THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2022 DIET
SKILLS LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Examiner's Reports

and

Marking Guides

FOREWARD

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

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

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

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

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

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

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

NOTES

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

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EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

TUESDAY, NOVEMBER 15, 2022

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

FINANCIAL REPORTING

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

There has been agitation to stop importation of containers from China, to increase patronage of local industries. The Board of Favour PLC is planning to acquire 75% controlling interests in either Grace Limited or Blessing Limited which produce better and cheaper containers locally. As a trainee working in Obokun Chartered Accountants, the Managing Partner has requested you to carry out performance score cards of the companies using accounting ratios to assess the viability of the acquisition.

Statement of comprehensive income for the year ended December 31, 2020:

	Favour Plc	Grace Ltd	Blessing Ltd
	₦' 000	**₦' 000**	**₦' 000**
Revenue	250,000	100,000	100,000
Cost of sales	(105,000)	(30,000)	(40,000)
Gross profit	145,000	70,000	60,000
Administrative expenses	(39,000)	(19,000)	(27,000)
Profit before interest and taxation	106,000	51,000	33,000
Finance costs: Interest on 10% loan notes	(6,000)	(3,000)	(30,000)
12% Preference share dividends	(1,200)	(600)	(1,800)
Profit before taxation	98,800	47,400	1,200
Income tax expense	(29,640)	(14,220)	(360)
Profit for the year	**69,160**	**33,180**	**840**

Statement of financial position as at December 31, 2020:

Assets:	Favour Plc ₦' 000	Grace Ltd ₦' 000	Blessing Ltd ₦' 000
Non-current assets:			
Property, plant and equipment (PPE) at cost	680,000	330,000	350,000
Accumulated depreciation	(90,000)	(50,000)	(60,000)
Carrying amounts	**590,000**	**280,000**	**290,000**
Current assets:			
Inventories	100,000	90,000	160,000
Trade receivables	70,000	40,000	60,000
Bank	230,000	100,000	50,000
	400,000	**230,000**	**270,000**
Total assets	**990,000**	**510,000**	**560,000**
Equity and liabilities:			
Ordinary shares of ₦1.25 each	480,000	200,000	110,000
Retained earnings	323,160	237,180	12,840
Equity	**803,160**	**437,180**	**122,840**
Non-current liabilities:			
10% loan notes	60,000	30,000	300,000
12% preference shares	10,000	5,000	15,000
	70,000	**35,000**	**315,000**
Current liabilities:			
Trade payables	109,640	34,220	90,360
10% loan notes interest	6,000	3,000	30,000
12% preference shares dividends	1,200	600	1,800
	116,840	37,820	122,160
Total equity and liabilities	**990,000**	**510,000**	**560,000**

Additional Information:

(i) Inventories as at December 31, 2019 were ₦60 million, ₦30 million and ₦50 Million and the current market prices, 30 kobo, 28 kobo and 10 kobo for Favour Plc, Grace Limited and Blessing Limited respectively.

(ii) Purchases for cash within 365 days in the year 2020 were 10%, 20% and 40% of cost of sales for Favour Plc, Grace Limited and Blessing Limited respectively.

Required:

a. Calculate the following ratios for Grace Limited and Blessing Limited.

i. Net profit margin
ii. Quick ratio
iii. Debt equity ratio
iv. Proprietary ratio
v. Earnings yield
vi. Net asset per share (10 Marks)

b. Draft a technical report titled 'Performance Scorecard' of Blessing Limited and Grace Limited and advise Favour Plc in which of the two companies it should acquire 75% controlling interests. (10 Marks)

c. The Chief Financial Officer (CFO) of Favour Plc noted that the records of Blessing Limited and Grace Limited are maintained using block chain technologies.

Required:
Discuss the type of records that a company can maintain in blockchain and state **TWO** benefits of making use of this technology. (10 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

Financial statements and extract from the cashbook of Obudu Nigeria Limited for the year ended December 31, 2020 are summarised below:

Obudu Nigeria Limited
Statement of profit or Loss for the year ended December 31, 2020

	₦'000
Revenue	169,314
Cost of sales	(102,798)
Gross profit	66,516
Investment income	15,000
Expenses:	
Depreciation	(7,650)
Salaries and wages	(4,712)
Other cash expenses	(7,594)
Loss on disposal of equipment	(2,061)
Interest expense	(3,375)
Profit before taxation	56,124
Income tax expense	(16,988)
Profit for the year	39,136

Obudu Nigeria Limited

Statement of financial position as at December 31

	2020	2019
Non-current assets:	**₦'000**	**₦'000**
Property, plant and equipment	98,550	86,400
Current assets:		
Inventories	21,308	11,363
Trade receivables	22,703	14,063
Cash and bank	5,940	7,088
Trade investments	675	1,238
	149,176	120,152
Equity and liabilities:		
Ordinary share capital of ₦1 each	28,125	22,500
Retained earnings	40,111	21,600
	68,236	44,100
Non-current liabilities		
8% loan notes	33,750	40,500
Current liabilities		
Trade payables and accruals	35,375	30,240
Taxation	11,815	5,312
	149,176	120,152

Obudu Nigeria Limited

Cash book extract for the year ended December 31, 2020

	Bank	Cash
Receipts:	**₦'000**	**₦'000**
Opening balance b/f	5,500	1,588
Receipts from customers	153,602	8,087
Sale of investment	563	-
Transfer from cash	4,500	-
Disposal of equipment	1,600	1,019
Proceeds from issue of shares	5,625	-
	171,390	10,694
Payments:		
Salaries and wages	2,000	2,712
Other expenses	5,462	2,132
Payment to trade suppliers	108,623	-
Purchase of motor vehicles	22,230	-
Dividends paid	9,000	-
Transfer to bank	-	4,500
Interest paid	2,250	-
Tax paid	10,485	-
Redemption of 8% loan notes	6,750	-
Balance c/f	4,590	1,350
	171,390	10,694

Other Information

(i) The 8% loan notes have been partly redeemed. It is expected that the full redemption will be made in five years time.

(ii) A cash payment for insurance of ₦1million was omitted in the cash book and other records.

(iii) The investments are not easily realisable.

Required:

a. Prepare the statement of cash flows for the year ended December 31, 2020 using the direct method in accordance with IAS 7. (9 Marks)

b. Prepare a statement of reconciliation of the operating profit to cash flow from operations. (5 Marks)

c. Discuss the benefits of statement of cash flows information to users of financial statements. (6 Marks)

(Total 20 Marks)

QUESTION 3

a. Food Plc has a subsidiary, Eba Limited. The statements of financial position of the companies as at September 30, 2020 are presented below:

	Food Plc	Eba Limited
Assets:	**₦'000**	**₦'000**
Non-current assets	536,000	258,000
Investment in subsidiary at cost	220,000	-
Current assets:		
Inventories	88,500	92,000
Trade and other receivables	75,400	69,800
Bills receivables	30,000	-
Cash and bank	25,600	32,200
Due from Eba Limited	20,000	-
Total assets	995,500	452,000
Equity and liabilities:		
Ordinary share capital	400,000	150,000
Share premium	50,000	-
Retained earnings	203,400	88,500
General reserve	105,600	64,600
Non-current liabilities:		
10% Loan notes	100,000	50,000
Current liabilities:		
Trade and other payables	96,300	46,900
Bank overdrafts	40,200	-
Bills payables	-	40,000
Due to Food PLC	-	12,000
Total equity and liabilities	**₦995,500**	**₦452,000**

Additional Information:

(i) Food PLC acquired four hundred and eighty million shares in Eba Limited two years ago when the balances in retained earnings and general reserves were ₦60,000,000 and ₦48,000,000 respectively.

(ii) The fair value of non-controlling interests in Eba limited as at the acquisition date was ₦158,000,000.

(iii) During the year, goods costing ₦80,000,000 to Food PLC were transferred to Eba Limited. It is the policy of Food PLC to transfer goods at cost plus 25%. A quarter of these goods have been sold by Eba Limited at year end.

(iv) Part of the bills receivable have been discounted by Food PLC.

(v) The sum of ₦8,000,000 transferred by Eba Limited to Food PLC as part payment for indebtedness was received after the reporting date.

(vi) An impairment test revealed a loss of ₦16,000,000 on the goodwill arising on the acquisition of Eba Limited.

(vii) The carrying amount of the net assets of Eba Limited is ₦20,000,000 more than the fair value at acquisition date. This was due to the loss in value of the company's machinery occasioned by change in technology. The machinery is depreciated at a flat rate of 15% on cost.

(viii) The nominal value of the ordinary shares of Food PLC are denominated in 50 kobo per share, while those of Eba Limited are 25 kobo each.

Required:

a. Prepare the consolidated statement of financial position of Food group as at September 30, 2020. (15 Marks)

b. A gain from a bargain purchase may arise in the course of a business combination and when this happens, the acquirer must review or reassess the procedure used to measure certain items at the acquisition date.

Required:

c. Explain the term "Gain from a bargain purchase" and identify the three items stipulated in IFRS 3 that must be reviewed. (5 Marks)

(Total 20 Marks)

QUESTION 4

IFRS is published subject to the appropriate level of IASB approval. This also includes the opinions of any dissenting IASB members and basis of IASB conclusions.

Required:

a. Describe **SIX** steps involved in the process of issuing International Financial Reporting Standards (IFRS). (6 Marks)

b. Explain any **TWO** enhancing characteristics of financial information. (2 Marks)

c. **IFRS 9** - Financial Instruments, prescribes principles for reporting, recognising and de-recognising financial instruments in the financial statements of an entity.

Required:
Explain **TWO** classes of financial instruments in accordance with IFRS 9.
(4 Marks)

d. On January 1, 2020, an entity bought Lagos State Government Bond in the capital market for ₦575,000,000. The principal amount of the bond is ₦500,000,000 and it is redeemable at par on December 31, 2025. The bond has a stated interest rate of 15% payable annually and an effective interest rate of 12%.

Draft an amortisation schedule to indicate the amortised cost at the end of each year and the journal entries at the end of December 31, 2025.
(8 Marks)
(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

The Institute of Chartered Accountants of Nigeria (ICAN) prescribes ethical behaviour for Chartered Accountants as well as fundamental principles, and threats to these principles.

You are required to:

a. Explain briefly what is meant by professional behaviour and outlines **THREE** threats that could affect the work of professional accountants.
(5 Marks)

b. IAS 38 prescribes the requirements for reporting intangible assets in the financial statements of an entity.

Required:

i. Explain **FIVE** conditions under which development costs can be recognised as intangibles in financial statements. (5 Marks)

ii. Highlight **FIVE** conditions, which should be considered to determine The useful life in the amortisation of intangible assets in the financial statements. (5 Marks)

(Total 15 Marks)

QUESTION 6

a. IAS 33-Earnings Per Share (EPS) requires entities to calculate basic and diluted earnings per share. However, diluted EPS and basic EPS will usually differ when there are potential ordinary shares in existence.

Required:

i. Explain the term potential ordinary share giving **THREE** examples as stated in IAS 33. (3 Marks)

ii. Describe the procedure for ranking when there are several types of potential ordinary share in issue when calculating diluted EPS. (3 Marks)

b. The following information relates to Jumai Nigeria Limited for the year ended December 31, 2020.

Issued ordinary shares of 50k each	₦ 3,000,000
Profit for the year	₦18,000,000

Average market price of shares during the year was ₦70 per share. The potential financial instruments in existence in the company are detailed below:

i. 800,000 options with exercise price of ₦52.50.

ii. 5% convertible bond of ₦6,000,000. Each bond is convertible in year 2025 into ordinary shares at the rate of 30 new shares for every ₦100 bonds.

iii. 200,000 8% convertible preference shares at ₦10 per share. Each preference share is convertible in year 2024 at the rate of one ordinary share for every 25 preference shares held.

The Company income tax rate is 30%.

Assume that all the options are exercised.

Required:

Rank the potential ordinary shares and calculate the diluted EPS for the year ended December 31, 2020. (7 Marks)

c. EPS is probably the single most important indicator of an entity's performance.

Required:

State **THREE** of the limitations of EPS. (2 Marks)

(Total 15 Marks)

QUESTION 7

a. Briefly explain **SIX** purposes of Conceptual Framework of the International Accounting Standard Board (IASB). (9 Marks)

b. Explain **THREE** basic steps in the application of Business Model test in IFRS 9. (6 Marks)

(Total 15 Marks)

SOLUTION 1

(a) Computation of relevant accounting ratios for Grace Limited & Blessing Limited

		Grace Limited	Blessing Limited
i.	Net profit margin = Profit before interest and tax × 100 / Revenue	51,000 × 100 / 100,000 = 51%	33,000 × 100 / 100,000 = 33%
ii.	Quick ratio/acid test = Current assets – inventory / current liabilities	230,000 – 90,000 / 37,820 = 3.70:1	270,000 – 160,000 / 122,160 = 0.90:1
iii.	Debt to equity ratio = Long-term debt / Total Equity x 100 / 1	35,000 × 100 / 437,180 = 8.01%	315,000 × 100 / 122,840 = 256.43%
iv.	Proprietory ratio = Shareholder's fund / Tangible assets	437,180 / 510,000 = 0.86:1 or 86%	122,840 / 560,000 = 0.22:1 or 22%
v.	Earnings yield = EPS x 100 / MPS	20.7 × 100 / 28 = 73.93%	0.95 × 100 / 10 = 9.50%
	Earnings per share (EPS) = PAT x 100 / No. of Ord Share	33,180 × 100 / 160,000 ord. = 20.7 kobo	840 x 100 / 88,000 ord. = 0.95 kobo
vi.	Net asset per share = Net asset / No. of Ord Share	437,180 / 160,000 =273 kobo OR ₦2.73k	122,840 / 88,000 = 140 kobo OR ₦1.40k

(b) **Obokun & Co.**
(Chartered Accountants)
Lagos, Nigeria

FROM: Trainee Accountant **TO**: Managing Partner

November 15, 2021

SUBJECT: Analysis of financial performance scorecard of Blessing Limited and Grace Limited

Further to the request to carry out performance scorecard of the above two companies, using accounting ratios, to assess the viability of their acquisition, the following findings have been made:

Profitability performance of the two companies

i. Based on the computed net profit margin of the two companies, the net profit margin of Grace Ltd is 51% while that of Blessing Ltd shows 33%, indicating that Grace Ltd is more profitable than Blessing Ltd.
ii. The profitability level of Blessing Ltd is seen to be too low. This was probably due to poor control of overhead by Blessing Ltd since the two companies almost have the same gross profit.
iii. In addition, the earnings yield of Grace Ltd is high, 73.93% while that of Blessing Limited is 9.5%. This is an indication that Grace Ltd is likely to provide shareholders of Favour Plc more returns than Blessing Ltd.

Liquidity position of the two companies

i. With reference to the computed quick ratio of the two companies, it can be deduced that Grace Ltd is more liquid than Blessing Ltd. The quick ratio of Grace Ltd is 3.7:1 while that of Blessing Ltd is 0.9:1.
ii. This indicates that Grace Ltd will be more comfortable in meeting its short-term debt obligations than Blessing Ltd.

Gearing and solvency position of the two companies

i. Based on the computed debt to equity ratio, it is obvious that the gearing level of Grace Ltd is better than that of Blessing Ltd. Grace Ltd's gearing ratio is 8.01% which is within the acceptable range, while Blessing Ltd's gearing ratio is 256.43%. This shows that Blessing Ltd is highly geared and high risk to invest in.

ii. In addition, the proprietary ratio computed for the two companies indicates that the shareholders in Grace Ltd would be more secured and protected in the case of liquidation, compared to Blessing Ltd that has a lower proprietary ratio of 22%. Furthermore, the net asset per share of Grace Ltd is higher than that of Blessing Ltd, indicating that Grace Ltd is more solvent and financially stable.

Conclusion

However, in view of the fact that Grace Ltd will be capable of utilising its resources more efficiently and considering the fact that it is a highly profitable company with a fairly suitable liquidity position we would advise that, the directors of Favour Plc should acquire 75% interest in Grace Ltd.

Recommendations

Further information that may be useful to the board of directors of Favour Plc when making acquisition decisions are:

i. In this case, the analysis has been made on the draft financial statements. These may be unreliable or change when finalised. Audited financial statements would add credibility;
ii. Other relevant information should be considered, for example profit forecasts, cash budgets, capital expenditure budget and future prospects;
iii. There would be need to ascertain current (fair) value of assets to be acquired;
iv. The level of risks and uncertainties within the business industry should be considered;
v. The purchase consideration and mode of payment for the acquisition should also be considered;
vi. Tax implication should also be considered; and
vii. Competitive advantage; and management quality of the target entity.

Do not hesitate to contact me for any area of this report that requires further clarification.

Thank you.

Trainee Accountant

(c) **Types of records that are maintained in block chain**

The following are the type of records that a company can maintain in block chain:

i. **Ledger:** It is used to record financial and non-financial transactions in an open, secured and decentralised ledger;

ii. **Auditing records:** It helps in keeping financial transactions transparent and auditable;
iii. **Inventory records:** It makes the transaction records of inventory accessible to authorised users at any time and location; and
iv. **Banking records:** It enables quick funds transfer, recording of financial transactions accurately, recording smart contracts, protecting and transferring ownership of assets, verifying people's identities and credentials, and much more.

Benefits of making use of blockchain technology

The following are the benefits of blockchain technology:

i. It will benefit businesses by reducing costs, increasing traceability and enhancing security;
ii. It allows for the encryption of data through blocks, which track the time and date of a transaction;
iii. The technology could be used to make audit process more efficient, because it would keep an accurate record of when a transaction occurred and who authorised it; and
iv. It would limit the chances of an electronic record being altered.

Examiner's report

Part (a) of the question tests the performance evaluation of two companies with the aim of making acquisition decisions using ratio analysis, while part (b) requires the candidates to discuss types of accounting records that can be maintained using blockchain technologies and the benefits of the technology.

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

Most candidates were able to calculate the ratios but could not carry out correct evaluations using the ratios to arrive at the appropriate conclusions and make relevant recommendations.

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

	Marking Guide	**Marks**	**Marks**
a)	- Stating name of companies	1	
	- Calculation of net profit margin	1½	
	- Calculation of quick/acid test ratio	1½	
	- Calculation of debt to equity ratio	1½	
	- Calculation of proprietory ratio	1½	
	- Calculation of earnings yield	1½	
	- Calculation of net asset per share	1½	10

b)	**Technical report on performance scorecard**		
	- Memo format for report	1	
	- Analysis of profitability performance	2	
	- Analysis of liquidity position	2	
	- Analysis of gearing and solvency position	2	
	- Conclusion of the report	1	
	- Recommendation	1	
	- Closing of the report	<u>1</u>	10
c)	**Types of Records and Benefit of Block chain**		
	- Stating three (3) types of records	3	
	- Explanation of three(3) types records	3	
	- Stating two(2) correct benefits of blockchain	<u>4</u>	<u>10</u>
	Total		**<u>30</u>**

SECTION B

SOLUTION 2

(a) **Obudu Nigeria Limited**

Statement of cash flows for the year ended December 31, 2020 using the direct method

Operating Activities:	**₦'000**	**N'000**
Cash received from customers (153,602 + 8,087)		161,689
Cash paid to suppliers		(108,623)
Cash paid to employees (2,000 + 2,712)		(4,712)
Cash paid for other expenses (5,462 + 2,132 + 1,000)		(8,594)
Cash flows from operations		**39,760**
Interest paid		(2,250)
Taxation paid		(10,485)
Net cash flows from operating activities		**27,025**
Investing activities:		
Proceeds from disposal of investment	563	
Proceeds from disposal of equipment (1,600 + 1,019)	2,619	
Purchase of motor vehicles by cash	(22,230)	
Net cash flows from investing activities		(19,048)
Financing activities:		
Proceeds from issue of shares	5,625	
Redemption of 8% loan notes	(6,750)	
Dividend paid by cash	(9,000)	
Net cash flows from financing activities		(10,125)
Net Increase in cash and cash equivalents for the year		(2,148)
Cash and cash equivalents at the beginning (5,500 + 1,588)		7,088
Cash and cash equivalent at the end (4,590 + 1,350 - 1,000)		4,940

	₦'000
Note I – cash/bank balance in statement of financial position	5,940
Less – Omitted payment for Insurance	(1,000)
	4,940

(b) **Obudu Nigeria Limited**

Reconciliation of operating profit to cash flow from operation

Operating activities:	**₦'000**	**₦'000**
Profit before taxation		56,124
Add (Less) Adjustments:		
Insurance expenses omitted	(1,000)	
Investment income	(15,000)	
Interest expenses	3,375	
Depreciation	7,650	
Loss on disposal of equipment	2,061	(2,914)
Cashflows from operations before working capital		53,210
Working capital changes:		
Increase in inventories (11,363 - 21,308)	(9,945)	
Increase in trade receivables (14,063 - 22,703)	(8,640)	
Increase in trade payables and accruals (35,375 - 30,240)	5,135	(13,450)
Cash flows from operations		**39,760**
Interest paid		(2,250)
Taxation Paid		(10,485)
Net cashflows from operating activities		**27,025**

(c) **Benefits of statement of cash flows information to users of financial statements**

(i) Where the direct method is used in preparing the statement of cash flows, it reveals information which are not available in any other financial statement.

(ii) A statement of cash flows provides information which helps users to evaluate changes in the net assets of an entity and in its financial structure (including its liquidity and solvency).

(iii) It provides information that helps users to assess the ability of the entity to determine the amount and timing of its cash flows in order to adapt to changing circumstances and unexpected opportunities.

(iv) It is useful in assessing the ability of the entity to generate cash and cash equivalents.

(v) It helps users of accounts to compare the performance of different entities because unlike profits, comparisons of cash flows are not affected by the different accounting policies used by different entities.

(vi) Historical cash flows are often a fairly reliable indicator of the amount, timing and certainty of future cash flows.

(vii) The statement brings into sharp contrast the entity's earning capacity with its spending activity.

(viii) Focus on cash flows explains the nature of the events which have affected the cash movements.

Examiner's report

The question tests the candidate's knowledge of the preparation of statements of cash flows in accordance with the provisions of IAS7 and the benefits of the statement to users of financial information.

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

The common pitfall was the inability of candidates to correctly account for the cash payment relating to Insurance expenses which were omitted in the cashbook.

The candidates should pay more attention to the preparation of final accounts which also include preparation of statement of cash flows.

	Marking guide	**Marks**	**Marks**
a)	Preparation of statement of cash flows:		
	- Correct title of statement	¼	
	- Determination of cash flows from operating activities	3¾	
	- Determination of cash flows from investing activities	1¼	
	- Determination of cash flows from financing activities	1	
	- Determination of cash and cash equivalent	2¾	9
b)	Reconciliation of operating profit to cash flow from operations		
	- Correct title of the reconciliation statement	¼	
	- Stating the profit before taxation	¼	
	- Adjustments on profit before taxation	1¾	
	- Determination of changes in working capital	2	
	- Determination of net cash flows from operating activities	¾	5
c)	Six benefits of Statement of Cash flows information:		6
	Total		**20**

SOLUTION 3

(a) **Food Plc**

Consolidated statement of financial position as at September 30, 2020

Assets:	**₦'000**
Property plant and equipment (536,000+258,000 – 20,000+9,000)	783,000
Goodwill (Wk 3)	124,000
Total Non-current assets	907,000
Current asset:	
Inventories (88,500+92,000-15,000)	165,500
Trade and other receivables (75,400+69,800)	145,200
Cash and bank (25,600+32,200)	57,800
Cash in transit (Wk 8)	8,000
Total current assets	376,500
Total assets	**1,283,500**
Equity:	
Ordinary shares of 50k each	400,000
Share premium	50,000
Retained earnings (Wk 6)	205,600
General reserves (₦105,600 + 80% of ₦16,600)	118,880
	774,480
Non-controlling Interest (Wk 5)	165,620
Total equity	940,000
Non-current liabilities:	
10% Loan notes (100,000+50,000)	150,000
Current liabilities:	
Trade and other payables (96,300+46,900)	143,200
Bank overdraft	40,200
Bills payables (Wk 7)	10,000
Total current liabilities	193,400
Total liabilities	343,400
Total equity and liabilities	**1,283,500**

Working notes

Wk 1: Group structure

Food Plc ---------------80% (480m/(150m/0.25))--------------- Eba Limited

NCI = 20%

Wk 2: Net asset of subsidiary	At Rep. Date	At Acq. Date	Post-Acq.
	₦'000	**₦'000**	**₦'000**
Ordinary share	150,000	150,000	-
Retained earnings	88,500	60,000	28,500
General reserves	64,600	48,000	16,600
Fair value adjustment:			
Property	(20,000)	(20,000)	-
Depreciation	9,000	-	9,000
	292,100	238,000	54,100

Excess Depreciation $^{15}/_{100} \times$ ₦20,000 $\times$ 3 years = ₦9000

Wk 3: Determination of goodwill on acquisition

	₦'000	**₦'000**
Fair value of consideration transfer:		
Cost of Investments		220,000
NCI at fair value		158,000
		378,000
Less: Net Assets of Subsidiary at acquisition		(238,000)
Goodwill at acquisition		140,000
Impairment		(16,000)
Goodwill at reporting date		124,000

Wk 4: Unrealised profit	**₦'000**
URP = 80,000 x 3/4 x 25%	15,000
Wk 5: Valuation of NCI	**₦'000**
NCI at acquisition (Wk 3)	158,000
Add: Share of post-acquisition profit (20% of 54,100)	10,820
Impairment of goodwill (20% x 16,000)	(3,200)
	165,620
Wk 6: Consolidated retained earnings	**₦'000**
Food PLC	203,400
Add: Share of post-acquisition profit (80% x 37,500)	30,000
Unrealised profit (Wk 4)	(15,000)
Impairment of goodwill (80% x 16,000)	(12,800)
Consolidated retained earnings	205,600

Wk 7: Consolidated Bill Payables	**₦'000**
Bills receivables - Food PLC	(30,000)
Bills payables - Eba Limited	40,000
Consolidated Bills Payables	10,000

Wk 8: Consolidated cash in transit	**₦'000**
Due from Eba Limited	20,000
Due to Food Plc	(12,000)
Cash in Transit	8,000

(b) **Explanation of Gain from a bargain purchase (Negative Goodwill) and the three items that must be reviewed**

A bargain purchase is a business combination in which the calculation of goodwill leads to a negative figure. When this happens the acquirer must reassess whether it has correctly identified all the assets acquired and all the liabilities assumed and must recognise any additional assets or liabilities that are identified in that review.

Under IFRS 3, the acquirer must then review the fair value used to measure the amounts to be recognised at the acquisition date for all the following:

i. The identifiable assets acquired and liabilities assumed;
ii. The non-controlling interest in the acquired company (if any); and
iii. The consideration transferred.

Any amount remaining after applying the above requirements is recognised as a gain in profit or loss on the acquisition date.

Examiner's report

The question is on preparation of consolidated statement of financial position and it tests candidates' knowledge of simple group involving treatments of goodwill, cash-in-transit and fair value adjustments.

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

The common pitfalls was their inability to correctly calculate goodwill and determine the net assets of the subsidiary. Also most candidates could not explain the term gain from bargain purchase and items required for the review of the gain from bargain purchase as stated under IFRS3-Business Combinations.

Candidates are advised to pay more attention to International Financial Reporting Standards (IFRS) that relates to group financial statements for better performance at this level of the Institute's examination in the future.

Marking guide		**Marks**	**Marks**
a)	**Preparation of consolidated statement of financial position**		
	- Stating correct title of financial statement	¼	
	- Presentation of non-current assets	1¾	
	- Presentation of current assets	1¼	
	- Presentation of equity	1¾	
	- Presentation and evaluation of non-controlling interest	1½	
	- Presentation of non-current liabilities	¾	
	- Presentation of current liabilities	1½	
	- Calculation of net assets of subsidiary at reporting and acquisition dates	2½	
	- Calculation of goodwill on acquisition	1¾	
	- Calculation of consolidated retained earnings	1¼	
	- Calculation of unrealised profit in inventory	¼	
	- Determination of group structure	½	15
b)	Gain from bargain purchase		
	- Correct explanation of gain on bargain purchase	2	
	- Stating three (3) items which must be reviewed when gain from bargain purchase arises	3	5
	Total		**20**

SOLUTION 4

(a) Steps involved in the process of issuing International Financial Reporting Standards (IFRS) are:

i. A subject is identified as being appropriate for a new or revised standard;

ii. Consider the ways in which the IASB Conceptual Framework is applicable to the issue;

iii. National accounting rules and practice are studied and there is an exchange of views with national standards setters;

iv. An advisory group is established to give advice to the IASB;

v. A discussion document is issued by the IASB for public comment;

vi. After receiving comments on the discussion document, the IASB issues an exposure draft (subject to the appropriate level of IASB approval). The Exposure Draft also includes the opinions of any dissenting IASB members, and the basis for the IASB's conclusions;

vii. All comments on the Exposure Draft and discussion documents are considered; and

viii. An approved IFRS is published (subject to the appropriate level of IASB approval).

(b) **Enhancing characteristics of financial information**

i) **Comparability**

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

ii) **Verifiability**

This quality helps assure users that information faithfully represents the economic phenomena it purports to represent.

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

iii) **Timeliness:**

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

iv) **Understandability:**

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

(c) **Classifications of Financial Instruments in accordance with IFRS 9**

(i) **A Financial asset is measured at amortised cost if:**

- The financial asset is held within a business model in which the intention is to hold financial asset to collect contractual cash flows;
- Each group or portfolio is being classified as held to collect and or to sell or other; and
- Assets are classified as being held to collect, if it evaluates the appropriateness of the classification through testing against past activities.

(ii) **Fair value through other comprehensive income**

Within a business financial model, a financial asset is measured at fair value through other comprehensive income if:

- The assets are held when the objective of business model is achieved by collecting contractual cash flows and selling financial assets; and
- The terms of the contractual agreement of the financial assets give rise to cash flows on a specified date that is wholly for payments of principal and interest outstanding on the principal.

(iii) **Fair Value through profit or loss**

- It is the normal default classification for financial assets, which are applicable to all financial assets except they are to be measured at amortised cost or fair value through other comprehensive income; and
- This classification includes financial assets held for trading purposes and derivatives unless they are properly designated for hedging arrangements.

(d) **Amortisation Schedule**

Amortisation schedule indicating amortised cost at the end of each year

Year Ended	Amortised cost brought forward	Effective Interest at 12%	Cash received	Amortised cost carried forward
	₦	₦	₦	₦
2020	575,000,000	69,000,000	75,000,000	569,000,000
2021	569,000,000	68,280,000	75,000,000	562,280,000
2022	562,280,000	67,473,600	75,000,000	554,753,600
2023	554,753,600	66,570,432	75,000,000	546,324,032
2024	546,324,032	65,558,884	75,000,000	536,882,916
2025	536,882,916	64,425,950	575,000,000	26,308,866

The journal entries at the end of December 31, 2025 will be as follows:

	Dr.	Cr.
	₦	₦
Cash	575,000,000	
Balance as per amortisation table	26,308,866	
Investment in Lagos State Government Bond		536,882,916
Investment income		64,425,950
Being entries on amortisation of Lagos State Government bond		

Examiner's report

The parts (a) and (b) of the question is on International Accounting Standards Board (IASB) requirements which relates to process of issuing International Financial Reporting Standards (IFRS) and the enhancing characteristics of financial information. While part (c) and (d) dealt with classes of financial instrument under IAS 9 as well as preparation of amortisation schedule of government bonds.

Most candidates attempted parts (a) and (b) of the question while majority did not attempt parts (c) and (d), on Financial Instruments.

The performance of the candidates in this question was below average probably due to their poor performance in the parts (c) and (d).

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

	Marking guide	**Marks**	**Marks**
a)	Steps involved in issuing IFRS		
			6
b)	Enhancing characteristics of financial information:		
	- Stating two enhancing characteristics of financial information	1	
	- Explaining two enhancing characteristics of financial information	1	2
c)	Classes of financial instruments under IFRS 9:		
	- Stating classes of financial instrument	1	
	- Explaining of two classes of financial instrument	3	4
d)	Preparation of amortisation schedule:		
	- Stating relevant headings for the amortisation schedule	1¼	
	- Calculation of amortised cost carried forward for the years 2020 to 2025	5 ½	
	- Journal entries for the year ended 2025	1¼	8
	Total		**20**

SOLUTION 5

(a) Professional behaviour denotes that members must comply with relevant extant laws and regulations of the Institute of Chartered Accountants of Nigerian (ICAN) and that members of the Institute should avoid any action which discredits the profession. Members should behave with courtesy and consideration towards all with whom they come into contact with in professional capacity.

Fundamental threats to these principles

The fundamental threats to the principles of professional behaviour are as follows:

- **Self interest threat** may occur as a result of the financial or other interests from family members or immediate close friends;
- **Self-review threat** occurs when a previous judgement needs to be re-evaluated by members responsible for that judgement, that is, where a member maintains books of account of an entity, he may not be willing to find fault with the financial statements derived from those records;
- **Advocacy threats** occur when a Chartered Accountant provides false or misleading information in advocating for an entity. A Chartered Accountant may often need to promote the entity's position by providing financial information. As long as the information provided is neither false nor misleading, such actions would not create advocacy threat.
- **Familiarity threat** occurs when a Chartered Accountant becomes too sympathetic in the course of carrying out his or her professional duty as a result of interest from family members and close associates; and
- **Intimidation threats** occur when a member, in the process of performing his or professional duty is intimidated or influenced by fear, such a member entertains fear when he or she works with aggressive clients.

(b) i) Under IAS 38, the conditions under which development costs can be recognised as intangible assets in the financial statements are:

- 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; and
- The development expenditure can be measured reliably (for example, via costing records).

ii) The following are the factors to be considered in determining the useful life for the amortisation of an intangible asset, in the financial statements:

- The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;
- Typical product life cycles for the assets and public information on estimates of useful lives of similar assets that are used in a similar way;
- Technical, technological, commercial or other types of obsolescence;

- The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
- Expected actions by competitors or potential competitors;
- The level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;
- The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
- Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

Examiner's report

The question tests ICAN code of professional behaviour and provisions of IAS38 on Intangible Assets.

Most candidates attempted the question but their performance was below average.

The common pitfalls were as follows:

- Inability to correctly states the conditions under which development costs can be recognised as intangible assets in the financial statement; and
- Some candidates could not explain what is meant by professional behaviour and state the threats that could affect such behaviour.

Candidates are advised to read relevant professional accounting journals and pay special attention to accounting standards that are relevant at this level of the Institute's examination for better performance in future.

	Marking guide	**Marks**	**Marks**
a.	- Correct explanation of professional behaviour	2	
	- Stating three (3) threats to professional fundamental principles	3	5
b.(i)	Explanation of five (5) conditions under which development cost can be recognised as intangible assets		5
(ii)	Stating five (5) conditions which should be considered to determine the useful life in the amortisation of Intangible assets		5
	Total		**15**

SOLUTION 6

a i. **Potential ordinary share**

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

Three examples of potential ordinary shares are:

- Financial liabilities or equity instruments that are convertible into new ordinary shares at some time in the future, such as convertible debentures, convertible preference shares, etc.;
- **Share options and warrants.** Options and warrants are financial instruments that give the holders the right, but not the obligation, to purchase new ordinary shares at some time in the future at a fixed price; and
- Shares that will be issued if certain contractual conditions are met, such as contractual conditions relating to the purchase of a business.

ii. **Procedure for ranking potential ordinary share**

- When there are several types of potential ordinary shares in issue, they should be ranked in order of dilution, with the most dilutive potential ordinary shares ranked first;
- In order to carry out the ranking the earnings per incremental share is found for each potential ordinary share. This is the earnings adjustment that would be necessary, divided by the number of shares that would come into being if the shares were included in the calculation of diluted EPS; and
- The money options and warrants always rank first as they increase the number of shares in the calculation without affecting the earnings.

Jumai Nigeria Limited

b i. **Ranking Potential Ordinary Shares**

		Increase in earnings ₦	Increase in number of shares	Earnings per incremental ₦	Ranking
i.	Options	0.00	200,000 (wk 1)	0.00	1st
ii	**Convertible bonds:**				
	5% of ₦6,000,000	300,000			
	Less tax at 30%	(90,000)			
		210,000			
	₦6,000,000 x 30/100		1,800,000		2nd
		210,000	1,800,000	0.12 (wk 2)	
iii	**Preference shares:**				
	8% of ₦2,000,000 × 0.7	112,000			
		112,000			
	200,000 shares x 1/25		8,000	14.00 (wk 3)	3rd
			8,000		

ii) **Jumai Nigeria Limited**
Calculation of EPS

	Earnings	Number of shares	EPS	
	₦		₦	
Basic EPS	18,000,000	6,000,000	3.00	
Options	0	200,000		
Diluted EPS options only	18,000,000	6,200,000	2.90	Dilutive
Convertible Bonds	210,000	1,800,000		
**DEPS options and Bonds	18,210,000	8,000,000	2.28	Dilutive
Convertible pref shares	112,000	8,000	2.29	Not Dilutive
	18,322,00	8,008,000		

The diluted earnings per share is 2.28

Workings:

Wk 1 Cash received 800,000 × ₦52.50 = ₦42,000,000
Shares purchasable = ₦42,000,000 ÷ ₦70 = 600,000 shares
Dilutive number of shares = (800,000 - 600,000) = 200,000 shares

Wk 2 Convertible bonds = 210,000 ÷ 1.800,000 = 0.12

Wk 3 Preference share = 112,000 ÷ 8,000 = 14
**DEPS is diluted earnings per share

c) **Limitations of EPS**

(i) Not all entities use the same accounting policies. It may not always be possible to make meaningful comparison between EPS of different entities.
(ii) EPS does not take account of inflation, therefore growth in EPS over time might be misleading.
(iii) EPS measures an entity's profitability, but this is only part of an entity's overall performance. An entity's cash flows can be just as important as its profit (and more essential to its immediate survival). Changes in the value of assets that is holding gains can also be an important part of performance for some entities.
(iv) Diluted EPS is often described as an early warning to investors that the returns on their investment may fall sometimes in the future. However, diluted EPS is based on current earnings, not forecast earnings. This means that it may not be a reliable predictor of future EPS.
(v) EPS is not a complete tool for investment analysis as it cannot provide information on liquidity position of the entity.

Examiner's report

The question is on provisions of IAS 33-Earnings Per Share (EPS) and it also, tests candidates' knowledge of computation of diluted EPS and limitation of EPS as a means of determining an entity's performance.

Most candidates attempted the question, but performance was poor. Majority of the candidates could not explain and state the types of potential ordinary share, while others could not calculate the diluted earnings per share for options, convertible bonds and preference shares.

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

	Marking guide	**Marks**	**Marks**
ai)	Explanation of the term potential ordinary shares	1½	
	- Stating three (3) examples of potential ordinary shares	1½	3
ii)	Description of three procedures of ranking potential ord. shares		3
b)	Correct ranking of potential ordinary shares:		
	Options	1	
	Convertible bonds	1	
	Convertible preference shares	1½	
	Calculation of diluted EPS for the year:		
	Options	1½	
	Convertible bonds	1	
	Convertible preference shares	1	7
c)	Correctly stating three (3) limitations of EPS as means of evaluating entity's performance:		
	Presentation of solution	½	
	Three (3) limitations	1½	
			2
	Total		**15**

SOLUTION 7

Purpose of Conceptual Framework of International Accounting Standards Boards (IASB)

a) The purposes of Conceptual Framework of the International Accounting Standard Board (IASB) are to assist:

i. In the development of future international standards;
ii. In the review of the existing standards;
iii. National standard setters in development of national standards;
iv. Preparers of financial statements in the application of international standards;

v. In dealing with topics that are not yet covered in the international standards;

vi. Auditors in forming opinion as to whether financial statements conform with the international standards;

vii. Users of financial statements to interpret the information in the financial statements prepared in accordance with the international standards; and

viii. Those who are interested in the work of IASB with information about its mode of operations and approaches to the formulation of international standards.

b) **Basics Steps in the Application of Business Model Test in IFRS 9**

The steps in the application of business model tests under IFRS 9 are as follows:

i. Sub-dividing where necessary loans and receivables into different groups or portfolios based on the way they are managed;

ii. Objective identification of the entity, which is used in the course of its business to manage each group or portfolio;

iii. Classification for each group or portfolio of financial assets as being held to collect, and held to sell; and

iv. The appropriateness of the classification will be evaluated through back-testing of past activities, for the assets classified as held to collect.

Examiner's report

The question tests candidates' knowledge of Conceptual Framework issued by International Accounting Standards Board (IASB) and the applications of Business Model Test for various classes of financial instruments under IAS 9.

Most candidates attempted the question and performance was average.
The candidates performed very well in part(a) of the question which is on purpose of Conceptual Framework but performed badly in part (b) that requires them to explain steps in the application of Business Model Test under IAS 9.

Candidates are advised to pay more attention to accounting standards on financial instruments and other relevant standards at this level of the Institute's examination for better performance in future.

	Marking guide	**Marks**
a.	Explanation of six (6) purposes of Conceptual Framework of International Accounting Standards Board (IASB)	9
b.	Explanation of three (3) basic steps in the application of business model test in IFRS 9	6
	Total	**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

AUDIT AND ASSURANCE

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

WEDNESDAY, NOVEMBER 16, 2022

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

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

AUDIT AND ASSURANCE

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

In an accountancy class on "Audit Opinion in International Standards on Auditing", Ado, a lecturer at ICAN University, was explaining to the students that the end product of external audit work is the auditor's opinion expressed on the financial statements. He stated that a general purpose financial statement was in compliance with the financial reporting framework designed to meet the common financial information needs of a wide variety of users.

The role of audit is to provide a high level of assurance to the users of the financial statements and that it is necessary for users to have confidence that consistent **auditing standards** have been applied to the audits of financial statements of companies. He went further to explain that the overall objectives of the independent auditor is to ensure that the conduct of an audit is in accordance with International Standards on Auditing. He concluded that the auditor's report shall include a section with the heading "Opinion" as stated below

Opinion
We have audited the financial statements of Inajit Plc set out on pages XXX to XXXX which comprise the statement of financial position as at year end date, and the statement of profit or loss and other comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of financial position of Inajit Plc as at year end date, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Companies and Allied Matters Act 2020 and Financial Reporting Council Act, 2011.

At the end of the lecture a student in the class came to you for further explanation on the topic.

Required:

a. State the objectives of the independent auditor as stated in International Standards on Auditing. (5 Marks)
b. Outline what ISA 200 requires the auditor to do in relation to the audit of financial statements. (10 Marks)
c. Explain the scope of audit as described in the independent auditor's report. (5 Marks)
d. Highlight the role of regulatory bodies in ensuring that audits are carried out in line with standards. (10 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

The International Standards on Auditing (ISA) 230 deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements.

Required:

a. State **FIVE r**easons for preparing audit documentation. (5 Marks)
b. Highlight the requirements of ISA 230 on audit documentation. (3 Marks)
c. State **FIVE** contents each of current and permanent files. (10 Marks)
d. Explain who owns audit working papers and why. (2 Marks)

(Total 20 Marks)

QUESTION 3

ISA 210, *Agreeing the Terms of Audit Engagements,* requires that the auditor needs to agree the terms of audit engagement prior to commencement of work.

Required:

a. What is an engagement letter? (2 Marks)
b. Highlight **EIGHT** major items expected to be found in a typical audit engagement letter. (8 Marks)
c. State **FIVE** advantages of an engagement letter. (5 Marks)
d. State **FIVE** requirements of ISA 210 with respect to the preconditions for accepting appointment as an auditor. (5 Marks)

(Total 20 Marks)

QUESTION 4

You are part of an audit team engaged on the audit of an engineering company which has a substantial amount of plant and machinery in its books. While reviewing the accounts, you also observed that there were some current assets and liabilities that may require external confirmations.

Required:

a. How would you establish the amount and level of audit evidence required for the current assets and liabilities? (5 Marks)

b. State which procedures will be applied to generate audit evidence in the following scenarios:

  i. Confirming the accuracy of figures in the trade receivables account
  ii. Confirming that the plant and machinery purchased in the year is actually in use during the year
  iii. Ascertaining that the change in performance is in line with expectation
  iv. Confirming the accuracy of the total receivable figures in the statement of financial position
  v. Confirming contingent liability as to legal fees (5 Marks)

c. State the audit procedures you would take concerning the disposal of plant and machinery. (5 Marks)

d. State the requirements of ISA 505 concerning maintaining control over the external confirmation requests of current assets and liabilities. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

In the apex bank's regulatory supervisory report to Dutse Bank Limited, the management has been directed to ensure institution of an Internal Audit Unit. Prior to this time, the bank believed that internal audit staff might be colluding with other staff to suppress information on fraudulent transactions and as such the desired result might not be achieved. Apart from this, it was considered that savings could be made from transport, hotel and other allowances to be paid to staff when on official assignments. The independent auditor had earlier mentioned the need for this in the audit report but management was of the view that it is acceptable to cross-train employees in different departments to be able to audit departments other than their own. In the opinion of management, this will provide a more independent and unbiased view through checks and balances. The audit function they perform through multitasking will best add value to the progress of the organisation.

It is also the belief of management that the basic processes of both accounting and auditing are similar. The two systems use essentially the same procedures and techniques of bookkeeping, computation and analysis. To them, accounting and auditing strive to ensure that the financial statements and records provide a fair reflection of the actual financial position of an organisation. Both activities are inter-related and go hand in hand, especially in setting up processes in the organisation, hence, there is no need for any Internal Audit Unit or duplication of efforts.

As the independent auditor of the bank, you were shown the regulatory supervisory report and you have been asked to make presentation to the Board of Directors on the necessity for the Internal Audit Unit in the bank.

Required:

a. Explain the need for the internal audit functions in an organisation. (5 Marks)

b. State the various measures that can be taken to protect the independence of internal auditors. (5 Marks)

c. Explain the weaknesses and limitations of internal audit. (5 Marks)

(Total 15 Marks)

QUESTION 6

When prompted on a question at the presentation meeting to the audit committee of AMIRAH Plc, the Partner of OIO professional services stated that the end result of the statutory audit is general purpose financial statements on which audit opinion will be expressed. He explained that the auditor shall express an unmodified opinion when the auditor concludes his work, based on the audit evidence obtained, that the financial statements as a whole are free from material misstatement and that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. However, if the external auditor is unable to obtain sufficient and appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report. In summary, the auditor's opinion is a certification that accompanies financial statements after the examination of the books of accounts.

You are the manager in the firm and a member of the audit committee has requested for more explanation on the presentation by the partner.

Required:

a. Explain general purpose financial statements. (5 Marks)

b. Highlight to an audit committee member, the contents of audit opinion in financial statements. (10 Marks)

(Total 15 Marks)

QUESTION 7

In order to ensure that an audit is carried out effectively and efficiently, the work needs to be planned, controlled and recorded at each stage of the program.

Required:

a. What matters must be taken into consideration when planning an audit? (3 Marks)

b. What are the benefits of adequate audit planning? (3 Marks)

c. What are the key benefits that would arise from spreading the audit work across interim and final audits? (4 Marks)

d. State **FIVE** audit procedures that are carried out at the final audit stage. (5 Marks)

(Total 15 Marks)

SOLUTION 1

(a) The objectives of the auditor are formally specified in ISA 200 as:

i. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework; and

ii. To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

(b) In relation to the audit of financial statements, ISA 200 requires the auditor to:

i. Comply with all ISAs relevant to the audit;

ii. Comply with relevant ethical requirements;

iii. Plan and perform an audit with professional scepticism;

iv. Exercise professional judgement in planning and performing an audit; and

v. Obtain sufficient and appropriate audit evidence to allow him to obtain reasonable assurance

(c) The scope of an audit as described in the independent auditor's report contains the following points:

i. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements;
ii. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement in the financial statements, whether due to fraud or error;
iii. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control;
iv. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management; and
v. Assessment and evaluating the overall presentation of financial statements.

(d) The role of regulatory bodies in ensuring that audits are carried out in line with standards normally includes the following:

i. Offering professional qualifications for auditors, to provide evidence that auditors possess a minimum level of technical competence;
ii. Establishing procedures to ensure that the professional competence of auditors is maintained. This includes matters, such as:
    - Ensuring that audits are performed only by 'fit and proper' persons, who act with professional integrity;
    - Requiring that the members carry out their audit work in accordance with appropriate technical standards (for example, in accordance with International Standards on Auditing, known as ISAs);
    - Ensuring that auditors remain technically competent and up to date with modern auditing practice (for example, by following a programme of continuing professional development);
    - Providing procedures for monitoring and enforcing compliance by its members with the rules of the regulatory body. These include rules and procedures for the investigation of complaints against members and the implementation of disciplinary procedures where appropriate
    - Maintaining a list of registered auditors which is made available to the public; and
    - Such a system is referred to as a system of self-regulation. In such a system, the regulation of auditors is carried out by their own professional bodies.

The government may appoint a public body with similar responsibilities to a self-regulating professional body.

The public body may, therefore, establish rules and procedures for:

i. Approving/authorising individuals to perform audit work;
ii. Ensuring that authorised auditors have the necessary minimum skills and knowledge to carry out their audit work to a proper standard; and
iii. Handling complaints and taking disciplinary measures against auditors, where appropriate.

In addition, Statutes (e.g. CAMA) establish that certain individuals are ineligible to act as an external auditor in the context of a given company, even if they are members of an appropriate regulatory body. These exclusions are designed to help to establish the independence of the auditor. In line with section 403 of CAMA 2020, the following individuals are prohibited from acting as the auditor of a company:

i. An officer or servant of the company;
ii. A person who is a partner of or in the employment of an officer or servant of the company; or
iii. A body corporate.

Examiner's report

This question which is in four parts, tests the candidates' knowledge of the requirements of the International Standards on Auditing (ISAs)

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

The candidates' commonest pitfall was their inability to explain the requirements of the International Standards on Auditing (ISAs)

Candidates are advised to read the ISAs because of their importance in relation to the audit of financial statements.

Marking guide

		Marks	Marks
a)	**Stating the objectives of the independent auditor as stated in International Standards on Auditing**		
	-3 marks for "to obtain assurance of financial statements being free from material misstatement for the auditor's opinion"	3	
	- To report and communicate on financial statements as required by ISAs	2	5
b)	**Outlining what IAS 200 requires the auditor to do in relation to the audit of financial statements**		
	2 marks each, subject to a maximum 5 requirements of ISA 200		10
c)	**Explanation on the scope of audit as described in the independent auditor's report**		
	1 mark each, subject to a maximum 5 points		5
d)	**Highlighting the role of regulatory bodies in ensuring that audits are carried out in line with standards**		
	- 2 marks for setting professional qualification for auditors	2	
	- 1 mark each for self-regulatory role by the professional bodies, subject to a maximum of 4 points	4	
	- 1 mark each for regulation by government, subject to a maximum of 4 points	4	10
	Total		**30**

SOLUTION 2

a) Audit documentation is the record of auditing procedures and documents applied, evidence obtained and conclusion reached by the auditor, in the audit engagement or process.

Audit documentation

i. Can be used as a defence, if the auditor is ever accused of negligence;
ii. Makes the review of the audit work easier;
iii. Represents a better level of quality control over an audit;
iv. Shows auditors in later years how the audit was conducted;
v. Can be used as a training tool for junior auditors;
vi. Ensures that members of the audit team are accountable for their work; and
vii. Assists to keep a record of all matters of continuing importance to future audit.

b) **ISA 230 requirements**

The auditor should prepare, on a timely basis, audit documentation that provides:

i. A sufficient and appropriate record of the basis for the audit report; and
ii. Evidence that the audit was performed in accordance with ISAs and applicable legal and regulatory requirements.

c) **Current audit files** contain information that relate to a specific audit engagement. Examples are:

i. Management accounts for the current period;
ii. List of major schedules of balances;
iii. Management letter;
iv. Letter of representation;
v. Audit queries and their dispositions;
vi. Audit adjustments;
vii. Current period's audited financial statements;
viii. Circularisation letters and responses;
ix. Extract of minutes of board meetings held during the period;
x. Current period's management budget and estimates;
xi. Audit programme;
xii. Audit planning materials like audit plan, risk assessment and materiality threshold;
xiii. Audit checklists; and
xiv. Copy of letter of engagement.

Contents of a permanent audit file include:

i. Certificate of incorporation;
ii. Memorandum and articles of association or any other legal constitution;
iii. Organisation structure and management profile;
iv. List of branches and addresses;
v. List of banks and locations;
vi. Copy of letter of engagement;
vii. Copies of audited financial statements to date;
viii. Copies of important agreements entered into by the company or entity;
ix. List of directors;
x. List of major shareholders or members of the entity;
xi. Summary of the history and development of the entity; and
xii. Summary of the accounting system and other operational procedures.

d) **Owners of audit working papers**

Audit working papers are owned by the auditors. The auditor, in a statutory audit, is performing in a principal capacity and not as an agent. If any legal issue arises from his audit, he has to defend himself, hence ownership of the working papers is appropriate.

The working papers **do not** form part of the accounting records of the client, and do not belong to the client. Auditing standards require the auditor to ensure that working papers are kept safe and their contents are kept **confidential**. Information therefore should only be made available to third parties in accordance with ethical guidelines and legal requirements.

Examiner's report

The question tests the candidates' understanding of the requirements of ISA 230 on audit documentation.

About 80% of the candidates attempted the question. Performance of the candidates was fair in parts(c) and (d) which relate to the contents of current and permanent files, and ownership of audit working papers, respectively but was poor in parts (a) and (b) which asks for the reasons for audit documentation, and requirements of ISA 230 on audit documentation, respectively.

The major pitfall of the candidates was their inability to explain the provisions of the International Standards on Auditing (ISA).

Candidates are advised to study the ISAs and also make use of the Institute's Study Text and Pathfinder.

Marking guide	**Marks**	**Marks**
a) **Stating the reasons for preparing audit documentation**		
1 mark each for a reason for preparing audit documentation, subject to a maximum of 5 points		5
b) **Stating the requirements of ISA 230 on audit documentation**		
1½ marks each, subject to a maximum of 2 requirements of ISA 230 on audit documentation		3
c) **Stating the contents of current and permanent files**		
1 mark each, subject to a maximum of 5 contents of current file	5	
1 mark each, subject to a maximum of 5 contents of permanent file	5	10
d) **Explanation of ownership of audit working papers**		
1 mark for stating the auditor is the owner of audit working papers	1	
1 mark for stating the reason in respect of the above	1	2
Total		**20**

SOLUTION 3

a) An engagement letter is a mandatory requirement which sets out the legal relationship between a professional firm and its client.

It should be provided before any work is undertaken as it sets out key information, including the scope of the contract.

b) **An engagement letter should include details of the following:**

i. The objective and scope of the audit;
ii. The responsibilities of the auditor;
iii. The responsibilities of management;
iv. Identification of the underlying financial reporting framework;
v. Reference to the expected form and content of any reports to be issued;
vi. Any restriction of the auditor's liability when such possibility exists;
vii. The expectation that management will provide written representation;
viii. The basis on which fees are computed and any billing arrangements;
ix. A request for management to acknowledge receipt of the engagement letter and to agree to its terms;
x. Arrangements concerning the involvement of other auditors and experts; and
xi. The planning and performance of the audit.

c) **Advantages of an engagement letter include:**

i. It helps to dissect responsibilities in the sense that the management is responsible for the preparation of financial statements, whereas the auditor is responsible to ensure that these financial statements have not been misstated;
ii. It prevents risk of misunderstandings with client;
iii. It makes the client better informed and educated on the nature and scope of the audit;
iv. The information contained in the engagement letter assists in planning the audit; and
v. It serves as a means of avoiding legal liability for claims that auditors did not perform the assignment as promised.

d) **Five requirements of ISA 210 with respect to the preconditions for accepting appointment as an auditor include:**

i. Establishing if the financial reporting framework to be used in the preparation of the financial statements is acceptable;
ii. Obtaining the agreement of management that it acknowledges and understands its responsibility for the preparation of the financial statements and internal controls to ensure that the financial statements are not materially misstated;
iii. Ensuring no limitation of scope is imposed by management that would disable auditor's opinion;

iv. Providing the auditor with all relevant and requested information and unrestricted access to all personnel by management or those charged with governance; and

v. Ensuring that management agrees to their responsibilities.

Examiner's report

The question tests candidates' understanding of the provisions of ISA 210- *Agreeing the Terms of Audit Engagements.*

About 80% of the candidates attempted the question but the performance was fair in parts (a) and (b) and poor in parts (c) and (d).

The major pitfall of the candidates was their inability to state the preconditions for accepting an appointment as an auditor as stated in ISA 210.

Candidates should study the requirements of relevant ISAs and cover the entire syllabus when studying for future examinations.

Marking guide		**Marks**
a)	**Explanation of an engagement letter**	
	2 marks for explaining and identifying major items in an engagement letter	2
b)	**Highlighting major items in a typical engagement letter**	
	1 mark each, subject to a maximum of 8 major items in the engagement letter	8
c)	**Stating the advantages of an engagement letter**	
	1 mark each, subject to a maximum of 5 advantages of engagement letter	5
d)	**Stating the preconditions for accepting appointment as an auditor**	
	1 mark each, subject to a maximum of 5 requirements of ISA 210 for preconditions for accepting any appointment	5
	Total	**20**

SOLUTION 4

a. The factors that determine the amount and level of audit evidence for the current assets and liabilities include the:
   i. Effectiveness of internal control measures put in place;
   ii. Materiality of the items of current assets and liabilities;
   iii. Effectiveness of the accounting system;
   iv. Reliability of the enterprise staff and management;
   v. Consistency of the evidence;

vi. Sampling method applied to obtain audit evidence;
vii. Professional judgement by the auditor on evidence gathering process; and
viii. The level of risk that the financial statements might not give a true and fair view.

b. The procedures that will be applied to generate audit evidence in the following scenarios are as follows:

i) **Trade receivables account**

Accuracy of the figures in the accounts can be confirmed by obtaining confirmation from external/third parties. Direct confirmation involves asking customers to provide written confirmation directly to the auditors of their account balances with the client entity.

ii) **Purchase of plant and machinery in the year**

- Obtain/prepare a schedule for the additions.
- Check the authorisation of the expenditusre to purchase these additions.
- Confirm that total additions reconcile with the movement between the opening and closing balances in the notes to the financial statements.
- Inspect a purchase invoice or other documents as evidence of the cost of any additions and confirm that the documents are in the company's name.
- Verify the existence of the acquired plant and machinery by means of physical inspection, where applicable.
- Check that entries in the accounting records are correct, confirming the allocation of total expenditure between capital and revenue expenditure.

iii) **Change in performance**

This can be ascertained to be in line with expectation by comparing budgets with actual performance in the period. Analytical review procedures will identify unusual variation between the budget and actual.

This could help management to identify areas where the variations occurred and assist in necessary investigation to know the reason(s) for such variations, whether expected or abnormal.

iv) **Accuracy of the total receivable figures in the statement of financial position**

The auditors need to be satisfied that the presentation and disclosure of the total trade receivables is correct. This can be done by:

- Agreeing the list of receivable ledger balances (on which he based his substantive procedures) with the financial statements figure;

- Correct disclosure and classification of receivables in the financial statements;
- Conduct cut-off tests between credit sales procedures and trade receivables; and
- Checking that due provision is made for doubtful receivables.

v) **Contingent liability as to legal fees**

- Ascertain the approach taken by the client's management to identify contingencies on legal fees.
- Review minutes of the board meeting where such matter was discussed and approved.
- Review the client's correspondence with lawyers and invoices for legal services.
- Consider direct confirmation from lawyers of matters handled on behalf of the entity under audit.

c. **Procedures for disposal of plant and machinery include:**

i. Obtaining or preparing a schedule of disposals for the period;
ii. Checking or the authorisation of the disposals;
iii. Confirming cost and the accumulated depreciation figures of the items have been removed from the accounting records;
iv. Verifying the calculation of the figure for the gain or loss on disposal and verify that this figure has been correctly recorded in the ledger; and
v. Discussing with management, the possibility of unrecorded disposals of assets.

d. **The requirements of ISA 505 concerning the external confirmation requests of current assets and liabilities**

The auditor should maintain control over the confirmation process in the:

i. Identification of the member or members of the audit team responsible for controlling the external confirmation process, the resources assigned and the timing of the related procedures;
ii. Selection of items for which external confirmations will be requested;
iii. Design and preparation of the confirmation requests;
iv. Communication of the confirmation requests to the appropriate confirming party;
v. Consideration of the results (responses, non-responses and exceptions) of confirmation requests; and
vi. Evaluation of the evidence obtained from the confirmation requests.

Examiner's report

The question which is in four parts tests the candidates' knowledge on audit evidence and the requirements of ISA 505 on external confirmation regulation.

About 20% of the candidates attempted the question. The performance was poor.

The candidates' major pitfall was the candidates' inability to generate audit evidence in given scenarios.

Candidates are advised to study very well for future examinations by covering the entire syllabus. They should also make use of the Institute's Study Text and Pathfinder.

Marking guide		**Marks**
a) **Stating the amount and level of audit evidence required for current assets and liabilities**		
1 mark each for stating the amount and level of audit evidence, subject to a maximum of 5 points		5
b) **Stating the procedures to be used and applied to generate audit evidence in the following scenarios:**		
(i) Confirming the accuracy of figures in the trade receivables account	1	
(ii) The plant and machinery purchased in the year is actually in use during the year	1	
(iii) Ascertaining that the change in performance is in line with expectation	1	
(iv) Confirming the accuracy of the total receivables figures in the statement of financial position	1	
(v) Confirming contingent liability as to legal fees	1	5
c) **Stating the audit procedures concerning disposal of plant and machinery**		
1 mark each for any of the 5 procedures for the disposal of plant and machinery		5
d) **Stating the requirements of ISA 505 concerning control over external confirmation requests of current assets and liabilities**		
1 mark each for any of the 5 requirements of ISA 505 for external confirmation request		5
Total		**20**

SOLUTION 5

a) **The need for internal audit function include:**

i. **Monitoring of internal control:** The establishment of adequate internal control system is a responsibility of management and is an important aspect of good corporate governance. Because the internal control system needs to be monitored on a continuous basis, large companies are likely to establish internal audit function to assist management in this role. Internal audit is therefore usually given specific responsibility by management for reviewing internal controls, monitoring their operation and recommending improvements via reports to those charged with governance;

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

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

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

v. **Special investigations** into particular areas such as suspected fraud.

b) **Measures to protect internal audit independence include:**

i. **Reporting lines** - The internal auditor should report to the audit committee or those charged with governance;

ii. **Deciding the scope of internal audit work -** The scope of work carried out by the internal auditors should not be decided by the Finance Director or line management responsible for the operations that might be subjected to audit. This is to avoid the risk that the internal auditors might be assigned to investigation of non-contentious areas of the business. The scope of internal audit work should be decided by the Chief Internal Auditor or by the audit committee.

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

iv. **Appointment of the head of internal audit -** The head of internal auditor should not be appointed by a senior executive who may have some self interest in wishing to appoint an internal auditor that can easily be controlled. Instead, the audit committee should be responsible for appointing a new head of internal audit, subject perhaps to approval by the board of directors;

v. **Designing internal controls -** The internal auditors should not be responsible for the design of internal controls within the entity. If they did, they would then be auditing their own work, which will amount to a self review threat and this is unacceptable. Senior management in accounting and finance or line management should have responsibility for the design and implementation of internal controls, taking advice where appropriate from the external auditors when control weaknesses are identified during the external audit; and

vi. **Professionalism-** It is advisable to appoint someone who is professionally qualified to head the internal audit function to assist in maintenance of independence.

c) **Weaknesses and limitations of internal audit**

Since internal audit is not a regulatory requirement, there is no requirement for internal auditors to be professionally qualified for the work they do (although there may be a professional institute or association of internal auditors). It is therefore a matter for the entity setting up the internal audit function what qualifications or experience it requires of the members of its internal audit team.

In contrast, the external auditor must comply with regulations set by government and his professional body covering technical and professional standards and qualifications. However, internal auditors who are members of a professional body (such as the ICAN) will need to comply with the requirements of that body in any work that they do.

Limitations to having an internal audit unit include:

i. The cost of having one; and
ii. The problems that may arise with ensuring the independence of the internal auditors.

Examiner's report

The question tests candidates' knowledge of internal audit functions, weaknesses and limitations of internal audit, and independence of the auditors.

About 85% of the candidates attempted the question but the performance was just fair.

Some of the candidates were not able to explain the weaknesses and limitations of internal audit.

Candidates should endeavour to cover all relevant areas of the syllabus in their preparations for subsequent examinations.

Marking guide

		Marks
a)	**Stating the need for internal audit function** 1 mark each for any of the 5 needs for internal audit function	5
b)	**Stating the measures to be taken to protect the independence of the internal auditors** 1 mark each for a measure to protect auditors independence, subject to a maximum of 5 points	5
c)	**Stating the weaknesses and limitations of internal audit** 1 mark each for any of the 5 points on weakness and limitations of internal audit	5
	Total	**15**

SOLUTION 6

a. **General purpose financial statements**

In line with ISA 700, the Auditor's Report on Financial Statements, general purpose financial statements are financial statements prepared in accordance with a general-purpose framework, that is designed to meet the common financial information needs of a wide range of users.

The financial reporting framework may be a fair presentation framework or a compliance framework. The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework.

b. The contents of audit opinion in financial statements to the audit committee. The auditor is required to evaluate whether:

i. He has obtained sufficient, appropriate audit evidence as to whether the financial statements are free from material misstatement;
ii. Uncorrected misstatements are material individually or in aggregate;
iii. The financial statements have been prepared in accordance with the requirements of the applicable financial reporting framework (which for a "fair presentation framework" will include evaluating whether the financial statements give a true and fair view and in particular whether:
   - The financial statements adequately refer to or describe the applicable financial reporting framework;
   - The financial statements adequately disclose the entity's significant accounting policies;
   - The significant accounting policies are appropriate and consistent with the applicable financial reporting framework;
   - Accounting estimates are reasonable;
   - The information in the financial statements are relevant, reliable, comparable and understandable;

- The financial statements provide adequate disclosures; and
- The terminology used in the financial statements is appropriate.

Examiner's report

The question tests the candidates' understanding of general purpose financial statements and contents of audit opinion.

About 20% of the candidates attempted the question and the performance was poor.

The candidates' major pitfall was lack of understanding of general-purpose financial statement.

The candidates should study well for the examinations making use of the Institute's Study Text and other relevant materials.

Marking guide		**Marks**	**Marks**
a)	**Explanation of general purpose financial statements**	3	
	Explanation on general purpose financial statements		
	Explanation on fair presentation framework	2	5
b)	**Highlighting the contents of audit opinion in financial statement to an audit committee member**		
	2 marks each, subject to a maximum of 5 contents of the audit opinion		10
	Total		**15**

SOLUTION 7

a. The following matters should be taken into consideration in planning an audit:

i. Preliminary work to be done before the audit proper;
ii. Review of previous years' working papers;
iii. Review of changes in relevant legislation and auditing or accounting practice guidelines;
iv. Analytical review of management accounts, interim accounts, etc.;
v. Review of changes in the business or its management;
vi. Review of changes in systems or accounting procedures;
vii. Timing requirements;
viii. Extent of preparation by the client of analyses, schedules and summaries;
ix. Use of internal audit;
x. Degree of reliance on internal controls;
xi. Rotational testing and verification;
xii. Joint auditors, if any; and
xiii. Review of relevant business or enabling environment.

b. **Benefits of adequate audit planning include:**

i. Helping the auditor to devote appropriate attention to important areas of the audit;

ii. Helping the auditor to identify and resolve potential problems;

iii. Helping the auditor to organise and manage the audit engagement so that it is performed in an effective and efficient manner;

iv. Assisting in the selection of staff with appropriate experience and the proper assignment of work to them; and

v. Allowing for the direction and supervision of staff and review of their work.

c. **The key benefits that would arise from spreading the audit work across interim and final audits include:**

i. More flexible resource planning within the firm – the planning of the interim audits is typically more flexible than the timing of final audit. This helps reduce demand for audit staff during "busy season" (traditionally the first few months of a calendar year when many clients require their final audit to take place);

ii. Earlier identification of significant matters;

iii. Shareholders and other users receive audited financial statements earlier;

iv. Increased audit efficiency; and

v. Suitability for large and dynamic organisations, making the conclusion of the final audit faster.

d. **Audit procedures that are carried out at the final audit stage include:**

i. Reviewing the audit evidence collected;

ii. Reviewing the final version of the financial statements;

iii. Checking the quality control;

iv. Communicating with those charged with corporate governance;

v. Holding audit clearance meeting;

vi. Reviewing subsequent events;

vii. Carrying out analytical review; and

viii. Obtaining third party confirmations, such as bank letters and trade receivable confirmations for review and proper analysis.

Examiner's report

The question which is in four parts tests the candidates' understanding on audit planning, spreading audit work across interim and final audits, and the audit procedures that are carried out at the final stage.

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

The candidates' commonest pitfall was their inability to state audit procedures that are carried out at the final audit stage.

The candidates are enjoined to prepare well for the Institute's examinations by making use of ICAN Study Text and Pathfinder.

Marking guide		**Marks**
a)	**Stating the matters to be taken into consideration when planning an audit**	
	1 mark each, subject to a maximum of 3 consideration in planning an audit	3
b)	**Stating the benefits of adequate audit planning**	3
	1 mark each, subject to maximum of 3 benefits of adequate planning	
c)	**Stating the key benefits of spreading the audit work across interim and final audits**	4
	1 mark each, subject to a maximum of 4 key benefits for spreading the audit work across interim and final audits	
d)	**Stating the procedures that are carried out at the final audit stage**	
	1 mark each, subject to maximum of 5 procedures	5
	Total	**15**

ICAN/222/Q/B4 **Examination No...................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

PERFORMANCE MANAGEMENT

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.
8. A formula sheet and discount tables are provided with this examination paper.

WEDNESDAY, NOVEMBER 16, 2022

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

PERFORMANCE MANAGEMENT

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Koliwi Limited is a company that builds innovative and environmentally friendly housing. Their houses use high quality materials and the unique patented energy saving technology used in the houses has been the result of the company's own extensive research in the area.

Koliwi Limited is planning to expand into another country and has been asked by a prominent person in that country for a price quotation to build them a house. The Board of Directors believes that securing the contract will help to launch their houses in the country and have agreed to quote a price for the house that will exactly cover its relevant cost.

The following information has been obtained in relation to the contract:

(1) The Chief Executive and Marketing Director recently met with the potential client to discuss the house. The meeting was held at a restaurant and Koliwi Limited provided food and drinks at a cost of ₦37,500.

(2) 1,200 kg of Material Z will be required for the house. Koliwi Limited currently has 550 kg of Material Z in its inventory purchased at a price of ₦5,800 per kg. Material Z is regularly used in its houses and has a current replacement cost of ₦6,500 per kg. The resale value of the Material Z in inventory is ₦3,500 per kg.

(3) 400 hours of construction workers' time are required to build the house. Koliwi Limited construction workers are paid an hourly rate of ₦2,200 under a guaranteed wage agreement and currently have spare capacity to build the house.

(4) The house will require 90 hours of the engineers' time. Koliwi Limited engineers are paid a monthly salary of ₦475,000 each and do not have any

spare capacity. In order to meet the engineering requirement for the house. Koliwi Limited can choose one of two options:

(i) Pay the engineers an overtime rate of ₦5,200 per hour to perform the additional work.

(ii) Reduce the number of engineers' hours available for their existing job, for the building of Product Y. This would result in lost sales of Product Y.

Summary details of the existing job the engineers are working on:

Information for one unit of Product Y	
Sales revenue	₦486,000
Variable costs	₦336,500
Engineers' time required per unit	30 hours

(5) A specialist machine would be required for 7 weeks for the house to be built. Koliwi Limited has 4 weeks remaining on the 15 week specialist machine rental contract that cost ₦1,500,000. The machine is currently not in use. The machine can be rented for an additional 15 weeks at a cost of ₦1,525,000. The specialist machine can only be rented in blocks of 15 weeks.

Alternatively, a machine can be purchased for ₦16,000,000 and sold after the work on the house has been completed for ₦14,000,000.

(6) The windows required for the house have recently been developed by Koliwi Limited and use the latest environmentally friendly insulating material. They produced the windows at a cost of ₦3,495,000 and are currently the only ones of their type. They were planning to exhibit the windows at a house building
conference. The windows would only be used for display purposes at the conference and would not be for sale to prospective clients.

Koliwi Limited has had assurances from three separate clients that they would place an order for 25 windows each if they saw the technology demonstrated at the conference. The contribution from each window is ₦1,045,000. If the windows are used for the contract, Koliwi Limited would not be able to attend the conference. The conference organisers will charge a penalty fee of ₦150,000 for non-attendance by the Company. The Chief Executive of Koliwi Limited can meet the clients directly and still secure the orders for the windows. The meetings would require two days of the Chief Executive's time. The Chief Executive is paid an annual salary of ₦41,400,000 and contracted to work 260 days per year.

(7) The house to be built requires 400kg of other materials. Koliwi Limited currently has none of these materials in its inventory. The total current purchase price for these other materials is ₦600,000.

(8) Koliwi Limited fixed overhead absorption rate is ₦3,700 per construction worker hour.

(9) Koliwi Limted normal policy is to add 12% mark-up to the cost of each house.

Required:

a. Produce a schedule that shows the minimum price that could be quoted for the contract to build the house. Your schedule should show the relevant cost of each of the **NINE** items identified above. You should also explain each relevant cost value you have included in your schedule and why any values you have excluded are not relevant. (21 Marks)

b. Explain **TWO** reasons why relevant costing may not be a suitable approach to pricing houses in the longer term for Koliwi Limited. (4 Marks)

c. Recommend, with justifications, a pricing strategy for Koliwi Limited to use to price the innovative, environmentally friendly houses when they are launched in the new country. (5 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

Ibezi Nigeria Limited manufactures and sells three products A, B and C.
The company is recently considering the introduction of an activity-based costing approach to facilitate efficient cost allocation, as well as achieve improvement in cost accuracy and reduction.

Under Activity based wrong approach, direct materials and direct labour are allocated to products and indirect costs are apportioned using cost pools which represent the time activity areas. The Traditional costing approach uses the two direct cost categories and a single indirect cost pool where overheads are allocated using direct labour hours.

The following information is provided for the next period.

	Product A	Product B	Product C
Production and sales (units)	120,000	75,000	30,000
Direct material cost	₦190	₦180	₦160
Direct labour hours	6	8	7
Machine hours	4	8	9
Number of production runs	15	30	75
Number of component receipts	45	75	360
Number of production orders	45	30	75

Direct labour is paid at ₦8 per hour. Variable overhead is paid at ₦34 per unit for Product A, ₦44 per unit for Product B and ₦38 per unit for Product C.

Fixed overhead costs in the period are expected to be as follows:

	₦	Cost Driver
Set up	1,260,000	Production Runs
Machine	8,100,000	Machine Hours
Goods inwards	2,520,000	Company Receipt
Packaging	1,800,000	Production Order
Engineering	1,620,000	Production Order
	15,300,000	

Required:

a. Calculate the unit costs of each product using:

i. Traditional Cost approach, based on direct labour hourly rate. (5 Marks)

ii. The ABC method. (5 Marks)

b. The company considered the pricing of the three products where sales prices have remained uncertain as shown in the table below:

Product A		**Product B**		**Product C**	
Prob.	₦	Prob.	₦	Prob.	₦
0.5	300	0.6	350	0.5	450
0.3	360	0.3	400	0.4	440
0.2	390	0.1	420	0.1	430

Compute the expected unit sales prices for the three products and the total profit or loss for each product that will arise from the implementation of the ABC approach and the traditional costing method. (7 Marks)

c. State reasons why activity based costing approach may be preferred to traditional absorption costing approach in a modern manufacturing environment. (3 Marks)

(Total 20 Marks)

QUESTION 3

High Tech plc is a manufacturer of computer applications (apps) and has contracts to supply the components to contractors operating throughout the West African region.

Set out below is a part of the Master Budget for the component for the month of April 2021.

Budget for April 2021

	₦	₦
Sales 3,000 batches of apps at ₦80.00		240,000
Direct materials 225,000kg at ₦0.40 per kg	90,000	
Direct labour 5,000 hours at ₦12.00 per hour	60,000	
Variable Overhead (absorbed on direct Labour hours)	15,000	
Fixed overhead (absorbed on output)	30,000	195,000
Profit		45,000

High Tech plc uses absorption costing to arrive at product cost. Annual fixed overhead budget for the year ending April 2021 is ₦360,000 and the normal annual output is expected to be 36,000 batches.
Early in May 2021, these results were available to operating managers:

INCOME STATEMENT ACCOUNT FOR APRIL 2021

	₦	₦
Sales of 2,800 batches		225,000
Direct materials 210,000 kg at a cost of	88,000	
Direct labour 4,400 hours at a cost of	52,000	
Overhead: Variable	12,000	
Overhead: Fixed	36,000	
		188.000
Profit		37,000

Required:

a. Prepare a full standard cost card per batch showing contribution margin. (4 Marks)

b. Calculate all relevant variances and prepare a report reconciling budgeted and actual contribution for April 2021. (12 Marks)
Outline **FOUR** factors to be taken into consideration by the management of the company before deciding whether or not to investigate any

particular variance shown on the April Report prepared in (b) above.
(4 Marks)
(Total 20 Marks)

QUESTION 4

Ukachi and Sons limited has two operating divisions, X and Y, which are treated as profit centres for the purpose of performance reporting.

Division X makes two products, Product A and Product B. Product A is sold to external customers for ₦248 per unit. Product B is a part-finished item that is sold only to Division Y.

Division Y can obtain the part-finished item from either Division X or from an external supplier. The external supplier charges a price of ₦220 per unit. Department Y produces Product C which is sold at a mark up of 25% of cost which is the company sales policy.

The production capacity of Division X is measured in total units of output, Products A and B. Each unit requires the same direct labour time. The costs of production in Division X are as follows:

Cost Element	**Product A**	**Product B**
	₦	₦
Variable cost	184	192
Fixed cost	76	76
Total unit cost	260	268

Required:

a. i. What is an optimal transfer price or price range for Product B?
(3 Marks)

ii. What would be the optimal transfer price for Product B if there is spare production capacity in Division X? (3 Marks)

iii. What would be the optimal transfer price for Product B if Division X is operating at full capacity due to a limited availability of direct labour and there is unsatisfied external demand for Product A?
(5 Marks)

b. The following additional information relate to business activities in the two divisions.

Particular	**Dept. X**	**Dept. Y**
Product A: Production / Sales units	150,000	
Product B: Production of part finished items	100,000	
Product B: Procurement from external suppliers		80,000
Product C: Sales		180,000
Investment Capital	₦40 million	₦50 million
Cost of Capital	15%	15%

Required:

i. Prepare an operating statement showing the optimal profit the Divisions can generate in the period when operating at full capacity with no spare capacity. (4 Marks)

ii. Using the return on investment and residual income approaches Provide a comparative analysis of the performance of the divisions provided for the period. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

Zinko Limited is launching a new, innovative product onto the market and is trying to decide on the right launch price for the product. The product's expected life is three years. Given the high level of costs which have been incurred in developing the product, Zinko Limited wants to ensure that it sets its price at the right level and has therefore consulted a market research company to help it do this. The research, which relates to similar but not identical products launched by other companies, has revealed that at a price of ₦60, annual demand would be expected to be 250,000 units. However, for every ₦2 increase in selling price, demand would be expected to fall by 2,000 units and for every ₦2 decrease in selling price, demand would be expected to increase by 2,000 units.

A forecast of the annual production costs which would be incurred by Zinko Limited in relation to the new product are as follows:

Annual production (units)	**200,000**	**250,000**	**300,000**	**350,000**
	₦	**₦**	**₦**	**₦**
Direct material	2,400,000	3,000,000	3,600,000	4,200,000
Direct labour	1,200,000	1,500,000	1,800,000	2,100,000
Overheads	1,400,000	1,550,000	1,700,000	1,850,000

Required:

a. Calculate the total variable cost per unit and total fixed overheads. (3 Marks)

b. Calculate the optimum (profit maximising) selling price for the new product and calculate the resulting profit for the period.
Note: If $P = a + bx$; then, $MR = a - 2bx$. (7 Marks)

c. The sales director is unconvinced that the sales price calculated in (b) above is the right one to charge on the initial launch of the product. He believes that a high price should be charged at launch so that those customers prepared to pay a higher price for the product can be 'skimmed off' first.

Required:
Discuss the conditions which would make skimming a more suitable pricing strategy for Zinko Limited and recommend whether Zinko Limited should adopt this approach instead. (5 Marks)

(Total 15 Marks)

QUESTION 6

Kolawole Limited (KL) manufactures equipment for metal testing. It also manufactures the electronic testing equipment.

The company has a well-established cost and management accounting system. The cost accounting system records the actual manufacturing costs for the electronic chips and the testing equipment, and also produces standard unit costs for the purposes of budgeting and variance analysis. The management accountant of KL is pleased with the management information system that is in place within the company, and is particularly proud of the budgetary control reporting system that provides monthly control reports to the board within one week of the end of each month.

The market for metal testing equipment is growing at a reasonable rate, but there are three other competitors in the market. Competition between them is strong and consequently profit margins are fairly low at the moment, KL is operating at a profit. KL's senior management are not sure what any competitor might do next, although they suspect that at least one of them may be in financial difficulty. KL's sales director is certain that although low prices are one factor in the buying decisions of customers, customers are much more concerned about the quality, reliability and functional features of the equipment that KL produces.

At a recent board meeting, the board made two important decisions. The first was a decision not to invest in new equipment for manufacturing electronic chips that would significantly reduce the water and energy consumption in the production process. This decision was taken because the discounted cash flow return on investment was considered insufficient.

The second decision was an agreement that costs would need to be reduced to improve profitability. In relation to this, the board decided that employees in the manufacturing units should be empowered more, and should be given some authority to take decisions affecting production operations.

The board also discussed the current lack of sufficient strategic information within KL. They were aware that the decision not to invest in the new equipment had not taken into consideration the probability of rising water and energy costs in the future, and they felt they needed more information to help them predict the long-term prospects for their industry.

Required:

a) Explain the difference between strategic, tactical and operational information, and give examples of each that should be used by a company such as Kolawole Limited. (10 Marks)

b) Discuss why it will be important for Kolawole Limited to monitor non-financial aspects of performance as well as financial performance. (5 Marks)

(Total 15 Marks)

QUESTION 7

A producer of high quality executive motor cars has developed a new model which it knows to be very advanced both technically and in style, compared to the competition in its market segment.

The company's reputation for high quality is well-established and its servicing network in its major markets is excellent. However, its record in timely delivery has not been so good in previous years, though this has been improving considerably.

In the past few years, it has introduced annual variations/improvement in its major models. When it launched a major new vehicle some six years ago, the recommended retail price was so low in relation to the excellent specification of the car that a tremendous demand built up quickly and a two-year waiting list for the car developed within 6 months. Within three months a second-hand model has been sold at an auction for nearly 50% more than the list price and even after a year of production a sizeable premium above list price was being obtained.

The company considers that, in relation to the competition, the proposed new model will be attractive as was its predecessor six years ago. Control of costs is very good so that accurate cost data for the new model are on hand. For the previous model, the company assessed the long-term targeted annual production level and calculated its prices on that basis. In the first year production was 30% of that total.

For the present model, the company expects that the relationship between first-year production and longer-term annual production will also be about 30%, though the absolute levels in both cases are expected to be higher than previously.

The senior management committee, of which you are a member, has been asked to recommend the pricing approach that the company should adopt for the new model.

Required:

a. List the major pricing approaches available in this situation and discuss in some detail relative merits and demerits to the company of each approach in the context of the new model. (10 Marks)

b. Recommend which approach you would propose, giving your reasons. (5 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

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

a = the time taken for the first unit of output

x = the cumulative number of units produced

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

LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

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

a = price when Q = 0

$MR = a - 2bQ$

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

$$Y = a + bX$$

where

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

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

Coefficient of determination (r^2)

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

The Miller-Orr Model

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

Annuity Table

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

Where r = discount rate

n = number of periods

Discount rate (r)

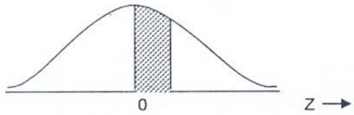
Periods

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

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

NORMAL DISTRIBUTION

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



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

SOLUTION 1

a.

	₦	Note
Food and drink at meeting	-	1
Material Z	7,800,000	2
Construction workers	-	3
Engineers	448,500	4
Specialist machine	1,525,000	5
Windows	150,000	6
Other materials	600,000	7
Fixed overhead	-	8
Profit margin	-	9
Total relevant cost	10,523,500	

Notes

1) The food and drink costs are sunk. The meeting with the client has already occurred and therefore the costs are not relevant.

2) Material Z is regularly used by KL. The 550kg currently in inventory will need to be replaced and therefore should be valued at replacement cost. ₦6,500 × 550kg = ₦3,575,000. The remaining 650kg required for the contract is not owned by KL and therefore will need to be purchased at the replacement cost.
₦6,500 × 650 = ₦4,225,000. The total relevant cost is ₦7,800,000.

3) The construction workers have spare capacity to complete the work and are employed under a guaranteed wage agreement. Construction workers will be paid whether or not they work on the contract. Therefore, the cost is not relevant.

4) Engineers are salaried and this is not an incremental cost. However, they are currently at full capacity and do not have time within their normal hours to complete the 90 hours of work required. The engineer's additional time should be valued at opportunity cost. If overtime is paid, the cost would be 90 hours× ₦5,200 = ₦468,000.

   Alternatively, switching engineers from their existing job.
   90 hours/30 hours to produce a unit = 3 units valued at contribution per unit ₦149,500 = ₦448,500.

   The lower cost of the two options is ₦448,500 and this is the relevant cost.

5) The first rental period is part-way through and the payment of ₦1,500,000 has already been made. Therefore, this is a sunk cost and not relevant. In order to obtain the machine for the required seven week period another 15 week standard rental agreement would have to be entered into, therefore the relevant cost is ₦1,525,000.

If the machine was to be purchased, the relevant cost would be ₦2,000,000 (sales price less resale value). The lower relevant cost of the two options is to rent the machine for another rental period at ₦1,525,000.

6) The cost to produce the windows has already been incurred and is therefore sunk and not relevant.

If KL uses the windows for the building and misses the conference, the sales will not be lost. The chief executive will visit the clients at a later date to secure the sales. Therefore, there is no incremental loss in contribution. The chief executive's time is not relevant as he is paid an annual salary and would receive this irrespective of the visit to the clients.

However, should the windows be used for the building, KL would not be able to attend the conference and be liable to pay the non-attendance fee of ₦150,000.

7) 400kg of other materials are required for the building. The incremental cost is ₦600,000.

8) Fixed costs are not relevant as they will be incurred irrespective of whether the contract is taken or not.

9) Profit mark-up is not relevant as KL is producing a minimum price quotation to exactly cover the relevant cost.

b. When quoting a minimum price for the contract, relevant costing principles are being used. Only relevant costs i.e. those that change as a direct result of the contract decision are included in the quoted cost.

The minimum price will result in KL making neither a profit nor a loss. This is not a sustainable pricing policy in the longer term as it does not include a contribution to the fixed costs of the organisation.

Relevant costing does not include a profit margin. This is not suitable for KL in the longer term as the company is planning to expand into different countries and investors will also require a return on their investment.

c. Market skimming would be a suitable pricing strategy to launch the houses in the new country. Market skimming charges a high price for the product initially where the product is unique and there are significant barriers to entry for competitors. The price is reduced as new competitors enter the market with a similar product. The strategy aims to maximise the profit from the product.

The high quality materials and unique energy saving technology used in the houses should command high prices from customers keen to have a house with this technology. The house that consumers are willing to pay a high price for, together with the barrier to competitors of the new energy saving technology, make KL's product suited to the market skimming pricing strategy. This market skimming approach will allow KL to recover the research and development costs incurred to develop the energy saving technology.

Marking guide

		Marks	Marks	Marks
1 a.	Minimum Price Schedule (12 ticks at 1 mark	12		
	Justification statements (9 ticks at 1 mark)	9	21	
b.	Reasons for relevant costing (2 points at 2 marks each)		4	
c.	- Correct Recommendation	2		
	- Any 2 Justifications at 1½ marks	3	5	**30**

Examiner's report

This question tests candidates' knowledge of price setting using Marginal Costing, Absorption Costing and Relevant Costing criteria and pricing method for new innovative products and projects

The question was well attempted by the candidates because it is a compulsory question.

The pitfall noticed in their performance includes candidates' inability to decipher the costs that are relevant and non-relevant costs. Also candidates' inability to know that skimming pricing strategy will best be adopted in the type of situation Koliwi Limited finds itself in the production of special, innovative and environmental friendly project. It is recommended that candidates preparing for ICAN future examination read the ICAN Study Text.

SOLUTION 2

a) i. Unit cost using Traditional approach:

	A	B	C
	₦	₦	₦
Material	190	180	160
Labour	48	64	56
Variable overhead	34	44	38
Overhead	60	80	70
Unit Cost	332	368	324

Workings:

Total overhead		=	₦15,300,000
=	6 x 120,000	=	720,000
=	8 x 75,000	=	600,000
=	7 x 30,000	=	210,000
			1,530,000 hours

Direct labour hourly rate = $\frac{₦15,300,000}{1,530,000}$ = ₦10/hour

	Product A	Product B	Product C
Direct Labour hours per unit	6 hours	8 hours	7 hours
Direct Labour hourly rate (₦)	10	10	10
Unit overhead cost	₦60	₦80	₦70
Labour cost at ₦8 per hour	₦48	₦64	₦56

ii. Unit cost of Production using ABC approach in overhead absorption

Unit Cost of Product (ABC Approach)

	A	B	C
	₦	₦	₦
Material	190.000	180	160
Labour	48	64	56
Value OH	34	44	38
Overhead	35.83125	66.57	200.25
Unit Cost	307.83125	354.57	454.25

Workings:

Computation of total activity volumes:

	Product Quantity	Direct Labour	Material Cost	Machine Hours	Company Receipt	Production run	Production Order
a	120,000	720,000	22.800,000	480,000	45	15	45
b	75,000	600,000	13,500,000	600,000	75	30	30
c	30,000	210,000	4,800,000	270,000	360	75	75
	Total	1,530,000	41,100,000	1,350,000	480	120	150

Overhead cost per activity (cost driver rate)

Activity	Overhead Cost Allocated	Cost Driver	Activity per period	Overhead Absorption Rate (₦)
	₦			
Set up	1,260,000	Production run	120	10,500 per cost
Machine	8,100,000	Machine hours	1,350,000	6
Goods inwards	2,520,000	Company receipts	480	5,250
Packaging	1,800,000	Production order	150	12,000
Engineering	1,620,000	Production order	150	10,800
	₦15,300,000			

Allocation of Overhead to Product Activity (Computation of Overhead cost per unit using ABC Approach)

Activity	**Cost Driver Rate**	**A**	**B**	**C**	**Total Cost**
		120,000	75,000	30,000	
		₦	₦	₦	₦
Sep up:					
15 product runs	10,500	157,500			157,500
30 product runs	10,500		315,000		315,000
75 production run	10,500			787,500	787,500
Total		157,500	315,000	787,500	1,260,000
Machine:					
480,000 machine hours	6	2,880,000			2,880,000
600,000 machine hours	6		3,600,000		3,600,000
270,000 machine hours	6			1,620,000	1,620,000
Total		2,880,000	3,600,000	1,620,000	8,100,000
Good Include:					
45 receipts	5,250	236,250			236,250
75 receipts	5,250		393,750		393,750
360 receipts	5,250			1,890,000	1,890,000
Total		**236,250**	**393,750**	**1,890,000**	**2,520,000**

Packaging:					
45 production order	12,000	540,000			540,000
30 production order	12,000		360,000		360,000
75 production order	12,000			900,000	900,000
Total		540,000	360,000	900,000	1,800,000
Engineering:					
45 production order	10,800	486,000			486,000
30 production order	10,800		324,000		324,000
75 production order	10,800			810,000	810,000
		486,000	324,000	810,000	1,620,000
Total		**4,299,750**	**4,992,750**	**6,007,500**	**15,300,000**
Unit cost of overhead		₦35.83125	₦66.57	₦200.25	

i. **Expected Sales Price**

Product A			Product B			Product C		
Price	Pr	Expected Selling Price	Price	Pr	Expected Selling Price	Price	Pr	Expected Selling Price
₦		₦	₦		₦	₦		₦
300	0.5	150	350	0.6	210	450	0.5	225
360	0.3	108	400	0.3	120	440	0.4	176
390	0.2	78	420	0.1	42	430	0.1	43
		336			372			444

ii. **Profit Computation using Traditional Costing Approach**

	A	B	C
	₦	₦	₦
Unit Sales Price	336	372	444
Unit Cost	332	368	324
Unit Profit	4	4	120
Quantity	120,000	75,000	30,000
	₦480,000	**₦300,000**	**₦3,600,000**

Profit Computation Using ABC Approach

	A	B	C
	₦	₦	₦
Unit Sales Price	336	372	444
Unit Cost	307.83125	354.57	454.25
Unit Profit/(cost)	28.16875	17.43	(10.25)
Quantity	120,000	75,000	30,000
Total Profit	**3,380,250**	**1,307,250**	**(307,500)**

c. Why ABC is preferred to traditional approach

ABC is preferred traditional costing due to the following reasons:

i. The traditional absorption costing method uses a single basis to absorb fixed overhead costs even if the overhead costs are not related to the basis used.

ii. ABC groups overhead costs into cost pools and assigns a suitable cost driver to each cost pool. By so doing, overheads are absorbed on basis that best reflect the manner in which they were incurred.

iii. ABC uses multiple absorption basis unlike traditional absorption costing method that uses a single basis of absorption.

iv. ABC provides useful information about the activities that drive overhead costs.

v. ABC provides information that could be relevant to long-term cost control and long-term product pricing.

vi. ABC approach shows a more realistic costing approach.

Examiner's report

This question tests candidates' understanding of ABC approach in overhead absorption and cost based pricing in situation of uncertainty. The question was well attempted due to its familiarity. Performance by candidate is above average.

The pitfall noticed was wrongful computation of unit sales price of products due to wrong adoption of the probabilities needed in the computation of sales price.

Candidates are hereby encouraged to carry out their revision using the ICAN study text when preparing for Examination.

Marking guide

			Marks	Marks
(a)	i.	Unit Cost using Traditional Method (25 ticks at 5 ticks for one mark)	5	
	ii.	Unit Cost using ABC method (40 ticks at 8 ticks for 1 mark)	5	10
(b)		- Computation of Selling Price and total profit per product for ABC and traditional method (21 ticks at 3 ticks per mark)	7	
(c)		Importance of ABC over Traditional approach. (Any 2 points at 1½ marks)	3	10
		Total		**20**

SOLUTION 3

a) Workings

Budgeted material usage 225,000/3,000 = 75 kg per unit
Budgeted labour hours 5,000/3,000 = 1.666hrs per unit
Budgeted variable overhead rate: 15,000/5,000 = ₦3.00 per direct labour hr.
Budgeted fixed overhead absorption 30,000/3,000 = ₦10.0 per unit

Standard specification per unit:

	₦	₦
Selling price		80
Variable costs		
Direct materials (75 x ₦0.4)	30	
Direct labour (1.666 x ₦12)	20	
Variable overheads (1.666 x ₦3)	5	55
Contribution		25
Less fixed overheads		10
Profit		15

b) **Workings**

Actual production = 2,800 batches
Actual material cost: 88,000/210,000 =₦0.42 per kg
Actual labour cost 52,000/4,400 = ₦11.82 per hour.

Summary of Variances (excluding Volume variances)
Comparison of Budget v Actual (both for 2,800 units)

Detailed Variances:

Material Price

(SP – AP) x AQ	
(0.4 – 0.42) x 210,000	(4,000)A
Material usage	
(SQ – AQ) x SP	
(210,000 – 210,000) x £0.40	-
check	(4,000)A

Labour Rate

(SR – AR) x AH
(12 – 11.82) x 4,400 | 800F

Labour Efficiency

(SH – AH) x SR
(4,667 – 4,400) x £12 = 3,200F
check 4,000F

Variable Overhead Efficiency

(SH – AH) x SR
(4,667 – 4,400) x £3.0 800F

Variable overhead expenditure
(AH x SR) – Actual cost

(4,400 x 3) – 12,000 1,200F
2,000F

Fixed overhead expenditure
(budgeted cost – actual cost)
30,000 – 36,000 (6,000)A

Sales Margin Price Variance

Actual Revenue – Budgeted revenue for actual level of output

225,000 - 224,000 1,000F

Sales Margin volume variance
(Actual units – Budgeted units) x standard contribution per unit

(2,800 – 3,000) x ₦25.00 (5,000)A

Fixed Overhead Capacity Variance = SC (BH – AH)
N6 (5,000 – 4,400)
= N3,600A

Fixed Overhead Efficiency Variance = SC (AH – SHAP)

$$₦6 \left[4{,}400 - \frac{2{,}800}{3{,}000} X \frac{5{,}000}{1}\right]$$

= ₦1,600F

Fixed Overhead Volume Variance = ₦3,600A + ₦1,600F

= ₦2,000A

ii. **Reconciliation of Budgeted contribution and Actual Contribution for April 2021**

Budgeted Contribution (₦25 x 3000 batches)			75,000
Sales variance: Sales Price variance	1000F		
Sales quantity margin variance	5000A		(4000)
Standard profit			71,000
Standard cost variance			
	Favourable	Adverse	
Direct material price variance		N4000	
Direct Material usage variance			
Direct labour rate variance	800		
Direct labour efficiency variance	3200		
Variable overhead expenditure variance	800		
Variance overhead efficiency variance	1200		
Total	6000	4000	2000F
Actual Contribution			73,000

c) **FACTORS TO CONSIDER BY MANAGEMENT BEFORE INVESTIGATING VARIANCE**

i. Size of the variance: generally, the cause of the variance is more likely to be significant if thevariance is large. This is a matter of materiality and management may need to determine what is material.

ii. Favourable or adverse variance: significant favourable or adverse variance may need to be investigated. However, adverse variance tends to require more investigation than favourable variances because of the impact of adverse variances on profit.

iii. Probability that the cause of the variance will be controllable: whether or not to investigate avariance will depend on management's expectation that the cause of the variance will be controllable.

iv. Cost and benefit of the control action: investigating a variance has a cost in terms of management's time actual cost incurred. A variance should not be investigated unless the expected benefits outweigh the cost.

v. Reliability and accuracy of the figures.

vi. Possible interdependencies of variances

vii. The inherent variability of the cost or revenue trends in variances.

Examiner's report

This question tests candidates' understanding of standard costing, variance computation and reconciliation of Budgeted Contribution with Actual Contribution. Many candidates attempted the question. Being a familiar question, performance was high and encouraging.

The pitfall was in candidates failing to compute capacity and efficiency variance preferring to determine the volume variance only.

It is advised that candidates read the questions thoroughly in order to provide solution that fulfil the requirement of the question and familiarise themselves with the ICAN study text.

Marking guide

3.		Marks	Marks
a.	Standard Cost Card (8 ticks at ½ mark)	4	
B i.	Computation of variances and preparation of reconciliation statements (24 ticks at ½ mark)	12	
ii.	Any four considerations at 1 mark for each consideration	4	
	Total		**20**

SOLUTION 4

(a) i. **OPTIMAL TRANSFER PRICE OR PRICE RANGE FOR PRODUCT B**

Since the only consumer of product B is Division Y, the minimum transfer price should be set at marginal cost less any cost savings due to internal sales.

The variable cost per unit of product B is ₦192, hence the minimum transfer price should be set at ₦192 per unit of B.

The maximum transfer price per unit for B would be the price that the external supplier charges Division Y, which is ₦220.

Hence, the optimal transfer price per unit would lie between a minimum of ₦192, and a maximum of ₦220.

ii. **OPTIMAL TRANSFER PRICE FOR PRODUCT B IF THERE IS SPARE CAPACITY**

If Division X has spare production capacity, then the units of product B have no opportunity cost and should be transferred to Division Y at variable cost less any cost savings due to internal sales. The transfer price would therefore be N192 per unit.

iii. **OPTIMAL TRANSFER PRICE FOR PRODUCT B IF DIVISION X OPERATES AT FULL CAPACITY**

If Division X is at full capacity and would forego sales of product A to suppy product B to Division Y, then the units of product B would have to be transferred at marginal cost less any cost savings plus the contribution forgone on sales of product A.

The contribution per unit of A is ₦64 (i.e. ₦248 – ₦184). Thus, the optimal transfer price would be ₦192 + ₦64 = ₦256.

(b)ii. **OPERATING STATEMENT**

Division X		**Division Y**	
	₦		₦
Sales		Sales	
Product A to external parties (150,000 x ₦248)	37,200,000	Product C (₦256 x 1.25 x 180,000)	57,600,000
Product B to Division Y (100,000 x ₦256)	25,600,000		
	62,800,000		57,600,000
Variable costs		Costs	
Product A (150,000 x ₦184)	27,600,000	80,000 @ ₦220	17,600,000
Product B (100,000 x ₦192)	19,200,000	100,000 @ ₦256	25,600,000
	46,800,000		43,200,000
Contribution	16,000,000		
Fixed costs			
Product A (150,000 x ₦76)	11,400,000		
Product B (100,000 x ₦76)	7,600,000		
	19,000,000		
Profit /(Loss)	(3,000,000)	Profit/(Loss)	14,400,000

ii. **COMPARATIVE ANALYSIS OF PERFORMANCE**

	Division X	**Division Y**
	₦	**₦**
Profit /(loss)	(3,000,000)	14,400,000
Investment	40,000,000	50,000,000
	%	%
ROI	**-7.5%**	**28.80%**
Cost of capital	15%	15%
	₦	**₦**
Profit/(loss)	-3,000,000	14,400,000
Charge on capital employed	6,000,000	7,500,000
Residual Income (RI)	**(9,000,000)**	**6,900,000**

Due to the transfer price policy of operating at full capacity, Division X is not able to charge a share of its fixed costs to division Y, hence Division X is operating at a loss of N3million while Division Y with no fixed overhead cost implication is operating at a Profit of ₦14.4 million.

The ROI for division X is therefore negative of ₦3million for its investors while Division Y generates a 28.80% returns per Naira invested.

Division X generates a residual loss of ₦9million while Division Y generates a residual income of ₦14.40 million. The cost of capital for both Divisions is the same at 15% but Division Y has a higher investment base.

Examiner's report

The question tests candidates' understanding of transfer pricing and divisional performance appraisal. This is a familiar question that should have attracted high performance from the candidates.

However, candidates' performance was average due to lack of understanding of Transfer pricing in situations of spare capacity and where there is limited resources.

Candidates are hereby encouraged to study the ICAN Performance Management Manual and indeed other Management Accounting text books to widen their scope of understanding and knowledge of transfer pricing and divisional performance evaluation when preparing for future ICAN examination.

Marking guide

4.		Marks	Marks
(a)i.	Optimal transfer price	3	
ii.	Optimal transfer price when there is space capacity	3	
iii.	Optimal transfer price under limited resources	5	11
(b)i.	Operating Statement (12 ticks for 4 marks)	4	
ii.	Computation of ROI and residual income (10 ticks at ½ mark)	5	9
	Total		**20**

SOLUTION 5

a) **Variable cost per unit**

Material cost =₦2,400,000/200,000 = ₦12 per unit

Labour cost = ₦1,200,000/200,000 = ₦6 per unit

Variable overhead cost using high-low method:

(₦1,850,000 - ₦1,400,000)/(350,000 - 200,000) = ₦3 per unit

	₦
Direct material	12
Direct labour	6
Variable overhead	3
	21

Fixed cost = ₦1,400,000 - (200,000 x ₦3) = ₦800,000

b) **Optimum price**

Find the demand function

Demand function is $P = a + bx$, where:

P = Price per unit

x = quantity

$b = \Delta P/\Delta x = -2/2000 = -0.001$

Therefore $P = a - 0.001x$

Find value for 'a' by substituting the known values for P and x:

$60 = a - (0.001 \times 250{,}000)$

$a = 310$

(**Note:** This is the maximum selling price, that is, the price at which no quantity will be demanded.)

Therefore P = 310 - 0.001x

Identify marginal cost (MC)

MC = unit variable = ₦21

Identify total revenue (TR)

TR = (P)(x) = (310 - 0.001x)(x)

= $310x - 0.001x^2$

Identify marginal revenue (MR)

MR = dTR/dx = 310 - 0.002x

Equate MC and MR to find x

21= 310 - 0.002x

x = 144,500

Substitute x into demand function to find P

P = 310 - (0.001 x 144,500) = ₦165.50

Calculate profit

Total contribution = 144,500 x (₦165.50 - 21) =	₦20,880,250
Fixed cost	(800,000)
Profit	₦20,080,250

c) **Market skimming**

As the sales director suggests, market skimming is a strategy which initially charges high prices for the product in order to take advantage of those buyers who want to buy it as soon as possible, and are prepared to pay high prices in order to do so.

If certain conditions exist, the strategy could be a suitable one for Zinko Ltd. The conditions are as follows:

- Where a product is new and different, so that customers are prepared to pay high prices in order to gain the perceived status of owing the product early. All we know about Zinko Ltd's product is that it is 'innovative', so it may well meet this condition.

- Where products have a short life cycle this strategy is more likely to be used, because of the need to recover development costs and make a profit quickly. Zinko Ltd's product does only have a three-year life cycle, which does make it fairly short.

- Where high prices in the early stages of a product's life cycle are expected to generate high initial cash inflows. If this is the case here, then skimming would be useful to help Zinko Ltd cover the high initial development costs which it has incurred.

- Where barriers to entry exist, which deter other competitors from entering the market, as otherwise, they will be enticed by the high prices being charged. These might include prohibitively high investment costs, patent protection or unusually strong brand loyalty. According to the information we have been given, high development costs were involved in this case, which would be a barrier to entry.

- Where demand and sensitivity of demand to price are unknown. In Zinko Ltd's case, market research has been carried out to establish a price. However, this information is based on the launch of similar but not identical products, so it is not really known just how accurate it will be.

Examiner's report

This question tests candidates' understanding of using high-low method in analysing costs as well as using derived cost data in computing optimum selling price under situation of imperfect competition. It also tests candidates' knowledge of condition that will make skimming price policy more suitable for the company in the prevailing situation.

Candidates attempt on this question was high. However, performance was average. The pitfall was candidates' inability to compute the profit maximising selling price to determine the profit for the period.

Candidates are encouraged to use effectively ICAN Study Text when preparing for future examinations of the Institute.

Marking guide

5.		Marks	Marks
(a)	Total unit variable costs and total fixed cost (6 ticks at ½ mark)	3	
(b)	Optimum Selling Price and resulting profit (14 ticks at ½ mark)	7	
(c)	Skimming Price conditions (Any 2 points at 2½ marks)	<u>5</u>	
	Total		**15**

SOLUTION 6

a) Strategic, tactical and management information are classifications of information that distinguish the purposes for which that information is used. The classifications can also be used to distinguish the type of information that is used at different levels in an organisation with a hierarchical management structure.

Managers at all levels need information to make business decisions. The nature of information required varies according to the level of management and the type of decision. Kolawole Limited (KL) has a management information system that should generate information for decision making at the strategic, tactical, and operational levels of management.

Strategic information

Strategic management needs strategic information. This is information that helps strategic managers to make long-term plans, assess whether these plans will be met, review existing strategies, and make changes or improvements. Strategic information has the following characteristics:

i. If is often information about the organization as a whole or a large part of it
ii. It is usually in summary form, without much detail
iii. It is generally relevant to the longer-term
iv. It is often prepared on ah-hoc basis
v. It may be qualitative or quantitative in nature

For KL, relevant strategic information example would include information about competitors in the market. It appears that a competitor may be in financial difficulty; it may be useful for KL to know more about this and the reasons why the competitor may be in difficulty. It would also be useful to have information about how rival organisations may respond to any competitive initiative by KL.

The management of KL would also benefit from strategic information about technological developments in the industry, the possibility of rising water and energy prices, or even the possibility of government action to discourage excessive energy use by business organisations.

Tactical information

This is information reported to middle managers for the purpose of planning and budgetary control. Tactical information is used to decide how the resources of the organisation should be used, and to monitor how well they are being used. The features of tactical information are:

i. It is usually information about individual departments or operations
ii. It is usually in summary form, but in greater detail than strategic information
iii. It is generally relevant to the short term and medium term
iv. It is often produced on a routine and regular basis
v. It consists mainly of quantitative information

Tactical information examples include both non-financial and financial information. Examples of tactical information include budgets, variance reports for control purposes, efficiency and capacity ratios and summary information about quality failures (re-working of faulty items and items returned under warranty) and on-time deliveries.

Operational Information

Operational information is needed to enable supervisors and front line managers to organize and monitor operations and to make on-the-spot decisions whenever operational problems arise. Operational information may be needed by employees to process transactions in the course of their regular work.

The features of operational information are:

i. It is usually information about specific transactions, jobs, or tasks
ii. It may be summarized at a work group level but is more detailed than tactical information
iii. It is generally relevant to the short term
iv. It is usually about transactions, jobs, and tasks on a daily basis
v. It consists mainly of quantitative information

Examples of operational information include detailed information about throughput times, machine failures and downtime, bottlenecks, complaints, quantities of rejected items and so on.

b) **Importance of non-financial measures** - The quality and reliability of the equipment that KL produces could both potentially be critical success factors for KL because they are likely to be important in customers' buying decisions.

By performing well in these areas, KL should be better placed to sustain its financial performance than if it performs badly in them. For example, if it provides its customers with high quality, reliable equipment, this should ensure a high level of customer retention, which should in turn help it maintain its revenues.

In this way, there would seem to be a strong link between non-financial performance and financial performance.

Importance of financial measures: However, it is also important that KL continues to monitor its financial performance, because there is no guarantee that favourable non-financial performance will necessarily translate into favourable financial performance. For example, although KL's equipment may be very reliable, if it is significantly more expensive than competitors', customers may choose to buy the competitors' equipment instead.

Also, the directors have already highlighted the importance of reducing costs in order to improve profitability. This identifies the importance of monitoring financial performance, in order to assess how successfully KL is reducing its costs and improving profitability.

Combination of measures – KL's profit margins are known to be low, as a result of the intense competition in the market. This reinforces the need to monitor aspects of its financial performance (such as costs and margins). However, it is equally important to monitor whether sale and market share are increasing or decreasing in this competitive market, and how KL is performing in relation to the other critical success factors which will affect customers buying decisions.

Examiner's report

The question tests candidates' knowledge of strategic, tactical and operational management, and features of information needed in each level. It also tests candidates' understanding of the importance of financial and non-financial information in evaluating organisations performance.

The question was well attempted by candidates. Performance of candidates was adjudged high. The only pitfall observed was candidates' concentration on definitions of the 3 levels of information without highlighting the differences.

Candidates are advised to read the questions thoroughly before attempting them. They are also advised to use at all time ICAN Study Text in their revisions.

Marking guide

6.		Marks	Marks
a.	-Differences between strategic, tactical and operational information (3 points each at 1 mark per point at each level	9	
	- Examples (1 example for each level of information at $^1/_3$ mark per example)	<u>1</u>	10
b.	- Importance of both financial and non-financial indicators (1 point for each type of information at 2½ marks)		5
	Total		**15**

SOLUTION 7

(a) The following are the major pricing approaches which may be used in this situation:

(i) - Price skimming
- Penetration pricing

(ii) **Price skimming**
This involves charging a high price relative to competitors. The advantage is that the contribution earned per unit is high. The potential disadvantage is that market share will be restricted. In this situation this restriction in market share would be beneficial in the early stages since it is expected that production in the first year is to be restricted. This would also avoid charging too low a price as happened previously. It would be necessary to advertise to promote the technological and style advantages to potential customers which would help to justify the higher price.

(iii) **Penetration pricing**
Here the aim is to charge a lower price than competitors in order to obtain a high market share at an early stage in the product life cycle. The advantage is that a lower price will encourage people to 'try out' a new product rather than keeping with a familiar 'existing' product. This incentive would appear unnecessary in this case on two counts. Firstly, the reputation of the company is well established and the car's predecessor was well received six years ago.

Secondly, the car is very advanced both technically and in style compared with the competition. This 'non-price' advantage may be sufficient to encourage people to choose this vehicle.

The main advantage of penetration pricing - a high market share - would be a disadvantage for this particular car since it could result in excess demand in the first year, a waiting list and further damage to reputation regarding delivery.

Another disadvantage of charging a low price is the small contribution generated on sales. It may be necessary to charge a lower price at a later stage if a superior quality competitor comes on to the market.

In this case there is a further pricing option which is to charge a price at a similar level to that of competitors. The better technology and style of the car would act as selling features which could result in increased market share which would be a disadvantage in the early stages when production capacity is restricted.

Advantages are that market share may be obtained without offering a discount against competitors' prices and that a price similar to competitors' will not 'rock the boat'. A low price could start a 'price war' which could be very damaging.

(b) In this situation the approach proposed is to charge a high price relative to competitors in the first year and a price similar to that of competitors in later years because:

(i) It enables a high contribution to be earned per car in the first year to compensate for the higher average cost caused by volume being lower and to aid recovery of development costs.
(ii) It is likely to match demand with production, i.e. low in first year and increasing thereafter.
iii) High prices in the first year should prevent excess demand and waiting.
(iv) A high initial price may make it easier to boost market share in the second year when prices are reduced.

Examiner's report

This question tests candidates' knowledge of pricing new products and in this situation, pricing of technically advanced products. Candidates attempt on the question was very high.

Performance was above average. The pitfall was candidates' inability to list the two pricing methods and stating the merits and demerits of the two pricing strategies. Candidates are encouraged to always read the questions before attempting same in order not to stray away from the requirements of the question.

Marking guide

7.		Marks	Marks
a.	- List of pricing approach (2 price strategy at 2 marks each)	4	
	- Merit (Any one merit for each strategy at 1½ marks)	3	
	- Demerit (Any one demerit for each Y strategy at 1½ marks)	3	10
b.	- Recommendation	2	
	- Justification (Any two points at 1½ marks)	3	5
	Total		**15**

ICAN/222/Q/B5 **Examination No...................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

PUBLIC SECTOR ACCOUNTING & FINANCE

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

THURSDAY, NOVEMBER 17, 2022

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

PUBLIC SECTOR ACCOUNTING & FINANCE

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Akanga Local Government of Babulu State constructed a large Liquefied Petroleum Gas (LPG) Station located at its headquarters as an investment property. The purpose is to enhance its internally generated revenue (IGR) so as to complement revenue allocation from the federation account. The LPG station was leased to Home-Use Limited, a Government Business Enterprise (GBE), at a lease rental of ₦8 million payable yearly in advance, commencing from January 1, 2017 to December 31, 2020. The associated finance cost was 10% per annum, when calculating the annual rentals.

The LPG station had a fair value of ₦28million at the inception of the lease, with a residual value of ₦4million at the end of the lease period. Included in the terms of the lease agreement was that the lessee, Home-Use Limited, reserves the right to maintain the gas station throughout the period of the lease. Depreciation is charged on the LPG station on a straight line basis. The accounting year end of Home-Use Limited is December 31.

Required:

a.i. Show how the lease will be treated in the financial statements (extract) of the lessee, Home-use limited, for the years 2017, 2018, 2019 and 2020. (14 Marks)

ii. IPSAS 13-Leases, is formulated to prescribe for the lessor and the lessee the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.

You are required to identify **THREE** features of an operating lease and **FIVE** features of a finance lease. (8 Marks)

b. IPSAS 16-Investment property: is any property held by a government body for the purpose of earning rentals or for capital appreciation, or both.

You are required to state **FOUR** examples of investment property and **FOUR** disclosures that should be made when an investment property is stated at revalued amount. (8 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

IPSAS Board (IPSASB) adopted a due process for the development of International Public Sector Accounting Standards.

Required:

a. Identify **FIVE** stages of IPSASB due process. (5 Marks)

b. Enumerate **FIVE** observations by United Nations on government accounting system in developing countries and identify **FIVE** characteristics of a good public sector accounting system as contained in the United Nations manual on government accounting. (10 Marks)

c. Automated Accounting Transaction Recording and Reporting System (ATRRS) is an ICT based accounting software application, which facilitates the input of accounting transactions, reconciliations and generation of standard accounting reports that meet the treasury requirements.

Identify **FIVE** benefits of the ATRRS accounting software. (5 Marks)

(Total 20 Marks)

QUESTION 3

a. In the course of writing Medium-Term Expenditure Framework (MTEF) report, a lot of issues relating to states in the federation were integrated into the report.

Required:

i. Identify **FIVE** key information contained in the MTEF. (5 Marks)

ii. Identify the **FIVE** requirements of the Fiscal Responsibility Act as it affects time lag for preparation of MTEF the notifying the National Assembly. (3 Marks)

iii. State **THREE** documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget. (3 Marks)

b. A responsible government owes the duty to provide estimates of revenue and expenditure as contained in the constitution and other enabling Acts.

Required:

i. Discuss the term 'fiscal transparency'. (4 Marks)

ii. Identify and explain **THREE** codes of good practices and transparency in line with IMF code of good practices as related to the Nigerian government. (3 Marks)

(Total 20 Marks)

QUESTION 4

a. Nun Local Council Development Area (LCDA) of Bayelsa State has a population of about 1,548,412, citizens based on the last census carried out a year ago. An annual population growth rate of 6% and a 1% rural-urban migration in the past years has been estimated for Nun LCDA.

The following additional information relate to the LCDA:

i. The population strata show:

- Adult Men - 50%
- Adult women - 20%
- Children - 30%

ii. 90% of adult men and 80% adult women are taxable with a flat tax of ₦800 per month.

iii. The LCDA has a Central Market Building that is let out to traders with rent as detailed below:

- 2 floors of warehouses - ₦8million/ floor per annum
- 300 lock-up shops - ₦120,000/ shop per annum
- 150 sheds - ₦82,000/shed per annum

iv. The market opens for 28 days in a month.

v. It is estimated that 17,200 hawkers trade in the market on daily basis and are charged ₦200 per day for 25 days in the month while the market also witnesses 1,500 additional hawkers on each of the 3 market days in a month.

vi. There are 2,411 houses which are charged local tenement rate of ₦1,000 per annum.

vii. The overhead costs for the LCDA in year 2020 are detailed below:

	₦
Motor vehicle maintenance	540,000
Drainage cleaning	185,000
Transport and travelling	140,000
Office maintenance	128,000
Hotel accommodation	223,000
Utility services	200,000
Others	240,000

viii. Inflation factor is estimated at 25%.

Required:

a. Prepare revenue budget and overhead cost budget of Nun LCDA for the year ended December 31, 2021. (15 Marks)

b. Enumerate **FIVE** functions of the Ministry of Finance, Budget and Planning. (5 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

a. The principles of fiscal federalism is concerned with the design of fiscal constitutions. It is how taxing, spending and regulatory functions are allocated among governments and how inter-governmental transfers are structured.

Required:

Differentiate between the crowding-in effect and crowding-out effect of fiscal policy. (5 Marks)

b. The total amount of money borrowed by government directly or through any of the authorised agencies is known as public debt.

Required:

Explain **FOUR** ratios that can be used for measuring debt sustainability of a country and one shortcoming of each ratio. (10 Marks)

(Total 15 Marks)

QUESTION 6

Otunba Local Government wishes to boosts 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. After the projects end, it is unlikely that similar investment opportunities will occur.

Expected net cash flows 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. Explain briefly why the rankings in (b) differ from that in (a) above (1 Mark)

(Total 15 Marks)

QUESTION 7

External debt does not constitute a burden when optimally deployed and the return on investment is sufficient to meet maturing obligations as at when due, while servicing of the domestic economy is not undermined.

Required:

a. Enumerate and explain **THREE** ratios or indicators commonly used to determine the extent of indebtedness of a country. (6 Marks)

b. Identify and explain **SIX** reasons for borrowing. (9 Marks)

(Total 15 Marks)

SOLUTION 1

a. i. **Home-Use Limited**

Statement of profit or loss (extracts) for the years ended December 31, 2017, 2018,2019 and 2020

		₦'000
1/01/2017	Lease rental	8,000
31/12/2017	Depreciation expense	6,000
31/12/2017	Interest expense	2,000
1/01/2018	Lease rental	8,000
31/12/2018	Depreciation expense	6,000
31/12/2018	Interest expense	1,400
1/01/2019	Lease rental	8,000
31/12/2019	Depreciation expense	6,000
31/12/2019	Interest expense	740

1/01/2020	Lease rental	8,000
31/12/2020	Depreciation expense	6,000
31/12/2020	Interest expense	140

Home-Use Limited

Statement of financial position (extracts) as at December 31, 2017, 2018, 2019 & 2020

		₦'000
2017	**Non-current assets**	
	Carrying value of LPG Station (28,000-6,000)	22,000
	Non-current liabilities	
	Lease obligation (28,000 – 8,000)	20,000
2018	**Non-current assets**	
	Carrying value of LPG Station (28,000-12,000)	16,000
	Non-current liabilities	
	Lease obligation (22,000 – 8,000)	14,000
2019	**Non-current assets**	
	Carrying value of LPG Station (28,000-18,000)	10,000
	Non-current liabilities	
	Lease obligation (15,400 – 8,000)	7,400
2020	**Non-current assets**	
	Carrying value of LPG Station (28,000-24,000)	4,000
	Non-current liabilities	
	Lease obligation (8,140 - 8,000 + 14)	154

Workings:

Year	Capital b/f	Rental payment	Capital outstanding	Interest at 10%	Capital c/f
	₦'000	₦'000	₦'000	₦'000	₦'000
2017	28,000	(8,000)	20,000	2,000	22,000
2018	22,000	(8,000)	14,000	1,400	15,400
2019	15,400	(8,000)	7,400	740	8,140
2020	8,140	8,000	140	14	154

ii. **Features of operating lease are:**

- Ownership is not transferrable;
- Risks and rewards incidental to ownership resides with the lessor;
- Lease contains no bargain option;
- Lease term does not cover the major part of the asset's economic life;

- Present value of minimum lease payment does not cover substantially the assets value;
- It is not specialised nature;
- The assets is easily replaceable;
- Lessee does not bear the lessor's cancellation loss;
- No option to extend rental at lower than market value; and
- Gains or losses from the fluctuations in the fair value of the residual value does not accrue to the lessee

Features of finance lease are:

- Ownership is transferrable to the lessee;
- Risks and rewards incidental to ownership resides with the lessee;
- It carries the option to purchase the asset at a lower value than the fair value;
- The lease term is for the major part of the economic life of the assets even if ownership is not transferred;
- At the inception of the lease, the present value of the minimum lease payments cover substantially at least the fair value of the leased assets;
- The leased assets are of specialised nature that only the lessee can use without major modifications;
- Other assets cannot easily replace the leased assets;
- If the lessee can cancel the lease, the losses associated with the cancellation are born by the lessee;
- The lessee has the ability to continue the lease for a secondary period at a rent substantially lower than the market rent; and
- Gains or losses from the fluctuations in the fair value of the residual accrue to the lessee.

b.i. **Examples of investment property are:**

- Land held by a government hospital for capital appreciation, which may be sold at a beneficial time in future;
- Land held for a currently undetermined future use;
- A building owned by the reporting entity (or held by the reporting entity under a finance lease);
- A building that is vacant but is held to be leased out to less than one or more operating leases on a commercial basis to external parties; and
- Property that is being constructed or developed for future use as investment property.

ii. **Disclosures that should be made when an investment property is stated at a revalued amount are:**

- The effective date of their valuation;
- Whether an independent valuer was involved;
- The methods and significant assumptions applied in estimating the assets' fair values;
- The extent to which the assets' fair values were determined directly by reference to observable prices in an active market or recent market

transactions at arm's length terms, or were estimated using other valuation techniques;

- The revaluation surplus, indicating the change for the period;
- The sum of all revaluation surpluses for individual items of investment property within that class; and
- The sum of all revaluation deficits for individual items of investment property within that class.

Examiner's report

Part (a i) of the question tests candidates' knowledge on how lease will be treated in the financial statements (extract) of the lessee while part (a ii) requires the candidates to identify the features of operating lease and finance lease. Part (c) of the question also tests candidates' knowledge on the examples and disclosure requirements of investment property (IPSAS 13).

As a compulsory question, all the candidates attempted the question and their performance was average.

The common pitfalls were the inability of the candidates to calculate the amount of the lease rentals that will be treated in the financial statements (extract) of the lessee and state the features of operating and finance leases. Also candidates were unable to state examples and disclosure requirements of investment property.

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

Marking guide

		Marks	Marks
a..i.	**Statement of profit or loss (extracts)**		
	Title	½	
	Calculation of lease rental, depreciation expense and interest expense of 2017	1½	
	Calculation of lease rental, depreciation expense and interest expense of 2018	1½	
	Calculation of lease rental, depreciation expense and interest expense of 2019	1½	
	Calculation of lease rental, depreciation expense and interest expense of 2020	1½	
	Statement of financial position (extracts) as at 31 December		
	Title	½	
	Calculation of carrying value of non-current assets for 2017, 2018, 2019 and 2020	1	

	Calculation of lease obligation under non-current liabilities for 2017, 2018, 2019 and 2020	1	
	Workings	5	14
ii	**Features of operating lease and finance lease**		
	Three features of operating lease	3	
	Five features of finance lease	5	8
b.	Four examples of investment property	4	
	Four disclosure requirements when an investment property is stated at revalued amount	4	8
	Total		**30**

SECTION B

SOLUTION 2

(a) The IPSASB adopts a due process for the development of IPSASs that provides the opportunity for comment by interested parties including IFAC member bodies. Auditors, preparers (including finance ministries), standards setters and individual are priorities.

The IPSASB's due process for projects normally, but not necessarily takes the following stages:

i. Study of national accounting requirements and practice and exchange of views about the issues with national standard-setters;
ii. Consideration of pronouncement issued by:
  - The International Accounting Standard Board (IASB);
  - National standard setters, regulatory authority and other authoritative bodies;
  - Professional accounting bodies; and
  - Other organisations interested in financial reporting in the public sector.
iii. Formation of Steering Committees (SC). Projects Advisory Panels (PAPs) or sub-committees to provide input to the IPSASB on a project;
iv. Publication of an exposure draft for public comment usually for at least four (4) months. This provides an opportunity to those affected by the IPSASB's pronouncements for comments before they are finalised and approved by the IPSASB. The exposure draft will include a basis for conclusion;
v. Consideration of all comments received within the comment period on discussion documents and exposure drafts, to make modifications to the proposed standards as considered appropriate in the light of the IPSASB's; and
vi. Publication of an IPSAS which includes a basis for conclusion that explains the steps in the IPSASB's due process and how the IPSASB reached its conclusions.

(b) **Some observations on government accounting system in developing countries by United Nations manual**

The general features of government accounting system as published by the United Nations are as follows:

i. Unlike the advanced countries, where research work has been documented and published, the records of general practice in the developing countries are difficult to obtain;
ii. Relatively, little effort has been given to social government accounting and budgetary control system;
iii. Accounting procedures in government departments, which reflect complicated systems of checks and balances, tend to impair the efficacy and timeliness of the accounting information and statistics produced;
iv. 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;
v. Bookkeeping or administrative legal compliance procedures are more common than modern accounting approaches;
vi. Accounting tends to be identified with expenditure control. The fact is that expenditure is subject to multiple checks;
vii. The amount of paper work is much, but no efficiency, accountability or financial control is achieved;
viii. The accounting data upon which government budgets and plans are based are frequently inaccurate and incomplete; and
ix. Financial reports are delayed and generally in arrears. They consequently become obsolete at the point of implementation.

Characteristics of a good system of public sector accounting as published by the United Nations (UN).

The characteristics are as follows:

i. Comply with constitutional, statutory and other legal requirements of the relevant country;
ii. It must be related to budget classifications. Budgetary and financial management must be closely integrated;
iii. It must 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/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. It must 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. It must 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.

(c) **Benefits of the ATRRS Accounting software are:**

i. Familiarise the workforce with the use of IT equipment at an early stage of Government Integrated Financial Management Information System (GIFMIS) implementation, which would enable a smoother transition to the GIFMIS software;
ii. Potentially reduce training period and requirement for GIFMIS;
iii. Potentially reduce GIFMIS implementation cost;
iv. Shorten business process re-engineering period (i.e. it is faster to transit from a semi-automated process than a manual process;
v. Facilitates ease of reconciliation of the various bank accounts; and
vi. Ensure that clean and accurate data will be available for migration to GIFMIS.

Examiner's report

Part (a) of the question tests the candidates' knowledge of the five stages of IPSASB due process for development of standards. Part (b) tests the candidates' knowledge of the United Nations' observations and recommendation on features of good system of public sector accounting in the developing countries, as contained in the United Nations Manual on Government Accounting. Part (c) tests the candidates' knowledge on the benefits of Automated Accounting Transactions Recording and Reporting System (ATRRS).

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

The common pitfalls were the inability of the candidates to differentiate between developing countries and advanced countries. Most of the observations provided by the candidates are for advanced counties as against of developing countries. Also the candidates were unable to identify some benefits of the ATRRS accounting software

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

Marking guide

		Marks	Marks
a.	Five stages of IPSASB adoption of the due process		5
b.	Five observations on government accounting system in developing countries	5	
	Characteristics of a good system of public sector accounting as contained in a United Nations manual on government accounting	5	10
c.	Five benefits of the ATRRS accounting software		5
	Total		**20**

SOLUTION 3

(a) i. **The MTEF contains the following information:**

- A macro-economic framework setting out the three financial years, the underlying assumptions, and an evaluation and analysis of the macro-economic projection for the preceding three financial years;
- Fiscal strategy document setting out:
  - Federal government's medium-term financial objectives; and
  - The policies of the federal government for the medium term relating to taxation, recurrent expenditure borrowings, lending and investment and other liabilities;
- The strategies, economic, social and developmental priorities of government for the next three financial years;
- An explanation of the finance objectives, strategic, economic, social and developmental priorities and fiscal measures;
- An expenditure and revenue framework, which will set out:
  - Estimates of aggregate revenue for the federation for each financial year, based on the pre-determined commodity reference price adopted and tax revenue projections;
  - Aggregate expenditure for each of the next three financial years;
  - Minimum capital expenditure projection for the federation for each of the next three financial years; and
  - Aggregate tax expenditure projection for the federation for each of the next three financial years;
- A consolidated debt statement indicating and describing the fiscal significance of the debt liability and measures to reduce the liability; and
- A statement on the nature and fiscal significance of contingent liabilities and quasi-fiscal activities and measures to offset the crystallisation of such liabilities.

ii. **Requirements of the Fiscal Responsibility Act as it affect time lag for preparation of MTEF and notifying the National Assembly are:**

- A copy of the underlying revenue and expenditure profile for the next two years;

- A report setting out actual and budgeted revenue and expenditure with a detailed analysis of the performance of the budget for the 18 months up to June of the preceding financial year;
- A fiscal target broken down into monthly collection targets;
- Measures of cost, cost control and evaluation of result of programmes financed with budgetary resources;
- A fiscal target document derived from the underlying medium–term expenditure framework, setting out the following relevant targets such as inflation rate, fiscal account balances and any other development deemed appropriate; and
- A fiscal risk document evaluating the fiscal and other related risks to the annual budget and specifying measures to be taken to offset the occurrence of such risks.

iii. **Documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget are:**

- A macro-economic framework;
- A fiscal strategy paper;
- An expenditure and revenue framework;
- A consolidated debt statement; and
- A statement on contingent liabilities.

b. i. **Fiscal transparency**

This is the aspect of accountability, which requires government to carry out all aspects of budgeting responsibilities with openness, trust, basic values and ethical standards without hiding anything from the public. Where a government has something to hide, public reporting is more likely to be infrequent, unreliable and less comprehensive in order to hide material facts.

ii. **IMF code of good practices and transparency**

- **Clarity of roles and responsibilities:** The government sector should be separated from the rest of the public sector and from the rest of the economy. Also, policy and management roles within the public sector should be clearly stated and publicly disclosed;
- **Open budget process:** There should be clear procedures for budget execution, monitoring and reporting. The budget preparation should be guided by well-designed macroeconomic and fiscal policy objectives;
- **Public availability of information:** The public should be provided with comprehensive information on past, current and projected fiscal activity on major fiscal risks. The central government should publish information on the level and composition of its debts and financial assets, significant non-debt liabilities and natural resource assets. Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability; and
- **Assurances of integrity:** These should include that:

- Fiscal data should meet accepted data quality standards and budget forecasts and updates should reflect recent revenue and expenditure trends, underline macroeconomic development;
- Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions to historical fiscal data and any changes to data classification should be explained;
- Ethical standards of behaviour for public servants should be clear and made public;
- Purchases and sales of public assets should be internally audited and audit procedures should be open to review;
- Fiscal information should be independently scrutinised. All public finances and policies should be subject to scrutiny by national audit body or an equivalent organisation that is independent of the executive; and
- The national audit body or equivalent organisation should submit all reports, including its annual report to the legislature and publish them.

Examiner's report

Part (a) of the question requires candidates to identify the key information to be contained in the Medium – Term Expenditure Framework (MTEF). Part (b) requires candidates to identify requirements of Fiscal Responsibility Act as it affects time lag for preparation of MTEF, notifying the National Assembly and to outline the documents that should accompany the estimates of revenue and expenditure of the annual budget. Part (c) of the question requires the candidates to discuss the term 'fiscal transparency' and also to identify and explain codes of good practices and transparency in line with IMF code of good practices as related to the Nigerian government.

Few candidates attempted the question and performance was below average.

The common pitfalls were the inability of the candidates to identify the key information to be contained in MTEF, requirements of Fiscal Responsibility Act as it affects time lag for preparation of MTEF, discuss the term 'fiscal transparency' and explain codes of good practices and transparency in line with IMF code of good practices as related to the Nigerian government.

Candidates are advised to read widely and ensure they have adequate knowledge of relevant provisions of MTEF and other international provisions on codes of good practices and transparency. Pathfinder and Study Text of the Institute are relevant learning materials on this aspect of the syllabus for better performance in future examinations.

Marking guide

		Marks	Marks
a.	Identification of five key information to be contained in an MTEF		5
b. i.	Identification of five requirements of Fiscal Responsibility Act as it affects time lag for preparation of MTEF and notifying the National Assembly	5	
ii.	Three documents that should accompany the estimates of revenue and expenditure of the annual budget	3	8
c. i.	Explanation of 'fiscal transparency'	4	
ii.	Identification any three codes of good practices	1½	
	Explanation any three codes identified	1½	7
	Total		**20**

SOLUTION 4

a. i.

Nun Local Council Development Area, Bayelsa State
Revenue budget for the year ended December 31, 2021

Revenue	**Note**	**₦**	**₦**
Revenue generated from tax:	1		
Adult men:		7,019,585,280	
Adult women:		2,495,852,544	
Total taxable income			9,515,437,824
Rent LCDA property:	2		
Warehouses		16,000,000	
Lock-up shops		36,000,000	
Sheds		12,300,000	
Total rent from LCDA property			64,300,000
Fees from market hawkers:	3		
Regular hawkers		1,032,000,000	
Other hawkers		134,640,000	
Total fees from market hawkers			1,166,640,000
Tenement rate:			
Tenement rates collected on houses			2,411,000
Total revenue budget			**10.748,788,824**

ii.

Nun Local Council Development Area, Bayelsa State
Overhead cost budget for the year ended December 31, 2021

	Note	**₦**
Motor vehicle maintenance	5	675,000
Drainage cleaning		231,250
Transport and travelling		175,000
Office maintenance		160,000
Office accommodation		278,750
Utility services		250,000
Others		300,000
Total overhead cost budget		**2,070,000**

Workings

1	**Population**	
	Current population with 6% growth (1.06 X 1,548,412)	1,641,317
	Less: 1% Rural-urban migration (.01 X 1,641,317)	16,413
	Total population of Nun LCDA	**1,624,904**
	Revenue generated from tax	**₦**
	Adult men: (50% of 1,624,904 X .9 X 800 X 12)	7,019,585,280
	Adult women: (20% of 1,624,904 X .8 X 800 X 12)	2,495,852,544
	Total taxable income	**9,515,437,824**
2	**Rent on local government property**	**₦**
	Warehouses (2 x 8,000,000)	16,000,000
	Lock-up shops (300 x 120,000)	36,000,000
	Sheds (150 x 82,000)	12,300,000
	Total rent from LCDA property	**64,300,000**
3	**Fees from market hawkers:**	**₦**
	Regular hawkers (17,200 x 200 x 25 X 12)	1,032,000,000
	Other hawkers (18,700 x 200 x 3 X 12)	134,640,000
	Totalfees from market hawkers	**1,166,640,000**
4	**Tenement rates**	**₦**
	Tenement charges collected on houses (2,411 x 1,000)	**2,411,000**
5	**Overhead cost**	**₦**
	Motor vehicle maintenance (540,000 X 1.25)	675,000
	Drainage cleaning 185,000 X 1.25)	231,250
	Transport and travelling (140,000 X 1.25)	175,000
	Office maintenance (128,000 X 1.25)	160,000
	Office accommodation (223,000 1.25)	278,750
	Utility services (200,000 X 1.25)	250,000
	Others (240,000 X 1.25)	300,000
	Total overhead cost	**2,070,000**

b. **The functions of the Ministry of Finance, Budget and Planning are as follows:**

i. Developing reasoned economic assumptions and forecasts;
ii. Issuing budget guidelines to the ministries and extra-ministerial departments;
iii. Acting as the liaison between the presidency, ministries and extra-ministerial departments during the budget preparation;
iv. Compiling total revenue and expenditure estimates;
v. Drafting the budget speech;
vi. Supervising and controlling the implementation of the budget;
vii. Monitoring and evaluating the performance of programmes funded through the government budget;
viii. Assessing the impact of the budget on the economy;

ix. Developing formats of returns aimed at ensuring cost effectiveness in the use of government resources; and
x. Carrying out research on budget utilisation and the attainment of national or state objectives.

Examiner's report

Part (a) of the question tests candidates' knowledge of the preparation of revenue and overhead cost budgets. Part (b) tests the functions of the Ministry of Finance, Budget and Planning.

Majority of the candidates attempted the question and performance was average

The common pitfalls were the inability of the candidates to prepare revenue and overhead cost budgets and identify the functions of the Ministry of Finance, Budget and Planning.

Candidates are advised that they should ensure they have adequate knowledge of the relevant provisions on the preparation of revenue and overhead cost budgets and other regulations relating to public sector account for better performance in the Institute's future examinations. The Pathfinder and Study Text of the Institute are relevant learning materials on this aspect of the syllabus.

Marking guide

		Marks	Marks
a.	**Preparation of revenue budget**		
	Title	1¼	
	Calculation of components of total revenue budget	2¾	
	Calculation of total revenue budget	½	
	Workings	3½	
	Preparation of overhead budget		
	Title	1	
	Calculation of components of total overhead budget	4	
	Workings	2	15
b.	**Functions of the Ministry of Finance, Budget and Planning**		
	Five functions		5
	Total		**20**

SOLUTION 5

a. **Crowding-in effect:** If public expenditure has positive or stimulating influence on private consumption, that is, personal consumption and investments, then we have crowding - in effects, which include:

i. Fiscal policy may crowd-in private investment, resulting in positive externalities in some cases. For example, if an increase in public investment is so effective in making people to believe that a boom may come soon, many firms are likely to invest more. Consequently, other firms will increase their investments. This is a desirable outcome of the crowding-in effect, which comes from the positive effect on people's attitude regarding future economic conditions;

ii. It is important for the efficacy of fiscal policy that public spending, especially public investment, produces a profitable outcome for private agents. If a public investment project makes private firms more productive, then crowding-in effect occurs; and

iii. In such situation, government may only stimulate a small number of private firms and/or industries. However, because of the crowding-in effect, this policy may produce more investment in the whole economy.

Crowding-out effect: Public expenditure can have positive and negative effect or influence on private sector, if the public expenditure has negative or restrictive influence on private consumption especially on investments, we have crowding - out effect which include:

i. When governments borrow to pay for a stimulus, this drives up borrowing costs for households and firms, reducing the amount of consumption and investment;

ii. Crowding-out effect reduces the effectiveness of expansionary policies aimed at increasing the total demand for a nation's output;

iii. An increase in the interest rate depresses investment and hence income. This offsetting effect is called the crowding-out effect in the sense that an increase in public spending crowds out private investment; and

iv. A situation when increased interest rates lead to a reduction in private investment spending, it dampens the initial increase of total investment.

b. **Ratios that can be used for measuring debt sustainability of a country and their shortcomings are:**

i. **External debt service to export ratio**

The debt-to-exports ratio is defined as the ratio of total outstanding debts at the end of the year to the economy's exports of goods and services for any one-year. This ratio can be used as a measure of sustainability because an increasing debt-to-exports ratio over time, for a given interest rate, implies that total debt is growing faster than the economy's basic source of external income, indicating that the country may have problems meeting its debt obligations in the future.

Shortcomings

- Countries that use external borrowing for productive investment with long gestation periods are more likely to exhibit high debt-to-exports ratios. But as the investments begin to produce goods that can be exported, the country's debt-to-exports ratio may start to decline. So, for these countries, the debt-to-exports ratio may not be too high from an inter-temporal perspective, though in any given year it may be perceived as large.
- Some countries may benefit from highly concessional debt terms, while others may pay high interest rates. For such countries to better capture the implied debt burden in terms of the opportunity cost of capital, it is useful to report it and analyse the average interest rate on debt. We may also need to the present value of debt by discounting the projected stream of future amortisation payments including interest, with a risk-neutral commercial reference rate.

ii. **Debt to GDP ratio**

The debt-to-GDP ratio is defined as the ratio of the total outstanding external debt at the end of the year to annual GDP. By using GDP as a denominator, the ratio may provide some indication of the potential to service external debt by switching resources from production of domestic goods to the production of exports. Indeed, a country might have a large debt-to-exports ratio but a low debt-to-GDP ratio, if exports comprise a very small proportion of GDP.

Shortcomings

- While the debt-to-GDP ratio is immune to export-related criticisms that mainly focus on the differing degree of value added in exports and price volatility of exports, it may be less reliable in the presence of over-or under-valuations of the real exchange rate, which could significantly distort the GDP denominator.
- Also, as with the debt-to-exports ratio, it is important to take account of the country's stage of development and the mix of concessional and non-concessional debt.

iii. **Ratio of present value of debt to fiscal revenue**

This is defined as the ratio of future projected debt-service payments discounted by market-based interest rates (a risk-neutral commercial reference rate) to annual fiscal revenue. This ratio can be used as a measure of sustainability in those countries with a relatively open economy facing a heavy fiscal burden of external debt. In such circumstances, the government's ability to mobilise domestic revenue is relevant and will not be measured by the debt-to-exports or debt-to-GDP ratios. An increase in this indicator over time indicates that the country may have budgetary problems in servicing its debts

Shortcomings

- Fiscal policy can be swayed by politics and placating voters, which can lead to poor decisions that are not informed by data or economic theory.
- If monetary policy is not coordinated with fiscal policy enacted by governments, it can undermine efforts as well

iv. **Ratio of debt service to exports**

This ratio is defined as the ratio of external debt-service payments of principal and interest on long-term and short-term debt to exports of goods and services for any one-year.

The debt-service-to-exports ratio is a possible indicator of debt sustainability because it indicates how much of a country's export revenue will be used up in servicing its debt and thus, also, how vulnerable the payment of debt service obligations is to an unexpected fall in export proceeds. This ratio tends to highlight countries with significant short-term external debt.

A sustainable level is determined by the debt-to-exports ratio and interest rates, as well as by the term structure of debt obligations. The latter may affect credit worthiness because the higher the share of short-term credit is in overall debt; the larger and more vulnerable is the annual flow of debt-service obligations.

Shortcomings

- The amortisation payments on short-term debt are typically excluded from debt service and the coverage of private sector data can often be limited, either because the indicator is intentionally focused on the public sector or because data on private debt service are not available.
- A debt-service-to-export ratio not corrected for the import intensity of exports is biased downward for economies with a higher propensity to export.

v. **Ratio of international reserves to short-term debt**

This ratio is a pure liquidity indicator that is defined as the ratio of the stock of international reserves available to the monetary authorities to the short-term debt stock on a remaining-maturity basis. This could be a particularly useful indicator of reserve adequacy, especially for countries with significant, but not fully certain, access to international capital markets.

The ratio indicates whether international reserves exceed scheduled amortisation of short-term, medium-term, and long-term external debt during the following year; that is, the extent to which the economy has the ability to meet all its scheduled amortisations to non-residents for the coming year, using its own international reserves.

It provides a measure of how quickly a country would be forced to adjust if it were cut off from external borrowing, for example, because of adverse developments in international capital markets.

Shortcomings

- A large stock of short-term debt relative to international reserves does not necessarily lead to a crisis as being portrayed by the ratio. Many advanced economies have higher ratios of short-term debt to reserves than many emerging economies, which have shown vulnerability to financial crisis.
- The ratio assumes that measured international reserves are indeed available and can be used to meet external obligations; this has not always been true historically.

Examiner's report

Part (a) of the question tests candidates' knowledge on the difference between the crowding – in effect and crowding – out effect of fiscal policy while part (b) tests candidates' knowledge on the ratios that can be used for measuring debt sustainability of a country and one shortcoming of each ratio.

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

The common pitfalls were the inability of the candidates to differentiate between the crowding – in effect and crowding – out effect of fiscal policy. Also, the candidates were unable to explain the ratios that can be used for measuring debt sustainability of a country and one shortcoming of each ratio,

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

Marking guide

		Marks	Marks
a.	**Discussion of crowding-in effect**		
	Definition	$1^1/_2$	
	Explanation of any two of the effects	1	
	Discussion of crowding-out effect		
	Definition	$1^1/_2$	
	Explanation of any two of the effects	1	5
b.	**Ratios that can be used for measuring debt sustainability of a country and one shortcoming of each ratio**		
	Identification of any four ratios	2	
	Explanation of the four identified ratios	4	
	Identification of any one shortcoming of the identified ratios	4	10
	Total		15

SOLUTION 6

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 ₦'000	DCF ₦'000	CF ₦'000	DCF ₦'000	CF ₦'000	DCF ₦'000	CF ₦'000	DCF ₦'000	CF ₦'000	DCF ₦'000	CF ₦'000	DCF ₦'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**

(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	= NPV / 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 that 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, 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, 1,100,000/1,800,000 X 18.82 = ₦11,500,000.

(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. Also, the main difference between NPV and profitability index is that the PI is represented as a ratio, so it does not indicate the cash flow size.

Examiner's report

Part (a) of the question tests candidates' knowledge of the calculation of net present value of projects and their ranking while part (b) asks the candidates to calculate the Profitability Index (PI) and rank the projects to determine how the fund available would be best invested. Pat (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, 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 the Pathfinder and Study Text of the Institute for better performance in the future's examinations.

Marking guide

		Marks	Marks
a.	Calculation of net present value of projects A – F	$6^1/_2$	
	Ranking	$\underline{1^1/_2}$	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	$\underline{1}$	6
c.	Explanation on the reason why ranking between NPV and PI approach to project appraisal differs.		$\underline{1}$
	Total		**$\underline{15}$**

SOLUTION 7

a. There are four major ratios or indicators commonly used to determine the extent of indebtedness of any country. These ratios are explained briefly below:

i. **External debt service to export ratio**: This relates total external debt service to export of goods and services. It reflects the level of export earnings committed to servicing external debts. Since external debts are denominated in foreign currency, then servicing and repayment must be in foreign currency, which can only be procured through export earnings;

ii. **External debt stock to export ratio:** The ratio relates to the availability of foreign exchange earnings in the economy. It is an important indicator since foreign exchange is needed to pay off foreign debts. It reflects the extent to which total exports of goods and services can be used to liquidate external debt outstanding. The movement in this ratio is an indicator of the nation's debt service capacity;

iii. **External debt stock to nominal gross domestic product ratio**: This ratio measures the extent to which total domestic output can be deployed to wipe out total outstanding external debt obligations. The higher this ratio the greater the degree of external debt burden; and

iv. **External debt service to nominal gross domestic product ratio.** This ratio relates to the proportion of total domestic output set aside for servicing external debt. The ratio will be rising where total domestic output is falling.

The higher these ratios the greater are the debt burden. However, it is important to emphasise that debt service ratios should be interpreted with caution because the ratio will be relatively low if the country continues to default in debt service payment.

b. **General reasons for borrowing**

The following are some of the reasons that have been advanced to justify the need for a country to borrow:

i. **Huge and persistent budget deficit:** The government borrows when its expenditure is greater than its revenue (budget deficit), especially after its taxing capacity has been stressed to the limit;

ii. **Balance of payments disequilibrium:** Excessive reliance on foreign resources to sustain domestic production processes, and on foreign goods and services beyond the nation's foreign exchange earning capacity may lead government into contracting debt obligations;

iii. **Rapidly increasing population**: In most developing countries, population is growing faster than the level of national output. The need arises for government borrowing to expand public enterprises and public utilities to cater for the welfare of the people;

iv. **Implementation of development programmes:** To promote economic development usually require provision of new and upgrading of existing social and economic infrastructural facilities, like roads, railways, electricity, schools and hospitals. The tax revenue of government may be insufficient to execute such projects, hence the resort to government borrowing;

v. **Economic instability**: A stable economy naturally provides an enabling environment for economic growth and development. Public debt of the internal type may be contracted to control inflation, while both internal and external borrowing may be used to stimulate economic activities during economic depression;

vi. **Natural disasters**: Government has the responsibility to provide relief to the victims of earthquake, flood, fire disasters, famines, sectarian violence and other natural calamities. Government borrowing may be justified because such occurrences are never expected or budgeted for.

vii. **Fluctuations in government revenue**: Most countries operate mono product economies, depending on only one (or very few) export product for foreign exchange earnings. A sudden poor performance of such product in the international market would reduce income considerably and adversely affect budget implementation. Any country that finds itself in such a situation may have no option than to borrow to bridge the financial resource gap;

viii. **War-time borrowing**: Financial resources needed to prosecute wars are usually beyond the capacity of the government. Hence, the need to borrow arises to avoid devastating consequences of defeat; and

ix. **Debt servicing**: New debt with favourable terms and conditions may be undertaken to service old debts thereby reducing the burden of debt on the economy.

Examiner's report

Part (a) of the question tests candidates' knowledge of the ratios or indicators commonly used to determine the extent of indebtedness in a country while part (b) asks the candidates to identify and explain reasons for borrowing.

Few candidates attempted the question and their performance was average.

The common pitfalls were the inability of the candidates to identify and explain any three ratios or indicators commonly used to determine the extent of indebtedness in a country. Also, the candidates were unable to identify and explain the reasons for borrowing.

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

Marking guide

		Marks	Marks
a.	**Ratios commonly used to determine the extent of indebtedness of a country**		
	Identification of the three ratios	3	
	Explanation of any three ratios identified	3	6
b.	**Reasons for borrowing**		
	Identification of the six reasons for borrowing	3	
	Explanation of six reasons identified for borrowing	6	9
	Total		**15**

ICAN/222/Q/B6 **Examination No........................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

CORPORATE STRATEGIC MANAGEMENT & ETHICS

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

THURSDAY, NOVEMBER 17, 2022

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

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

CORPORATE STRATEGIC MANAGEMENT & ETHICS

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Aziko Brothers Limited is a company that engages in the manufacture and sale of Fast-Moving Consumer Goods (FMCG) in Nigeria. The company manufactures detergent, cosmetics, pasta, confectioneries, and food seasoning. The profit of the company has experienced a steady average growth of 15% annually in the last ten years of operation. This growth was in part fuelled by the success of its flagship product, Goodlife detergent, which is currently a household name in Nigeria. This product contains an active ingredient developed by the company's Research and Development Department. This active ingredient enables Goodlife to clean clothes more deeply without affecting the colour and texture of fabrics than any other brand in the market.

However, some competitors have been able to replicate the deep cleaning effect of Goodlife detergent in their respective brands, thus eating into the market share of Goodlife. Consequently, Aziko Brothers Limited experienced, for the first time in decades, a decline in its profit, relative to the previous year. To maintain and improve the company's future performance, management of Aziko Brothers Limited decided to pursue the following growth strategies:

- Acquisition of a 1,000 hectares farmland for growing palm fruits and the establishment of a palm oil/palm kernel processing plant for the production of palm kernel oil, an active ingredient in the production of detergent and cosmetics;
- Acquisition and refurbishment of an abandoned cement factory to exploit an opportunity in the cement market created by a sharp decline in the production capacity of the largest producer of cement in the country and increase in demand due to population growth; and
- Diversification into the production of washing machines through the acquisition of Aqua Electronics Limited, a manufacturer of electrical appliances.

Required:

a. i. In the light of the above scenario, explain the term diversification (2 Marks)

ii. Identify factors that signal to a firm the time to pursue diversification strategy. Given these signals for diversification, draw conclusions on the need for Aziko Brothers Limited to diversify. (6 Marks)

b. Drawing from the success of Goodlife detergent, advise Aziko Brothers Limited on the benefits of adopting innovation as a growth strategy. (6 Marks)

c. Identify and explain the types of diversification being proposed by Aziko Brothers Limited. (4 Marks)

d. Advise the management of Aziko Brothers Limited on the role of accountants in the business strategy formulation and implementation process. (12 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

ABC Confectioneries, makers of a well-known brand of biscuits recently received a consignment of vital raw materials to produce its flagship brand - Shortbread Biscuits. However, due to poor handling during the delivery process, the raw materials became contaminated, which led to a change in the materials' colour and texture. The quality control department of ABC confectioneries, however, passed the materials as good, leading to their subsequent use in the production of Shortbread Biscuits. This led to massive complaints of food poisoning by customers. Citing this as reason, many of the company's wholesalers who took the company's products on credit, started defaulting in payments. Demand for Shortbread biscuits dropped. All financial indices show that the company may not be able to meet its financial obligation to its creditors.

You have been engaged by ABC Confectioneries to advise management on effective risk management, to avoid the future occurrence of such an incident.

a. Using the Turnbull report as framework, identify and present to the management of ABC confectioneries the categories of risks to which the company was exposed because of the contamination of the raw materials. (12 Marks)

b. Advise the management of ABC Confectionaries on ways of embedding risk awareness in the firm's corporate culture. (8 Marks)

(Total 20 Marks)

QUESTION 3

Mrs. Eze was appointed the Chief Executive Officer (CEO) of a mining company that recently suffered reputational damage due to unethical practices of the immediate past board of directors. Part of Mrs. Eze's goal is to reposition the company as an organisation that is ethical in its practices and can be trusted. To achieve this goal, the CEO is trying to convince members of the board of directors of the connection between organisational culture and corporate ethical behaviour. She intends to introduce a new set of corporate culture that will support ethical behaviour among members of staff.

Required:

a. Prepare a position paper on the connection between organisational culture and ethical behaviour. (6 Marks)
b. Using the Johnson and Scholes cultural web, advise Mrs. Eze on key elements of organisational culture. (10 Marks)
c. Suggest to the board steps to be taken to create culture that supports ethical behaviour of employees. (4 Marks)

(Total 20 Marks)

QUESTION 4

Consequent upon the recent lockdown to curtail the spread of the covid 19 pandemic, Oxede& Co. (Chartered Accountants) is thinking of transforming into a virtual organisation. Advise the management of Oxede& Co. On the:

a. Meaning and characteristics of virtual organisations (10 Marks)
b. Advantages and disadvantages of transforming into a virtual organisation. (10 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

Corporate governance disclosure has become a major requirement in today's business environment. Firms are increasingly becoming obliged to disclose even information that are not mandatory for them to divulge.

Required:

a. Illustrate how corporate governance disclosure can enhance firm performance. (10 Marks)

b. Identify the principles of disclosure and communication of corporate governance statements. (5 Marks)

(Total 15 Marks)

QUESTION 6

A friend of yours owns an evaporated milk manufacturing plant which produces Mountain Milk, the fastest selling brand currently controlling over 50% of market share. He is hoping to increase its currently high profit and market share from the sale of Mountain Milk. Market growth rate for evaporated milk is at an all-time high of 10%.

Using the Classical Product Lifecycle as framework, advise your friend on:

a. Product lifecycle stages of a consumer good like evaporated milk. (4 Marks)

b. Likely current stage of Mountain Milk in the product lifecycle. (3 Marks)

c. Appropriate marketing strategies for Mountain Milk, using the marketing mix. (8 Marks)

(Total 15 Marks)

QUESTION 7

Andrew is a newly qualified chartered accountant employed as an Accountant in the Treasury department of Teller Bank. Taqua is the Head of Treasury Department. One of the leading depositors of the bank is Oxede Trading Company (OTC) whose Financial Controller, Tony, always collect over-riding commission on all deposits made by the Company to the bank.

Andrew observed that this over-riding commission was not reported to OTC. The over-riding commission was deducted from the interest due to OTC, so it did not affect the cost of the fund to the bank. Andrew tried to convince Taqua to stop this act, but he retorted that the payment of over-riding commission was necessary to ensure that the Treasury Department met its target.

Andrew is expected to make all his reports to Management through his HOD, Taqua. Despite this situation, Andrew decided to expose this to the board. The bank has no policy on this issue.

Required:

a. Explain the process Andrew should take to inform the board of this issue. (2 Marks)

b. Discuss the issues that Andrew should consider before embarking on his intended action. (9 Marks)

c. Based on the scenario, advise with reasons whether Andrew should embark on his planned action. (4 Marks)

(Total 15 Marks)

SECTION A:

SOLUTION 1

a. i. Diversification is the strategy of selling new products in new markets. There are two types of diversification:

- Concentric diversification: where the new productsand markets are related in some way to existing products and markets.

- Conglomerate diversification: where both the new products and markets are unrelated to existing ones.

ii. Signals for diversification are:

- For as long as opportunities for profit and growth exist in current market, firms should not be in a hurry to diversify:

- Diminishing opportunities and stagnating or consistently reducing sales in the current market. This should normally serve as a signal to diversify. From the given scenario, the decline in profit made from the detergent business is a signal for Aziko Brothers Limited to diversify;

- When the new business can expand into industries whose technologies and products complement existing businesses. This justifies the diversification into the production of washing machines and palm kernel oil;

- When the business can leverage existing competencies and capabilities by expanding into businesses where the same resource strengths are key success factors and valuable competitive assets;

- Where diversification into closely related businesses opens new avenues for cost reductions. This also justifies diversification into palm kernel oil production; and

- When the company has a powerful and well-known brand name whose goodwill can be transferred to the products of other businesses and thereby used as a lever for driving up the sales and profits of the other businesses. The company can leverage on the popularity of the Goodlife brand to achieve success in the cement and washing machine businesses, thus justifying the diversification.

Conclusion: From the above, it can be concluded that it is time for Aziko Brothers Limited to diversify. Also, there are good chances that the company will achieve success in the new lines of business.

b. From the given scenario, the company achieved success in the detergent business from the innovation output of its research and development department. From this, one can identify the following as benefits of adopting innovation as a growth strategy:

i. **Product renewal**: Output of innovation can lead to modification and improvement of product design, efficiency, and attributes for enhanced customer satisfaction. This is particularly useful to maintain and improve sales and lengthen the product's life cycle;
ii. **Product adaptation**: Innovation could help in the modification of the product for adaptation into new markets. For example, a detergent may start off as useful only for handwashing but later be modified to be useable for machine wash to meet the need of that segment of the market;
iii. **Developing new products**: The output of innovation through invention may be the development of a new product. Such a product may become successful throughout its life; and
iv. Developing New Technology: This could also be an output of innovation. Ground-breaking technologies in biochemistry, communication, data storage, etc, could put a firm on the path of long-term success.

c. Aziko Brothers Limited pursued the following diversification strategies:

i. **Concentric diversification**: The diversification into palm kernel oil and washing machine production are examples of concentric diversification; and
ii. **Conglomerate diversification**: This involves diversification into unrelated businesses. From the scenario, diversification into the production of cement is an example of conglomerate diversification.

d. The following are roles of accountants in the formulation and implementation of corporate strategies:

i. Design and implementation of models for recording financial transactions and preparation of financial reports and accounts.
ii. Design and implementation of models for providing financial information to support accurate drafting, implementation, monitoring,

controlling and measurement of strategy performance in a timely manner. These models include budgets and budgetary controls, capital investment appraisal, discounted cash flow(DCF) analyses etc;

iii. Assist the R & D and marketing departments in new product screening and new product development and marketing decisions;

iv. Strategic investment appraisals which involve a strategic and financial assessment of proposed investment projects;

v. Provision of reporting system for marketing function through management information on customers, channels of distribution and product profitability;

vi. Working in conjunction with the marketing department to assess the effectiveness of marketing initiatives and the marketing mix; and

vii. Identification and measurement of added value throughout the entire value chain.

Examiner's report

This compulsory scenario based 30-mark question from the Strategic Management section of the syllabus tests diversification and innovation as growth strategies, and the roles of accountants in strategy formulation and implementation.
Virtually all the candidates attempted this question.

Performance was below average, as less than 50% of the candidates scored less than 50% of the marks obtainable.

- The common pitfall was inability of many candidates to:
- Identify factors indicative of the need for diversification;
- Benefits of adopting innovation as a growth strategy; and
- The role of accountants in strategy formulation and implementation.

Skills level candidates should pay particular attention to applying their knowledge to simple scenarios, as this is the distinguishing feature between foundation and skills levels of the examination.

Marking guide

		Topics	**Number of points**	**Marks per point**	**Total**
a	i	Definition	1	1	2
		Types of diversification	1	1	
	ii	Indicators of the need for diversification	3	$1^1/_2$	$4^1/_2$
		Conclusion	1	$1^1/_2$	$1^1/_2$
b		Benefits of innovation strategy	3	2	6
c		Types of diversification pursued by Aziko Brothers Limited	2	2	4
d		Role of accountants in strategy formulation and implementation	6	2	12
		Total			**30**

SOLUTION 2

a. Using the Turnbull Report as framework, the following are risks faced by ABC confectionaries:

   i. **Market Risk**: Risks associated with changes in market prices. From the scenario, there exist no evidence of a change in market prices because of the contamination. However, due to the fear of consuming contaminated product, the demand for shortbread shrank. Thus, there is a market risk;

   ii. **Credit Risk**: Risks of losses from bad debts or delay by customers in settling debts. The complaints by customers led to a rise in default rates by wholesalers. As such there exists a credit risk in the incidence;

   iii. **Liquidity Risk**: Risks that companies will be unable to meet financial obligations when they arise. The level of exposure of the firm to this risk is high because of the decline in sales occasioned by the contamination incident;

   iv. **Technology Risk**: Risks that arise due to change in technology. From the given scenario, there is no indication that the company may or will be exposed to technology risk because of the contamination incident;

   v. **Legal Risk:** Risks such as regulatory risk arising from failure to comply with laws and regulations and risk of losses from legal actions and lawsuits. From the given scenario, even though no breach of laws or regulation was mentioned, legal risk could arise from lawsuits instituted by customers who suffered food poisoning due to consumption of shortbread biscuits;

   vi. **Health, Safety and Environmental Risk**: Risks associated with the health and safety of stakeholders such as employees, customers, suppliers, visitors, community etc. From the given scenario, there is health risk in respect of the customers who consumed shortbread biscuits and employees who handled the contaminated input;

   vii. **Reputation Risk:** Risks of damage to the reputation of the firm and brand with customers and the public. The scenario shows that the contamination could damage the reputation of the firm and its product brand with customers and the public; and

   viii. **Business Probity Risk:** Risks from loss due to failure of the firm to act in an honest way. From the scenario, the firm failed to act in an honest way by intentionally using contaminated inputs.

b. To embed risk awareness into an organisation's corporate culture is to ensure that thinking about and controlling risk is a natural and regular part of employees' behaviour. To accomplish this:

   i. There should be reporting systems in place for disclosing issues relating to risk. There should be sharing of risk-related information;

   ii. Managers and other employees should recognise the need to disclose information about risks and about failures in risk control;

iii. There should be a general recognition that problems should not be kept hidden. Bad news should be reported as soon as it is identified. The sooner the problems are identified, the sooner control measures can be taken(and the less the damage and loss);

iv. To create a culture in which problems are disclosed, there must be openness and transparency. Employees should be willing to admit to mistakes;

v. Openness and transparency will not exist if there is a 'blame' culture;

vi. Individuals should not be criticised for making mistakes if theyown up to them promptly; and

vii. The attitude should be that problems with risks will always occur. When they do happen, the objective should be to take measures to deal with the problems. Mistake should be analysed to find solutions and prevent a repetition of the problem. Risk management should be a constructive process.

Examiner's report

This scenario-based question on Risk Management tests categorisation of risk, using the Turnbull framework, and ways of embedding risk awareness in a firm's corporate culture.

About 70% of the candidates attempted this question, however, performance was below average, as many candidates scored less than 50% of the marks obtainable.

Some candidates could not apply the Turnbull framework to the scenario, while some do not know how to embed risk awareness into a firm's corporate culture.

Candidates are enjoined to develop the key skill of applying professional knowledge to practical situations.

Marking guide

	Topics	**No. of points**	**Mark per point**	**Total**
a.	Turnbull Framework	8	$1^1/_2$	12
b.	Embedding risk awareness in corporate culture	4	2	8
	Total			**20**

SOLUTION 3

a. Culture is a set of dominant beliefs, attitudes, values, and norms that are shared by a group of people. Organisational culture therefore is a set of beliefs, values, and norms that are shared by individuals in an organisation. Ethics connotes a set of moral principles that govern a person's behaviour and is concerned with the question of rightness and wrongness of an action.

   Thus, there is a link between organisational culture and ethical behaviour because a people's culture shapes their beliefs, norms, and values. These links are:

   i. Organisational culture guides employees when faced with ethical dilemmas;
   ii. Organisations whose cultures support unethical and risky behaviour stand the risk of damaging their reputation; and
   iii. Organisational culture and ethics are psychologically linked and mutually reinforcing. Hence, organisations must put in place cultures that support ethical behaviour among all employees including management and board members.

b. The cultural web is made up of six interrelated elements of culture. These are:

   i. **Routines and rituals**: ways in which things are generally done in the organisation;
   ii. **Stories and myths**: History of how the organisation got to its present level and the heroic efforts of its past members. Such information is mostly transmitted via oral tradition;
   iii. **Symbols**: These are representations of the nature of the organisation such as logo, office building,etc;
   iv. **Power structure**: Organisations are influenced by individuals who are in positions of power. In some organisations however, power could come from influence, accomplishments, and expertise.
   v. **Organisational structure**: The culture of an organisation is affected by its organisation and management structure. Hierarchical and bureaucratic organisations might find it particularly difficult to adapt to change and are often conservative in their outlook; and
   vi. **Control systems**. Performance measurement and reward systems within an organisation establish the views about what is important and what is not so important. Individuals will focus on performance that earns rewards. For example, it has been suggested that cash bonus systems help to create the profit-driven culture in investment banks.

The cultural web within a company shapes its corporate posture.

c. Steps to be taken to create corporate culture that supports ethical behaviour are:

   i. **Leadership by example**: Corporate culture usually begins at the top. Board members, management and other leaders within the organisation should set the stage for ethical behaviour through their ethical conducts. This sends a positive message to other employees;

   ii. **Creation and communication of organisation's corporate codes of ethics**: Sending a clear message to employees about what the firm sees as the organisation's ethical standard as reflected in its documented corporate codes of ethics sends a positive signal;

   iii. **Ethical training programmes**: Organising training programmes for employees on ethical behaviour sends a strong positive signal that will raise the ethical standard of the organisation;

   iv. **Reinforcing Ethical behaviour**: This could be achieved through the inclusion of ethical behaviour in the employee appraisal process. Also, employees who imbibe high ethical standard should be openly rewarded and those who fall below expectation sanctioned; and

   v. **Whistleblowing**: Firms should encourage employees to report unethical behaviour and protect those who make such reports.

Examiner's report

This question on Ethics tests:

Connection between organisational culture and ethical behaviour; Application of Johnson and Scholes Cultural Web to organisational culture; and
Creation of organisational culture to support ethical behaviour by employees.

Only a few candidates attempted this question. Performance was poor, as many candidates did not know how to create organisational culture to support ethical behaviour by employees.

Candidates and trainers should develop skills to apply principles and concepts to situations.

Marking guide

	Topics	**No. of points**	**Mark per point**	**Total**
a.	Connection between ethical behaviour and organisational culture	2	3	6
b.	Johnson and Scholes' cultural web	5	2	10
c.	Steps involved in creating corporate culture that supports ethical behaviour	4	1	4
	Total			**20**

SOLUTION 4

a. The meaning of virtual organisation should have the following defining points:

   i. Virtual organisations, also known as digital organisations, network organisation or modular organisations are boundary less organisations with no identifiable physical existence;
   ii. It consists of individuals working from physically dispersed workplaces
   iii. Virtual organisations are driven by information and communication Technology (ICT) infrastructure such as mobile devices and the internet;
   iv. Such organisation might not actually have any employees; and
   v. The ICT is the backbone of virtual organisations.

   Characteristics of virtual organisations are:

   i. Flat organisation structure such as matrix structure;
   ii. Dynamic and flexible to changes in the business environment;
   iii. Communication between members is mostly informal;
   iv. Makes possible people from various backgrounds and discipline to work together in multidisciplinary virtual teams;
   v. Vague organisational boundaries;
   vi. Work from Home (WFH); and
   vii. Customers/clients-focused.

b. **Advantages of virtual organisation are:**

   i. saves time;
   ii. It reduces travel expenses;
   iii. It eliminates lack of access to needed experts;
   iv. Makes it possible to form virtual teams regardless of the location and proximity of each member;
   v. Allows dynamic team membership which makes it possible for individuals to work in different teams, in some cases simultaneously;
   vi. Employees can be assigned to multiple concurrent teams;
   vii. Effective communication among team members through
   viii. Facilitates Work-Life Balance; and
   ix. Makes it possible to hire needed talents, regardless of their location or even country of residence.

   Disadvantages of virtual organisation are:

   i. Lack of physical interaction can cause loss of synergy that comes with face-to-face interaction;
   ii. Lack of verbal and non-verbal cues could hamper effective communication;
   iii. Limited room for informal interactions that physically working together brings;

iv. Could lead to security and regulatory breaches; and
v. Could lead to reputational risk arising from lack of physical presence.

Examiner's report
This Strategic Management question tests meaning, characteristics, and advantages and disadvantages of virtual organisations.

About 80% of the candidates attempted this question. Performance was above average. However, some candidates could not fully state the characteristics of a virtual organisation.

Candidates are enjoined to ensure that they fully comprehend all aspects of the syllabus.

Marking guide

	Topics	No. of points	Mark per point	Total
a	Definitions of virtual organisations	5	1	5
	characteristics of virtual organisations	5	1	5
b	Advantages	6	1	6
	Disadvantages of virtual organisations	4	1	4
	Total			**20**

SOLUTION 5

a. The influence of corporate governance disclosure on firm performance is made apparent from the angle of its importance to companies. This includes:

i. **Transparency**: Corporate governance disclosure ensures transparency. Improved transparency enables investors to make more informed decisions, thus reducing the possibility of misuse or manipulation of investors' funds.
ii. **Prevention of financial and economic crises**: With adequate disclosure, better and more informed decisions are made. Also, the incidence of malpractice among board members and other stakeholders within the firm is reduced. Notable firms such as Enron went into crisis due to inadequate corporate governance disclosures.
iii. **Elimination of insider trading and window dressing**: Full disclosure prevents those with privileged information from misusing it for personal gains. It also prevents the incidence of window dressing and manipulation of accounts.

iv. **Allows investors to make informed decisions:** Sentiments about mistrust and speculation by investors are reduced, leading to improved investor confidence. This will contribute positively to the success of the firm's growth strategy through access to needed funds from the financial market.

v. **Reduction of market volatility:** One of the causes of volatility in the financial market is lack of transparency. With adequate corporate governance disclosures, market uncertainties are reduced.

vi. Corporate governance disclosure could enhance firm reputation which, in turn, will enhance its performance. Inadequate corporate governance disclosure can impinge negatively on the company's integrity which could adversely affect performance.

vii. Improved disclosure enables shareholders to exercise their ownership rights thus enhancing firm performance monitoring.

viii. Lack of transparency on application of environmental and ethical standards could give the public a wrong impression of the firm's operations.

ix. It serves as a deterrent to fraud and corruption.

b.

i. **Reliability**. Reliable information is information that is sufficiently accurate for investors to trust when making their investment decisions.

ii. **Understandability**. One of the criticisms of International Financial Reporting Standards (IFRSs) is that financial reporting in accordance with IFRSs can be very complex, and some investors might not properly understand the information that they provide. Many investors support the idea that companies should provide information about themselves in a narrative form, in addition to providing financial statements.

iii. **Timeliness.** In the financial markets, 'timely' often means 'communicated as soon as possible'. Information should be made available to all investors as soon as possible after it becomes available.

iv. **Availability.** When information is disclosed by companies, it should be equally available to all investors.

v. **Divulged through Convenient Channels**. Information should be made available by convenient channels of communication. Companies should be encouraged to make it available in electronic form to investors who want to receive it in that form. For example, companies should use their web sites for making disclosures.

vi. The opportunities for exploiting confidential information to make a personal profit should be minimised. By making information available to investors quickly, opportunities for insider dealing would be reduced.

Examiner's report
This Corporates Governance question on how corporate governance disclosure enhances performance, and principles of disclosure and communication of corporate governance.

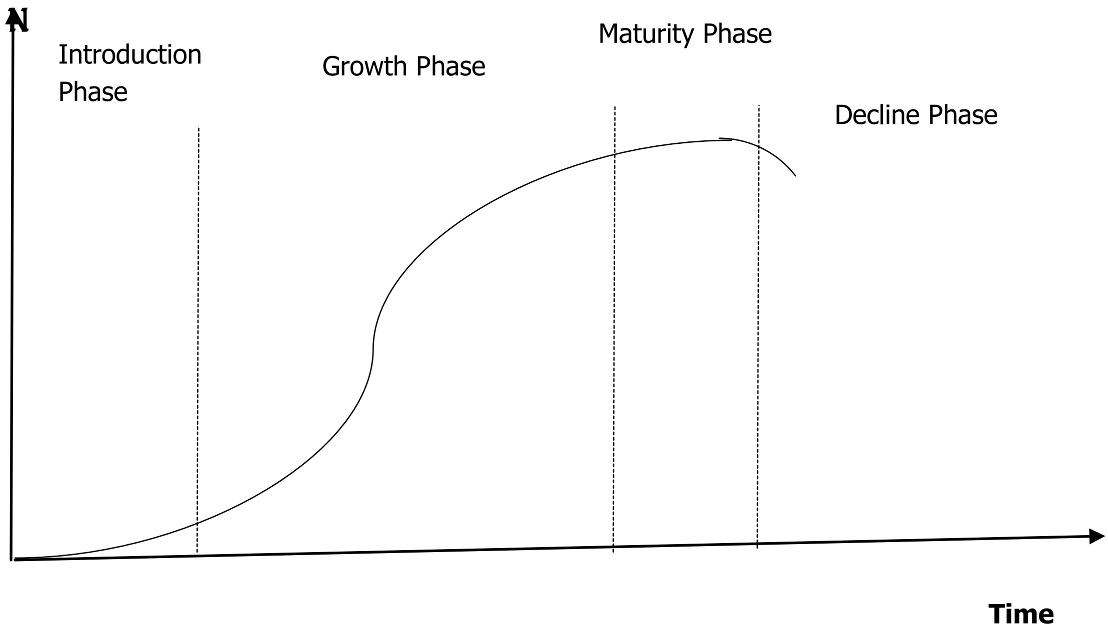
Very few candidates attempted this question. Performance was below average.
A number candidates could not link corporate governance disclosure with firm performance, thus losing valuable marks.

Candidates are advised to study well all aspects of the syllabus when preparing for future examination.

Marking Guide

	Topics	No. of points	Mark per point	Total
a.	Impact of corporate governance disclosure on firm performance	5	2	10
b.	Principles of disclosure and communication of corporate governance statement	5	1	5
	Total			**15**

SOLUTION 6



a. Stages of consumer goods in the product lifecycle are:

i. **Introduction phase**. During this phase:

- There is some demand, but total sales are low;
- Firms that make and sell the product incur investmentcosts;
- Start-up costs and running costs are high; and
- The product isnot yet profitable.

ii. **Growth phase**. During the growth phase:

- Total sales demand in the market grows at a faster rate than the introduction phase.
- New entrants are attracted into the market by the prospects of high sales and profits.
- At an early stage during the growth phase, companies in the market begin to earn profits.

iii. **Maturity phase**. During the maturity phase:

- Total annual sales remain stable;
- Prices and profits stabilise;
- The opportunity for more growth no longer exists, although the life of the product might be extended, through product updates.
- More companies might seek to improve profits by differentiating their products more from those of competitors and selling to a 'niche' market segment.

iv. **Decline phase**. Eventually:
- Total annual sales in the market will start to fall;
- As sales fall, so too do profits;
- Companies gradually leave the market; and
- At some point in time, it is no longer possible to produce and sell the product at a profit, and the product is therefore discontinued by the last of the companies that makes it.

b. From the given scenario, Mountain milk is likely to be at the growth stage of the product lifecycle. This is because

i. It is currently in a high growth market with a market growth rate of 10%; and
ii. Huge profit is currently being made from the sale of mountain milk

c. Using the marketing mix, the following are strategies that can be adopted to improve the market performance of Mountain milk:

i. **Product**: This refers to the features of a product and its quality. During the growth stage, new flavours and varieties of Mountain milk can be introduced to satisfy the needs of various categories of customers. For example, the introduction of low-fat milk for health-conscious customers. Also, product quality should be maintained and possibly improved upon;
ii. **Price**: This is the selling price of the product. Effort must be made to ensure that product prices are competitive, relative to that of competing products. The producers must of Mountain milk must be careful not to raise prices too high above those of competitors;
iii. **Place**: The channel through which the product gets to customers. The producers of Mountain milk might consider innovative channels such as door-to-door distribution and online marketing to maintain and improve market share; and
iv. **Promotion**: The way in which products are advertised and promoted. At the growth stage of the product lifecycle, manufacturers of Mountain milk should continue investing in brand building and aggressive advertisement and publicity to maintain and increase the product's market share.

Examiner's report

This is a Strategic Management question which tests application of product life cycle to place a product and using a marketing mix to develop a marketing strategy.

More than 90% of the candidates attempted this question and performance was good.

The few candidates who performed poorly mixed up the features of the various phase of the product lfe cycle, and some could not identify the phase of the product on the product life cycle.

Candidates are advised to prepare well for future examinations.

Marking guide

	Topics	No. of points	Mark per point	Total
a.	Stages of product life cycle of consumer goods	4	1	4
b.	Current stages of Mountain Milk in the product life cycle	3	1	3
c.	Appropriate marketing strategy using the marketing mix	4	2	8
	Total			**15**

SOLUTION 7

a. Andrew should embark on whistle blowing.

Whistleblowing means reporting suspicion of illegal or improper behaviour to a person in authority. Oftentimes, the regular reporting lines must be ignored to reach the person in authority.

b. Andrew should consider the following before embarking on the whistle blowing exercise:

i. Are all the facts correct? Could he have misunderstood the overriding commission? Or has Andrew drawn a wrong conclusion about it?
ii. Is there sufficient evidence for blowing the whistle?
iii. Double check the facts of the situation without emotions;
iv. Consider discussing the matter with an independent confidential third party such as professional help line;

v. Think about the impact that blowing the whistle may have on the whistle blower's career;
vi. Will the result of being victimised or bullied outweigh the benefit of blowing the whistle?
vii. Double check Teller Bank's policy and whistle blowing procedures in the staff manual. Andrew should ensure he follows the process, if any;
viii. Establish whether there is scope to discuss the matter confidentially with the Human Resources Department of Teller Bank;
ix. Is there an internal audit department which could be made aware of the issue and take ownership of the findings and follow it up?
x. Consider if there is a legal or professional obligation to report, such as NOCLAR.

c. Based on the scenario I advise that Andrew should embark on his planned action because:

i. The payment of over-riding commission without the knowledge of OTC is unethical and illegal;

ii. Andrew has a professional obligation under the ICAN code of professional conduct to report such illegal activities to appropriate authorities; and

iii. Payment of over-riding commission in this context, is an unfair competitive practice.

Examiner's report
This scenario-based question is on whistleblowing procedure.
More than 80% of the candidates attempted this question. General performance was below average.

Most of the candidates were able to identify the concept as whistleblowing, but many could not state the steps to take in whistleblowing. These steps are important to protect the whistle-blower in societies rife with corruption.

Whistleblowing is an important ethical concept in societies fighting corruption, so all budding accountants should be well grounded in it.

Marking guide

	Topics	No. of points	Mark per point	Total
a	Identification and definition of whistleblowing	1	2	2
b	Factors to be considering before whistleblowing	9	1	9
c	Whether whistleblowing is the appropriate option	4	1	4
	Total			**15**

ICAN/222/Q/B3 Examination No...................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

TAXATION

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.
8. Tax and Capital Allowances rates are provided with this examination paper.

TUESDAY, NOVEMBER 15, 2022

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2022

TAXATION

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

AbdulRamon Limited is an agricultural company which commenced business on February 1, 2020. It is engaged in plantations, cattle ranching and poultry business, and prepares its financial statements to October 31 of every year. Its recent financial statements showed the following results:

Period/year ended October 31	**2020**	**2021**
Revenue:	**₦'000**	**₦'000**
Plantation crops	-	36,000
Cattle ranching proceeds	29,000	42,000
Poultry (sale of eggs and spent layers)	21,000	39,000
Gross revenue	50,000	117,000
Deduct:		
Deduct: expenses:		
Preliminary expenses	132	132
Purchases: Cockerels	8,000	12,000
Animal feeds	6,000	7,500
Wages and salaries	2,000	4,200
Depreciation	492	900
Office rent	360	0
Drugs and vaccines for animals	120	130
Interest on bank loan	580	650
General expenses	62	75
Increase in closing inventories (animals and crops) for resale	(400)	(600)
Net profit	32,654	92,013

Other information:

Preliminary expenses amounted to ₦1,0526,000 and it is to be written off in equal amounts over a period of eight assessment years, commencing from the period ended October 31, 2020.

The break-down of the preliminary expenses is as follows:

		₦
(i.)	Stamp duties and registration expenses	108,400
(ii.)	Cost of initial clearing and cultivation of land for plantation	70,000
(iii.)	Gratification to local chiefs and heads of families, so as to attract labourers to the farm	500,000
(iv.)	Cost of labour and technical expertise on the first planting operation on plantations	56,060
(v.)	Cost of nursery plant purchased from Federal Ministry of Agriculture	191,540
(vi.)	Cost of nursery plant from the Institute of Agricultural Research and Training (IART)	130,000
		1,056,000

The following details were extracted from the company's register of property, plant and equipment:

Description	**Cost (₦)**	**Date of purchase**
Motor vehicle	2,040,500	February 2, 2020
Office furniture	355,000	February 2, 2020
Agric tractor	1,037,000	November 7, 2021
Equipment used in spraying plantation	70,000	December 1, 2020
Building (administrative block)	2,081,000	January 9, 2021

There was no disposal of any asset within the period.

You are required to compute:

a. The capital allowances for the relevant assessment years. (10 Marks)

b. The adjusted profits for the relevant assessment years. (10 Marks)

c. The income tax liabilities for the relevant assessment years. (10 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

a. Mr. Zakari incorporated Zaki Limited on October 1, 2016, but the company did not commence business until March 2017. The company prepares its audited financial statements to February 28, every year. However, due to disruption of business activities arising from the COVID-19 pandemic, the company ceased business on April 30, 2020.

The adjusted profits for the relevant years are as follows:

	₦
Year ended February 28, 2019	20,000,000
Year ended February 28, 2020	5,000,000
Period ended April 30, 2020.	100,000

Required:

Given the provisions of the Finance Acts 2019 and 2020, determine the:

i. Basis periods for the relevant years of assessment. (9 Marks)

ii. Assessable profits for the relevant years of assessment. (3 Marks)

b. Stamp duties had been one of the underutilised sources of revenue for the Nigerian Government until the recent amendments introduced by the Finance Act 2019 which expanded the scope of dutiable instruments.

Required:

i. List **FIVE** each of chargeable transactions under:
- Ad-valorem instruments
- Fixed duty investments (5 Marks)

ii. List **THREE** instruments exempted from stamp duties? (3 Marks)

(Total 20 Marks)

QUESTION 3

The Federal Government is committed to diversifying the sources of government revenues by significantly increasing tax to gross domestic product (GDP) ratio, among other things. The attainment of this laudable objective will require an overhaul of the government's tax policy which is a key function of the Ministry of Finance.

Nigerian tax system, like any tax system, is a tripartite structure which comprises the tax policy, tax laws and tax administration.

Required:

a. Explain **FIVE** specific objectives the National tax policy is designed to achieve. (5 Marks)

b. Explain the following terminologies:

   i. Tax policy (5 Marks)
   ii. Tax laws (5 Marks)
   iii. Tax administration (5 Marks)

(Total 20 Marks)

QUESTION 4

Capital allowance can be defined as a relief that is claimable by a taxpayer who incurs qualifying capital expenditure (QCE) during a basis period in respect of assets in use for the purpose of trade or business at the end of the basis period. It is granted in lieu of depreciation charged which is treated as non-allowable expense for tax purposes.

Required:

a. Explain **THREE** types of capital allowances claimable by a taxpayer. (6 Marks)

b. Big City Enterprises Limited is a trading company located in Lokoja, Kogi State of Nigeria. It commenced trading on January 1, 2020 and makes up its accounts to June 30, every year.

For tax purposes, the adjusted profits of its first two years of operation are as follows:

	₦'000
January 1, 2020 to June 30, 2020	8,500
July 1, 2020 to June 30, 2021	22,400

It acquired property, plant and equipment as follows:

Date	**Assets purchased**	**₦'000 Cost**
January 2, 2020	Motor vehicle	8,400
April 1, 2020	Office equipment	2,300
September 7, 2020	Furniture and fittings	1,200

The company achieved a revenue of ₦26,000,000 for the first six months after commencement of business. Due to favourable business climate, its revenue increased to ₦102,000,000 in the year ended June 30, 2021.

Required:

i. Determine the basis periods for assessment and capital allowances. (4 Marks)

ii. Compute the income tax payable for the relevant assessment years. (ignore minimum tax computation). (8 Marks)

iii. Explain the meaning of **"in use"** in relation to the second schedule of Companies Income Tax on Capital Allowance. (2 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

QUESTION 5

a. E-commerce presents a major challenge for tax administrators, given the often multi-jurisdictional nature of the transactions and the potential anonymity of the parties.

It is, therefore, crucial to give the subject a critical examination through the lenses of relevant statutes.

Most often, the terms "e-business and "e-commerce" are used intercheageably, however, they are not synonymous.

Required:

Explain **FIVE** differences between "e-commerce and "e-business. (5 Marks)

b. The law requires all taxpayers to obtain taxpayers identification number (TIN) which shall be dislayed on all documents by the taxpayer in all business transactions with other companies, individuals, government and government agencies. This number shall be used for the purpose of filing tax returns.

You are required to:

i. State the major objectives of taxpayers identification number (TIN)? (5 Marks)

ii. State the list of items required to be contained in the returns to be filed by companies with the Federal Inland Revenue Service (FIRS). (5 Marks)

(Total 15 Marks)

QUESTION 6

Personal income tax is imposed on individuals who are in employment, self-employment, partnerships, etc. In Nigeria, the taxation of individuals is guided by the provisions of Personal Income Tax Act Cap P8 LFN 2004 (as amended).

Required:

a. Explain "employment", "vocation" and "profession". (6 Marks)

b. Explain "cash emoluments" and "benefits-in-kind". (2 Marks)

c. Explain **THREE** general rules for quantifying "benefits-in-kind" in respect of:

i. Use of assets, owned, acquired, rented or hired by the employer (3 Marks)

ii. Provision of residential accommodation by the employer (2 Marks)

iii. Provision of domestic staff by an employer (2 Marks)

(Total 15 Marks)

QUESTION 7

Withholding tax is a tax deducted from the payments made to a taxable person pending the determination of the final tax liability.

It has enabled the government to keep track of incomes of taxpayers from whom withholding tax has been deducted. The credit notes issued to taxpayers by the Revenue have been useful in defraying the total tax liability.

a. What levels of government are the ultimate beneficiaries of withholding tax? (3 Marks)

b. State **FIVE** items in the withholding tax returns/payment schedule. (5 Marks)

c. What are the penalties for late remittance and non deduction of withholding tax from payments due to taxpayers? (3 Marks)

d. In which currency is withholding tax deducted paid over to the Revenue and what is the role of the Central Bank of Nigeria in the process? (4 Marks)

(Total 15 Marks)

NIGERIAN TAX RATES

1. **CAPITAL ALLOWANCES**

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

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

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

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

After the 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%; 2% or 0%
5.	TERTIARY EDUCATION TAX	(2.5% of Assessable Profit)
6.	CAPITAL GAINS TAX	10%
7.	VALUE ADDED TAX	7.5%
8.	HYDROCARBON TAX	15% (Petroleum prospecting License and Marginal Fields Companies) 30% (Petroleum Mining Lease Companies)

SOLUTION 1 **BASED ON OCTOBER 31, YEAR END**

(a) **AbdulRaman Limited**

Computation of capital allowances

	Motor vehicle	Office furniture	Ranching and plantation expenditure	Plantation equipment	Building	Total
Initial allowance	50	25	30	95	15	
Annual allowance	25	20	50	-	10	
	₦	₦	₦	₦	₦	₦
Assessment year 2021						
(9 months)						
Cost	2,040,500	355,000	447,600	-		2,843,100
Initial allowance	(1,020,250)	(88,750)	(134,280)	-		1,243,280
Annual allowance	(191,297)	(39,938)	(117,495)	-		348,730
						1,592,010
W.D.V. c/f to A.Y 2022	828,953	226,312	195,825	-	-	
Assessment year 2022						
Cost	-	-	-	70,000	2,081,000	2,151,000
Initial allowance -	-	-	-	(66,500)	(312,150)	378,650
Annual allowance						
- Old asset	(255,063)	(53,250)	(156,660)	-	-	464,973
- New asset	-	-	-	-	(176,885)	176,885
-						1,020,508
W.D.V. c/f to A.Y 2023	573,890	173,062	39,165	3,500	1,591,965	
Assessment year 2023						
Cost	-	-	-	1,037,000	-	1,037,000
Initial allowance	-	-	-	(985,150)	-	985,150
Annual allowance						
- Old asset	(255,063)	(53,250)	-	-	(176,885)	485,198
- New asset	-	-	-	-	-	-
						1,470,348
W.D.V c/f to AY 2024	318,827	119,812	39,165	55.350	1,415,080	

Notes:

i. Based on the provisions of Finance Act, 2019, there would not be any gap or overlapping period anymore, except for transitional purposes only.

ii. Certain expenses included in preliminary expenses have been capitalised as qualifying capital expenditure (plantation) in accordance with the provisions of para (1) of Schedule 2 of CITA (as amended).

The capitalised costs consist:

	₦
- Cost of initial clearing and cultivation	70,000
- Cost of labour and technical expertise on the first planting	56,060
- Cost of nursery plant from Federal Ministry of Agriculture	191,540
- Cost of nursery plant from IART	130,000
	447,600

iii. Stamp duties and registration expenses have been disallowed as they are incurred in bringing the company into existence and not for the purpose of producing the profits assessable to tax.

iv. Gratification to local chiefs and heads of families have been disallowed because the expenditure was not incurred wholly and exclusively for the purpose of providing the company's profit or loss.

v. There would be no restriction in capital allowances to be claimed in any period because companies in agricultural production are exempted from such restriction.

(b) **Computation of adjusted profits**
For 2021 and 2022 assessment years

	2021	2022
	₦	₦
Net profit for accounts	32,654,000	92,013,000
Add: Disallowable expenses:		
- Preliminary expenses	132,000	132,000
- Depreciation	492,000	900,000
Adjusted profit	33,278,000	93,045,000

(c) **Computation of income tax liabilities**
For 2021 and 2022 assessment years

Assessment year 2021 (1/2/2020 – 30/10/2020)

	₦
Adjusted profit	33,278.000
Capital allowances	(1,592,010)
Total profit	31,685,990
Companies income tax (20% of total profit)	6,337,198
Tertiary education tax (2% of assessable profit)	665,560
Assessment year 2022 (1/11/2020 – 31/10/2021)	
Adjusted profit	93,045,000
Capital allowances	(1,020,508)
Total profit	92,024,949
Companies income tax (30% of total profit) =	27,607,347.60
Tertiary education tax (2% of assessable profit)	1,860,900

Workings

(i) **Determination of basis period (BP) based on Finance Act, 2019**

YOA	**B.P for assessments**	**B.P for capital allowances**
2021	1/2/2020 – 31/10/2020	1/2/2020 – 31/10/2020
2022	1/11/2020 – 31/10/2021	1/11/2020 – 31/10/2021
2023	1/11/2021 – 31/10/2022	1/11/2021 – 31/10/2022

Examiner's report

The question tests candidates' knowledge of the taxation of agricultural companies, taking into consideration the relevant provisions of Finance Acts 2019, 2020 and 2021.

This being a compulsory question, about 100% of the candidates attempted the question. The performance of the candidates was poor.

The commonest pitfalls of the candidates were their inability to capitalise some of the preoperational expenses in line with the provisions paragraph 1 of Schedule 2 of CITA (as amended). Additionally, some them could not prorate the initial allowance and were unable to identify the relevant basis periods.

Candidates are advised to read widely and be conversant with the provisions of the Finance Acts and other relevant tax laws before sitting for subsequent examinations to enhance better performance.

Making guide

QUESTION 1 BASED ON OCTOBER 31 YEAR END		**Marks**	**Marks**
a.	**Computation of capital allowance**		
	Heading	½	
	Assessment year 2021		
	Cost (3 ticks @ ½ mark each)	1½	
	Initial allowance (3 ticks @ ½ mark each)	1½	
	Annual allowance (3 ticks @ ½ mark each)	1½	
	Total capital allowance (1 tick)	¼	
	Assessment year 2022		
	Cost (2 ticks @ ¼ mark each)	½	
	Initial allowance (2 ticks @ ¼ mark each)	½	
	Annual allowance:		
	- Old asset (3 ticks @ ¼ mark each)	¾	
	- New asset (1 tick @ ½ mark each)	½	
	Total capital allowance (1 tick)	¼	
	Assessment year 2023		
	Cost (1 tick)	½	
	Initial allowance (1 tick)	½	
	Annual allowance:		
	- Old asset (3 ticks @ ¼ mark each)	¾	
	- New asset (1 tick)	¼	
	Total capital allowance	¼	10
b.	**Computation of adjusted profits for relevant assessment years**		
	Heading	1	
	Assessment year 2021		
	Net profit per accounts	1	
	Add: Disallowable expenses:		
	- Preliminary expenses	1	
	- Depreciation	1	
	Adjusted profit	1½	
	Assessment year 2022		
	Net profit per accounts	1	
	Add: Disallowable expenses:		
	- Preliminary expenses	1	
	- Depreciation	1	
	- Adjusted profit	1½	10

c. **Computation of income tax liabilities for relevant assessment Years**

Heading	1	
Assessment year 2021	1	
Adjusted profit	1	
Capital allowances	1	
Total profit	½	
Companies income tax (20% of total profit)	½	
Tertiary education tax (2% of assessable profit)	½	
Assessment year 2022	1	
Adjusted profit	1	
Capital allowances	1	
Total profit	½	
Companies income tax (30% of total profit)	½	
Tertiary education tax (2% of assessable profit)	½	10
Total		30

SOLUTION 2

a. **Zaki Limited**

(i) **Computation of basis periods**

Year	Basis period
2019	1/3/2017 - 28/2/2018
2020	1/3/2018 - 28/2/2019
2021	1/3/2019 - 28/2/2020
2021(Cessation)	1/3/2020 - 30/4/2020

(ii) **Computation of assessable profits**

Year	Basis period	Assessable Profit ₦
2020	1/5/2018 – 28/02/2019	20,000,000
2021	1/3/2019 – 28/02/2020	5,000,000
2021	1/3/2020 – 30/4/2020	100,000

Note: If the company had ceased business on any date from July 1, 2020 to December 31, 2020, the year of cessation would have been 2022 assessment year.

b. (i) The two forms of stamp duties are:

- **Ad-valorem**

  These are duties that vary with the amount of consideration and are in accordance with a scale prescribed by the Act. The Commissioner of Stamp Duties or adjudicator will need to know the amount involved in the transaction. This will enable him determine the appropriate duty to be paid.

Examples of instruments that are assessed based on ad-valorem basis are:

- Deed of assignment;
- Sales agreement;
- Tenancy or lease agreement;
- Insurance policies;
- Contract agreements;
- Vending agreement;
- Charter-party;
- Contract notes;
- Legal mortgage and debenture loans;
- Share capital of companies; and
- Promissory notes.

- **Fixed duties**

  These are duties that do not vary with the consideration for the document being stamped.

  Examples of instruments assessed by fixed duties are:
  - Power of Attorney (POA);
  - Certificate of occupancy (C of O);
  - Appointment of receiver;
  - Memorandum of understanding (MOU);
  - Joint venture agreements (JVA);
  - Ordinary agreements and receipts;
  - Guarantor forms; and
  - Proxy form.

(ii) **Instruments exempted**

Instruments that are specifically exempted are as follows:

- Those relating to agreements between the Federal Government and other foreign governments;
- Instruments relating to reconstruction and amalgamation; subject to specified condition under section 104(1) of the Act;
- Transactions and sales of properties of a company under liquidation arising from a compulsory winding up by a court or creditors' voluntary winding up;
- Based on Central Bank circular number CBN/GEN/DMB/02/006 dated January 15, 2016, titled "Currency and Remittance of Statutory Charges or Receipts to Nigerian Postal Service under the Stamp Duties Act", the following transactions are exempted from stamp duties:
  - Transactions relating to savings accounts holders, salary accounts or students savings accounts;

- Payments and deposits for self to self-transactions whether inter or intra-bank; and
- Payments for goods supplied or services rendered if the amount is under ₦1,000, payment of salaries or wages, pensions, gratuities, etc;

- Section 56 of the Finance Act, 2019, exempts the following "exempt receipts" and "general exemptions" from stamp duties;
  - **Exempt receipts**
    - Receipts given by any person in a regulated securities lending transaction carried out under regulations issued by the Securities and Exchange Commission

  - **General exemptions which include the following:**
    - Shares, stocks or securities transferred by a lender to its approved agent or a borrower in furtherance of a regulated securities lending transactions;
    - Shares stocks or securities returned to a lender or its Approved agent by a borrower in pursuant to a regulated securities lending transaction; and
    - All document relating to a regulating transactions carried Out under regulations issued by the Securities and Exchange Commission; and
    - Share transfer based on FIRS information circular on "clarifications on the provisions of the Stamp Duties Act" No: 2020/05 dated April 29, 2020.

Examiner's report

The question tests candidates' knowledge of computations of assessable profits of a company in cessation, chargeable transactions subject to ad-valorem and fixed duties, and instruments exempted from stamp duties.

About 50% of the candidates attempted the question and the performance was poor.

The commonest pitfalls of the candidates were their inability to ascertain the relevant basis periods for a company in cessation and were also unable to state the instruments that are exempted from stamp duties.

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
a (i)	**Computation of basis periods for the relevant years of Assessment**		
	Heading (2 ticks @½ mark each)	1	
	Assessment year 2019		
	Year	1	
	Basis period	1	
	Assessment year 2020		
	Year	1	
	Basis period	1	
	Assessment year 2021		
	Year	1	
	Basis period	1	
	Assessment year 2021 (ceasation)		
	Year	1	
	Basis period	1	9
(ii)	**Computation of assessable profits for the relevant years of Assessment**		
	Assessment year 2020		
	Basis period	½	
	Assessable profit	½	
	Assessment year 2021		
	Basis period	½	
	Assessable profit	½	
	Assessment year 2021 (ceasation)		
	Basis period	½	
	Assessable profit	½	3
b i.	Ad-valorem instruments		
	(½ mark for any correct transaction subject to a maximum of 5 points)	2½	
	Fixed duty instruments		
	(½ mark for any correct transaction subject to a maximum of 5 points)	2½	5
ii.	Instruments exempted from stamp duties		
	(1 mark for each correct instrument subject to a maximum of 3 points)		3
	Total		**20**

SOLUTION 3

a. Objectives of the NTP

The National tax policy provides the fundamental guidelines for the orderly development of the Nigerian tax system. The policy is expected to achieve the following specific objectives, among others:

(i) Guide the operation and review of the tax system;

(ii) Provide the basis for future tax legislations and administration;

(iii) Serve as a point of reference for all stakeholders on taxation;

(iv) Provide benchmark on which stakeholders shall be held accountable; and

(v) Provide clarity on the roles and responsibilities of stakeholders in the tax system.

b. The tax system usually involves a tripartite aspect, namely the tax policy, tax laws, and tax administration.

i. **Tax policy**

The tax policies are general statements of intention, which guide the thinking and the action of all concerned towards the realisation of the set goals. They usually include:

- Movement of emphasis from income tax to consumption tax that is less prone to tax evasion;
- Pursuance of a tax law regime with the aim of reducing Individual tax burden, widening the tax net and encouraging savings and investments; and
- Introduction of the self-assessment scheme to encourage taxpayer participation in the tax assessment process, which is considered to be realistic in approach. The policy can also include movement from coercive method of taxation to voluntary compliance as in the case of Nigeria in recent time.

ii. **Tax laws**

The tax laws include the following notable tax legislations in Nigeria:

- Personal Income Tax Act Cap. P8 LFN 2004;
- Companies Income Tax Act Cap. C21 LFN 2004 (as amended);
- Petroleum Industry Act 2021;
- Capital Gains Tax Act Cap. C1 LFN 2004 (as amended);
- Value Added Tax Act Cap. V1 LFN 2004 (as amended);
- Education Tax Act Cap. E4 LFN 2004(as amended);and
- Stamp Duties Act Cap. S8 LFN 2004.

In Nigeria, the Constitution vests the legislation of income tax, whether personal or corporate on the Federal Government in order to promote uniformity. However, the three tiers of government share the administration of the various taxes. Tax laws are reviewed periodically in line with the changes in social, political and economic conditions of the country.
The power to impose tax in Nigeria is within the exclusive legislative authority of the Federal Government. There are various machineries set up by the government to ensure strict compliance of these laws; non-compliance attracts penalties and fines.

iii. **Tax administration**

This involves practical interpretation and application of the tax laws. The bodies charged with the administration of tax in Nigeria are the Federal, State and Local governments. The tax authorities of these tiers of government derive their formation from the relevant laws which include:

- The Federal Inland Revenue Service (FIRS), sections 1, 2, and 3 of the Federal Inland Revenue Establishment Act (FIRSEA) 2007;
- The State Internal Revenue Service (SIRS), sections 87 of Personal Income Tax Act Cap P8 LFN 2004 (as amended); and
- The Local Government Revenue Committee, section 90 of Personal Income Tax Act Cap P8 LFN 2004 (as amended).

Examiner's report

The question tests candidates' knowledge of the specific objectives of the National tax policy (NTP) 2017, and the tripartite structure of the Nigerian tax system.

About 90% of the candidates attempted the question but the performance was average.

The commonest pitfall of the candidates was their inability to explain the specific objectives of the National tax policy (NTP) 2017.

Candidates are advised to familiarise themselves with the provisions of the National tax policy (NTP) 2017 and also read ICAN Pathfinders and Study Text in their preparations for subsequent examinations.

Marking guide

		Marks	Marks
a.	**Specific objectives the National tax policy is designed to achieve**		
	(1 mark for each objective subject to a maximum of 5 points)		5
bi.	Explanation of tax policy		
	General statements of intention	1	
	Guide towards realisation of set goals	1	
	Any 3 examples	3	5
ii.	Explanation of tax laws		
	(1 mark for each tax law mentioned subject to a maximum of 5points)		5
iii.	Explanation of tax administration:		
	Involves practical interpretation and application of the tax laws	2	
	3 bodies charged with the administration	3	5
	Total		20

SOLUTION 4

a. **Types of capital allowances are:**

(i) **Initial allowance (IA)**

This is a relief that is granted to a business that has incurred a qualifying capital expenditure in the basis period of the year or in the year the qualifying expenditure was incurred. Initial allowance is granted to give an immediate relief from the huge expenditure incurred by the business. Initial allowance has the following attributes:

- It is claimable only once throughout the useful life of the asset;
- It is determined by applying initial allowance rate on asset's cost; and
- Initial allowance is never prorated on account of the basis period being less than twelve months. However, if the relevant tax authority establishes that the asset has been put to private use, the amount of initial allowance that will be allowed as a deduction from profit shall be restricted to the proportion attributable to the business use of the assets.

(ii) **Annual allowance (AA)**

This relief is granted annually on the residue of qualifying capital expenditure incurred on the qualifying capital expenditure after deducting initial allowance. Annual allowance has the following attributes:

- It is granted annually over the useful life of the asset;
- It is determined by dividing the cost of the assets less initial allowance over the assets useful life, taking into consideration the specified rates;
- Annual allowance shall be prorated where the basis period of a year of assessment is less than twelve months;
- Annual allowance is calculated on straight line basis; and
- A book value of ₦10 shall be deducted from annual allowance claimable in the last year of the assets life and retained until the asset is disposed off.

(iii) **Investment allowance**

This is an incentive granted to a business that incurred qualifying capital expenditure on plant and machinery. Investment allowance has the following features:

- It is granted only once in the life of the asset;
- It is granted only on plant and machinery; and
- It is granted at the rate of 10%;
- Initial allowance is never prorated on account of the basis period being less than twelve months. However, if the relevant tax authority establishes that the asset has been put to private use, the amount of initial allowance that will be allowed as a deduction from profit shall be restricted to the proportion attributable to the business use of the assets; and
- It is never used in determining the tax written down value of the asset. In other words, investment allowance does not impact the tax written down value of the asset. However, it should be added to other capital allowances i.e. IA and AA, and deducted from assessable profit.

(iv) **Balancing adjustments**

These shall arise upon the disposal of a qualifying capital expenditure in a year of assessment. The disposal may result in either:

- **Balancing allowance**
  This is arrived at when the tax written down value of the qualifying capital expenditure is greater than the sale proceeds at the time of disposal. Balancing allowance shall be added to other capital allowances that is IA and AA and deducted from assessable profit; or
- **Balancing charge**
  This is arrived at when the tax written down value of a qualifying capital expenditure is less than the sale proceeds at the time of disposal. Balancing charge being a gain shall be

added to assessable profit. However, since balancing charge is a claw back of capital allowances previously enjoyed on the disposal asset, the amount to be added back to profit shall not exceed the relief previously enjoyed. Consequently, the excess of balancing charge being capital gains shall be assessed under the Capital Gains Tax Act.

(b) i. **Big City Enterprises Limited**

Determination of basis periods for assessment and capital allowances

Assessment Years	Basis period	Assessable profit	Capital allowances
		₦	₦
2021	1/1/2020 – 30/6/2020	8,500,000	Motor vehicle and office equipment
2022	1/7/2020 – 30/6/2021	22,400,000	Furniture and fittings

ii. **Computation of income tax payable**

Assessment year 2021	**₦**	**₦**
Adjustment profit		8,500,000
Capital allowances (see workings)	6,018,750	
But limited to $66^2/_3$ of adjusted profit	(5,666,667)	(5,666,667)
Unutilised capital allowances c/f	352,083	
Total profit		2,833,333

Companies income tax payable (20% of total profit) = ₦566,666.60

Tertiary education tax payable (2% of assessable profit) ₦ 170,000.00

Assessment year 2022		
Adjusted profit		22,400,000
Capital allowances - b/f	352,083	
- For the year	1,817,500	(2,169,583)
(See workings)		
Total profit		20,230,417

Companies income tax payable (30% of total profit) ₦ 6,069,125.10

Tertiary education tax payable (2% of assessable profit) ₦448,000.00

Workings

Computation of capital allowances

	Motor vehicle	Office equipment	Furniture and fitting	Total
Initial allowance (%)	50	50	25	
Annual allowance (%)	25	25	20	
	₦	₦	₦	₦
Assessment year 2021				
Cost	8,400,000	2,300,000		10,700,000
Initial allowance	(4,200,000)	(1,150,000)		5,350,000
Annual allowance	(525,000)	(143,750)		668,750
				6,018,750
W.D.V c/f to A.Y. 2022	3,675,000	1,006,250		
Assessment year 2022				
Cost			1,200,000	
Initial allowance			(300,000)	300,000
Annual allowance	(1,050,000)	(287,500)	(180,000)	1,517,500
				1,817,500
W.D.V c/f to A.Y. 2023	2,625,000	718,750	720,000	

b. iii. An initial or an annual allowance in respect of qualifying expenditure incurred in respect of any asset shall only be made to a company for a year of assessment if at the end of its basis period for that year, it was the owner of that asset and that asset was in use for the purposes of a trade or businesses carried on by that company.

Examiner's report

The question tests candidates' knowledge of commencement principles, computation of capital allowances and explanation of "in use" in relation to capital allowances, and computation of companies income tax payable.

About 75% of the candidates attempted the question but performance was fair.
The commonest pitfall of the candidates was their inability to identify the basis periods for assessments and capital allowances. Also, they could not explain the meaning of "in use" in relation to capital allowances.

Candidates are advised to read ICAN Study Text and Pathfinders when preparing for subsequent examinations to ensure better performance in future.

Marking guide

		Marks	Marks
a.	**Types of capital allowances**		
	(1 mark for any correct capital allowance subject to a maximum of 3 points)	3	
	(1 mark for explanation of a correct capital allowance subject to a maximum of 3 points)	3	6
b i.	**Basis periods for assessment and capital allowances**		
	Assessment year 2021		
	Year	1	
	Basis period	1	
	Assessment year 2022		
	Year	1	
	Basis period	1	4
ii.	Computation of income tax payable		
	Assessment year 2021		
	Year	¼	
	Adjusted profit	¼	
	Capital allowances	¼	
	Limited to 662/3 of adjusted profit	¼	
	Unutilised capital allowances c/f	¼	
	Total profit	½	
	Companies income tax payable (20% of total profit	½	
	Tertiary education tax payable (2% of assessable profit)	¼	
	Assessment year 2022		
	Year	¼	
	Adjusted profit	¼	
	capital allowances - b/f	¼	
	- For the year	¼	
	Total profit	¼	
	Companies income tax payable (30% of total profit)	¼	
	Tertiary education tax payable (2% of assessable profit)	¼	

<u>Workings:</u>		
<u>Assessment year 2021</u>		
Year	¼	
Cost (2 ticks @ ¼ each)	½	
Initial allowance (2 ticks @ ¼ each)	½	
Annual allowance (2 ticks @ ¼ each)	½	
Capital allowance	¼	
<u>Assessment 2022</u>		
Year	¼	
Cost	¼	
Initial allowance	¼	
Annual allowance(3 ticks @ ¼ each)	¾	
Total allowance	<u>¼</u>	8

iii. **Meaning of "in use"**

The asset was in use at the end of the basis period for that year	1	
The asset was in use for the purposes of trade or business carried out by the company	<u>1</u>	<u>2</u>
Total		**<u>20</u>**

SOLUTION 5

(a) Most often, the terms "e-business" and "e-commerce" are used interchangeably; however, they are not synonymous. E-commerce refers to buying and selling online, while e-business encompasses all business conducted online. Therefore, e-commerce can be viewed as a subset of e-business.

Below are the differences between e-commerce and e-business:

S/N	E-commerce	E- business
i.	E-commerce involves commercial transactions done over the internet.	E- business is the conduct of business process on the internet.
ii.	E-commerce is use of electronic transmission medium that caters for buying and selling of products and services.	In addition, 'e-business' also includes the exchange of information directly related to buying and selling of products.
iii.	Activities that essentially involve monetary transaction are termed "e-commerce".	This includes activities like procurement of raw materials or goods, customer education, looking for suppliers, etc.
iv.	E-commerce usually requires the use of just a website.	E-business involves the use of CRM's, ERP's that connect different business processes.

v.	E-commerce involves the mandatory use of the internet.	E-business could involve the use of internet, intranet, or extranet.
vi.	E-commerce is narrower concept and restricted to buying and selling.	E-business is a broader concept that involves market surveying, supply chain and logistics management, and using data mining.

(b) i. **Objectives of tax identification number (TIN)**

Tax identification number (TIN) is a unique nine-digit number allocated to taxpayers with a view to identifying an individual, business or any other entity in tax returns and other documents filed with the tax authorities.

The major objectives of introducing TIN, as specified in Joint Tax Board Bulletin 2011 include:

- Creating closer linkage between tax authorities in Nigeria;
- Aiding cooperation and information sharing amongst the tax authorities; and
- Increasing revenue generation accruing to all tiers of the government.

ii. **Items to be contained in returns to be filed by companies to FIRS**

Section 55 of the CITA, Cap C21, LFN 2004 (as amended) provides that all companies (including businesses granted exemption from incorporation) to at least once a year without notice or demand from the Federal Inland Revenue Service (FIRS), file a return with the FIRS in a prescribed form and containing prescribed information together with the following documents:

- Audited financial statements;
- Income tax and capital allowance computation schedules;
- Completed copy of Companies Income Tax (Form IR3C-4Coy);
- Completed copy of Tertiary education tax (Form 4D EDT);
- Evidence of payment of companies income tax liability; and
- Evidence of payment of Tertiary education tax liability.

Examiner's report

The question tests candidates' understanding of the taxation of "e-commerce" and "e-business".

About 55% of the candidates attempted the question but performance was poor.
The commonest pitfalls of the candidates were their inability to state the differences between "e-commerce" and "e-business". In addition to the foregoing, some candidates could not state the objectives of taxpayers identification number (TIN).

Candidates are advised to read widely before sitting for the Institute's examinations.

Marking guide

		Marks	Marks
a.	**Differences between "e-commerce" and "e-business"**		
	(1 mark for each explanation subject to a maximum of 10 points)		5
i.	**Objectives of tax identification number (TIN)**		
	(1½ marks for each of the three major objectives stated)	4½	
	Identification of an individual taxpayer	½	5
ii.	**Items required to be contained in returns filed by companies with FIRS**		
	(1 mark for each content subject to a maximum of 5 points)		5
	Total		**15**

SOLUTION 6

(a) **Employment**

Employment is an agreement between an employer and an employee that the employee will provide certain services on the job and in the employer's designated workplace to facilitate the accomplishment of the employer organisation's goals and mission, in return for compensation. The agreement can be verbal, implied or an official employment contract.

In employment, the employer determines where, when, how, why and what of the work that is performed by the employee. The degree of input, autonomy and self-directedness that an employee experiences on a job is a by-product of an employer's philosophy of management and employment. Employment ends at the prerogative of the employer or the employee.

Vocation

A vocation is a specified business, occupation, profession, or trade to which a person is specially drawn or for which he or she is suited, trained or qualified. Vocation can either be an activity that serves as an individual's regular source of livelihood or as an activity engaged in especially as a means of passing time.

Profession

A profession refers to an occupation that requires specialized education, knowledge, training and ethics. Although professionals make their living in what they do, this paid work is often more than just a job or occupation alone. Whether the occupation is law, medicine, plumbing, writing, interior design or accounting, those who are in it are expected to meet and maintain common standards.

Professions are, ideally, made up of people who should have high ethical standards, special knowledge and skills. The responsibility of people in certain occupations to the public is an important distinction from those who may participate in the fields on an amateur or non-professional basis. For example, if a home owner hires a non-licensed plumber to save money, he or she wouldn't be able to hold this person to the same standards as a licensed professional in the same industry.

(b) **Cash emoluments**

Cash emoluments are the remuneration that an employee receives from the employer in cash.

Cash emoluments include salary, wages, fee, allowance or other gain or profit from employment, including compensations, bonuses, premiums, benefits, and share of profits received by an employee.

Benefits–in–kind (BIK)

Benefits-in-kind mean those expenses incurred by an employer in the provision of benefits to the employee.

Such benefits often include: furnished living accommodation; gardener/stewards (domestic servants), use of official car for private purposes by employees; installation of air conditioners or generator in an employee's residence, etc.

These benefits are regarded as part of the employee's taxable income if these relate to services rendered by the employee.

Benefits-in-kind will also include such benefits which are usually provided to the spouse, family, servant, dependent or guest of the employee.

(c) **The following are the general rules for quantifying benefits-in-kind on the use of assets, etc:**

i. **Use of assets owned acquired by the employer**

The employee is deemed to have derived income equal to 5% of the cost of assets if known or 5% of the market value at the date of acquisition and where the cost is not known, to be determined by the tax authorities.

Assets rented or hired by the employer

The employee is deemed to have derived an income equal to the annual amount of the rent or hire expended by the employer on the asset.

Where an employee has made any refund in respect of the asset rented or hired by the employer for the employee's benefit, the employee shall be deemed to have derived income equal to the difference between the amount incurred by the employer and any amount refunded by the employee.

ii. **Provision of residential accommodation by the employer**

If an employer provides residential accommodation for the benefit of an employee anywhere in Nigeria and the employee pays no rent for the premises, or pays a rent which is less than the annual value of the premises, the employee is deemed to have derived income each year equal to the annual rateable value of the premises less any rent paid by the employee.

The annual rateable value of any premises is that value as determined by the relevant tax authority for purposes of local rate.

iii. **Provision of domestic staff by the employer**

Where an employer engages the service of domestic staff (such as driver, steward, washman, housemaid, gardener, etc.) for the exclusive benefit of an employee, the cost incurred in form of salary by the employer for the use of the domestic staff by the employee shall be deemed as income in the hands of the employee and taxed accordingly.

The income of a domestic staff shall only be deemed as income in the hands of the employee only where the domestic staff is not a permanent employee of the employer, that is, a contract staff.

Examiner's report

The question tests the candidates' knowledge of the taxation of individuals with emphases on explanations of "employment", "vocation", "profession", "cash emoluments", and benefits-in- kind.

Over 80% of the candidates attempted the question but performance was average. The commonest pitfall was the candidates' inability to explain the general rules for quantifying "benefits-in-kind".

Candidates are advised to read relevant study materials in order to perform well in future examinations.

Marking guide

		Marks	Marks
a.	**Explanation of "employment", "vocation" and "profession"**		
	Employment		
	Employment is an agreement between an employer and an employee.		
	Agreement can be verbal, implied or an official employment contract.		
	The employer dictates the terms.		
	Employment ends at the prerogative of the employer or the employee		
	(1 mark for any correct point subject to a maximum of 2 points)	2	
	Vocation		
	Definition	1	
	Nature of vocation	1	
	Profession		
	Definition	1	
	Explanation	1	6
b.	**Explanation of "cash emoluments" and "benefits-in-kind"**		
	Cash emoluments		
	Definition/explanation	½	
	Examples	½	
	Benefits-in-kind		
	Definition	½	
	Examples	½	2
c.	**Rules for qualifying "benefits-in-kind"**		
	i. **Use of asset owned or acquired, by the employer**		
	Employee's deemed derived income is equal to 5% of the cost of asset or	1	
	5% if the market value at the date of requisition	1	
	Assets rented or hired by the employer		
	Employee's deemed derived income is equal to the amount of the rent or hire expended by the employer,	½	
	Where the employee's makes a refund, the employee's deemed derived income is equal to the difference between the amount incurred by the employer and any amount refunded by the employee.	½	3
	ii. **Provision of residual accommodation by the employer**		
	Employee's deemed derived income is equal to the annual rateable value of the property less any rent paid by the employee.		2
	iii. **Provision of domestic staff by the employer**		
	Employee's deemed income shall be the cost incurred in form of salary by the employer for the use of the domestic staff.	1	
	The income of the domestic staff shall only be deemed as income in the hands of the employee only where the domestic staff is not a permanent employee of the employer, that is, a contract staff.	1	2
	Total		**15**

SOLUTION 7

(a) **Ultimate beneficiaries of withholding tax**

The Companies Income Tax Act and Personal Income Tax Act clearly specify the ultimate government beneficiary of withholding taxes. These are the state governments through the agency of the State Internal Revenue Service (SIRS) and the Federal government through the Federal Inland Revenue Service (FIRS).

Therefore, the administration of withholding tax is within the purview of both the FIRS and the SIRS.

(b) **Contents of WHT returns/payment schedule**

Each withholding tax cheque, being paid to the Revenue must be accompanied with a payment schedule, which is a list of those who suffered the deductions that make up the cheque. The payment schedule must contain the following particulars:

i. Name of the taxpayers who suffered the deductions;
ii. Their addresses;
iii. The nature of their activities/services and period covered;
iv. Their tax file numbers (now Tax Identification Number (TIN);
v. The total amount payable;
vi. The rate of tax applied;
vii. The amount of tax withheld;
viii. The balance paid to the taxpayer;
ix. The tax contract for which returns were being made;
x. The date of payment; and
xi. The cheque number and date.

(c) **Penalty for late remittance and non-deduction of withholding tax from payments**

Section 82 of CITA 2004 (as amended) specifies that where any person who being obliged to deduct any tax under section 78 (deduction of tax from interest, etc), 79 (deduction of tax on rent), 80 (deduction of tax from dividend) or 81 (deduction of tax at source) of this Act fails to deduct or having deducted fails to pay to the FIRS within 21 days from the date the amount was deducted or the time the duty to deduct arose, shall be guilty of an offence and shall be liable to a penalty of 10% per annum of the tax withheld or not remitted, as the case may be.

Similarly, failure to deduct or having deducted, fails to remit to the SIRS within 30 days, withholding tax withheld from payments due to individuals, shall be guilty of an offence punishable on conviction and shall be liable to a fine of ₦5,000, in addition to the tax deductible or deducted, but not remitted, plus interest at the prevailing commercial rate.

(d) **Currency of deduction**

The currency in which tax is to be deducted and paid over to the relevant tax authorities is the currency of transaction. Where the transaction is in foreign currency, the tax is to be withheld in the foreign currency and paid to the relevant tax authority, through the Central Bank of Nigeria (CBN). The CBN would then effect the necessary conversion, using the ruling rate of exchange and then credit the appropriate government account with the sum.

Examiner's report

The question tests the candidates' knowledge of ultimate beneficiaries of withholding tax, filing of returns/payment schedule, penalties, and currency of payment for withholding tax.

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

The commonest pitfall was candidates' lack of knowledge of the penalties payable for non deduction and late remittance of withholding tax to the appropriate tax authorities.

Candidates are advised to pay attention to this particular aspect of the syllabus.

Marking guide

		Marks	Marks
a.	**Ultimate beneficiaries of withholding tax**		
	State Internal Revenue Service	1½	
	Federal Income Revenue Service	1½	3
b.	**Withholding tax returns/payment schedule**		
	(1 mark for any correct item subject to a maximum of 5 points)		5
c.	**Penalties for the late remittance and non deduction of withholding tax**		
	Companies		
	Penalty of 10% per annum of the tax withheld or not remitted		
	Individuals	1½	
	Penalty/fine of ₦5,000 plus interest at the prevailing commercial rate	1½	3
d.	**Currency of deduction/remittance**		
	Currency of transaction		4
	Total		**15**