THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

MAY 2023 DIET
PROFESSIONAL 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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CORPORATE REPORTING

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, MAY 16, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

CORPORATE REPORTING

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

a. The draft statement of financial position of Omi PLC, Ruwa Limited and Mmili Limited as at November 30, 2020 are as follows:

	Omi PLC	Ruwa Limited	Mmili Limited
Non-current assets:	**₦'M**	**₦'M**	**₦'M**
Property,plant and equipment	4,920	2,020	1,024
Investment – Ruwa Limited	2,560	--	--
Investment – Mmili Limited	640	400	--
	8,120	2,420	1,024
Current assets:			
Inventories	1,200	540	260
Trade receivables	960	420	196
Cash and cash equivalents	360	200	320
Total current assets	2,520	1,160	776
Total assets	10,640	3,580	1,800
Equity and liabilities:			
Equity			
Share capital	6,000	2,000	800
Share premium	1,200	400	200
Revaluation reserve	--	--	280
Retained earnings	2,500	800	240
	9,700	3,200	1,520
Non-current liabilities	540	100	80
Current liabilities	400	280	200
Total equity and liabilities	10,640	3,580	1,800

Additional Information:

(i) Omi PLC acquired 80% of the ordinary share capital of Ruwa Limited on December 1, 2017 when the retained earnings were ₦400million. The fair value of the net assets of Ruwa Limited was ₦2,840million. Any fair value adjustment related to net current assets, and these net current assets had been realised by November 30, 2020. There had been no new issue of shares in the group since the current group structure was created.

(ii) Omi PLC and Ruwa Limited had acquired their holdings in Mmili Limited on the same date as part of an attempt to mask the true ownership on Mmili Limited. Omi PLC acquired 40% and Ruwa Limited acquired 25% of the ordinary share capital of Mmili Limited on December 1, 2018. The retained earnings of Mmili Limitedon that date were ₦200million and those of Ruwa Limited were ₦600million. There was no revaluation surplus in the books of Mmili Limited on December 1, 2018. The fair value of the net assets of Mmili Limited at December 2018 were not materially different from their carrying amount.

(iii) The group operates in an information technology sector and has incurred a significant amount of expenditure on the development of various internet products. Those costs were formerly written off to statement of profit or loss as incurred but then reinstated when the related internet products were brought into commercial use. The reinstated costs are shown as development inventories. The costs do not meet the criteria in IAS 38 – Intangible Assets for classification as intangibles and it is unlikely that the net cash inflows from these products will be in excess of the development costs. In the current year, Ruwa Limited has included ₦80million of these costs in inventory of which₦20million relates to expenditure on a product written off in periods prior to December 1, 2017. Commercial sales of these product has commenced during the current period. The Accountant now wishes to ensure that the financial statements comply with IFRS as regards this matter.

(iv) Ruwa Limited had purchased a significant amount of new internet equipment during the year. The cost before trade discount of this equipment was ₦200million. The trade discount of ₦24million was taken to the income statement. Depreciation is charged on straight line basis over six years' period.

(v) The policy of the group is to state the property, plant and equipment at depreciated historical costs. The group changed from the revaluation model to the cost model under IAS 16 - Property, Plant and Equipment in the year ended November 30, 2020 and restated all its assets to historical cost in that year except for the property, plant and equipment of Mmili Limited which had been revalued by the directors of Mmili Limited on December 1, 2019. The value were incorporated in the financial records creating revaluation surplus of

₦280million. The property, plant and equipment of Mmili Limited were originally purchased on December 2018, at a cost of ₦1,200 million. The assets are depreciated over six years on straight line basis. The group does not make an annual transfer from revaluation reserves to retained earnings in respect of the excess depreciation charged on the revalued property, plant and equipment. There were no additions or disposals of the property, plant and equipment of Mmili Limited for the two years ended November 30, 2020.

(vi) It is the group's policy to value non-controlling interests at acquisition at their proportionate share of subsidiary's identifiable net assets.

(vii) During the year the directors of Omi PLC decided to establish a defined benefit pension scheme for employees of the parent company and contributed cash to it to the tune of ₦400million. The following details relate to the scheme as at November 30, 2020.

	₦'M
Present value of obligation	520
Fair value of plan assets	500
Current service cost	440
Interest cost - scheme liabilities	80
Expected return on pension assets	40
Actuarial gain	60

The only entry in the financial statement made to date is in respect of cash contribution which has been included in Omi's PLC trade receivables.

The directors have been uncertain as to how to deal with above pension scheme in the consolidated financial statements because of the significance of the potential increase in the charge to the statement of profit or loss relating to the pension scheme. They wish to recognise immediately any actuarial gain in statement of profit or loss.

Required:

Prepare consolidated statement of financial position of Omi group for the year ended November 30, 2020 in accordance with relevant IFRS. (22 Marks)

b. The directors of Omi PLC after reviewing the group statement of financial position for the year end November 30, 2020, are of the opinion that the company might be unable to meet up with a future loan agreement which the company is planning to enter into early next financial year and they have therefore suggested the following to improve liquidity position of the group.

(i) To factor the company's receivables which amounted to ₦400 million. Thus the company would receive cash of 80% of the amount immediately, the factoring company will charge a fee of ₦32million for their services.

The debt will be factored without recourse to the group and the balance will be paid by the factoring company, 30 days after the receivables are factored.

(ii) The executive director marketing services suggested that instead of entering into factoring contract, it would have been better, if the financial statements are adjusted to appear as if land located in Ikoyi has been sold before the year end and thereby making the liquidity position better in order to meet up with the future loan agreement.

Required:

Discuss the rules of IFRS 9 – Financial Instrument relating to derecognition of a financial asset. Apply these rules to the suggestions made by the directors in b(i) above and discuss the ethical implication of the suggestion made by executive director marketing services in (bii) on the issue of the sale of land.

(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 IN THIS SECTION

QUESTION 2

Octopus Petroleum PLC is a multi-national oil and gas group operating in the Niger Delta areas of Nigeria. The company has been highly profitable over the years.

The group explores and extracts natural resources, hold reserves and has recently become involved in the downstream sector by opening various commercial retail outlet for sale of petrol to motorists.

In June 2020, the company was involved in an ecological disaster in Ogoni area of Niger Delta as a result of massive oil spillage due to some technical faults, thereby resulting to spilling oil into the surrounding ocean and damaging wildlife and local communities.

Investors are concerned about the future prospect of Octopus Petroleum PLC and whether it represents a safe investment since the company normally operates in the lucrative oil and gas sector.

Octopus Petroleum Group. annual report for the year 2020 and its comparative figures are shown below:

Octopus Petroleum Group
Consolidated statement of profit or loss for years ended December 31

	2020	2019
	₦'M	₦'M
Revenue	21,290	19,345
Cost of sales	(16,670)	(15,535)
Gross profit	4,620	3,810
Distribution costs	(580)	(525)
Administrative expenses	(635)	(705)
Profit from operations	3,405	2,580
Finance cost	(210)	(190)
Profit before tax	3,195	2,390
Tax expense	(640)	(515)
Profit for the year before spillage costs	2,555	1,875
Cost associated with Ogoni oil spill	(3,700)	--
Profit for year	(1,145)	1,875

Octopus Petroleum Group
Consolidated statements of financial position as at December 31

	2020	2019
	₦'M	₦'M
Assets:		
Non-current assets:		
Property plant and equipment	8,345	7,445
Current assets:		
Inventories	3,185	2,295
Trade receivables	4,410	4,030
Cash and cash equivalents	1,915	2,805
	9,510	9,130
Total assets	17,855	16,575
Equity and liabilities		
Equity:		
Ordinary share capital (₦1 each)	6,945	6,945
Retained earnings	890	2,660
	7,835	9,605
Non-current liabilities		
Provisions	3,170	85
Borrowings	2,090	2,380
	5,260	2,465
Current liabilities		
Trade payables	4,120	3,990
Tax liabilities	640	515
	4,760	4,505
Total equity and liabilities	17,855	16,575

Additional Information:

(i) The ₦3,700 million provision for Ogoni Oil spill is an estimated cost net relevant tax.

(ii) Calculating the financial cost of the oil spill in Ogoni land had been slightly problematic for Octopus Petroleum Groupin many ways. However, ₦530million had been expended by year end, while the future cost of clean-up and compensation have not yet been identified or determined.

(iii) However, one of such uncertain cost is fines payable to Federal Government of Nigeria in respect of the incident. The appropriate arms of the NNPCL and the Federal Government are still investigating the incident and how Octopus Petroleum responded to the problem. Fines have been levied in respect of past incidents, and some are in excess of ₦2,500 million.

(iv) Octopus Petroleum Grouphas vertically integrated in the second half of year 2020 by acquiring and re-branding a large number of petrol stations across the country.

(v) Octopus Petroleum oil reserves are at record high levels at the end of the 2020 financial year.

(vi) Also the price of oil has increased by approximately 5% during year 2020 financial year.

(vii) In common with many oil companies, Octopus PetroleumGroup valued inventory on a last-in-first-out basis (LIFO). The auditors of Octopus Petroleum Group exceptionally allow this treatment, although it contravenes the accounting standard IAS 2.

(viii) Octopus Petroleum Group maintained its dividend payment at ₦625million for years 2020 and 2019.

(ix) It is the global practice for inventors in the oil and gas sector to evaluate investments using the following category of ratios.

Profitability:

- Return on capital employed (C. E = Equity + Borrowings)
- Return on equity
- Gross profit percentage
- Operating profit percentage

Liquidity:

Current ratio

Acid test ratio

Use of resource or financial position;

- Inventory turnover
- Assets turnover
- Interest cover
- Gearing ratio

Required:

a. Analyse the performance of Octopus Petroleum Groupover the two year period. Your analysis should also consider the group's ability to finance the cost of the oil spill in Ogoni land in the coming years. (14 Marks)

b. Annual reports of the group, also contains separate financial statements of the parent (Octopus Petroleum Plc.). Some companies also include social and environmental report as part of their financial statements.

Required:

i. Explain why it is better to use the consolidated financial statements for financial analysis rather than those of the parent separate financial statements. (4 Marks)

ii. Enumerate the possible contents of an environmental report included in an annual report of companies. (2 Marks)

(Total 20 Marks)

QUESTION 3

You are the Financial Controller of Gongon Group, on January 2, 2021, you are busy preparing the financial statements for the year ended December 31, 2020. You are under a lot of pressure as you have been asked to present the draft financial statements to the Board of Directors in two day's time.

The first draft of the financial statements of each of the three companies have been prepared and they are now on your table. You have also managed to compile a list of outstanding issues that you need to consider before the financial statements are presented to the Board.

The outstanding issues are as follows:

First issue:

Gongon Group has three investment properties in its books. Investment properties are measured in the financial statements at fair value (as permitted under IAS 40 - Investment properties), while owner occupied properties are measured at cost less accumulated depreciation and impairment losses.

The properties are currently presented at 2019 year end valuations. No adjustments have been made for the current year.

During the year 2020, there was a change of use of two of Gongon Group investment properties. Property 'A' a commercial warehouse located at Apapa that has been let on a commercial basis for a number of years, was re-assigned as office space for the company. The tenants were notified and vacated the premises on May 1, 2020. The property was valued at ₦8,000,000 on January 1, 2020, ₦7,600,000 on May 1, 2020, and ₦7,400,000 on Dec. 31, 2020. It is the company policy to depreciate owner-occupied property at a rate of 2% per annum on a monthly basis.

Property 'B' was acquired in year 2014 for ₦10,000,000 and is valued at ₦9,000,000 on January 1, 2020. In late 2020, resulting from falling property prices in the country, the director agreed to dispose of this property. The propertywas empty since September and was put on the market in October with an asking price of ₦8,800,000. Although there has been some interest in the property, no firm offer had been made by the year end. Estimates of disposal costs are about ₦600,000. The value remained at ₦8,800,000 at December 31, 2020.

Property 'C' is valued at ₦18,500,000 at December, 2018.

The summarised financial statement of Gongon PLC and the two other companies are as follow:

Draft Statements of financial position at December 31, 2020

	Gongon PLC	Bandel Limited	Osune Limited
Assets:			
Non-current assets:	₦'000	₦'000	₦'000
Property, plant and equipment (PPE)	120,000	55,800	15,000
Investment:			
Shares in Bandel Limited	40,000	--	--
Shares in Osune Limited	30,000	--	--
Investment properties	32,000	--	--
	222,000	55,800	15,000

Current assets:	171,400	24,000	16,000
Total assets	393,400	79,800	31,000
Equity and liabilities			
Equity	330,000	24,600	24,000
Other non-current liabilities	21,000		--
Current liabilities	42,400	55,200	7,000
Total equity and liabilities	393,400	79,800	31,000

Extract of draft statement of profit or loss and other comprehensive income for the year ended December 31, 2020

	Gongon PLC ₦'000	Bandel Limited ₦'000	Osune Limited ₦'000
Profit before tax	80,000	6,000	5,000
Income tax expense	(6,600)	(660)	(400)
Profit for the year	73,400	5,340	4,600

Second Issue:

On January 1, 2020 Gongon commenced a defined benefit plan for a number of head office employees. Under the pension scheme. Gongon PLC has an obligation to provide these staff with agreed post-employment benefit. Gongon PLC carries out the actuarial and investment risk assessments associated with the pension scheme.

The following is the draft details of the scheme:

Information on Gongon's Pension Scheme

	₦'000
Interest income on plan assets	330
Employers contribution to plan	11,000
Current service cost	12,000
Interest on plan liability	360
Fair value of plan assets as at 31/12/2020	11,600
Present value of plan obligation at 31/12/2020	12,400

The Chief Accountant of the Gongon PLC was not sure which accounting standard to apply when accounting for pension scheme. The only adjustment made to account for the scheme was to expense the company's contribution of ₦11million for the 2020 financial year in the statement of profit or loss and other comprehensive income and to credit the cash account.

Required:

a. Discuss and carry out the analysis of the required accounting treatment of the first issue showing relevant calculations and impact where appropriate on the financial statements of Gongon PLC as at December 31, 2020. (12 Marks)

b. Review the accounting treatment on second issue - pension plan; making necessary disclosures in accordance with the relevant accounting standard. (8 Marks)

(Total 20 Marks)

QUESTION 4

a. There has been significant divergence in practice over recognition of revenue mainly because International Financial Reporting Standards (IFRSs) contain limited guidance in certain areas. The International Accounting Standards Board (IASB) as a result of the joint project with the US Financial Accounting Standards Board (FASB) has issued IFRS 15 - Revenue from Contracts with Customers. IFRS 15 sets out a five-step model, which applies to revenue earned from a contract with a customer with limited exceptions, regardless of the type of revenue transaction or the industry. Step one in the five-step model requires the identification of the contract with the customer and is critical for the purpose of applying the standard. The remaining four steps in the standard's revenue recognition model are irrelevant if the contract does not fall within the scope of IFRS 15.

Required:

Discuss the criteria which must be met for a contract with a customer to fall within the scope of IFRS 15. (10 Marks)

b. At August 31, 2016, Evolve LTD controlled a wholly owned subsidiary, Resource LTD, whose only assets were land and buildings, measured in accordance International Financial Reporting Standards. On August 1, 2016 Evolve LTD published a statement stating that a binding offer for the sale of Resource LTD had been made and accepted and, at that date, the sale was expected to be completed by August 31, 2016. The non-current assets of Resource LTD were measured at the lower of their carrying amount or fair value less costs to sell at August 31, 2016, based on the selling price in the binding offer. This measurement was in accordance with IFRS 5-Non-Current Assets Held for Sale and Discontinued Operations.

However, Evolve LTD did not classify the non-current assets of Resource LTD as held for sale in the financial statements at August 31, 2016, because there were uncertainties regarding the negotiations with the buyer and a risk that the agreement would not be finalised. There was no disclosure of these uncertainties and the original agreement was finalised on September 20, 2016.

Required:

Advise Evolve LTD on how the above transactions should be correctly dealt with in its financial statements with reference to relevant International Financial Reporting Standards. (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

a. Most regulatory authorities in Nigeria such as Security and Exchange Commission (SEC), Central Bank of Nigeria (CBN), Federal Inland and State Internal Revenue Services issued conditional relief for meeting reporting deadlines, for filing annual and other returns required by law during the pandemic.

However, companies still need to look out for further reporting updates and to monitor current and potential effects that Corona Virus (COVID 19) could have on their financial reporting.

Required:

Discuss **FOUR** financial reporting issues that should be considered by companies as a consequence of COVID-19. (8 Marks)

b. There has been various arguments around the world that there should be more extensive disclosures in the annual report of companies. However, others have argued that instead of having extensive disclosures in annual report, efforts should have been placed almost exclusively on reducing the quantity of information in such annual reports. This is because it is believed that this excessive disclosure is burdensome and can overwhelm users of financial statements: Also other are of the opinion that there is no such thing as too much 'useful' information to the users of the financial statements.

Required:

Discuss why it is important to ensure that optimal level of disclosure is made in an annual reports and identify and explain the barriers which may exist when trying to reduce excessive disclosure of information in an annual report.

(7 Marks)

(Total 15 Marks)

QUESTION 6

a. Omoge Nigeria PLC has the following share options scheme for its directors as at May 31, 2021.

Directors Name	Grant Date	Options Granted	Fair Value of Options at grant date	Exercise Price	Vesting Date
Adamu Salisu	June 1, 2019	400,000	3	4	June 2021
Chukwu Eze	June 1, 2020	1,200,000	2.5	5	June 2023

The price of the company's share at May 31, 2021 is ₦8 per share and at May 31, 2020 was ₦8.50 per share.

The directors must be working for Omoge Nig. PLC on the vesting dates in order for the options to vest.

No directors have left the company since the issue of the share option and none are expected to leave before June 2023. The options can be exercised on the first day of the month in which they vest.

In accordance with IFRS 2, an expense of ₦600,000 has been charged to profit in the year ended May 31, 2020 in respect of the share option scheme.

The cumulative expense for the two years ended May 31, 2021 is ₦2,200,000.

Tax allowances arise when the options are exercised and the tax allowance is based on the option's intrinsic value at the exercise date.

Assume tax rate of 30%

Required:

Evaluate the deferred tax implication of the share options for the year ended May 31, 2020 and 2021. (10 Marks)

b. On your first day at Omoge Nigeria Plc as the Chief Financial Officer (CFO) of the company you were sitting in the staff canteen where you overheard a conversation between two of the Admin Officers of the company. They were gossiping about Mr. Adamu Salisu the finance director.

According to the conversation, Adamu Salisu may have been involved in an unethical activities in respect of Omoge Nigeria Plc takeover of Bobo Limited.

Adamu Salisu's wife is a director in Bobo Limited prior to the takeover. Mrs. Salisu owned 30% of the shares in Bobo Limted, it was suggested that Mr.

Adamu Salisu the finance director over paid substantially for Bobo Limited and that Mr. Adamu Salisu facilitated the over payment in order to benefit his wife (Mrs. Salisu). He did this allegedly by colluding with his wife to falsify records submitted to the accountant who undertook due diligence in respect of the takeover. Mr. Adamu Salisu is apparently not well liked, the Admin Staff regard him as intimidating and it seems they would be pleased if he lost his job.

Required:

Discuss the ethical implications of the above and possible actions that may arise from the incident. (5 Marks)

(Total 15 Marks)

QUESTION 7

a. Fine Face (FF) Limited produces and sells its range of body care products through three separate divisions. In addition there are two laboratories which carry out research and development activities.

In the first of these laboratories, the research and development activities is funded internally and centrally for each of the three sales divisions. It does not carry out research and development activities for other entities. Each of the three divisions is given a budget allocation, which it uses to purchase research and development activities from the laboratory. The laboratory is directly accountable to the divisional heads for this expenditure.

The second laboratory performs contract investigation activities for other laboratories and body care companies. This laboratory earns 75% of its revenue from external customers and these external revenues represent 18% of the organisation's total revenue.

The performance of the second laboratory's activities and the three separate divisions is regularly reviewed by the Chief Operating Decision Maker (CODM). In addition to the head of divisions, there is a head of the second laboratory. The head of the second laboratory is directly accountable to the CODM and they discuss the operating activities, allocation of resources and financial results of the laboratory.

Fine Face Limited (FF) is uncertain as to whether the research and development laboratories should be reported as two separate segments under IFRS 8 – Operating Segments.

Required:

Advice the directors of Fine Face Limited on this issue. (8 Marks)

b. Jafuwara PLC is a public limited company, that trade in six business areas which are reported separately in its internal accounts provided to the Chief Operating Decision Maker (CODM).

The results of these segments for the year ended December 31, 2021 are as follows:

Operating Segment Information as at Dec. 31, 2021

	Business areas	Revenue External	Revenue internal	Total	Segment profit/ loss	Segment assets	Segment liabilities
		₦'M	₦'M	₦'M	₦'M	₦'M	₦'M
i.	Chemical-Africa	28	14	42	2	62	28
	Rest of the world	112	6	118	26	156	68
ii.	Pharmaceutical-wholesale	118	16	134	18	208	70
iii.	Pharmaceutical-retail	44	Nil	44	(4)	60	24
iv.	Cosmetics	24	6	30	4	36	20
v.	Hair care	22	2	24	8	42	16
vi.	Body care	36	48	84	(12)	108	38
		384	92	476	42	672	264

Required:

Draft a report, addressed to the directors of Jafuwara PLC advising them on which of the operating segments constitute a 'reportable' operating segments for the year ended December 31, 2021 in accordance with IFRS 8. (7 Marks)

(Total 15 Marks)

SOLUTION 1

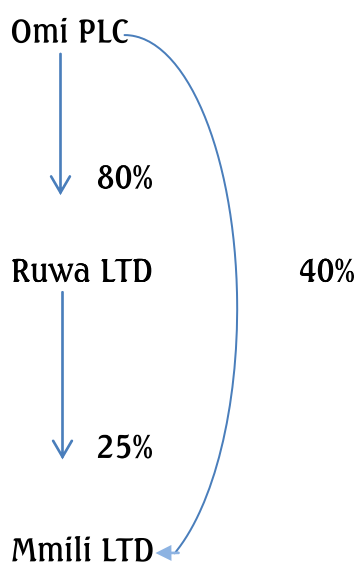
(a) **Omi GROUP**

Consolidated statement of financial position as at November 30, 2020

Non-current assets:	₦'m
Property plant and equipment (w5)	7,720
Goodwill (w2)	528
	8,248
Current assets:	
Inventories ₦(1,200 + 540 + 260 – 80)	1,920
Receivables ₦(960 + 420 + 196 – 400)	1,176
Cash and cash equivalents ₦(360 + 200 + 320)	880
	3,976
Total assets	12,224
Equity and liabilities:	
Share capital	6,000
Share premium	1,200
Retained earnings (w4)	2346
Equity	9546
Non controlling interest	1058
Non-current liabilities:	
Pension obligation (w7.1)	20
Other non current liabilities ₦(540 + 100 + 80)	720
Current liabilities ₦(400 + 280 + 200)	880
Total equity and liabilities	12,224

Workings:

(w1) Group Structure



Omi PLC in Mmili Ltd (Direct 40% indirect (80 x 25% = 20%) = 60%

(w2) Goodwill

	Omi in Ruwa PLC		Omi in Mmili LTD (Indirect)		Omi in Mmili LTD (Direct)	
	₦'m	₦'m	₦'m	₦'m	₦'m	₦'m
Consideration at Acq		2,560	(80% x 400)	320		640
Net asset acquired:						
Share capital	2,000		800		800	
Share premium	400		200		200	
Retained earnings	400		200		200	
Fair value adjustments	40		-		-	
	2,840		1,200		1,200	
80% (2840)		(2,272)	20% 1200	(240)	40% (1200)	(480)
		288		80		160

Goodwill = ₦288 + ₦80 + ₦160 = ₦528

W3 Non-controlling interests

	Ruwa LTD	Mmili LTD
	₦'m	₦'m
Net asset per question	3,200	1,520
Investment Mmili Ltd	(400)	--
Development costs written off	(80)	--
Trade discount on PPE less depreciation (w5)	(20)	--
Elimination of revaluation reserve (w6)		(280)
Adjustment for excess depreciation (w6)	--	56
	2,700	1,296
	at 20% = 540	at 40% = 518.4
Non-controlling interests	(540 + 518.4)	= 1058.4

W4 Retained earnings

	Omi PLC	Ruwa LTD	Mmili LTD
	₦'m	₦'m	₦'m
As per question	2,500	800	240
Fair value adjustment realised	--	(40)	--
Development cost written off	--	(80)	--
Trade discount on tangible assets less depreciation	--	(20)	--
Adjustment for excess depreciation (w6)	--	--	56
At acquisition	--	(400)	(200)
	2,500	260	96
Group shares of Ruwa LTD (80% x 260)	208		
Group share of Mmili LTD (60% x 96)	57.6		
Less defined benefit scheme (w7.1)	(420)		
	2345.6		

N:B The development costs do not meet the recognition criteria in IAS 38 and they cannot be treated as inventory, they have been previously written off as incurred. They were reinstated after acquisition. So they must be written off to post-acquisition reserve.

W5 Property plant and equipment (PPE)

	₦'m
Omi PLC	4,920
Ruwa LTD	2,020
Mmili LTD	1,024
	7,964
Less: Adjustments to PPE of Mmili LTD (w6.1)	(224)
Ruwa LTD trade discount net of depreciation (24 x 5/6)	(20)
	7,720

Note: IAS 16 state that PPE must be measured net of trade discount.

W6 Adjustment to PPE of Mmili LTD

	Valuation	Depreciated historical cost
	₦'m	₦'m
Cost at December 1, 2018	1,200	1,200
Depreciation (1,200/6)	(200)	(200)
	1,000	1,000
Revaluation	280	--
	1,280	1,000
Depreciation 1,280/5	(256)	(200)
	1,024	800

(w6.1) Adjustment required to the group account

	₦'m	₦'m
DR revaluation surplus	280	--
CR retained earnings (256 – 200)		56
CR property plant and equipment (PPE)		224

W7 Pension per Statement of financial position (SFP):

		₦'m
(i)	Present value of pension obligation	520
	Fair value of plan assets	500
	Pension liability	20
(ii)	Pension per Profit or Loss:	₦
	Current service cost	440
	Interest cost	80

Expected return on plan assets	(40)
Actuarial gain	(60)
Transferred to retained earnings	420

Adjustment to group:

	₦'m	₦'m
DR retained earnings	420	--
CR Trade receivables	--	400
CR pension obligation	--	20

(b) Rules of IFRS – Financial Instrument relating to derecognition of financial assets

IFRS 9: Financial assets is derecognised if one of the following three combination of circumstances occur.

- The contractual right to cash flows from the financial assets expires;
- The financial assets is transferred and substantially all of the risk and rewards of ownership pass to the transferee; or
- The financial assets is transferred, substantially all the risk and rewards of ownership are neither transferred nor retained but control of the assets has been lost.
- Most transactions being considered involve receipt of cash.
- Transactions where assets is derecognised may lead to the recognition of a profit or loss on disposal.
- Transactions where asset is NOT derecognised lead to the recognition of liability for the cash received.

Application of Factoring of Debt

- In the scenario, with factoring of the receivable. The contractual right to cash flows of the financial assets will expire.
- Also the assets (receivables) have been transferred to another party (factoring company) i.e. (80% of it and balance later).
- Therefore substantially all the risk and rewards of ownership has been passed to the factoring company.

Therefore Omi Plc must derecognise the financial assets (receivables of N400 million) from it records by;

		DR	CR
		₦'m	₦'m
(i)	Cash & cash equivalent	320	
	Receivables		320
	Being cash received on initial factory of receivables		
(ii)	Profit or Loss	32	
	Receivables		32
	Being service charged incurred on factoring of debt		

(iii)	Cash and cash equivalent	48	
	Receivables		48
	Being cash balance paid after 30 days		

Ethical Issues

- Manipulation of financial statements do not involve breaking rules, however the purpose of financial statement is to present a fair representation of the company or the group position.
- Accountants have the responsibility to issue financial statements that do not mislead users as they assume that such profession are acting in an ethical capacity, thus giving financial statements credibility.
- Accountants should seek to promote or preserve public interest and not carry act with a mindset to deceive the public by manipulating financial statements or transactions.
- Therefore accountants should present financial statements that meet the qualitative characteristics set out in financial reporting frame work. Faithful representation and verifiability are two or such concept and its important for accountants to ensure that these concepts are applied in the preparation and disclosure of financial information.
- If this is allowed, it may lead to litigation and cause disrepute to the organisation's image
- The financial statements will mislead the borrower and other users and breach the principle of IAS 1.

Examiner's report

Part (a) of the question tests candidates' knowledge of the preparation of consolidated statement of financial position and the adjustment arising thereon, while part (b) tests the application of IFRS 9- Financial Instruments relating to derecognition of financial assets and the ethical implication of the transaction.

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

The common pitfalls of the candidates were their inability to prepare the necessary adjustments relating to pension obligation and measurements of property, plant and equipments net of trade discount. Majority of the candidates did not understand derecognition rules of IFRS on of financial assets, application of factoring debt and the ethical issues on manipulations of financial statements.

Candidates are advised to pay more attention to application of accounting standards and basic principles of various adjustments to the preparation of consolidated statement of financial position. They are advised to practice more questions and use ICAN Study Texts for better performance in future examinations.

Marking guide

		Marks	Marks
(a)	Preparation of statement of financial position	3½	
	Computation of:		
	- Goodwill	4	
	- Non-controlling interest	2¼	
	- Group retained earnings	3½	
	- Group property, plant and equipment	1¼	
	- Adjustment to PPE valuation	1½	
	- Pension obligations	2	
	Other workings and adjustments	4	22
(b)	Rules of IFRS on financial instruments	1½	
	Application of debt factoring	1½	
	Derecognition of financial assets	2	
	Ethical implications on the sales of land	3	8
	Total		**30**

SOLUTION 2a

Octopus petroleum group
Calculation of the relevant ratios

	Ratios	Formulae	2020		2019	
	Profitability ratios					
1.	Return on capital employed (ROCE)	PBIT / Capital employed	3,195+210 / 7,835+2,090 × 100/1	34.31%	2,390+190 / 9,605+2,380 × 100/1	21.53%
2.	Return on equity	PAT(b/4 spillage cost) / Equity	2,555 / 7,835 × 100/1	32.61%	1,875 / 9,605 × 100/1	19.52%
		PAT(after spoilage cost) / Equity	(1,145) / 7,835 × 100/1	14.61%	1,875 / 9,605 × 100/1	19.52%
3.	Gross profit percentage	Gross profit / Revenue × 100/1	4,620 / 21,290 × 100/1	22%	3,810 / 19,325 × 100/1	19.70%
4.	Operating profit percentage	Operating profit / Revenue × 100/1	3,405 / 21,290 × 100/1	16%	2,580 / 19,345 × 100/1	13.34%
	Liquidity ratios					
5.	Current Ratio	Current assets / Current liabilities	9,510 / 4,760	2:1	9,130 / 4,505	2.03:1
6.	Acid test ratio	Current assets-inventory / Current liabilities	9,510-3,185 / 4760 = 6325 / 4,760	1.33:1	9,130-2,295 / 4,505 = 6835 / 4505	1.52:1
	Use of resources/Financial position					
7.	Inventory turnover	Cost of sales / Inventories	16,670 / 3,185	5.2 times	15,525 / 2,295	6.8 times
8.	Assets turnover	Revenue / Total assets	21,290 / 17,855	1.2 times	19,345 / 16,575	1.2 times
9.	Interest cover	Profit from operations / Finance cost	3,405 / 210	16.2 times	2,580 / 190	13.6 times
10.	Gearing ratio	Borrowing / Equity + Borrowings × 100/1	2,090 / 9,925 × 100/1	21.05%	2,380 / 11,985 × 100/1	19.85%

Analysis and Interpretation of Ratios

Profitability

- Octopus Petroleum Group's underlying profit performance in year 2020 is strong and is reflected in an increase in the year's profit by N680 million from year 2019.
- This strong position of profit performance of Octopus Petroleum is also reflected in the return on capital employed which increased from 21.52% in year 2019 to 34.3% in year 2020.
- The decline noted on return on equity from 19.7% in year 2019 to negative (14.61%) in year 2020 was due to the huge provision for cost associated with oil spillage of ₦3,700 million in year 2020.
- The vertical integration during the year with establishment of petrol stations also contributed to growth in revenue by over 10% from ₦19,345million to ₦21,290million.
- Overheads also appeared to be well managed with operating profit percentage increasing from 19.7% to 21.7%.

Liquidity

- The liquidity position of the company appeared to be stable with current ratio of 2:1 for years 2019 and 2020.
- But there has been negative shift in liquidity position when the acid-test ratio is considered.
- This could be as a result of decline in cash position of Octopus Petroleum as a result of payment made in respect of oil spills whilst the inventory level are increasing.
- There is also the future possibility that the cash position of the company will decline further when they might pay more fines and penalties in respect oil spills in future.

Use of resources or financial position

- The inventory turnover has reduced significantly which has contributed to the stability of current ratio.
- The high level of oil reserves will be a major reason behind this and aligned with higher oil prices which would be reflected in much inventory because of the use of LIFO valuation system.
- The additional reserves necessary to service its groups of petrol stations would also be a contributing factor here.
- As regards financial position, the group's position appeared to be fairly strong in this respect.
- Interest cover has improved over the years. Also gearing has increased slightly despite repayment of some borrowings during the year. The substantial loss in year 2020 has reduced the Group's equity substantially.

Overall

- The profit performance of the company is good enough with increasing margin, improved revenue and adequate provisions made for possible cost of oil spillage.
- Also the group has been able to maintain the same of level of dividend payment for years 2019 and 2020 despite the huge provision made for cost associated with oil spillage.
- The disaster will impact on the group's financial performance and position for years to come, and the group could be considered to be fortunate in that its core business is so strong and that it has also built up its oil reserve at the year end.
- Although cash and cash equivalents of Octopus petroleum have dwindle during the year end are not adequate to cover known estimated cashflows of the oil spills.
- However, the incentives level (oil reserves) could normally be disposed of fairly quickly and this could absorb any future liquidity that may arise in case of payment of finesor penalty for oil spills.
- Also the gearing level of Octopus Petroleum is fairly low hence, they could still accommodate more borrowings to meet up future commitments.

Conclusion

In light of the mitigating factors highlighted above investors may still invest in Octopus petroleum.

b. i. **Use of consolidated financial statements for financial analysis**

Using consolidated financial statements for financial analysis is better than using the separate financial statements of the parent or subsidiary companies because consolidated financial statements provide a more accurate and comprehensive picture of the financial health and performance of the entire enterprise group.

(i) It ensures that manipulation is avoided as all assets and liabilities are shown together.
(ii) It shows the group as a single economic unit
(iii) It helps to determine the liquidity position of the entire organisation
(iv) It helps to ensure easy understanding of the financial statements
(v) The separate financial statement of the parent in annual report of group is mostly for the fulfillment of law and accounting standards. They are therefore of little or no significance.
(vi) Consolidated financial statements provides stakeholders with full information concerning the entire activities in which they have invested.
(vii) Consolidated financial statements combined the financial information of the parent company and its subsidiaries to show the overall financial performance and position of the group.

(viii) Consolidated financial statements also adjust for any intercompany transactions, which can lead to double-counting or errors in interpreting an entity's financial results.

(ix) Using consolidated financial statements can provide a clearer picture of the extent to which the assets and liabilities of the group and its subsidiaries are interconnected.

i. Contents of environmental reports included in annual report of companies

An environmental report section in an annual report of a company may include the following contents:

- Overview of the Company's Environmental Management System (EMS) and sustainability strategy;
- Details of environmental policies, standards, and compliance with regulatory requirements;
- Environmental Performance Indicators, such as carbon emissions, energy consumption, water usage, and waste management;
- Environmental risks, opportunities, and mitigation strategies;
- Green Initiatives and innovative sustainability programs undertaken by the company;
- Environmental awards and recognitions, if any;
- The company's progress towards achieving its environmental and sustainability goals;
- Future plans and priorities towards environmental stewardship;
- The entities policies towards environmental issues;
- Any impairment or deterioration since previous year;
- An assessment of the key risks faced and how the company intends to respond;
- Government legislations on environmental matters and how the entity ensures compliance with legislation;
- Significant imitative taken by the company to improve environmental issues;
- Key environmental performance indicators;
- Financial information relating to environmental costs, including the entity’s accounting policy;
- Results of test of regulatory authorities;
- Environmental impact of gas emissions;
- Details of any provisions or contingent liabilities relating to environmental matters; and
- The amount charged to income statement during the accounting period in respect of expenditure to prevent or rectify damage to the environment caused by the entity’s operation.

By including an environmental report section in their annual report, companies can demonstrate their commitment towards sustainable development, transparency in environmental performance, and accountable corporate citizenship.

Examiner's report

Part (a) of the question tests candidates' knowledge of the computation of ratios on profitability, liquidity, use of resources or financial position and interest cover ratios. Part (b) of the question tests candidates' knowledge on the use of consolidated financial statements for financial analysis and contents of environmental report in an annual report of companies.

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

The common pitfalls of the candidates were their inability to derive the figures to be used for the computation of the ratios and poor analysis and interpretation of the results. They are unable to present logically reasons why consolidated financial statements are better than using separate financial statements of parent or subsidiary companies. Some candidates do not know the contents of environmental reports included in annual reports of companies.

Candidates are advised to ensure that they practice more past questions on ratio analysis. They should also get familiar with all the contents of an annual report of companies for analysis and interpretation purposes.

Marking guide

			Marks	Marks
(a)	Computation of relevant ratios			
	i.	Profitability ratios	4	
	ii.	Liquidity ratios	2	
	iii.	Use of resources ratios	4	10
	Analysis and interpretation of ratios			
	-	Profitability	1	
	-	Liquidity	1	
	-	Use of resources	1	
	-	Overall conclusion	1	4
(b)	i.	Why consolidated financial statements are better than financial statements for analysis (Four correct points)	4	
	ii.	Contents of an environmental report (Four correct points)	2	6
		Total		20

SOLUTION 3

(a) First Issue

There are three properties to consider. These are:

Properties	Value at Jan. 1, 2020	Activities
	₦'000	
a.	8,000	Change of use to owner occupied
b.	9,000	Change use to held for sales remain in IAS 40 adjust fair value at year end
c.	15,000	No change, adjust to fair value

Property 'A'

- In accordance with IAS 40, a transfer from investment property carried at fair value to owner occupied property, the fair value at the date of change of use is deemed to be the 'cost of the property under its new classification.
-
- The cost will then be depreciated in accordance with the company's accounting policy.

	₦'000
Fair value at Jan 1, 2020	8,000
Fair value at May 1, 2020	7,600
Fair value adjustment	400

Depreciation is to be charged is for 8 months (May 1 to Dec. 31 2020)
= ₦7,600,000 x 2% x 8 months (8/12) = ₦101,333
Carrying amount = (₦7,600,000 – 101,333) = ₦7,498,667

	₦'000
Fair value at Dec 31, 2020	7,400,000
Carrying amount at Dec 31, 2020	7,498,667
Impairment for the year	98,667

Property 'B'

- Property 'B' held for sale as at December 31, 2020. Property 'B' should continue to be presented as Investment property under IAS 40 until it is disposed of IFRS 5 – Non-Current Assets Held for Sale and Discontinued Operation does not apply here.
- However property 'B' will be adjusted to fair value as at December 31, 2020 as follows:

	₦'000
Property B fair value at Jan1, 2020	9,000
Fair value at Dec 31, 2020	8,800
Fair value adjustment	200

	₦'000
DR profit or loss	200
CR investment property	200

Being loss on fair value adjustment taken to profit or loss

Property 'C'

- There is no change in the use for property 'C'
- It only needs to be restated to fair value at the year end

	₦'000
Fair value at Jan 1, 2020	
₦[32,000 – 8,000 – 9,000]	15,000
Fair value at Dec. 31, 2020	18,500
Fair value adjustment	3,500
	₦'000
DR Investment property	3,500
CR profit or loss	3,500

Being gain on fair value adjustment on reinstatement transfer to profit or loss

Gongon PLC

Revised adjustments to draft statement of financial position

	₦'000
PPE ₦[120,000 + 7,400 (property A)]	127,400
Investment:	
Share in Bandel Ltd	40,000
Share in Osun Ltd	30,000
Investment property	
₦[32,000 – 8,000 – 200 + 3,500]	27,300
	224,700
Current assets	**171,400**
Total assets	**396,100**
Equity and liabilities:	₦'000
Equity ₦(330,000 + 3500 – 600 – 200)	332,700
Current liabilities	42,400
Non-current liabilities	21,000
Total equity liabilities	**396,100**

(b) 2nd Issue

- The applicable accounting standard is IAS 19 (Employee Benefits). Gongon pension scheme is a defined plan as Gongon has an obligation to provide agreed employment benefits and the entity carries the actuarial and investment risk associated with pension scheme.
- The accountant has accounted for the employees contribution to the scheme, incorrectly by simply recognising the employer contribution in the statement of profit or loss.
- IAS 19 requires defined benefit liabilities assets to be recognised on the statement of financial position at the new amount of the present value of the obligation less the fair value of plan assets at reporting date.

- A defined benefit plan may give rise to current service cost and net interest expense, which should be recognised through the profit or loss.
- In addition any actuarial gain and or losses from the remeasurement of the defined pension liabilities or assets should be recognised through other comprehensive income.

Pension assets

	₦'000		₦'000
Opening bal.	Nil		
Return on asset	330		
Employers contribution	11,000		
Re-measurement - actuarial gain [11,600 – 11,330]	270	Closing bal.	11,600
	11,600		11,600

Pension liabilities

	₦'000		₦'000
		Opening bal.	Nil
		Interest cost	360
		Current service cost	12,000
Closing bal.	12,400	Re-measurementloss [12,400 – 12,360]	40
	12,400		12,400

Finally, the Chief Accountant's previous accounting treatment for the employees contribution should be corrected.

	₦'000	₦'000
DR Net Pension liability (SOFP)	11,000	
CR Pension contribution expenses (P or L)		11,000

Being correction on the acquisition treatment of pension contribution

Financial statements extract

Statement of profit or loss and other comprehensive income for the period	₦'000
Pension cost expenses:	
Interest cost	360
Correct service cost	12,000
Return in assets	(330)
	12,030
Other comprehensive income:	₦'000
Actuarial gain	270
Statement of financial position:	₦'000
Current assets:	
Cash contributed	11,000
Pension assets	11,600
Current liabilities:	22,600
Employees benefit liability	12,400

Examiner's report

Part (a) of the question tests candidates' knowledge of the required measurement and presentation of properties from or to investment property according to IAS 40 - Investment Properties, change of use and fair value adjustment, while part (b) tests the review of the accounting treatments and disclosure of IAS 19-Employee Benefits and defined benefits plan.

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

The common pitfalls of the candidates were lack of understanding of the requirement of the question applying the real life situation to IAS 40-Investment Properties and IAS 19 -Employee Benefits and defined benefits plan.

Candidates are advised to get familiar with knowledge of accounting standards and how to relate the application to real life situation in the financial statements. They should also do in-depth study on accounting standards examinable at this level of the Institute examinations for better performance in future.

Marking guide

		Marks	Marks
(a)	Summary of the first outstanding issue	1½	
	Accounting treatment of investment properties for the following:		
	- Commercial warehouse changed to owner occupier	2¼	
	- Change of use to held for sales	2½	
	- No change in use but adjust to fair value	2	
	Revised adjustment to draft financial statements	3¾	12
(b)	Accounting treatment and issues on:		
	Defined benefit plan	2	
	Pension assets	2	
	Pension liabilities	2	
	Correction of the previous accounting treatment	2	8
	Total		20

SOLUTION 4

a) **Criteria for a contract with customer to fall within the scope of IFRS 15**

IFRS 15 International Financial Reporting Standard 15 outlines the requirements for the recognition, measurement, and disclosure of revenue from contracts with customers. To fall within the scope of IFRS 15, certain criteria must be met, including:

(i) Identification of the contract: A contract exists when there is an agreement between the parties that creates enforceable rights and obligations. The contract can be written, oral or implied;
(ii) Identification of performance obligations: To fall within the scope of IFRS 15, the contract must specify the goods or services to be provided. These are called performance obligations, which can be explicit, implicit, or arise from customary business practices;
(iii) Determination of transaction price: The transaction price is the amount of consideration that a company expects to receive from a customer in exchange for goods or services. To fall within the scope of IFRS 15, the transaction price must be fixed or determinable;
(iv) Allocation of transaction price: If a contract has multiple performance obligations, the transaction price must be allocated to each obligation based on its relative standalone selling price;
(v) Measurement of revenue: Revenue is recognised when performance obligations are satisfied, either over time or at a point in time. Revenue is measured as the amount of consideration to which an entity expects to be entitled in exchange for the goods or services provided;
(vi) Disclosures: Companies must disclose information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers;
(vii) The parties to the contract have approved the contract;
(viii) Each party's rights in relation to the goods or services to be transferred can be identified;
(ix) The payment terms and conditions for the goods or services to be transferred can be identified;
(x) The contract has commercial substance;
(xi) The collection of an amount of consideration to which the entity is entitled to in exchange for the goods or services is probable;
(xii) If the above criteria are met, a contract shall not be re-assessed unless there is an indication of a significant change in facts or circumstances. However, if the contract does not meet the above criteria the entity will continue to re-assess the contract going forward to determine whether the criteria are subsequently met;
(xiii) The new revenue model would apply to all contracts with customers except leases, insurance contracts, financial instruments, guarantees and certain non-monetary exchanges. The sale of non-monetary financial assets, such as property, plant and equipment, real estate or intangible assets will also be subject to some of the requirements of the new model; and
(xiv) A contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of another standard, in which case;
- If the other standards specify how to separate and/or initially measure one or more parts of the contract, then an entity shall apply those separation and measurement requirements first. The transaction price is then reduced by the amounts that are initially measured under other standards; and

- If other standards do not provide guidance on how to separate and/or initially measure one or more parts of the contract, then IFRS 15 will be applied.

In conclusion, to fall within the scope of IFRS 15, these criteria must be met, and companies must apply the principles and guidance of the standard to ensure accurate revenue recognition. The proper implementation of IFRS 15 can help ensure consistent and transparent financial reporting around the world.

b) **IFRS 5: Non-Current Assets Held for Sale and Discontinued Operations**

The non-current assets of Resource should have been presented as held for sale in the financial statements. In accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 5 states that:

(i) The appropriate level of management must be committed to a plan to sell;
(ii) The asset for the sale must be probable;
(iii) Evolves LTD acceptance of a binding offer in August 2016 and the publication of this information indicated a high probability of sale.
(iv) Despite the uncertainties surrounding the sale, the transaction remained highly probable at 31 August 2016. IFRS 5 does not require the existence of a binding sales agreement in order to classify a non-current asset as held for sale but only a high probability of its occurrence; and
(v) Other criteria which indicate that the non-current assets should be shown as held for sale include the fact that:
   - A buyer for the non-current assets has been found;
   - The sale occurred within 12 months of classification as held for sale;
   - The asset was actively marketed for sale at a sales price which has been accepted, and despite the uncertainties at 31 August 2016;
   - Events after the reporting period indicate that the contract was not significantly changed or withdrawn;
   - The fact that the information regarding the uncertainties was not publicly disclosed is irrelevant;
   - Thus as the non-current assets met the criteria to be classified as held for sale, they should have been measured and presented as such in the financial statements;
   - IFRS 5 also states that immediately before the initial classification of the asset as held for sale, the carrying amount of the asset should be measured in accordance with applicable IFRSs. This was already the case as regards the non-current assets of Resource LTD;
   - IFRS 5 requires an entity to classify a non-current asset as held for sale if its carrying amount will be recovered principally through sale rather than through continuing use;

- The acceptance of an offer by Evolve LTD indicates that the transaction met the criteria to be classified as held for sale at August 31, 2016.
- The finalisation of the agreement on September 20, 2016 only confirmed the situation existing at August 31, 2016;
- Further, more evolve LTD cannot apply IFRS 5 measurement criteria without classifying the item as held for sale in its statement of financial position particularly as a profit or impairment may arise when using such criteria; and
- Assets classified as held for sale must be presented separately on the face of the statement of financial position.

Examiner's report

Part (a) of the question tests candidates' knowledge of the criteria which must be met for a contract with a customer to fall within the scope of IFRS 15, while part (b) of the question tests candidates' knowledge of the principles behind IFRS 5 – Non-Current Assets Held for Sale and Discontinued Operations.

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

The common pitfalls of the candidates were their inability to understand and correctly interpret the requirements of the question.

Candidates are advised to carry out in-depth study to cover all areas of the syllabus, practice more questions and pay attention to accounting standards that are examinable in corporate reporting. They should use ICAN Study Texts for better performance in future examinations.

Marking guide

		Marks	Marks
(a)	**Criteria for a contract with customers to fall within the scope of IFRS 15**		
	- Ten correct points		10
(b)	**Presentation of non-current assets as held for sale in the financial statements:**		
	- Provisions of IFRS 5 on sales and discontinued operations	4	
	- Other criteria to show non-current assets as held for sale	<u>6</u>	<u>10</u>
	Total		<u>**20**</u>

SOLUTION 5

(a) **Four financial reporting issues that should be considered by companies as a consequence of covid-19**

i. **Going concern and liquidity**
Companies affected by the crisis will be concerned about the survival of their organisations and the key will be 'cashflows'. That is, whether or not the company would have enough cash to survive the next six to 12 months.
When preparing financial statements, the management has to make an assessment of a company's ability to continue as a going concern and whether the going concern assumption is appropriate. Therefore, management will need to consider the existing and anticipated effect of the Corona Virus outbreak on its activities in its assessment.

Given the unpredictability of the potential impact, there may be material uncertainty that cast doubts on the company's ability to operate under going concern basis. If the company nevertheless prepares the financial statements under this assumption, it must disclose these uncertainties.

The degree of consideration required, the conclusion reached and the required level of disclosure will depend on the circumstances in each case as not all companies will be affected in the same manner.

ii. **Impairment assessment**
At the end of each reporting period, companies are required to assess whether there is impairment of non-financial assets. An asset is impaired when a company is not able to recover its carrying value either by using it or selling it.

The adverse impact on companies caused by measures to stop the spread of the disease, such as, temporary manufacturing closures and travel and importation, exportation restrictions, can be considered as impairment indications.

When assessing impairment, companies are required to determine recoverable amount of the assets. This calculation requires an estimate of expected future cash-flows and expectation about variations in cash-flows.

The cash-flows forecast should reflect management best estimate of the economic condition that will exist over the remaining useful life of the asset.

iii. **Contract modification**

Companies affected by COVID-19 outbreak may experience cash-flows challenges as a result of disrupted operations, higher operating cost or loss of revenue.

The company may need to obtain additional financing, amend the terms of debt agreement or obtain waivers if they no longer satisfied debt covenants. In such case, they will need to consider whether any changes to existing arrangement represent a substantial modification or potentially a contract extinguishment.

There are also consequences for lenders, such as financial institutions e.g. banks, insurance companies, are being asked to help borrowers by providing relief on cash-flow obligations. This will be considered as contract modification and will require the institutions to think about the measurement of their loan portfolios and expected credit losses.

iv. **Fair value measurement**

Companies are required to measure some of their assets and liabilities at fair value. This is a date-specific exit price estimate based on assumption that market participant would make under current conditions.

The fair value measurement (FVM) impact would depend on the evaluation of whether the severity of the pandemic outbreak at reporting date would have impacted participant's valuation assumption at that time.

Disclosure may be needed to enable users to understand whether or not the outbreak has been considered for the purpose of FVM. Users of financial statements should understand the basis for selecting assumptions and inputs that were used and the related sensitivities.

v. **Government assistance and income tax**

Part of the response by government to the Corona Virus outbreak has been to introduce support measures for individuals and companies along with wider economic stimulus packages.

These measures include, direct subsidies, tax exemptions, tax reductions, and credits extended for expiry period of unused tax losses, reduction of public levies, and low interest on loans.

All these will have an impact on financial reporting. Relief measures may fall within the scope of standards, such as IAS 12-Income Tax, IAS 20-Government Grant and Assistance etc.

One important factor to consider when accounting for an income tax consequences is whether the government concerned has substantially enacted the relevant laws. Companies will need to determine whether changes of tax rates and laws are substantially enacted as at the reporting dates.

vi. **IAS 37-Provision, Contingent Liabilities and Contingent Assets**
Organisation needs to consider the impact of COVID 19 by making provision for redundancy etc. If COVID 19 impact will make the organisation to downsize the work force.

vii. **IAS 34 Interim Financial Statements**
Organisation may consider to prepare interim financial statements before the year end. This will enable them to know the net worth of the organisation post COVID 19 era.

(bi) **Why optimal disclosure should be made in annual report of companies**

(i) **To ensure compliance with laws and regulations** as well as financial reporting standards requirements;

(ii) **Requirement of regulations:** Companies having several regulations may need to disclose more information to ensure compliance with the regulations requirements;

(iii) **Nature of the business:** Quoted companies may need to disclose more information in their annual reports unlike companies that are not quoted on stock exchange;

(iv) **Consideration of various stakeholders:** In a bid to provide adequate information to various stakeholders of a company, extensive information are included in the annual report to satisfy all stakeholders such as shareholders creditors, suppliers, employees etc;

(v) **Companies aiming at 'providing integrated' reporting:** The need for companies to adopt integrated reporting could also lead to excessive reporting in the annual reports;

(vi) It improves organisation reputation and builds trust with stakeholders;

(vii) More disclosure assists and improves decision making of shareholders investments;

(viii) Regulatory compliance: More disclosure shows transparency and reduces penalties or sanctions from regulators; and

(ix) Competitive advantage: More disclosure gives organisations competitive advantage over those that fail to disclose financial information.

(ii) **Barriers which may exist when trying to reduce excessive disclosure in companies annual reports:**

(i) Threat to future litigation may outweigh any benefit to derived from reducing disclosure of information in the annual reports of companies;

(ii) Preparers and auditors may be reluctant to change from current position unless risk of regulatory challenges is reduced;

(iii) Effect of previous years disclosure: If disclosure has been made in previous years. it might be difficult not to make similar disclose in current year particularly if there are no standards to support such non-disclosure;

(iv) Preparers may wish to present balanced and sufficiently informative disclosures and may be unwilling to change;

(v) Company may appear less transparent leading to lots of trust and credibility amongst stakeholders;

(vi) Failure to disclose non-financial information will expose the company to reputational risk; and

(vii) Lack of competitive advantage; Company will lose customers to other organisations that give more information on non-financial activities like Environmental Stationery Requirement (ESR), environmental reporting etc.

Examiner's report

Part (a) of the question tests candidates' knowledge of financial reporting issues that should be considered by companies as a consequence of COVID-19 while part (b) of the question tests candidates' knowledge of importance of optimal level of disclosure in an annual reports and the barriers which may exist when trying to reduce excessive disclosure of information in corporate annual reports.

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

The common pitfalls of the candidates were their inability to present the financial reporting issues of the consequence of COVID-19 points in a logical sequence. Lack of extensive reading reflected in their performance on information disclosure requirements in an annual report.

Candidates are advised to familiarise themselves with all aspects of the syllabus and pay attention to contemporary issues in corporate reporting for better performance in future examination.

Marking guide

		Marks	Marks
(a)	Correct identification of financial reporting issues	2	
	Discussing four financial reporting issues as a consequence of COVID-19	6	8
(b)	Reasons for optimal disclosure in the annual reports of companies	4	
	Barriers which may exist when trying to reduce excessive disclosure in companies annual report	3	7
	Total		**15**

SOLUTION 6

(a) (i) **Deferred tax for the year ended May 31, 2020**

	₦
Fair value (400,000 x N8.50 x ½)	1,700,000
Exercise price of option (400,000 x 4 x ½)	(800,000)
Intrinsic value (estimated tax addition)	900,000
Tax @ 30%	270,000

The cumulative remuneration expense is ₦600,000 which is less than the estimated tax deduction of ₦900,000. Therefore:

- A deferred tax assets of ₦270,000 should be recognised in the statement of financial position.
- Also a deferred tax credit of ₦(600,000 x 30%) =₦180,000
- The excess of ₦(900,000 – 600,000) = ₦300,000 x 30% = ₦90,000 is credited to equity.

Accounting Entries:	**₦**
Dr. Deferred tax assets =	270,000
Cr. Equity (Retained earnings)	90,000
Cr. Deferred tax liability	180,000

Deferred tax forthe Year ended May 31, 2021

	₦
Fair value:	
Adamu Salisu (400,000 x N8.50)	3,200,000
Chukwu Eze (1,200,000 x N8 x 1/3)	3,200,000
	6,400,000
Exercise price of option:	
Adamu Salisu (400,000 x N4)	(1,600,000)
Chukwu Eze (1,200,000 x N5 x 1/3)	(2,000,000)
Intrinsic value (estimated tax deduction)	2,800,000
Tax at 30%	840,000
Less: Previously recognised as at May 31, 2020	(270,000)
	570,000

The cumulative remuneration for the two years is ₦2,200,000 (given) which is less than the estimated tax deduction of ₦2,800,000.

- Therefore, a deferred tax asset of ₦840,000 is recognised in the statement of financial position as May 31, 2021.
- There is potential deferred tax income of ₦570,000 for the year ended May 31, 2021.
- Of this ₦90,000 (600,000 x 30%) – 90,000 goes directly to equity.
- The remainder (₦570,000 – 90,000) i.e. N480,000 is recognised in the profit or loss for the year.

(b) **Ethical Implications and possible actions**

Ethical implications are as follows:

(i) Bobo LTD financial statements were deliberately misrepresented and this breached ethical code of objectivity and fairness
(ii) Failure to disclosure to Omoge Nig PLC that Mrs Adamu Salisu own 30% in Bobo Ltd fails to comply with IAS 24 Related Party Transactions.
(iii) Adamu Salisu is not honest and straight forward because he facilitated the overpayment of Bobo acquisition. This goes against the ethical code of objectivity.

These results in:

- Bobo LTD was overpriced due to window dressing;
- Lack of fair presentation may reduce public confidence in the organisation;
- Mr Adamu Salisu should be investigated and sanctioned if found culpable;
- Stakeholders dissatisfaction. Stakeholders may be dissatisfied for lack of information and may feel left in the dark about important aspects of the company's operations; and
- Failure to disclose related party transaction activities will affect users judgement.

Possible actions are:

- The issue that I overheard in the conversation is potentially highly significant. However, it contains no actual evidence and the allegation may apparently be informed by the dislike of Mr. Adamu Salisu (the Director of Finance). This may be no more than malicious gossip without any foundation in facts;
- As the CFO, even if the allegation is considered as malicious gossip, It should not be completely ignored the first task should be to investigate the allegations, as discreetly as possible;
- If the investigation turn out to be true that Mr. Adamu Salisu was involved in adjusting the price paid for takeover of Bobo LTD, then the issue would not just be one of unethical behaviour, it may also have a criminal dimension as a fraudulent manipulation of documents might have taken place;
- Once the allegations are established with relevant facts, the matter can be escalated, to the appropriate level. As a Chartered Accountant, a member is bond by the codes of ethics of ICAN which stipulates that a member must act with integrity in all circumstances and must display professional behaviour;
- As a new CFO of Omoge Company, I will endeavour to find out if the company has a procedure for dealing with issues of these nature. If such

procedure is not available, I will refer the matter to the Chairman of the company's audit committee with all necessary facts; and

- Aside from the ethical and legal issues that are potentially involved in this case, there are also accounting implication in respect of the disclose of related party transactions in accordance with IAS 24.

Examiner's report

Part (a) of the question tests candidates' knowledge of the evaluation of the deferred tax implications of share option scheme, while part (b) tests candidate's knowledge of the ethical implications and possible actions arising from deliberate misrepresentation of information in the financial statements.

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

The common pitfalls of the candidates were their inability to understand the tax implications of share option scheme, computation of deferred tax arising from the share option and lack of technical expression on ethical principles applicable to fraudulent manipulation of financial statements.

Candidates are advised to pay more attention to all aspects of the syllabus. They are to understand all accounting standards as they are applicable to fundamental principles of corporate financial reporting for better performance in Institutes future examinations.

Marking guide

		Marks	Marks
(a)	**Computation of deferred tax on share option scheme:**		
	- Deferred tax – Year 2020	5	
	- Deferred tax – Year 2021	5	10
(b)	**Ethical implications of:**		
	- The Finance Directors deliberate misrepresentation of financial statements	1	
	- Failure to disclose related party transaction according to provisions of IAS-24	1	
	- Violation of code of objectivity and fairness	1	3
	Possible advise arising from the incident		
	- Malicious gossip	½	
	- Fraudulent manipulation of document	½	
	- Non display of professional behaviour	½	
	- Reference to audit committee	½	2
	Total		**15**

SOLUTION 7

(a) IFRS 8 – Operating Segments states that an operating segment is a component of an entity which engages in business activities from which it may earn revenue and incur costs. In addition discrete financial information should be available for the segment and these results should be regularly reviewed by the entity's Chief Operating Decision Maker (CODM) when making decisions about resources allocation to the segment and assessing its performance. However, if a function is an integral part of the business, it may be disclosed as a segment even though it may not earn revenue.

i. Other factors should be taken into account when identifying the operating segments. These include the nature of the activities of each components, the existence of managers responsible for them and information presented to the board of the directors.
ii. IFRS 8 also has certain quantitative measures to identify a segment, although an entity can report segment information for smaller operating segments, if there is a belief that the information is useful.
iii. According to IFRS 8, an operating segment is one which meets any of the following quantitative thresholds.
    - Its reported revenue, including sales to external customers and inter-segment sales or transfer is 10% more of the combined revenue, internal and external of all operating segments.
    - The absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount the combined reported profit of all operating segments which did not report a loss and the combined reported loss of the operating segments which reported a loss.
    - Its assets are 10% or more of the combined assets of all operating segments.

iv. As regards the two research and development laboratories, qualitative and quantitative factors should be considered in determining the operating segments. The quantitative factor will include whether the resultant operating segments are consistent with the principles of IFRS 8, whether the operating segment represents the level at which the CODM is assessing performance and allocating resources and whether the identified operating segments enable users of its financial statements to evaluate its activities and financial performance and the business environment it operates in.
v. As a result of the application of the above criteria, the first laboratory will NOT be reported as a separate operating segment.
vi. The divisions have heads directly accountable to and maintaining regular contact with the CODM to discuss all aspects of their divisional performance. The divisions seem to be consistent with core principles of IFRS 8 and should be reported as separate segments. The laboratory does not have a separate segment manager and existence of a separate manager is normally an important factor in determining operating

segments. Instead the laboratory is responsible to the divisions themselves, therefore, does not seem to be any discrete performance information for the segment which is reviewed by the CODM.

vii. The second laboratory should be reported as a separate segment. It meets the qualitative threshold for percentage of total revenue and other criteria for an operating segment. It engages in activities which earns revenue and incur costs, its operating results are reviewed by the CODM and discrete information available for the laboratory activities, finally it has a separate segment manager.

(b) Chairman Board of Directors,

Jafurawa PLC,
Lagos.
Nigeria.

Dear Sir,

Report on operating segments in accordance with IFRS 8

Introduction

IFRS 8 operating segments states that an operating segment is separately reportable if it has been identified as a separate operating segment meeting the operating segment definition; and

i. Its reported revenue is 10% or more of the combined revenue (external and internal) of all operatives segment; or
ii. The absolute amount of its reported profit or loss is 10% or more of the greater of the combined profit of all operating segments that did not report a loss and the combined reported loss of all operating segments that reported a loss; or
iii. Its assets are 10% or more of the combined assets of all operating segments.

The advice based on the above are as follows;

- **Chemicals**
  All criteria are met

- **Pharmaceutical** – Wholesales also met all the criteria

- **Pharmaceutical** – retails
  The pharmaceutical retails segment is not separately reportable, as it does not meet the quantitative threshold. It can however, still be reported as a separate operating segment if the management believes that information about segment would be useful to user of the financial statements.

Alternatively, the group could consider amalgamating it with the pharmaceutical Wholesale segment; provided the two operating segments have similar economic characteristics and share a majority of the aggregation criteria which exclude the type of customer.

- **Cosmetics**
  The Cosmetics segment does not meet the quantitative thresholds and therefore it is not separately reportable. It can also be reported separately if the management believes the information would be useful to users. Alternatively, the group may be able to amalgamate it with the body care segment, provided the operating segments have similar economic characteristic and share a majority of the aggregation criteria, otherwise it would also be disclosed in an all other segment column.

- **Hair Care**
  The hair care is separately reported due to its profitability being greater than 10% of total segments profit.

- **Body Care**
  All criteria are met and should reported as a separate segment.

Operating segments to be reported based on revenue test are:
- Rest of the world;
- Pharmaceutical Wholesale; and
- Body care.

Operating segment to be reported based on assets test are:
- Rest of the world;
- Pharmaceutical Wholesale; and
- Body care.

Operating segment to be reported based on profit or loss test are:
- Rest of the world;
- Pharmaceutical Wholesale;
- Body care; and
- Hair care.

The following operating segments are the reportable segments since they have fully met criteria required by IFRS 8 for reportable segments:
1. Rest of the world;
2. Pharmaceutical Wholesale;
3. Body care; and
4. Hair care.

While Chemical Africa, Pharmaceutical retail and cosmetics will be grouped together and not as a separate segment because they fail to meet up with any of the tests.

Conclusion
Also IFRS 8, states that at least 75% of total external revenue must be reported by operating segments. This condition has been met, as the reportable segments account for 82% of the total external revenue

$$\text{That is: } \frac{384 - (24 + 44)}{384} \times \frac{100}{1} = \frac{316}{384} \times 100 = \underline{\underline{82.29\%}}$$

Thank you.

Yours faithfully,

XYZ LTD.

Workings

		Revenue as % of total revenue (₦476m)	Profit or loss as % of Profit of all segments in profit (₦58m)	Assets as % of total assets (₦672m)
1.	Chemical	33.6%	48.3%	32.4%
2.	Pharmaceutical (Wholesale)	28.2%	31.0%	31.0%
3.	Pharmaceutical (Retail)	9.2%	6.9%	8.9%
4.	Cosmetics	6.3%	6.9%	5.4%
5.	Hair Care	5.0%	13.8%	6.3%
6.	Body Care	17.6%	20.7%	16.1%

Examiner's report
Part (a) of the question tests candidates' practical understanding of the transactions based on the requirements of IFRS 8- Operating Segments, while part (b) of the question tests candidates' knowledge of report writing and advising on the operating segments that constitute a reportable operating segments using revenue, profit or loss and assets.

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

Common pitfalls of the candidates were poor display of the expectations of professional accountants in ensuring adherence to accounting standards IFRS 8. Most candidates' that attempted the question did not understandthe criteria to use to meet the definition of reportable operating segments.

Candidates are advised to understand the requirements of IFRS 8 and also report writing at this level of the Institute's examination. They should also be familiar with ICAN Study Texts for better performance in Institute's future examinations.

Marking guide

		Marks	Marks
(a)	Definition of operating segments according to IFRS 8	1	
	Identification of criteria used for operating segments	3	
	IFRS 8 identification of reportable segment	2	
	Application of criteria to Fine Face (FF) Limited		
	- First Laboratory	1	
	- Second Laboratory	1	8
(b)	Advise in report format		
	- Introduction	½	
	- Advise on each business area	3	
	- Computation of each operating segments revenue, profit or loss and assets	3	
	- Conclusion on the company as a reportable segment	1	
	- Closing remarks	½	7
	Total		**15**

ICAN/231/V/C4 **Examination No..........................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA | Accuracy and Integrity

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

ADVANCED 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, MAY 16, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

ADVANCED TAXATION

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

Hyland Nigeria Limited commenced business as a manufacturer of stationery on January 1, 2021. The company, in December 2020 acquired all the assets and liabilities of a foreign company operating in Nigeria, Lowland Incorporated, and got it reconstituted for turn-around and better profitability.

The directors of the newly reconstituted company have just considered the draft financial statements and annual tax returns prepared by the Financial Accountant for the year ended December 31, 2021.

In the course of the board meeting, diverse opinions were expressed by members on the treatment of dividends received (₦3,600,000) by the company on equity holdings from another Nigerian public limited liability company. The dividends received are also part of the proposed profits to be distributed to shareholders of the company in form of dividend payment. All efforts made by the Financial Accountant to explain the position of the Companies Income Tax Act 2004 (as amended) on dividends were rebuffed by majority of the members. Being a reconstituted company, one of the directors posited that the possibility of the company enjoying some tax reliefs/incentives from the government, which may impact the company's profitability positively, was very high.

The Managing Director of the company, following the decision of the board, has contacted your firm of tax consultants to help provide professional advice on the issues discussed.

The following details were extracted from the company's financial records for the year ended December 31, 2021:

	₦'000	₦'000
Turnover		278,500
Cost of sales		(118,600)
Gross profit		159,900
Dividend received (net)		3,600
Other operating income		1,800
		165,300

Deduct:		
Directors' emoluments	2,100	
Administrative staff salaries	35,500	
Rent and rates	22,750	
Motor running expenses	2,200	
Traveling expenses	1,960	
Power and lighting	13,800	
Telephone and postage	1,540	
Depreciation	7,500	
Subscription and donations	5,400	
Allowance for doubtful debts	24,700	
Finance costs	2,640	
Repairs and maintenance	2,190	
Legal and professional fees	3,630	
Other operating expenses	12,990	(138,900)
Net profit		**26,400**

The following additional relevant information was provided:

(i) Subscription and donations consisted of:

		₦'000
Subscription - Manufacturers Association of Nigeria		400
Donations – state flood victims' relief fund		4,900
	Royal Elites Brothers' Klub	100
		5,400

(ii) Allowance for doubtful debts included:

	₦'000
General provision	12,500
Specific provision	16,800
Bad debts recovered	(4,600)
	24,700

(iii) **Repairs and maintenance was made up of:**

	₦'000
Repairs of manufacturing plants	490
Improvement to industrial building	1,400
Maintenance of delivery van	300
	2,190

(iv) **Legal and professional fees included:**

	₦'000
Audit fee	3,000
Legal fee in respect of reacquisition of lease	630
	3,630

(v) **Other operating expenses were:**

	₦'000
Expenses on increase in share capital	2,500
Fines for traffic offence	250
Christmas/Eid Kabir gifts to customers	3,100
Embezzlements by cashiers	500
Sundry (all allowable)	6,640
	12,990

(vi) Tax written down values of qualifying capital expenditure (QCE) as at December 31, 2020:

QCE	Amount ₦	Date of acquisition
Industrial building (1)	4,200,000	January 2, 2017
Non-industrial building (1)	5,400,000	April 13, 2017
Manufacturing plants (2)	3,600,000	November 10, 2019
Motor vehicles (5)	2,500,000	December 12, 2019
Furniture and fittings (8)	1,800,000	June 5, 2020

(vii) Additional assets acquired during the year ended December 31, 2021:

QCE	Amount ₦	Date of acquisition
Motor vehicle (Delivery van)	1,400,000	February 13, 2021
Furniture and fittings (3)	900,000	March 7, 2021
Manufacturing plant (1)	1,200,000	July 1, 2021

(viii) Unrelieved losses as at December 31, 2020 was ₦55,900,000.

(ix) Unutilised capital allowances as at December 31, 2020 was ₦16,155.000.

Required:

As the company's Tax Consultant, you are to prepare a report to the Managing Director of Hyland Nigeria Limited, which should reveal the:

a. Adjusted profit of the company for the year (7 Marks)

b. Tax payable for the relevant assessment year (14 Marks)

c. Advice on the tax implications of the dividends received to the company and its shareholders (6 Marks)

d. Comment on tax benefits/incentives applicable to a reconstituted company in Nigeria in line with the provisions of Companies Income Tax Act 2004 (as amended) (3 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Tax legislations are becoming increasingly complex thereby creating more risks for professional accountants and tax practitioners. The role of technology in running a contemporary accounting firm and/or tax practice is changing rapidly, bringing along a wide range of issues, new layers of complexity and regulatory pressure.

Your firm of chartered accountants is organising an in-house training for the newly employed audit officers and you have been mandated by the Senior Partner to prepare a paper on: "Risk and role of technology in accounting/tax practice".

Required:

As the paper presenter, you are to prepare a paper which is to be delivered at the training for the attention of the Senior Partner, which should **explain** the following areas:

a. Risks of running professional accounting firm and/or tax practice (4 Marks)

b. Measures to mitigate the identified risks (5 Marks)

c. Roles of technology in running a contemporary accounting/tax practice (3 Marks)

d. Benefits and challenges of adopting technology by professionals in accounting firm and/or tax practice (8 Marks)

(Total 20 Marks)

QUESTION 3

Transfer pricing has become a topical fiscal policy issue globally due to the need by various governments to prevent tax evasion and avoidance of economic double taxation. Developing countries, especially, are therefore encouraged to develop appropriate transfer pricing regulations that will seek to protect their tax bases and raise revenue without jeopardising investors' interest.

NADA Incorporated, Canada, is a multinational enterprise with head office in Quebec, Canada. The company, which was established more than three decades ago, has interests in oil and gas; textile; and telecommunication sectors in several countries in America, Europe and Asia, Rwandan and Kenyan companies took advantage of the successful commencement of the African Continental Free Trade Area agreement (ACFTA) through sales to the West African market in the third quarter of 2022. Based on the foregoing, NADA Incorporated plans to establish its presence in the Nigerian business environment.

While deliberating on the feasibility of the proposed establishment of a textile company in the northern part of the country, the issue of transfer pricing regulations and practices were noted by the board of directors. The Nigerian Income Tax (Transfer Pricing) Regulations 2018 was accessed via a trusted online medium, read and analysed. However, the aspect of transfer pricing documentation and arm's length comparability factors were not clear to the directors.

You have been engaged by one of the promoters of NADA Incorporated in Nigeria (PROMOT Link) as the company's Tax Consultant to help provide professional advice on the "grey areas" of interest.

Required:
You are to send a report to the Managing Director PROMOT Link for his review (before sending same to the Group Operating Officer, NADA Incorporated) explaining the following:

a. Transfer pricing compliance report (3 Marks)
b. Transfer pricing declaration form to be submitted to the Federal Inland Revenue Service (FIRS) (6 Marks)
c. Transfer pricing disclosure form to be submitted to the FIRS (6 Marks)
d. Arm's length comparability factors in transfer pricing (5 Marks)

(Total 20 Marks)

QUESTION 4

Jaga Petroleum Limited was granted an oil mining lease (OML) in January 2001 for exploration of oil and gas in onshore and shallow water operations for twenty years and a further renewal of twenty years, if application is made.

At the expiration of the initial license in December 31, 2020, the company decided not to apply for extension of its current license under the Petroleum Profit Tax regime and opted for automatic conversion on January 1, 2021, to the petroleum mining lease (PML) as enshrined in the Petroleum Industry Act 2021.

The following details were extracted from the financial statements of the company for the year ended December 31, 2021:

(i) **Revenue:**

Category	**Type**	**Quantity (million barrels)**	**Actual Price $**	**Fiscal Price $**
Crude oil sold	Bonny light	7.5	75	77
	Forcados medium	5.2	69	70
Condensate from associated gas sold	ABC condensate	4	55	54
Gas liquid from associated gas sold	XYZ liquid	3.8	48	50

(ii) **Expenses/expenditure:**

Item	**₦'million**
Royalty incurred and paid for	118,900
Production cost	112,660
Concession rentals	25,200
Repairs of plant, machinery and fixtures	2,680
First exploration well costs	2,770
Repairs of production implement utensils	1,850
Cost of gas reinjection wells	1,250
NDDC charge	200
Purchase of information on existence of petroleum deposits	305
Customs duties	106
First two appraisal wells costs	3,900
Decommissioning and abandonment	1,500
Depreciation	2,820
Environmental remediation fund	1,800
State government ground rent fee	22
Finance costs	25
Host community costs	1,400
Miscellaneous expenses	1,129
Administrative costs	1,980

The following additional information was also made available:

(ii) First two appraisal wells costs consisted of 60% tangible costs and 40% intangible costs.

(iii) Expenditure for the purchase of information on existence of petroleum deposits included:

	₦'million
Acquisition of geophysical information	100
Geological data and information	120
Others	85
	305

(v) Miscellaneous expenses were:

	₦'million
Gas flare fee	720
Donations to orphanage homes	132
Terminalling cost	169
Stamp duty	18
Signature bonus paid for the acquisition of petroleum deposits	90
	1,129

(vi) Agreed capital allowances for the year was ₦4,500 million.

(vii) Production allowances after commencement of the Act:

	₦'million
Onshore operations	800
Shallow water operations	1,100
	1,900

(viii) Assume that ₦440 is equivalent to US $1 and tax liabilities payable will be in local currency (Naira).

Required:

Compute for the relevant assessment year, the company's:

a. Hydrocarbon tax liability (16 Marks)

b. Companies income tax liabilities (4 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Fashion Stitches Limited, Lagos, is a private limited liability company that deals in sewing and sales of clothes, and allied materials for medium and upper class clients in highbrow areas of the country. Apart from its core staff in the sewing unit, there are others who are usually "on the move" traveling to major cities, such as Abuja, Kaduna, Ibadan and Port Harcourt, to receive orders from clients.

While reviewing their activities in the first quarter ended March 31, 2022, the Operating Officer stated that the recent increase in cost of traveling and staff salaries, which had jumped up by over 150% compared to the corresponding period of 2021, had impacted negatively on the financial performance of the company.

The management took a decision to relocate the business to the Federal Capital Territory (FCT), Abuja, where over 75% of their clients' reside on or before November 15, 2022. Implementation of the decision will however involve the disposal and re-acquisition of some assets needed for the purpose of the business.

The underlisted transactions took place between April and October 2022:

(i) The property (land and building) in Lagos which was acquired in 2008 for ₦18,220,000 was sold for ₦65,100,000. Incidental cost of disposal included estate valuers' fee of ₦1,627,500; renovation expenses of ₦1,800,000 and advertisement cost of ₦250,000. A new property was bought in the FCT for ₦80,000,000.

(ii) Sewing machines and other tailoring equipment bought between 2015 and 2019 (which are now considered to be outdated), for ₦3,300,000 were disposed for ₦2,800,000. New set of machines and equipment were acquired for ₦7,130,000.

(iii) A 10 KVA generating set which cost ₦1,500,000 in 2017 was disposed for ₦1,900,000 and another one was acquired for ₦2,450,000.

Required:

As the company's accountant and who is also in charge of preparing and filing of tax returns to the appropriate tax authorities, for each of the listed transactions, you are to:

a. Compute the capital gains tax (if any) (7 Marks)

b. Compute the roll-over relief (if any) (5 Marks)

c. Determine the costs at which capital allowances will be granted to the company by the tax authorities on each of the newly acquired assets. (3 Marks)

(Total 15 Marks)

QUESTION 6

Tax planning is a right that taxpayers must exercise to reduce tax liability and improve profitability while fully complying with existing tax legislations to avoid penalties and further risks. Thin capitalisation and non-tax factors are important fiscal policy issues which corporate players and governments in different tax jurisdictions should not undermine.

Required:

a. Explain the concept of 'thin capitalisation' and the problems it may create to both creditors and tax authorities. (5 Marks)

b. Discuss the thin capitalisation rules put in place by the Federal Government via the provisions of the Finance Act 2019. (4 Marks)

c. Explain briefly, **SIX** important non-tax factors, which may affect the choice of location of a corporate entity by a holding company in another tax jurisdiction. (6 Marks)

(Total 15 Marks)

QUESTION 7

Tax incentives are those special exclusions, exemptions or deductions from income or tax credits offered to taxpayers by the government as an encouragement to engage in specified activities. These fiscal incentives have generated a lot of debates among Nigerian lawmakers, economists, accountants, tax practitioners, tax administrators and the public.

The Federal Government is, however, optimistic that the positive effects tax incentives have on the economy far outweigh the negative effects (via reduction in revenue).

A notable wealthy businessman and Chairman of a conglomerate company, High Level Group of Companies, was surprised to know during legislative debate that over ₦6 trillion in tax incentives was provided for in the forthcoming national budget.

The Chairman of the conglomerate has just approached your professional accounting firm to provide advice on some salient issues in respect of tax incentives available to companies in some specific areas.

Required:

As the officer designated by your firm to handle this task, you are to present a report to the Principal Partner for his review before it is sent to the client, explaining the tax incentives available to a:

a. Mining business (under the Minerals and Mining Act 2007) (6 Marks)

b. Gas utilisation (downstream operations) business (5 Marks)

c. Company that is eligible for road infrastructure tax credit scheme (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 & 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: Finance Act 2019 specifies:
   30% (Large Company)
   20% (Medium-Sized Company)
   0% (Small Company)
5. TERTIARY EDUCATION TAX: 2% of assessable profit (up to December 31, 2021)
   2.5% of assessable profit (with effect from January 1, 2022)
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

Action & Co (Tax Consultants)
2, Ojo Road, Eco City

Date: .....

The Managing Director
Hyland Nigeria Limited
Lagos

Re: Computation of adjusted profit, tax liabilities and other matters

We refer to your request on computation of adjusted profit and tax liabilities for the financial year end of December 31, 2021, professional advice on implications of dividends received by the shareholders and the company, and tax benefits to a reconstituted company. We hereby present a report for your review.

(a) **Adjusted profit**

The company made a net profit of ₦26.4 million during the period under review. Following the provisions of the Companies Income Tax Act 2004 (as amended) some adjustments were made on the financial statements to get the adjusted profit of ₦51.28 million (see attached appendix 1).

(b) **Tax liabilities**

The company inherited loss of ₦55.9 million from the foreign company as well as unutilised capital allowances of ₦16.155 million. The adjusted profit was used to relieve part of the loss and balance of ₦4.62 million will be carried to 2023 assessment year.

The capital allowance for the year (₦7.534 million) and the one inherited from the acquired foreign company could not be utilised in the current year and therefore carried forward to next year (2023 assessment year). This amounted to ₦7.550,155 million.

The company has zero total profit, but will be liable to pay a minimum tax of ₦1.402 million and 2.5% of the adjusted (assessable) profit as tertiary education tax of ₦1.282 million. The total tax liabilities payable amounted to ₦2.684 million.

The company is advised to file its annual tax returns and accompany it with cheque of ₦2.684 million in favour of Federal Inland Revenue urgently.

Appendix 1: Computation of adjusted profit

	₦'000	₦'000
Net profit as per accounts		26,400
Add back:		
Depreciation	7,500	
Subscription and donations (Royal Elites)	100	
Allowance for doubtful debts (General prov.)	12,500	
Repairs and maintenance: Improvement to industrial building	1,400	
Legal –reacquisition of lease	630	
Embezzlement by cashiers	500	
Christmas/Eid Kabir gifts to customers	3,100	
Other operating expenses:		
Increase in share capital	2500	
Fines for traffic offence	250	28,480
		54,880
Less: Non-taxable incomes:		
Dividend received (net)		3,600
Adjusted profit		**51,280**

Appendix 2: Computation of tax liabilities

	₦'000	₦'000
Adjusted/assessable profit		51,280
Less: Loss b/f	55,900	
Relieved	(51,280)	(51,280)
Unrelieved loss c/f	4,620	
Less: Capital allowances:		Nil
Unutilised brought forward	16,155	
For the year (see Wk 1)	7,534,	
Total available for utilisation	23,689	
Utilised	Nil	(Nil)
Unutilised c/f	23,689	
Total profit		**Nil**
Higher of:		
Companies income tax @ 30% total profit and	Nil	
Minimum tax (Wk. 2)	1,402	1,402
Tertiary education tax @ 2.5% of assessable profit		1,282
Total tax payable		**2,684**

Workings 1: Capital allowances

	Industrial building	Non-industrial building	Manufacturing plants	Motor vehicles	Furniture and fittings	Capital Allowance
	IA 15%	IA 15%	IA 50%	IA 50%	IA 25%	
	AA 10%	AA 10%	AA 25%	AA 25%	AA 20%	
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
2022 A/Y						
TWDV	4,200	5,400	3,600	2,500	1,800	
Additions	1,400		1,200	1,400	900	
IA	(210)		(600)	(700)	(225)	1,735
AA	(819)	(900)	(1,950)	(1,425)	(585)	5,679
Inv allow			(120)			120
						7,534
2023 A/Y						
TWDV	4,571	4,500	2,250	1,775	1,890	

Notes on annual allowances for 2022 assessment year

(i) Industrial building
Old asset (unexpired tax life = 10 – 4 = 6years)

	₦
AA = ₦4,200,000/6 =	700,000
AA (New asset) = $\frac{₦1,400,000 - ₦210,000}{10}$ =	119,000
	819,000

(ii) Non-industrial building
Old asset (unexpired tax life = 10 – 4 = 6 years)

AA = ₦5,400,000/6 = ₦900,000

(iii) Manufacturing plants
Old asset (unexpired tax life = 4 – 2 = 2 years)

	₦
AA = ₦3,600,000/2 =	1,800,000
AA (New asset) = $\frac{₦1,200,000 - ₦600,000}{4}$ =	150,000
	1,950,00

(iv) Motor Vehicles

	₦
Old asset (unexpired tax life = 4 – 2 = 2 years)	
AA = ₦2,500,000/2 =	1,250,000
AA (New asset) = $\frac{₦1,400,000 - ₦700,000}{4}$ =	175,000
	1,425,000

(v) Furniture and fittings
Old asset (unexpired tax life = 5 – 1 = 4 years)

	₦
AA = ₦1,800,000/4 =	450,000
AA (New asset) = $\frac{₦900,000 - ₦225,000}{5}$ =	135,000
	585,000

Workings 2 : Minimum tax computation

	₦'000
Gross turnover	278,500
Gross dividend ($\frac{₦3,600,000}{0.9}$)	4,000
Other operating income	1,800
	284,300
Less: Franked investment income	(4,000)
Gross turnover for minimum tax computation	280,300
Minimum tax @ 0.5%	1,402

Note: Expense incurred on Christmas/Eid Kabir gifts to customers was disallowed because the gifts were not promotional in nature (not branded gifts).

(c) Tax implications of the dividends received by the company and its shareholders include:

i. The dividends received on equity in a Nigerian listed company (₦3.6 million) under the Companies Income Tax Act 2004 (as amended) is regarded as franked investment income (FII);

ii. The tax the company has suffered, ₦400,000 (that is ₦4 million – ₦3.6 million) is the final tax and therefore such income should be excluded from the total profit as it is not liable to further tax;

iii. Since the company is redistributing the entire dividends to the shareholders, the shareholders will have to suffer 10% withholding tax of ₦360,000; and

iv. But the company is to recoup the 10% (₦400,000) it suffered from the withheld deduction made by the Nigerian listed company.

(d) **Tax benefits/incentives applicable to a reconstituted company in Nigeria include:**

i. There will be no application of either the commencement or cessation rules;
ii. All the qualifying capital expenditure transferred are deemed to have been made at their tax written down value;
iii. In the computation of capital allowance, no initial allowance may be computed while the annual allowance would be based on the un-expired tax life of the qualifying capital expenditure;
iv. Any unutilised capital allowances transferred are deemed to have been transferred prior to the sale; and
v. Any unrelieved losses transferred are deemed to have been incurred on the first day of the reconstitution. Such a loss is then available for relief against the taxable profit of the year of reconstitution and the three subsequent tax years.

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

Yours faithfully,

Larry Oyedele
Senior Partner
For: Action & Co (Chartered Accountants)

Examiner's report

The question tests the candidates' understanding of the provisions of Companies Income Tax Act 2004 (as amended) in respect of computations of adjusted profit; companies income tax; tax implications of dividends received by the company on its shareholders and benefits/incentives applicable to a reconstituted company in Nigeria.

Being a compulsory question, all the candidates attempted the question. Candidates demonstrated a fair understanding of the question and performance was average.

The commonest pitfall was the inability of some candidates to identify correctly the allowable and disallowable expenses in line with the provisions of Companies Income Tax Act 2004 (as amended) and state the incentives applicable to a reconstituted company in Nigeria.

Candidates are advised to familiarise themselves with issues concerning computations of companies income tax and incentives applicable to a reconstituted company in Nigeria by reading extensively the Institute's Study Text, other relevant textbooks, and the Companies Income Tax Act 2004 (as amended).

Marking guide

		Marks	Marks
(a)	**Computation of adjusted profit**		
	Memo (heading)	½	
	Memo (discussion of result)	½	
	Net profit as per accounts	½	
	Depreciation	½	
	Subscription and donations (Royal Elites)	½	
	Allowance for doubtful debts (general provision)	½	
	Improvement to industrial building	½	
	Legal –reacquisition of lease	½	
	Embezzlements by cashiers	½	
	Christmas/ Eid Kabir gifts	½	
	Increase in share capital	½	
	Fines for traffic offence	½	
	Dividends received (net)	½	
	Adjusted profit	½	7
(b)	**Computation of tax liabilities:**		
	Memo (discussion of results)	1	
	Losses b/f	1	
	Relieved	1	
	Unutilised capital allowances c/f	1	
	Capital allowances for the year	1	
	Capital allowances: utilized	1	
	Total profit	1	
	Companies income tax	½	
	Minimum tax	1	
	Tertiary education tax	1	
	Capital allowances computation for 2022 A/Y:		
	Additions (Industrial building)	¼	
	Additions (manufacturing plants)	¼	
	Additions (motor vehicles)	¼	
	Additions (furniture and fittings)	¼	
	IA (Industrial building	¼	
	IA (manufacturing plants)	¼	
	IA (motor vehicles)	¼	
	IA (furniture and fittings)	¼	
	Capital allowance (IA column	¼	
	AA (industrial building)	¼	
	AA (non-industrial building)	¼	
	AA (manufacturing plants)	¼	
	AA (motor vehicles)	¼	
	AA (furniture and fittings)	¼	
	Capital allowance (AA column)	¼	
	Investment allowance (manufacturing plants)	¼	

	Capital allowance (Investment allowance column)	¼	
	Total capital allowances	¼	14
(c)	**Tax implications of the dividends received by the company and its shareholders**		
	2 marks for each discussion on tax implications of the dividends received by the company and its shareholders, subject to a maximum of 3 points		6
(d)	**Comment on tax benefits/incentives applicable to a reconstituted company in line with the provisions of CITA (2004)**		
	1 mark for each discussion on the tax benefits/incentives applicable to a reconstituted company, subject to a maximum of 3 points		3
	Total		**30**

SOLUTION 2

Colends & Co (Chartered Accountants)
Colmas Road, Abeokuta

INTERNAL MEMO

Date: ....

From: Audit Manager
To: Senior Partner

Subject: In-house training programme - paper on risk and role of technology in accounting/tax practice

I refer to your directive that I should prepare a paper on the above- named topic for presentation at the upcoming in-house training for our newly-employed audit officers. I hereby present a paper for your review before same is presented at the training programme.

(a) The risks of running professional tax practice in Nigeria include:

(i) **Lack of expertise**
Inadequate experience or knowledge of practitioners could lead to errors when they advise clients on technical matters. Examples include giving wrong professional opinions on tax matters, advice of tax implications of business arrangements and re-organisations or restructuring;

(ii) **Lack of attention to details**
This may lead to errors that could have been avoided if there had been procedures and controls not in place. This includes late filing of tax returns, the penalties of which are high for clients;

(iii) **Lack of documentation**
This is the failure to maintain evidence of client engagement terms or tax filing positions in working paper files. This could result in non-detection of the client's non-compliance with certain tax laws; and

(iv) **Unpredictable income for owners**
Owner's income can be unpredictable. Owners are responsible for the financial well-being of their employees and the last person to get paid is the owners. While others can mentally "check out" at the end of the work day, owner's brain is typically plugged into business.

(b) Measures to mitigate the risks include the following:

(i) **Only take on work within your circle of competence**: Tax practitioners can avoid many of these risks by only accepting work for which they have either adequate experience or the ability to outsource the work to qualified tax specialists;

(ii) **Implement quality control systems in professional tax practice**: Quality control systems can only help avoid common pitfalls and manage risk, they can also help you improve your practice effectiveness;

(iii) **Use checklists**: A best practice is to create general tax preparation and review checklists for all of your staff to use;

(iv) **Implementation of a task and deadline tracking system**: A task tracking system can help tax practitioner monitor client filings and meet their due dates;

(v) **Follow client acceptance practices**: Before taking on new clients, it's wise to determine their past filing history and any issues encountered with the relevant tax authorities and their past tax advisors;

(v) **Invest in education**: The Nigerian tax system is becoming complex and constantly changing, so the practice should continually invest in staff training;

(vii) **Document all material advice in writing**: When tax practitioners give their clients material verbal advice, they should also document a summary of the discussion in case an issue arises later; and

(viii) **Obtain professional valuations**: When related parties transact with each other in significant transactions including reorganisations, professional valuations should be obtained to avoid the significant risks associated with an unreasonable valuation. If the client doesn't want to obtain a valuation, tax practitioners should decide on whether the work should be done at all. At a minimum, the risks should be communicated and documented in their working paper files.

(c) Roles of technology in tax practice include:

(i) With the use of technology applications, such as cloud accounting, the tax practices are able to take advantage of powerful taxation software and services based on remote servers. This enhances the ability of the practice to share financial data with team members regardless of location or time zone;

(ii) Cloud accounting and other technology-driven tax solutions deliver a wide range of benefits to tax practice regardless of size. The primary benefit offered by cloud accounting is the ability to automate otherwise time-consuming tasks;

(iii) Modern tax technology is able to assist with the complex nature of crypto currency tax reporting. Major crypto currency exchanges can work to keep customer data extremely secure and private, which can make it difficult to track trades for capital gains or income tax reporting. By providing crypto currency - specific tools, cloud-based taxation technology establishes a future-proof foundation for crypto currency adoption and tax strategy; and

(iv) Cloud-based tax practice keeps data safe with enterprise-scale security, eliminating the threat of data breaches. Data breaches are extremely costly for practice of all sizes. Both large and small-scale tax practice are often the target of hackers that attempt to steal sensitive client's data.

Therefore, to cope with continuous changes in tax landscape, tax practice firm needs to invest heavily in technology to enhance their services offering to their clients.

(d) The benefits of adopting technology by professionals in accounting firm and/or tax practice include:

(i) **Winning more clients**: It is obvious that majority of clients would prefer to hire tax practice firms that are adaptive to technology changes;

(ii) **Retaining more clients**: Adoption and adaptation of modern technologies would make practising firms to render the much needed valuable and improved services which make clients retain them;

(iii) **Cross-selling services**: Technology provides platforms to enable practising firms make their services more visible to many clients;

(iv) **Adding greater value**: Firms that adopt new technologies are able to automate most of the routine and labour-intensive tasks. This makes it possible for such firms to focus their attention on tasks that generate greater values for their clients;

(v) Timely delivery of services to clients;

(vi) It promotes ease of filing returns and paying taxes by the clients; and

(vii) It leads to a better productivity on the part of the tax practitioners and administrators.

The challenges of adopting technology by professionals in accounting firm and/or tax practice include:

(i) Low computer literacy level;
(ii) Poor internet facility;
(iii) Possible cyber threat;
(iv) High implementation cost;
(v) Lack of technical know-how;
(vi) Challenge of data validation- garbage-in; garbage-out; and
(vii) Resistance from the management and other users. In-house resistance to adoption and implementation of the technological-driven tools.

Thank you.
Nuru Odeogbo

Examiner's report

The question tests the candidates' knowledge of risks and roles of technology in running a contemporary accounting/tax practice.

About 70% of the candidates attempted the question, and they exhibited a clear understanding of its requirements. The performance was above average.

The commonest pitfall was the inability of some candidates to explain the measures to mitigate the identified risks in running professional accounting firm and/or tax practice in Nigeria.

Candidates are advised to pay attention to risks and role of technology in running professional accounting firm and/or tax practice by reading the Institute's Study Text and other relevant textbooks.

Marking guide

		Marks	Marks
a)	**Risks of running professional accounting firm and/or tax practice**		
	Memo (address)	½	
	Memo (heading)	½	
	1 mark for each discussion of risks of running professional accounting firm and/or tax practice, subject to maximum of 3 points	3	4
b)	**Measures to mitigate the identified risks**		
	1 mark for each discussion of measures to mitigate the identified risks, subject to a maximum of 5 points		5
c)	**Roles of technology in running a contemporary accounts/tax practice**		
	1 mark for each discussion of the roles of technology in running a contemporary accounting/tax practice, subject to a maximum of 3 points		3
d)	**Benefits and challenges of adopting technology by professionals in accounting firm and/or tax practice**		
	1 mark for each discussion of benefits of adopting technology by professionals in accounting firm and/or tax practice, subject to a maximum of 4 points	4	
	1 mark for each discussion of challenges of adopting technology by professionals in accounting firm and/or tax practice, subject to a maximum of 4 points	4	8
	Total		**20**

SOLUTION 3

Level Up & Co (Chartered Accountants)
2, Jega Road, BirniKebbi

Date: .....

The Managing Director
PROMOT Link
Sokoto
Dear Sir,

RE: TRANSFER PRICING DOCUMENTATION AND ARM'S LENGTH COMPARABILITY FACTORS

I refer to our discussion of October 10, 2022 on the request by NADA Incorporation for advice on Nigerian transfer pricing documentation and arm's length comparability factors. I hereby present a report for your review before same is forwarded to the Group Operating Officer, NADA Incorporated, Canada.

(a) **Transfer pricing compliance report stipulates the following:**

(i) The documentation retained by a connected person shall be adequate to enable the Service verify that the controlled transaction is consistent with the arm's length principle;
(ii) The burden of proof that the conditions of the controlled transactions are consistent with the arm's length principle shall be that of the taxable person; and
(iii) The taxable person will be regarded as satisfying this burden of proof if it provides documentation consistent with this regulation to support compliance with the arm's length principle of the taxable profits derived from its controlled transactions.

(b) **Transfer pricing declaration form to be submitted to FIRS**
The Federal Inland Revenue Service expects all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in transfer pricing declaration form that contains the following:

(i) Particulars of reporting company or entity;
(ii) Particulars of immediate parent company;
(iii) Particulars of directors of reporting company;
(iv) Particulars of major shareholders of reporting company and related parties;
(v) Ownership, structure of reporting entity and related parties;
(vi) Particulars of subsidiaries and other connected persons;
(vii) Particulars of external auditors of reporting entity;
(viii) Particulars of tax consultant of the reporting entity;
(ix) Particulars of company secretary of the reporting entity;
(x) Particulars of the person making the declaration; and
(xi) Declaration.

(c) **Transfer pricing disclosure form to be submitted to FIRS**

The Federal Inland Revenue Service expects all taxpayers to develop appropriate transfer pricing policy and provide relevant information to be stated in transfer pricing disclosure form that contains the following:

(i) Particulars of reporting company or entity;
(ii) Income from controlled transactions;
(iii) Costs of controlled transactions;
(iv) Summary of controlled transactions with connected persons;
(v) Transfer pricing method and documentation;
(vi) Basic financial information for reporting entity and the group;
(vii) Particulars of person making the disclosure; and
(viii) Declaration.

(d) **Arm's length comparability factors in transfer pricing**

The Federal Inland Revenue Service (FIRS), in determining whether a transaction has been conducted at arm's length will consider the following on a comparative basis:

(i) The similarity or identical nature of the transaction to that entered into by an unconnected taxable person;
(ii) The facts and circumstances of the transactions per economic relevance;
(iii) The characteristics of the goods, property or services transferred or supplied;
(iv) The functions undertaken by the person entering into the transaction per resources and the risk expended and the risks assured;
(v) The contractual terms of the transactions;
(vi) The economic circumstances in which the transactions take place; and
(vii) The business strategies pursued by the connected taxable persons to the controlled transaction.

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

Yours faithfully,

Kemmy Adesanya
Senior Partner
For: Level Up & Co (Chartered Accountants)

Examiner's report

The question tests candidates' understanding of transfer pricing regulation and practices in Nigeria, with particular emphases on issues involving transfer pricing compliance report; transfer pricing declaration form and disclosure form to be submitted to the Federal Inland Revenue Service; and arm's length comparability factors in transfer pricing.

About 80% of the candidates attempted the question, and they showed a fair understanding of the question and performance was average.

The commonest pitfall was the inability of the candidates to state correctly the transfer pricing disclosure form to be submitted to the Federal Inland Revenue Service.

Candidates are advised to read the Institute's Study Text, the Nigerian Income Tax (Transfer Pricing) Regulations 2018 and other relevant textbooks on transfer pricing when preparing for future examinations.

Marking guide

		Marks	Marks
a)	**Transfer pricing compliance report**		
	Memo (address)	½	
	Memo (heading)	½	
	1 mark for each discussion of transfer pricing compliant report, subject to maximum of 2 points	2	3
	Transfer pricing documentation report		
b)	**Transfer pricing documentation report**		
	1 mark for each discussion of transfer pricing declaration Form to be submitted to FIRS, subject to a maximum of 6 points		6
c)	**Transfer pricing disclosure form to be submitted to FIRS**		
	1 mark for each discussion of transfer pricing disclosure form to be submitted to FIRS, subject to a maximum of 6 points		6
d)	**Arm's length comparability factors in transfer pricing**		
	1 mark for each discussion of arm's length comparability Factors in transfer pricing, subject to a maximum of 5 points		5
	Total		**20**

SOLUTION 4

(a) **Jaga Petroleum Limited**
Computation of hydrocarbon tax liability
For 2022 assessment year

	₦'million	₦'million
Revenue:		
Value of crude oil sold:		
Bonny light (7.5m barrels x $77 x ₦440)		254,100
Forcados medium (5.2m barrels x $70 x ₦440)		160,160
Value of condensate from associated gas sold(4m barrels x $55 x ₦440)		96,800
Value of gas liquid from associated gas sold(3.8m barrels x $50 x ₦440)		83,600
Gross revenue		594,660
Balancing charge		Nil
Total gross income		594,660
Allowable deductions (Section 263):		
Royalty incurred and paid for	118,900	
Production cost	112,660	
Concession rentals	25,200	
Repairs of plant, machinery and fixtures	2,680	
First exploration well	2,770	
Repairs of production implement utensils	1,850	
Cost of gas reinjection wells	1,250	
NDDC charge	200	
Purchase of information (₦305 – ₦85)	220	
First two appraisal wells cost	3,900	
Decommissioning and abandonment	1,500	
Environmental remediation fund	1,800	
State government ground rent levy	22	
Host community costs	1,400	
Miscellaneous (₦1,129 – ₦720 – ₦132 – ₦90)	187	
Total allowable cost	274,539	
Total costs subject to CPR limit (Wk 1)	(131,539)	(131,539)
Excess allowable cost carried forward	143,000	
Adjusted profit		463,121
Less: Loss relief		Nil
Assessable profit		463,121
Less: Section 266 and 6th Schedule deductions:		
Capital allowances		4,500
		458,621
Less: Production allowances:		
Onshore operations	800	
Shallow water operations	1,100	1,900
Chargeable profit		456,721

Workings on cost price ratio

		₦'million	₦'million
	Gross revenue		594,660
(i)	***Maximum allowable @ 65%***		***386,529***
	Total operating cost		274,539
	Capital allowances		4,500
	Total eligible costs		279,039
	Less: Exempted costs incurred (Section 263):		
	Royalty paid	118,900	
	NDDC charge	200	
	Concession rentals	25,200	
	Host community funds	1,400	
	Environmental remediation fund	1,800	147,500
(ii)	***Net total costs to be subject to CPR***		***131,539***

Maximum allowable cost is the lower of (i) and (ii), which is **₦131,539**

(b)

Jaga Petroleum Limited
Companies income tax liabilities
For 2022 assessment year

		₦'million	₦'million
Gross total income			594,660
Less:			
Section 263 allowable deductions			
CITA allowable deductions:		274,539	
Administrative cost	1,980		
Finance costs	25		
Donations to orphanage	132	2,137	276,676
Assessable profit			317,984
Add: Balancing charge			Nil
			317,984
Less: Loss relief			Nil
			317,984
Less: Capital allowances			4,500
Total profit			313,484
Companies income tax @ 30% of total profit			94,045.20
Tertiary education tax @ 2.5% of assessable profit			7,949.60
Total tax payable			101,994.80

Examiner's report

The question tests candidates' knowledge of computations of hydrocarbon tax and companies income tax of a company in upstream petroleum operations in line with the provisions of Petroleum Industry Act 2021.

About 50% of the candidates attempted the question, but majority of them lacked a good understanding of its requirements, hence their performance was below average.

The major pitfall of the candidates was their inability to identify correctly the allowable and disallowable expenses relevant in the computations of cost-price ratio, hydrocarbon tax and companies income tax.

Candidates are advised to study extensively the template provided by the Federal Inland Revenue Service on computations of hydrocarbon tax and companies income tax and relevant sections of the Petroleum Industry Act 2021.

Marking guide

		Marks	Marks
(a)	**Computation of hydrocarbon tax:**		
	Value of crude oil sold (Bonny)	½	
	Value of crude oil sold (Forcados)	½	
	Value of condensate from associated gas sold	½	
	Value of gas liquid from associated gas sold	½	
	Royalty incurred and paid for	½	
	Production cost	½	
	Concession rentals	½	
	Repairs of plant, machinery and fixtures	½	
	First exploration well	½	
	Repairs of production implement utensils	½	
	Cost of gas reinjection wells	½	
	NDDC charge	½	
	First two appraisal wells cost	½	
	Decommissioning and abandonment	½	
	Purchase of information	½	
	Environmental remediation fund	½	
	State government ground rent levy	½	
	Host community costs	½	
	Miscellaneous	½	
	Total costs subject to CPR limit (Wk 1)	½	
	Excess allowable cost carried forward	½	
	Adjusted profit	½	
	Assessable profit	½	
	Capital allowances	½	
	Production allowances (onshore)	½	
	Production allowances (shallow water)	½	
	Chargeable profit	½	
	Hydrocarbon tax @ 30%	½	

Workings on CPR:		
Total operating cost	½	
Capital allowances	½	
Net total costs to be subject to CPR	½	
Max allowable cost	½	16

(b) **Computation of companies income tax:**

Administrative cost	½	
Finance costs	½	
Donations to orphanage homes	½	
Assessable profit	½	
Capital allowances	½	
Total profit	½	
Companies income tax	½	
Tertiary education tax	½	4
Total		**20**

SOLUTION 5

(a)

Fashion Stitches Limited
Computation of capital gains tax
For 2022 assessment year

Property

	₦	₦
Sales proceeds		65,100,000
Deduct:		
Cost of acquisition	18,220,000	
Incidental cost of disposal:		
Estate valuers' fee	1,627,500	
Renovation expenses	1,800,000	
Advertisement cost	250,000	21,897,500
Capital gains record		43,202,500
Less: Roll-over relief ((B)(i))		43,202,500
Net capital gains		Nil
Capital gains tax @ 10%		Nil

Sewing machine and other tailoring equipment

	₦
Sales proceeds	2,800,000
Deduct: Cost of acquisition	3,300,000
Capital loss	(500,000)

Generating set

	₦
Sales proceeds	1,900,000
Deduct: cost of acquisition	1,500,000
Capital gains record	400,000
Less: Roll-over relief ((b)(iii))	400,000
Net capital gains	Nil
Capital gains tax @ 10%	Nil

(b) **Computation of roll-over relief**

Property

	₦
The lower of:	
Sales proceeds	65,100,000
And amount re-invested	80,000,000
Less: Cost of old asset	18,220,000
Roll-over relief	46,880,000

This is restricted to the capital gains record of ₦43,202,500

Sewing machine and other tailoring equipment
No roll-over relief is available for asset that has a capital loss

Generating set	₦
The lower of:	
Sales proceeds	1,900,000
And amount re-invested	2,450,000
Less: Cost of old asset	1,500,000
Roll-over relief	400,000

(c) Costs at which capital allowances will be granted on the newly acquired assets. This is the cost of acquisition of each of the newly acquired assets, as indicated below:

Property: ₦80,000,000
Sewing machine and other tailoring equipment: ₦7,130,000.
Generating set: ₦2,450,000

Examiner's report

The question tests candidates' understanding of capital gains tax computations. About 90% of the candidates attempted the question. Candidates showed a good understanding of the requirements of the question, and their performance was satisfactory.

The major pitfall was the inability of some candidates to identify correctly the costs at which capital allowances will be granted to the company by the tax authorities in line with the provisions of Capital Gains Tax 2004 (as amended).

Candidates are advised to read the Institute's Study Text, other relevant textbooks and the Capital Gains Tax Act 2004 (as amended), as this will go a long way in assisting them to pass future examinations.

Marking guide

		Marks	Marks
(a)	**Computation of capital gains tax:**		
	Property:		
	Sales proceeds	½	
	Cost of acquisition	½	
	Estate valuers' fee	½	
	Renovation expenses	½	
	Advertisement cost	½	
	Net capital gains	½	
	Capital gains tax	½	
	Sewing machine and other tailoring equipment:		
	Sales proceeds	½	
	Cost of acquisition	½	
	Capital loss	½	
	Generating set:		
	Sales proceeds	½	
	Cost of acquisition	½	
	Net capital gains	½	
	Capital gains tax	½	7
(b)	**Computation of roll-over relief:**		
	Property:		
	Sales proceeds	½	
	Amount re-invested	½	
	Less: Cost of old asset	½	
	Roll-over relief	½	
	Sewing machine and other tailoring equipment:		
	No roll-over relief	1	
	Generating set:		
	Sales proceeds	½	
	Amount re-invested	½	
	Less: Cost of old asset	½	

	Roll-over relief	½	5
(c)	**Costs at which capital allowances will be granted:**		
	Property: ₦80,000,000	1	
	Sewing machine and other equipment: ₦7,130,000	1	
	Generating set: ₦2,450,000	1	3
	Total		**15**

SOLUTION 6

(a) **Concept of thin capitalisation**

A company is said to be thinly capitalised when its capital is made up of a much greater proportion of debt than equity, that is, its gearing, or leverage, is too high.

This is perceived to create problems for two classes of people. These are the:

(i) Creditors who bear the solvency risk of the company, which has to repay the bulk of its capital with interest;

(ii) Tax authorities, who are concerned about abuse by excessive interest deductions.

(b) **Provisions of Finance Act, 2019 on thin capitalisation**

(i) Prior to the commencement of Finance Act, 2019, there were no thin capitalisation rules in Nigeria. However, in practice, FIRS sometimes seeks to disallow interest deductions considered excessive, which in most cases are usually done arbitrarily.

(ii) The Finance Act, 2019 now introduces a specific benchmark of thirty percent (30%) of earnings before interest, taxes, depreciation and amortisation (EBITDA) in a year as the limit for interest deduction on loans by a foreign 'connected person'.

(iii) Where there is excess interest, such is considered as a disallowable deduction in that year.

(iv) Any unclaimed interest as a result of the restriction can be claimed within 5 years, after which it is lost. The Act exempts Nigerian subsidiaries of foreign companies engaged in banking and insurance from this rule.

(c) Non-tax factors

The tax regime that applies in a specific location is generally an important consideration of a holding company and usually plays a role in the decision of where the company should be established. However, non-tax factors cannot be undermined as they are key to the success of the investment that is undertaken. The more important non-tax factors include:

(i) **Economic and political stability:** A tax jurisdiction that is not stable economically and politically will not attract foreign investors and will also lose its local investment to other tax jurisdictions with fair or stable economy;

(iii) **Adequate physical, business, accounting and legal infrastructure:** Availability of infrastructures that support business, accounting, and legal operation in a country is an encouraging factor usually considered by some entities in citing a fixed base in a country;

(iv) **The absence (or limited presence) of bureaucratic obstacles:** Little or no bureaucratic bottle-necks give confidence to investors in locating their business entities in a tax jurisdiction;

(v) **Adequate communication channels:** Availability of information source, reliable medium of communication, security of information and adequate communication channels play vital role in affecting the choice of an entity in citing its holding company in a country;

(vi) **The availability of an adequate dispute resolution mechanism:** A tax jurisdiction with an independent and effective dispute resolution process and procedures is often considered ahead of countries without such process in citing of business entity and holding company;

(vii) **Effective banking system:** A country with a standard and reliable system of banking operation and financial sector shall be deemed suitable for facilitating financial transactions if the holding company or branch of the entity is present in such tax jurisdiction;

(vii) Ability to repatriate profit freely;

(viii) The social, economic and political stability, and risks within different countries are major considerations in the decision-making, especially where the need for raising of finance is important;

(ix) A factor that supplements the social, economic and political stability is the functionality of the country's legal system and rule of law. Thus, not only should the legal system be suitable for transacting business, but it should also be possible for legal subjects to enforce their legal rights;

(x) Alternative dispute resolution as a legal process is normally an expedient and cheap alternative to the often lengthy legal processes. Where available, it should also be reliable. The country's government should also respect the rule of law and ideally have an enshrined constitution that protects the rights of the country's subjects;

(xi) The commercial language of the host country is also important. It is important that the language used is the same as the language of the investor (or at least a common language such as English or French);

(xii) Linked to the prevailing commercial language, are reliable communication channels such as telecommunication, fax and email, without which the performance of various roles would be impaired; and

(xiii) Business deals with control and management (including investment management) and the discharging of such services requires a few highly skilled people in the areas of law, financing and financing structures, economics, accounting and auditing. Most holding companies do not necessarily require large numbers of employees to be stationed in the host country.

Examiner's report

The question tests candidates' knowledge of thin capitalisation concept and rules as provided for in Finance Act 2019; and non-tax factors, which may affect the choice of location of a corporate entity by a holding company in another tax jurisdiction.

About 70% of the candidates attempted the question. Candidates displayed fair understanding of the question, and performance was average.

The major pitfall was the inability of some candidates to correctly explain the thin capitalisation rules put in place by the Federal Government via the provisions of the Finance Act 2019.

Candidates are advised to read the Institute's Study Text, and other relevant textbooks, when preparing for future examinations.

Marking guide

		Marks	Marks
a)	**Concept of thin capitalisation and the problems it may create to both creditors and tax authorities**		
	1 mark for explanation of the concept of thin capitalisation	1	
	2 marks for discussion of problems of thin capitalisation to the creditors.	2	
	2 marks for discussion of problems of thin capitalisation to the tax authorities.	2	5
b)	**Thin capitalisation rules put in place by the Federal Government via the provisions of Finance Act 2019**		4
	2 marks for each discussion of thin capitalisation rules put in place by the Federal Government in Finance Act 2019, subject to a maximum of 2 points		

c) **Important non-tax factors, which may affect the choice of location of a corporate entity by a holding company in another tax jurisdiction**

1 mark for each discussion of important non-tax factors which may affect the choice of location of a corporate entity by a holding company in another tax jurisdiction, subject to a maximum of 6 points 6

Total **15**

SOLUTION 7

Colphys & Co (Chartered Accountants)
Ore-Benin City Road, Okada

INTERNAL MEMO

Date: ....

From: Tax Manager
To: Principal Partner

Subject: TAX INCENTIVES IN SPECIFIC SECTORS

I refer to our client's request for professional advice in respect of tax incentives available to businesses in the mining, gas utilisation (downstream operations) and a company that is eligible for road infrastructure tax credit scheme. I hereby present a report for your review before same is presented to our client.

(a) Mining incentives

The key incentives available to companies engaged in mining operations under the Mining Act are summarised below:

(i) Tax holiday for an initial period of 3 years from commencement of operations and renewable for additional 2years. Any dividend recorded during the tax holiday period will not be subject to withholding tax upon distribution to shareholders;

(ii) Exporters of mineral products may be permitted to retain part of their foreign exchange earning in a domiciliary account for the purpose of acquiring spare parts and other mining inputs;

(iii) Exemption from customs and import duties in respect of plant, machinery equipment and accessories imported exclusively for mining operations. However, the plant and equipment can only be disposed of locally upon payment of the applicable customs and import duties;

(iv) Free transferability of foreign currency through the Central Bank of Nigeria (CBN) for the following:

- Payment for servicing of certified foreign loan; and
- Remittance of foreign capital in event of sale or liquidation of the business;

(v) Grant of personal remittance quota for expatriate personnel free from any tax imposed by any enactment for the transfer of external currency out of Nigeria;

(vi) Accelerated capital allowance on mining expenditure (95% initial allowance and retention of 5% until asset is disposed);

(vii) Grant of investment allowance of 10% on qualifying plant and machinery;

(viii) All infrastructure cost provided by the mining company and approved by the Mining Cadastre Office to be capitalised and capital allowance claimed at 95% in the first year of operation;

(ix) A company may also be entitled to claim an additional rural investment allowance on its infrastructure cost, depending on the location of the company and the type of infrastructure provided;

(x) Annual indexation of unutilised capital allowance carried forward by 5% for mines that commenced production within five (5) years from the date of enactment of the Act. Whilst the period for new companies to enjoy this incentive lapsed in 2012, new producers may apply to the Minister of Finance, through the Minister of Mines and Steel Development, to enjoy this incentive. Such application may be considered on a case by case basis; and

(xi) The Minister may grant a concession for the royalty payable on any mineral to be deferred for a number of years, subject to the approval of the Federal Executive Council.

(b) **Incentives for gas utilisation (downstream operations) as provided under the Companies Income Tax Act (CITA)- Section 39 of CITA**

A company engaged in gas utilisation (downstream operations) shall be granted the following incentives:

(i) An initial tax free period of three years which may be subject to the satisfactory performance of the business, be renewed for an additional period of two years. This tax free period shall start on the day the company commences production as certified by the Ministry of Petroleum Resources;

(ii) As an alternative to the initial tax free period granted under (a) above, an additional investment allowance of 35 percent which shall not reduce the value of the asset. However, a company that claims this shall not be entitled to claim investment allowance of 15 percent;

(iii) Accelerated capital allowance after the tax relief period as follows:
- An annual allowance of 90 percent with 10 percent retention for investment in plant and machinery; and
- An additional investment allowance of 15 percent which shall not reduce the value of the asset;

(iv) Tax free dividend during the tax free period where:
- The investment for the business is in foreign currency; and
- The introduction of imported plant and machinery during the period was not less than 30 percent of the equity share capital of the company; and

(v) Interest payable on loan obtained with the prior approval of the Minister for a gas project shall be deductible.

Provisions of Finance Act, 2020 on Incentives for gas utilisation are:

(vi) The Finance Act, 2020 amended section 39(1) of CITA (as amended) to grant the incentives only to companies whose trade or business involves gas utilisation in downstream operations. The mere consumption of gas does not qualify for the claim of this incentive;

(vii) The tax-free period is to start on the day the trade or business commences production as certified by the Ministry of Petroleum Resources (MPR);

(viii) A company which had claimed incentive for the trade or business of gas utilisation under any law including the former PPTA and IDITRA is barred from claiming this incentive; and

(ix) The erstwhile restriction based on intention to claim this incentive has now been removed.

(c) **The Executive order 007- Companies Income Tax (Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme) Order 2019 provides that:**

(i) The Scheme is a public-private partnership, which enables private companies fund the construction and refurbishment of eligible roads in Nigeria. In return, participants in the Scheme are entitled to recover the project funds by way of tax credits, claimable against Companies Income Tax (CIT) payable;

(ii) The Scheme will be implemented and administered by a special management committee (the Committee), consisting of representatives from relevant Ministries and Agencies, including Federal Inland Revenue Service (FIRS) and chaired by the Minister of Finance;

(iii) The Scheme is open to Nigerian companies (other than corporation sole), institutional investors and a pool of companies operating through a special purpose vehicle set up as an infrastructure fund. Eligible road refers to any road approved by the President as eligible for the Scheme on the recommendation of the Minister of Finance and as duly notified to participants;

(iv) The primary benefit of this Scheme to participants is the ability to recover the project cost as tax credit against CIT payable. This credit is represented by the Road Infrastructure Tax Credit (RITC). RITC covers:

- Project cost (any expenditure wholly, reasonably, exclusively and necessarily incurred by a participant for the construction or refurbishment of an eligible road as quoted by the participant in its project cost bid and as certified by the Committee); and
- A single uplift (similar to interest), which is equivalent to the prevailing monetary policy rate (MPR) of the Central Bank of Nigeria (CBN), plus 2% of the project cost. The uplift (income) would not constitute taxable income in the hands of a participant. and

(v) The Scheme will be in force for a period of 10 years from the date of commencement in January 2019 to 2029.

Thank you.

Debby Ogunmade

Examiner's report

The question tests candidates' understanding of tax incentives available to companies in the mining sector in line with the provisions of Minerals and Mining Act 2007 (as amended); gas utilisation (downstream operations); and those that are eligible for road infrastructure tax credit scheme.

About 80% of the candidates attempted the question, and they showed a fair understanding of it, making the performance average.

The commonest pitfall was the candidates' inability to identify correctly and explain the incentives available for a company that is eligible for road infrastructure tax credit scheme.

Candidates are advised to prepare adequately for future examinations by reading the Institute's Study Text, other relevant textbooks and tax laws in respect of tax incentives in Nigeria.

Marking guide

		Marks	Marks
a.	**Tax incentives available to a mining business under the Minerals and Mining Act 2007**		
	Memo (address)	½	
	Memo (heading)	½	
	1 mark for each discussion of tax incentives available to a mining business, subject to a maximum of 5 points	5	6
b.	**Tax incentives available to a gas utilisation (downstream operations) business**		
	1 mark for each discussion of tax incentives available to a gas utilisation (downstream operations) business, subject to a maximum of 5 points		5
c.	**Tax incentives available to a company that is eligible for road infrastructure tax credit scheme**		
	1 mark for each discussion of tax incentives available to a company that is eligible for road infrastructure tax credit scheme, subject to a maximum of 4 points		4
	Total		**15**

ICAN/231/V/C3 Examination No.........................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

STRATEGIC FINANCIAL 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, MAY 17, 2023

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

STRATEGIC FINANCIAL 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

KK, a company quoted on the Stock Exchange, has cash balance of ₦230 million which are currently invested in short-term money market deposits. The cash is intended to be used primarily for strategic acquisitions, and the company has formed an acquisition committee with a remit to identify possible acquisition targets. The committee has suggested the purchase of ZL, a company in a different industry that is quoted on the AIM (Alternative Investment Market). Although ZL is quoted, approximately 50% of its shares are still owned by three directors. These directors have stated that they might be prepared to recommend the sale of ZL, but they consider that its shares are worth ₦220 million in total.

Summarised financial data

	KK		ZL
	₦'000		**₦'000**
Revenue	4,800,000		380,000
Pre tax operating cash flow	510,000		53,000
Taxation (33%)	(168,300)		(17,490)
Post tax operating cash flow	341,700		35,510
Dividend	110,000		8,420
Non-current assets	1,680,000		84,000
Current assets	1,350,000		47,000
Current liabilities	(996,800)		(39,000)
	2,033,200		92,000
	KK		**ZL**
Long-term finance			
Ordinary shares (25 kobo par)	100,000	(ZL 10 kobo par)	5,000
Reserves	1,583,200		52,000
12% Bond	200,000		-
10% Bank term loan	150,000	Recent 11% bank loan	35,000
	2,033,200		92,000

	KK	ZL
	₦'000	**₦'000**
Current share price	785 kobo	370 kobo
Earnings yield	10.9%	19.2%
Average dividend growth during the last five years	7% pa	8% pa
Equity beta	0.95	0.8
Industry data:		
Average P/E ratio	10:1	6:1
Average P/E of companies recently taken over, based upon the offer price	12:1	7:1

The risk free rate of return is 6% per annum and the market return is 14% per annum.

The rate of inflation is 2.4% per annum and is expected to remain at approximately this level.

Expected effects of the acquisition:

(i) 50 employees of ZL would immediately be made redundant at an after tax cost of ₦12 million. Pre-tax annual wage savings are expected to be ₦7.50 million (at current prices) for the foreseeable future.

(ii) Some land and buildings of ZL would be sold for ₦8 million (after tax).

(iii) Pre-tax advertising and distribution savings of ₦1.50 million per year (at current prices) would be possible.

(iv) The three existing directors of ZL would each be paid ₦1 million per year for three years for consultancy services. This amount would not increase with inflation.

Required:

a. Calculate the value of ZL based upon:

i. The use of comparative P/E ratios (3 Marks)

ii. The dividend valuation model (4 Marks)

iii. The present value of relevant operating cash flows over a 10 year period (10 Marks)

iv. Provide an evaluation of each of the three valuation methods in (i) to (iii) above. (7 Marks)

v. Recommend whether KK should go ahead with the offer for ZL. (2 Marks)

b. The regulation of takeovers varies from country to country. Outline the typical factors that such a regulation includes. (4 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

You are a Financial Analyst at Tayo Research Group (TRG). You begin valuing Aba Hotels Plc (AHP), a thinly and infrequently traded stock currently selling at 217 kobo, cum 2021 dividend.

For estimating AHP's required return on equity, TRG uses the capital asset pricing model (CAPM) approach, but you think its equity beta of 1.20 is not reliable because of the stock's extremely thin trading volume. You have therefore obtained the beta and other pertinent data for Eko Hotel Plc (EHP) – (See Table 1), a midsized company in the same industry with high liquidity trading on the Nigerian Stock Exchange.

Table 1: Valuation Data for EHP

Asset beta	0.763
Debt beta	0.150
Debt ratio (D/D+E)	0.60
Effective tax rate	30%

Summarised financial data for AHP is shown below:

Statement of profit or loss account

	2019	2020	2021*
	₦'000	₦'000	₦'000
Sales	305,500	357,600	409,200
Taxable income	40,500	49,000	56,700
Taxation	(14,175)	(17,150)	(19,845)
	26,325	31,850	36,855
Dividend	(9,340)	(10,228)	(11,200)
Retails earnings	16,985	21,622	25,655

Statement of Financial Position (₦'000)

	2021*
Non-current assets	216,800
Current assets	158,000
Current liabilities	(104,800)
	270,000
Ordinary Shares (50 kobo par value)	80,000
Reserves	130,000
15% bond 2026(₦100 par value)	60,000
	270,000

(*2021 figures are unaudited)

Other relevant information

(i) It has been estimated that the debt/equity ratio of AHP is 0.16 and beta of its debt is 0.2

(ii) The risk free rate is 12% and the market risk premium is 5%.

(iii) AHP has effective tax rate of 35%.

(iv) As a result of recent capital investment, stock market analysts expect post-tax earnings and dividends to increase by 25% for two years and then to revert to the company's existing growth rates.

Required:

a. Stock market analysts sometimes use fundamental analysis and sometimes technical analysis to forecast future share prices.
What are fundamental analysis and technical analysis? (4 Marks)

b. Using the dividend valuation model, estimate what a fundamental analyst might consider to be the intrinsic (or realistic) value of the company's shares.

Comment upon the significance of your estimate for the fundamental analyst. (12 Marks)

c. Explain whether your answer to (b) above is consistent with the semi-strong and strong forms of the efficient markets hypothesis (EMH), and comment upon whether financial analysts serve any useful purpose in an efficient market. (4 Marks)

(Total 20 Marks)

QUESTION 3

Tinco Limited (TL) is considering an expansion project. The project will involve the acquisition of an automated production machine costing ₦11,000,000 and payable now. The machine is expected to have a disposal value at the end of 5 years, which is equal to 10% of the initial expenditure.

The following schedule reflects a recent market survey regarding the estimated annual sales revenue from the expansion project over the Project's five-year life:

Level of demand	₦'000	Probability
High	16,000	0.25
Medium	12,000	0.50
Low	8,000	0.25

It is expected that the contribution to sales ratio will be 50%. Additional expenditure on fixed overheads is expected to be ₦1,800,000 per annum.

TL incurs a 20% tax rate on corporate profits. Corporate tax is paid one year in arrears.

TL's after-tax nominal (money) discount rate is 15.5% per annum. A uniform inflation rate of 5% per annum will apply to all costs and revenues during the life of the project.

All of the values above have been expressed in terms of current prices.

You can assume that all cash flows occur at the end of each year and that the initial investment does not qualify for capital allowances.

Required:

a. i Evaluate the proposed expansion from a financial perspective. (10 Marks)
   ii Calculate and interpret the sensitivity of the project to changes in:
   - the expected annual contribution (3 Marks)
   - the tax rate (2 Marks)

b. You have now been advised that the capital cost of the expansion will qualify for written down allowances at the rate of 25% per annum on a reducing balance basis. Also, at the end of the project's life, a balancing charge or allowance will arise equal to the difference between the scrap proceeds and the tax written down value.

   You are required to calculate the financial impact of these allowances. (5 Marks)

(Total 20 Marks)

QUESTION 4

The directors of Kenny plc wish to make an equity issue to finance an ₦800 million expansion scheme, with an expected net present value of ₦110 million. It is also to re-finance an existing 15% term loan of ₦500m and pay off penalty of ₦35m for early redemption of the loan. Kenny has obtained approval from its shareholders to suspend their pre-emptive rights and for the company to make a ₦1,500 million placement of shares which will be at the price of 185 kobo per share. Issue costs are estimated to be 4 per cent of gross proceeds. Any surplus funds from the issue will be invested in commercial paper, which is currently yielding 9 per cent per year.

Kenny's current capital structure is summarised below:

	₦million
Ordinary shares (25 kobo per share)	800
Share premium	1,120
Revenue reserves	2,310
	4,230
15% term loan	500
11% bond	900
	5,630

The company's current share price is 190 kobo, and bond price ₦102. Kenny can raise bond or medium-term bank finance at 10 per cent per year.

The stock market may be assumed to be semi-strong form efficient and no information about the proposed uses of funds from the issue has been made available to the public.

Taxation may be ignored.

Required:

a. Discuss **FOUR** factors that Kenny's directors should have considered before deciding which form of financing to use. (6 Marks)

b. Explain what is meant by pre-emptive rights, and discuss their advantages and disadvantages. (4 Marks)

c. Estimate Kenny's expected share price once full details of the placement, and the uses to which the finance is to be put, are announced. (8 Marks)

d. Suggest two reasons why the share price might not move to the price that you estimated in (c) above. (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. The following financial information relates to TAXIM Plc, a listed company:

Year	**2021**	**2020**	**2019**
Profit before interest and tax (₦m)	18.3	17.7	17.1
Profit after tax (₦m)	12.8	12.4	12.0
Dividends (₦m)	5.1	5.1	4.8
Equity market value (₦m)	56.4	55.2	54.0

TAXIM Plc has 12 million ordinary shares in issue and has not issued any new shares in the period under review. The company is financed entirely by equity.

The annual report of TAXIM Plc states that the company has three financial objectives:

Objective 1: To achieve growth in profit before interest and tax of 4% per year

Objective 2: To achieve growth in earnings per share of 3.5% per year

Objective 3: To achieve total shareholder return of 5% per year

TAXIM Plc has a cost of equity of 12% per year.

Required:

Analyse and discuss the extent to which TAXIM Plc has achieved each of its stated objectives. (9 Marks)

b. Discuss **FOUR** ways to encourage managers to achieve stakeholder objectives. (6 Marks)

(Total 15 Marks)

QUESTION 6

Neko Plc has issued the following statement as part of its annual report:

'This company aims at all times to serve its shareholders by paying a high level of dividends and adopting strategies that will increase the company's share price. Satisfying our shareholders will ensure our success. The company will reduce costs by manufacturing overseas wherever possible, and will attempt to minimise the company's global tax bill by using tax haven facilities.'

Required:

a. Discuss the validity and implications of each of the comments and strategies in the above statement. (10 Marks)

b. Produce a short note outlining how the company should estimate its dividend capacity. (5 Marks)

(Total 15 Marks)

QUESTION 7

Obong plc recently received a takeover bid from Abdul plc. If the bid for Obong plc is successful, it will provide Abdul plc the needed competitive edge in research and development to expand its laboratories into the production of the covid-19 vaccine. The shareholders of Obong plc will only accept an offer that meets a required return of 14% on their current shareholdings.

Obong plc recently paid a dividend of ₦20 and this is expected to grow at a rate of 7% for the foreseeable future.

Required:

a. Estimate the share price of Obong plc today. (2 Marks)

b. If Obong plc accepts the bid from Abdul plc, it is estimated that the new growth rate will rise to 12% for the first 3 years and thereafter stabilise at 7%. Calculate the new share price to the shareholders of Obong plc. (2 Marks)

c. As a financial advisor, recommend to the shareholders of Obong Plc whether the offer from Abdul plc should be accepted. (2 Marks)

d. According to Efficient Market Hypothesis (EMH), it is believed that the market would react instantly and accurately to the merger announcement between Obong plc and Abdul plc.

Define briefly the **THREE** forms of EMH and their implications to the market. (9 Marks)

(Total 15 Marks)

Formulae

Modigliani and Miller Proposition 2 (with tax)

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

Asset Beta

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

Equity Beta

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

Growing Annuity

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

Modified Internal Rate of Return

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

The Black-Scholes Option Pricing Model

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

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

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

The Put Call Parity

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

Binomial Option Pricing

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

$$d = 1/u$$

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

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

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

Annuity Table

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

Where r = discount rate

n = number of periods

Discount rate (r)

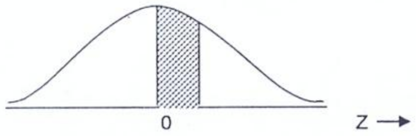
Periods

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

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

NORMAL DISTRIBUTION

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



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

SOLUTION 1

a) i) **P/E ratio**

Since ZL operates in a different industry, the comparative P/E ratio valuation must be based upon the average P/E ratios in that industry. The P/E ratio of 7:1 will therefore be used.

Current share price	370 kobo
Earnings yield	19.2%
Earnings per share	71.04 kobo (370 × 19.2%)
Price per share	497.28 kobo (71.04 × 7)
Value of ZL	₦248.64m (₦4.9728 × 50m shares)

Problems with calculations

The problem with this approach is that P/E ratios are based on historic performance, and take no account either of the likely impact of the takeover on the performance of the company, or of its current earnings projections.

Comparability of companies

In this case, there is further problem in that it is not known whether the recently taken over companies on which the ratio is based were sufficiently similar to ZL in terms of size, rate of growth, type of activities and overall level of risk. It may well be that the average should be adjusted to take into account the particular situation of ZL.

ii) **Dividend valuation model**

The dividend valuation method (including growth) for share valuation is:

$$P_0 = \frac{d_0(1+g)}{K_e - g}$$

In the case of ZL:

$d_0 = ₦8,420,000$

g = 8%, assuming that this rate of dividend growth will continue

K_e = can be estimated using the Capital Asset Pricing Model (CAPM):

$E(r_i) = R_f + \beta_i(E(r_m) - R_f)$

Where $E(r_i)$ = cost of equity

R_f = risk free rate of return (6%)

β_i = beta factor (0.8)

$E(r_m)$ = market rate of return (14%)

$E(r_i)$ = 6% + 0.8(14% - 6%) = 12.4%

$$P = \frac{₦8,420,000\ (1+0.08)}{(0.124 - 0.08)} = ₦206.67\text{m}$$

Weakness of dividend valuation model

The main weakness of this approach is the method used to estimate the growth rate. This assumes that the historic rate of dividend growth will continue at a constant rate into the future, but the current rate of dividend growth is different from that of KK, and could well change following the acquisition. However, the model does attempt to relate the share price to the future stream of earnings from the business, and in this sense is more realistic than the comparative P/E ratio basis of valuation.

iii) **Operating cashflows**

The first stage is to estimate what the operating cash flows will be following the acquisition.

	₦'000
Current pre-tax operating cash flow	53,000
Post-acquisition adjustments:	
Annual wage savings	7,500
Advertising/distribution savings	1,500
	62,000
Taxation (33%)	20,460
Annual post tax cash flow	41,540

The other cash flows to be taken into account are:

		₦'000
Year 0:	Redundancy costs (after tax)	(12,000)
	Sale of land and buildings (after tax)	8,000
Years 1 – 3:	Consultancy payments of ₦2,010,000 (₦3,000,000 × 0.67) per year after tax.	

Discount rate

The discount rate used will be the existing weighted average cost of capital (WACC) for ZL, although it must be recognised that this could be different after the acquisition since KK is a much larger company and its shares are quoted on the main market rather than the AIM. The cost of equity has already been calculated above as 12.4%, and the cost of debt is 11% as per the statement of financial position. The following expression will be used.

$$\text{WACC} = K_{eg} = \frac{V_E}{(V_E + V_D)} + K_d(1 - T)\frac{V_D}{(V_E + V_D)}$$

Where: K_{eg} = cost of equity in geared company

K_d = cost of debt

T = tax rate (33%)

V_E = market value of equity (50m × ₦3.70 = ₦185m)

V_D = market value of debt (₦35m)

$$\text{WACC} = 12.4\% \frac{185}{(185 + 35)} + 11\% (1 - 0.33)\frac{35}{(185 + 35)}$$

WACC = 11.60%

This discount rate has been calculated on the basis of market values, and therefore, will incorporate inflation. The cash flows (with the exception of the consultancy fees) all exclude inflation and therefore, either the nominal discount rate that has been calculated must be adjusted to the real rate, or the cash flows must be adjusted to include inflation.

If we adjust the discount rate to exclude the expected 2.4% rate of inflation: 1.116 ÷ 1.024 = 1.0898, i.e. the real discount rate to be used is 8.98%, say 9.0%.

PV of cash flow

The present value of the cash flows can now be found.

	Year 1 ₦'000	Year 2 ₦'000	Year 3 ₦'000	Total ₦'000
Gross payment to directors (after tax)	2,010	2,010	2,010	
11.6% discount factors	0.896	0.803	0.720	
PV cash flow	1,801	1,614	1,447	(4,862)
Ongoing cash flows for 10 years at 9% (41,540 × 6.418)				266,604
Income from land and buildings				8,000
Redundancy costs				(12,000)
Total PV of relevant operating cash flows				257,742

Problems with calculations

Although this is theoretically the best method of valuation to use, the calculations are in reality quite crude. Any likely changes in the pattern of the cash flows following the acquisition are ignored, as are any strategic plans that the company may have for such a long time frame. Ten years is a long period over which to estimate cash flows, inflation rates and discount rates, and there will inevitably be a large margin for error in the figures.

End of period

In addition, the question of what happens at the end of the ten year period is not addressed. Is there an appropriate terminal value that could be used in the calculations to reflect the ongoing value of ZL as a business?

v) **Comparison with offer price**

Two of the valuation methods used, including the present value of the operating cash flows (which is possibly the best of the three approaches) give a valuation greater than the proposed offer price of ₦220m. If KK can successfully complete negotiations at this price, and if the acquisition of ZL would be in line with KK's long-term strategic objectives, then it is recommended that the offer should go ahead.

b) The regulation of takeovers usually includes the following factors:

- At the most important time in the company's life – when it is subject to a takeover bid – its directors should act in the best interest of their shareholders, and should disregard their personal interests;
- All shareholders must be treated equally;
- Shareholders must be given all the relevant information to make an informed judgement;
- The board of the target company must not take action without the approval of shareholders, which could result in the offer being defeated;
- All information supplied to shareholders must be prepared to the highest standards of care and accuracy;
- The assumptions on which profit forecasts are based and the accounting policies used should be examined and reported on by accountants; and
- An independent valuer should support valuations of assets.

Examiner's report

The question tests many aspects of business valuation.

In part (a), candidates are expected to value the given company using three different methods.

Part (b) of the question tests the candidates' knowledge of regulation of take overs.

Being a compulsory question, a large number of the candidates attempted it but the level of performance was disappointedly low.

In part (a) of the question, candidates lost marks due to the following factors:

- Use of wrong P/E ratio
- Inability to derive the EPS from the given earnings yield
- Failure to identify the relevant cash flows when using the operating cash flows method
- Using the wrong WACC.
  In part (b), most of the candidates could not provide any meaningful response.

Candidates need to practise past questions using the Pathfinder and cover the syllabus comprehensively.

Marking guide

			Marks	Marks
(a)	i.	Computation of the value of ZL based on the use of the comparative P/E ratios:		
		Selecting the average P/E of companies recently taken over, based upon the offer price for ZL	½	
		Stating the current share price	½	
		Stating the earnings yield	½	
		Computation of the EPS	½	
		Computation of price per share	½	
		Computation of the value of ZL	½	3
	ii.	Computation of the value of ZL based upon the dividend valuation model		
		Computation of the cost of equity using CAPM	2	
		Computation of the ZL value	2	4
	iii.	Computation of the value of ZL using the PV of the relevant operating cash flows:		
		Estimation of the operating cash flows	3	
		Computation of the discount rate using the WACC	2	
		Calculation of the real discount rate	1	

		Computation of the PV of the cash flow	4	10
	iv.	Evaluation of the three valuation methods:		
		Evaluation of the comparative P/E ratios	2	
		Evaluation of the dividend valuation model	2	
		Evaluation of the PV of operating cash flows	3	7
	v.	Recommendation on whether KK should go ahead with the offer		2
(b)	Factors that are considered in the regulation of takeovers			4
		Total		**30**

SOLUTION 2

a) Fundamental analysis involves the study of a company's earnings, dividends and other financial information to predict future share prices. Fundamental analysts investigate companies in depth and use various valuation models to estimate the 'intrinsic, realistic or underlying' value of a share, which they believe might differ from the current market price. If the intrinsic value is estimated to be above the current share price the advice would be to buy the share in question. Many techniques are used to estimate intrinsic value including dividend growth models, earnings yield models and regression models.

The most important form of technical analysis is Chartism. Chartism involves the study of historic share price and volume information to see if any patterns or relationships exist. Chartists believe that historic share price behaviour, as revealed by such patterns, will repeat itself and they analyse charts of current share price movements to identify whether established historic patterns are currently occurring. If such patterns are identified the chartists believe that the historic patterns will reveal future share price movements. Knowledge of company earnings or other economic data is not required. Technical analysis is often said to have no underlying economic logic.

b) **Cost of equity**

- The asset beta of EHP (= 0.763) given in Table 1 reflects the systematic business risk of the hotel industry. This will be used to calculate the equity beta of AHP. Note that the other data given in the table are irrelevant since we are already given the asset beta of the proxy.

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

where

β_A = asset beta of the proxy = 0.763

β_D = beta of debt of AHP = 0.2

V_D/V_E = debt/equity ratio of AHP = 0.16

t = effective tax rate of AHP = 0.35

β_E = 0.763 + (0.763 – 0.2)(0.16)(1 – 0.35) = 0.82

- K_E = 12 + 0.82(5) = 16%

Current growth rate

From the dividend history:

g = $(11{,}200/9{,}340)^{1/2}$ – 1 = 9.5%

Dividend per share

Number of shares = 80m/0.5 = 160 million

Current dividend per share = ₦11,200/160,000 = ₦0.07

This means that the current ex-dividend value per share = 217 – 7 = 210 kobo

Calculation of intrinsic value per share

This is given as the present value of future dividends:

			Kobo
Year 1	$7(1.25)\left(\frac{1}{1.16}\right)^1$	=	7.54
2	$7(1.25)^2\left(\frac{1}{1.16}\right)^2$	=	8.13
3 – infinity	$\frac{7(1.25)^2(1.095)}{0.16-0.095} \times \left(\frac{1}{1.16}\right)^2$	=	136.93
Intrinsic value per share			152.60

The significance to the fundamental analyst would be that AHP's shares, currently trading at 210 kobo (ex-div), are overpriced and are likely to fall in value. The analyst would recommend investors owning AHP's share to sell their shares.

c) The semi-strong form of the EMH suggests that share prices quickly and without bias, fully reflect all relevant publicly available information.
The strong form of the EMH goes one sta ge further in suggesting that share prices fully reflect all information, including insider information.

If the EMH is correct, in either the semi-strong or strong form, the current market price will already correctly value AHP's shares and there is nothing to be gained by attempting to estimate an intrinsic value. The EMH is not consistent with fundamental analysis and, in an efficient market, there is no need to recommend that the share be sold as the share is not overvalued.

A necessary feature of an efficient market is that relevant new information is quickly and accurately disseminated to interested parties. Financial analysts are an important means by which such information is communicated, and therefore help to make the market efficient.

Analysts still serve a useful purpose although their forecasts of future share prices are of little value in an efficient market.

Examiner's report

This is a 3-part question. In part (a), candidates are expected to explain fundamental analysis and technical analysis.

In part (b), they are expected to determine, using dividend valuation model, the intrinsic value of a company's shares. They are also expected to comment on the relevance of intrinsic to the fundamental analyst.
In part (c), candidates are expected to demonstrate their knowledge of the efficient market hypothesis.

Only about 20% of the candidates attempted the question. It is absolutely clear that the candidates lacked any knowledge of this aspect of the syllabus.

In part (b), candidates lost valuable marks due to:

- Inability to calculate the appropriate cost of capital
- The use of WACC rather than cost of equity.
- Failure to calculate the correct growth rate of dividend.
- Inability to handle 2-growth dividend valuation model.

Once again it is important that students preparing for this examination should cover the syllabus comprehensively.

Marking guide

		Mark s	Marks
(a)	Explaining what fundamental analysis and technical analysis are		4
(b)	Computation of intrinsic value:		
	Calculation of effective tax rate of AHP	½	
	Calculation of the equity beta of AHP	2	
	Calculation of cost of equity	1	
	Computation of current growth rate	1	
	Computation of number of shares	½	

Computation of current dividend per share	½	
Computation of the current ex-dividend value per share	½	
Calculation of intrinsic value per share	4	
Comment on the estimate for the fundamental analyst	2	12
(c) Explanation on whether your answer is consistent with semi-strong and strong forms of EMH and their usefulness		4
Total		**20**

SOLUTION 3

a) i)

- Expected annual sales (₦000) = (16,000 × 0.25) + (12,000 × 0.5) + (8,000 × 0.25) = ₦12,000
- Expected annual contribution = ₦12,000 × 0.5 = ₦6,000
- Expected annual cash profit = ₦6,000 – 1,800 = ₦4,200

All the above figures are in real terms. Due to the one-year delay in the payment of tax, the cash profits will be converted to money cash flows and tax calculated on the money cash profits. The money cash profits are expected to grow annually by the rate of inflation of 5%.

Calculation of NPV (₦000)

Year	**1**	**2**	**3**	**4**	**5**	**6**
Cash profits	4,410	4,631	4,862	5,105	5,360	-
Tax at 20%	-	(882)	(926)	(972)	(1,021)	(1,072)
Scrap value	-	-	-	-	1,404*	-
NCF	4,410	3,749	3,936	4,133	5,743	(1,072)
PVF at 15.50%	0.866	0.750	0.649	0.562	0.487	0.421
PV	3,819	2,812	2,554	2,323	2,797	(451)

Total PV	₦13,854
Initial outlay	(11,000)
NPV	2,854

(* = 1,100 × $(1.05)^5$ = ₦1,404)

Alternative Approach – Using real cash flows

An alternative approach is to make use of real cash flows and real cost of capital.

- Real cost of capital =
$$\frac{1 + \text{money cost of capital}}{1 + \text{inflation rate}} - 1 = \frac{1.155}{1.05} - 1 = 10\%$$

- **Tax payment in real terms**. Due to the one year delay in payment of tax, the real tax liability each year, from year 2 - 5 = (₦4,200 × 0.2) × $(1.05)^{-1}$
  = ₦800

Calculation of NPV (₦000)

Item	Year	NCF	PVF at 10%	PV
Outlay	0	(11,000)	1	(11,000)
Cash profit	1 - 5	4,200	3.791	15,922
Tax	2 - 6	(800)	3.446*	(2,757)
Scrap value	5	1,100	0.621	683
NPV				2,848

(* Annuity factor at 10%, years 2 - 6)

The small difference in NPV is due to rounding errors

Recommendation

The project has a positive NPV and if other factors are held constant, it should be accepted.

ii) **Sensitivity – contribution**

- **Using real cash flows approach (₦000)**

  Annual real contribution = ₦6,000

  Related annual real tax (Years 2 - 6) = ₦6,000 × 0.2 × $(1.05)^{-1}$ = ₦1,143

Calculation of present value

Item	Year	NCF	PVF at 10%	PV
Contribution	1 - 5	6,000	3.791	22,746
Related tax	2 - 6	(1,143)	3.446	(3,939)
Total PV				18,807

Sensitivity = NPV/PV of contribution = ₦2,848/₦18,807 = 15.14%

This means that the total annual contribution can drop by maximum of 15.14% to avoid negative NPV.

Thus, the minimum annual contribution = ₦6,000,000 × (100% - 15.14%)
= ₦5,091,600.

- **Sensitivity – tax rate**
  - Using real cash approach (₦000)
  Sensitivity = NPV/PV of tax
  = ₦2,848/2,757 = 103.30%

  This means that the tax rate can increase by maximum of 103.30% if the project is to remain viable. The maximum tax rate is therefore:
  20% × (100% + 103.30%) = 40.66%.

  This means that if the project is to remain viable, the maximum tax rate allowed is 40.66%.

b)

> ***Note:***
>
> *The annual written down allowances are fixed and do not increase with inflation. They are already in money terms. Consequently, they decline in real terms over the years. If real cash flows approach is adopted, the annual written down allowances (or better still, the related tax savings) must be converted to real cash flows by dividing by:*
>
> *(1 + inflation rate)^n. An alternate and easier approach to calculate their impact, is to discount them (note that they are already expressed in nominal terms) at the nominal discount rate. That is the approach adopted*

Computation of written down allowances

	₦000	WDA ₦000	Tax Savings at 20%	Year due
Cost	11,000	-	-	-
Year 1: WDA, 25%	(2,750)	2,750	550	2
	8,250			
Year 2: WDA, 25%	(2,063)	2,063	413	3
	6,187			
Year 3: WDA, 25%	(1,547)	1,547	309	4
	4,640			
Year 4: WDA, 25%	(1,160)	1,160	232	5
	3,480			
Year 5: Scrap value	(1,404)			
Bal. allowance	(2,076)	2,076	415	6

Calculation of PV (₦000)

Year	2	3	4	5	6
Tax savings	550	413	309	232	415
PVF at 15.50%	0.750	0.649	0.562	0.487	0.421
PV	413	268	174	113	175

Total PV = ₦1,143 or ₦1,143,000

This means that the NPV of the project will increase by ₦1,143,000 as a result of tax savings associated with written down allowances.

Examiner's report

This question tests candidates' knowledge of capital budgeting involving taxation, inflation, and risk and uncertainty.

Candidates are expected to compute the relevant cash flows and eventually the NPV of the project.

A very high proportion of the candidates attempted the question but performance was only average.

Many of the candidates that attempted the question failed to achieve any reasonable marks due to the following reasons:

- Lack of clear understanding of the treatment of inflation.
- Wrong calculation of tax cash flows
- Wrong calculation of tax depreciation
- Discounting real cashflows with money cost of capital.

It is recommended that students should cover the syllabus comprehensively and practise past questions.

Marking guide

			Marks	Marks
(a)	i.	Evaluation of the proposed expansion:		
		Computation of expected annual sales	1	
		Computation of expected annual contribution	½	
		Computation of annual cash profit	½	
		Calculation of NPV	7½	
		Recommendation	½	10
	ii.	Computation and interpretation of sensitivity of the project to changes in expected annual contribution	3	
		Computation and interpretation of sensitivity of the project to changes in the tax rate	2	5

(b)	Computation of written down allowances	3	
	Calculation of the PV of tax savings	1½	
	Explanation of the NPV change as a result of tax savings	½	5
	Total		**20**

SOLUTION 4

a. When choosing between alternative forms of finance, the directors of Kenny might consider the following:

i) **Cost.** If the market is efficient then the cost paid for any individual financing source will be the appropriate cost for that source, taking into account the relative risks of alternative sources. The fact that debt finance is normally cheaper than equity finance does not necessarily mean that debt finance should be chosen. Cost is important as it affects the company's overall cost of capital and therefore, its market value per share. Assuming that financial structure influences the market value of a company, the company should attempt to select the financing combination that minimises its overall cost of capital;

ii) **Risk.** The effect of financing upon risk can be measured in several ways, including financial gearing, interest cover, cash-flow cover, and the company's beta coefficient (systematic risk);

iii) **Control.** The ownership structure of the company's shares, and hence the control of the company, will differ according to the financing method selected;

iv) **Market conditions**. If share prices are falling, an equity issue might not succeed or, if interest rates are expected to fall, a fixed-rate debt issue might be unwise. Market conditions can, therefore, influence the financing choice;

v) **Speed of raising finance.** Some forms of finance can be raised more quickly and easily than others. If the need for funds is urgent, speed of raising finance might outweigh some other considerations; and

vi) **Flexibility**. Can the finance be redeemed easily and cheaply, or swapped into another form of commitment (e.g. an interest rate swap)?

(**Note:** Reasonable alternative factors will be rewarded)

b. Pre-emptive rights mean that companies wishing to make a further issue of equity shares for cash must first offer the shares to existing shareholders in proportion to their existing holdings.

Their advantages might include:

i) They allow shareholders to maintain a certain percentage holding in a company.
This might be particularly important to companies that are controlled by a few large investors, and to institutional investors;

ii) Alternative forms of share issue might have to be made at a lower price than a rights issue in order to attract new investors, if pre-emptive rights did not exist.

Disadvantages might include:

i) They are a form of restrictive practice that is not appropriate to modern stock markets;

ii) Companies can raise finance more quickly and more cheaply when pre-emptive rights do not exist, for example, through placements.

c. In a semi-strong market the share price should accurately reflect new relevant information when it becomes publicly available. This would include the effect on Kenny of the expansion scheme and the redemption of the term loan.

	₦m	₦m
Existing value of equity = ₦1.90 × 3,200m shares		6,080
NPV of new project		110
Proceeds of the new issue		1,500
Issue cost (4%)		(60)
Future cash flows avoided at present value:		
- interest ₦500m × 15% × 3.791*	284.325	
- redemption value ₦500m × 0.621**	310.500	594.825
Redemption cost now	(500)	
Penalty cost now	(35)	(535.000)
Expected total market value		7,689.825

* Annuity factor at 10% for 5 years

** PV factor at 10% for year 5

The appropriate discounting rate to use is the rate of interest at which the company can otherwise borrow equivalent amount.

d. i) Changes in factors affecting the value of the company's shares between the setting of the terms of issue and the issue date;

ii) existing shareholder reaction to the issue;

iii) the effect of the extra volume of shares on their marketability;

iv) whether forecast earnings from the new funds are considered realistic by the market.

Examiner's report

The question tests various aspects of sources of finance. Candidates are expected to discuss factors that determine the sources of finance to use in a given scenario. They are expected to discuss pre-emptive rights and the advantages and disadvantages.

Almost all the candidates attempted the question. It is however, surprising that students' performance was very disappointing. It is very worrisome that candidates at this level of the examination do not understand 'pre-emptive rights'.

In part (c), candidate did not provide any meaningful calculations.

Once again we advise that students preparing for this examination should cover the entire syllabus in their revision.

Marking guide

		Marks	Marks
(a)	Discussion on the four factors to be considered before deciding which form of financing to use		6
(b)	Explanation of pre-emptive rights	2	
	Advantages of pre-emptive rights	1	
	Disadvantages of pre-emptive rights	1	4
(c)	Computation of expected share price:		
	Calculation of existing value of equity	1	
	Stating NPV of new project	½	
	Stating proceeds of the new issues	½	
	Calculation of issue cost	1	
	Calculation of future interest	1	
	Calculation of future redemption value	1	
	Redemption cost now	½	
	Penalty cost now	½	
	Calculation of the expected total market value	½	
	Calculation of the expected share price	½	
	Implications of announcement of placements of Kenny's share and the semi-strong form hypothesis	1	8
(d)	Explanation on the two reasons why share price might not move		2
	Total		**20**

SOLUTION 5

a) **Objective 1**

TAXIM Plc has stated an objective to achieve growth in profit before interest and tax of 4% per year. Analysis shows that profit before interest and tax growth was 3.4% in 2021 (18.3m/17.7m) and 3.5% in 2020 (17.7m/17.1m). TAXIM Plc has therefore, not achieved this objective in either year.

Objective 2

Year	**2021**	**2020**	**2019**
Profit after tax	₦12.8m	₦12.4m	₦12.0m
Number of shares	12m	12m	12m
Earnings per share (kobo)	106.67	103.33	100.00
Annual growth	3.2%	3.3%	

TAXIM Plc has stated an objective to achieve growth in earnings per share of 3.5% per year. Analysis shows that growth in earnings per share was 3.2% in 2021 (106.67kobo/103.33kobo) and 3.3% in 2020 (103.33kobo/100.00kobo). TAXIM Plc has therefore, not achieved this objective in either year.

Objective 3

TAXIM Plc has stated an objective to achieve growth in total shareholder return (TSR) of 5% per year. Analysis shows that growth in TSR was 11.4% in 2021 and 11.7% in 2020. TAXIM Plc has therefore, achieved this objective in both 2021 and 2020.

Year	**2021**	**2020**	**2019**
Equity market value	₦56.4m	₦55.2m	₦54.0m
Number of shares	12m	12m	12m
Share price	₦4.70	₦4.60	₦4.50
Dividends	₦5.1m	₦5.1m	₦4.8m
Number of shares	12m	12m	12m
Dividend per share(kobo)	42.5	42.5	40.0

On a per share basis:

2021 TSR = 100 x (470 – 460 + 42.5)/460 = 11.4%

2020 TSR = 100 x (460 – 450 + 42.5)/450 = 11.7%

Alternatively, using total values:

2021 TSR = 100 x (56.4m – 55.2m + 5.1m)/55.2m = 11.4%

2020 TSR = 100 x (55.2m – 54.0m + 5.1m)/54.0m = 11.7%

b) The achievement of stakeholder objectives by managers can be encouraged by managerial reward schemes, for example, share option schemes and performance-related pay (PRP), and by regulatory requirements, such as corporate governance codes of best practice and stock exchange listing regulations.

Share option schemes

The agency problem arises due to the separation of ownership and control, and managers pursuing their own objectives, rather than the objectives of shareholders, specifically the objectives of maximising shareholder wealth. Managers can be encouraged to achieve stakeholder objectives by bringing their own objectives more in line with the objectives of stakeholders such as shareholders. This increased goal congruence can be achieved by turning the managers into shareholders through share option schemes, although the criteria by which shares are awarded need very careful consideration.

Performance-related pay (PRP)

Part of the remuneration of managers can be made conditional upon their achieving specified performance targets, so that achieving these performance targets assists in achieving stakeholder objectives. Achieving a specified increase in earnings per share, for example, could be consistent with the objective of maximising shareholder wealth. Achieving a specified improvement in the quality of emissions could be consistent with a government objective of meeting international environmental targets.

However, PRP performance objectives need very careful consideration if they are to be effective in encouraging managers to achieve stakeholder targets. In recent times, long-term incentive plans (LTIPs) have been accepted as more effective than PRP, especially where a company's performance is benchmarked against that of its competitors.

Corporate governance codes of best practice

Codes of best practice have developed over time into recognised methods of encouraging managers to achieve stakeholder objectives, applying best practice to many key areas of corporate governance relating to executive remuneration, risk assessment and risk management, auditing, internal control, executive responsibility and board accountability. Codes of best practice have emphasised and supported the key role played by non-executive directors in supporting independent judgement and in following the spirit of corporate governance regulations.

Stock exchange listing regulations

These regulations seek to ensure a fair and efficient market for trading company securities such as shares and loan notes. They encourage disclosure of price-sensitive information in supporting pricing efficiency and help to decrease information asymmetry, one of the causes of the agency problem between shareholders and managers. Decreasing information asymmetry encourages managers to achieve stakeholder objectives as the quality and quantity of information available to stakeholders gives them a clearer picture of the extent to which managers are attending to their objectives.

Monitoring

One theoretical way of encouraging managers to achieve stakeholder objectives is to reduce information asymmetry by monitoring the decisions and performance of managers. One form of monitoring is auditing the financial statements of a company to confirm the quality and validity of the information provided to stakeholders.

Note: Only four ways to encourage the achievement of stakeholder objectives were required to be discussed.

Examiner's report

Part (a) of the question tests candidates' knowledge of basic corporate financial objectives. Part (b) tests candidates' knowledge of how to align managers' and shareholders' objectives. Almost all the candidates attempted the question and performance was average.

In part (a), candidates lost valuable marks because they could not calculate the basic metrics needed to measure the identified objectives such as growth rates and total shareholders returns etc.

Part (b) of the question was well answered in most cases.

It is recommended that students should not neglect any section of the syllabus.

Marking guide

		Marks	Marks
(a)	Analysis and discussion on whether objective 1 was achieved	2	
	Analysis and discussion on whether objective 2 was achieved	3	
	Analysis & discussion on whether objective 3 was achieved	4	9
(b)	Discussion on four ways to encourage managers		6
	Total		**15**

SOLUTION 6

a) i) **Serving its shareholders by paying high dividends**

This assumes that shareholders demand high dividends, whereas some may not do so and may prefer appreciation of the value of their shares, particularly if dividends are highly taxed.

A policy of continuing to pay high dividends will mean that shareholders and the stock market may expect these levels to continue indefinitely; if dividends fall, these thwarted expectations may lead to the share price falling as well.

However in the long-term high dividends levels may prove unsustainable, because insufficient monies are being retained for investment in projects that will yield the cash surpluses necessary for dividends.

ii) **Adopting strategies that will increase the company's share price**

Maximising share price is not the same as maximising shareholder wealth. In addition Gordon's growth rate model suggests that the growth of dividends, and hence share price, is dependent on the proportion of funds retained; the higher the proportion retained, the more can be invested in projects that generate surpluses and hence higher long-term dividends.

iii) **Satisfying our shareholders will ensure our success**

Other stakeholders, as well as shareholders, are affected by Neko Plc activities and they will impact on Neko Plc success to varying degrees. Loss of key employees because of poor working conditions may impact adversely, also suppliers stopping credit because Neko Plc has been a slow payer. Neko Plc will also have to fulfil legal and regulatory requirements imposed by the government and regulators; failure to do may lead to heavy costs and ultimately threaten its existence. Neko Plc may also be more attractive to consumers if it follows what is regarded as ethical and environmental best practice.

iv) **Reducing costs by manufacturing overseas**

Manufacturing overseas may reduce the costs of factors of production. However Neko Plc will have to bear costs of investment, and also perhaps increased selling and distribution costs. There may also be increased costs arising from controlling the quality of overseas output and managing the overseas operations. Neko Plc directors should also consider the risk implications; perhaps political instability might threaten the value of Neko Plc investment. In addition there are threats to Neko Plc reputation due to ethical concerns over loss of home country employment and wealth generation.

v) **Minimising global tax bill by using tax haven facilities**

Tax haven facilities may mean that Neko Plc has a reduced burden of certain taxes, including corporate taxes, capital gains taxes and taxes on remittances. Neko Plc may also benefit from improved tax efficiencies, if it has a number of subsidiaries and can channel transactions through the tax haven.

However, there will be some incorporation costs and the benefits of the tax haven may decrease over the long-term as governments close tax loopholes and restrict the use of havens. Perhaps also the ethical climate is becoming less favourable to tax havens because of the loss of tax to governments and the secrecy surrounding the affairs of some companies who use tax havens, so Neko Plc might suffer some loss of reputation when using them.

b) **Dividend capacity**

The free cash flow is the amount of money that is available for distribution to the capital contributors. If the project is financed by equity only, then these funds could be potentially distributed to the shareholders of the company.

However, if the company is financing the projects by issuing debt, then the shareholders are entitled to the residual cash flow left over after meeting interest and principal payments. This residual cash flow (free cash flow to equity) represents dividends that could potentially be paid to shareholders.

This is usually not the same as actual dividends in a given year because normally the management of a company deliberately smoothes dividend payments across time.

The free cash flow to equity is a measure of what is available to the shareholders after providing for capital expenditures to maintain existing assets and to create new assets for future growth. Thus, if a firm has substantial working and capital expenditure requirements then the free cash flow can be negative even if the earnings are positive.

Accurate financial forecasts covering timing and size of all cash flows are essential in order to determine the dividend capacity of a company.

Examiner's report

Part (a) of the question tests candidates' knowledge of how to assess various stated corporate objectives.

Part (b) on the other hand asks candidates to explain how dividend capacity can be estimated.

Part (a) of the question was barely properly attempted by a good number of the candidates.

In part (b), performance was extremely poor thereby indicating that candidates had no idea of the subject matter. This is despite the fact that 'Free Cash Flow to Equity' (FCFE) is a regular topic in this examination.

Effective revision, using past questions and the pathfinder will always enhance candidates' performance in the examination.

Marking guide

		Marks
(a)	Discussion on the validity and implications of each strategy	10
(b)	Short note outlining how the company should estimate its dividend capacity	5
	Total	**15**

SOLUTION 7

a) Current share price:

$P_0 = D_1/(r - g)$

$= 20(1.07)/(0.14 - 0.07)$

$=$ ₦305.71

b) **Revised share price**

PV of future dividends:

			₦
Year 1	$20\,(1.12)/1.14$	=	19.65
2	$20(1.12)^2/\,(1.14)^2$	=	19.30
3	$20(1.12)^3/\,(1.14)^3$	=	18.97
			57.92

Year 4 – Infinity:

$\frac{20(1.12)^3(1.07)}{0.14 - 0.07}(1.14)^{-3}$	=	289.90
		347.82

c) The offer for takeover is expected to increase the share price from ₦305.71 to ₦347.82 and if all other factors remain constant, the offer should be accepted.

d) The three forms of EMH are:

1) **Weak-Form EMH**

The weak-form EMH asserts that current stock price fully reflects all security market information, including the historical sequence of prices, rates of return, trading volumedata, and other market generated information, such as block trades, and transactions by exchange specialists. Because it assumes that current market prices already reflect all past returns and any other securities market information. This hypothesis implies that past rates of return and other historical market data should have no relationship with future rates of return (that is rates of return should be independent). A primary implication of the weak form of the EMH is that an investor cannot consistently earn excess returns using technical analysis trading rules.

2) **Semistrong-Form EMH**

The semistrong form of the EMH states that current market prices reflect all publicly available information. The semistrong hypothesis encompasses the weak-form hypothesis, because all the market information considered by the weak-form hypothesis, such as stock prices, rates of return, and trading volume, is public. Public information also include all non-market information such as earnings and dividend announcements, P/E ratios, dividend yield ratios, stock splits, news about the economy, and political news. The hypothesis implies that investors who base their decisions on any important information after it is public should not derive above-average risk-adjusted profits from their transactions, considering the cost of trading because the security price already reflects all such new public information.

A key implication of the semi-strong form is that the calculation of intrinsic value of shares in order to identify mispricing is fruitless in an efficient market.

3) **Strong-Form EMH**

The strong-form EMH contends that stock prices fully reflect all information from public and private sources. This means that no group of investors has monopolistic access to information relevant to the formation of prices, Therefore, this hypothesis contends that no group of investors should be able to consistently derive above-average risk-adjusted rates of return. The strong form EMH encompasses both the weak-form and the semistrong-form EMH.

Further, the strong-form EMH extends the assumption of efficient markets, in which prices adjust rapidly to the release of new public information, to assume perfect markets, in which all information is cost-free and available to everyone at the same time.

Examiner's report

The question tests candidates' knowledge of share valuation using dividend valuation model and the Efficient Market Efficiency (EMH). Almost all the candidates attempted the question.

Part (a) of the question was well answered with most of the candidates scoring the allocated 2marks. However, in parts (b) most of the candidates could not handle 2 – stage growth and thereby losing valuable marks.

In part (b) a good number of the candidates provided the required solution and scored decent marks.

It cannot be overstated that students need to cover the syllabus comprehensively before presenting themselves for the examination.

Marking guide

		Marks
(a)	Estimation of current share price	2
(b)	Computation of the revised share price	1
(c)	Recommendation to shareholders	2
(e)	Definition and discussion on implications to the market of the three forms of EMH	9
	Total	**15**

ICAN/231/V/C2 Examination No.........................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

ADVANCED 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, MAY 17, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

ADVANCED 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

Romeo and Juliet Plc is an indigenous company incorporated on March 5, 2012. The entity operates in the oil sector of the economy which has experienced severe income decline over the past years. The global oil prices hit a record low of about $28 per barrel in 2019 and 2020, hence, this has further plunged the company and the industry into downward slide, in income generation. The company is also affected by foreign exchange difficulties faced by most companies in the country resulting from the increased regulation of foreign exchange. Regular cases of oil theft, pipeline vandalism and insecurity have also affected the operations of major international oil companies which are the entity's major customers. As a result of the above, the company recorded the following in her books of account:

i) Financial losses - the company has made consistent losses from the financial year ended December 31, 2017 to date;

ii) Current liability position - the Company's current liabilities exceeded its current assets; and

iii) Negative net operating cash position - the Company has maintained a negative net operating cash position from December 31, 2017 to date.

Furthermore, the company's performance has worsened as a result of decrease in sales and increase in expenses.

The largest proportion of the current liabilities is the intercompany borrowings, which accounted for 62% (2020 - 45%) of the total current liability balance. The borrowings stood at ₦1.5billion, ₦1.6billion and ₦2billion for the financial years ended 31 December, 2019, 2020 and 2021 respectively. The finance costs in relation to the borrowings stood at ₦230million in the year ended December 31, 2021 (2020- ₦214 million).

The company has currently defaulted on a number of its contractual obligations with its directors and there was no Directors' remuneration in the current year due to its continuous loss making position.

At the pre-audit meeting with management of Romeo and Juliet Plc, your firm (the auditors) were informed that, in the year, the company was involved in a business combination with another oil company and to pay for the cost of acquisition, an additional intercompany loan was obtained because of the poor financial position of the company. In addition, the company's major investment in an associated company was disposed. The business acquisition proposal has all necessary regulatory approvals. It was approved at the meeting of the directors, annual general meeting of the company in the previous year and disclosed in the company's prior year financial statements as business matters.

After the meeting with management, you have started the preparation for the year-end audit and in compliance with regulatory requirements and the auditing standards, a key Audit Matter should be inserted on the opinion page.

Required:

a. Evaluate the criteria that will help the engagement team to determine what qualifies as a matter requiring significant auditor's attention and can be classified as a Key Audit Matter. (8 Marks)

b. Discuss the factors that will determine matters of most significance to be communicated to those charged with governance. (10 Marks)

c. Discuss the criteria for what must be included in the description of Key Audit Matter on the audit opinion. (6 Marks)

d. Evaluate what should be done assuming that you have determined that there are no Key Audit Matter to be reported in the above scenario. (6 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

QUESTION 2

There is an indication of increasing application of technology in the business and commercial world. A lot of activities are now carried out on a real time basis and payment systems are gradually reducing the use of cheques.

Your new audit client is one of the companies that has recently enhanced their business settings with respect to receipts and payments. The previous auditor has little depth in information and communication technology despite the growing trend. The client's management also thinks that its performance in the past has been inadequately reported due to the complicity of the key accounting staff and inadequacies of the previous auditor. The client is therefore considering its options in the circumstances.

Required:

a. Discuss the challenges encountered in the provision of assurance engagements on e-commerce systems and the approach to address these challenges. (8 Marks)

b. Evaluate the ethical principles that will be relevant in the conduct of forensic investigation of this client and the considerations the accountant needs to bear in mind in such an assignment. (7 Marks)

c. For proper conclusion of the exercise, set out the reporting requirements of an assurance engagement. (5 Marks)

(Total 20 Marks)

QUESTION 3

Messrs PK Industries Limited was incorporated and operates its business in Nigeria.

The company has existed over the years. During most of this period, it imported some major components from China. Imports usually take some time to arrive after necessary forms have been completed and submitted to the bank.

Two of the directors have two other companies that supply fuel and other local resources needed by the company. The company's directors are aware of this but prefer to do their business rather than patronise other suppliers.

In the last few years, the turnover of the company fluctuated between ₦500 million and ₦1billion. The two other companies owned by the two directors are currently trading on loans granted by the company.

Following what was considered to be an increasing harsh economic environment and high cost of power supply, the company registered a subsidiary company with a production outfit in Ghana while still maintaining its head office operations in Nigeria. Part of the raw materials needed in Ghana are procured in Nigeria and transported to Ghana through hired trailers. This process is being used until a suitable supplier is found in Ghana.

The company decided to hold the next Annual General Meeting (AGM) in the company's premises in Ghana with all the directors/shareholders traveling to Ghana on a direct flight from Abuja to Accra at the company's expense. It was decided that this was an opportunity to evaluate the Ghanaian environment for further business decisions.

The audit of the Nigerian company and its Ghanaian company were done by different firms.

Required:

a. Evaluate the risks involved in the scenario above. (5 Marks)

b. Discuss the risk assessment procedures that the auditor of Messrs PK Industries Limited need to adopt as required by ISA 550. (11 Marks)

c. Prepare the key guidelines to the audit in accordance with ISA 600. (4 Marks)

(Total 20 Marks)

QUESTION 4

Piton Drilling and Engineering Services Limited was established in 2001 by Andrew and Cole. The company provides consultancy, engineering and training services in borehole drilling, power generation, environmental engineering services under drilling, training, and laboratories divisions. The largest division is drilling of which contributes income of more than 60%, while training and laboratory services contribute only over 30% of total income. Piton Drilling & Engineering Services Limited saw opportunity in combining business operation with Valemu Limited, a small engineering company with three members. Valemu Limited has strong presence in the riverine areas and commenced operations about two years ago.

The issue of the business combination was brought to the attention of Peter who is the Engagement Partner for the audit of Piton Drilling and Engineering Services Limited. He suggested that Andrew and Cole should perform due diligence on the operations of Valemu Limited, regardless of the fact that they are in similar business operations. He explained that the exercise will be necessary to reduce risk of failure of the merged entity, as both quantitative and qualitative information will be available about the operations of the entity before going on to decide on signing the agreement. It was explained that the due diligence should cover financial viability and long-term sustainability of the merged entity. He made reference to a situation where a large department store was forced to wind down its operations after business combination when it was discovered that the entity merged with was highly indebted to the bank and most of the assets have been pledged as collateral for loans with banks.

Some staff of your firm have already been assigned to the audit engagement and you told them that the audit will be delayed because a due diligence is being carried out on the operations of the entity Piton Drilling and Engineering Services Limited wants to merge with. One of the inquisitive staff, who is tired of staying in the office, came up to you with a lot of questions among which is why the audit and the due diligence review could not serve the same purpose.

Required:

a. Differentiate between due diligence report and external audit report. (3 Marks)

b. Discuss the items you feel should be investigated or reported on in the due diligence exercise to make it of value to Piton Engineering Services Limited. (7 Marks)

c. Evaluate the benefits of using a professional service firm for the exercise. (3 Marks)

d. Highlight the format of the due diligence report. (7 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

Vigo Microfinance Bank Limited was incorporated on July 1, 2014, as a public limited company under the Companies and Allied Matters Act. The bank obtained Microfinance banking licence from the Central Bank on August 5, 2015 to operate on a nationwide basis and commenced business operation on September 5, 2015. The bank's principal business is to provide microfinance banking and related services to the poor and underserved segment of the society with a view to alleviating poverty under the Microfinance Institutions Ordinance. In 2019, the bank decided to convert to a commercial bank and commenced business operation on August 10, 2019 after final approval from the regulator. As at December 31, 2019, the bank had five branches (2016:24) at the Federal Capital and other four major geo-political zones in the country.

With the new commercial banking licence, the bank employed the services of F.K. George Professional Services to audit its financial statements. As part of the activities to be carried out on the initial engagement, the external auditors began a review of the books of account of the predecessor auditor and the following issues emanated, among others:

i. Some property, plant and equipment in the books of account and in prior year financial statements had negative net carrying amounts;

ii. The basis for impairment included in prior year financial statements regarding loans and advances could not be established from the working papers;

iii. There was a material amount of pre-operating expenses that was included in receivables schedules of which could not be satisfactorily provided;

iv. The audit work performed on interest income in the prior year was not supported by sufficient appropriate audit evidence;

v. Details of outstanding tax liabilities could not be provided as the amount in the financial statements was the figure supplied to the external auditor by the tax consultant. It was discovered that the figures were not subjected to review by the former external auditor;

vi. There was no satisfactory explanation on nil balances included in prior year financial statements on contingent liabilities as there were no evidence that request for confirmation were made from all solicitors of the bank; and

vii. Details of contraventions included in the examiner's report were not considered for disclosures in the financial statements.

The Central Bank is requesting for the financial statements of the bank and management is worried that there is a delay in the release of the financial statements by the new external auditors despite several notifications and reminders.

The Chief Finance Officer of the bank complained to you as a member of the engagement team about the delay in concluding the audit. He could not see the reason why your firm should be concerned about prior period financial statements issues when your firm was not the one that expressed opinion on it. Added to this, the responsibility for the financial statements rest on the board of directors.

Required:

a. Discuss why your firm needs to carry out the above exercise. (3 Marks)

b. Analyse the nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence. (8 Marks)

c. Evaluate what your firm might likely do in case of inability to obtain sufficient appropriate audit evidence from the exercise. (4 Marks)

(Total 15 Marks)

QUESTION 6

The audit of one of your firm's new clients is ongoing. Review and compliance procedures were being carried out by the audit team. There were unsatisfactory issues with some of the data generated for use in the testing process. These issues were escalated and there was therefore the need to bring in the firm's IT specialists for confirmation purposes. With your competence in this area, you were asked to provide the necessary guide and assurance needed by the audit team.

Required:

a. Evaluate the components of the governing principles of the Nigerian Data Protection Regulation, 2019 as applicable in the circumstance. (6 Marks)

b. Discuss the requirements of the data protection framework. (9 Marks)

(Total 15 Marks)

QUESTION 7

At the annual general meeting of Aggressive Bank Limited for the year 2020 the shareholders complained about increasing cases of customers complaints about fraud. It was believed that if drastic actions are not taken to reduce this, it could lead to brand damage and reputational issues. In performing their oversight functions, the audit committee of the bank commissioned the internal audit unit to identify issues of fraud and likely causes. From the internal audit report, the following issues were noted:

i. Due to poor information security system, some unscrupulous individuals hacked into customers current/savings deposits accounts and made unauthorised transfers to their bank accounts;

ii. There were cases of forged cheques with forged signatures, cards, and withdrawal slips which were used to withdraw money from bank accounts. These acts were perpetrated through collusion with staff of the bank;

iii. Cases of opening and operating fictitious bank accounts where illegal transfers were made. The problem is compounded with incomplete know your customer (KYC) activities carried out by the bank's personnel;

iv. Granting of loans to fictitious borrowers through fictitious accounts opened in branches of the bank;

v. Some junior staff making claims of overtime for hours not worked;

vi. Suppression of cash/cheques that were supposed to reflect on customers' deposits and loan repayments. The cash/cheques were diverted to the fictitious accounts in operation in the bank; and

vii. Cases of alteration of programmes, or application packages and gaining access to unauthorised domains or accounts to give credit to accounts for which the funds were not intended.

The following were identified as likely causes:

- Weak accounting and internal control system;
- Negligence and poor supervision of subordinates;
- Inadequate follow up or disregard for "know your customers (KYC)" rule;
- Poor information technology and data base management;
- Poor salaries and conditions of service;
- Failure to perform regular end of day call-over;
- Non implementation of sanctions on employees who failed to comply with standard operating procedures;
- Notwithstanding details of fraud and forgeries to regulators as required due to fear of negative publicity or image;
- Lack of experience and inadequate training; and
- Inadequate infrastructure in the bank as manifested in constant power failure, congested office space and non-completion of expected daily task before closing.

The audit committee having gone through this internal audit report, decided to act swiftly by mandating the management to engage a forensic expert to report forensic report from on this. Your firm has been appointed to submit a report on this issue in the next four weeks.

Required:

a. Discuss the ethical principles you believe will be applicable in this situation. (5 Marks)

b. Assess and advise on the procedures you will take to gather evidence for an acceptable report to management. (5 Marks)

c. Evaluate the agencies and relevant laws you will recommend to management to tackle these problems, where legal actions might be required. (5 Marks)

Total 15 Marks)

SOLUTION 1

a. The matters that in the auditor's professional judgement were of most significance, in the audit of the financial statements of the current period, and can be classified as Key Audit Matters include:

   i. Areas of higher assessed risks of material misstatements or significant risks;

   ii. Significant auditor judgements relating to areas in the financial statements that included significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty;

   iii. Significant events or transactions that had a significant effect on the financial statements or the audit;

   iv. Other matters that require significant auditor attention which may /may not be disclosed in the financial statements like the implementation of a new IT system;

   v. Matters that are likely to jeopardise the going concern of the entity such as the persistent decline in revenue as well as business loss;

   vi. Matters relating to the auditor's judgement such as determining materiality and materiality threshold;

   vii. Matters relating to changes in the business structure such as the business combination with another oil company as well as the major investment disposal;

   viii. The financing of the business from intercompany loans as well as the default in contractual obligations to the directors; and

   ix. Generally, issues relating to significant fraud risks.

b. Factors that would be considered in determining which matters are of most significance to be communicated to those charged with governance includes:

   i. Significance of interactions between the auditor, management and the audit committee;

   ii. The importance of the matters to the understanding of the financial statements as a whole;

   iii. The materiality of the matters;

   iv. Corrected and uncorrected misstatements relating to the matters and their nature;

   v, Complexities relating to the accounting policy, for example subjectivity in selecting the accounting policy or difference in the policy compared to industry norms;

vi. The nature and extent of audit function to address the matter, for example use of experts;

vii. Difficulties in performing audit procedures and obtaining sufficient audit evidence;

viii. Severe internal control deficiencies;

ix. Inter-relatedness with other matters, for example long-term contracts which affect revenue recognition;

x. Significant matters which require auditor's attention in performing the audit;

xi. Areas of higher assessed risk of material misstatements or significant risks identified;

xii. Significant matters which required auditor's judgment that also involve significant management judgment, including accounting estimates; and

xiii. Accounting estimates that have been identified as having high estimation uncertainty.

c. The description of the Key Audit Matters in the auditor's report include the following:

i. Reference to the related disclosure(s) in the financial statements (if any);
ii. Explanation of why the matter was considered to be one of most significance;
iii. Audit evidence obtained; and
iv. Audit conclusion reached.

d. If the auditor determines that there are no Key Audit Matters to communicate in the auditor's report, the auditor should:
i. Discuss this conclusion with the engagement quality control reviewer;
ii. Communicate this conclusion with those charged with governance; and
iii. Explain in the auditor's report that this section of the auditor's report is intended to describe the matters communicated with those charged with governance based on the auditor's professional judgment.

Examiner's report

The question tests the candidates' knowledge of the requirements of issues to be classified as Key Audit Matters, matters to be communicated to those charged with governance and also tests responses to such issues as they arise.

This is a compulsory question and almost all the candidates attempted it but the performance was poor.

The commonest pitfall of the candidates was their inability to apply the issues presented to answer a specific scenario.

Candidates are advised to study the Institute's Study Text and Pathfinders which are freely available on the Institute's website.

	Marking guide	**Marks**	**Marks**
a.	**Criteria for determining methods that require auditors attention which can be classified as KAM**	1	
	(1 mark for introduction)		
	(1 mark each for any 7 points)	7	8
b.	**Factors the auditor would consider to determine matters to be communicated to those charged with governance**		
	(1 mark each for any 10 points)		10
c.	**Content of KAM for the auditor's report**		
	(1½ marks for any 4 points)		6
d.	**Reporting obligations of an auditor where there is not KAM to communicate in the report**		
	(2 marks for each point subject to maximum of 3 points)		6
	Total		**30**

SOLUTION 2

a. Performing an assurance engagement on e-commerce systems provides additional challenges for auditors. These include:

i. The need for specialist knowledge about e-commerce systems;

ii. Problems that may arise when some aspects of the e-commerce system (such as the electronic payments system) are outsourced by the client to another entity;

iii. The role of the client's internal auditors in monitoring the integrity of the e-commerce system;

iv. The need for specialist controls (general and application controls) for the system;

v. Possible problems of independence and conflicts of interest, if the audit firm was involved in designing or setting up the e-commerce system that is now subject to 'audit';

v. Loss of transaction integrity;

vi. The use of inappropriate accounting policies (for example in respect of capitalisation of website development costs; and

viii. Legal and regulatory risks.

The audit approach to an e-commerce system should include the following elements:

i. The audit firm should decide whether the engagement should be accepted as in any professional engagement;

ii. The firm should then plan the engagement and make available audit staff with appropriate expertise in e-commerce systems;

iii. The firm should obtain a detailed knowledge of the client's business;

iv. It should consider liaison with the internal auditors of the client and ascertain if there have been internal audit investigations into the client's e-commerce transactions or system;

v. The firm should identify and evaluate the risks in the system;

vi. It should ascertain and evaluate the control environment and the specific internal controls that are in operation; and

vii. It may also be appropriate to perform a going concern review, particularly in the case of entities that rely mainly on e-commerce activities for their income.

b. The ethical principles applicable to accountants carrying out forensic investigation of the client include:

i. **Integrity**: In legal disputes and criminal investigations, individuals may be dishonest and tell lies. However, the forensic accountant must act with integrity and honesty at all times;

ii. **Objectivity**: The forensic accountant is paid by a client to carry out an investigation, and the client will presumably be hoping for a particular outcome to the investigation. For example, in a fraud investigation, the criminal investigators who use a forensic accountant may be hoping for evidence of guilt. However, the forensic accountant must remain independent (in spite of the advocacy threat) and should seek to obtain evidence to reach a fair opinion;

iii. **Professional competence and due care**: Forensic accounting is a Specialised area of work, and individuals should be sufficiently competent to do the work;

iv. **Confidentiality**: The normal ethical rule is that accountants should maintain client confidentiality and should not disclose information without the client's consent. An exception is that the duty of confidentiality is overridden by the requirement to provide evidence when requested in a court of law. Legal requirements for disclosure override the rules of client's confidentiality; and

v. **Professional behaviour**: Forensic accountants often appear as witnesses in court, and in the public eye, they should display professional behaviour and act in a way that is not detrimental to the image of the accounting profession.

There are some particular considerations that an accountant will have to bear in mind when carrying out forensic investigation, these include:

i. To whom a duty of confidentiality is owed (particularly when acting as an expert witness in relation to both sides of a legal claim);
ii. Duties to the court;
iii. Acting in the public interest; and
iv. Legal privilege in the context of money laundering.

This last area is a particularly important one for forensic accountants. Most accountancy work, for example, auditing or accounts preparation, gives rise to the duties to report suspicions of money laundering.

However, when an accountant is working in a legal capacity, it may be that information obtained during the course of that work is subject to legal privilege. If so, the accountant would be wrong to make a report of suspicion of money laundering. Whether or not legal privilege applies in a particular situation is a complicated question, and the accountant should take legal advice on his position.

c. The report prepared by accountants at the end of an assurance engagement will include the following elements:

i. A **title**, indicating that the report is an independent assurance report;
ii. An **addressee** (the person or body to which the report is addressed);
iii. Identification of the **level** of assurance obtained;
iv. **Subject matter of the report**, including any relevant information relating to the subject matter reviewed, such as the time period for which the information was gathered;
v. **Suitable criteria** that have been selected for assessment;
vi. Any inherent **limitations** in performing the work;
vii. Where appropriate, a statement that the use of the report must be restricted to certain specified users, or that the use of the report should be restricted to a specific purpose for which it was prepared;
viii. A statement to identify the responsible party and the measurer and to describe their and the practitioner's responsibilities;
ix. A statement that the engagement was carried out in accordance with ISAEs, ISQC 1 and independence and ethical requirements;
x. A summary of the work performed;
xi. The practitioner's **conclusion**; and
xii. The **date, name and address** of the practitioner.

Examiner's report

The question tests the candidates' knowledge of the challenges encountered in e-commerce, the ethical principles in forensic investigation and reporting on forensic exercises.

The question was attempted by about 80% of the candidates but the performance was below average.

The commonest pitfall of the candidates was their lack of understanding of e-commerce despite its growing trend.

Candidates are advised to familiarise themselves with practical aspects of engagement and also the Institute's Study Text and Pathfinders.

	Marking guide	**Marks**	**Marks**
a.	**Challenges of providing assurance engagement on an e-commerce systems and the approach to address the challenges**		
	(1 mark each for any 3 challenges,) and	3	
	(1 mark each for any 5 audit approaches)	5	8
b.	**Ethical principles relevant in the conduct of forensic investigation and what the accountant should consider**		
	(1½ marks for any 4 ethical principles,) and	6	
	(1 mark for any consideration)	1	7
c.	**Reporting requirements for an assurance engagement**		
	(½ mark for any 10 requirements)		5
			20

SOLUTION 3

a. The risks to be identified from the scenario presented in the case could be divided into business risks and financial statement risks.

Business risks:

These include:

i. Setting up new business in a foreign country requires commitment to set up and grow the business. This may be beyond the capacity of the company;

ii. Establishing business will also require huge initial financial set up. This will involve huge capital commitment;

iii. The cost of moving shareholders and directors to Ghana for AGM is likely to have a drain on the resources of the company and may be unjustified by the proposed business development evaluation;

iv. Granting loans to directors' other businesses would likely be at an interest below the market rate and would be a drain on the resources of the company due to improper application of resource;
v. Damages and possible loss of goods and resources that are freighted to the foreign component;
vi. Revenue earning fluctuation of the business between ₦500m and ₦1Billion;
vii. Control risk within the organisation;
viii. Poor corporate governance; and
ix. Risks associated with unknown scenarios of Ghanaian business environment

Financial statement risks:
These include:

i. The need to engage an international audit firm or different firms in the two countries will involve huge costs;
ii. The challenges in the proper currency conversion of the transactions of the subsidiary company;
iii. Risk of material misstatement of all related parties' activities to ensure that the financial statements reflect a true state of affairs of the company; and
iv. Risk of financial misappropriation.

b. **Risk assessment procedures**

The Related Party transactions are covered in ISA 550. The risk assessment procedures relate to ISAs 240 and 315.
As part of the risk assessment procedures required by ISAs 240 and 315, the auditor is required to perform the following procedures:

i) Consider the risk of material misstatement due to fraud or error arising from related party relationships and transactions;
ii) Make inquiries of management in respect of;
  - The identity of related parties;
  - The nature of relationships with those related parties; and
  - The nature of any transactions entered into with those parties during the period; and
iii) Obtain an understanding of the internal controls in operation over:
  - The identification of, accounting for and disclosure of related party relationships and transactions
  - The authorisation and approval of significant related party transactions; and
  - The authorisation and approval of significant transactions outside the normal course of Business.

c. ISA 600: special considerations – audits of group financial statements (including the work of component auditors)

The revised ISA introduced a number of new requirements where other auditors audit group components, increasing the group auditor's involvement in the work of component auditors. New requirements include:

i) Deciding whether to accept or continue an appointment as group auditor, considering whether the group engagement team will be able to be involved in the work of component auditors to the extent necessary to obtain sufficient appropriate audit evidence;

ii) Obtaining an understanding of the group, its components and their environment and assessing the risk of material misstatement of the group financial statements (which can be mitigated by strong group-wide controls);

iii) Obtaining an understanding of component auditors, including their professional competence and whether they will comply with ethical requirements which apply to the group audit; and

iv) Determining a materiality level for the group as a whole and for each components where competent auditors will perform an audit or a review for the purposes of the group audit; and

v) Responding to assessed risks, including:

- Requiring an audit of the financial information (using component materiality) of any component which is of individual financial significance;

- Requiring an audit of the financial information, or an audit of specific areas or specified audit procedures for any component which is significant because it is likely to include group level significant risks;

- Requiring analytical procedures at group level for non-significant components; and

- Determining the level of involvement of the group engagement team in the work performed by component auditors (for significant components, the group engagement team must be involved in the component auditor's risk assessment in order to identify the risks of material misstatement).

Examiner's report

The question tests the candidates' knowledge of the concept of risk and its assessment procedures in related party transactions with respect to *ISA 550: Related Parties*, and the audit guidelines in accordance with *ISA 600: Special Considerations in Audit of Group Financial Statement.*

The question was attempted by about 70% of the candidates but the performance was poor.

The commonest pitfall of the candidates was their inability to discuss the risk assessment procedures as required by ISA 550.

Candidates are advised to pay close attention to the technicalities involved in audit guidelines and other technical documents.

	Marking guide	**Marks**	**Marks**
a.	**Identification of risks from the scenario and classifying business risk and financial statement risks.**		
	Business Risk		
	(1 mark for any 3 points)	3	
	Financial Statement Risks		
	(1 mark each for any 2 points)	2	
			5
b.	**Discuss the Risk assessment procedure in line with ISA 550**		
	(1 mark for the introduction, and)	1	
	(2 marks each for any 5 points)	10	11
	Preparation of key guidelines to audit in accordance with ISA 600.		
	(1 mark each for any 4 points)		4
			20

SOLUTION 4

a. The differences between due diligence report and external audit report include:

   i) **Due diligence report** is mostly not regulated by law while **external audit report** is usually regulated by law and standards;

   ii) **Due diligence report** focuses on future information such as management account, profit forecast, etc; but **external audit report** is focused on historical financial information;

   iii) **Due diligence report** involves enquiries, analytical procedures and inspection of documents while **external audit** involves substantive testing of transactions and account balances;

iv) **Due diligence report** reviews both financial and non-financial information such as the company structure, credibility of owners, directors, management, etc. of the future earning potential of the business to be acquired or merged with, risk assessment and other information necessary to decide on the viability of the merger or acquisition. While an **external audit report** focuses on financial data as well as past activities of the business. It also provides a high level of assurance to the users of the financial statements;

v) **A due diligence report** is used for making decisions regarding mergers and acquisitions and provides the client with necessary information required to determine whether or not to merge or acquire the proposed company and to decide what price to offer for the merger or acquisition. While **external audit report** provides assurance on the truth and fairness of the financial statements of the company and is required by law to be carried out and submitted to the audit committee; and

vi) Audit reports only on the truth and fairness of the financial results, while a due diligence review will investigate reasons for the trends observed in operational results of the company over a relevant time period in terms of relevancy for the proposed transaction.

b. **The items to be investigated or reported on in the due diligence exercise of Valemu Limited to make if of value to Piton Engineering Services Limited includes:**

i) **Financial performance and financial position**: The practitioner should look at the available historical financial information about the target company, such as its financial statements for the past few years. Ratio analysis will often be used to make an assessment. The practitioner will also look at the target company's management accounts, budgets and profit/cash flow forecasts, and at any current business plan;

ii) **Operational issues**: The practitioner should also look for any operational issues in the target company that may raise questions about its value. For example, the target company might have important contracts with major customers, and the practitioner should try to find out when these contracts reach their termination date and the probability that the contracts will be renewed. Other operational problems may be discovered, such as a high rate of labour turnover, or high costs incurred in meeting warranties or guarantees to customers;

iii) **Management representations**: Management of the takeover target may have provided representations to the potential buyer. For example, they might have given a written assurance that the target company is not subject to any tax investigation or potential litigation. Due diligence work should seek to establish that these representations appear to be correct and/or are correct;

iv) **Identification of assets**: A takeover usually results in purchased goodwill in the consolidated accounts. However, the takeover target may have several intangible assets that do not appear in its statement of financial position (because they were internally-generated assets) but which should be recognised for the purpose of consolidation. Examples are internally-generated patent rights, customer lists and databases and brand names. These should be identified and valued for inclusion in the consolidated statement of financial position after the acquisition. It is also useful for the management of the potential buyer to be aware of the nature and estimated value of the intangible assets that they would be acquiring; and

v) **Benefits and costs of a takeover**: Due diligence may also include an attempt to estimate the future benefits of the takeover, such as cost savings from synergies such as economies of scale. Any 'one off' expenses such as redundancy costs and reorganisation costs will have to be estimated – by the potential buyer if not by the due diligence process.

Other items include:

i) Contingent assets and liabilities;

ii) Environmental due diligence;

iii) Any outstanding investigation by government authorities; and

iv) Contract with third parties (terms and conditions).

c. **Benefits of using a professional firm for a due diligence exercise include:**

i) Hiring a professional service firm to do the work saves management time for the potential buyer;

ii) The practitioners assigned to the due diligence work should have suitable experience on this type of work;

iii) For large takeover, the amount of time and resources required to carry out proper due diligence can be substantial for a large take-over; and

iv) Using a professional firm to do due diligence may help to reassure shareholders of the potential buyer (or investors who will be asked to provide loan finance for the takeover) that the acquisition has been properly evaluated.

d. **Format of the due diligence report.**

A due diligence report is expected to be presented in the format below as prescribed by ISQE 2400:

i) **Introduction/executive summary:** This section provides a brief summary of the target company to the client and highlights areas of concern;

ii) **Main section of report**: The contents and order of this section will be agreed with the client in advance and could include areas such as:

- Analysis of audited financial statements going back several years;
- Any audit issues in the past;
- Legal issues, such as potential litigation;
- Corporate governance analysis;
- SWOT analysis;
- Any financial obligations, such as loans or leases;
- Details of key suppliers and customers;
- Key employees; and
- Details of key employment matters such as pensions, redundancy obligations; and

iii) **Appendices:** It will contain the detailed documentation used to compile the main section of report, for example, copies of financial statements, copies of lease contracts or loan terms.

Examiner's report

The question tests the candidates' knowledge of the distinction between due diligence and external audit exercises as well as the benefits of using a professional service firm in carrying out a review engagement.

The question was attractive to candidates as about 90% of them attempted it but the performance was on the average.

The commonest pitfall was the candidates' inability to explain the requirements of the different types of assurance engagements.

Candidates are advised to pay close attention to review engagements and study the Institute's Study Text and Pathfinders, for success in the future examinations.

	Marking guide	Marks	Marks
a.	**Identifying the difference between due diligence report and external audit report**		
	(1 mark each for any 3 points of difference)		3
b.	**Discussion of Items to be investigated or reported in a due diligence exercise**		
	(1 mark each for any 7 points)		7

c. **Evaluation of benefits of using a professional service firm**
(1 mark each for any 3 points) 3

d. **Presenting the format of due diligence report**
(1 mark each for any 7 points) 7

Total **20**

SOLUTION 5

a. **The exercise is necessary to determine:**

i) Whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
ii) Whether the current financial year balances reflect consistent application of appropriate accounting policies as in previous years; and
iii) If there is consistency of classification and disclosure between the current financial year and prior years.

b. **The following audit procedures are required to obtain sufficient appropriate audit evidence:**

i) Read the most recent financial statements and audit report, if any, for information relevant to opening balances;
ii) Check that the prior period's closing balances have been correctly brought forward;
iii) Check that opening balances reflect appropriate accounting policies;
iv) Carry out the following procedures:

- Where the prior financial statements were audited, review the predecessor auditors' working papers to obtain evidence with reference to balances;
- Consider whether audit procedures carried out in the current period provide related evidence on some of the opening balances. For example, cash received from customers in the current period gives evidence of the existence of a receivable at the opening date.

v) If evidence is found that opening balances could contain material misstatements affecting the current period's financial statements, perform appropriate additional procedures to assess the effect;

vi) If misstatements do exist, communicate this to those charged with governance in accordance with ISA 450; and

vii) Check that the accounting policies reflected in the opening balances have been consistently applied in the current period (or a change of accounting policy has been properly approved and disclosed).

c. **What the firm is likely to do in event of inability to obtain sufficient appropriate audit evidence include:**

i) Discuss with management and those charged with governance on our inability to obtain sufficient appropriate audit evidence required to reach a conclusion, explaining to them the implications of this;

ii) Determine whether it is possible to resign from the audit engagement (if permitted by law), where it is not possible, seek legal counsel on necessary actions to take; and

iii) Issue a modified audit report detailing the reasons for this. Where it is material but not pervasive, then a qualified opinion will be given but where it is material and pervasive, then a disclaimer of opinion will be issued stating that there was a limitation in the ability to obtain sufficient appropriate audit evidence.

Examiner's report

The question tests the candidates' knowledge of the requirements of audit evidence and the procedure of obtaining audit evidence in various assurance engagements.

Over 60% of the candidates attempted the question, and the performance was above average.

The commonest pitfall was the candidates' inability to explain the procedures of evidence gathering and reporting requirements.

Candidates are advised to read thoroughly the Institute's Study Text and Pathfinder before sitting for subsequent examinations.

	Marking guide	**Marks**	**Marks**
a.	**Discussion of reasons for the audit procedure for the exercise**		
	(1 mark for each for 3 points)		3
b.	**Analysis of the nature and extent of audit procedure**		
	(2 marks each for any 4 points)		8
c.	**Evaluation of the Auditor's response in case of inability to obtain sufficient appropriate audit evidence**		
	(2 marks each for any 2 points)		4
			15

SOLUTION 6

a. The National Information Technology Development Agency (NITDA) issued the Nigerian Data Protection Regulation (NDPR) in 2019, pursuant to its enabling power under the NITDA Act 2007. Without prejudice to other procedures in the regulation or any instrument for the time being in force, the regulation has the governing principles (Principle 2.1) of data processing to the effect that:

i. Personal data shall be:
   - Collected and processed in accordance, with specific, legitimate and lawful purpose consented to by the data subject; provided that:
     - A further processing may be done only for archiving, scientific research, historical research or statistical purposes for public interest; and
     - Any person or entity carrying out or purporting to carry out data processing under the provisions of this paragraph shall not transfer any personal data to any person;
   - Adequate, accurate and without prejudice to the dignity of human person;
   - Stored only for the period within which it is reasonably needed; and
   - Secured against all foreseeable hazards and breaches such as theft,

   cyber attack, viral attack, dissemination, manipulations of any kind, damage by rain, fire or exposure to other natural elements;

ii. Anyone who is entrusted with personal data of a data subject or who is in possession of the personal data of a data subject owes a duty of care to the said data subject; and

iii. Anyone who is entrusted with personal data of a data subject or who is in possession of the personal data of a data subject shall be accountable for his acts and omissions in respect of data processing, and in accordance with the principles contained in this regulation."

b. **The requirements of the data protection framework include the following:**

i. **Consent:** Data controllers and processors must first seek the consent of the data subject without undue influence, fraud, and coercion. usually, consent is obtained through clear data privacy policies to which the data subject has consented; and

ii. **Data protection audit:** The NDPR mandates all organisations that process the personal data of more than 1000 data subjects in a period of 6 months and 2000 data subjects in a period of 12 months to submit a data protection audit report to NITDA not later than March 15, every year. This involves the organisation's audit of its data privacy and protection practices. Audits are meant to show that the data controller or processor complies with the law.

The audit should state the following:

i. The data the organisation collects on its employees and members of the public;

ii. The purpose for which such data is collected;

iii. Notice given to individuals regarding the collection and use of their personal information;

iv. The access given to individuals to review, amend, correct, supplement, or delete such data;

v. Whether or not the consent of these individuals was obtained before collecting, using, transferring, or disclosing these data; and the methods employed to obtain consent;

vi. The policies and practices of the organisation for the proper use and security of these data;

vii. Organisation's policies and procedures for privacy and data protection; and

viii. The policies and procedures of the organisation for assessing the impact of technologies on the stated privacy and security policies.

Examiner's report

The question tests the candidates' knowledge of components of data protection regulation framework in accordance with the Nigerian Data Protection Regulation, 2019.

About 70% of the candidates attempted the question and the performance was above average.

The commonest pitfall of the candidates was their inability to explain the computerised setting and data handling as well as the requirements for the regulation on data.

Candidates are advised to study the Institute's Study Text and Pathfinders.

	Marking guide	**Marks**	**Marks**
a.	**Evaluation of the components of the governing principle of the Nigeria Data Protection Regulation**		
	(1 mark for introduction)	1	
	(1 mark each for any 5 points)	5	6

b. **Discussion of this requirements of the Data Protection Framework** 4
(2 marks for any 2 points)
Consent and Data Protection Audit: audit requirements
(1 mark each for any 5 points) 5 9

15

SOLUTION 7

a. Ethical principles applicable in this situation include:

i) **Integrity:** In legal disputes and criminal investigations, individuals may be dishonest and tell lies. However the forensic accountant must act with integrity and honesty at all times;

ii) **Objectivity:** The forensic accountant is paid by a client to carry out an investigation, and the client will presumably be hoping for a particular outcome to the investigation. For example, in a fraud investigation, the criminal investigators who use a forensic accountant may be hoping for evidence of guilt. However the forensic accountant must remain independent (in spite of the advocacy threat) and should seek to obtain evidence to reach a fair opinion;

iii) **Professional competence and due care:** Forensic accounting is a specialised area of work, and individuals should be sufficiently competent to do the work;

iv) **Confidentiality:** The normal ethical rule is that accountants should maintain client confidentiality and should not disclose information without
the client's consent. An exception is that the duty of confidentiality is overridden by the requirement to provide evidence when requested to a court of law. Legal requirements for disclosure override the rules of client confidentiality; and

v) **Professional behavior:** Forensic accountants often appear as witnesses in court, and in the public eye they should display professional behaviour and act in a way that is not detrimental to the image of the accounting profession.

b. **The procedures to be carried out to gather evidence for an acceptable report to management include:**

i) Establishing the objectives of the investigation.

ii) Planning the investigation with a view to achieving the objectives. For example in an investigation into suspected fraud, the auditor should plan how to establish whether fraud has occurred, how it could have happened, how long has it been going on as well as who has committed the fraud and how much has been lost;

iii) Planning in a way that will provide sufficient appropriate evidence to achieve the objectives of the investigation. The evidence should be strong enough to 'stand up' to scrutiny in court, if required. In fraud cases, evidence should therefore try to establish a motive for the alleged fraudster, identify the opportunity that the fraudster had to commit the fraud and also any evidence of measures by the fraudster to conceal his crime;

iv) Noting that evidence may be gathered in various ways – similar to the methods used in a normal audit. This includes interviewing individuals (including individuals suspected of fraud);

v) Using the evidence obtained to reach an opinion. If the evidence is insufficient, he should try to obtain additional evidence; and

vi) Preparing a report for the client at the end of the investigation.

c. **The agencies and their enabling Acts include:**

i. **Economic and Financial Crimes Commission (EFCC Act) 2004**
Part of the duties of the EFCC is to carry out investigation of financial crimes, including advance fee fraud, money laundering, counterfeiting, illegal charges, transfers, future market fraud, fraudulent encashment of negotiable instruments, computer credit card fraud and contract crimes;

ii. **Independent Corrupt Practices and Other Related Offences Commission** (ICPC) Act, 2000. Duties of ICPC include receiving and investigating complaints from members of the public on allegations of corrupt practices in the public service and in appropriate cases, prosecute the offenders;

iii. **Federal Inland Revenue Service (FIRS Act):** Part of its duties include to adopt measures to identify, trace, freeze, confiscate or seize proceeds derived from tax fraud or evasion;

iv. **Money Laundering (Prohibition) Act, 2011 (as amended);**

v. **Bank and Other Financial Institutions Act (BOFIA) (as amended):** This Act grants to the CBN power to order a special examination or investigation of the books and affairs of any bank where it is in the public interest to do so.

v. The Nigerian Financial Intelligence (NFLU) Act 2018.

vi. The Nigerian Police Special Fraud Unit (SFU) Section 419 of the Nigeria Constitution.

Examiner's report

The question tests the candidates' knowledge of ethical principles involved in the given scenario, guidelines with respect to evidence from the client and agencies of government on fraud investigation.

About 90% percent of the candidates attempted the question but the performance was below average.

The commonest pitfalls were the candidates' lack of understanding of what is required to gather evidence, and the restrictions to the disclosure of evidence.

The candidates are advised to study the Institute's Study Text and the Pathfinder thoroughly before attempting subsequent examination.

	Marking guide	**Marks**	**Marks**
a.	**Discussion on tax ethical principles applicable in a situation**		
	(1 mark each for 5 points)		5
b.	**Assessment on tax procedure to gather evidence**		
	(1 mark each for any 5 points)		5
c.	**Listing of the agencies and relevant laws to tackle fraud and legal actions that might be required.**		
	(1/2 mark each for any 5 agencies mentioned)		
	(½ mark each for stating the laws of the tax	$2^1/_2$	
	5 agencies mentioned)	$2^1/_2$	5
			15

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

CASE STUDY

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
4. examination number.

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

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

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

THURSDAY, MAY 18, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2023

CASE STUDY

Time Allowed: 4 hours (including reading time)

INSTRUCTION: YOU ARE TO USE CASE STUDY ANSWER BOOKLET FOR THIS PAPER

PRE-SEEN

This material is issued prior to the examination date to enable candidates familiarise themselves with the case scenario so as to undertake any research and analysis they think fit. This pre-seen part of the Case Study examination is also published on the Institute's website: www.icanig.org/students.

You **MUST NOT** bring this material with you to the Examination Hall. On receipt of the material, you are to spend the few days to the examination date to familiarise yourself with the information provided, carry out additional research and analysis about the industry and analyse the financials provided in preparation for the examination.

Candidates should note that the use of pre-seen part of the Case Study will not significantly help them in their preparation for this examination. It is essential that they carry out sufficient analytical work on their own in order to have a good understanding of the pre-seen part of the case scenario.

At the start of the examination, candidates will receive the complete case scenario which will include both the pre-seen and the unseen which includes the requirements. You must use the answer paper provided by ICAN in the Examination Hall. Any solution presented with other papers **WILL NOT** be assessed.

Assessment of the Case Study

The marks in the Case Study examination are awarded for professional skills and are approximately allocated as follows:

▸	Assimilating and using information	20%
▸	Structuring problems and solutions	20%
▸	Applying judgement	20%
▸	Drawing conclusions and making recommendations	20%
▸	Demonstrating integrative and multidisciplinary skills	10%
▸	Presenting appropriate appendices	10%

Ethical issues do not form a specific requirement, as this has been deemed to have been tested in other subjects of the ICAN professional examination, but will be tested within a requirement which may include the following areas:

- Lack of professional independence or objectivity;
- Conflicts of interest among stakeholders;
- Doubtful accounting and or creative accounting practice;
- Unethical business/commercial practice; and
- Inappropriate pressure to achieve a reported result.

Candidates should note that marks are not awarded for just simply restating facts from the case scenario but marks are awarded for demonstrating professional skills and technical depth. Therefore, to succeed, candidates are required to:

- Show sufficient evidence of knowledge of the case scenario;
- Be able to carry out appropriate analysis of the issues involved and suggest feasible solutions to the problems identified;
- Demonstrate ability to make informed judgement on the basis of analysis carried out; and
- Generate reasoned conclusions upon which relevant recommendations are made.

Candidate that omits any one of these will have a slim chance of success in the examination.

Case Study:

List of exhibits

1 About you (Thomas Chukwudi) and your employer, Chikwelu, Adedigba, Kamal & Co (Chartered Accountants)

2 Dadly Cement Nigeria Limited (DCNL) – History, competitors, board, management, etc

3 Dadly Cement Nigeria Limited's 3-year financial summary

4 Dadly Cement Nigeria Limited: Proposed growth strategies

Exhibit 1

About you (Thomas Chukwudi) and your employer, Chikwelu, Adedigba, Kamal & Co (Chartered Accountants).

You are Thomas Chukwudi, a prospective ICAN Chartered Accountant working for Chikwelu, Adedigba, Kamal & Co. (Chartered Accountants). You report to Dare Adedigba, the business advisory partner.

Your responsibilities include:

- Preparing detailed financial analyses and reports as may be required by your firm's clients;
- Analysing your clients' financial statements to identify areas of weakness and proffering solutions to correct the anomalies;
- Assessing operational and strategic business proposals, to see how each aligns with the client's objectives and its impact on the company's business and financial risks;
- Assessing your firm's clients' financial and business forecasts together with the assumptions upon which they are based, to form judgements and propose recommendations to their respective boards; and
- Drafting reports for your partner's perusal and approval, before sending them to your clients.

Your responsibilities demand that you keep abreast of the business and economic environments, both nationally and internationally, so as to be able to carry out your tasks effectively.

Exhibit 2

Dadly Cement Nigeria Plc (DCN): History, competitors, board, management, etc

History

Dadly Cement Plc was incorporated in Nigeria in 1956 and commenced production in Lagos, in June 1959. As the company expanded into other regions, it established more plants, such as, Aba Plant in 1967 and Kaduna Plant in 1973. By 1981, the company had become one of the largest cement companies in the country, in terms of capital investment. In 1992, another plant was added in Ogun State. In September 2003, the company acquired its fifth plant in Enugu State, and in October 2013, its sixth plant, sited also in Enugu State, with 3 million metric tonnes per annum capacity, the largest cement plant in Nigeria at present.

DCN was listed on the Nigerian Stock Exchange (NSE) in 1983. As at December 31, 2020, it had a market capitalisation of approximately ₦448 billion, making it one of the largest cement companies in Nigeria by market capitalisation. DCN has received several awards in the capital market including, the NSE President's Merit Award in the Cement Sector, the NSE Quoted Company of the Year Award, the NSE CEO's Distinguished Award for Compliance and the NSE CEO's award as the Most Compliant Listed Company on the Nigerian Stock Exchange. The company is also a recipient of the Institute of Chartered Secretaries and Administrators of Nigeria (ICSAN's) Award for Excellence in Corporate Governance (corporate category) as well as the Institute of Directors Nigeria Corporate Governance Award. These awards are a reflection of the company's continued commitment to excellence in corporate governance matters.

DCN, in its operational performance, is also a recipient of several awards and recognitions, such as product quality, marketing excellence, productivity and innovation, health and safety, corporate social responsibility and sustainability.

Competitors

The major competitors for Dadly cement Plc are Dangote Plc. and Nigerian Cement Plc. Dadly, Dangote and Nigerian Cement control approximately 90% of the market for cement in Nigeria. The three companies have production plants across the country with sales depots and distributors in major cities in the country.

Board and management

Board

The current members of Dadly Cement Plc board are:

Chief Kanmi Odeku	Chairman
Mr. Wymenga Walter	Managing director
Mr. Andrew Young	Finance director
Mr. Mark Sijbe	Marketing/Distribution director
Mr Thompson Chukwura	Non – executive director
Mrs Serah Akpabio	Non – executive director
Mr Anu Famuyiwa	Non – executive director

Management

The following are the top management of Dadly Cement Plc.:

Mr. Wymenga Walter	Managing director
Mr. Andrew Young	Finance director
Mr. Mark Sijbe	Marketing/Distribution director
Dr. John Adimula	General manager – human resources
Mrs. Doris Etam	Company Secretary/Legal Adviser
Mr Paul Rutten	General manager – Production
Mr. Jordi Rob	General manager – Supply chain

DCN's Mission
To be the leading company in the cement industry in Nigeria, marketing high quality brands to deliver superior value to all our stakeholders in an environmentally friendly way.

DCN's Vision
To bring happiness to all people through our great brands, passionate people and world class performance.

DCN's Core Values
Our cherished values include:

- **Respect**
  For our people, the society and the environment.
- **Performance**
  A culture of top-level performance to deliver outstanding value to our stakeholders.
- **Customer Service**
  We exist to serve and satisfy our customers.

DCN's Corporate Social Responsibility (CSR) and Sustainability
DCN is a socially responsible corporate organisation with a good track record of corporate social initiatives. Sustainability has become the way of doing business in DCN. DCN, as an environmentally friendly organisation is creating value for all its stakeholders, with a sustainable environment as its watch word. The company uses its goodwill, strong brand name, economic position and good reputation as a socially responsible organisation to create shared value in a manner that empowers stakeholders to exercise their talents and utilise opportunities to contribute towards sustainable development.

DCN continues to identify and respond to major challenges confronting the country through its huge corporate social investments, especially in the areas of education, the environment, water, youth empowerment, talent development and sports, amongst others.

DCN is heavily involved in sponsoring sports in the country with the sponsorship covering football, athletics, tennis, cycling, chess, golf, squash, dart, sailing and "*Ayo*", among others. The company's goal is the development of sportsmen and women who will be able to participate in national and international competitions, and boost the sports profile of the country.

DCN has built several solar powered boreholes, commissioned independent street lights and constructed bus shelters across Nigeria. This is because DCN believes in the growth of the communities where it operates as its business grows.

In recognition of DCN's vast CSR footprints across the country, it has been awarded the prize of the Most Socially Responsible Company in Nigeria, severally.

DCN's approach to sustainability covers its entire value chain of minning, haulage, packaging and distribution. Its sustainability initiatives include protection of natural resources, reduction in CO_2 emissions, waste control, sustainable sourcing practices, amongst others.

DCN's corporate governance

DCN's board of directors is responsible for the overall long-term success of the company, policy formulation and the strategic direction of the business as well as providing effective leadership to achieve the company's objectives in a manner that respects its core values.

DCN's code of business conduct

DCN is committed to conducting business with integrity and fairness, with respect for laws and its values. This commitment is outlined in the company's Code of Business Conduct ("The Code"). The Code explains what DCN stands for and what is expected from all its employees – individually and as a team – at every level.

Ancillary industries

DCN, following its backward integration policy, has partnered with and supported the establishment and growth of several ancillary industries, which provide the company's raw and packaging materials. These include limestone, asphalt and Jute bags etc.

By using limestone as a main ingredient, DCN supports ₦8.8 billion in value added representing 0.05% of manufacturing GDP and 50,000 jobs (0.12% of the manufacturing labour force) throughout the limestone value chain.

Exhibit 3

Dadly Cement Nigeria Plc 3-year financial summary
Statement of Financial Position

	2020	2019	2018
Assets	₦'m	₦'m	₦'m
Property, plant and equipment	76,683.0	71,174.2	49,214.1
Intangible assets and goodwill	26,781.7	26,993.8	27,183.5
Investments	75.0	75.0	75.0
Inventories	10,321.6	12,326.4	13,766.5
Trade and other receivables	7,185.5	10,039.3	3,538.2
Prepayments	500.2	517.6	2,903.7
Deposit for imports	68.4	933.4	566.7
Cash and cash equivalents	4,764.4	4,757.1	10,938.3
Total assets	**126,379.8**	**126,816.8**	**108,186.0**
Liabilities			
Loans and borrowings	4,500.0	22,500.0	23,500.0
Employee benefits	4,637.4	2,983.4	3,433.3
Deferred tax liability	10,915.0	11,192.3	10,615.8
Current tax liabilities	12,043.3	9,746.8	9,961.5
Dividend payable	3,188.2	2,824.1	2,364.8
Trade and other payables	34,916.3	30,846.3	19,277.5
Total liabilities	**70,200.2**	**80,092.9**	**69,152.9**
Equity			
Share capital	1,890.7	1,890.7	1,890.7
Share premium	2,284.0	2,284.0	2,284.0
Revaluation reserve	-	-	3,544.9
Share based payments	25.0	76.2	-
Retained earnings	51,979.9	42,473.0	31,313.5
Total Equity	56,179.6	46,723.9	39,033.1
Total liabilities and equity	**126,379.8**	**126,816.8**	**108,186.0**

Exhibit 3 Cont'd

Income Statement

	2020	2019	2018
	₦'m	₦'m	₦'m
Revenue	134,306.8	126,337.1	115,061.6
Cost of sales	(66,068.3)	(63,611.0)	(60,180.6)
Gross profit	68,238.5	62,726.1	54,881.0
Other income	1,037.7	1,000.1	172.6
Marketing and distribution expenses	(21,474.8)	(19,725.3)	(16,510.4)
Administrative expenses	(13,215.7)	(11,695.1)	(10,219.3)
Operating profit	34,585.7	32,305.8	28,323.9
Finance income	275.6	279.9	664.6
Finance costs	(3,741.1)	(4,773.5)	(802.1)
Net finance costs	(3,465.5)	(4,493.6)	(137.5)
Profit before tax	31,120.2	27,812.2	28,186.4
Taxation	(9,580.0)	(8,790.8)	(9,173.6)
Profit for the year	21,540.2	19,021.4	19,012.8
Profit for the year attributable to:			
Owners of the company	**21,540.2**	**19,021.4**	**19,012.8**
Earnings per share:			
Basic and diluted (kobo)	570	503	503

Exhibit 4

Dadly Cement Nigeria Plc: Proposed growth strategies

At its September, 2021 meeting, the board reviewed the performance of the company thus far and discussed the future growth strategies of the company.

During the discussion, the board noted, from the management report that the company has no presence in some parts of the country, which is affecting the company's penetration into those areas. Also, the need to add more vibrant brands to the company's product offerings was discussed.

The board finally arrived at the following growth strategies for the next two years:

1. Scout for existing Cement companies operating in the parts of the country where the company does not have presence, which the company can acquire or merge with. This will enable the company to meet two of its strategic objectives, first to have presence in those parts of the country and second, to add new brands to its product portfolio;

2. If there are no cement companies for acquisition or merger, then the company will have to build new cement plants to cater for those parts of the country where the company has no presence;

3. Scout for an overseas plant with vibrant products and enter into franchise agreement with the plant, which will allow the company to manufacture and market the brands in Nigeria; and

4. Introduce two new products, "Bloc Plaster" and "Falcon", already developed by the company's research and development department, into the market within the next six months.

UN-SEEN

Case Study: Dadly Cement Nigeria Plc

List of exhibits

The following exhibits are newly provided and did not form part of the materials provided as pre-seen:

5 Email from Dare Adedigba to Thomas Chukwudi

6 Email from Andrew Young, Dadly Cement Plc Finance director, to Dare Adedigba

7 The proposed merger with Castel Cement Limited

8 Castel Cements' 3-year financial summary

9 Post-merger operating assumptions

Dadly Cement Nigeria Plc: Case Study requirement

You are Thomas Chukwudi, a prospective ICAN Chartered Accountant working for Chikwelu, Adedigba, Kamal & Co. (Chartered Accountants). You report to Dare Adedigba, the business advisory partner.

Requirement

You are required to prepare a draft report, as set out in the email dated 20 August 2021 from Dare Adedigba to you (Exhibit 5). Your report should comprise the following:

- An executive summary
- Responses to the two detailed requirements set out in Exhibit 5, including appropriate appendices.

State clearly any assumptions you have made. All workings should be attached to your answer.

The following time allocation is suggested:

Reading and planning	1 hour
Performing calculations and financial analysis	1 hour
Drafting report	2 hours

Marks allocation

All of the marks in the Case Study are awarded for the demonstration of professional skills, allocated broadly as follows:

Applied to the four elements of your report (as described above)	
Assimilating and using information	20%
Structuring problems and solutions	20%
Applying judgement	20%
Drawing conclusions and making recommendations	20%
	80%
Applied to your report as a whole	
Demonstrating integrative and multidisciplinary skills	10%
Presenting appropriate appendices	10%
	100%

Ensure that you address the two requirements in your report as failure to address any requirement, including, not submitting an executive summary will affect your chances of success. In addition, as indicated above, all four skills areas will be assessed under each of the four elements of your report. Accordingly, not demonstrating your judgement or failing to include appropriate conclusions and/or recommendations in each of your report will adversely affect your chances of success.

Exhibit 5

Email from Dare Adedigba to Thomas Chukwudi

From: Dare Adedigba
Sent: 20 August 2021
To: Thomas Chukwudi

Subject: Dadly Cement Nigeria Plc

I have just received a mail from Andrew Young, Dadly Cement finance director, asking us to evaluate the financial strength, profitability trend and management operational efficiency of Castel Cement Limited, the company which Dadly Cement Plc is proposing to enter into merger with. The company will also want us to comment on the benefits that could accrue from the merger to the stakeholders, especially the shareholders of both companies. Furthermore, Dadly Cement Plc will want us to prepare a forecast income statement for 2022, on the assumption that the merger is consummated by January 1, 2022. The company is also considering introducing two new products, "Bloc Plaster" and "Falcon" into the market, which will definitely impact on the forecast income statement.

I am attaching to this email, exhibits 6 to 9 in respect of the above.

Please draft for my review, a report addressed to the board of Dadly Cement Plc. The report should comprise:

1. Evaluation of the financial strengths, profitability trend and management operational efficiency of Castel Cement Limited, limiting your analysis to essential ratios that will assist the board of the company to conclude on its merger proposal with Castel Cement Limited. You are also required to highlight the benefits that will likely accrue from the merger to the stakeholders of both companies, if the merger proposal is eventually successful. Furthermore, with the aid of the simple calculations, suggest an appropriate share exchange ratio to guide Dadly board in their decision; and

2. Prepare a draft income statement forecast for 2022 of the combined entity, assuming the merger is completed by January 1, 2022, taking into consideration the assumptions in exhibit 9. You are to comment briefly on the forecast, whether it will meet the board's strategic objective for the merger, or not.

This assignment is crucial to the strategic plan of Dadly Cement Plc and the board of the company will want us to give it a comprehensive and careful attention, as any mistake would mean a serious setback for the company. I have been informed that the company's board meeting, at which a final decision will be taken on the merger is coming up in a month's time. I would, therefore, like you to focus on this assignment with keen observance to details and accuracy. I expect to receive your draft report in two weeks' time, as this will enable me to have enough time to review the report before submission to Dadly Cement Plc.

I look forward to receiving your draft report.

Dare

Exhibit 6

Email from Andrew Young, Dadly Cement Finance director to Dare Adedigba

From: Andrew Young – Finance director – Dadly Cement Plc.
To: Dare Adedigba – Partner - Chikwelu, Adedigba, Kamal & Co.
Subject: Business Advisory
Date: 15 August, 2021

Dare,

Our board has been meeting to consider the growth strategies which the company should pursue in achieving its strategic objectives of being the best cement company, in the country with brands that are consumers' first choice. Our purpose is to constantly increase shared value for our stakeholders, especially increasing our earnings per share by 10% per annum in the next five years.

At its July, 2021 meeting, the board took a decision to initiate merger talks with Castel Cement Limited and introduce two new products to the market in the coming year, as part of the company's growth strategies.

As a prelude to the final decision on the merger proposal, our board would like you to carry out an analysis of the financial strengths, profitability trend and management operational efficiency of Castel Cement Limited. You are required to limit your analyses to only essential ratios that could assist the board in its decision. Please recommend what in your view, should be the appropriate share exchange ratio.

Also, based on its strategic intents, the board would like you to comment on possible benefits that could result from the merger to both companies' stakeholders, most especially, the shareholders.

Prepare a draft forecast income statement for 2022 of the combined entity, assuming the merger is completed by January 1, 2022, taking into consideration the assumptions in exhibit 9. You are to comment briefly on the forecast, whether it will meet the board's strategic objective for the merger, or not.

I am looking forward to the receipt of your report on the above issues. I need to receive your report on time before our next board meeting, which comes up in the third week of October.

Thanks for always being there for us.

Andrew

Exhibit 7

The Proposed Merger

The board proposed the Scheme of Merger primarily to ensure that the company remains competitive. In addition, the directors are of the opinion that significant cost and revenue synergies will accrue from the proposed merger thus creating additional value to the shareholders of both companies.

Objective of the merger

The objective of the merger is to create value for all key stakeholders, particularly the shareholders, by deriving synergies and benefits from increased economies of scale and enhanced operating and administrative efficiencies.

The proposal

Transfer and consideration

It is being proposed that:

a. All the assets, liabilities and undertakings of Castel Cement Limited, including real properties and intellectual property rights, will be transferred to Dadly Cement Plc;

b. The entire issued share capital of Castel Cement Limited comprising 248,000,000 ordinary shares of 50 kobo each be cancelled and Castel Cement Limited be dissolved without being wound up;

c. In consideration for the transfer of all the assets, liabilities and undertakings of Castel Cement Limited to Dadly Cement Plc, it is proposed that all shareholders of Castel Cement Limited will be allotted shares in Dadly Cement Plc, based on share exchange ratio that will be agreed or shall be entitled to receive cash consideration for shares in Castel Cement Limited, based on a price to be agreed.

Benefits from the merger

It is believed that the proposed acquisition will provide a number of strategic opportunities and benefits to both companies' shareholders, employees, and customers as well as the cement industry and the larger economy.

The proposed acquisition will therefore strongly reinforce Dadly's commitment to the growth and development of the cement industry, have positive impact on the Nigerian economy at every level, create more employment opportunities and contribute to internally generated revenue for the three tiers of government.

Information Regarding Castel Cement Limited

Castel Cement Limited is engaged in the production, marketing and selling of cement and related products. The company's brands include Port cement 42.5R and Port cement 42.5N.

Castel Cement Limited operates through three operational plants in Sagamu, Awka and Makurdi. As at December 31, 2020, Castel Cement Limited had revenue of ₦16.9 billion, an authorised share capital of ₦350.0 million, made up of 700 million ordinary shares of ₦0.50 each and an issued share capital of ₦124.0 million. The shareholders funds as at December 31, 2020 stood at ₦6.97 billion.

Valuation methodology

The Financial Advisers recommend the following valuation methods in establishing the fair value of Dadly Cement Plc and Castel Cement Limited, in deriving the implied share exchange ratio for the proposed merger:

- Net book value;
- Historical Market Prices;
- Over the Counter ("OTC") Trading Prices; and
- Earnings yield.

Net book value

This is a valuation based on the historical net book value of the two companies. The net book value per share is calculated by dividing the net assets by the number of shares in issue.

Historical Market Prices

Typically, prices of securities traded on exchanges provide market defined benchmarks of fair value. Dadly Cement Plc is listed on the Nigerian Stock Exchange (NSE) and its share price provides probably the best indication of its value. 60 day volume weighted average closing prices to August 8, 2021 of Dadly Cement Plc shares on the NSE was ₦135.18.

OTC Trading Prices

NASD PLC ("NASD") is the promoter and operator of an OTC platform for non-quoted securities. Trades in non-quoted securities are matched automatically on this trading platform under conditions similar to a formal stock exchange. Castel Cement Limited is listed on the NASD OTC platform and its share price provides a defined benchmark of fair value.

However, stocks trading on this platform are not as liquid as those trading on the NSE. The last trading price of Castel Cement Limited on the NASD OTC platform, prior to the announcement of the proposed merger, was ₦90.00 per share on August 8, 2021.

Earnings yield

The companies' shares are valued using their annual earnings and a suitable earnings yield. The valuation will be based on earnings yield, calculated based on three years average earnings per share, using the latest three years' financial statements. Earnings yield for the industry is 4% per annum. However, the earnings yield so calculated for Castel Cement Limited will be increased by 10% to allow for the higher risk of investing in private companies. The market price of Dadly Cement Plc on the NSE and the market price of Castel Cement Limited on the OTC, as at August 8, 2021 will be used for the calculation.

Transfer of Assets, Liabilities and Undertakings

Subject to this Scheme being approved by a majority representing not less than three-quarters in value of the ordinary shares held by the shareholders of Dadly Cement Plc and Castel Cement Limited present at their respective court-ordered meetings, and the Scheme being approved by SEC and sanctioned by the Court, Castel Cement Limited shall transfer all of its assets, liabilities, and undertakings, including real properties and intellectual property rights to Dadly Cement Plc upon the terms and subject to the conditions that shall be agreed without any further act or deed.

Cancellation of Share Capital

The entire share capital of Castel Cement Limited shall be cancelled after the merger.

Exhibit 8

Castel Cement Limited: 3-year summarised financial statements

Statement of Financial Position as at December:

	2020	2019	2018
Assets	**₦'m**	**₦'m**	**₦'m**
Property, plant and equipment	10,652.2	7,552.1	4,401.3
Intangible assets	438.3	-	-
Other receivables	-	3,039.9	1,114.5
Investments	62.3	2,427.3	1,752.6
Non-current assets	11,152.8	13,019.3	7,268.4
Inventories	2,392.2	1,515.6	1,641.5
Trade and other receivables	6,758.9	4,035.4	1,114.9
Cash and cash equivalents	614.8	1,325.6	2,309.6
Assets held for sale	1,242.9	-	-
Current assets	11,008.8	6,876.6	5,066.0
Total assets	**22,161.6**	**19,895.9**	**12,334.4**
Equity			
Share capital	124.0	123.9	99.2
Share premium	3,502.4	3,502.4	530.1
Reserve for own shares	(110.9)	(110.9)	-
Retained Earnings	3,453.9	3,950.1	2,649.6
Total equity	6,969.4	7,465.5	3,278.9
Liabilities			
Loans and borrowings	1,662.8	5,745.0	3,400.0
Employee benefits	501.3	436.5	392.1
Deferred tax liabilities	1,762.4	1,245.5	726.3
Non-current liabilities	3,926.5	7,427.0	4,518.4
Current tax liabilities	230.7	235.6	823.3
Loans and borrowings	5,607.2	-	385.7
Dividend payable	94.8	58.2	71.9
Trade and other payables	5,333.0	4,709.6	3,256.2
Current liabilities	11,265.7	5,003.4	4,537.1
Total liabilities	15,192.2	12,430.4	9,055.5
Total equity and liabilities	**22,161.6**	**19,895.9**	**12,334.4**

Exhibit 8 Cont'd

Statement of Comprehensive Income for the years ended 31 December:

	2020	2019	2018
	₦'m	₦'m	₦'m
Revenue	16,957.2	16,763.6	13,954.4
Cost of Sales	(10,739.3)	(10,262.3)	(7,807.4)
Gross profit	6,217.9	6,501.3	6,147.0
Other income	43.0	25.0	11.9
Selling and distribution expenses	(2,363.4)	(2,194.9)	(2,092.4)
Administrative expenses	(2,733.5)	(2,051.4)	(1,738.9)
Results from operating activities	1,164.0	2,280.0	2,327.6
Finance income	598.5	586.9	34.9
Finance costs	(876.0)	(725.4)	(156.1)
Net finance costs	(277.5)	(138.5)	(121.2)
Profit before tax	886.5	2,141.5	2,206.4
Taxation	(325.8)	(533.1)	(778.0)
Profit for the year	560.7	1,608.4	1,428.4
Other comprehensive income			
Items that will never be reclassified to profit or loss:			
Defined benefit plan actuarial gains	13.4	18.1	(36.2)
Tax on other comprehensive income	(4.0)	(5.4)	10.9
Other comprehensive income for the year, net of tax	9.4	12.7	(25.3)
Total comprehensive income for the year	**570.1**	**1,621.1**	**1,403.1**
Earnings per share:			
Basic and diluted earnings per share (kobo)	230	684	596

Exhibit 9

Post-merger operating assumptions

The following post-merger assumptions have been made:

1. Dadly Cement Plc will be able to increase the combined revenues of both companies in 2020 by 10% in 2022;

2. Dadly Cement Plc, in 2022, will be able to eliminate the following from the combined 2020 operating expenses of both companies:

    - Selling and distribution expenses ₦2 billion;
    - Administrative expenses ₦2 billion; and
    - Finance cost ₦277.5m;

3. Dadly Cement Plc will introduce two new products, "Bloc Plaster" and "Falcon", into the market in 2022. This will result in additional revenue of ₦1.5 billion. Production costs will be approximately 52.3% of revenue while additional marketing and distribution expenses of ₦450 m will be incurred in the year to promote the two products;

4. All other costs are assumed to remain at their 2020 levels; and

5. Taxation provision for 2022 is assumed to be the taxation figures in the income statements of both companies in 2020.

ICAN CASE STUDY MAY 2023

DADLY CEMENT NIGERIA PLC

Marking Key

DATE			**CANDIDATE NO.**	
TIME			**MARKER NUMBER**	

	Exc Sum	Req 1	Req 2	Overall	TOTAL
SA					
CA					
BC					
NC					
V					
Total	**5**	8	8	4	25

Executive Summary: Dadly Cement Nigeria Plc

1. General

- States the purpose of the report
- States the summary of the two requirements
- States the assumptions
- States reservations, e. g. scepticism

V | NC BC CA SA

2. Requirement 1: Conclusions

- Administrative expenses is increasing.
- Liquidity problem.
- Suppliers may stop supporting the Castel Cement
- Castel operations may result in losses in the near future.
- Castel has not taken advantage of debt capital.
- Appropriate share exchange ratio.
- Merger will result in benefit to both companies' shareholders.

V | NC BC CA SA

3. Requirement 1: Recommendations

- Control administrative expenses.
- Control cost of sales.
- Improve on payment to suppliers.
- Share exchange ratio.

V | NC BC CA SA

4. Requirement 2: Conclusions

- Income statement forecast looks good.
- The strategic objective of Dadly for going into the merger will be achieved.
- Shareholders of both companies will benefit from the merger.
- Differences in culture may pose problem.
- The merger may draw adverse comments from consumers.

V | NC BC CA SA

5. Requirement 2: Recommendations

- The two companies are advised to go ahead with the merger.
- The merger will help Dadly to achieve its strategic objective.
- Dadly must see how to align the culture of both companies.
- Consumers may react negatively to the merger, so Dadly should plan to manage this.

V | NC BC CA SA

REQUIREMENT 1 - Castel Cement Nigeria Limited's financial statement analysis.

1. USES DATA AND INFORMATION APPROPRIATELY

- Uses information on exhibit 8 - summarised 3-year financial statements for the ratios.
- Uses information on exhibit 7 to explain the benefits of the merger to both companies' shareholders.
- Uses information on exhibit 7 to determine the share exchange ratio.
- Uses information on exhibit 3 - Dadly Cement's 3-year summarised financial statements to determine the share exchange ratio.

V	NC	BC	CA	SA

2. USES PROFESSIONAL TOOLS AND KNOWLEDGE

- Calculates Debt/Equity ratio
- Calculates Debt/Total assets
- Calculates Interest cover
- Calculates Current ratio
- Calculates Quick assets ratio
- Calculates Gross margin ratio
- Calculates Return on equity
- Calculates Return on capital employed
- Calculates Return on total assets
- Calculates Rate of stock turnover
- Calculates No. of days in receivables
- Calculates No. of days in Payables

V	NC	BC	CA	SA

3. USES ANALYTICAL SKILLS (material points) written report

- Determines trend in Castel Cement's financial strength.
- Determines the share exchange ratio.
- Determines trend in Castel Cement's profitability.
- Determines trend in Castel Cement's management operational efficiency.
- Determines the price per share of Dadly Cement to be used in in calculating the share exchange ratio.
- Determines the price per share of Castel Cement to be used in in calculating the share exchange ratio.

V	NC	BC	CA	SA

4. IDENTIFIES ISSUES AND OPTIONS

- Identifies that Castel Cement's debt/equity ratio has reduced drastically.
- Identifies that Castel Cement's interest cover has reduced drastically.
- Identifies that no. of days in payables is gradually increasing.
- Identifies that revenues to total assets is reducing gradually.
- Identifies that Castel Cement's liquidity ratios are still within the tolerable limits.
- Identifies that Castel Cement's gross margin has been eroded.
- Identifies that Castel Cement's days in receivables has increased drastically.
- Identifies that Castel Cement's return on equity has reduced drastically.
- Identifies that Castel Cement's return on capital employed has reduced drastically.
- Identifies that Castel Cement's return on assets has reduced drastically.

V	NC	BC	CA	SA

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5. APPLIES PROFESSIONAL SCEPTICISM AND ETHICS

- Recognises that with the merger, Dadly is turning the industry into an oligopoly.
- Recognises that Dadly Cement may kill competition in the industry.
- Recognises that Castel Cement has not been settling its suppliers timely, as payable days has been increasing.
- Recognises that Castel Cement is gradually moving to being wholly equity financed.
- Recognises that Castel Cement has not been making effective use of its assets to generate revenue.

V	NC	BC	CA	SA

6. EVALUATIVE SKILLS AND JUDGEMENT

- Recognises that revenue has been growing steadily from year to year.
- Recognises that the company' s return on capital employed has reduced from 30.30% in 2018 to 16.18% in 2020
- Recognises that return on equity has dropped from 43.56% in 2018 to 8.05% in 2020.
- Recognises that payable days has deteriorated from 152 days to 181 days.
- Recognises that receivable days have deteriorated from 29 days to 145 days.
- Determines the share exchange ratio.
- Recongises the benefits that will accrue to the shareholders of both companies

V	NC	BC	CA	SA

7. CONCLUSIONS (Draws distinct conclusions under a heading)

- Concludes that the continous increase in administrative expenses is a problem.
- Concludes that the liquidity position of Castel Cement may become a problem.
- Concludes that the suppliers may stop supplying materials to Castel Cement on credit.
- Concludes that if the trend continues, the company will make losses in the coming years.
- Concludes that Castel Cement is becoming wholly equity financed.
- Concludes on the appropriate share exchange ratio.
- Concludes that the merger will result in benefits to the shareholders of both companies.
- Concludes on the benefits that will accrue to the shareholders of both companies.

V	NC	BC	CA	SA

8. RECOMMENDATIONS (commercial / relevant)

- Recommends that Castel Cement should immediately introduce measures to curtail its administrative expenses.
- Recommends that Castel Cement should introduce measures to curtail rising cost of sales.
- Recommends that Castel Cement must take steps to improve its liquidity position.
- Recommends that Castel Cement should reduce the payable days to encourage suppliers to continue to supply to it on credit
- Recommends that Castel Cement should introduce some debt capital into the business.
- Recommends a share exchange ratio to be used for the merger.

V	NC	BC	CA	SA

REQUIREMENT 2 -Appraisal of forecast income statement for combined Entity

1. USES DATA AND INFORMATION APPROPRIATELY

- Uses information on exhibit 8 - summarised 3-year financial statements to prepare the income statement forecast.
- Uses information on exhibit 7 to perpare the forecast income statement.
- Uses information on exhibit 3 - summarised 3-year financial statements to prepare the income statement forecast.
- Uses information on exhibit 9 to perpare the forecast income statement.

V	NC	BC	CA	SA

2. USES PROFESSIONAL TOOLS AND KNOWLEDGE

- Calculates the combined entity's revenue.
- Prepares the income statement forecast for 2022.
- Calculates the combined entity's cost of sales.
- Calculates the combined entity's selling and . distribution expenses.
- Calculates the combined entity's administrative expenses.
- Calculates the combined entity's finance cost.
- Calculates the combined entity's earnings per share.

V	NC	BC	CA	SA

3. USES ANALYTICAL SKILLS (material points)
(written into report)

- Determines the combined entity's revenue.
- Determines the combined entity's cost of sales.
- Determines the combined entity's selling and . distribution expenses.
- Determines the combined entity's administrative expenses.
- Determines the combined entity's finance cost.
- Determines the combined entity's earnings per share.

V	NC	BC	CA	SA

4. IDENTIFIES ISSUES AND OPTIONS

- Identifies that the assumptions made may not be accurate.
- Identifies that the culture of both companies may differ.
- Identifies that issue of dissenting shareholders must be taken into consideration.
- Identifies that the merger may be kicked against by the stakeholders, as it is likely to further reduce competion in the industry.

V	NC	BC	CA	SA

5. APPLYING PROFESSIONAL SCEPTICISM AND ETHICS

- Discusses that the accuracy of the income statement forecast depends on the accuracy of the assumptions made by the management.
- Discusses that the merger will further reduce competition in the industry. which is not in the interest of consumers.
- Discusses the possible effect of managing the different culture in the two companies.
- Discusses the possibility of having to deal with dissenting shareholders of Castel Cement.
- Discusses the possibility of the market rejecting the two new products to be introduced by Dadly Cement.

V	NC	BC	CA	SA

6. EVALUATIVE SKILLS AND JUDGEMENT
(uses analytical headings)

- Evaluates the post merger assumptions.
- Evaluates the forecast income statement.
- Evaluates the earning per share of the combined entity.
- Evaluates the cement industry in Nigeria and the position of Dadly Cement.
- Evaluates the public perception of the merger in the light of reduced competion.

V	NC	BC	CA	SA

7. CONCLUSIONS
(Draws distinct conclusions under a heading)

- Concludes that the income statement forecast shows an improved results.
- Concludes that the shareholders of both companies would benefit from the merger.
- Concludes that earnings per share of both companies would improve.
- Concludes that Dadly Cement must plan to manage the differences in culture between the two companies.

V	NC	BC	CA	SA

8. RECOMMENDATIONS (commercial / relevant)

- Recommends that the two companies should go ahead with the merger.
- Recommends that the merger will result in Dadly Cement meeting its strategic objective.
- Recommends that Dadly Cement needs to manage the differences in culture between the two companies.
- Recommends that Dadly Cement needs to manage any adverse publicity that may arise from the merger.

V	NC	BC	CA	SA

Appendices	Main Report

Appendices for R1

- Shows Debt/Equity ratio
- Shows Debt/Total assets
- Shows Interest cover
- Shows Current ratio
- Shows Quick assets ratio
- Shows Gross margin ratio
- Shows Return on equity
- Shows Return on capital employed
- Shows Return on total assets
- Shows Rate of stock turnover
- Shows No of days in receivables
- Shows No of days in Payables
- Shows the calculation of Dadly price per share.
- Shows the calculation of Castel price per share.

V	NC	BC	CA	SA

Appendices for R2

- Shows the income statement forecast.
- Shows the workings for the income statement forecast.
- Shows the EPS forecast of the combined entity.
- Shows the calculation of the share exchange ratio.
- Shows the adjustments necessary to arrive at the income statement forecast.
- Shows the number of Dadly shares to be issued to Castel shareholders.

V	NC	BC	CA	SA

Report: Structure

- Sufficient appropriate headings
- Appropriate use of paragraphs / sentences
- Legible/clear hand writing
- Correctly numbered pages

V	NC	BC	CA	SA

Report: Style and language

- Relevant disclaimer (external report)
- Suitable language for the board
- Tactful / ethical comments
- Acceptable spelling and punctuation

V	NC	BC	CA	SA

CC	
SC	
IC	
ID	
NA	
Total	

Appendix 1

Castel Cement Nigeria Limited

Financial statement analysis

	2018	2019	2020
Financial strength			
Debt/Equity ratio	3,400.0/3,278.9	5,745.0/7,465.5	1,662.8/6,969.4
	1.04	0.77	0.24
Debt/Total assets	9,055.5/12,334.4	12,430.4/19,895.9	15,192.2/22,161.6
	0.73	0.62	0.69
Interest cover	2,327/156.1	2,280.0/725.4	1,164.0/876.0
	14.9 times	3.1 times	1.3 times
Current ratio	5,066.0/4,537.1	6,876.6/5,003.4	11,008.8/11,265.7
	1.1:1.0	1.4:1.0	1.0:1.0
Quick assets ratio	3424.5/4537.1	5,361/5,003.4	8,616.6/11,265.7
	0.8: 1.0	1.1:1.0	0.8:1.0
Profitability trend			
Gross margin	6,147.0/13,954.4%	6,501.3/16,763.6%	6,217.9/16,957.2%
	44.05%	38.78%	36.67%
Return on equity	1,428.4/3,278.9%	1,608.4/7,465.5%	560.7/6,969.4%
	43.56%	21.54%	8.05%
Return on capital employed	2,362.5/7,797.3%	2,866.9/14,892.5%	1762.5/10,895.9%
	30.30%	19.25%	16.18%
Management operational efficiency			
Return on total assets	2,362.5/12,334.4%	2,866.9/19,895.9	1762.5/22,161.6%
	19.15%	14.41%	7.95%
Rate of stock turnover	7.807.4/1641.5*	10,262.3/1,579	10,739.3/1,953.9
	4.8 times	6.5 times	5.5 times
No of days in receivables	1,114.9/13,954.4*365	4,035.4/16,763.6*365	6,758.9/16,957.2*365
	29 days	88 days	145 days
No of days in Payables	3,256.2/7,807.4*365	4,709.6/10,262.3*365	5,333.0/10,739.3*365
	152 days	168 days	181 days
Revenue to total assets	13,954.4/12,334.4	16,763.6/19,895.9	16,957.2/22,161.6
	1.13 times	0.84 times	0.77 times

*Closing inventory was used because there was no opening inventory.

Appendix 2

Determination of share exchange ratio

Calculation of price per share:

Dadly Cement:		
Net book value:		₦
Total assets Dec 2020	126,379,800,000	
Total liabilities	-70,200,200,000	
Net book value:	56,179,600,000	
No of outstanding shares	3,781,400,000	
Net book value per share	14.85682551	14.86
Historical market price		135.18
Earnings yield		
Earnings per share:		
2018	503	
2019	503	
2020	570	
	1576	
Average earnings per share	525.3333333	
Earnings yield	0.04	
Value per share	13133.33333	131.33
		281.37
Average		93.79
Castel Cement:		
Net book value:		
Total assets Dec 2020	22,161,600,000	
Total liabilities	-15,192,200,000	
Net book value:	6,969,400,000	
No of outstanding shares	248,000,000	
Net book value per share	28.10241935	28.1
OTC price per share		90
Earnings yield		
Earnings per share:		
2018	596	
2019	684	
2020	230	
	1510	
Average earnings per share	503.3333333	
Earnings yield	0.044	
Value per share	11439.39394	114.39
Average pice per share		232.49
		77.50
Share exchange		1.2102
Total Castel shares		248,000,000
Shares of Dadly to be alloted (248,000,000/1.2102)		204,924,805.805.81722
		204,924,806

Appendix 3

Dadly Cement Nigeria Plc

Forecast income Statement

	2022
	₦'m
Revenue	167,890.4
Cost of sales	- 85,272.9
Gross profit	82,617.5
Other income	1,080.7
Marketing and distribution expenses	- 22,288.2
Administrative expenses	- 13,949.2
Operating Profit	47,460.8
Finance income	874.1
Finance costs	- 4,339.6
Net finance costs	- 3,465.5
Profit before taxation	43,995.3
Tax expense	- 9,905.80
Profit after taxation	34,089.50
EPS (kobo)	855.16

Workings

	Dadly Cement	Castel Cement	ADJUSTMENT	FINAL
Revenue	134,306.8	16,957.2	16,626.4	167,890.4
Cost of sales	- **66,068.3**	- **10,739.3**	- **8,465.3**	- 85,272.9
Gross profit	68,238.5	6,217.9	8,161.1	82,617.5
Other income	**1,037.7**	**43.0**	**-**	1,080.7
Marketing and distribution expenses	- 21,474.8	- 2,363.4	1,550.0	- 22,288.2
Administrative expenses	- 13,215.7	- 2,733.5	2,000.0	- 13,949.2
Operating Profit				
Finance income	275.6	598.5	-	874.1
Finance costs	- 3,741.1	- 876.0	277.5	- 4,339.6
	31,120.2	**886.5**	**11,988.6**	43,995.3
Taxation	9,580.0	325.8	-	9,905.8

Earnings per share calculation		
Dadly existing shares	3,781,400,000	
Issued to Castel Cement's shareholders	204,924,306	
	3,986,324,306	
Earnings (₦m)	34089.5	
EPS kobo	855.1612308	855.16

Dtmak Nigeria Limited
Evaluation of the proposed Bata factoryr
Calculation of contribution per pair

	Contribution	Probability	Expected contribution
	₦		₦
	6,000	0.20	1,200
	5,000	0.30	1,500
	4,000	0.50	2,000
			4,700

	Year 1	Year 2 - Year 5
No of pairs per annum	20,000	30,000
Contribution per pair	4,700	4,700
Total contribution per annum	94,000,000	141,000,000

Calculation of net present value

	Year	**Cash flow**	**Disc factor**	**Present value**
		₦million		**₦million**
Project cost	0	-360	1	- 360.00
Working capital	0	-40	1	- 40.00
Contribution - year 1	1	94	0.8475	79.67
Contribution - year 2 - 5	Year 2 - Year 5	141	2.2797	321.44
Working capital	5	40	0.4371	17.48
NPV				18.59

Examiner's report

The case scenario is on Dadly Cement Nigeria Plc, which planned to merge with another cement company, as a growth strategy. The Pre-seen case scenario includes the history, board and management, growth strategies and the financials of Dadly Cement, while the Un-seen introduces details of the planned merger, the financials of Castel Cement Limited, which Dadly Cement was trying to merge with, methods of determining the share exchange ratio and the post -merger operating assumptions. As usual, there are two requirements that students are to address. These are:

- Evaluation of the financial strength, profitability trend and management operational efficiency of Castel Cement Limited, limited to essential ratios that will assist the board of Dadly to conclude on its merger proposal with Castel Cement Limited. They are also required to highlight the benefits that will likely accrue to the stakeholders of both companies, if the merger proposal is eventually successful. Furthermore, candidates are to, by simple calculations, suggest an appropriate share exchange ratio to guide Dadly board in their decision; and
- Prepare a draft income statement forecast for 2022 of the combined entity, assuming the merger is completed by January 1, 2022, taken into consideration the assumptions in exhibit 9. Candidates are to comment briefly on the forecast, whether it will meet Dadly board's strategic objective for the merger, or not.

To perform very well in the Case Study, candidates must prepare the following appendices:

- Various ratios on Castel Cement financials (financial strength, profitability trend and management operational efficiency);
- Determination of share exchange ratio and the number of shares of Dadly to be allotted to the shareholders of Castel Cement; and
- Post-merger income statement forecast of Dadly Cement Nigeria Plc.

Candidates' performance was very poor, as only very few candidates scored up to 50%.

The common pitfalls of the candidates are:

- Most candidates did not address requirement 2 of the Case Study, income statement forecast of the combined entity, thereby losing substantial marks;
- Some candidates did not calculate the share exchange ratio and so did not calculate the number of shares of Dadly Cement to be allotted to the shareholders of Castel cement;
- Lack of understanding of how to write a formal report with appropriate headings and subheadings to address issues required; and
- Inability to write a good executive summary.

Candidates are advised to practise and perfect the art of report writing, learn to address specific requirements of each Case Study and ensure they bring to bear the knowledge they had gained in other subjects when preparing for future examination.