1^1/_2$	6	
			12
	Total		**15**

SOLUTION 7

ai. A corporate code of ethics is a code of ethical behaviour, issued by the board of directors of a company. It is a formal written statement which should be distributed or made easily available to all employees. The decisions and actions of all employees in the company must be guided by the code.

ii. The purpose of corporate code of ethics are:

- Managing for compliance: To ensure that all concerned comply with relevant laws and regulations and conduct themselves in ways that the public expects. For example, companies providing services to the public need to ensure that their representatives are polite and well-behaved in their dealings with customers; and
- Managing stakeholder relations: A code of ethics can help to improve and develop the relations between the company and its stakeholders by improving the trust that stakeholders have in the company. The code might therefore include the ethical stance of the company on disclosing information (openness and transparency) to stakeholders and the investing public and on respecting the rights of stakeholders.

b. **Contents of corporate code of ethics (in outline form)**

It should contain:

- General statement(s) about ethical conduct by employees (and other internal stakeholders);
- Specific reference to the company's dealing with each stakeholder group e.g.

❖ Employee
- Recognition of human rights
- Equal opportunities for all employees
- Non tolerance of harassment of employees
- Concern for health and safely of employees
- Respect for privacy of confidential information
- Entertainment

- ❖ Customers
  - Fair dealing with customers
  - Product safety/quality
  - Truthfulness of advertisement
  - Respect for privacy of confidential information

- ❖ Competitor
  - Fair dealing the competitors
  - Attitude to industrial spying

- ❖ Shareholders
  - Maintenance of trust and confidence or shareholders
  - Disclosure of information i.e. openness and transparency

- Elements of general statement(s):
- Specification of needs to comply with local laws
- Need to comply with policies and procedures of the company otherwise it may lead to disciplinary action
- Overview of business conduct to maintain the company's reputation and (good name)
- Other statement on:
  - Commitment to integrity
  - Protection of the environment
  - Pursuit of excellence and respect for the individual

Examiner's report

This question tests candidates' knowledge of Corporate Code of Ethics; its purpose and contents.

Most candidates attempted this question, but less than half of them scored more than 50% of the marks.

The common pitfalls were the inability to articulate the purpose and clearly explain the contents of Corporate Code of Ethics.

Candidates are advised to procure and study publications such as Corporate Codes of Ethics published by ethically conscious organisations, especially, listed companies. They will equip them with vital information that will be useful in the examination.

Marking guide

		Marks	Marks
ai.	Meaning of a Corporate Code of Ethics: @1 point		1
ii	Purpose of Corporate Code of Ethics: @2 points	4	
	Contents of Corporate Code of Ethics: 10 points	10	
			14
	Total		**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2021

TAXATION

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Miss Opeyemi Olunba is a young engineer who has been working in an oil sector for over 5 years. She currently earns a gross salary of ₦10,000,000 per annum. She recently attended two interviews for a new job at Joke Oil & Gas in Rivers State and Dabiri Hotels & Suite in Lagos State.

She has been called by the two companies to assume office on April 1, 2021. The following salaries and allowances were offered by the two companies:

Joke Oil & Gas:

	₦
Basic salary	50,000,000
Housing allowance	20,000,000
Transport allowance	2,000,000
Utility allowance	800,000
Meal allowance	500,000
Leave allowance	5,800,000
Clothing allowance	2,000,000
Official car	10,000,000
	91,100,000

Dabiri Hotels & Suite:

	₦
Basic salary	55,000,000
Transport allowance	10,000,000
Utility allowance	2,000,000
Meal allowance	5,000,000
Leave allowance	5,000,000
Clothing allowance	4,100,000
Official car	10,000,000
	91,100,000

Additional information:

(i) Miss Opeyemi currently lives in her apartment in Lagos State. If she accepts the offer of Joke Oil & Gas, she will rent out the apartment for ₦20,000,000 per annum, although she will need to carry out some modifications of the house. She intends to borrow ₦12,000,000 from ABC Bank at an annual interest rate of 20%, for the modification of the premises. The loan repayment will start with effect from August 1, 2021.

(ii) If she accepts this offer, she will pay rent of ₦5,000,000 in Port Harcourt.

(iii) She has a child who is a student at St. John University.

(iv) She maintains her parents.

(v) She pays life assurance premium of ₦5,000,000 per year on herself.

(vi) Her employers will deduct and remit on her behalf:

Contribution to national housing fund	₦5,000,000
Contribution to pension fund	₦3,000,000

(vii) She pays national health insurance premium of ₦1,000,000 on herself.

Miss Opeyemi has approached you as a tax consultant to advise her on which of the offers to accept with the aim of achieving a higher income after tax.

Required:

a. Compute personal income tax liability of Miss Opeyemi for the relevant year of assessment. (25 Marks)

b. Advise Miss Opeyemi on the employment that will enable her to achieve a higher income after tax. (5 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

XYZ Limited was incorporated on August 31, 2012, and it commenced business on May 31, 2013. Diki (Malaysia) Limited is its subsidiary in Malaysia. An extract of the financial statements of XYZ Limited for the year ended December 31, 2020, revealed the following:

	₦
Assessable profit	2,000,000
Interests and depreciation deducted before arriving at the assessable profit of ₦2,000,000 are as follows:	
Interest on loan paid to:	
- Diki(Malaysia) Limited	1,050,000
- Other creditors	1,000,000
Depreciation	400,000

Based on the information provided by the company, it was discovered that out of the loan paid to other creditors, ₦450,000 was in respect of a loan obtained to generate tax-exempt profits.

The Managing Director of XYZ Limited approached you as the tax consultant to explain the provision of section 24 of CITA 2004 (as amended) and the Seventh Schedule in respect of the interest deductible by a Nigerian Company.

Required:

a. Compute the interest deductible in the relevant assessment year. (16 Marks)

b. Explain how the excess interest not deducted in the relevant assessment year would be treated. (4 Marks)

(Total 20 Marks)

QUESTION 3

The advent of the VAT concept in the twenty first century brought about a global acceptance by many countries. This was due largely to the ease of administration and high collection yield.

VAT as a consumption tax is a multi-stage levy collected at every stage of production, sale of goods and rendition of services.

The Finance Act 2019 also stipulates the offences and penalties associated with VAT.

Adegboyega Enterprise is a manufacturing outfit based in Jankara, Lagos State. In 2020, the company sold its vatable product, to a wholesaler, Ikeja Venture for ₦3,500,000. The wholesaler sold the products to a retailer, Mrs. Adeosun, for ₦4,900,000, who finally sold it to consumers for ₦6,300,000 (VAT inclusive).

Assume there was no closing inventory at each stage of the transaction.

Required:

a. Compute total VAT payable to Federal Inland Revenue Service by Adegboyega Enterprises on the transactions stated above. (9 Marks)

b. Explain the penalties associated with the following:
   i. Failure to register for VAT return (2 Marks)
   ii. Failure to notify the FIRS of change of address, or cessation of trade or business. (2 Marks)
   iii. Failure to submit VAT returns (2 Marks)

c. Explain the merits and demerits of VAT. (5 Marks)

(Total 20 Marks)

QUESTION 4

Ajani-Ogun Ventures Limited was incorporated on February 1, 2012 and commenced business on September 1, 2013. The company makes up accounts to August 31, every year. The following additional information is provided:

	₦
(i) Adjusted (loss)/profit for:	
Year ended August 31, 2017	(95,000)
Year ended August 31, 2018	55,000
Year ended August 31, 2019	35,000
Year ended August 31, 2020	65,000

(ii) Capital allowances for each year of assessment are as given below:

	₦
2018	6,500
2019	5,000
2020	4,200
2021	4,000

The Finance Director was worried that the tax officials would soon conduct a tax audit of their financial transactions and he wanted to know the tax liabilities payable to the Federal Inland Revenue Service for the relevant assessment years.

During the year ended August 31, 2020, the company achieved a revenue of ₦20,000,000.

Required:

a. Compute the income tax for 2018 to 2021 years of assessment taking into consideration the provisions of the Finance Act, 2019. (ignore minimum tax computation). (15 Marks)

b. Explain **FIVE** rules governing loss relief for companies. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

The Companies Income Tax Act Cap C21 LFN 2004 (as amended) empowers the Federal Inland Revenue Service to assess the income of corporate organisations.

Corporate organisations are required to file tax returns within a specified period of time to the relevant tax authority.

Required:

a. Explain the documents/information required to be forwarded to the relevant tax authority when registering with the nearest integrated tax office. (5 Marks)

b. State the time lag for filing the first set of returns and subsequent ones. (5 Marks)

c. State the penalty for late filing of tax returns on the due dates. (5 Marks)

(Total 15 Marks)

QUESTION 6

Taxable supplies of goods and services are those listed under the First Schedule of the Value Added Tax Act Cap VI for 2004 (as amended). Essentially, these are goods and services liable to value added tax at the prescribed rate.

Required:

Explain when goods and services shall be deemed to be supplied in Nigeria in accordance with section 2 of VAT Act (as amended). **(Total 15 Marks)**

QUESTION 7

Tago Nigeria Limited was incorporated in 2009 as a trading company. It supplies office furniture, equipment and other office materials to end users.

Due to the favourable business climate in recent years, the company achieved a gross turnover of ₦120,000,000 in 2020. The directors were impressed by the profits posted by the company, hence the decision to computerise the accounting system of the company.

You were appointed the tax consultant to the company in 2018. You are aware that in 2006, the Federal Inland Revenue Service (FIRS) deployed the first tax portal (Webportal) to automate and streamline taxpayer's registration and other tax administration system (ITAS) known as SIGTAS. This was implemented though its deployment was stalled.

Following the enactment of the Finance Act, 2020, the Federal Inland Revenue Service is empowered to automate filing of tax returns and payment processes.

You attended a seminar organised by the Federal Inland Revenue Service in June 2021, to inform tax consultants of the adoption of a locally developed tax management solution known as TAXPRO MAX. The FIRS insisted that manual filings of tax returns would no longer be allowed.

At a meeting held with the Managing Director of Tago Nigeria Limited, you intimated him of the tax development. He was worried that there could be a delay in filing of tax returns for the year ended December 31, 2020, more so when taxpayers are yet to be fully aware of this new development.

Required:
Explain to the management **FIVE** different aspects of tax administration that the tax management solution known as TAXPRO MAX can handle.

(Total 15 Marks)

NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

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

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

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

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

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

4. COMPANIES INCOME TAX RATE 30%
5. TERTIARY EDUCATION TAX (2% of Assessable Profit)
6. CAPITAL GAINS TAX 10%
7. VALUE ADDED TAX 7.5%

SOLUTION 1

(a) Miss Opeyemi

Computation of personal income tax for 2021 assessment year

Employment with Joke Oil and Gas (1/4/21-31/12/21)

	₦'000	₦'000
Basic salary ($^9/_{12}$ x ₦50,000,000) 1/4/21 – 31/12/21		37,500
Housing allowance ($^9/_{12}$ x ₦20,000,000)		15,000
Transport allowance ($^9/_{12}$ x ₦2,000,000)		1,500
Utility allowance ($^9/_{12}$ x ₦800,000)		600
Meal allowance ($^9/_{12}$ x ₦500,000)		375
Leave allowance ($^9/_{12}$ x ₦5,800,000)		4,350
Clothing allowance ($^9/_{12}$ x ₦2,000,000)		1,500
		60,825
Benefits-in-kind (BIK)		
Car ($^9/_{12}$ x 5% x ₦10,000,000)		375
		61,200
Gross salary from former employment (1/1/21-31/3/21) ($^3/_{12}$ x ₦10,000,000)		2,500
		63,700
Unearned income:		
Rental income ($^9/_{12}$ x ₦20,000,000)	15,000	
Deduct: Interest on loan (20% of ₦12,000,000 x $^5/_{12}$)	1,000	14,000
Total income		77,700
Tax exempt items:		
Life assurance premium	5,000	
Contributions to national housing fund	5,000	
Contributions to pension fund	3,000	
Contributions to nation health insurance scheme	1,000	(14,000)
Gross income		63,700
Consolidated relief allowance		
1% of ₦63,700,000 +20% of ₦63,700,000		(13,377)
Chargeable income		50,323

Computation of personal income tax (PIT) payable

	₦
First ₦300,000 @ 7%	21,000
Next ₦300,000 @ 11%	33,000
Next ₦500,000 @ 15%	75,000
Next ₦500,000 x 19%	95,000
Next ₦1,600,000 x 21%	336,000
Next ₦47,123,000 @ 24%	11,309,520
₦50,323,000	
PIT payable	11,869,520

Employment with Dabiri Hotel and Suites (1/4/2021-31/12/2021)

	₦'000	₦'000
Basic salary ($^9/_{12}$ x ₦55,000,000)		41,250
Transport allowance ($^9/_{12}$ x ₦10,000,000)		7,500
Utility allowance ($^9/_{12}$ x ₦2,000,000)		1,500
Meal allowance ($^9/_{12}$ x ₦5,000,000)		3,750
Leave allowance (($^9/_{12}$ x ₦5,000,000)		3,750
Clothing allowance ($^9/_{12}$ x ₦ 4,100,000)		3,075
		60,825
Benefits-in-kind (BIK)		
Car (5% x ₦10,000,000 x $^9/_{12}$)		375
		61,200
Gross salary from former employment(1/1/21-31/3/21) ($^3/_{12}$ x ₦ 10,000,000)		2,500
Total income		63,700
Tax exempt items:		
Contributions to life insurance premium	5,000	
Contributions to national housing fund	5,000	
Contributions to pension fund	3,000	
Contributions to national health insurance scheme	1,000	(14,000)
Gross income		49,700
Consolidated relief allowance:		
(1% of ₦49,700,000 + 20% of ₦49,700,000)		(10,437)
Chargeable income		39,263

Computation of personal income tax payable

			₦
First	₦300,000	@ 7%	21,000
Next	₦300,000	@ 11%	33,000
Next	₦500,000	@ 15%	75,000
Next	₦500,000	@ 19%	95,000
Next	₦1,600,000	@ 21%	336,000
Above	₦36,063,000	@ 24%	8,655,120
	₦39,263,000		
PIT payable			9,215,120

(b) The results as computed have revealed the following:

	Joke Oil & Gas ₦	Dabiri Hotel and Suites ₦
Total income	77,700,000	63,700,000
PIT payable	(11,869,520)	(9,215,120)
	65,830,480	54,484,880
Rent to be paid in PH	(5,000,000)	-
Net income	60,830,480	54,484,880

Arising from the above, Miss Opeyemi is advised to accept the offer from Joke Oil and Gas which has a higher net income of ₦60,830,480.

Examiner's report

The question tests candidates' knowledge of the taxation of employment income, taking into consideration the relevant provisions of Finance Acts 2019 and 2020.

This being a compulsory question, all the candidates attempted the question. The performance of the candidates was fair.

The common pitfalls of the candidates were their inability to prorate the basic salary and allowances, and benefits-in-kind of the taxpayer, taking into consideration the relevant dates of employment of the former and new employments. Additionally, some of the candidates could not compute the consolidated relief allowance correctly, in line with the provisions of the Finance Acts 2019 and 2020.

Candidates are advised to read the Institute's Pathfinder and Study Text, and cultivate the habit of solving taxation questions/problems before sitting for subsequent examinations to enhance better performance.

Marking guide

		Marks	Marks
1(a)	Computation of personal income tax		
	Heading:		
	- Name	¼	
	- Computation for relevant assessment year	¼	
	<u>Joke Oil and Gas</u>		
	(i) Earned income (9 ticks @ ½ mark each)	4½	
	(ii) Unearned income (3 ticks @ ½ mark each)	1½	
	(iii) Tax exempt items (5 ticks @ ½ mark each)	2½	
	(iv) Consolidated relief allowance	½	
	(v) Computation of personal income tax payable (6 ticks @ ½ mark each)	3	
	<u>Dabiri Hotel and Suites</u>		
	(i) Earned income (9 ticks @ ½ mark each)	4½	
	(ii) Tax exempt items (5 ticks @ ½ mark each)	2½	
	(iii) Gross income	½	
	(iv) Consolidated relief allowance	½	
	(v) Chargeable income	½	
	(vi) Computation of personal income tax payable (6 ticks @ ½ mark each)	3	

	(vii) PIT payable	1	25
1b	Advice on the employment		
	(i) Heading:		
	Joke oil & Gas	½	
	Dabiri Hotel & Suites	½	
	(ii) Total income (2 ticks @ ½ mark each)	1	
	(iii)PIT payable (2 ticks @ ½ mark each)	1	
	(iv) Rent to be paid in PH	1	
	(v) Advice on the offer	1	5
Total			30

SOLUTION 2

a. XYZ Limited
Computation of interest deductible in 2021 assessment year

	₦	₦
Assessable profit		2,000,000
Add:		
Interests deducted : Diki (Malaysia) Ltd	1,050,000	
: Other creditors	1,000,000	
Depreciation	400,000	2,450,000
Earnings before interest, taxes, depreciation and amortisation (EBITDA)		4,450,000
Interest deducted before restriction:		
Interest paid to Diki (Malaysia) limited		1,050,000
Interest paid to other creditors		1,000,000
Total interest expenses		2,050,000
Interest for tax exempt profits		(450,000)
Interest qualifying for deduction		1,600,000
Restriction:		
30% of EBITDA (30% of ₦4,450,000)	=	1,335,000

Amount of interest deductible in 2021 assessment year is the lower of:

(i) 30% of EBITDA (₦4,450,000)	=	₦1,335,000
		or
(ii) Interest qualifying for deduction	=	₦1,600,000

The interest deductible is ₦1,335,000

b. **Treatment of excess interest not deducted in the relevant assessment year**

The excess interest of ₦1,600,000 less ₦1,335,000 which is ₦265,000, will be carried forward and added to the interest expense for that year with a view to computing its restriction.

It should be noted that the excess interest of ₦265,000, may only be carried forward for a period not exceeding five years, that is, 2026 assessment year, whilst applying for each of the years, the same rule based on which the excess interest expenditure was first computed.

Examiner's report

The question tests candidates' knowledge of interest deductible in arriving at the adjusted profit of a limited liability company.

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

The common pitfalls of the candidates were their inability to compute interest to be deducted in arriving at the adjusted profit and explain how the excess interest not deducted would be treated in subsequent years, in line with the provisions of the Finance Act 2019.

Candidates are advised to pay attention to the amendments to tax laws and effects on tax computations in their preparations for future examinations.

Marking guide

			Marks	**Marks**
2a	**Computation of interest deductible:**			
	(i)	Heading:		
		- Name	½	
		- Computation for relevant assessment year	½	
	(ii)	Assessable profit	1	
	(iii)	Add backs (3 ticks @ 1 mark each)	3	
	(iv)	Earnings before Interest, taxes, depreciation & Amortisation	1	
	(v)	Interest deducted before restriction (2 ticks @ 1 mark each)	2	
	(vi)	Interest for tax exempt profits	1	
	(vii)	Interest qualifying for deduction	1	
	(viii)	Restriction		
		- 30% of EBITDA	1	
		- Amount of interest deductible in 2021 assessment year	2	
		- Interest qualifying for deduction	2	
	(ix)	Interest deductible	1	16

2b	**Treatment of excess interest not deducted:**		
	(i) Excess interest to be carried forward	2	
	(ii) Carry forward period of 5 years	2	4
	Total		**20**

SOLUTION 3

(a) **Adegboyega Enterprise**
Computation of VAT payable to FIRS

Stage	**Computation**	₦	**VAT payable** ₦
(i)	Manufacturer: sales value	3,500,000	
	Gross VAT @ 7.5%	262,500	
	Net VAT		262,500
(ii)	Wholesaler: sales value	4,900,000	
	Gross VAT @ 7.5%	367,500	
	Net VAT (₦367,500 – ₦262,500)		105,000
(iii)	Retailer: sales value (VAT inclusive)	6,300,000	
	Gross VAT ($\frac{0.075}{1.075}$ x ₦6,300,000)	439,535	
	Net Vat (₦439,535 – ₦367,500)		72,035
Total VAT payable to FIRS			439,535

(b) i. **Failure to register for VAT-** Section 8 of VAT Act (as amended)

A taxable person who fails to register for VAT, is guilty of an offence and liable on conviction to a penalty of ₦50,000 for the first month in which the failure occurs and ₦25,000 for each subsequent month in which the failure continues.

ii. Failure to notify change of address or permanent cessation of trade or business (section 28 of VAT Act)
A person who fails to notify the FIRS of the change of address, is guilty of an offence and liable to pay a penalty of ₦50,000 for the first month in which the failure occurs and ₦25,000 for each subsequent month in which the failure continues.

iii. **Failure to submit VAT returns – section 35 VAT Act (as amended)**
A taxable person, who fails to submit VAT returns to the FIRS, is liable to a penalty of ₦50,000 for the first month in which failure occurs and ₦25,000 for every subsequent month in which the failure continues.

(c) **Merits and demerits of VAT**

(i) **Merits**

These include:

(i) Reliable source of government revenue;
(ii) It eliminates the narrow scope and cascading effect of the repealed sales tax;
(iii) It is a consumption tax, hence very easy to collect;
(iv) Fairness is established because consumers pay the tax in line with their
consumption of goods and services received; and
(v) It can be used as a tool of fiscal policy. Items can be exempted and tax
rate can be changed to achieve specific economic objective.

(ii) **Demerits**

These include:

(i) High administrative cost on the part of the government;
(ii) High cost of keeping records by the companies/agents;
(iii) Injustice in the distribution of the VAT proceeds;
(iv) Corruption on the part of tax officials can render VAT ineffective; and
(v) Problem of inadequate information can make VAT administration ineffective.

Examiner's report

The question tests candidates' knowledge of the computation of VAT payable by taxable persons to the Federal Inland Revenue Service (FIRS), penalties associated with late VAT filings and notifications, and merits and demerits of VAT.

About 90% of the candidates attempted the question and the performance was average.

The commonest pitfall of the candidates was their inability to explain penalties relating to late VAT filings.

Candidates are advised to familiarise themselves with the provisions of VAT Act 2004 (as amended).

Marking guide

		Marks	Marks
3.			
a.	**Computation of VAT payable:**		
	(i) Heading:		
	Name	½	
	Computation of VAT Payable	½	
	(ii) Manufacturer:		
	- Sales value	½	
	- Gross VAT	1	
	- Net VAT	1	
	(iii) Wholesaler:		
	- Sales value	½	
	- Gross VAT	1	
	- Net VAT	1	
	(iv) Retailer:		
	- Sales value	1	
	- Gross VAT	1	
	- Net VAT	1	9
b.	**Explanation of penalties payable:**		
	(i) Failure to register for VAT:		
	- The penalty is ₦50,000 for the first month	1	
	- ₦25,000 for each subsequent month	1	
	(ii) Failure to notify change of address:		
	- The penalty is ₦50,000 for the first month	1	
	- ₦25,000 for each subsequent month	1	
	(iii) Failure to submit VAT returns:		
	- The penalty is ₦50,000 for the first month	1	
	- ₦25,000 for each subsequent month	1	6
c.	**Explanation on merits and demerits of VAT:**		
	- Merits of VAT (3 ticks @ 1 mark each for any 3 points)	3	
	- Demerits of VAT (2 ticks @ 1 mark each for any 2 points)	2	5
Total			**20**

SOLUTION 4

(a) Ajani Ogun Enterprises

Computation of income tax payable for 2018 – 2021 assessment years

YOA	**Basis period**			**Assessable profit/loss**
2018	1/9/2016 – 31/8/2017	₦	₦	₦
	Adjusted loss			(95,000)
	Unrelieved loss c/f			(95,000)
	Capital allowance for the year		6,500	
	Capital allowance utilized		-	
	Unutilized capital allowance c/f		6,500	
	Total profit			Nil
	Companies income tax@30% of total profit			Nil
	Tertiary education tax @ 2% of assessable profit			Nil
2019	1/9/17 – 31/8/18			
	Adjusted profit			55,000
	Unrelieved loss b/f		95,000	
	Relieved loss for the year		(55,000)	(55,000)
	Unrelieved loss c/f		(40,000)	
	Capital allowance for the year:	5,000		
	Unutilized C/A b/f	6,500		
		11,500		
	Capital allowance utilised	-		
	Unutilized C/A c/f	11,500		
	Total profit			Nil
	Companies income tax @ 30% of total profit			Nil
	Tertiary education tax @2% of assessable profit			1,100
2020	1/9/18 – 31/8/19			
	Adjusted profit			35,000

	₦	₦	₦
Unrelieved loss b/f		40,000	
Relieved loss for the year		(35,000)	(35,000)
Unrelieved loss c/f		(5,000)	
Capital allowances for the year	4,200		
Unutilized C/A b/f	11,500		
Unutilized C/A c/f	15,700		
Total profit			Nil
Companies income tax @ 30% of total profit			Nil
Tertiary education tax @ 2% of assessable profit			700

2021	1/9/19 – 31/8/20			
	Adjusted profit			65,000
	Unrelieved loss b/f		(5,000)	
	Relieved loss for the year		5,000	(5,000)
	Unrelieved loss c/f		Nil	
				60,000
	Capital allowance for the year	4,000		
	Unutilised capital allowance b/f	15,700		
		19,700		
	Utilized capital allowance for the year	(19,700)		(19,700)
	Unutilized C/A c/f	Nil		
	Total profit			40,300

Given the fact that the company did not achieve a turnover of ₦25,000,000 during the year, it will not pay companies income tax and tertiary education tax.

b. **Rules on loss relief**

The following points are to be noted in the application of the rules on loss relief for companies:

i. Trading loss to be deducted from assessable profits of an assessment year, shall not exceed the actual loss incurred by the company in the previous assessment years.
ii. Losses are not aggregated with assessable profits in the computation of a company's total profits, in strict compliance with the provision of Section 31 (1) of CITA. Consequently, a trading loss from one of the company's sources of profits cannot be set-off against profits from another source. A loss incurred from a particular line of business can only be relieved in future

years from assessable profits derived from the same source or line of business;

iii. When losses incurred in two different assessment years are being carried forward against future profits, the first loss incurred will be relieved in priority to the subsequent loss;

iv. When trade ceases, any terminal loss resulting there from which could not be relieved in the year of cessation due to insufficiency or non-availability of profit, is deemed lost;

v. There is no provision under the Nigerian tax system for carry-back of terminal loss;

vi. A claim for relief of losses takes precedence over claim for capital allowances; and

vii. It is granted automatically to all taxpayers, that is, there is no need for a written application by the taxpayer.

Examiner's report

The question tests candidates' knowledge of the computations of companies income tax, tertiary education tax and the rules governing loss reliefs for companies.

More than 90% of the candidates attempted the question. Candidates demonstrated a poor understanding of the question, hence the performance was poor.

The commonest pitfall was the inability of the candidates to explain the rules governing loss relief.

Candidates are advised to read ICAN Study Text and Pathfinder when preparing for subsequent examinations to ensure better performance in future.

Marking guide

		Marks	Marks
4(a)	Computation of income tax for 2018 to 2021 assessment years		
	(i) Heading		
	Name	¼	
	Computation of relevant assessment year	¼	
	(ii) 2018		
	- Adjusted loss	½	
	- Unrelieved loss c/f	1	
	- Capital allowances for the year	1	
	- Companies income tax @ 30% of total profit	½	
	- Tertiary education tax @ 2% of assessable profit	½	
	-		

	(iii) 2019		
	- Adjusted profit	½	
	- Unrelieved loss b/f	½	
	- Relieve loss for the year	½	
	- Capital allowances for the year	½	
	- Unutilised capital allowances b/f	½	
	- Companies income tax	½	
	- Tertiary education tax	½	
	(iv) 2020		
	- Adjusted profit	½	
	- Unrelieved loss b/f	½	
	- Relieved loss for the year	½	
	- Capital allowances for the year	½	
	- Unutilised capital allowances b/f	½	
	- Companies income tax	½	
	- Tertiary education tax	½	
	(v) 2021		
	- Adjusted profit	½	
	- Unrelieved loss b/f	½	
	- Relieved loss for the year	½	
	- Capital allowance for the year	½	
	- Unutilised capital allowances b/f	½	
	- Utilised capital allowance for the year	½	
	- Conclusion	1	15
4b	Rules governing loss relief for companies		
	(1 mark each for any correct 5 points)		5
Total			**20**

SOLUTION 5

(a) Corporate organisations are required by law to file tax returns to the Federal Inland Revenue Service in accordance with CITA 2004 (as amended). The returns must be submitted to the integrated tax office nearest to the registered address of the business.

Documents required to be forwarded to the relevant tax authority when registering with the nearest integrated tax office include:

(i) Certified true copy of the certificate of incorporation;
(ii) Certified true copy of the memorandum and articles of association;

(iii) Certified copy of form CAC 7 (Particulars of directors);
(iv) Letter of appointment of external auditors and tax representatives;
(v) Letter of acceptance by the external auditors and tax representatives; and
(vi) Answers to the questionnaire which include the following information:
- Date of commencement of operations;
- Accounting year end;
- Registered office and address of the company;
- Business address of the company if different from the registered office;
- Names and addresses of the directors of the company;
- Names and addresses of the bankers;
- Names and addresses of the auditors;
- Name and address of the company secretary;
- Particulars of the shareholders stating names, addresses and amount of shareholding; and
- Any other relevant information.

The registration letter for VAT shall be accompanied with the following documents:
(i) Completed copy of VAT form 001, that is VAT registration form; and
(ii) Certificate of incorporation.

(b) The time lag for filing the first set of returns and subsequent ones are as follows:
(i) **First set of returns (New company)**
Within 18 months from the date of incorporation or 6 months after the end of its first accounting period, whichever is earlier.

(ii) **Subsequent returns (Existing companies)**
A company that has been in business for more than eighteen months, the due date for filing tax returns is six months after the end of the company's accounting year.

(c) Penalty for late filing of returns at the due dates
Section 55, CITA (as amended) makes provision for payment of penalty by any company that fails to comply with the requirements for filing of tax returns. A defaulting company shall pay:
(i) ₦25,000 in the first month in which it fails to file its annual returns; and
(ii) ₦5,000 for each subsequent month in which the failure continues.

In addition, any director, manager, secretary, servant or agent of a defaulting company who is proved to be guilty of connivance, neglect or acquiescence to the commission of the offence, of non–compliance with the above provision, shall be liable to a fine of ₦100,000 or imprisonment for 2 years or both.

Examiner's report

The question tests candidates' knowledge of the computations of companies income tax, tertiary education tax and the rules governing loss reliefs for companies.

More than 90% of the candidates attempted the question. Candidates demonstrated a poor understanding of the question, hence the performance was poor.

The commonest pitfall was the inability of the candidates to explain the rules governing loss relief.

Candidates are advised to read ICAN Study Text and Pathfinder when preparing for subsequent examinations to ensure better performance in future.

Marking guide

		Marks	Marks
5a	**Documents/information required (1 tick @ 1 mark each for any 5 points)**		5
b.	**Time lag for filing of tax returns**		
	(i) First set of returns		
	- Within 18 months from incorporation	1	
	- 6 months after end of first accounting year	1	
	- Whichever is earlier	1	
(ii)	Subsequent returns		
	- Within 6 months from the accounting year end (1 tick @ 2 marks)	2	5
5c	Penalty for late filing		
	- Penalty of ₦25,000 in the first month (1 tick @ 2 marks)	2	
	- Penalty of ₦5,000 for each subsequent month (1 tick @ 2 marks)	2	
	- Fine for director, manager, secretary, etc guilty of connivance	1	5
Total			**15**

SOLUTION 6

Goods and services shall be deemed to be supplied in Nigeria in accordance with section 2 of VAT Act as amended by Finance Act, 2020, if:

(a) In respect of goods:
   (i) These goods shall be physically present in Nigeria at time of supply, imported into Nigeria, assembled in Nigeria, or installed in Nigeria; or

   (ii) The beneficial owner of the rights in or over the goods is a taxable person in Nigeria and the goods or right is situated, registered or exercisable in Nigeria.

(b) In respect of services:
   (i) The service is rendered in Nigeria by a person physically present in Nigeria at the time of providing the service;
   (ii) The service is provided to and consumed by a person in Nigeria, regardless of whether the service is rendered within or outside Nigeria or whether or not the legal or contractual obligation to render such service rests on person within or outside Nigeria; and
   (iii) The service is connected with existing immovable property (including the services of agents, experts, engineers, architects, valuers, etc) where the property is located in Nigeria.

(c) In respect of an incorporeal:
   (i) The exploitation of the right is made by a person in Nigeria;
   (ii) The right is registered in Nigeria, assigned to or acquired by, a person in Nigeria regardless of whether the payment for its exploitation is made within or outside Nigeria; or
   (iii) The incorporeal is connected with a tangible or immovable asset located in Nigeria.

Tutorial

It is pertinent to state that:
(i) Services rendered to and consumed by a Nigerian resident while physically outside Nigeria, is not liable to VAT in Nigeria;
(ii) Services rendered remotely, online or by other virtual means to Nigerian residents or persons, is liable to VAT in Nigeria;
(iii) Regardless of the medium of delivery of the service, services provided to persons while in Nigeria, shall be liable to VAT in Nigeria; or
(iv) Services performed in Nigeria to persons in Nigeria is liable to VAT irrespective of the residence status of the service provider.

Examiner's report

The question tests the candidates' knowledge on when goods and services shall be deemed to be supplied in Nigeria in accordance with section 2 of VAT Act (as amended).

Over 40% of the candidates attempted the question and they demonstrated a poor understanding of the question, hence the performance was poor.

The commonest pitfall was the candidates' inability to explain when goods and services shall be deemed to be supplied in Nigeria.

Candidates are advised to read relevant study materials in order to perform well in future examinations.

Marking guide

	Marks
Explanation on when goods and services shall be deemed to be supplied in Nigeria:	
In respect of goods (2 ticks @ 3 marks each)	6
In respect of services (3 ticks @ 2 marks each)	6
In respect of incorporeal (3 ticks @ 1 mark)	3
	15

SOLUTION 7

TAXPRO MAX has the capacity to handle the following aspects of tax administration:

(a) E-registration
Deployment and use of a robust and integrated tax management software makes it possible for accurate taxpayers' data to be captured by the tax authority. Each taxpayer enrolled is assigned a unique tax identification number (TIN) and it is now possible for taxpayers to do self-enrolment through a web application service;

(b) E-assessment
When taxpayers file returns electronically, it is possible for their tax liabilities to be computed and assessment notice generated automatically and sent to their email accounts;

(c) E- payments

Technology has made it possible for taxpayers to make payments through several electronic channels, such as point of sale (POS); internet banking; bank transfers; unstructured supplementary service date (USSD) or even using their credit/debit cards from the comfort of their homes;

(d) E-filing

Most integrated tax management solutions come along with a module that facilitates electronic filing. This enables taxpayers to file their returns from their offices without the stress of going to the tax office which might be several kilometers away. For instance, the FIRS has been encouraging taxpayers to make use of the recently deployed TaxPro solution to file their periodic tax returns, including VAT and CIT returns;

(e) E-tax calculator

Modern tax authorities develop and deploy this tool on their websites to enable taxpayers and their consultants to compute the accurate amount of taxes to be paid. This function has been part of the FIRS website (www.firs.gov.ng) in the last few years;

(f) E-TCC

Many individual and corporate taxpayers require their tax authorities to issue tax clearance certificates (TCCs) to them on yearly basis. Through the use of appropriate technology, taxpayers can apply for their TCCs electronically and have them sent to their email accounts, if the conditions are met;

(g) E-reporting

Each tax authority requires various performance reports to be generated on a periodic basis. These reports can be generated within seconds at the click of a button; and

(h) E-tax audit

Technology has made it possible for the entire process of tax audit to be carried out without the tax auditors visiting the premises of the taxpayer and vice versa. For instance, all the pre and post –audit meetings can be held using video conferencing tools and documents can be exchanged electronically through emails.

Examiner's report

The question tests the candidates' knowledge of aspects of tax administration and how the tax management IT solution known as TAXPRO MAX can be handle same.

About 50% of the candidates attempted the question but performance was poor.

The common pitfalls were candidates' lack of knowledge of the different aspects of tax administration, and inability to explain how TAXPRO MAX can handle same.

Candidates are advised to pay attention to this particular aspect of the syllabus when preparing for future examinations.

Marking guide

		Marks
7	**Different aspects of tax administration that the tax management solution known as TAXPRO MAX can handle**	
(a)	E-registration	
	- Possible for accurate tax payers' data to be captured	1
	- Each taxpayer enrolled is assigned a unique tax identification number (TIN)	1
	- Possible for taxpayers to do self-enrolment through a web application service	1
		3

		Marks
(b)	E-assessment	
	- Possible for taxpayers' tax liabilities to be computed	1
	- Assessment notice generated automatically	1
	- Sent to their email accounts	1
		3
(c)	E-payments	
	- Payments through several electronic channels	½
	- Point of sale (POS)	½
	- Internet banking	½
	- Bank transfers	½
	- Unstructured supplementary service (USSD)	½
	- Using their credit/debit cards	½
		3

(d) E-filing

- Module that facilitates electronic filing	1
- Enables taxpayers to file their returns from their offices	1
- File their periodic tax returns	1
	3

(e) E-tax calculator

- To enable taxpayers and their consultants to compute the accurate amount of taxes to be paid	3

(f) E-TCC

- Taxpayers can apply for their TCCs electronically	3

(g) E-reporting

- Performance reports can be generated within seconds	3

(h) E-tax audit

- Process of tax audit to be carried out without the tax auditors visiting the premises of the taxpayer and vice versa	1
- All the pre and post-audit meetings can be held using video conferencing tools	1
- Documents can be exchanged electronically through emails	1
	3

(3 marks each for any five aspects of tax administration)