THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

# PATHFINDER

## NOVEMBER 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.

# TABLE OF CONTENTS

ICAN/232/V/C1 Examination No.....................

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2023

## 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, NOVEMBER 14, 2023**

**DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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**

Sports PLC is a company which operates in the service sector. Sport PLC has business relationship with Football PLC and Volleyball PLC. The financial positions of these companies as at September 30, 2020 are stated below:

| | Sports PLC | Football PLC | Volleyball PLC |
|---|---|---|---|
| | **₦'m** | **₦'m** | **₦'m** |
| **Non-current assets:** | | | |
| Property, plants and equipment | 1,840 | 600 | 620 |
| Investment in subsidiaries: | | | |
| Football PLC | 1,460 | | |
| Volleyball PLC | | 640 | |
| Investment in Handball PLC | 96 | | |
| Intangible assets | 396 | 60 | 70 |
| | 3,792 | 1,300 | 690 |
| **Current assets** | **1,790** | **960** | **500** |
| **Total assets** | **5,582** | **2,260** | **1,190** |
| | | | |
| **Equity and liabilities** | | | |
| Ordinary share capital | 1,840 | 800 | 400 |
| Other components of equity | 146 | 74 | 50 |
| Retained earnings | 1,790 | 884 | 278 |
| **Total equity** | 3,776 | 1,758 | 728 |
| Non-current liabilities | 990 | 246 | 186 |
| Current liabilities | 816 | 256 | 276 |
| **Total liabilities** | 1,806 | 502 | 462 |
| **Total equity and liabilities** | **5,582** | **2,260** | **1,190** |

**The following information is relevant to the preparation of the group's financial statements:**

i. On October 1, 2018 Sports PLC acquired 70% of the equity interest of Football PLC. The purchase consideration consisted of cash of ₦1,460 million. At acquisition, the fair value of the non-controlling interests in Football PLC was ₦590 million. On October 1, 2018 the fair value of the identifiable net assets acquired was ₦1,670 million and retained earnings of Football PLC were ₦638 million and other components of equity were ₦54 million. The excess in fair value is due to non-depreciable land.

ii. On October 1, 2019 Football PLC acquired 80% of the equity interest of Volleyball PLC for cash consideration of ₦640 million. The fair value of 20% holding of the non-controlling interests was ₦144 million, a 30% holding was ₦216 million and a 44% holding was ₦322 million. At the date of acquisition, the fair value of the identifiable net assets of Volleyball PLC was ₦724 million, retained earnings were ₦212 million and other components of equity were ₦40 million. The excess in fair value is due to non-depreciable land. It is the group's policy to measure the non-controlling interests at fair value at the date of acquisition.

iii. Both Football PLC and Volleyball PLC were tested for impairment as at September 30, 2020. The recoverable amounts of both cash generating units as stated in the individual statements at September 30, 2020 were Football PLC, ₦2,850 million and Volleyball PLC, ₦1,208 million respectively. The directors of Sports PLC felt that any impairment of assets was due to poor performance of the intangible assets. The recoverable amount has been determined without consideration of liabilities which relate to the financing of operations.

iv. Sports PLC acquired a 14% interest in Handball PLC on October 1, 2018 for a cash consideration of ₦36 million. The investment was accounted for under IFRS 9-Financial Instruments and was designated as fair value through other comprehensive income (FVTOCI). On April 1, 2020 Sports PLC acquired additional 16% interest in Handball PLC for cash consideration of ₦54 million and achieved significant influence. The value of the original 14% investment on April 1, 2020 was ₦42 million. Handball PLC made profit after tax of ₦40 million and ₦60 million for the years to September 30, 2019 and September 30, 2020 respectively.

   On September 2020, Sports PLC received a dividend from Handball PLC of ₦4 million, which has been credited to other components of equity.

v. Sports PLC purchased patents of ₦20 million to use in a project to develop new products on October 1, 2019. Sports PLC has completed the investigative phase of the project, incurring an additional cost of ₦14 million and has determined that the product can be developed profitably. An effective and working prototype was created at a cost of ₦8 million and in order to put the product into condition for sale, a further ₦6 million was spent. Finally, marketing costs of ₦4 million were incurred. All of the above costs were included in the intangible assets of Sports PLC.

vi. Sports PLC intends to dispose off a major line of the patent's business operations. At the date the held for sale criteria were met, the carrying amount of the assets and liabilities consisting of the line of business were:

| | ₦'m |
|---|---|
| Property, plant and equipment (PPE) | 36 |
| Inventories | 98 |
| Current liabilities (Trade payables) | 6 |

It is anticipated that Sports PLC will realise ₦60 million for the business. No adjustments have been made in the financial statements in relation to the above decision.

**Required:**

Prepare the consolidated statement of financial position for Sports PLC Group as at September 30, 2020. **(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**

Mama-Kitchen PLC owns a number of subsidiaries that operate standard fastfood eateries in all the six geopolitical zones of the country. You are the financial analyst of your Bank (Pam-Pam Bank Nigeria Limited) which owns 10% of the issued share capital of Mama-Kitchen PLC.

You are provided with the following financial and background information on Mama-Kitchen PLC.

## Mama-Kitchen PLC
## Consolidated statement of profit or loss for year ended September 30

| | 2023 | 2022 |
|---|---|---|
| | ₦'m | ₦'m |
| Revenue | 188,900 | 145,850 |
| Cost of sales | (141,700) | (110,400) |
| Gross profit | 47,200 | 35,450 |
| Admin expenses | (31,200) | (22,400) |
| Profit from operations | 16,000 | 13,050 |
| Finance cost | (2,050) | (2,100) |
| Profit before taxation | 13,950 | 10,950 |
| Income tax expense | (3,050) | (2,300) |
| Profit for the year | 10,900 | 8,650 |
| Earnings per share - basic | 26.8k | 21.3k |
| Earnings per share - diluted | 21.2k | 19.2k |

## Mama-Kitchen PLC
## Consolidated statement of cash flows for the year ended September 30

| | | 2023 | | 2022 |
|---|---|---|---|---|
| **Cash flows from operating activities:** | ₦'m | ₦'m | ₦'m | ₦'m |
| Profit before taxation | | 13,950 | | 10,950 |
| Finance cost | | 2,050 | | 2,100 |
| Depreciation and amortisation | | 15,300 | | 11,050 |
| Loss on disposal of PPE | | 150 | | 50 |
| (Increase)/decrease in inventories | | (200) | | 50 |
| Increase/decrease in receivables | | (1,250) | | (100) |
| Increase in trade payables | | 2,250 | | 650 |
| | | 32,250 | | 24,750 |
| Interest paid | | (2,050) | | (2,200) |
| Tax paid | | (1,600) | | (1,300) |
| **Net cash flows from operating activities** | | 28,600 | | 21,250 |
| | | | | |
| **Cash flows from investing activities:** | | | | |
| Purchase of PPE | (29,850) | | (28,950) | |
| Proceed from sale of PPE | 100 | | 150 | |
| Net cash used in investing activities | | (29,750) | | (28,800) |
| | | | | |
| **Cash flows from financing activities:** | | | | |
| Proceeds from issues of shares | 1,200 | | 100 | |
| Borrowings | 3,250 | | 10,000 | |
| Net cash flow from financing activities | | 4,450 | | 10,100 |
| Net increase in cash and cash equivalents | | 3,300 | | 2,550 |
| Cash and cash equivalents at beginning | | 12,400 | | 9,850 |
| Cash and cash equivalents at year end | | 15,700 | | 12,400 |

**Details of revenue, fast food outlets profits and new fast food outlets openings for the year ended September 30**

| | 2023 | 2022 |
|---|---|---|
| | ₦'m | ₦'m |
| **Revenue per fast food outlets:** | | |
| At September 30 | 1,770 | 1,715 |
| Opened in the current financial year | 1,290 | - |
| **Gross profit per outlet opened** | **₦'m** | **₦'m** |
| At September 30 | 435 | 415 |
| In the current financial year | 345 | |

**Note:**

30 new outlets were opened during the year ended September 30, 2023 to bring the total to 115 fast food outlets

**Additional financial information**

| | **2023** | **2022** |
|---|---|---|
| Gross profit margin | 25% | 24.3% |
| Debt equity ratio | 35.2% | 44.4% |
| Current ratio | 0.56:1 | 0.48:1 |
| Trade payables payment period | 86days | 103days |
| Return on capital employed | 20% | 19.1% |
| Cash return on capital employed | 40.2% | 36.3% |
| Earnings before Interest, tax, depreciation and amortisation (₦'m) | 31,300 | 24,100 |
| Non-current assets turnover | 1.68times | 1.49times |
| Share price (at September 30) | 302k | 290k |

**Background information**

i. Mama-Kitchen PLC has a reputation of depreciating its assets more slowly than others in the industry.
ii. The strategy of the group is to fund new fast food outlets capital expenditure from existing operating cash flows without need to raise new borrowings.
iii. Revenue growth in the industry is estimated at 4.1% per annum.
iv. It is the company's policy to increase promotional and advertising spending on new outlets to encourage strong initial sales.
v. The board has accused the management of concentrating on new outlet openings to the detriment of existing outlets.
vi. One of your colleague, a financial analysts, on going through the consolidated financial statements of Mama-Kitchen PLC has stated that the company has not been able to pay dividends because of the debit balance on its consolidated retained earnings.

**Required:**

a. Draft a report addressed to the Managing Director of Pam-Pam Bank Limited analysing the profitability, cash flows and investors ratios of the Mama-Kitchen PLC. You should also identify and justify matters that you consider will require further investigations. (13 Marks)

b. Explain the validity or otherwise of your colleague financial analyst's statement that Mama-Kitchen PLC was unable to pay dividends because of the debit balance on consolidated retained earnings. (4 Marks)

c. Explain the usefulness and limitations of diluted earnings per share information to investors. (3 Marks)

**(Total 20 Marks)**

## QUESTION 3

a. Puppsy PLC had identified the following segments in its annual financial statements for the year ended September 30, 2020:

   i. Segment A
   ii. Segment B
   iii. Segment C

   The company disclosed two reportable segments. Segments A and B were aggregated into a single reportable operating segment. Operating segments A and B have been aggregated on the basis of their similar basic features, and the nature of their goods and services. In the local train market, it is the local transport authority which awards the contract and pays Puppsy PLC for its services. In the local train market, contracts are awarded following a competitive tender process, and the ticket prices paid by passengers are set by and paid to the transport authority. In the inter- city train market, ticket prices are set by Puppsy PLC and the passengers pay Puppsy PLC for the service provided.

**Required:**

Advise Puppsy PLC on how the above issues should be dealt with in its financial statements for the year ended September 30, 2020. (10 Marks)

b. Puppsy PLC was given a building by a private person in August 2018. The benefactor of the building included a condition that the building must be brought into use as a train museum in the interests of the local community or the asset (or a sum equivalent to the fair value of the asset) must be returned. The fair value of the asset was ₦7.5 million in August 2019. Puppsy PLC took over the building in November 2018.

However, the company could not utilise the building in accordance with the condition until August 2019 as the building needed some renovation and adaptation and in order to abide with the condition attached to it. Puppsy PLC spent ₦2.5 million on renovation and adaptation.

**Required:**
Advise Puppsy PLC on how the above accounting issues should be dealt with in its financial statements for the year ended July 31, 2019 and July 31, 2020.

(10 Marks)

**(Total 20 Marks)**

## QUESTION 4

a. Derecognition of financial instruments is the removal of a previously recognised financial asset or liability from an entity's statement of financial position.

**Required:**
Discuss the rules of IFRS 9-Financial Instruments relating to the derecognition of a financial asset. (10 Marks)

b. Royal Business Limited (RBL) held portfolio of trade receivables with carrying amount of ₦40million at May 31, 2022. At that date, the entity entered into a factoring agreement with Hexlinks Bank Limited (HBL), whereby it transfers the receivables in exchange for ₦36million in cash.

Royal Business Limited has agreed to reimburse the factor (HBL) for any shortfall between the amount collected and ₦36million. Once the receivables have been collected, any amount above ₦36million, less interest on this amount will be repaid to Royal Business Limited. Royal Business Limited has derecognised the receivables and charged ₦4million as a loss to profit or loss.

**Required:**
Explain how the rules of derecognition of the financial assets will affect the portfolio of trade receivables in Royal Business Limited's financial statements.

(3 Marks)

c. During year 2021, Pelumi Limited invested in 800,000 shares in an NGX quoted company. The shares were purchased at ₦4.54 per share. The broker collected a commission of 1% on the transaction.

Pelumi Limited elected to measure their shares at fair value through other comprehensive income (FVTOCI).

The quoted share price as at December 31, 2021 was ₦4.22 to ₦4.26. Pelumi Limited decided to adopt a 'sale and buy back' strategy for the shares to realise a tax loss and therefore sold the shares at the market price on December 31, 2021 and bought the same quantity back the following day. The market price did not change on January 1, 2022. The broker collected 1% commission on both transactions.

**Required:**
Explain the IFRS 9 accounting treatment of the above shares in the financial statement of Pelumi Limited for the year ended December 31, 2021.
**Note:** Show relevant calculations. (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

a. Digital transformation in the finance and accounting industry was accelerated by the technological development following the COVID-19 pandemic which reshaped business models and organisations globally. For many organisations, the impetus to full digital adoption and transformation was major enablers for survivals and growth.

**Required:**
Identify and explain various ways in which finance executives can embrace digital transformation in accounting, financial and corporate reporting. (10 Marks)

b. Westham PLC is a multinational energy group recently quoted on (NGX) Nigerian Exchange Limited and London Stock Exchange (LSE). Among its many activities, the group operates an oil refinery in Nigeria, a nuclear waste disposal facility in South Africa and a coal extraction facility in Kenya.

The finance director of Westham PLC is aware that other companies in similar sector are including social responsibility and environmental reports as part of their corporate annual report.

**Required:**

i. Identify and explain the requirements for including this type of information in corporate annual reports in Nigeria. (2 Marks)

ii. Discuss the benefits of the publication of social and environmental reports. (3 Marks)

**(Total 15 Marks)**

## QUESTION 6

There is general acceptance that using traditional financial reporting as the sole measure of a company's performance and financial standing is a flawed approach. However, corporate sustainability report help to fill this gap but are not often linked to a company's strategy or financial performance and provide insufficient information on value creation.

Integrated reporting, is a new approach, which is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, leads to the creation of value in the short, medium and long term.

**Required:**

a. In the context of the above scenario, critically discuss the limitations of financial reporting and the extent to which integrated reporting might improve the usefulness of annual reports of companies. (11 Marks)

b. Identify the **FOUR** major aims of International Integrated Reporting Council (IIRC) in the evolution of corporate reporting. (4 Marks)

**(Total 15 Marks)**

## QUESTION 7

Roman Limited prepares its financial statements in accordance with International Accounting Standards. On March 16, 2017, Roman Limited made a public announcement of a decision to reduce the level of emission of harmful chemicals from its factories. The average useful life of the factories on March 31, 2017 was 25 years. The depreciation of the factories is computed on straight-line basis method and charged to cost of sales. The directors formulate the proposal for emission reduction following agreement in principle earlier in the year.

The directors prepared detailed estimates of the costs of their proposals and these showed that the following expenditure would be required:

₦60 million on March 31, 2018

₦60 million on March 31, 2019

₦80 million on March 31, 2020

All estimates were for actual anticipated cash payments. No contracts were entered into until after April 1, 2017. The estimate proved accurate as far as the expenditure due on March 31, 2018 was concerned. When the Directors decided to proceed with this project, they used discounted cash flow techniques to appraise the proposed investment. The annual discount rate was 8%. The company has a reputation of fulfilling its financial commitments after it has publicly announced them. Roman Limited has made a provision for the expected costs of its proposal in the financial statements for the year ended March 31, 2017.

In accordance with the provisions of IAS 37-Provisions, Contingent Liabilities and Contingent Assets.

**You are required to:**

a. Explain the decision of the directors of Roman Limited to recognise the provision in the statement of financial position as at March 31, 2017. (6 Marks)

b. Compute the appropriate provisions in the statement of financial position in respect of the proposed expenditure at March 31, 2017 and March 31, 2018. (4 Marks)

Compute the **TWO** components of the charge to statement of profit or loss in respect of the proposal for the year ended March 31, 2018. You should explain how each component arises and identify where in the statement of profit or loss each component is reported. (5 Marks)

**(Total 15 Marks)**

**SOLUTION 1**

## Sports Group

**Consolidated statement of financial position as at September 30, 2020**

| | |
|---|---|
| **Assets** | |
| **Non-current assets** | **₦'M** |
| Property, plant and equipment (1,840+ 600 + 620 + 178 + 72 – 36) | 3,274 |
| Investment in subsidiaries | |
| Investment in Handball PLC (96-96 + 101) (wk8) | 101 |
| Intangibles assets (396 + 60 + 70 – 54) wk7 – 18 (wk9) | 454 |
| Goodwill (wk3) | 380 |
| **Total non-current assets** | **4,209** |
| | |
| **Current assets** | |
| Current assets (1,790 + 960 + 500 – 98) | **3,152** |
| Discontinued operation (36+98-68) | **66** |
| **Total current assets** | **3,218** |
| | |
| **Total assets** | **7,427** |
| **Equity** | |
| Ordinary shares | 1,840 |
| Other components of equity (wk6) | 155.60 |
| Retained earnings (wk5) | 1,872.16 |
| Non-controlling interests (669.8 + 119.44) (wk4) | 789.24 |
| **Total equity** | **4,657.00** |
| | |
| **Non current liabilities** | |
| Non current liabilities (990+246+186) | **1,422** |
| | |
| **Total non current liabilities** | **1,422** |
| | |
| **Current liabilities** | |
| Current liabilities (816+ 256 + 276 – 6) | **1,342** |
| Discontinued operation (wk 10) | **6** |
| **Total current liabilities** | **1,348** |
| | |
| **Total equity and liabilities** | **7,427** |

**Working notes:**

1. **(SPORT PLC GROUP)**
**Group Structure**

**SPORT PLC**

**FOOTBALL PLC**

**VOLLEY BALL PLC**

Control 70%
NCI 30%
**Total 100%**

**Indirect Holding**

Control 56% (70% x 80%)
NCI 44%
**Total 100%**

2.
a. **Fair value of subsidiary net assets of Football PLC**

| | at Acquisition 01/10/2018 ₦'M | | at Reporting 30/09/2020 ₦'M |
|---|---|---|---|
| Ordinary shares | 800 | | 800 |
| Other components of equity | 54 | | 74 |
| Retained earnings | 638 | | 884 |
| Land fair value gain | 178 | | 178 |
| Fair value of net asset | 1,670 | | 1,936 |
| Post acquisition profit | | 266 | |
| Less other OCE shared between parent and NCI (74 -54) | | (20) | |
| **Post acquisition profit** | | **246** | |

b. **Fair value of subsidiary net assets of Volleyball PLC**

| | at Acquisition 01/10/2019 ₦'M | | at Reporting 30/09/2020 ₦'M |
|---|---|---|---|
| Ordinary shares | 400 | | 400 |
| Other components of equity | 40 | | 50 |
| Retained earnings | 212 | | 278 |
| Land fair value gain | 72 | | 72 |
| Fair value of net asset | 724 | | 800 |
| Post acquisition profit (800 -724) | | 76 | |
| Less other OCE shared between parent and NCI (50 – 40) | | (10) | |
| **Post acquisition profit** | | **66** | |

3.

a. **Goodwill of football PLC**

| | ₦'M |
|---|---|
| Purchase consideration | 1,460 |
| Fair value of NCI | 590 |
| Total purchase consideration | 2,050 |
| Less: Total fair value of net assets at acquisition | (1,670) |
| **Goodwill at acquisition date** | **380** |
| Impairment | - |
| **Goodwill at reporting date** | **380** |

b. **Goodwill of Volleyball PLC**

| | ₦'M |
|---|---|
| Purchase consideration | 640 |
| Indirect holding (640 x 30%) | (192) |
| Fair value of NCI | 322 |
| Total purchase consideration | 770 |
| Less: Total fair value of net asset at acquisition | (724) |
| **Goodwill at acquisition date** | **46** |
| Impairment wk 7 (100 – 46) = 54 to intangible assets | (46) |
| **Goodwill at reporting** | - |

**Note:** ₦54 million is the impairment losses attributable to intangible assets

4.

a. **Non controlling interests of football PLC**

| | ₦'M |
|---|---|
| Fair value of NCI | 590 |
| Share of OCE football PLC (74-54) = 20 x 30% | 6 |
| Share of profit wk2 (246 x 30%) | 73.8 |
| **Total** | **669.8** |

b. **Non controlling interests of football PLC**

| | ₦'M |
|---|---|
| Fair value of NCI | 322 |
| Indirect holding (640 x 30%) | (192) |
| OCE Volleyball PLC (50 - 40) = 10 x 44% | 4.4 |
| Share of impairment loss (100 x 44%) wk7 | (44) |
| Share of profit (66 x 44%) wk 2 | 29.04 |
| **Total** | 119.44 |

5. **Group retained earnings**

| | ₦'M |
|---|---|
| Parent retained earnings | 1,796 |
| Share of impairment loss (100 x 56%) (wk7) | (56) |
| Share of profit of Handball Associate (wk8) | 9 |
| Investigative and marketing costs of project (wk9) (14-4) | (18) |
| Impairment from discontinued operation (wk9) | (68) |
| Share of profit Football PLC (246 x 70%) | **172.2** |
| Share of profit Volleyball PLC (66 X 56%) | 36.96 |
| **Total** | **1,872.16** |

6. **Other components of equity**

| | ₦'M |
|---|---|
| OCE of parent in SOFP | 146 |
| Fair value gain of 14% investment in Handball (42-36) | (6) |
| Dividend paid by Handball (wk 8) | (4) |
| Share of other component of equity Football PLC (74-54) = 20 x 70% | 14 |
| Share of other component of equity Volleyball PLC (50-40) = 10 x 56% | 5.6 |
| **Total** | **155.60** |

7.
a. **Determination of impairment**

| | Football PLC | Volleyball PLC |
|---|---|---|
| | ₦'M | ₦'M |
| Total assets | 2,260 | 1,190 |
| Fair value adjustment | 178 | 72 |
| Unimpaired goodwill | 380 | 46 |
| Total carrying amount | 2,818 | 1,308 |
| Impairment loss (Wk 7b) | nil | (100) |
| Recoverable amounts | **2,850** | **1,2/08** |

b. **Allocation of impairment**

| | DR | CR |
|---|---|---|
| Retained earnings wk5 (100 x 56%) | **56** | |
| Non-controlling interests wk4 (100 x 44%) | **44** | |
| Goodwill of Volleyball PLC | | 46 |
| Intangible assets | | 54 |
| Total of impairment loses | **100** | **100** |

8. **Investment in Handball Plc**

| | | ₦'M | ₦'M |
|---|---|---|---|
| Cash consideration (01/10/2018) | | 36 | |
| increase in Fair value | | 6 | 42 |
| | | | |
| Fair value at 1/4/2020 | | | |
| Cash consideration (1/04/2020) | 16% | | 54 |
| **Total Cost of investment in Associate 30%** | | | **96** |
| Share of profit (60 x 30% x $^6/_{12}$ to $^R/_E$ ) wk5 | | | 9 |
| Dividend paid on 30/09/2020 | | | (4) |
| **Total of Investment in Associate (SOFP)** | | | **101** |

**Notes**

i. The investment had been designated as per IFRS 9-Financial instruments at fair value through other comprehensive income (FVTOCI).
The gain of ₦42m – ₦36m = ₦6m now realised is not reclassified to profit or loss for the year, but may be transferred as a movement in reserve from other components of equity (w6) to retained earnings (w5).

ii. The dividend should have been credited to Sport PLC's profit or loss for the year rather than to other comprehensive income. The associate is not impaired as the carrying amount in the separate financial statements of Sports PLC does not exceed carrying amount in the consolidated financial statements and the dividend does not exceed the total comprehensive income of the associate in the period in which it was declared.

9.

a. **Intangible assets**

| **Amount qualified for capitalisation:** | ₦'M |
|---|---|
| Purchase of patent | 20 |
| Cost of prototype created | 8 |
| Cost to put the product into condition for sale | 6 |
| **Total** | **34** |

b. **Cost to be expensed from intangible asset**

| | ₦'M |
|---|---|
| Cost on investigative phase of the project | 14 |
| Marketing cost | 4 |
| **Total to be expensed** | **18** |

| Journal | DR | CR |
|---|---|---|
| Retained earnings (wk5) | 18 | |
| Intangible asset SOPF | | 18 |

10a. **Discontinued operation**

| Carrying amount: | ₦'M |
|---|---|
| Property, plant and equipment (PPE) | 36 |
| Inventories | 98 |
| Trade payables | (6) |
| Total carrying amount | 128 |
| Impairment (**Balancing figure**) to **wk5** | (68) |
| Recoverable amount (realised) | 60 |

b. **Journal for discontinued operation**

| | DR | CR |
|---|---|---|
| | ₦'M | ₦'M |
| Property, plant and equipment (PPE) | | 36 |
| Inventories | | 98 |
| Current liability (Trade payables) | 6 | |
| Retained earnings (wk5) impairment | 68 | |
| Current asset last line as (discontinued operation) | 60 | |
| **Total** | **134** | **134** |

**Examiner's report**

The question tests candidates' knowledge of the preparation of consolidated statement of financial position and the adjustments on subsidiaries and associate. It also tests the principles of impairment of assets and discontinued operations on the major line of business.

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

The common pitfalls of the candidates were their inability to prepare correctly the necessary adjustments relating to the fair value of subsidiaries, net assets, computation of goodwill, non-controlling interests, determination of other components of equity and computation of impairment losses. Other candidates did not understand the adjustments required for discontinued operations.

Candidates are advised to pay more attention to the principles of various adjustments required for the preparation of the consolidated statement of financial position by practicing more questions and making use of ICAN Study Texts for better performance in future examinations.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| 1. | **Consolidated statement of financial position:** | | |
| | **Non-current assets:** | | |
| | Determination of property, plant and equipment | 2 | |
| | Determination of Investment in subsidiaries | 1 | |
| | Calculation of Intangible assets | 1½ | |
| | Determination of goodwill | 2¾ | 7¼ |
| | Determination of current assets | 1¼ | |
| | Calculation of discontinued operation | 3¾ | 5 |
| | Computation of equity | 1¾ | |
| | Ascertain that other components of equity | 1½ | |
| | Retained earnings | 2 | |
| | Calculation of non-controlling interest | 2¾ | 8 |
| | **Computation of non-current liabilities:** | | 1 |
| | Calculation of current liabilities | 1¼ | |
| | Computation of discontinued operation | 1 | 2¼ |
| | Computation of other adjustments: | | |
| | Determination of group structure | ¾ | |
| | Computation of fair value of subsidiary net asset- Football | 1¼ | |
| | Computation of fair value of subsidiary net asset Volleyball | 1¼ | |
| | Determination of impairment | 1¼ | |
| | Allocation of impairment | 1 | |
| | Calculation of investment in associate | 1 | 6½ |
| | **Total** | | **30** |

**SOLUTION 2**

a. From:

Financial analyst

To: Managing director

Subject: Analysis of performance of Mama-Kitchen PLC

**Introduction**

- On initial analysis, the information of the group indicates that the group has grown significantly during year 2023, as revenue increased by 29.5% [₦188,900m to ₦146,850m]. Also operating profit increased by 22.6% [from ₦13,050m to ₦16,000m].
- However additional information shows that there have been structural changes in the business with about 35% [30/115-30) x 100%] increase in the number of outlets that have been opened.
- These structural changes will need to be considered in determining the performance of the business.
- Also the statement of cash flows shows a strong operating cash flow, however, these cash flows are being re-invested in the new outlets openings (through capital expenditure). The group's objective is to limit its new debt financing but this may be hindering the availability of distribution of dividends to investors.

**Profitability**

- The revenue has grown by 29.5% during the year for existing outlets. However, the real rate of growth may be lower than this as some outlets may have only been open for part of the previous year (i.e. 2023 is first full year of opening).
- A rate of organic growth of 3.2% in existing outlets is disappointing and below the industry average of 4.1%. It may be that Mama-Kitchen only operates in this industry which has a different growth rate that management are concentrating on new outlets.
- Also, gross profit margin has grown year-on-year, from 24.3% to 25%. However, the segmental analysis shows that gross profit margin from existing outlets have only improved marginally. This could be due to:
  - The location of the new outlets;
  - Strong promotional activities for the new outlets in their initial phase;
  - Old outlets require refitting or advertising supports; and
  - Management focusing on new outlets to the detriment of the old ones.
- Mama-Kitchen PLC has a reputation for under depreciating assets, some support for this is indicated by the losses on disposal in both years (see statement of cash flows). The depreciation rates are inconsequential when considering the cash flows which is strong.

- Non-current assets turnover supports the assertion that management has managed the assets well as it has improved, year to year
- Finance cost in the statement of profit or loss have reduced by ₦50m, but the statement of cash flows shows that net borrowings have increased by ₦3,250million.

**Cash flows**

- The improvement in ROCE is supported by the increase in cash return on capital employed to 40.2%. As expected, it is higher than ROCE as the ratio has taken into account depreciation and amortisation.
- The cash flows show that the quality of operating profit is strong. Cash generated from operations as a percentage of profit from operations is over 200% and improving year on year.
- The current ratio is low at 0.56:1 but this may not be unusual in an industry where customers will pay cash for their products and cashflow will be almost immediate. However, cash is high and probably inventory which may include a high payable balance.
- Trade payable period has fallen but the absolute amount of trade payable has increased. This may be due to expansion of the business. Trade payables will be principal for some goods and possibly lease rentals. It may also be due to changes in payment pattern as the number of outlets expands.

**Investors ratios**

- EPS has grown by 25.8% $\left[\frac{26.8-21.3}{21.3}\right]\%$ but diluted EPS has only increased by 10.4% $\left[\frac{21.2-19.2}{19.2}\right]\%$. This is potentially a concern. There appeared to be some diluting instruments in issue that are having potential adverse effects on future earnings. This could affect the future movement in market price.
- Also P/E ratio has fallen. This may be in line with general trends in share price or may be as a result of investors' disappointment. The company is not paying dividends and the investing public may be unhappy about this. The policy of reinvestment of cash flows limits dividend payments without taking more debts.

**Matters for further investigations**

- Further analysis of revenue may be required in relation to opening of new outlets.
- Locations of the new outlets opened in order to understand the reasons for the higher margin on new against old outlets.

- Non-current asset disclosure information – to determine depreciation and amortisation policies and overall effect on profitability.
- Analysis of capital expenditure between new and old outlets.
- Dividend policy – shareholders will pressurise for payment of dividend.
- Detailed future outlets opening and plan for additional capital expenditure.
- Details of administrative costs or changes to ascertain the employee cost in several of the types of business that is labour intensive.
- Details of the potential diluting financial instruments that might have affected the future EPS.

b. **Payment of Dividend**

- Distributable profits are described as accumulated realised profit less accumulated realised loss of an entity. They are usually accumulated in retained earnings of companies.
- However, the legality of dividends distribution is determined by the distributable profit in the separate financial statements (of single company) rather than the consolidated retained earnings.
- A company may have debit balance in its consolidated retained earnings (due to losses of some subsidiaries companies) but it may have a credit balance in its own retained earnings which may allow for dividend payment to the parent company's shareholders.
- Therefore the colleague's comment is incorrect and further investigation is needed to determine why no dividends have been paid or proposed.

c. **Usefulness and limitations of diluted earnings per share (diluted EPS)**

**Usefulness:**

i. The information helps users of financial statements to make predictions of future earnings and cash flows.

ii. The diluted EPS disclosure provides additional information regarding the future of basic EPS amount, in that it relates current earnings to a possible future capital structure.

iii. The diluted EPS figures shows how current earnings of a company as adjusted for any profit effect of the issue of the new shares would be diluted or shared amongst the future potential new shares as well as the current shares. This gives the current shareholders an idea of the effect these dilutive financial instruments could have on their shareholdings in the future.

**Limitations:**

i. The diluted EPS is based upon the current earnings figure, as adjusted for any profit effects of the issue of the new shares. This earnings figure, may not be relevant in future years. What is more important is the level of the earnings at the time conversion actually takes place.

ii. Also, the calculation assumes a worst case scenario, that all potential diluting financial instruments will be exercised. However, future events do not unfold like this. For example, holders of a convertible debt may choose to redeem rather than convert their debts or share options issued may lapse, if the holders leave the company or there are adverse future movements in the share price.

**Examiner's report**

Part (a) of the question tests candidates' knowledge of report writing after computation of the relevant ratios such as profitability, cash flows and investors ratios. They are also requested to identity and justify matters that will require further investigations from the ratios computed. Part (b) of the question tests candidates' knowledge on why dividends are not paid from the debit balance of consolidated retained earnings, while part (c) of the question tests candidates' knowledge on the usefulness and limitations of diluted earnings per share information to investors.

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

The common pitfalls of the candidates were their inability to carry out analysis and interpretation of the results. Others could not correctly state the reasons why dividends can be paid despite a debit balance in the consolidated retained earnings of the group. Also, some candidates do not know the usefulness and limitations of diluted earnings per share information to investors.

Candidates are advised to ensure that they practice more past questions on ratio analysis. They should also get familiar with the presentation format of report writing.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | Introduction | 1½ | |
| | Report on profitability | 4 | |
| | Report on cash flows | 2½ | |
| | Report on investors ratios | 2½ | |
| | Explaining matters for further investigations | 2½ | 13 |
| b. | Explanation on payments of dividends | | 4 |
| c. | Explaining the usefulness of diluted earnings per share | 1½ | |
| | Limitations of diluted earnings per share | 1½ | 3 |
| | **Total** | | **20** |

## SOLUTION 3

a. **Aggregation of operating segments**

IFRS 8 - Operating Segments requires quoted companies to disclose information about their different operating segments, in order to allow users of the financial statements to gain a better understanding of the company's financial position and performance.

IFRS 8 defines an operating segment as a component of an entity:

- that engages in business activities from which it earns revenues and incurs expenses;
- whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and
- for which discrete financial information is available.

**Quantitative thresholds**

An entity must report separately information about an operating segment that meets any of the following quantitative thresholds:

- Its reported revenue, including external sales and intersegment sales is 10% or more of the combined internal and external revenue of all operating segments;
- Its reported profits is 10% or more of the greater of the combined profit of all segments that did not report a loss and combined reporting loss of all segments that reported a loss; and
- Its assets are 10% or more of the combined assets of all operating segments.

**Reportable Segments**

An entity must report separately information about each operating segment that:

- Has been identified in accordance with the definition of an operating segment shown above;
- Or is aggregated with another segment; and
- Or exceeds the quantitative thresholds.

**Aggregation of Segments**

Two or more operating segments may be aggregated into a single operating segment if they have similar economic characteristics, and the segments are similar in each of the following respects:

i. The nature of the products and services;
ii. The nature of the production process;
iii. The type or class of customer for their products and services;
iv. The methods used to distribute their products or provide their services; and

v. If applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

Aggregating operating segments A and B on the basis of their similar basic features and the nature of their goods and services seems to be in order, but the customers for the goods and services are different. Therefore, this aggregation may not be permitted under IFRS 8 due to the following reasons:

i. While the goods and services are the same or similar, the customers for those goods and services are different. Therefore, the third aggregation criterion has not been met;

ii. In the local market, the company is not exposed to passenger revenue risk, since a contract is awarded by competitive tender. In contrast, in the inter-city train market, the company is exposed to passenger revenue risk, as it sets prices which customer may or may not choose to pay;

iii. Fifth criterion, regulatory environment, is not met, since the local authority is imposing different set of rules to that which applies in the inter-city market; and

iv. In conclusion, the two segments have different economic features and so should be reported as separate segments rather than aggregated.

b. The applicable standard here is IAS 16-Property, Plant and Equipment. IAS 16 states that the cost of an item of property, plant and equipment should be recognised when these two conditions are met:

i. It is probable that future economic benefit associated with the item will flow to the entity; and
ii. The cost of the item can be measured reliably.

These conditions are normally met when the risks and rewards have been transferred to the company, and they may be assumed to be transferred when the contract is unconditional and irrevocable.

- As at July 31, 2019, the condition of use has not been complied with and Puppsy PLC is yet to take possession of the building.
- The building may however, be recognised in the year ended July 31, 2020, as the conditions of donation were fulfilled in August 2019.
- The fair value of the building of ₦7.5million must be recognised as income in the profit or loss for the year, as it was a gift.
- The renovation and adaptation cost must also be included as part of the cost of the asset in the statement of financial position, because according to IAS 16, the cost of asset includes directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in a manner intended by management.

The transactions are to be recorded as follows:

| | | ₦'m | ₦'m |
|---|---|---|---|
| Debit | Property, plant and equipment | 10,000 | |
| Credit | Profit or loss for the year | | 7,500 |
| Credit | Cash/Bank/payables | | 2,500 |

## Examiner's report

Part (a) of the question tests candidates' knowledge on the aggregation of operating segments based on its economic characteristics, while part (b) tests the identification of applicable accounting standards to a practical scenario and the accounting treatments required for recognition of costs under IAS 16, as well as risks and rewards associated with the recognition of costs.

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

The commonest pitfall of the candidates was lack of understanding of the requirements of the question as it relates to real life situation under IAS 16-Property, Plant and Equipments.

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

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **Advice to Puppsy PLC on the following:** | | |
| | Aggregation of operating segments | 2 | |
| | Information on quantitative thresholds | 1½ | |
| | Report on reportable segments | 1½ | |
| | Economic characteristics of aggregating operating segments | 3 | |
| | Advice why aggregation may not be permitted under IFRS | 2 | 10 |
| b. | **Advice on how relevant accounting issues should be dealt with:** | | |
| | Identification of applicable accounting standard | 1 | |
| | Identification of two conditions to be met for recognition of cost | 2 | |
| | Highlighting the risks and rewards applicable to Puppsy PLC | 5 | |
| | Correct Journal entries to record the transactions | 3 | 10 |
| | **Total** | | 20 |

## SOLUTION 4

a. The rules of IFRS 9 provides guidance on when and how financial assets should be derecognised with the aim of ensuring that financial assets are derecognised when the transfer of rights and risks occur, providing transparent and accurate reporting of an entity's financial position. Therefore, in accordance with IFRS 9 provisions, financial asset can only be derecognised under the following conditions:

   i. **Contractual right to receive cash flows:** Derecognition generally occurs when an entity no longer has the contractual rights to receive cash flows from a financial asset. Transfer or loss of contractual right to receive cash flows can happen through a sale, securitisation, or other forms of transfer;

   ii. **Transferring of substantial risks and rewards:** If an entity retains substantially all the risks and rewards associated with a financial asset despite transferring the contractual rights, derecognition is not appropriate. In such cases, the asset continues to be recognised on the entity's statement of financial position. Therefore, for derecognition, the entity must have transferred the risks and rewards attributed to the financial asset. When determining whether an entity retains significant risks and rewards, factors such as the extent of exposure to losses or benefits, the variability in possible outcomes and the entity's ability to control the risks and rewards are considered;

   iii. **Loss of control**: Derecognition may also occur when the entity no longer has control over the financial asset. This typically involves transferring the financial asset to a third party and relinquishing control over it;

   iv. **Continuing involvement**: In certain cases, even if control is lost, the company may have continuing involvement in the financial asset. In such scenarios, the asset may still be recognised, either fully or partially, on the statement of financial position of the company;

   v. Exchange of the financial asset with another asset or liability;

   vi. Conversion of the financial asset to equity item e.g ordinary shares; and

   vii. **Other specific circumstances and scenarios:** The specific circumstances surrounding each transaction need to be carefully evaluated to determine if derecognition is appropriate. Additionally, IFRS 9 provides further guidance on specific scenarios, such as repurchase agreements and collateralised financing transactions, to determine the appropriate derecognition treatment.

b. In this scenario, Royal Business Limited (RBL) entered into a factoring agreement with Hexlinks Bank Limited (HBL) to transfer the receivables in exchange for ₦36 million in cash. The rules of derecognition of financial assets will have an impact on the portfolio of trade receivables in Royal Business Limited's financial statements. The rules of derecognition will affect RBL's financial statements in the following ways:

i. **Initial derecognition**:
When RBL transferred the trade receivables to HBL, it derecognised them from its financial statements. This means that the carrying amount of ₦40 million is removed from RBL's statement of financial position, and there is a loss of ₦4 million recognised in profit or loss;

ii. **Continued involvement and potential liability:**
Although RBL has transferred the receivables, it has agreed to reimburse HBL for any shortfall between the amount collected and ₦36 million. This means that RBL has retained a potential liability related to the receivables. However, the exact accounting treatment for this potential liability depends on the terms of the factoring agreement and the specific guidance outlined in the accounting standards;

iii. **Subsequent repayment:**
Once the receivables are collected, any amount above ₦36 million, less interest, will be repaid to RBL. This repayment would typically be recognised as a separate transaction, such as a cash inflow or a reduction in the liability owed to HBL; and

iv. It is important to note that the specific accounting treatment of the factoring agreement and subsequent repayment will depend on the applicable accounting standards, such as IFRS or GAAP, and the specific terms of the agreement.

In conclusion, derecognition of the trade receivables in RBL's financial statements removes the assets from the statement of financial position and the loss is recognised in profit or loss. However, RBL's potential liability and subsequent repayment arrangement with HBL may require additional analysis and consideration based on the applicable accounting standards.

**c. Accounting treatments of share transactions in the financial statements of Pelumi Company Limited as at December 31, 2021**

i. The shares are initially measured at fair value (the purchase price plus the transaction cost (₦800,000 x ₦4.54k) = ₦3, 632,000 + (₦3, 632,000 x 1%)
= ₦3,668,320

ii. The investment is derecognised on December 31. The fact that the same quantity of shares are repurchased the next day does not prevent derecognition since the company has no obligation to repurchase them. Therefore, the risks and rewards of ownership are not retained.

iii. Immediately before derecognition, a loss is recognised in other comprehensive income as the company elected to hold the investment at fair value through other comprehensive income and the investment must be re-measured to fair value at the date of derecognition – (IFRS 9)

i.e. [₦800, 000 x ₦4.22k bid price] = ₦3, 376,000
less initial cost
= (₦3, 668, 320)
loss = (₦292,320)

iv. Transaction cost on sales =(₦3,376,000 x 1%) = (₦33, 760) are recognised in profit or loss.

## Examiner's report

The question tests candidates' knowledge of the rules of IFRS 9 - Financial Instruments relating to derecognition of financial assets in part (a), while part (b) tests application of the rules of the derecognition and how they will affect the portfolio of trade receivables in financial statements and part (c) tests candidates' knowledge of the accounting treatments of share transactions in the financial statements.

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

The commonest pitfall of the candidates was their lack of understanding of the provisions of IFRS 9 as it relates to derecognition of financial assets.

Candidates are advised to carry out in-depth study to cover all areas of the syllabus, practice more past questions and pay attention to relevant accounting standards that are examinable at this level of the Institutes' examination. They should also use ICAN Study Texts for better performance in future examinations.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **IFRS 9 provisions on when and how financial assets should be derecognised:** | | |
| | Identification of five (5) provisions | 2½ | |
| | Discussion of the five provisions identified | 7½ | 10 |
| b. | Explanation of rules of derecognising of financial assets. | 2½ | 4 |
| | Conclusion on derecognition in the financial statements | ½ | 3 |
| c. | Treatment of shares transactions in the financial statements. | | 7 |
| | **Total** | | **20** |

## SOLUTION 5

a. Below are some of the various ways in which finance executive can embrace digital transformation in accounting, financial and corporate reporting:

  i. **Automation**: Automated accounting refers to the use of technology and software to automate various accounting tasks and processes. It involves using software applications and systems to perform tasks like data entry, accounts reconciliation, financial data updates, and preparation of financial statements. This allows for more value-added focus on financial data analysis and strategic decision making activities;

  ii. **Data analytics**: Data analytics are used by accountants to do things like discern patterns in customer spending, identify market behaviour, anticipate trends and predict regulatory reactions. Accountants who specialise in data analytics manage, analyse and mine multiple streams of data;

  iii. **Cloud computing**: Cloud computing is a catch-all term for software, storage and services delivered through the internet. A business owner, benefits by taking advantage of computing power that's outside the business using it to cut costs, increase flexibility and control. It allows for information sharing, improved efficiency and streamlining processes;

  iv. **Blockchain technology**: Blockchain is a decentralised, distributed ledger that focuses on the ownership and transfer of assets. It records transactional data in a way that is almost impossible to manipulate. Blocks of transactional data connect in chronological order;

  v. **Artificial Intelligence (AI)**: This refers to the use of artificial intelligence (AI) technologies, such as machine learning algorithms and natural language processing to automate and enhance various accounting processes. This includes tasks such as financial reporting, audit and compliance, fraud detection, and data analysis. For instance, intelligent chat bots can handle routine inquiries, predictive analytics and risk management; and

  vi. **Streamlining reporting processes:** Digital transformation enables finance executives to streamline their reporting processes by leveraging tools like data visualisation and reporting software, generate insightful reports efficiently, minimise manual errors and improve the accuracy of financial statements.

b. i. Requirements for including social responsibility and environmental information in corporate annual reports in Nigeria include the following:

  - **Nigerian Code of Corporate Governance:** The Nigerian Code of Corporate Governance provides guidelines for companies to disclose information relating to social responsibility and environmental practices. It encourages companies to report on their policies, initiatives, and performance in these areas;

- **Companies and Allied Matters Act Cap. C20, Law of the Federal Republic of Nigeria 2020 (as amended) (CAMA):** CAMA requires companies to include in their annual reports information on social responsibility and environmental practices, including policies and measures taken to mitigate environmental impact;

- **Nigerian Exchange Limited (NGX) listing requirements:** The NGX requires listed companies to comply with sustainable business practices. It encourages companies to disclose social and environmental information in their annual reports, promoting transparency and accountability; and

- **Global Reporting Initiative (GRI) standards**: Many companies in Nigeria choose to adopt international standards, such as the GRI Standards, for reporting social responsibility and environmental information in their annual reports. These guidelines provide a comprehensive framework for reporting on sustainability and related topics.

ii. The benefits of the publication of social and environmental reports are:

- **Enhanced reputation and stakeholder trust:** Social and environmental reports demonstrate a company's commitment to responsible business practices. Publishing such reports can help build trust and enhance the reputation of the company among stakeholders, including customers, investors and the general public;

- **Improved risk management:** Social and environmental reports highlight potential risks associated with a company's operations. By disclosing these risks, companies can proactively address them and implement measures to mitigate environmental impacts, reducing legal and reputational risks;

- **Increased access to capital:** Investors are increasingly considering social and environmental factors when making investment decisions. By publishing social and environmental reports, companies can attract socially responsible investors and access capital from sources that prioritise sustainable business practices;

- **Competitiveness and market differentiation:** Companies that include social and environmental information in their annual reports can gain a competitive advantage by differentiating themselves as being socially responsible and environmentally conscious. This can lead to increased market share and customer loyalty; and

- **Regulatory compliance and stakeholders' expectations:** Publishing social and environmental reports helps companies meet regulatory requirements and aligns with the growing expectations of stakeholders who are demanding transparency and accountability.

By including social responsibility and environmental information in their annual reports in Nigeria, companies like Westham PLC can demonstrate their commitment to sustainable practices, gain a competitive edge and contribute to the overall well-being of the society.

**Examiner's report**

Part (a) of the question tests candidates' knowledge of ways in which finance executives can embrace digital transformation in accounting, financial and corporate reporting, while part (b) of the question tests candidates' knowledge of legal and regulatory requirements for including social and environmental information in corporate annual reports and the benefits of such publications.

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 information required in a logical sequence. They were not able to identify and explain details of information requirements in a corporate 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 examinations.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | **Ways by which finance executives can embrace digital transformation in accounting, financial and corporate reporting:** | | |
| | Identification of five (5) digital transformations | 2½ | |
| | Explanation of the five (5) digital transformations identified | 7½ | 10 |
| b i. | **Requirements for including social responsibility and environmental information in corporate annual reports in Nigeria** | | |
| | Identifying and explaining four (4) of such requirements | | 2 |
| ii. | Identify and explain six(6) benefits of the publications | | 3 |
| | **Total** | | **15** |

## SOLUTION 6

a. Financial reporting plays a crucial role in providing information about a company's financial performance and position. However, it has certain limitations. Integrated reporting is an approach that seeks to address some of these limitations by providing a more holistic view of a company's value creation, incorporating not only financial but also environmental, social and governance (ESG) factors.

**The limitations of financial reporting under IFRS are as follows:**

i. It focuses on single economic bottom line that is, profit;
ii. Financial reporting ignores social and environmental externalities;
iii. Financial accounting has myopic focus on information needs of suppliers of capital and those making resources allocation decisions;
iv. Materiality is used to make decisions as to whether to include items in financial statements or not;
v. Discounting of future liabilities for inclusion in financial statements or impairment testing does not align with providing for environmental and social impacts;
vi. Financial reporting uses subjectivity and estimates for example allowance for bad debts and the valuation of assets, which can vary between companies and may not truly reflect the economic reality;
vii. Financial accounting requires professional judgment and includes subjectivity which can reduce comparability;
viii. There is no consistency or comparability disclosures based on legitimacy;
ix. Financial reports primarily focus on historical data, providing a snapshot of the company's financial performance in the past. This limits their ability to provide insights into future prospects or risks; and
x. Many valuable assets of a company such as brand reputation, employee skills or intellectual property, are intangible and may not be adequately represented in traditional financial statements.

**Integrated reporting, on the other hand, might improve usefulness of annual report of companies in the following ways:**

i. **Holistic view of performance:** Integrated reporting encourages companies to provide a comprehensive view of their performance by integrating financial and non-financial information. This enables stakeholders to understand the broader impact of the company on various capitals, including financial, human, social and natural.
ii. **Long-term value creation:** Integrated reporting emphasises the creation of long-term sustainable value. By considering environmental, social and

governance (ESG) factors, companies can better communicate their strategies for managing risks and opportunities that impact both financial and non-financial aspects.

iii. **Enhanced transparency:** Integrated reporting encourages greater transparency by requiring companies to disclose not only the positive aspects but also the challenges they face. This can build trust and credibility with stakeholders;

iv. **Stakeholder engagement:** Integrated reporting promotes dialogue with various stakeholders. By understanding the needs and expectations of stakeholders, companies can tailor their reporting to be more relevant and useful to a diverse audience.

v. **Forward-looking information:** Integrated reporting encourages companies to provide insights into their future strategy and how they are adapting to emerging trends and challenges, addressing the historical focus of traditional financial reporting.

vi. **Alignment with Global Reporting Initiatives:** Integrated reporting aligns with global reporting initiatives (GRI) such as the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD), providing a more standardised approach to reporting.

b. The International Integrated Reporting Council (IIRC) has played a significant role in promoting integrated reporting, which seeks to provide a more comprehensive view of a company's value creation. The IIRC has outlined several aims in the evolution of corporate reporting. However, here are the four major aims of the IIRC:

i. **Integration of financial and non-financial information:** The IIRC aims to encourage companies to integrate financial and non-financial information in their reporting. This involves presenting a cohesive and interconnected view of how various forms of capital, including financial, human, social and natural, contribute to the organisation's ability to create value over time.

ii. **Emphasis on long-term value creation:** The IIRC emphasises the importance of reporting that focuses on the long-term sustainability of the business. Integrated reporting encourages companies to move beyond short-term financial performance and consider the broader impacts of their activities on both internal and external stakeholders.

iii. **Enhanced communication and transparency:** The IIRC aims to improve communication between companies and their stakeholders by promoting transparency and clarity in reporting. Integrated reporting is designed to be more accessible to a wide range of stakeholders, providing a clearer understanding of a company's strategy, governance, performance and prospects.

iv. **Consistency and global alignment:** The IIRC works towards achieving consistency and global alignment in integrated reporting practices. This involves collaborating with various stakeholders, standard-setting organisations and regulators to develop a common framework and language for integrated reporting that can be applied globally.

**Examiner's report**

Part (a) of the question tests candidates' knowledge of the limitations of financial reporting and the extent to which integrated reporting might improve the usefulness of annual reports of companies. While part (b) tests candidate's knowledge of the major aims of International Integrated Reporting Council (IIRC).

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

The commonest pitfall of the candidates was their lack of understanding of ways by which integrated reporting might improve the usefulness of annual reports of companies and lack of full knowledge of the aims of IIRC.

Candidates are advised to pay more attention to all aspects of the syllabus, particularly the areas that relates to contemporary issues in corporate financial reporting for better performance in the Institutes future examinations.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | Limitations of financial reporting under IFRS | | |
| | Six (6) limitation discussed | 6 | |
| | Ways by which integrated reporting will improve usefulness of annual report of companies | 5 | 11 |
| | Five (5) points discussed | | |
| b. | Identification four (4) major aims of International Integrated Reporting Council (IIRC) in the evolution of corporate reporting | | 4 |
| | **Total** | | 15 |

**SOLUTION 7**

**Decision of the directors to recognise provision for emission reduction cost in the statement of financial position**

a. The scenario in Roman Limited is based on IAS 37- Provisions, Contingent Liabilities and Contingent Assets. IAS 37 states that provision is a liability of uncertain timing and amount, therefore it can only be provided for. If an organisation satisfies the criteria below:

   i. Contractual or legal obligations exist;
   ii. If it can be measured reliably; and

iii. If it is probable that there will be an outflow of economic benefits.

In line with Roman Limited management of their decision to reduce factory emission and decision to recognise provision in financial statement at the year ended December 31, 2017 despite that the contract will be signed on April 1, 2017. It can be established that:

i. The announcement was made on March 16, 2017 although contact was not signed yet, contractual obligation exists due to their good corporate governance and practice to reduce emission;
ii. It can be measured reliably based on estimated value stated by the organisation taking into consideration time value of money; and
iii. There will surely be an outflow of economic benefits.

The decision of management validates the prudency concept that all known losses must be provided for, therefore, the management will make the following accounting entries.

Debit - Profit or Loss account
Credit - Statement of financial position (SOFP); with discounted cash flow as at

March 31, 2017.

**Conclusion**

Two of the conditions in IAS 37 are very clearly met. Roman Limited will incur expenditure, that is transfer of economic benefits is virtually certain and the directors have prepared detailed estimates of the amount. Although, Roman Limited is not legally obliged to carry out the project, it appears it has, a constructive obligation to do so. IAS 37 states that an entity has a constructive obligation if both of the following conditions apply:

i. It has indicated to other parties that it will accept certain responsibility by an established pattern of past practice or published policies; and
ii. As a result, it has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
Roman Limited has a reputation of fulfilling its financial commitments once they have been publicly announced. Therefore, the obligating event is the announcement of the proposal on March 16, 2017. The obligation exists as at March 31, 2017 and Roman Limited is required to recognise provision.

b. **Computation provisions as at March 31, 2017**

| | Amount (₦) | DCF | NPV (₦) |
|---|---|---|---|
| 2018 | 60,000 | 0.9259259 | 55,556 |
| 2019 | 60,000 | 0.8573388 | 51 ,440 |
| 2020 | 80,000 | 0.7938322 | 63,507 |
| | | | **170,503** |

Journal

| | | | |
|---|---|---|---|
| Dr | Profit or loss | 170,503 | |
| Cr | Provisions (non-current liability) | | 114,947 |
| Cr | Provisions (Current liability) | | 55,556 |

**Computation of provisions as at March 31, 2018**

| | Amount | DCF | NPV |
|---|---|---|---|
| Year | ₦ | ₦ | ₦ |
| 2018 | 60,000 | 1 | 60,000 |
| 2019 | 60,000 | 0.9259259 | 55,556 |
| 2020 | 80,000 | 0.8573388 | 68,587 |
| | | | **184,143** |

Journal

| | | | |
|---|---|---|---|
| Dr | Profit or Loss | 13,640 | |
| Cr | Provision | | 13,640 |

Tutorial 8% x 170,503 = ₦13,640

c. The charges to income statement for the year ended March 31, 2018 comprise:

i. Depreciation (₦170,500,000/25) = **₦6,820,000**

This is to be reported in cost of sale.

The provision of ₦170, 500,000 also represents an asset, as it gives rise to future economic benefits. This is capitalised and depreciated over 25 years that is, average useful life of the factories.

ii. Unwinding of the discount expenditure:

| | | ₦'000 |
|---|---|---|
| March 31, 2018 | (60,000 – 55,556) | 4,444 |
| March 31, 2019 | (55,556 – 51,440) | 4,116 |
| March 31,2020 | ( 68,587 – 63,507) | 5,080 |
| | | 13,640 |

**Examiner's report**

Part (a) of the question tests candidates' understanding the provisions of IAS 37- Provisions, Contingent Liabilities and Contingent Assets on the recognition of provisions in the statement of financial position. Part (b) of the question tests candidates' knowledge of computation of the provisions, while part (c) of the question tests candidates' knowledge of accounting treatment of the provisions in the financial statements.

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

Common pitfalls of the candidates were inadequate knowledge of the provisions of IAS 37, poor understanding of how to compute appropriate provisions and their accounting treatments in the financial statements.

Candidates are advised to understand the requirements of all the accounting standards that are examinable at this level of the Institute's examination. They should also be familiar with ICAN Study Texts for better performance in the Institute's future examinations.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | **Recognition of provisions in the statement of financial position:** | | |
| | Identification of the three (3) criteria to be satisfied | 1½ | |
| | Discussion and application of the criteria | 3 | |
| | Accounting entries for the provisions | 1 | |
| | Conclusion on the recognition of the provision | ½ | 6 |
| b. | Computation of the appropriate provisions in the financial statements. | | |
| c. | Computation of two components of charges to statements of profit or loss. | | 5 |
| | **Total** | | 15 |

ICAN/232/V/C4 Examination No..........................

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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, NOVEMBER 14, 2023**

**DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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

Paper World Nigeria Limited, Ibadan, a manufacturer of paper pulp, paper and paperboard, was granted a pioneer certificate by the Federal Government on May 1, 2017, for an initial period of three years. As a result of unfavourable business climate (which resulted in poor financial performances); and several interference by officials of the Ministry of Industry, particularly on issues relating to dividend policy, treatment of losses, and capital allowances, the company did not apply for an extension to the pioneer status.

The company had the following statements for the first three years of operations:

| (i) | **Year ended** | **April 30, 2018** | **April 30, 2019** | **April 30, 2020** |
|---|---|---|---|---|
| | | **₦'000** | **₦'000** | **₦'000** |
| | Net loss | (28,700) | (25,500) | (20,200) |
| | After charging: | | | |
| | Salaries and wages | 15,300 | 16,100 | 17,360 |
| | Transport and traveling | 1,100 | 1,700 | 1,820 |
| | Depreciation | 6,800 | 7,530 | 8,600 |
| | Rent and rates | 1,200 | 1,400 | 1,500 |
| | Donations to social clubs | 100 | 0 | 250 |
| | Allowance for doubtful debts: | | | |
| | Specific | 1,400 | 1,200 | 1,500 |
| | General | 1,850 | 1,750 | 1,800 |
| | General expenses | 1,650 | 1,820 | 1,900 |

(ii) The following qualifying capital expenditure (QCE) items acquired during the pioneer period were certified by the Federal Inland Revenue Service (FIRS) as at the end of the pioneer period:

(iii)

| **QCE** | **Number of Items** | **Amount ₦'000** |
|---|---|---|
| Non-industrial building | 1 | 10,000 |
| Industrial building | 1 | 25,600 |
| Manufacturing industrial plants | 2 | 12,600 |
| Furniture and fittings | 8 | 3,400 |
| Motor vehicles | 2 | 4,000 |

Additional QCEs acquired:

| **QCE** | **Number of Items** | **Amount ₦'000** | **Date of Acquisition** |
|---|---|---|---|
| Furniture and fittings | 2 | 500 | June 12, 2020 |
| Motor vehicles | 1 | 2,200 | March 7, 2021 |

(iv) Operational result:

During the year ended April 30, 2021, the company's records revealed the following:

| | **₦'000** | **₦'000** |
|---|---|---|
| Turnover | | 102,500 |
| Dividend income (grossed up) | | 1,200 |
| Other operating income | | 800 |
| | | 104,500 |
| Deduct: | | |
| Salaries and wages | 39,600 | |
| Repairs and maintenance | 3,500 | |
| Depreciation | 15,300 | |
| Rents and rates | 6,800 | |
| General and administrative expenses | 9,970 | |
| Legal fees | 2,500 | |
| Audit and accountancy fees | 3,200 | |
| Allowance for doubtful debts | 6,600 | |
| Bank charges | 2,100 | 89,570 |
| Net profits | | **14,930** |

**The following additional information in respect of the operational result was provided:**

(v) Dividend income was from equity shares acquired from a Nigerian listed company.

(vi) Repairs and maintenance was made up of:

| | ₦'000 |
|---|---|
| Repairs of manufacturing industrial plant | 1,500 |
| Maintenance of motor vehicles | 800 |
| Improvement to non-industrial building | 1,200 |
| | 3,500 |

(vii) General and administrative expenses comprised:

| | ₦'000 |
|---|---|
| Transport and traveling | 3,750 |
| Advertisement | 4,920 |
| Transfer to revenue reserve | 1,300 |
| | **9,970** |

(viii) Legal fees consisted of:

| | ₦'000 |
|---|---|
| Collection of trade debts | 1,100 |
| Fine for late filing and payment of tax | 50 |
| Legal expenses on new issue of shares | 1,350 |
| | **2,500** |

(ix) Allowance for doubtful debts included:

| | ₦'000 |
|---|---|
| Bad debts written off | 2,800 |
| Specific provision | 2,500 |
| General provision | 3,700 |
| Bad debts recovered | (2,400) |
| | **6,600** |

**Required:**

As the company's newly appointed Tax Consultant, you are required to prepare a report to the Managing Director stating the:

a. Adjusted profits for the relevant periods (13 Marks)
b. Tax liabilities payable for the relevant assessment year (11 Marks)
c. Provisions of the Industrial Development (Income Tax Relief) Act 2007 (as amended) in respect of a pioneer company's:

   i. Dividend payment (2 Marks)
   ii. Losses made during the pioneer period (2 Marks)
   iii. Capital allowances for qualifying capital expenditure acquired during the pioneer period (2 Marks)

**(Total 30 Marks)**

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

### QUESTION 2

Brass Petroleum Producing Company Limited has been operating as an oil prospecting company in Nigeria for fifteen years. The company operates in both onshore and shallow water in the Koko area of Niger Delta region.

Following the provisions of the Petroleum Industry Act 2021, the company applied for, and was granted a petroleum prospecting license (PPL) on January 1, 2021.

Extracts from the company's financial records for the year ended December 31, 2021 revealed the following:

| | ₦'million | ₦'million |
|---|---|---|
| **Revenue:** | | |
| Value of crude oil sold | | 184,450 |
| Value of condensate from associated gas sold | | 47,175 |
| Value of natural gas liquid from associated gas sold | | 41,650 |
| Gross revenue | | 273,275 |
| Balancing charge | | 32 |
| | | 273,307 |
| **Deduct:** | | |
| Production cost | 106,470 | |
| Cost of gas reinjection wells | 600 | |
| Drilling cost incurred | 4,360 | |
| Depreciation of plant, machinery and fixtures | 1,500 | |
| Decommissioning and abandonment | 1,900 | |
| Repairs and maintenance | 5,750 | |
| Royalty cost paid | 40,990 | |
| Niger Delta Development Commission charge | 250 | |
| Finance costs | 510 | |
| Terminaling cost | 1,380 | |
| Donations to recognised charity home | 130 | |
| Concession rentals | 20,470 | |
| Host community fund | 1,000 | |
| Local government municipal levy | 100 | |
| Environmental remediation fund | 1,420 | |
| Cost incurred in seeking information for oil deposits | 370 | 187,200 |
| Net profit | | **86,107** |

**The following additional information was given:**

(i) Value of crude oil sold:

| Type | Quantity (barrels) | Actual price $ | Fiscal price $ |
|---|---|---|---|
| Forcados | 6,200,000 | 70 | 72 |

(ii) Value of condensate from associated gas sold:

| Type | Quantity (barrels) | Actual price $ | Fiscal price $ |
|---|---|---|---|
| OSO condensate | 3,700,000 | 30 | 30 |

(iii) Value of gas liquid from associated gas sold:

| Type | Quantity (barrels) | Actual price $ | Fiscal price $ |
|---|---|---|---|
| Pennington | 2,800,000 | 35 | 34 |

(iv) Drilling cost incurred comprised:

| | **₦'million** |
|---|---|
| Tangible drilling cost for first exploration well | 2,800 |
| Drilling the first two appraisal wells | 1,560 |
| | 4,360 |

(v) Repairs and maintenance:

| | **₦'million** |
|---|---|
| Repairs of plant, machinery and fixtures | 2,750 |
| Repairs or alteration of production implement utensils | 3,000 |
| | 5,750 |

(vi) Losses brought forward from last year was ₦655 million

(vii) Capital allowances computed:

| | **₦'million** |
|---|---|
| Brought forward | 320 |
| For the current year | 1,400 |
| | 1,720 |

(viii) Production allowances after commencement of the Petroleum Industry Act was ₦3,300 million.

(ix) Assume ₦425 is equivalent to US$1.

**Required:**

As the company's Tax Manager, you are to prepare a report to the Managing Director, showing in line with the provisions of Petroleum Industry Act 2021 and Companies Income Tax Act 2004 (as amended), the:

a. Hydrocarbon tax (14 Marks)

b. Companies income tax payable (6 Marks)

**(Total 20 Marks)**

## QUESTION 3

a. Explain the provisions of the Capital Gains Tax Act C1 LFN 2004 (as amended) in respect of tax payable on disposal of assets situated outside Nigeria by a non-Nigerian company. (2 Marks)

b. Damaturu Nigeria Limited had been in business as a manufacturer of dairy products for several years. In its bid to re-engineer its operations by investing in another viable product line (to be cited in a major city), the Board of Directors in February 2022, approved the sales and re-acquisition of some assets as shown below:

(i) The underlisted assets were acquired in 2015:

| | **₦'000** |
|---|---|
| Land | 25,000 |
| Plant and equipment | 13,000 |
| Factory building | 30,000 |

(ii) Sales proceeds from assets disposed of in July 2022:

| | **₦'000** |
|---|---|
| Land | 32,000 |
| Plant and equipment | 15,000 |
| Factory building | 38,000 |

(iii) Expenses incurred (as percentage of sales proceeds) in connection with disposal of assets:

| | |
|---|---|
| Legal | 1% |
| Professional valuers' fees | 3% |

(iv) Re-investment in new assets (for the purpose of the business) to replace the disposed ones, was made between September and October, 2022:

| | ₦'000 |
|---|---|
| Land | 28,000 |
| Plant and equipment | 18,000 |
| Factory building | 30,000 |

**Required:**

i. Compute the capital gains tax payable (if any) for each of the transactions and state the date of payment of the tax due. (14 Marks)

ii. Determine the relief available (if any) on the investment in the new assets. (4 Marks)

**(Total 20 Marks)**

## QUESTION 4

A notable State's Chamber of Commerce and Industries has invited you and three other tax consultants to their quarterly interactive forum, tagged "The Nigerian Double Taxation Agreement with the UK." The participants are top private sector-based industrialists who will be visiting the United Kingdom on a trade mission next week.

**Required:**

a. As the lead discussant, you are to prepare a paper explaining the provisions of the Nigerian double taxation agreements with the United Kingdom in respect of:

   i. Income arising from immovable properties (2 Marks)

   ii. Business profits not arising through a permanent establishment (2 Marks)

   iii. Profits or gains arising from the operations of ships and aircraft in international traffic (2 Marks)

   iv. Dividends derived by a company resident in one country from a company resident in another country (2 Marks)

   v. Interest arising in one country and paid to a resident of the other country (2 Marks)

b. State **THREE** foreign incomes exempted from Nigerian tax. (3 Marks)

c. Discuss **THREE** widely recognised resolution mechanisms being used by the Nigerian government to mitigate the effect of the conflicts between double taxation agreements and Nigerian tax laws. (3 Marks)

d. Explain **FOUR** benefits of double taxation agreements. (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

Zola Nigeria Limited has been in business for several years, preparing its accounts to December 31 of every year. Prior to the last two years, the company had a very good relationship with the Federal Inland Revenue Service (FIRS) as far as prompt filing of annual tax returns and payment of tax liabilities are concerned. The company was however fined for late filing of returns in the last financial year ended December 31, 2020.

In compliance with the provisions of the Companies Income Tax Act Cap C21 LFN 2004 (as amended), the company filed its annual returns for 2022 assessment year (year ended December 31, 2021) within the statutory period. Payment of tax due was also made.

The review done by the tax officials at the FIRS on the tax returns filed by the company necessitated the request for additional relevant documents to authenticate some items of expenditure and capital allowances claimed. The FIRS subsequently wrote a letter to the company for the submission of the documents within two weeks of the receipt of the letter. The receipt of the letter was acknowledged by the company, but it however failed to forward the required documents to the tax authorities. A reminder was sent to the company four weeks after the first letter was written, yet it failed to respond to the request made.

The Managing Director of the company has just received a letter from the tax office that a team of tax inspectors will be visiting the company in a fortnight to conduct a tax audit.

The company has approached your firm of chartered accountants to assist with advice on how the company should handle the forthcoming tax audit.

### Required:

Your Principal Partner has directed you, as a newly employed Audit Senior, to handle the engagement and expects you to prepare a report for his review before sending same to the client. The report should address the following:

a. Objectives of tax audits (5 Marks)

b. Stages in a typical tax audit process (4 Marks)

c. Schedule of requirements for FIRS tax audit (6 Marks)

**(Total 15 Marks)**

## QUESTION 6

The National tax policy (NTP) 2017, provides fundamental guidelines for the orderly development of the Nigerian tax system.

Professional accountants are one of the major stakeholders that are expected to drive the tenets of the tax policy for economic development of the country. In guiding professional accountants to behave in a responsible ethical manner, the International Ethics Standards Board for Accountants (IESBA), develops and issues in the public interest, high-quality ethical standards and other pronouncements for use of professional accountants around the world.

**Required:**

a. Explain **FIVE** fundamental features as provided for in the NTP 2017, which the existing and future taxes are expected to align with. (5 Marks)

b. Identify and explain **FOUR** principles and guidance for accountants as specified in the IESBA codes. (10 Marks)

**(Total 15 Marks)**

## QUESTION 7

Udi Nigeria Limited is a mining company which was established ten years ago. The company makes up its accounts to December 31 of every year. The Managing Director, who is an engineer, while having a chat with his former colleagues in the university during the week, heard for the first time, the concept of tax neutralities. He wondered how tax could be neutral.

On getting to the office the following week, he requested for further information on tax neutralities from the accountant, but based on his personal opinion, the accountant's response was not convincing enough.

The company is in the process of filing its annual returns for the year ended December 31, 2021, to the tax authorities. The Managing Director has directed the Financial Accountant to forward the following reports to you (being the company's Tax Consultant) in respect of the company's operational activities for the year:

| | ₦'000 | ₦'000 |
|---|---|---|
| Gross turnover | | 125,490 |
| **Deduct:** | | |
| Salaries and wages | 25,900 | |
| Depreciation of mining equipment | 15,400 | |
| Transport and traveling | 2,100 | |
| Repairs and maintenance | 3,700 | |
| Allowance for bad debts | 6,200 | |
| Electricity and other utilities | 4,660 | |
| Legal and professional fees | 4,850 | |
| Certified exploration expenditure | 4,500 | |
| Administrative expenses | 1,450 | |
| Development and processing expenditure | 2,500 | |
| Miscellaneous expenses | 3,420 | 74,680 |
| Net profit | | 50,810 |

**The following additional information was given:**

(i) Repairs and maintenance included an amount of ₦1,500,000, being cost of fittings incurred at the operational site.

(ii) Capital allowances computed:

| | ₦'000 |
|---|---|
| Brought forward | 750 |
| Current year (excluding current year capital expenditure) | 12,200 |
| | 12,950 |

**Required:**

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

a. Show the tax liabilities payable by the company for the relevant assessment year in line with the provisions of Nigerian Minerals and Mining Act 2007 (as amended). (9 Marks)

b. Explain the concept of tax neutralities and its applications to specific policy issues. (6 Marks)

**(Total 15 Marks)**

## NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

| | Initial % | Annual % |
|---|---|---|
| Building Expenditure | 15 | 10 |
| Industrial Building Expenditure | 15 | 10 |
| Mining Expenditure | 95 | Nil |
| Plant Expenditure (excluding Furniture & Fittings) | 50 | 25 |
| Manufacturing Industrial Plant Expenditure | 50 | 25 |
| Construction Plant expenditure (excluding Furniture and Fittings) | 50 | Nil |
| Public Transportation Motor Vehicle | 95 | Nil |
| Ranching and Plantation Expenditure | 30 | 50 |
| Plantation Equipment Expenditure | 95 | Nil |
| Research and Development Expenditure | 95 | Nil |
| Housing Estate Expenditure | 50 | 25 |
| Motor Vehicle Expenditure | 50 | 25 |
| Agricultural Plant Expenditure | 95 | Nil |
| Furniture and Fittings Expenditure | 25 | 20 |

2. INVESTMENT ALLOWANCE Up to August 31, 2023 (10%); and Finance Act 2023 (NIL)

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) and 3% of assessable profit, with effect from September 1, 2023 (Finance Act 2023)

6. CAPITAL GAINS TAX 10%

7. VALUE ADDED TAX 7.5%

8. HYDROCARBON TAX 15% (Petroleum prospecting Licence and Marginal Fields Companies)
30% (Petroleum Mining Lease Companies)

**SOLUTION 1**

**BFN & Co (Tax Consultants)**
**9, Alabata Road, Abeokuta**

**Date:**

The Managing Director
Paper World Nigeria Limited
2, Oyo-Ogbomoso Road
Ibadan.

Dear Sir,

**Re: Computation of adjusted profits, tax liabilities and other matters**

We hereby present a report in response to your request on computation of Company's adjusted profits, tax liabilities and other tax matters.

a. **Adjusted profits**

During the pioneer period (2018, 2019 and 2020), the company made a total adjusted loss of ₦45,720,000 (see attached Appendix 1).

The adjusted profit for the year ended April 30, 2021, was ₦36,630,000 (see appendix 2).

b. **Tax liabilities payable for 2022 assessment year**

With no total profit, the company is not liable to pay any companies income tax. However, payment of tertiary education tax, which is 2.5% of the assessable/adjusted profit, ₦915,750, is to be paid to the Federal Inland Revenue Service (FIRS). Given the fact that the company is not up to 48 calendar months in business, the company is exempted from paying minimum tax.

The Management is advised to immediately file its annual tax returns and accompany it with a cheque of ₦915,750 in favour of FIRS.

c. **Provisions of the Industrial Development (Income Tax Relief) Act 2007 (as amended) in respect of:**

i. **Dividend payment**

- Dividends can only be made out of profit.
- Dividends declared out of pioneer profit are not taxable (that is, free of withholding tax).
- Also, there is a limitation on a distribution of company's dividends. No dividends may be distributed in excess of a certain balance on its profit and loss account.

ii. **Losses made during the pioneer period**

- The pioneer company shall be deemed to have set up and commenced a new trade or business on the day next following the end of its tax relief period.
- Thus, any losses made during the pioneer period and certified by the Federal Inland Revenue Service may be available for relief during the new trade. The practice of the Service is to restrict the relief to the first year of the new trade.
- Any unrelieved losses outstanding at the end of the first year of the new trade will be deemed to have been lost permanently.

iii. **Capital allowances for qualifying capital expenditure (QCE) acquired during the pioneer period**

- Any qualifying capital expenditure incurred during the pioneer period will be aggregated and assumed to have been incurred on the first day of the new trade.

- These QCEs will now qualify for both initial and annual allowances as from the first assessment year of the new trade.

Please do not hesitate in contacting us if you need any further clarification on the above subject.

Yours faithfully,

**Dan Owoeye**
**Principal Partner**

**Appendix 1: Adjusted profits during pioneer period (for the year ended April 30, 2018, 2019 and 2020)**

| | **Year ended 30/4/2018** | | **Year ended 30/4/2019** | | **Year ended 30/4/2020** | |
|---|---|---|---|---|---|---|
| | **₦'000** | **₦'000** | **₦'000** | **₦'000** | **₦'000** | **₦'000** |
| Net loss as per accounts | | (28,700) | | (25,500) | | (20,200) |
| Add back: | | | | | | |
| Depreciation | 6,800 | | 7,530 | | 8,600 | |
| Donations | 100 | | 0 | | 250 | |
| General allowance for doubtful debts | 1,850 | 8,750 | 1,750 | 9,280 | 1,800 | 10,650 |
| Adjusted profit/ (loss) | | **(19,950)** | | **(16,220)** | | **(9,550)** |

**Working 1: Total adjusted profit/(loss) during the pioneer period**

| Year ended April 30 | Amount |
|---|---|
| | ₦'000 |
| 2018 | (19,950) |
| 2019 | (16,220) |
| 2020 | (9,550) |
| | **(45,720)** |

**Appendix 2: Adjusted profit for the year ended April 30, 2021**

| | ₦'000 | ₦'000 |
|---|---|---|
| Net profit as per accounts | | 14,930 |
| Add back: | | |
| Repairs and maintenance (improvement) | 1,200 | |
| Depreciation | 15,300 | |
| General and admin expenses (reserve) | 1,300 | |
| Legal fees: | | |
| Fine for late filing of returns | 50 | |
| Expenses on new issue of shares | 1,350 | |
| Allowance for doubtful debts (general prov) | 3,700 | 22,900 |
| | | 37,830 |
| Less: Income not taxable (dividends) | | 1,200 |
| Adjusted profit | | **36,630** |

**Appendix 3: Computation of tax liabilities**

| | ₦'000 | ₦'000 |
|---|---|---|
| Adjusted profit (from above) | | 36,630 |
| Less: Loss brought forward | 45,720 | |
| Loss relieved | (36,630) | (36,630) |
| Unrelieved loss that lapse | 9,090 | |
| | | Nil |
| Capital allowances for the year (W2) | 23,218 | |
| Recouped | (Nil | (Nil) |
| Capital allowances c/f | 23,218 | |
| Total profit | | Nil |
| Companies income tax @ 30% | | Nil |
| Tertiary education tax @ 2.5% of assessable profit | | 915.7 |

**Workings 2: Capital allowances**

| | Non-ind building | Industrial Building | Manuf Ind. plant | Furniture and fittings | Motor Vehicle | Capital allow |
|---|---|---|---|---|---|---|
| | IA 15% AA 10% | IA 15% AA 10% | IA 50% AA 25% | IA 25% AA 20% | IA 50% AA 25% | |
| | ₦'000 | ₦'000 | ₦'000 | ₦'000 | ₦'000 | ₦'000 |
| **2022 A/Y** | | | | | | |
| Cost | 10,000 | 25,600 | 12,600 | 3,400 | 4,000 | |
| Additions | 1200 | - | - | 500 | 2,200 | |
| | 11,200 | 25,600 | 12,600 | 3,900 | 6,200 | |
| IA | (1,680) | (3,840) | (6,300) | (975) | (3,100) | 15,895 |
| AA | (952) | (2,176) | (1,575) | (585) | (775) | 6,063 |
| Inv. Allow | - | - | (1,260) | - | - | 1,260 |
| | | | | | | **23,218** |
| **2023 A/Y** | | | | | | |
| TWDV | 8,568 | 19,584 | 4,725 | 2,340 | 2,325 | |

Note 1: Any QCE bought during the pioneer period is assumed to be acquired on the first day of the new trade (May 1, 2020).

Note 2: Annual allowances for 2022 assessment year

Non-industrial building = $\frac{₦11,200,000 - ₦1,680,000}{10}$ = ₦952,000

Industrial building = $\frac{₦25,600,000 - ₦3,840,000}{10}$ =- ₦2,176,000

Manufacturing industrial plant = $\frac{₦12,600,000 - ₦6,300,000}{4}$ = ₦1,575,000

Furniture and fittings = $\frac{₦3,900,000 - ₦975,000}{5}$ = ₦585,000

Motor vehicle = $\frac{₦6,200,000 - ₦3,100,000}{4}$ = ₦775,000

## Examiner's report

The question is divided into two parts. The first part tests the candidates' understanding of the provisions of Companies Income Tax Act 2004 (as amended) in respect of computations of adjusted profit and companies' income tax payable for the relevant assessment year. The second part tests the candidates' knowledge of the provisions of the Industrial Development (Income Tax Relief) Act 2007 (as amended), in respect of a pioneer company's dividend payment and losses made during the pioneer period.

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 the Companies Income Tax Act 2004 (as amended).

Candidates are advised to familiarise themselves with issues concerning computations of companies' income tax 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 profits** | | |
| | Memo (address or heading) | ½ | |
| | Memo (discussion of results) | ½ | |
| | Adjusted profits (30/4/2018): | | |
| | Net profit/(loss) | ½ | |
| | Depreciation | ½ | |
| | Donations | ½ | |
| | General provision for doubtful debts | ½ | |
| | Adjusted profit/(loss) | ½ | |
| | Adjusted profits (30/4/2019): | | |
| | Net profit/(loss) | ½ | |
| | Depreciation | ½ | |
| | General provision for doubtful debts | ½ | |
| | Adjusted profit/(loss) | ½ | |
| | Adjusted profits (30/4/2020): | | |
| | Net profit/(loss) | ½ | |
| | Depreciation | ½ | |
| | Donations | ½ | |
| | General provision for doubtful debts | ½ | |
| | Adjusted profit/(loss) | ½ | |
| | Total adjusted losses during the pioneer period | ½ | |
| | Adjusted profits (30/4/2021): | | |
| | Net profit as per accounts | ½ | |
| | Repairs and maintenance (improvement) | ½ | |
| | Depreciation | ½ | |
| | General and admin expenses (transfer to reserve) | ½ | |
| | Legal fees: | | |
| | Fine for late filing | ½ | |

| | | | |
|---|---|---|---|
| | Expenses on new issue of shares | ½ | |
| | Allowance for doubtful debts (general prov) | ½ | |
| | Income not taxable (Dividends) | ½ | |
| | Adjusted profit | ½ | 13 |
| b. | **Computation of tax liabilities** | | |
| | Memo (discussion of results) | $1^1/_2$ | |
| | Losses b/f | ½ | |
| | Relieved | ½ | |
| | Losses that lapse | ½ | |
| | Capital allowances for the year | ½ | |
| | Total profit | ½ | |
| | Companies income tax | ½ | |
| | Tertiary education tax | ½ | |
| | Capital allowances computation: | | |
| | IA (Non-industrial building) | ½ | |
| | AA (Non-industrial building) | ½ | |
| | IA (Industrial building) | ½ | |
| | AA (Industrial building) | ½ | |
| | IA (Manufacturing industrial plants) | ½ | |
| | AA (Manufacturing industrial plants) | ½ | |
| | Investment allow (Manufacturing industrial plants) | ½ | |
| | IA (Furniture and fittings) | ½ | |
| | AA (Furniture and fittings) | ½ | |
| | IA (Motor vehicle) | ½ | |
| | AA (Motor vehicle) | ½ | |
| | Total capital allowances | ½ | 11 |

c.

i. **Provisions of the Act in respect of a pioneer company's dividend payment**

1 mark for the discussion of the provisions of the Act in respect of a pioneer company's dividends payment, subject to a maximum of 2 points. 2

ii. **Provisions of the Act in respect of a pioneer company's losses made during the pioneer period**

1 mark for the discussion of the provisions of the Act in respect of a pioneer company's losses made during the pioneer period, subject to a maximum of 2 points. 2

iii. **Provisions of the Act in respect of a pioneer company's capital allowances for qualifying capital expenditure acquired during the pioneer period**

1 mark for the discussion of the provisions of the Act in

respect of a pioneer company's capital allowances for QCE acquired during the pioneer period, subject to a maximum of 2 points. 2

**Total** **30**

**SOLUTION 2**

**Baba Tee & Co (Chartered Accountants)**
**Plot 5, Osara Road, Abeokuta**

**INTERNAL MEMO**

**Date:** .......

**From:** Tax Manager

**To:** Managing Director

**Subject: Computation of Hydrocarbon Tax and Companies Income Tax Liabilities Payable**

I refer to your directive on the above subject and a draft report for your review and further action is hereby presented.

a. **Determination of hydrocarbon tax liabilities for the 2021 assessment year**

With losses relieved brought forward from last year and the grant of capital allowances and production allowances, the company made a chargeable profit of ₦150.622 billion. Hydrocarbon tax is at the rate of 15% of chargeable profit, which amounted to **₦22,593,300,000.**

b. **Determination of companies income tax liabilities for the 2022 assessment year**

The company made a total profit of ₦90.872 billion. Companies income tax is 30% of total profit and this gives **₦27,261,600,000**. The company is also to pay 2.5% of assessable profit as tertiary education tax **(₦2,330,375,000).**

Thank you.

**Tobby Babatolu**

**Appendix 1: Hydrocarbon tax for the 2021 assessment year**

| | ₦'million | ₦'million |
|---|---|---|
| **Revenue:** | | |
| Value of crude oil sold (6.2 million barrels x $72 x ₦425) | | 189,720 |
| Value of condensate from associated gas sold (3.7 million barrels x $30 x ₦425) | | 47,175 |
| Value of natural gas liquid from condensate gas sold (2.8 million barrels x $35 x ₦425) | | 41, 650 |
| Gross Revenue | | 278,545 |
| Balancing charge | | 32 |
| Total gross revenue | | 278,577 |
| **Allowable deductions (section 263 of PIA)** | | |
| Production cost | 106,470 | |
| Cost of gas reinjection wells | 600 | |
| Drilling cost | 4,360 | |
| Decommissioning and abandonment | 1,900 | |
| Repairs and maintenance | 5,750 | |
| Royalty cost paid | 40,990 | |
| NDDC charge | 250 | |
| Terminaling cost | 1,380 | |
| Concession rentals | 20,470 | |
| Host community fund | 1,000 | |
| Local government municipal levy | 100 | |
| Environmental remediation fund | 1,420 | |
| Total allowable cost | 184,690 | |
| Total costs subject to CPR limit (W1) | (122,280) | (122,280) |
| Excess allowable cost carried forward | 62,410 | |
| Adjusted profit | | 156,287 |
| Less: Loss relief | | 655 |
| Assessable profit | | 155,642 |
| Less: Section 266 and 6th Schedule deductions: | | |
| Capital allowances: | | |
| Brought forward | 320 | |
| For the current year | 1400 | 1720 |
| | | 153, 922 |
| Less: Production allowances | | 3,300 |
| Chargeable profit | | 150,622 |
| Hydrocarbon tax @15% of chargeable profit | | 22,593.3 |

**Workings on Cost-Price-Ratio limit**

| | ₦'million | ₦'million |
|---|---|---|
| Gross revenue | | 278,545 |
| Maximum allowable costs @65% | | 181, 054.25 |
| Total operating cost incurred | | 184,690 |
| Capital allowances | | 1,720 |
| Total eligible costs | | 186, 410 |
| Less: Exempted costs incurred (Section 263) | | |
| Royalty paid | 40,990 | |
| NDDC charge | 250 | |
| Concession rentals | 20,470 | |
| Host community fund | 1,000 | |
| Environmental remediation fund | 1,420 | 64,130 |
| Net total costs to be subjected to CPR | | 122,280 |
| Maximum allowable cost: | | |
| The lower of: | | |
| Net total costs to be subjected to CPR | | 122,280 |
| And | | |
| CPR @ 65% of gross income | | 181,054.25 |

**Appendix 2: Companies income tax for 2022 assessment year**

| | ₦'million | ₦'million |
|---|---|---|
| Revenue: | | |
| Value of crude oil sold | | 189,720 |
| Value of condensate from associated gas sold | | 47, 175 |
| Value of natural liquid from condensate | | 41,650 |
| Gross revenue | | 278,545 |
| Less: | | |
| Allowable deductions (section 263 of PIA) | | |
| Production cost | 106,470 | |
| Cost of gas reinjection wells | 600 | |
| Drilling cost | 4,360 | |
| Decommissioning and abandonment | 1,900 | |
| Repairs and maintenance | 5,750 | |
| Royalty cost paid | 40,990 | |
| NDDC charge | 250 | |
| Terminalling cost | 1,380 | |
| Concession rentals | 20,470 | |
| Host community fund | 1,000 | |
| Local government municipal levy | 100 | |
| Environmental remediation fund | 1,420 | |
| Total allowable cost | 184,690 | |
| Less: CITA allowable deductions: | | |

| | | | |
|---|---|---|---|
| Bank charges (Finance cost) | 510 | | |
| Donations to recognised Charity home | 130 | 640 | 185,330 |
| Assessable profit | | | 93,215 |
| Add: Balancing charge | | | 32 |
| | | | 93,247 |
| Less: Losses b/f | | | 655 |
| | | | 92,592 |
| Less: Capital allowances: | | | |
| Brought forward | | 320 | |
| For the current year | | 1,400 | 1,720 |
| Total profit | | | 90,872 |
| Companies income tax @ 30% of total profit | | | 27,261.60 |
| Tertiary education tax @ 2.5% of assessable profit | | | 2,330.375 |
| Total tax liabilities payable | | | **29,591.975** |

## Examiner's report

The question tests candidates' knowledge of computations of hydrocarbon tax and companies income tax of a company that operated in both onshore and shallow water in line with the provisions of Petroleum Industry Act 2021.

About 80% of the candidates attempted the question, but majority of them showed a fair understanding of its requirements, hence their performance was average.

The major pitfall of the candidates was their inability to identify correctly the allowable and disallowable expenses relevant to 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, companies' income tax and relevant sections of the Petroleum Industry Act 2021.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | Computation of Hydrocarbon tax | | |
| | Memo (Heading) | ½ | |
| | Memo (Discussion of result) | 1 | |
| | Value of crude oil sold | ½ | |
| | Value of condensate from associated gas sold | ½ | |
| | Value of natural gas liquid from condensate gas sold | ½ | |
| | Balancing charge | ½ | |
| | | | |
| | Allowable deductions (section 263 of PIA): | | |

| | | | |
|---|---|---|---|
| | Production cost | ½ | |
| | Cost of gas reinjection wells | ½ | |
| | Drilling cost | ½ | |
| | Decommissioning and abandonment | ½ | |
| | Repairs and maintenance | ½ | |
| | Royalty cost paid | ½ | |
| | NDDC charge | ½ | |
| | Terminaling cost | ½ | |
| | Concession rentals | ½ | |
| | Host community fund | ½ | |
| | Local government municipal levy | ½ | |
| | Environmental remediation fund | ½ | |
| | Total allowable cost | ½ | |
| | Total cost subject to CPR limit (W1) | ½ | |
| | Excess allowable cost carried forward | ½ | |
| | Less: Loss relief | ½ | |
| | Total capital allowances | ½ | |
| | Production allowances | ½ | |
| | Chargeable profit | ½ | |
| | Hydrocarbon tax @ 15% of chargeable profit | ½ | |
| | Workings (CPR limit): | | |
| | Net total cost to be subjected to CPR (₦122,280) | ½ | 14 |
| b. | Computation of income tax payable | | |
| | Memo (Discussion of result) | ½ | |
| | Gross revenue total (₦278,545) | ½ | |
| | Section 263 allowable deductions total (₦184,690) | ½ | |
| | Bank charges | ½ | |
| | Donations | ½ | |
| | Assessable profit | ½ | |
| | Balancing charge | ½ | |
| | Losses b/f | ½ | |
| | Capital allowances total (₦1,720) | ½ | |
| | Total profit | ½ | |
| | Companies income tax | ½ | |
| | Tertiary education tax | ½ | 6 |
| | **Total** | | **20** |

## SOLUTION 3

a. **The provisions of the Capital Gains Tax Act in respect of tax payable on disposal of assets situated outside Nigeria by a non-Nigerian company**

Section 4 of Capital Gains Tax Act 2004 (as amended) provides that Capital gains tax shall be charged on the amounts (if any) received or brought into Nigeria in respect of any chargeable gains, such amounts being treated as gains accruing when they are received or brought into Nigeria.

b. (i) **Damaturu Nigeria Limited**
**Computation of capital gains tax payable**
**For 2022 assessment year**

| | **Land** | | **Plant & equipment** | | **Factory building** | |
|---|---|---|---|---|---|---|
| | **₦'000** | **₦'000** | **₦'000** | **₦'000** | **₦'000** | **₦'000** |
| Sales proceeds | | 32,000 | | 15,000 | | 38,000 |
| Less: | | | | | | |
| Cost of acquisition | 25,000 | | 13,000 | | 30,000 | |
| Incidental expenses: | | | | | | |
| Legal (1%) of sale proceeds | 320 | | 150 | | 380 | |
| Professional Valuers (3%) of sale proceeds | 960 | 26,280 | 450 | 13,600 | 1,140 | 31,520 |
| Capital gains record | | 5,720 | | 1,400 | | 6,480 |
| Less: Roll-over relief (b)(ii) | | 3,000 | | 1,400 | | Nil |
| Net capital gains | | 2,720 | | Nil | | 6,480 |
| Capital gains tax @ 10% | | 272 | | Nil | | 648 |

In line with the provisions of Section 2, Finance Act 2020, the expected due date of payment of the tax liability is December 31, 2022.

b. (ii) **Roll-over relief**

| | Land | Plant & equipment | Factory building |
|---|---|---|---|
| | ₦'000 | ₦'000 | ₦'000 |
| Lower of: | | | |
| Sales proceeds | 32,000 | 15,000 | 38,000 |
| And | | | |
| Amount re-invested | 28,000 | 18,000 | 30,000 |
| Less: Cost of acquisition of old asset | 25,000 | 13,000 | 30,000 |
| Roll-over relief | 3,000 | 2,000 | Nil |

**NB: The roll-over relief in respect of plant & equipment is restricted to ₦1,400,000 (as in the capital gains record).**

## Examiner's report

The question tests candidates' understanding of the provisions of Capital Gains Tax Act 2004 (as amended) in respect of disposal of assets situated outside Nigeria by a non-Nigerian company, capital gains tax computations, and roll-over relief.

About 80% 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 correctly compute the roll-over relief.

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

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **Provisions of capital Tax Act in respect of tax payable on disposal of assets situated outside Nigeria by a non-Nigerian company** | | |
| | 2 marks for discussing the provisions of the Act in respect of tax payable on disposal of assets situated outside Nigeria by a non-Nigerian company | | 2 |
| b.i | **Computation of the capital gains tax payable as the date of payment of the tax date** | | |
| | Heading | ½ | |
| | Land: Sales proceeds | ½ | |

| | | | |
|---|---|---|---|
| | Land: Cost of acquisition | ½ | |
| | Land: Legal fees | ½ | |
| | Land: Professional valuers' fees | ½ | |
| | Land: Capital gains record | ½ | |
| | Land: Less: roll-over relief | ½ | |
| | Land: Net capital gains | ½ | |
| | Land: Capital gains tax @ 10% | ½ | |
| | Plant & equipment: Sales proceeds | ½ | |
| | Plant & equipment: Cost of acquisition | ½ | |
| | Plant & equipment: Legal fees | ½ | |
| | Plant & equipment: Professional valuers' fees | ½ | |
| | Plant & equipment: Capital gains record | ½ | |
| | Plant & equipment: Less: roll-over relief | ½ | |
| | Plant & equipment: Net capital gains | ½ | |
| | Plant & equipment: Capital gains tax @ 10% | ½ | |
| | Factory building: Sales proceeds | ½ | |
| | Factory building: Cost of acquisition | ½ | |
| | Factory building: Legal fees | ½ | |
| | Factory building: Professional valuers' fees | ½ | |
| | Factory building: Capital gains record | ½ | |
| | Factory building: Less: roll-over relief | ½ | |
| | Factory building: Net capital gains | ½ | |
| | Factory building: Capital gains tax @ 10% | ½ | |
| | Due date of payment of tax | 1½ | 14 |
| ii. | **Roll-over relief computation:** | | |
| | Land: Sales proceeds | ½ | |
| | Land: Amount re-invested | ½ | |
| | Land: Cost of acquisition of old asset | ½ | |
| | Plant & equipment: Sales proceed | ½ | |
| | Plant & equipment: Amount re-invested | ½ | |
| | Plant & equipment: Cost of acquisition | ½ | |
| | Factory building: Sales proceeds | ½ | |
| | Factory building: Amount re-invested | ½ | 4 |
| | **Total** | | **20** |

## SOLUTION 4

### Being a Paper on Nigerian Double Taxation Agreements and the United Kingdom

a. **Provisions of double taxation agreement with the UK with regards to:**

i. Income from immovable property may be taxed in the country in which the property is situated (Article 6);

ii. Business profits not arising through a permanent establishment are to be taxed only in the country of the taxpayer's residence. Profits attributed to a permanent establishment may be taxed in the country in which the permanent establishment is situated (Article 7);

iii. Profits or gains arising from the operation of ships and aircraft in international traffic are to be taxed only in the country of residence of the operator (Article 8);

iv. Dividends derived by one company which is resident in one country from a company resident in another country may be taxed in that country in which the dividend is derived. The withholding tax applicable in Nigeria is reduced to 7.5%; and

v. Interest arising in one country and paid to a resident of the other country may be taxed in that other country. The rate of tax in the source country is, in general, not to exceed 12.5 per cent. However, interest arising in one country and paid to the government or any government agency of the other country is to be exempt in the country of source (Article 11).

b. **Foreign incomes exempted from Nigerian tax**

With effect from January 1, 1988, investment incomes, namely; dividends, interests, royalties and rents, derived by a company from outside Nigeria, is exempted from Nigerian tax, provided that such income is brought into Nigeria through government approved channels.

Government approved channels means the Central Bank of Nigeria, any bank or other corporate body appointed by the Minister as authorised dealers under the Second-tier Foreign Exchange Market, Act or any enactment replacing that Act. In such situations, there would not have been any double taxation and therefore there would be no need to grant any relief in form of tax credit.

c. **Resolution of conflicts between double taxation agreements (DTAs) and Nigerian tax laws include:**

Where a resident of a contracting State considers that the action of one or both of the contracting States result or will result in taxation not in accordance with this agreement;

The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to resolve the case by mutual agreement with the competent authority of the other contracting State. Then;

The competent authorities of the contracting State shall endeavour to resolve by mutual agreement any difficulties or doubt arising as to the interpretation or application of the agreement; and

The competent authorities of a contracting State may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

d. **Benefits of double taxation agreement include:**

- Avoidance of double taxation;
- Clarification of taxing rights of each contracting State;
- Encouragement of economic cooperation between States;
- Prevention of fiscal evasion with anti-avoidance provision;
- Lowering of compliance cost;
- Promotion of bilateral investment between contracting States;
- Access to mutual agreement procedure (MAP) for dispute resolution;
- Non-discrimination in taxation matters; and
- Encouragement of uninterrupted exchange of information between the contracting States.

## Examiner's report

The question tests the candidates' knowledge of the provisions of the Nigerian double taxation agreements with the United Kingdom.

About 40% of the candidates attempted the question and they exhibited a fair understanding of its requirements. The performance was average.

The commonest pitfall was the inability of some candidates to explain the resolution mechanisms being used by the Nigerian government to mitigate the effect of the conflicts between double taxation agreements and the Nigerian tax laws.

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

## Marking guide

| | | Marks |
|---|---|---|
| a. i. | **Provision of the Nigerian double taxation agreements with the UK in respect of income arising from immovable properties**<br>2 marks for discussing the provisions of the double taxation agreement with the UK in respect of income arising from immovable properties | 2 |
| ii. | **Provisions of the Nigerian double taxation agreements with the UK in respect of business profits not arising through a permanent establishment**<br>2 marks for discussing the provisions of the double taxation agreement with the UK in respect of business profits not arising through a permanent establishment | 2 |
| iii. | **Provisions of the Nigerian double taxation agreements with the UK in respect of profits or gains arising from the operations of ships and aircraft in international traffic**<br>2 marks for discussing the provisions of the double taxation agreement with the UK in respect of profits or gains arising from the operations of ships and aircraft in international traffic | 2 |
| iv. | Provisions of the Nigerian double taxation agreements with the UK in respect of dividends derived by a company resident in one country from a company resident in another country.<br>2 marks for discussing the provisions of the double taxation agreement with the UK in respect of dividends derived by one company which is resident in one country from a company resident in another country | 2 |
| v. | **Provisions of the Nigerian double taxation agreements with the Uk in respect of interest arising in one country and paid to a resident of the other country**<br>2 marks for discussing the provisions of the double taxation agreement with the UK in respect of interest arising in one country and paid to a resident of the other country | 2 |
| b. | **Foreign incomes exempted from Nigerian tax**<br>1 mark for each item of foreign income exempted (interests, royalties, dividends and rents) from Nigerian tax, subject to a maximum of 3 items | 3 |
| c. | **Resolution mechanisms being used to mitigate the effect of the conflicts between double taxation agreements and Nigerian tax laws**<br>1 mark for discussing each resolution of conflict mechanism, | |

Subject to a maximum of 3 points 3

d. **Benefits of double taxation agreements**
1 mark for discussing each benefit of double taxation agreement, subject to a maximum of 4 points 4
**Total** **20**

**SOLUTION 5**

**SMAP & Co (Chartered Accountants)**
**67, Wheno Avenue, Badagry**

**INTERNAL MEMO**

**Date:**

**From**: Audit Senior

**To**: Principal Partner

**Subject: Zola Nigeria Limited**

I refer to our client's request on objectives of tax audits; stages of tax audit process and schedule of requirements required for Federal Inland Revenue Service tax audit. I hereby present a report for your consideration before same is presented to the client.

a. **The objectives of a tax audit are to enable the tax inspectors determine that:**

i. Adequate accounting books and records exist for the purpose of determining the taxable profits or loss of the taxpayer and consequently, the tax payable;
ii. The tax computations submitted to the tax authority by the taxpayer agree with the underlying records;
iii. All applicable tax legislations have been complied with;
iv. There is provision of an avenue to educate taxpayers on various provisions of the tax law;
v. Tax evasion is discouraged;
vi. Accounting and/or arithmetical errors in tax returns are detected and corrected;
vii. Feedback to the management on various provisions of the law and recommend possible changes;
viii. Cases involving tax fraud and recommend them for investigation;
ix. Taxable persons' failure to render tax returns are captured;

x. Taxable persons' rendering incomplete or in accurate returns are identified; and
xi. Voluntary compliance (which is one of the strong reasons in support of the self-assessment scheme) is encouraged.

b. **Stages in tax audit process include:**

i. Selection of the taxpayer to be audited;
ii. Preliminary review of the taxpayer's file;
iii. Notification of taxpayer;
iv. Pre-audit meeting;
v. Fieldwork;
vi. Post-audit meeting;
vii. Interim audit report;
viii. Post-audit review by regional/headquarters' audit unit;
ix. Reconciliation meetings; and
x. Final audit report.

c. **List of required documents for FIRS tax audit include:**

i. Audited accounts for the relevant years;
ii. Management accounts;
iii. Chart of accounts;
iv. Year-end final trial balance;
v. General ledgers/ledger printouts;
vi. Back up documents for entries in the General Ledger;
vii. Audit adjustment journals;
viii. Relevant schedules;
ix. Sales invoice file;
x. Purchases invoice file;
xi. Payment vouchers for bank and petty cash payments;
xii. Import documents;
xiii. Export documents (where applicable);
xiv. Fixed assets register/schedules;
xv. Value added tax file(s);
xvi. Evidences of Input VAT claimed;
xvii. Evidences of VAT deducted at source (if any);
xviii. Evidence of zero rated/exempted VAT items;
xix. Withholding tax file(s);
xx. Capital gains tax records;

xxi. Schedule of bankers and the bank statements for each of the period of audit coverage;
xxii. Minutes of Board's meetings;
xxiii. Inventory count records;
xxiv. Schedule of contracts executed, contract agreements/offer letters and valuation certificate for company engaged in construction;
xxv. Rent agreements; and
xxvi. Any other documents required for the audit, as the documents stated above are not exhaustive.

Thank you.

**Sunny Posu**

## Examiner's report

The question tests candidates' understanding of the objectives of tax audits; stages in a typical tax audit process; and schedule of requirements for Federal Inland Revenue Service (FIRS) tax audit.

About 60% of the candidates attempted the question and they showed a good understanding of the question and performance was above average.

The commonest pitfall was the inability of the candidates to state correctly the schedule of requirements for FIRS tax audit.

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

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **Objectives of tax audits** | | |
| | Memo (address) | ½ | |
| | Memo (heading) | ½ | |
| | ½ mark for each objective of tax audit, subject to a maximum of 8 points | 4 | 5 |
| b. | **Stages in a typical tax audit process** | | |
| | ½ mark for each stage in a typical tax process, subject to a maximum 8 points | | 4 |

c. **Schedule of documents required for FIRS tax audit**

½ mark for each schedule of requirements for FIRS tax audit, subject to a maximum of 12 points — 6

**Total** — **15**

## SOLUTION 6

a. **Guiding principles of Nigeria tax system**

According to the National tax policy 2017, all existing and future taxes are expected to align with the following fundamental features:

i. **Equity and fairness:** Nigeria tax system should be fair and equitable, devoid of discrimination. Taxpayers should be required to pay according to their ability;

ii. **Simplicity, certainty and clarity:** Tax laws and administrative processes should be simple, clear and easy to understand;

iii. **Convenience:** The time and manner for the fulfillment of tax obligations shall take into account the convenience of taxpayers and avoid undue difficulties;

iv. **Low compliance cost:** The financial and economic costs of compliance to the taxpayer should be kept to the barest minimum;

v. **Low cost of administration:** Tax administration in Nigeria should be efficient and cost-effective in line with international best practices;

vi. **Flexibility:** Taxation should be flexible and dynamic to respond to changing circumstances in the economy in a manner that does not retard economic activities; and

vii. **Sustainability:** The tax system should promote sustainable revenue, economic growth and development. There should be a synergy between tax policies and other economic policies of government.

b. **The fundamental principles and guidance for accountants (IESBA codes)**

The fundamental principles of ethics as specified by the International Ethics Standards Board for Accountants (IESBA) are:

i. Integrity;
ii. Objectivity;
iii. Professional competence and due care;
iv. Confidentiality; and
v. Professional behaviour.

i. **Integrity**

- A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness.

- A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information contains materially false or misleading statements.

ii. **Objectivity**

- A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

- A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding the activity.

iii. **Professional competence and due care**

A professional accountant shall comply with the principle of professional competence and due care. This requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation and act diligently and in accordance with applicable technical and professional standards.

iv. **Confidentiality**

A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and business relationships.

The principle of confidentiality imposes an obligation on all professional accountants to refrain from:

- Disclosing outside the firm or employing organisation confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
- Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.

v. **Professional behaviour**

- A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession.
- A professional accountant shall not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

## Examiner's report

The question tests candidates' understanding of the fundamental features provided for in the Nigerian Tax Policy 2017, which existing and future taxes are expected to align with and the principles and guidance of accountants as specified in the International Ethics Standards Board for Accountants (IESBA) codes.

About 70% of the candidates attempted the question. Candidates showed a fair 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 principles and guidance for accountants as specified in the IESBA codes.

Candidates are advised to read the Institute's Study Text, Institute of Chartered Accountants of Nigeria Act, and other relevant textbooks, as this will go a long way in assisting them to pass future examinations.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **Fundamental features as provided for in the NTP 2017, which the existing and future taxes are expected to align with** | | |
| | 1 mark for each discussion on fundamental features as provided for in the NTP 2017, which the existing and future taxes are expected to align with, subject to a maximum of 5 points | | 5 |
| b. | **Principles and guidance of accountants as specified in the IESBA codes** | | |
| | ½ mark for each identification of principles and guidance for accountants as specified in the IESBA codes, subject to a maximum of 4 points | 2 | |
| | 2 marks for each discussion on principles and guidance of accountants as specified in the IESBA codes, subject to a maximum of 4 points | 8 | 10 |
| | **Total** | | **15** |

## SOLUTION 7

**EPS & Co (Tax Consultants)**
**15, Enugu Road, Udi Town**

**Date:**

The Managing Director
Udi Nigeria Limited
15, Enugu Road
Udi Town

Dear Sir,

**Re: Computation of Tax Liabilities for 2022 Assessment Year and Tax Neutralities**

I refer to your requests on the computation of the company's tax liabilities for 2022 assessment year and explanation of the concept of tax neutralities. I hereby present a report for your consideration.

a. **Computation of tax liabilities for 2022 assessment year**

In line with the provisions of Companies Income Tax Act 2004 (as amended), the companies income tax liability payable for 2022 assessment year is ₦18,213,000 (that is 30% of total profit). The company is also liable to pay tertiary education tax at the rate of 2.5% of assessable profit and this amounted to ₦20,022,750.

The company is hereby advised to urgently file its self-assessment annual returns with the Federal Inland Revenue Service and accompany it with a cheque of the sum of ₦20,235,750, being the amount of total tax liabilities payable for the 2022 assessment year.

b. **The concept of tax neutrality**

i. The primary purpose of the tax system is to raise the revenue needed to pay for government spending. As such, the goal is to raise this revenue without distorting the decisions that individuals and firms would otherwise make for purely economic reasons.

ii. Non-neutralities in the tax system lead people and firms to devote more socially wasteful effort to transforming the form or substance of their activities to reduce their tax payments, for example, by hiring accountants to structure financial transactions in a manner that minimizes tax liability.

iii. In some cases, deviations from a neutral tax system are unavoidable. It is widely agreed that tax payment should increase with some measure of well-being, like income, consumption or wages.

iv. One inevitable consequence of this agreement is that the market consumption of goods and services will be taxed, either directly (as in a consumption tax) or indirectly (as in an income or employment tax, both of which tax the money used to purchase consumption goods). In other cases, deviations from a neutral tax system reflect the goals of policy makers.

## Applications of neutrality to specific policy issues

i. **Overall tax reform**: A broader base and lower rates

One of the traditional mantras of tax reform is to "broaden the base and lower the rates". This involves two objectives:

- Broadening the base helps make the tax code more neutral between different activities by including more types of income in the definition of income and allowing fewer deductions and credits for specified activities; and
- Lowering tax rates makes the tax code more neutral about the choice between working and not working.

ii. **Using the tax code to encourage desired behaviour**: Credits instead of deductions

In some cases, policy makers may want to encourage desired activities like home ownership or a college education. In these cases, it is worth examining whether the specific goal could be better accomplished through a spending program or through the tax code. In many cases, a spending program can be more effectively targeted and delivered to serve the goal in question. In some cases, subsidising these activities through the tax code may be more efficient.

iii. **Discouraging undesired activity**

Just as it can sometimes be appropriate to introduce non-neutralities into the tax system to encourage desired activities, it can also be appropriate to use the tax system to discourage undesirable ones like smoking, drinking alcohol, or emitting carbon. This can lead businesses and consumers to take the social costs of their actions into account, helping to ensure that the outcome of decentralised decisions and market competition leads to overall social efficiency.

Please do not hesitate in contacting us if you need any further clarification on the above subject.

Yours faithfully,

**Paulo Ojeaga**
**Senior Partner**
**for: EPS & Co (Tax Consultants)**

**Appendix 1: Tax liabilities computation**

| | ₦'000 | ₦'000 |
|---|---|---|
| Net profit as per accounts | | 50,810 |
| Add back: | | |
| Depreciation | 15,400 | |
| Allowance for bad debts | 6,200 | |
| Repairs and maintenance | 1,500 | |
| Certified exploration expenditure | 4,500 | |
| Development and processing expenditure | 2,500 | 30,100 |
| Adjusted/assessable profit | | 80,910 |
| Less: Capital allowances (Note 1) | | 20,200 |
| Total profit | | 60,710 |
| Companies income tax @ 30% | | 18,213 |
| Tertiary education tax @ 2.5% of assessable profit | | 2,022.75 |
| Total tax liabilities payable | | 20,235.75 |

**Capital allowances of new acquisitions**

| | Certified exploration | Development and processing | Furniture and fitting | Capital allowances |
|---|---|---|---|---|
| | IA 95% | IA 95% | IA25% | |
| | AA Nil | Nil | AA 20% | |
| | ₦'000 | ₦'000 | ₦'000 | ₦'000 |
| **2022 A/Y** | | | | |
| Cost | 4,500 | 2,500 | 1,500 | |
| IA | (4,275) | (2,375) | (375) | 7,025 |
| AA | (0) | (0) | (225) | 225 |
| | | | | 7,250 |
| **2023 A/Y** | | | | |
| TWDV | 225 | 125 | 900 | |

Note 1: capital allowances claimable:

| | ₦'000 |
|---|---|
| Brought forward | 750 |
| Current year (without additions during the year) | 12,200 |
| Current year additions | 7,250 |
| **Total** | **20,200** |

## Examiner's report

The question tests the candidates' understanding of the concept of tax neutralities and the provisions of the Nigerian Minerals and Mining Act 2007 (as amended), in respect of computations of tax liabilities of a mining company.

About 70% 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 the allowable and disallowable expenses in the determination of adjusted profit and the tax liabilities.

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 mining operations in Nigeria.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **Computation of tax liabilities** | | |
| | Memo (heading) | ½ | |
| | Memo (discussion of results) | 1 | |
| | Net profit as per accounts | ½ | |
| | Depreciation | ½ | |
| | Repairs and maintenance | ½ | |
| | Certified exploration expenditure | ½ | |
| | Development and processing expenditure | ½ | |
| | Adjusted/assessable profit | ½ | |
| | Capital allowances | ½ | |
| | Total profit | ½ | |
| | Companies income tax | ½ | |
| | Tertiary education tax | ½ | |
| | Capital allowance computation: | | |
| | IA (Development and processing expenditure) | ½ | |
| | IA (Certified exploration expenditure) | ½ | |
| | IA (Furniture and fittings) | ½ | |
| | AA (Furniture and fittings) | ½ | |
| | Total capital allowances | ½ | 9 |
| b. | **Concept of tax neutralities and its applications to specific policy issues** | | |
| | 1 mark for each discussion on the concept of tax neutralities, subject to a maximum of 3 points | 3 | |
| | 1½ marks for each discussion on applications of neutrality to specific policy issues, subject to a maximum of 2 points | 3 | 6 |
| | **Total** | | **15** |

**ICAN/232/V/C3** **Examination No..........................**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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, NOVEMBER 15, 2023**

**DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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**

Finkex Plc (FP) is a listed company which operates in the pharmaceutical sector, manufacturing a broad range of drugs under licence in a number of countries along the ECOWAS sub-region. For a number of years the company has grown organically.

Three years ago, the company acquired 20% of the issued share capital of Toba Plc (TP) for ₦110 million, as a route to both expansion and diversification. The acquisition was by private negotiation in exchange for an issue of its own shares.

Toba Plc is involved in a different area of the pharmaceutical sector from FP as it is primarily a research-driven company involved in the development of new drugs.

To fasten the realisation of its diversification strategy, the directors of FP have now decided to acquire the remaining 80% of Toba is share capital.

Extracts from the financial statements of Finkex Plc are given below:

**Finkex Plc**
**Extracts from financial statements for last two years**

| **Year** | **2023** | **2022** |
|---|---|---|
| | **₦'m** | **₦'m** |
| Non-current assets (including investment in Toba plc) | 602.8 | 499.4 |
| Current assets | 265.0 | 180.4 |
| | 867.8 | 679.8 |
| Current liabilities | 199.2 | 136.8 |
| | 668.6 | 543.0 |
| Non-current liabilities | 149.5 | 159.4 |
| **Net assets** | 519.1 | 383.6 |
| Issued share capital | | |
| (ordinary shares of ₦1 each) | 100.0 | 73.6 |
| Share premium | 84.0 | 12.4 |
| Profit or loss account | 335.1 | 297.6 |
| | **519.1** | **383.6** |

| | | |
|---|---|---|
| Sales revenue | 1320.6 | 496.0 |
| Earnings after tax | 51.50 | 37.60 |
| Dividend | 14.0 | 14.0 |
| **Retained profits** | **37.5** | **23.6** |

All that you know about Toba plc is that it has 114 million shares in issue; total share capital and reserves are ₦684 million; earnings after tax in the most recent year were ₦85.2 million on sales of ₦1,252.0 million, which were double those of the previous year; and that it has an investment valued at ₦80 million (book and market) in a type of enterprise which might not be of interest to Finkex Plc.

The current stock market prices per share are: Finkex Plc 300k; Toba plc 341k. Both companies pay tax at 50%.

**Required:**

a. At the above market prices, how many shares of Finkex Plc would have to be issued to buy the rest of Toba plc on a share-for-share offer? (4 Marks)

b. With regard to earnings and also the book value of assets per share, how would the above share-for-share offer affect the position of:

 i. existing shareholders in Finkex Plc; (6 Marks)

 ii. the 80% shareholders in Toba Plc whose shares were to be acquired? (4 Marks)

c. Assuming that the 80% shareholders in Toba Plc were prepared to accept ₦80 million 10% Loan Stock as part of the consideration:

 i. What advantages might there be for Finkex Plc in this arrangement? (2 Marks)

 ii. What total price could Finkex Plc afford to pay without diluting the earnings per share of its existing shareholders, as calculated in (b) (i) above? (6 Marks)

d. If the board of Toba Plc decided to advise its shareholders not to accept an offer from Finkex Plc, what arguments might they use - including any derived from the financial information available about Finkex Plc? (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

About one year ago, you were employed by Tesco, an American company based in New York. You work on-line from home in Nigeria and you are a member of the international treasury of Tesco.

Tesco supplies medical equipment to the USA and Europe. It also buys some basic raw materials from Europe.

It is currently 30 November 2024.

On 31, May 2025 Tesco is due to receive CHF16.3 million from a Swiss customer and also to pay CHF4.0 million to a Swiss supplier.

Exchange rates (quoted as US$/CHF1)

| | |
|---|---|
| Spot | 1.0292 – 1.0309 |
| Three months forward | 1.0322 – 1.0341 |
| Six months forward | 1.0356 – 1.0378 |

Annual interest rates available to Tesco:

| | **Investing rate** | **Borrowing rate** |
|---|---|---|
| Switzerland | 3.2% | 4.4% |
| USA | 4.6% | 5.8% |

Currency futures (contract size CHF125,000, futures price quoted as US$ per CHF1)

| | **Future price** |
|---|---|
| December | 1.0306 |
| March | 1.0336 |
| June | 1.0369 |

Currency options (contract size CHF125,000; exercise price quotation US$ per CHF1, premium: US cents per CHF1).

| | | Calls | | | Puts | |
|---|---|---|---|---|---|---|
| Exercise price | December | March | June | December | March | June |
| 1.0375 | 0.47 | 0.50 | 0.53 | 0.74 | 0.79 | 0.86 |

**Required:**

Advise Tesco, showing relevant calculations, which of the under listed hedging strategies the company should adopt for its CHF cash flows on 31 May 2025:

i. Forward contracts (3 Marks)

ii. The money market (5 Marks)

iii. Traded futures (6 Marks)

iv. Traded options (6 Marks)

In the case of options, assume the options are exercised.

**Note:** Any amount not hedged by a future or option contract will be hedged on the forward market. **(Total 20 Marks)**

## QUESTION 3

Niko Plc is a large company operating across the country. It is purely equity financed and has year-end of 31 December.

Currently the company has to fulfill a particular contract in Abuja, and it can do this in one of two ways.

Under the first (proposal A), it can purchase plant and machinery; while under the second (proposal B), it can use a machine already owned by the company.

The end-year operating net cash inflows in nominal (i.e. money) terms and before corporate tax are as follows:

| | 2024 | 2025 | 2026 |
|---|---|---|---|
| | **₦'000** | **₦'000** | **₦'000** |
| Proposal A | 200,000 | 275,000 | 350,000 |
| Proposal B | 350,000 | 350,000 | - |

(Assume today is 31 December 2023).

### Proposal A

Under this proposal the company will incur an outlay of ₦312,500,000 on 31 December 2023 for the purchase of plant and machinery.

The labour force required under the proposal will have to be recruited locally, and budgeted wages have been taken into account in preparing the estimates of future nominal net cash inflows given above.

The plant and machinery is expected to be scrapped on 31 December 2026, the nominal cash proceeds at that date being projected as ₦25,000,000.

**Proposal B**

The second proposal covers a two year period from 31 December 2023. It will require the company to use a machine which was purchased for ₦750 million a number of years ago and has been fully written down for tax purposes. The company has no current use for the machine, and its net realisable value at 31 December 2023 is ₦250 million.

However, if retained unused there would be no incremental costs of keeping it, and it would be sold on 1 January 2025 for an estimated ₦300 million in nominal money terms. If used under the second proposal, the expected residual value of the machine would be zero at the end of the two year period.

The labour force required under the second proposal would be recruited from elsewhere within the company, and in end-year nominal cash flow terms would be paid ₦100 million and ₦108 million respectively for 2024 and 2025. However, the staff that would have to be taken on in other departments to replace those switched over to the new project would in corresponding end-year nominal cash flow terms cost ₦110 million for 2024 and ₦118.80 million for 2025.

The end-year nominal net cash inflows of ₦350 million for both 2024 and 2025 which are associated with the second proposal are after deducting the remuneration of the work force actually employed on the scheme.

**Working Capital**

Working capital requirements in nominal money terms at the beginning of each year are estimated at 10% of the end-year operating net cash inflows referred to in the table above. The working capital funds will be released when a proposal is completed.

**Other information**

Expected annual inflation rates over the next four calendar years are:

| 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|
| 10% | 8% | 6% | 5% |

The company's real cost of capital is 10% per annum and is expected to remain at that rate for the foreseeable future.

Income tax is expected to be 40% over the planning period, tax being payable twelve months after the accounting year end to which it relates.

Capital allowances are available on plant and machinery at 20% reducing balance. You can assume that the company generates sufficient taxable profits to relieve all capital allowances at the earliest opportunity.

**Required:**

a. Calculate the net present value at 31 December 2023 of each of the two mutually exclusive projects; (17 Marks)

b. Indicate briefly any reservations you might have in basing an investment decision on these figures. (3 Marks)

**Notes**

i. Calculate to the nearest ₦000

ii. Show all calculations clearly

iii. Repetition of a project is not possible **(Total 20 Marks)**

## QUESTION 4

Xeco is looking to spend ₦15m to expand its existing business. This expansion is expected to increase profit before interest and tax by 20%. Recent financial information relating to Xeco can be summarised as follows:

| | **₦'000** |
|---|---|
| Profit before interest and taxation | 13,040 |
| Finance charges (interest) | (240) |
| Profit before taxation | **12,800** |
| Taxation | (3,840) |
| Profit for the year (earnings) | **8,960** |

Xeco is not sure whether to finance the expansion with debt or with equity. If debt is chosen, the company will issue ₦15m of 8% loan notes at their nominal value of ₦100 per loan note. If equity is chosen, the company will have a 1 for 4 rights issue at a 20% discount to the current market price of ₦6.25 per share. Xeco has 12 million shares in issue. The company pays corporate tax at 30%.

**Required:**

a. Evaluate whether, on financial grounds, Xeco should finance the expansion with debt or equity. (10 Marks)

b. Explain the relationship between systematic risk and unsystematic risk. (5 Marks)

c. Discuss the assumptions made by the capital asset pricing model. (5 Marks)

**(Total 20 Marks)**

## SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

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

## QUESTION 5

Ope plc has ₦10m 5 percent convertible bonds in issue. The option to convert into 40 ₦1 ordinary shares is open only for one more year; they must be either converted in one years' time or left as ordinary bonds until nine years' time when they will be redeemed at par. The current share price is ₦1.60 and annual growth rate in share price is 15 percent per annum. The current required return on Ope's equity is 25 percent, its business being relatively risky.

The current yield on ordinary non – convertible bonds in similar companies is 11 percent. These interest rates are expected to remain constant.

Ife plc has 100,000 warrants outstanding, each entitling the holder to subscribe for one ₦1 ordinary share at 90 kobo any time during the next 3 years. The current share price is 57 kobo and the capital growth is expected to be constant at 12 percent p.a. in the future. The current price of the warrant is 10 kobo.

**Required:**

a. Calculate the current value of Ope's convertibles as straight debt, i.e. ignoring the option to convert and the value if conversion were to take place today. Would you expect the market value of the convertible to be above or below each of these amounts and why? (5 Marks)

b. By how much should the share price of Ope Plc rise before holders would be induced to convert, on the last possible date for conversion? (4 Marks)

c. Explain why the market value of a convertible bond is likely to be affected by the dividend policy of the issuing company. (4 Marks)

d. Based on the projected capital growth for Ife Plc, would you expect holders of the warrants to exercise them before expiry? What is the minimum annual growth -rate of the share price necessary to induce holders to exercise their warrants? (2 Marks)

**(Total 15 Marks)**

## QUESTION 6

a. State and explain examples of conflicts of interest that may exist between shareholders and managers. (9 Marks)

b. Explain the likely implications for a typical company of lower interest rates. (6 Marks)

**(Total 15 Marks)**

## QUESTION 7

Kayode John just completed his ICAN examinations, picking up prices at every level of the examinations. John is starting a job as a junior financial analyst for Eko Assets Management. John is convinced that an in-depth understanding of the forward P/E ratio is one of the most useful tools for investment decisions. He plans to use the forward P/E ratio to help his firm identify undervalued stocks.

John is currently reviewing information on a company called Food-is-key Plc (FP). The company distributes healthy food across the country and has been in business for over twenty years. John spent many hours analysing the company. He believes that Nigerians will continue to eat more healthy food and FP may be an attractive investment.

John is concerned about FP's new management team. In a recent news conference, the new Chief Financial Officer (CFO) of FP stated that FP should have increased their dividend payout ratio to 60% last year. The CFO stated that a higher dividend payout ratio would have increased the stock price.

John is evaluating the validity of the CFO's statement. John expects that FP's Return on Equity (ROE) and required return would have remained the same if the company changed their dividend payout ratio to 60%. He is uncertain about the impact on the price of the stock. (Round all earnings, dividends and prices to the nearest kobo and round all other figures to four decimal places.)

For further information see Table 1" Statement of Financial Position for FP" and Table 2 "Income Statement for FP" and "Additional Information".

**Required:**

a. Provide an estimate of FP's ROE in 2023 and use the DuPont identity to decompose into three factors. (2 Marks)

**Notes**

- Due to missing information for 2022, use the statement of financial position values as of December 31, 2023, for your ROE calculation.
- The DuPont identity is given by:
  ROE = Profit margin × Total asset turnover × Equity multiplier
  ROE = (Net income/Sales) × (Sales/ Total assets) × (Total assets/ Equity)

b. Estimate the sustainable growth rate in 2023. (2 Marks)

c. Using the CAPM, calculate the required return for FP. (1 Mark)

d. Calculate, at the start of 2024, the forward P/E ratio and the stock price under two scenarios. The first scenario is based on the FP's actual dividend payout ratio in 2023. The second scenario is based on the assumption that the new CFO changed the dividend payout ratio to 60% in 2023. (Note: Base your computations on the constant growth dividend model). (6 Marks)

**Note:** Forward P/E ratio is also called leading P/E ratio = $P_0/E_1$

e. Should FP have changed the dividend payout ratio to 60% in 2023? Explain the reasons why increasing the dividend payout ratio would have been a good or bad idea for FP. What is the critical question that the CFO should consider when making this decision? Explain your answer. (4 Marks)

**(Total 15 Marks)**

**Table 1, Statement of financial position, as of December 31, 2023**

| | |
|---|---|
| | **₦'000** |
| **Current Assets** | |
| Cash | 20,000 |
| Accounts receivable | 60,000 |
| Inventories | 80,000 |
| **Total current assets** | **160,000** |
| **Other Assets** | |
| Property, plant and equipment | 375,000 |
| Accumulated depreciation | -75,000 |
| Net property, plant and equipment | 300,000 |
| Intangible assets | 215,000 |
| Other non-current assets | 50,000 |
| **Total non-current assets** | **565,000** |
| **Total assets** | **725,000** |
| **Current liabilities** | |
| Short-term notes payable | 25,000 |
| Accounts payable | 35,000 |
| **Total current liabilities** | **60,000** |
| **Long-term liabilities** | |
| Long-term liabilities | 225,000 |
| Other non-current liabilities | 35,000 |
| | **260,000** |
| **Total liabilities** | **320,000** |
| **Total long-term liabilities** | |
| **Shareholder equity** | |
| Ordinary shares | 50,000 |
| Retained earnings | 355,000 |
| **Total equity** | **405,000** |
| **Total equity and liabilities** | **725,000** |

**Table 2, Income statement for FP, from January 1, 2023 to December 31, 2023**

| | |
|---|---|
| In thousands of naira (except for per share data) | **₦'000** |
| Sales revenue | 675,000 |
| Cost of goods sold | 425,000 |
| **Gross profit** | **250,000** |
| | 170,000 |
| Selling, general and administrative expenses | |
| **Earnings b/F interest, taxes, depreciation and amortisation (EBITDA)** | **80,000** |
| Depreciation and amortisation | 15,000 |
| **Earnings, before interest and taxes (EBIT)** | **65,000** |
| Interest | 16,000 |
| **Earnings, before taxes** | **49,000** |
| Income taxes | 12,250 |
| **Net income** | **36,750** |

**Additional information**

| | |
|---|---|
| Number of shares outstanding (000) | 20,000 |
| Dividend distributed (000) | 15,000 |
| Return on 30 year Treasury securities | 2.75% |
| Expected return on a market index | 9.50% |
| Beta for FP | 0.8 |

# 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. $\dfrac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate

n = number of periods

*Discount rate (r)*

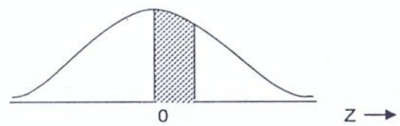
*Periods*

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

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

## NORMAL DISTRIBUTION

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




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

## SOLUTION 1

a. Total value of Toba = 114m × ₦3.41 = ₦388.74m
Value of current holding of FP (20%) = 77.748
Now to be acquired (80%) = 310.992
Number of shares in FP needed = ₦310.992m/₦3 = 103.664m

b. i **Earnings**: It is assumed that Toba plc is accounted for as an associated company of FP plc. This means that 20% of the profit of Toba plc is already included in the existing earnings of FP. After take over, only 80% of the existing earnings of Toba plc can be added to the earnings of FP.

| | **Expected** | **2023** | **2022** |
|---|---|---|---|
| No of shares: | | | |
| - Per SOFP | 100.00 | 100.00 | 73.60 |
| - Additional (issued to Toba) | 103.664 | - | |
| Total number of shares (q) | 203.664 | 100.00 | 73.60 |
| Earnings: | | | |
| - Per income statements | 51.50 | 51.50 | 37.60 |
| - 80% of Toba | 68.16 | - | |
| Total PAT | 119.66 | 51.50 | 37.60 |
| EPS (PAT ÷ q) | 58.75k | 51.50k | 51.09k |

The EPS will therefore increase to 58.75 kobo from a previous average of about 51 kobo.

**Assets**

**Existing**:

| | |
|---|---|
| Net Asset | ₦519.10 |
| No. of shares | 100.00 |
| Assets per share | ₦5.19 |

**Expected**

| | |
|---|---|
| Existing Net Asset of FP | 519.10 |
| Toba's net asset | 684.0 |
| Investment in associated company | (110.0) |
| | 1,093.10 |
| No of shares | 203.66 |
| Asset per share | ₦5.37 |

So, asset per share is expected to increase.

ii) **Earnings**

Existing EPS in Toba plc = ₦85.20m ÷ 114 = 74.74k

Share exchange ratio = VPS in Toba plc/ VPS in FP = 341/300

Every unit of share in Toba plc that currently earns 74.74, will after acquisition by FP earn = 58.75 × 341/300 = 66.78k.

This means there will be a loss of earnings by the existing shareholders of Toba plc.

**Asset**

Existing asset per share (APS) in Toba plc = ₦684/114 = ₦6

Expected APS in FP is ₦5.37 × ₦341/300 = ₦6.10.

This means that the existing 80% shareholders in Toba plc will have a marginal increase in APS.

d. i **The advantages for FP in the arrangement are as follows:**

- The loan interest is a tax deductible expense.
- As long as FP earns more than the 10% before tax on the assets of Toba plc, the ₦80m loan stock will gear up the return to the shareholders in the combined company.
- The loan stock will be long-term and the cash flows generated from the assets acquired in Toba plc may in fact repay the loan stock.
- Instead of issuing approximately 104m shares against an existing share capital of 100m shares, FP would need only 77m shares, i.e. a market value of ₦230.992m being ₦310.992m less ₦80m divided by the current share price of ₦3in FP. This would mean that the existing 80% shareholders would not hold the majority of the shares in the new combined company.

ii)

| | ₦'m |
|---|---|
| PAT, as calculated in (b) (i) | 119.66 |
| Add back tax | 119.66 |
| Current post-takeover EBIT | 239.32 |
| Less interest = 10% × ₦80m | (8.00) |
| EBT | 231.32 |
| New PAT | 115.66 |

Let the maximum price to pay = ₦x
Total value of the 80% holding in Toba = 0.8 × 114,000,000 × ₦x = 91,200,000x
Number of shares needed = ₦91,200,000x /₦3 = 30,400,000x shares
Expected total shares in FP = 30,400,000x + 100,000,000
Revised EPS in FP = ₦115,660,000/(30,400,000x +100,000,000)
Thus: 115,660,000/(30,400,000x + 100,000,000) = 0.5875
i.e. (30,400,000x + 100,000,000) (0.5875) = 115,660,000
30,400,000x + 100,000,000 = 196,868,085
x = ₦3.1865

| | |
|---|---|
| Total value of shares = 0.80 × 114m × ₦3.1865 | = 290,608,800 |
| Add loan stock | 80,000,000 |
| Total purchase consideration | =370,608,800 |

d. If the board of Toba plc decided to advise its shareholders not to accept an offer from FP the following arguments might be used:

- The earnings per share for the existing shareholders of Toba plc will fall unless there is a dramatic improvement in the performance of the combined company compared to the two individual companies.

- FP has an existing share capital of 100 million shares and is proposing to issue a further 103.664 million shares for 80% of Toba plc. In effect, therefore Toba plc is taking over FP because the 80% shareholders in Toba plc will hold the majority of the shares in the new combined company. However, the board of FP will be in control of the new combined company and furthermore, the board of Toba plc does not wish to take over FPbecause of the various reasons given below.

- Toba plc has doubled its turnover from the previous year and presumably has improved its earnings after tax.

- Following from point 3 above, the prospects of Toba plc may be very good and the existing shareholders in Toba plc will not reap the full future benefits because the benefits will be shared with the shareholders of FP.

- Toba plc has an investment valued at ₦80 million which is in a type of enterprise which might not be of interest to FP but this investment may be a major source of income for Toba plc and, therefore for the existing shareholders of Toba plc.

- During the previous year,FP issued 26.40 million ₦1.00 ordinary shares at ₦98 million (₦26.40 million + share premium of ₦71.60 million) which is a price of 3.71 naira per share, but the existing market price per share of FP is only ₦3.00, therefore the share price of FP has declined since the issue of the previous share capital.

- On sales of ₦1,320.60 million, FP made earnings after tax of only ₦51.50 million which is under 4% of sales, whereas Toba plc with sales of ₦1,252 million, made earnings after tax of ₦85.2 million which is about 7% of sales.

### Examiner's report

This is a four-part question testing candidates' knowledge of various aspects of acquisition.

In part (a), candidates were expected to calculate share exchange ratio.
In part (b), candidates were expected to use their results in (a) to evaluate the impact of the acquisition on earnings per share and asset per share of the respective shareholders.

In part (c), candidates were expected to evaluate the key advantages of paying for the acquisition using loan stock rather than cash. In addition, they were expected to estimate the offer price that will not dilute the earnings per share of the existing shareholders.

Finally in part (d), candidates were expected to provide arguments that might be used to persuade shareholders in Toba Plc against accepting the offer.

Being a compulsory question, most of the candidates attempted the question but the level of performance was very poor. Major error committed by most of the candidates was their inability to recognise the treatment of the initial acquisition of 20% by Finkex Plc as an associated company. Furthermore, candidates that attempted part (d) of the question merely produced generic solutions rather than relating their answers to the scenario painted in the question.

Candidates are reminded that success at this level of the examination requires critical thinking, demonstration of knowledge, and adequate preparation for the examination.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | Number of shares required to be issued to buy the rest of Toba Plc. | 4 | 4 |
| b. | How share –for share offer will affect position of: | | |
| i | Existing Shareholders in Finkex Plc | 6 | |
| ii | 80% Shareholders in Toba Plc | 4 | 10 |
| c. | Assuming 80% Shareholders in Toba Plc were prepared to accept the consideration: | | |
| i. | What advantages might Finkex Plc have | 2 | |
| ii. | What total price could Finkex Plc afford | 6 | 8 |
| d. | Argument not to accept Finkex Plc offer | 8 | 8 |
| | **Total** | | **30** |

**SOLUTION 2**

The amount to be hedged is the net receipt, i.e.
CHF16.3 – CHF4 = CHF12.3 million.

i. **Forward contract**

6 month rate is used, as it is 6 months between today's date (30 November) and date of settlement (31 May).
Net receipt = CHF12,300,000 × \$1.0356 = \$12,737,880
(**Tutorial note**: The quoted rates are direct to dollar. Therefore when converting the foreign currency, i.e. CHF in this case, to dollar, we multiply. We must therefore use the lower of the two rates).

ii. **Money market hedging**

- As foreign net asset is being hedged, borrow today for six months, at the foreign borrowing rate.
- The PV of the foreign net asset i.e. amount borrowed:
  CHF12,300,000/(1.022*) = CHF12,035,225
  (* Annual rate = 4.4%, 6 – monthly rate = 4.4/2 = 2.2%)
- Convert the amount borrowed, at **spotrate**, to dollar.
  Receipt = CHF12,035,225 × \$1.0292 = \$12,386,654
- Invest the dollar receipt in the US for 6 months at 4.6% p.a, i.e. 4.6/2 = 2.3% for 6 months.
  Net proceed = 12,386,654 × (1.023) = \$12,671,547

iii. **Futures**

- Sell CHF futures now to hedge against sale of CHF when money is received from Swiss customer.
- June futures (1.0369) to be selected as only date after 31 May.
- Number of contracts = CHF12,300,000/CHF125,000 = 98.4, say 98, hedging 98 × CHF125,000 = CHF12,250,000.
- Remainder of CHF50,000 (CHF12,300,000 – 12,250,000) to be hedged in forward market.
  Receipt = CHF50,000 × 1.0356 = $51,780
- **Futures price**: This can be estimated from March and June futures rates.
  Predicted futures rate at the end of May = 1.0336 + ((1.0369 – 1.0336) × 2/3) = 1.0358
  (**Tutorial note**: 31 May is 2/3 of time between 31 March and 30 June, so use 2/3 of the difference between March futures price of 1.0336 and June futures price of 1.0369).

> Alternatively, the futures price can be calculated from spot rate and June futures rate. 31 May is 6/7 of time between 30 November and 30 June, so use 6/7 of the difference between spot rate of 1.0292 and Junes rate of 1.0369.
>
> Predicted futures rate at the end of May = 1.0292 + ((1.0369 – 1.0292) × 6/7) =1.0358

Using either methods, the expected receipt can now be calculated.
Expected receipt = CHF12,250,000 × 1.0358 = CHF12,688,550

- **Summary of outcomes**

| | **CHF** |
|---|---|
| Futures | 12,688,550 |
| Remainder on forward market | 51,780 |
| | 12,740,330 |

iv. **Options**

- Call/put options? Buy CHF put options to hedge against sale of CHF when money is received from Swiss customer.
- Buy June options – the only date after May
- Number of contracts – 98, same as futures
- Total amount hedged, CHF12,250,000 – same as futures
- Remainder to be hedged on the forward contract: CHF50,000 – same as futures.

**Premium**

Premium = Number of contracts × contract size × 0.0086

= 98 × 125,000 × 0.0086 = $105,350

(Note that the premium is quoted in cents - not US dollars).

| Net receipt | |
|---|---|
| Receipt from option | **US$** |
| CHF125,000 × 98 × 1.0375 | 12,709,375 |
| Forward contract (as for futures) | 51,780 |
| Premium | (105,350) |
| | 12,655,805 |

**Summary**

| **Hedging Method** | **Net receipt ($)** |
|---|---|
| Forward contract | 12,737,880 |
| Money market | 12,671,547 |
| Futures | **12,740,330** |
| Options | 12,655,805 |
| Futures provide a better outcome | |

**Examiner's Report**

The question tests candidate's knowledge of foreign exchange risk management. They were expected to use four different hedging techniques of forward contract, money market, futures contracts and option contracts.

Only a very few candidates attempted the question and unsurprisingly the level of performance was very poor. The major problems encountered by the candidates who attempted it include:

- Failure to recognise the need to match the expected receipt and payment occurring at the same date and in the same currency;
- Failure of candidates to identify the relevant exchange rates to use;
- Inability to appropriately manipulate the various exchange rates, for example, dividing instead of multiplying and vice versar, etc.

It is recommended that students preparing for this examination should adequately cover the entire syllabus.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| | Determine the best hedging strategy | | |
| (i) | Forward Contract | 3 | |
| (ii) | The money market | 5 | |
| (iii) | Traded Futures | 6 | |
| (iv) | Traded Options | 6 | **20** |

**SOLUTION 3**

a. **Proposal A**

| **Time** | **0** | **1** | **2** | **3** | **4** |
|---|---|---|---|---|---|
| | (31.12.23) | (31.12.24) | (31.12.25) | (31.12.26) | (31.12.27) |
| | **₦'000** | **₦'000** | **₦'000** | **₦'000** | **₦'000** |
| (Outlay)/Scrap value | (312,500) | - | - | 25,000 | - |
| Net inflows | - | 200,000 | 275,000 | 350,000 | - |
| Tax on inflows at 40% | - | - | (80,000) | (110,000) | (140,000) |
| Tax savings on cap. allowances (W1) | - | 25,000 | 20,000 | 16,000 | 54,000 |
| Working capital (W2) | (20,000) | (7,500) | (7,500) | 35,000 | |
| NCF | (332,500) | 217,500 | 207,500 | 316,000 | (86,000) |
| PVF (W3) | 1 | 0.826 | 0.696 | 0.597 | 0.517 |
| Present values | (332,500) | 179,655 | 144,420 | 188,652 | (44,462) |

NPV = ₦135,765 i.e. ₦135,765,000.

**Proposal B**

| **Time** | **0** | **1** | **2** | **3** |
|---|---|---|---|---|
| | (31.12.23) | (31.12.24) | (31.12.25) | (31.12.26) |
| | **₦'000** | **₦'000** | **₦'000** | **₦'000** |
| Net inflow as given | - | 350,000 | 350,000 | - |
| Adjustment for labour (W5) | - | (10,000) | (10,800) | - |
| Adjusted net inflows | - | 340,000 | 339,200 | - |
| Related tax at 40% | - | - | (136,000) | (135,680) |
| Lost disposal proceeds (W4) | - | (300,000) | - | - |
| Balancing charge avoided at 40% | - | - | - | 120,000 |
| Working capital (W6) | (35,000) | - | 35,000 | - |
| NCF | (35,000) | 40,000 | 238,200 | (15,680) |
| PVF (W3) | 1 | 0.826 | 0.696 | 0.597 |
| Present values | (35,000) | 33,040 | 165,787 | (9,360) |

NPV = ₦173,187 i.e. ₦173,187,000.

Proposal B should be chosen because it has the higher NPV.

**Working Notes**

**1. Tax savings on capital allowances year ended**

| | | | Tax savings at 40% | Time due |
|---|---|---|---|---|
| | | **₦'000** | **₦'000** | |
| 31.12.23 | Investment | 312,500 | | |
| | WDA at 20% | (62,500) | 25,000 | 1 |
| | | 250,000 | | |
| 31.12.24 | WDA at 20% | (50,000) | 20,000 | 2 |
| | | 200,000 | | |
| 31.12.25 | WDA at 20% | (40,000) | 16,000 | 3 |
| | | 160,000 | | |
| 31.12.26 | Scrap proceeds | (25,000) | | |
| | Bal.allowance | 135,000 | 54,000 | 4 |

**2. Working capital (₦'000)**

| **Time** | **0** | **1** | **2** | **3** |
|---|---|---|---|---|
| Cum (10% of given operating CF) | 20,000 | 27,500 | 35,000 | - |
| (Incremental)/recovery | (20,000) | (7,500) | (7,500) | 35,000 |

**3. Money cost of capital**

Since we are given money cash flows, we must make use of money cost of capital (MCC).

MCC = (1 + RCC)(1 + inflation rate) -1
2024 MCC = (1.10)(1.10) -1 = 21%
2025 MCC = (1.10)(1.08) -1 = 18.8%
2026 MCC = (1.10)(1.06) -1 = 16.6%
2027 MCC = (1.10)(1.05) -1 = 15.5%

The discount factors are

| | | |
|---|---|---|
| Time 1 | 1/1.21 | = 0.826 |
| 2 | 1/1.21 × 1/1.188 | = 0.696 |
| 3 | 1/1.21 × 1/1.188 × 1/1.166 | = 0.597 |
| 4 | 1/1.21 × 1/1.188 × 1/1.166 × 1/1.155 | = 0.517 |

**4. Relevant cost of machine – Proposal B**

This proposal utilises existing machinery which would otherwise be sold. Therefore the opportunity cost should be included as cash flow. If proposal B is not undertaken the company has the choice of either selling the machine at 31 December 2023 for ₦250 million or selling it at 1 January 2025 for ₦300 million.

The PV of the two options are:

- **Sale at 31 December 2023**

| | | ₦'000 |
|---|---|---|
| Sale at 31 December 2023 (Time 0) | = | 250,000 |
| Bal. charge at 31 December 2024 | | |
| (Time 1) = ₦250,000 × 0.4 × 0.826 | = | (82,600) |
| PV | | 167,400 |

- **Sale at 1 January 2025 (Time 1)**

| | | |
|---|---|---|
| Sale proceeds (₦300,000 × 0.826) | = | 247,800 |
| Balancing charge at 31 December 2026 | = | (71,640) |
| (Time 3) = ₦120,000 × 0.597 | | |
| PV | | 176,160 |

Therefore the company should sell the machine at 1 January 2025 if Proposal B is not undertaken and the latter cash flows therefore represent the relevant cash flows to be included in the analysis.

5. **Labour costs - Proposal B**

The incremental labour cash flows arising from the project are the amount paid to the replacement staff, i.e. ₦110 million in 2024 and ₦118.80 million in 2025, but ₦100 million and ₦108 million have been deducted in arriving at the net cash inflows of ₦350 million for both years. Labour costs have therefore been under charged. Therefore cash inflow must be reduced by ₦10 million (₦110m – ₦100m) in 2024 and ₦10.80 million (₦118.80m – ₦110m) in 2025.

6. **Working capital – Proposal B (₦'000)**

| **Time** | **0** | **1** | **2** |
|---|---|---|---|
| Cum (=10% of given operating CF | 35,000 | 35,000 | - |
| Incremental | (35,000) | 0 | 35,000 |

b. **Reservations relating to the figures used in (a) include:**

- The accuracy of the estimated cash flows, inflation rates and discount rates.
- It is assumed that all cash flows are received at the year-end whereas they are likely to occur throughout the year.
- The projects may entail different levels of risk but this has been ignored in the analysis.

**Examiner's report**

This question tests candidates' knowledge of capital budgeting. The candidates were expected to demonstrate their ability to handle taxation, inflation, relevant cash flows, etc in capital budgeting.

About sixty percent of the candidates attempted the question but the performance level was very poor.

Most of the candidates could not identify the relevant cashflows. Furthermore, they failed to identify the appropriate timing of the tax savings associated capital allowances.

In addition, almost all the candidates that attempted the question failed to handle appropriately the yearly changing money cost of capital.

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

**Marking guide**

| | Marks | Marks |
|---|---|---|
| Calculate the NPV of the two projects | 17 | 17 |
| Reservations based on Investment decision | 3 | 3 |
| **Total** | | **20** |

**SOLUTION 4**

a. Increased EBIT = 13.040m × 1.2 = ₦15,648,000

**Financing by debt**

Current interest payment = ₦240,000
Increase in interest = 15m × 0.08 = ₦1,200,000
Revised interest payment = 1,200,000 + 240,000 = ₦1,440,000
Revised PBT = 15,648,000 – 1,440,000 = ₦14,208,000
Revised PAT = 14,208,000 × 0.7 = ₦9,945,600
Current EPS = 8,960,000/12,000,000 = ₦0.747 per share
Revised EPS = 9,945,600/12,000,000 = ₦0.829 per share
Current PER = 6.25/0.747 = 8.37 times
Revised share price = 8.37 × 0.829 = ₦6.94 per share
Capital gain = 6.94 – 6.25 = ₦0.69 per share

**Financing by equity**

Revised PBT = 15,648,000 – 240,000 = ₦15,408,000
Revised PAT = 15,408,000 × 0.7 = ₦10,785,600
Revised number of shares = 12m × 1.25 = 15m shares
Revised EPS = 10,785,600/15,000,000 = ₦0.719
Current PER = 6.25/0.747 = 8.37 times
Revised share price = 8.37 × 0.719 = ₦6.02 per share
TERP = ((4 × 6.25) + 5.00)/5 = ₦6.00 per share
Capital gain = 6.02 – 6.00 = ₦0.02 per share

**Comment on findings**

Financing by debt is recommended as this leads to the larger capital gain for the shareholders. This recommendation could have been made on the basis of EPS values alone, as the price/earnings ratio multiplier is the same for both financing choices. However, it is important to compare the share price arising from the equity financing option with the theoretical ex rights share price, rather than with the cum rights share price.

b. With any investment, there is a risk that the actual outcome may be different from the expected or predicted outcome. This risk can be reduced by holding several different investments, since different investments are affected to differing extents by changes in economic variables such as interest rates and inflation rates. The return from one investment may increase, for example, when the return from a different investment decreases. Holding a range of different investments is known as portfolio diversification.

Experience shows that there is a limit to the reduction in total risk that can be achieved as a result of portfolio diversification. The risk that cannot be removed by portfolio diversification is called systematic risk. It represents risk relating to the financial system as a whole that cannot be avoided by any company in which an investment is made.

The risk that can be removed through portfolio diversification is called unsystematic risk or specific risk, as it relates to specific companies in which investments are made.

Experience has shown that investing in the shares of between 20 and 30 companies is sufficient to eliminate almost all of the unsystematic risk from an investment portfolio.

Systematic risk contains both business risk and financial risk. A company with no debt finance faces business risk alone, while a company with both equity and debt finance faces both business risk and financial risk.

c. The capital asset pricing model (CAPM) is based on several key assumptions.

**Investors hold diversified portfolios**
While portfolio theory considers total risk, the CAPM considers only systematic risk, as it makes the assumption that all investors hold diversified portfolios. Investors will therefore only require compensation for the systematic risk in their portfolios.

**Single – period transaction horizon**
In order to compare the returns on different assets such as shareholdings, the CAPM assumes that all returns are over a standard single-period transaction horizon, usually taken to be one year.

**Perfect capital market**
The CAPM assumes a perfect capital market, with no taxes, no transaction costs and perfect information freely available to all participants.

**Borrowing and lending at the risk-free rate**
The CAPM assumes that all investors can borrow and lend at the risk-free rate of return. This represents a minimum rate of return required by all investors and is one of the variables in the CAPM equation.

**Homogenous expectations**
All investors have the same expectations, meaning they all have the same expectations regarding future assets prices, returns and economic conditions.

**Investors are rational**
Investors are rational and aim to maximise their utility, making decisions based on rational assessment of risk and return.

**Investors are price takers**
Individual investors are price takers, meaning that they accept market prices and do not have the ability to influence those prices.

**No short sale restrictions**
Investors are allowed to short sell securities without restrictions, enabling them to sell securities they do not own with the expectation of buying it back at a lower price.

**Instantaneous adjustment of prices**
Prices adjust instantaneously to new information and there is no time lag in reaction of assets prices to news or events.

**Investors have a mean variance optimisation objective**
Investors make investment decisions based on a mean-variance optimization framework seeking to maximise expected returns for a given level of risk or minimise risk for a given level of expected returns.

## Examiner's report

This question tests candidates' knowledge of capital budgeting. The candidates were expected to demonstrate their ability to handle taxation, inflation, relevant cash flows, etc in capital budgeting.

About sixty percent of the candidates attempted the question but the performance level was very poor.

Most of the candidates could not identify the relevant cashflows. Furthermore, they failed to identify the appropriate timing of the tax savings associated capital allowances.

In addition, almost all the candidates that attempted the question failed to handle appropriately the yearly changing money cost of capital.

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

## Marking guide

| | Marks | Marks |
|---|---|---|
| Evaluation: whether to finance with debt or equity | 10 | 10 |
| Explain relationship between systematic and unsystematic risk | 5 | 5 |
| CAPM Assumptions | 5 | 5 |
| | | **20** |

## SOLUTION 5

a. The current value of the convertible bonds as simple straight debt is the PV of future interest and the redemption value.

| | | |
|---|---|---|
| PV of interest at 11% for 9 years = ₦5 × 5.537* | = | 27.685 |
| PV of redemption value at 11% in year 9 = ₦100 × 0.391 | = | 39.100 |
| | | 66.785 |

(*Annuity factor at 11% for 9 years).
So, the value as debt $V_D$ = ₦66.785.
Conversion value today = (CR) ($VPS_0$), where

CR = conversion ratio, i.e. number of shares receivable on conversion = 40 shares

$VPS_0$ = current market value per share = ₦1.60

Conversion value = 40 × ₦1.60 = ₦64

Thus, value as equity ($V_E$) = conversion value = ₦64

(Note: The above calculations are based on face value of ₦100 of the convertibles.)

The market value of the convertible is expected be higher than both its value as debt and value of equity because of the option to convert to equity, the excess of the market value of the convertible over the straight debt value is directly the value of the option.

The reason for the market value exceeding the conversion value is that holders have the debt to fall back on if the share price drops and they do not necessarily have to convert. The debt value here acts as a floor price for the security which means an investor faces less risk than by simply investing directly in shares.

b. The last possible date for conversion is one year's time. If they are unconverted then their value is as a straight bond with **8 years** to redemption. The straight debt value at the end of year 1 (i.e. 8 years to redemption) is the PV of the remaining interest for 8 years and the redemption value in year 8.

| | | |
|---|---|---|
| PV of interest of ₦5 p.a. for 8 years at 11% = ₦5 × 5.146 | = | 25.730 |
| PV of redemption value in year 8 at 11% = ₦100 × 0.434 | = | 43.400 |
| Total value as debt ($V_D$) | = | 69.130 |

This is the expected value of the bond in one year's time. To induce the bond holders to convert at that point in time, the conversion value must be at least equal to ₦69.13. Thus:

$$CV \geq 69.13$$
$$40 \times VPS_1 \geq 69.13$$
$$VPS_1 \geq 1.728$$

The share price must therefore rise by minimum of ₦1.728 – ₦1.60 = ₦0.128

This entails minimum growth rate in share price of 8% ((1.728/1.60)-1).

(Note that the information on equity rate of return of 25% is totally irrelevant).

c. The company's dividend policy has a major impact on its share price, and hence on the perceived value of the convertible bonds.

Assuming for the moment that the company is reasonably profitable, any profit which is not declared as dividend are ploughed back into the business; more profits should ensue and, other things being equal, the share price will rise.

Were the company to distribute all of its profits, on the other hand, the share price is likely to stagnate. Whereas by definition, dividends and retentions benefit the shareholders, only retentions benefit the convertible bonds holders.
Thus, payment of dividend is expected to reduce the market value of convertible bonds.

d. It will be worthwhile to exercise the warrants if the share price exceeds the exercise price of ₦0.90. At the projected growth rate of 12% p.a., the expected share price in 3 years' time is = 57k $(1.12)^3$ = 80k. It will therefore not be worthwhile to exercise the warrants.

The minimum growth rate necessary to induce holders to exercise the warrants is given by:

$$57k(1 + g)^3 = 90k$$
$$(1 + g)^3 = 90/57$$
$$g = (90/57)^{1/3} - 1 = 16.45\%$$

## Examiner's report

The question tests candidates' knowledge of the valuation of convertable bonds and warrants. Only about twenty percent of the candidates attempted the question but the level of performance was far below average.

We emphasise once again the need for students to cover the entire syllabus and practice examination type of questions when preparing for this examination.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | Calculate the current value of Ope's convertible at straight debt | 5 | 5 |
| b. | Determine how much should share price of Ope's Plc rise | 4 | 4 |
| c. | Explain why market value of a convertible bond is likely to be affected | 4 | 4 |
| d. | Minimum annual growth rte required | 2 | 2 |
| | | | **15** |

## SOLUTION 6

a. Conflicts of interest between shareholders and managers can arise due to differences in their objectives and priorities. Here are some examples of such conflicts:

i. **Executive Compensation**: Managers might be motivated to increase their own compensation through bonuses, stock options, or other incentives, even if it does not align with the long-term interests of shareholders. This can lead to a misalignment of interests between shareholders and managers.

ii. **Risk-Taking**: Managers may be tempted to take excessive risks to boost short-term profits and enhance their reputation, while shareholders may prioritise long-term stability and sustainable growth. Such risk-taking can expose shareholders to potential losses.

iii. **Dividend Policies**: Managers might prefer to retain earnings for expansion or personal benefit, whereas shareholders may prefer higher dividends to maximise returns on their investment.

iv. **Mergers and Acquisitions**: Managers may pursue acquisitions that benefit their personal interests, such as increased power or job security, even if they are not in the best interest of shareholders or the company's overall performance.

v. **Related-Party Transactions**: Managers could engage in transactions with companies they have personal interests in, leading to potential conflicts between their personal gains and the company's financial well-being.

vi. **Information Asymmetry**: Managers have access to more information about the company's operations and financials than shareholders. They may use this advantage to their benefit or selectively disclose information, causing inequities among shareholders.

vii. **Time Horizon**: Managers might prioritise short-term results to boost their performance metrics, while shareholders might be interested in the company's long-term growth and sustainability.

viii. **Corporate Governance**: Managers may resist changes that improve corporate governance or provide more shareholder rights to retain their power and control over the company.

ix. **Resource Allocation**: Managers may allocate resources to projects that benefit them personally or their close associates, rather than projects that generate the highest return for shareholders.

x. **Insider Trading**: Managers with access to sensitive information may use it for personal financial gain through insider trading, which is illegal and unethical.

To mitigate these conflicts of interest, it is essential to have robust corporate governance mechanisms, independent board oversight, and transparent reporting to align the interests of shareholders and managers in the best interest of the company as a whole.

b. The implications of a fall in interest rates for a typical company are:

(i) The cost of floating rate borrowing will fall, making it more attractive than fixed rate borrowing. For most companies with borrowings, interest charges will be reduced, resulting in higher profitability and earnings per share.

(ii) The value of the company's shares will rise, both because of the higher level of company profitability and also because of the lower alternative returns that investors could earn from banks and deposits, if interest rates are expected to remain low in the longer term.

(iii) The higher share value results in a lower cost of equity capital, and hence a lower overall cost of capital for the company. Investment opportunities that were previously rejected may now become viable.

(iv) As interest rates fall, consumers have more disposable income. This may increase demand for the company's products. Falling returns on deposits may, however, encourage many people to save more, rather than spend.

**Examiner's report**

This two-part question. Part (a) of the question tests candidates' knowledge of agency problems. On the other hand, part (b) tests candidates' knowledge of the implications of reduction in interest rate.

Almost all the candidates answer the question. Candidates showed strong level of understanding in part (a) but performance in part (b) was very disappointing as majority of them could not provide any meaningful answer.

Candidates are strongly advised to practise past questions and other examination type of questions when preparing for this examination.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | Examples of conflicts of Interest | 5 | 5 |
| b. | Implications of lower interest rates on Company | 6 | 6 |
| | | | **15** |

## SOLUTION 7

a. ROE = Profit margin × Total asset turnover × Equity multiplier
ROE = (Net income/ Sales) × (Sales / Assets)× (Assets / Equity)
ROE
= (36,750) / (675,000)× (675,000 / 725,000)× (725,000 / 405,000)
= (0.0544) × (0.9310)× (1.7901) = 0.0907 (= 9.07%)

b. Sustainable growth rate (g) = ROE × retention rate (b)
b = 1 – dividend payout ratio
Dividend payout ratio = Dividends/ Net income
= 15,000/36,750 = 0.4082 = 40.82%
g = 9.07% × (1 – 0.4082) = 9.07% × 0.5918 = 5.37%

c. Required return = risk-free rate + Beta × (Expected return on market - risk-free rate) = 0.0275 + 0.8 × (0.095 – 0.0275) = 0.0815 (= 8.15%)

d. With the constant growth dividend model:
Theoretical stock price:
$P_0 = D_0 \times (1 + g)/ (r - g) = D_1 / (r - g)$
Forward P/E ratio = $P_0/E_1 = (D_1 / E_1) / (r - g)$
g = ROE × b
$(D_1 / E_1)$ = dividend payout ratio
So, $P_0 / E_1 = (D_1 / E_1)$ / (Required return – (ROE × b)) = (1 – b) / (r - g)
**Scenario 1: Based on actual dividend payout ratio**

- Using justified leading P/E ratio as above
  P/E ratio = payout ratio/(r - g)
  = $D_1/E_1/(r - g)$ = 0.4082/ (0.0815 – 0.0537) = 14.68
  (Recall that $D_1/E_1 = 1 - b$ = payout ratio)
  $P_{0=}$ (P / E) × $E_1$
  = (P / E) × $E_0$ × (1 + g)
  = (14.68)(36,750/20,000)(1.0537)
  =₦28.48

- **An alternative approach** is to first compute the theoretical price, using dividend valuation model with constant growth to infinity.

$P_0 = D_0 \times (1 + g)/ (r - g)$
$= D_1/(r - g)$. But:
$D_1 = E_1 \times (1 - b) = E_0 \times (1 + g) (1 - b)$
$E_1 = E_0 (1 + g) = (36{,}750/ 20{,}000) (1.0537) =$ ₦1.94
$P_0 = (1.94) (0.4082)/ (0.0815 – 0.0537) =$ ₦28.48
$P_0/E_1 =$ ₦28.48 / 1.94 = 14.68

**Scenario 2. Assume the company changed the dividend payout ratio to 60% in 2023.**

- Using justified leading P/E ratio.
  Justified leading P/E ratio = $P_0/E_1 = D_1/E_1/(r - g)$
  $= (1 - b)/(r - g)$ $g = (ROE)(b) = (9.07)(0.4) = 3.63\%$
  P/E ratio $= P_0/E_1 = (1 - b)/ (r - g)$
  $= (1 – 0.4)/ (0.0815 – 0.0363) = 13.27$
  $P_{0=} (P / E) \times E_1$
  $= (P / E) \times E_0 \times (1 + g)$
  $= (13.27)(36{,}750/20{,}000)(1.0363)$
  =₦25.28

- **Alternatively**: similar to what we did in scenario 1, we can also proceed as follows.
  $D_0 = (36{,}750/20{,}000) (0.6) = 1.1025$
  $g = 9.07 \times 0.4 = 3.63\%$
  $D_1 = 1.1025(1.0363)$
  $P_0 = 1.1025(1.0363)/(0.0815 – 0.0363) =$ ₦25.28
  $E_1 = E_0 (1 + g) = (36{,}750/20{,}000)(1.0363) = 1.904$
  $P_0/E_1 = 25.28/1.904 = 13.27$

e. No, FP should not have increased their dividend payout ratio to 60% in 2023. Increasing the dividend payout ratio from 40.82% to 60% would have decreased the price of the stock from ₦28.48 to ₦25.28. The CFO does not realise that paying out a higher percentage of earnings in dividends means that the company will retain less funds and forego good investments. This would result in a lower growth rate. (recall, growth = ROE × retention ratio).

In general increasing the dividend payout ratio impacts the stock price in two ways. The first is clear: a higher naira dividend will increase stock price. The second is that a higher payout ratio means lower growth which decreases the stock price. The factor that dominates depends on the simple question. Is the company making good investments?

If ROE > required return, then the company is making good investments; since the investments are earning more than the required return. Recall that FP has an ROE of 9.07% and a required return of 8.15% thus ROE (9.07%) > Required return (8.15%). FP is making good investments. Accordingly, FP increasing the dividend payout ratio to 60% would lower FP's stock price. This is because the company would be better off if they used their net income to reinvest in the company and make profitable investments.

## Examiner's report

This is a multi-part question testing some basic knowledge of finance. Part (a) tests candidates' knowledge of the major drivers of return on equity (ROE) using DuPont analysis. In part (b), candidates were expected to estimate sustainable growth rate. Part (c) tests candidates' knowledge of using CAPM to estimate required return. In the other part of the question, candidates were expected to estimate the forward P/E ratio and the appropriate stock price. They were also expected to explain the impact of payout ratio on stock price.

Most of the candidates attempted the question but generally the level of performance was very poor. Candidates were able to pick up some marks in parts (a) – (c). They however demonstrated complete lack knowledge in the remainly part of the question.

As already noted, students need to cover the entire syllabus when preparing for the institute examination.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | Estimate of FP's ROE in 2023 | 2 | 2 |
| b. | Estimate sustainable growth rate in 2023 | 2 | 2 |
| c. | Calculate the required return for FP | 1 | 1 |
| d. | Calculate forward P/E ratio and stock price | 6 | 6 |
| | Justify decision on increasing dividend payout ratio | 4 | 4 |
| | | | **15** |

**ICAN/232/V/C2** **Examination No....................**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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, NOVEMBER 15, 2023**

**DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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**

BP Fashion Limited is trading and expanding in the fashion industry. Over the years, the company has been audited by LMP Professional Services. The company is considering going to the stock market to raise funds through increase in its issued share capital for purpose of expansion into new markets.

The summarised two year financial statements and the nine (9) months accounts of the company are given below:

**BP Fashion Limited**
**Summarised Income Statement For the Years Ended December 31,**

| | 2019 | 2020 | 2021 (9 months) |
|---|---|---|---|
| | ₦'m | ₦'m | ₦'m |
| Revenue | 2,952 | 3,510 | 4,139 |
| Cost of sales | (1,402) | (1,671) | (1,987) |
| Gross profit | 1,550 | 1,839 | 2,152 |
| Other income | 15 | 21 | 25 |
| Operating costs: | | | |
| Employee costs | (390) | (460) | (538) |
| Occupancy costs | (262) | (312) | (373) |
| Other operating costs | (278) | (326) | (389) |
| Earnings before interests, taxes, depreciation and amortisation (EBITDA) | 635 | 762 | 877 |

## Summarised Statement of Financial Position

| | | 2019 | 2020 | 2021 (9 months) |
|---|---|---|---|---|
| | | **₦'m** | **₦'m** | **₦'m** |
| Property, plant and equipment | | 375 | 470 | 470 |
| Deferred tax | | 30 | 35 | 40 |
| Non-current assets | (A) | 405 | 505 | 510 |
| Inventories | | 425 | 525 | 655 |
| Trade and other receivables | | 125 | 150 | 175 |
| Cash and equivalents | | 425 | 545 | 780 |
| Current assets | (B) | 975 | 1,220 | 1,610 |
| **Total assets** | (A)+(B) | **1,380** | **1,725** | **2,120** |
| Share capital and reserves | | 885 | 1,135 | 1,430 |
| Long term loans | | 125 | 125 | 125 |
| Employees' benefits | | 20 | 35 | 50 |
| Deferred tax | | 55 | 65 | 70 |
| Non-current liabilities | | 200 | 225 | 245 |
| Trade and other payables | | 270 | 335 | 410 |
| Tax payable | | 25 | 30 | 35 |
| Current liabilities | | 295 | 365 | 445 |
| **Total equity and liabilities** | | **1,380** | **1,725** | **2,120** |

It has become necessary, and as part of the NGX Exchange Limited's requirements, to appoint another firm of accountants to review the financial statements for some specified periods. Your firm Stratcom Partners has been approached to carry out the necessary review.

**Required:**

a. Highlight the features of professional engagements as contained in ISRE 2410: *International Standard on Review Engagement* and ISRS 4410 (revised): *International standard on Related Services.* (8 Marks)

b. Detail out the procedures to be carried out in the review of interim financial information. (6 Marks)

c. In view of the changes in inventories in the financial statements given above, between the last two periods, provide the substantive procedures that would be carried out to establish a reliable evidence of the change. (6 Marks)

d. Prepare the outline of the reporting requirements of a compilation engagement. (10 Marks)

**(Total 30 Marks)**

## SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

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

### QUESTION 2

ABC Limited is owned and controlled by DOBS Plc which is involved in the manufacture of car fittings and accessories. TRC & Co (Chartered Accountants) where you work, has been auditing the DOBS Plc in the last five (5) years.

ABC Limited is preparing for its first AGM and at its last board of directors meeting, a member proposed appointing another firm different from TRC & Co, as its auditors. The appointment will subsequently be approved at the said AGM. With the directives from DOBS Plc, the idea was accepted and Tim Brown & Co. (Chartered Accountants) was appointed for the year under consideration.

There are issues with the marketing of the products of ABC Limited, and there have been criticisms in the public domain in the last two quarters. The audits of the two companies are going on concurrently by the two firms.

**Required:**

a. Prepare the list of items to be included in the "letter of instruction" TRC & Co. should send to Tim Brown & Co. (6 Marks)

b. For the purpose of ensuring that the financial statements are properly consolidated, prepare a document outlining the audit procedures TRC & Co. needs to adopt. (9 Marks)

c. Evaluate the nature of the business risk approach to be adopted by TRC & Co. in the review of ABC Limited during the audit. (5 Marks)

**(Total 20 Marks)**

### QUESTION 3

Giant Club has been in existence for about 6 years. The club membership comprises of eminent individuals in the society and has a certificate of registration under the relevant laws. It has an approximate enrollment of 1,000 members. The club's funding is supported by membership fees, parking fees, rental fees, voluntary donations, and income from endowment investments.

The club has been named as a beneficiary under the Wills of two deceased members. Collection on the proceeds of the estate is made subsequent to the balance sheet date. Collections from the Will receivable in the amount of ₦6,200,000 have been recorded based on the available information from the estate administrators. During 2020 financial year, the club was committed to giving scholarships to seven students in various higher institutions. Accordingly, the club has agreed to pay these individuals a regular pocket money in addition to providing medical coverage as the need arises. Since it is a non-for-profit organisation (NFPO), the club has not been conducting an independent statutory audit of the financial statements since inception. However, the club has been appointing her officers as at when due every two years.

The new Treasurer, who is a professional accountant, took over the control of the revealed treasury and his review revealed that:

- There was no periodic review of inventory items and background check on vendors/ suppliers;
- There were calls from vendors stating they haven't been paid when records show payments have been made;
- There were cases of cash takings not banked;
- No control over cheque lodgments and reconciliation of bank account;
- No background check for those who handled money;
- The computers in use for transactions did not have protective passwords;
- No evidence that the organisation sent acknowledgements to contributors with record of such acknowledgements kept on file;
- When new members were admitted and they made yearly subscription, the club did not issue pre-numbered tickets, which could then be compared to funds deposited;
- When cheques were issued, supporting documentation of expenses and approvals at the time of signing cheques were not available; and
- Requests for reimbursement were not checked for arithmetical accuracy and reasonableness before approval.

The new management of Giant Club has just appointed your firm as the external auditor and you have been selected as the senior in charge of the audit.

**Required:**

a. Discuss the activities you will carry out when performing the audit of the Club. (10 Marks)

b. Evaluate the key audit areas that you will focus on to get enough audit evidence on this type of audit. (5 Marks)

c. Determine other factors that should be of concern in this type of audit. (5 Marks)

**(Total 20 Marks)**

## QUESTION 4

Phil Plc has been in business of manufacturing textile materials for about twenty years and has been rendering good returns to shareholders on their investments until about few years ago, precisely in 2019. The business of the company went down drastically in 2020 due to measures taken to contain the spread of the COVID -19 virus which included travel bans, quarantines, social distancing, and closures of non-essential services. Covid-19 pandemic significantly caused disruptions to businesses worldwide, resulting in economic slowdown. The problem was aggravated with the Federal Government of Nigeria enforcing restriction of movements. All businesses and offices were affected with exception of power distribution, oil and gas (petroleum) and retail companies.

COVID-19 pandemic impacted on the economy generally and the following were the impacts on the company:

- Increase in cost of raw materials as a result of devaluation of the currency due to the drop in the price of crude oil;
- Shortage in supply of key raw materials sourced from other countries, for example, China; and
- Increase in ocean freight costs and inland transportation.

The impact of the outbreak of COVID-19 directly caused economic losses through disruptions in supply chains, demand, and financial markets, affecting the business investment, household consumption, and international trade. The crisis led to a decline in revenue.

However, despite the challenges, management kept on struggling to ensure maintenance of an impressive performance for the shareholders. A board member believed there is unhealthy relationship between management and the board of directors as she accused management of lack of transparency with the directors and has threatened to resign as a director of the company. The problem was compounded after the year-end audit when the auditors reported that the company's internal controls were ineffective and accused management in their report of fraudulent financial reporting. The external auditors also threatened to do a restatement on the prior year financial statements as it was believed that there were misstatements of certain account balances. The Managing Director and some directors believed that it is their responsibility to prepare financial statements and that the auditors does not have right to do any restatement on the financial statements. The Chairman of the audit committee, and few directors were in support of the auditors and appealed to the Managing Director and his supporters to allow auditors perform their duties as it is a regulated profession or else they will do a report to the Financial Reporting Council on the activities of management.

The external auditors were surprised at the actions of management, especially the Managing Director and have threatened to resign from the assignment. The external auditors, during the audit were not comfortable on the following issues:

(i) The supporting documents from which financial statements were prepared;

(ii) Review of opening balances revealing omission of some transactions and significant information in disclosures; and

(iii) Misapplication of accounting principles regarding amounts, classifications, presentation and disclosures.

Added to the above, the external auditors identified risks which they believed might likely affect asset valuation and other significant accrued liabilities. Your firm is envisaging that you may be invited for a discussion with the audit committee. Your team has been instructed to do a review of certain sections in preparation for the meeting.

**Required:**

a. Evaluate the rights and duties of the auditors in a professional engagement. (10 Marks)

b. Enumerate what you consider as the responsibilities of management and those charged with governance in Phil Plc. (5 Marks)

c. Discuss the reason why your firm may resign the appointment as the auditors of the company. (5 Marks)

**(Total 20 Marks)**

**SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)**

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

**QUESTION 5**

Hillary Professional Services is a medium-sized firm on a retreat having successfully combined business operations to take advantage of mandatory audit rotation guidelines. At the retreat it was agreed that a robust software to reduce paperwork was inevitable. All along, one of the combined firms has an Information Technology (IT) Unit which has been strengthened with the state of the art equipment.

All auditors are now encouraged to show more interest in information technology, most especially those that relate to data analytics, artificial intelligence and machine learning. Undoubtedly, understanding the business information system used by management is necessary as they affect risk assessment involved in the financial reporting process. It was also concluded that obtaining an understanding of the field of information technology is a standard audit procedure to be followed, otherwise it will be difficult to evaluate the adequacy of the expert's work as recommended by International Standards on Auditing. The purpose of the merger will be defeated if the firm will not be able to win jobs and perform well in a highly competitive market. The after-effect of COVID-19 pandemic has also revealed that one could work with flexibility anywhere if there is a robust audit Software in place.

The IT Audit Partner made a presentation on ''COBIT (Control Objectives for Information and Related Technologies) - a globally accepted suite of tools that a client might use in order to ensure IT is working effectively". He stated that COBIT is all about doing the right things the right way in order to deliver benefits to the client.

You are a staff of Hillary Professional Services. Based on the presentation made on COBIT at the retreat, you have been divided into groups and the groups are to debrief the main group after one hour.

**Required:**

a. State the purposes of COBIT (Control Objectives for Information and Related Technologies). (3 Marks)

b. Identify and explain the specific components of COBIT. (8 Marks)

c. Explain how COBIT will be applied in the business process. (4 Marks)

**(Total 15 Marks)**

## QUESTION 6

Reliable Limited is into wholesale and retail supply and distribution of stationeries to companies and educational institutions. The company maintains business relationship with other enterprises that are owned by close friends and relatives. The books of account of the company were kept manually and in simple excel. The company had only a staff in the accounts department since it is a small business operation.

A review of the company's operations shows that inventory of stationeries purchased was not properly valued due to incomplete recording of purchases made. Although bank statements are obtained, the balances on the bank statements were not reconciled with the cash book.

Cash from sales made, were not banked intact and expenses relating to cash takings from till were not all recorded or properly monitored. Added to this, goods bought from related parties were sometimes overvalued as suppliers made frivolous claims which could not be disputed due to poor record keeping. The Managing Director and owner of the company has been sick for some time and the wife concentrated more on her own business leaving the operations of the company to a relation who is not well educated. Available evidence revealed that invoices and vouchers of the company were approved without management review and the procedure or selection of suppliers was not transparent.

The company has just won a contract for supply of stationeries in one of the states in the Federation and it was found that there was inadequate cashflow to execute the contract. The manager of the company informed the Managing Director's wife of the development and it was agreed that a bank loan would be needed. On approaching the bank, an updated financial statements of the company was requested to determine the financial health of the business and ability to repay the loan when due.

Your firm has been appointed as auditors of the company with stipulated deadline to complete the audit so that the company could meet the bank's conditions. The firm has conducted a preliminary review of the operations of the company and some control gaps have been noted.

**Required:**

a. Discuss suitable control activities that will be required in the above scenario and how you will assess the degree of effectiveness of the internal control systems. (10 Marks)

b. Identify and explain what the external auditors are expected to do during the course of the above audit. (5 Marks)

**(Total 15 Marks)**

## QUESTION 7

The overseas technical partners of Orlando Professional Services came for a review of operations and system of internal control of the firm. A number of audit engagement files regarding financial statements on which the firm had expressed audit opinion were selected for review. It was believed that the strategic review will be necessary to determine the appropriate audit approach for a detailed audit plan in the firm to bring efficiency and enhance good client service delivery. The review exercise also covers:

i. The firm's basis of risk assessment on audit and assurance engagements;
ii. Determination of staff recruitment, training, reward and evaluation;
iii. Previous audit opinions on financial statements and progress on ongoing jobs;
iv. System of archival and retrieval of documents;
v. Major risks and other factors such as industry issues;

vi. Procedures for engaging and monitoring experts both internal and external; and
vii. Reports from regulators.

The team interviewed partners, staff and directors of major clients of the firm. It was believed that the outcome of the review exercise will help to reposition the firm and upscale strategies to get a fair share of the market in the upcoming mandatory rotation of auditors.

At the end of the exercise, it was reported that the audit strategy of the firm was not robust enough, too generic and lacked focus to meet firm's need in the next decade. The team recommended that proactive steps should be taken to evolve a good strategy that would stand the test of time in the light of the increasing competition in the audit and assurance market place.

As a staff of the firm, you have been selected as a member of the committee to develop the new audit strategies for submission in the next two weeks for the consideration and approval of the executive council of Orlando Professional Services.

**Required:**

a. Outline the approaches to the main audit strategies your firm is expecting to adopt. (9 Marks)

b. Explain the factors that will be considered in the selection of audit strategies. (4 Marks)

c. Explain the difference between Audit strategy and Audit Plan. (2 Marks)

**(Total 15 Marks)**

## SOLUTION 1

a. *ISRE 2410: International Standard on Review Engagements* deals with the review carried out by a company's external auditors on the interim financial statements (mid-year financial statements), where companies are required to produce interim statements. The interim financial statements are not subject to a full audit; however, they are subject to a review. On the whole, general auditing principles apply to this type of review. The auditing firm that reviews interim financial information (IFI) is normally the external auditor for the end-of-year accounts. The audit firm should:

   i. Comply with the same ethical requirements as it does for the main audit;
   ii. Implement appropriate quality control procedures;
   iii. Plan and perform the review with an attitude of professional skepticism;
   iv. Agree the terms of engagement with the client in an engagement letter; and

v. Prepare a documentation sufficient to support the auditor's review conclusions and to provide evidence that the review was conducted in accordance with ISRE 2410.

*ISRS 4410 (revised): Compilation Engagements* regulates the conduct of compilation engagements. The standard was revised in March 2012 following growth in demand from SMEs for services other than audit. Demand has been particularly strong in jurisdictions where audit exemptions have either been introduced or extended.

In a compilation engagement, no assurance is given by the review accountant about the information that has been compiled. However, the client gains some assurance from the requirement that the accountant for a compilation assignment must comply with professional code of conduct. The accountant is therefore obliged to exercise due care and technical competence in carrying out the work.

The key points of ISRS 4410 are as follows:

i. An engagement letter is required to detail the terms of the engagement which indicate that the:

   - Work to be carried out is not an audit and is not a review;
   - Engagement cannot be relied upon to disclose error, fraud or other irregularities;
   - Information on which the assignment will be based (for example, its accuracy and completeness) is the responsibility of the client's management;
   - Intended use and distribution of the information that will be provided at the end of the engagement;
   - Applicable financial reporting framework is being applied;
   - Responsibilities of the practitioner, including the requirement to comply with relevant ethical requirements; and
   - Expected form and content of the practitioner's report would be in accordance with legal and regulatory requirements.

ii. Planning and documentation will be required for the engagement;

iii. The accountant needs to have adequate knowledge of the client's business and its operations. This knowledge must also cover the accounting system, accounting records and applicable financial reporting framework;

iv. If the accountant becomes aware that the information provided is unsatisfactory (incomplete, inaccurate or otherwise unsatisfactory), he should ask management to correct or improve the information. If management refuses to do this, the accountant should withdraw from the engagement, and inform the entity accordingly; and

v. The practitioner must obtain an acknowledgement from management or those charged with governance that they take responsibility for the final version of the information.

b. Procedures for the review of interim financial information (IFI) should include the following:

i. The auditor should obtain an understanding of the entity and its environment, including its internal controls, in order to:

- Assess the risk of misstatement in the financial statements; and
- Select appropriate 'audit' procedures for the review.

ii. The auditor should make inquiries and perform analytical procedures sufficient to reach a conclusion for the review. This conclusion should be about whether anything has come to the auditor's attention to indicate that the IFI has not been prepared, in all material respects, in accordance with the applicable financial reporting framework. (As with ISRE 2400, the auditor's opinion is expressed in negative terms);

iii. If any critical matters come to the auditor's attention, the auditor should make additional inquiries or perform other procedures in order to obtain more information;

iv. The auditor should check that the IFI agrees or reconciles to the underlying accounting records;

v. The auditor should discover whether management has:

- Taken subsequent events into account; and
- Made an assessment of the entity's ability to continue as a going concern.

vi. The auditor should evaluate any uncorrected misstatements in the IFI, both individually and in aggregate. (This is the same as for the annual audit);

vii. The auditor should obtain written representations from management that:

- They acknowledge their responsibility for internal controls;
- The IFI has been prepared and presented in accordance with the applicable financial reporting framework;
- They believe the effect of any uncorrected misstatements are immaterial, both individually and in aggregate;

- There has been full disclosure of all significant facts, risk assessment, possible or actual non-compliance with laws and regulations, and subsequent events; and

viii. The auditor should ensure that any other information issued with the IFI is materially consistent with the IFI.

c. The substantive procedures for the evidence for the change in the inventories will include:

i. Attending inventory count to:
   - Observe procedures; and
   - Record the inventory counts;

ii. Recording cut-off information;

iii. Checking inventory valuation, at lower of cost and net realisable value (NRV);

iv. Checking inventory cut-off;

v. Performing appropriate analytical review procedures;

vi. Confirming the existence of inventory held at outside locations; and

vii. Checking the treatment of inventory held on client's premises but owned by a third party.

d. ISRS 4410 *(revised): Compilation Engagements* requires that the report on a compilation engagement must be in writing and contain the following:

i. Title;

ii. Addressee;

iii. A statement that the practitioner has compiled the financial information based on information provided by management;

iv. A description of the responsibilities of management, or those charged with governance in relation to the compilation engagement;

v. Identification of the applicable financial reporting framework;

vi. Identification of the financial information, including the title of each element of the financial information (if it comprises more than one element) and the date of the financial information;

vii. A description of the practitioner's responsibilities in compiling the financial information, including that the engagement was performed in accordance with ISRS 4410 (revised) and that the practitioner has complied with relevant ethical requirements;

viii. A description of what a compilation engagement entails;

ix. Explanation that as the compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or completeness of the information provided by management for the compilation;

x. Explanation that the practitioner does not express an audit opinion or a review conclusion on whether the financial information is prepared in accordance with the applicable financial reporting framework;

xi. If the financial information is prepared using a special purpose framework, an explanatory paragraph that describes the purpose of the financial information and the intended users and draws the readers' attention to the fact that the information may not be suitable for other purposes;

xii. Date of the report;

xiii. Practitioner's address; and

xiv. Practitioner's signature.

## Examiner's report

The question tests the candidates' knowledge of professional review engagements based on ISRE 2410: *International Standard on Review Engagements* and ISRS 4410: *International Standard on Related Services.* It further tests the candidates' understanding of reporting on compilations engagements.

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

The common pitfall of the candidates was lack of understanding of the components of review engagements as distinct from conventional audits.

Candidates are advised to familiarise themselves with the practical aspects of engagements and also read the Institute's Study Text and Pathfinders which are available on the Institute's website.

## Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **The introduction and naming of ISRE: 2410** | 1 | |
| | **Listing of the features of ISRE 2410** | | |
| | (½ mark each subject to a maximum of 4 features) | 2 | |
| | The introduction and naming of ISRE 4410 | 1 | |
| | **Listing the features of ISRE 4410** | | |
| | (1 mark each for any 4 features) | 4 | 8 |

b. **The procedures in the review of interim financial information**
(1 mark each subject to a maximum of 6 points) 6

c. **The substantive audit procedures to establish reliable evidence**
(1 mark each subject to a maximum of 6 points) 6

d. **Outline of Reporting requirements of compilation engagements**
(1 mark each subject to a maximum of 10 points) 10
**Total** **30**

## SOLUTION 2

a. **The group auditor's "letter of instruction" to the component auditor should set out:**

i. The work required;
ii. The use to be made of that work;
iii. The form and content of the component auditor's communication with the group engagement team;
iv. A request for cooperation;
v. Ethical requirements;
vi. Component materiality;
vii. Identified significant risks; and
viii. A list of known related parties.

b. **The procedures TRC & Co needs to adopt for the purpose of ensuring a proper consolidation of the financial statements**

| **Topic** | **Audit procedures** |
|---|---|
| Clerical accuracy | i. Confirm that figures have been transferred accurately from the financial statements of the components (individual companies in the group) to the consolidation schedule. |
| | ii. Check the arithmetical accuracy of all consolidation calculations, such as the consolidation total balances and total transaction values. |
| Status of investments | i. Confirm that the parent company has correctly classified investments as a subsidiary, associate, joint venture or simple investment, in accordance with standard accounting practice. |

| | | |
|---|---|---|
| | ii. | Confirm that the appropriate accounting treatment has been adopted by each of these classifications of investments in the group accounts. |
| Changes in the group | i. | For acquisitions: confirm fair values, the calculation of purchased goodwill and accounting treatment in accordance with IFRS 3 and any other relevant standards. |
| | ii. | Where there has been an acquisition during the year involving deferred consideration as part payment, check that the amount of the deferred consideration has been included in the cost of acquisition at discounted present value, using a current pre-tax cost of capital as the discount rate. (Note: The cost of acquisition affects the amount of the purchased goodwill). |
| | iii. | Where there has been an acquisition during the year involving a possible contingent consideration as part-payment, checking the reasonableness of the assumption that the recent value of the contingent consideration should be included in the cost of acquisition. |
| | iv. | For disposals, confirm the sale proceeds, and the calculation of the gain or loss on sale. |
| | v. | Check that the correct accounting treatments of items are applied in the consolidated income statement/statement of comprehensive income and the consolidated financial statements. For example, when a subsidiary has been acquired during the year, check that the calculation of pre-acquisition and post-acquisition profit is correct. |
| Consolidation adjustments | i. | Reconcile the inter-company transactions and balances (or review the reconciliation of the inter-company transactions and balances that has been made by client's staff). |
| | ii. | Confirm the inter-company balances. |
| | iii. | Check calculations of the adjustments for unrealised profit. |
| | iv. | Check the calculations and disclosure of non-controlling interests. |

| | | |
|---|---|---|
| | v. | Check the accounting treatment of inter-company dividends and other dividends. |
| Loss making investments | i. | Consider whether any goodwill on acquisition has suffered impairment. |
| | ii. | Consider whether a write down of the investment in the book of the parent company is needed. |
| | iii. | If a subsidiary makes losses consistently, its going concern status may be in question. |
| | iv. | However, the group may take a formal decision to provide financial support to the subsidiary. This decision, in effect would protect the going concern status of the subsidiary, even if it is making losses. In such a situation, the group auditor will normally request a 'comfort letter' (or 'support letter') to this effect from the directors of the parent company. |
| Related parties | i. | Ensure the provisions of IAS 24 are complied with. |
| | ii. | (Most components of the group will be 'related' to most other components). |
| Reporting | i. | Reach a conclusion about whether the group financial statements present a true and fair view. |

c. The business risk approach starts at an earlier stage than the 'conventional' audit risk model, which is based on inherent risks and control risks (and detection risks) and it involves the following:

i. By looking at the nature of the client's business, the auditor should develop an understanding of the events and circumstances that many affect the entity's ability to meet its objectives. By understanding business risks, the auditor should also develop a better understanding of the inherent risks and the control risks facing the client;

ii. The business risk approach is sometimes referred to as a 'top down' approach to an audit. The approach starts 'at the top' with the business, which generates the financial transactions. The approach ends 'at the bottom' with the financial statements which record the outcome of the business transactions. The business 'drives' the financial statements;

iii. This is a 'high level' approach to the audit, and has similarities with business management strategy. Using this approach to an audit successfully depends on having adequate and up-to-date information about the client's business and environment;

iv. For this reason, the larger auditing practices that use the business risk approach will often organise their audit teams into specialised industry groups, or may have industry experts available or may construct specialised databases for particular industries;

v. When the auditor takes a business risk approach he needs to be aware not only of the current position of the client's business, but also of possible future developments that may affect its goals and objectives; and

vi. The auditor is interested in business risk not for its own sake but in the light of its possible impact on the financial statements.

### Examiner's report

The question tests the candidates' knowledge of the relationship between the group auditor, and the component auditor, and the content of the "letter of instruction." Candidates are further expected to identify the risks associated with working with the component auditor.

The question was attempted by about 60% of the candidates, but the performance was below average.

The commonest pitfall of the candidates was their lack of understanding of the detailed aspects of the responsibilities of the group and component auditors in group audit and consolidation arrangements.

Candidates are advised to pay close attention to the requirements of the question and understand responsibilities of various parties, group audits and consolidation arrangements. They are also advised to study properly the Institute's Study Text and Pathfinders.

### Marking guide

| | | Marks | Marks |
|---|---|---|---|
| a. | **Items to be included in "letter of instructions"** | | |
| | (1 mark each for any 4 contents of the report) | | 6 |
| b. | **Document outlining the procedures TRC & Co needs to adopt for consolidation** | | |
| | (1 mark each subject to a maximum of 6 points) | 6 | |
| | (½ mark for discussion on each of 6 points) | 3 | 9 |
| c. | **The nature of business risk approach to adopt** | | |
| | (1 mark each subject to a maximum of 5 points) | | 5 |
| | **Total** | | **20** |

**SOLUTION 3**

a. The auditor should recognise the specific features of the NFPO. However, it is important to realise that the auditor is still performing an audit, and the overall- structure of the audit of an NFPO will be similar to the audit of a commercial organisation. However, the detail of the audit will probably differ.

The main points to bear in mind with the audit of an NFPO are summarised below. These are general principles. They should be modified as appropriate to reflect the circumstances of each particular NFPO.

| Audit area | Comments |
|---|---|
| Planning | **Consider:**<br>i. The objectives and scope of the audit work;<br>ii. Any local regulations that apply;<br>iii. The environment in which the organisation operates;<br>iv. The form and content of the final financial statements and the audit opinion; and<br>v. Key audit areas, including risk. |
| Risk | **Carry out an audit risk analysis under the usual headings of inherent risk, control risk and detection risk:**<br>i. Inherent risk (reflecting the nature of the entity's activities and the environment);<br>ii. Control risk (internal controls, and the risk that these may be inadequate: controls over cash collection and cash payments may be a key area for a not-for-profit organisation (NFPO) such as a clubs, because large amounts of cash may be collected from the public by volunteers); and<br>iii. Detection risk (the risk that the auditor will fail to identify any material error or misstatement in performing the audit). |
| Internal control | **Key areas of internal control in a not-for-profit organisation (NFPO) might include:**<br>i. Segregation of duties (although this may be difficult in a small NFPO with only a few employees);<br>ii. Authorisation of spending;<br>iii. Cash controls;<br>iv. Controls over income (donations, cash collections, membership fees, grants); and<br>v. The use of funds only for authorised purposes. |

| | |
|---|---|
| **Audit evidence** | **These include**:<br>i. A substantive testing approach (rather than a systems based approach) is likely to be necessary in a small NFPO, because of weaknesses in its internal control system;<br>ii. Key areas may include the completeness of recording transactions, assets and liabilities; and the possibility of misuse of funds;<br>iii. Analytical procedures may be used to '**make sense**' of the reported figures; and<br>iv. There should be a review of the final financial statements, including a review of the appropriateness of the accounting policies. |
| **Reporting** | i. If report on NFPO is required by law, the standard external auditor's report should be used.<br>ii. If the audit is performed on a voluntary basis, the report needs to reflect the agreed objective of the audit. However, it is good practice for the report to follow the general structure laid down by ISA 700:<br>• Title;<br>• Addressee;<br>• The auditor's opinion;<br>• Basis for opinion;<br>• Going concern & KAMs (if appropriate);<br>• Responsibility for the financial statements;<br>• Auditor's responsibilities;<br>• Other reporting responsibilities; and<br>• Name, signature, address of auditor and date. |

b. **Key audit areas to get enough audit evidence include**:

i. A substantive testing approach (rather than a system based approach) is likely to be necessary especially in small NFPO, because of weakness in its internal control system;

ii. The completeness of recording transactions, including assets and liabilities and the possibility of fund misuse;

iii. Analytical procedures may be used to "make sense" of the reported figures;

iv. Review of financial statement for the appropriateness of the accounting policies; and

v. Review of club's organisational structure.

With respect to the specific findings of the new Treasurer that were highlighted, substantive audit procedures would be applied to the respective accounting systems to address them and obtain sufficient appropriate audit evidence.

c. **Other factors that should be of concern include**:

i. Cash may be significant in clubs (not-for-profit organisations) and controls are likely to be limited;
ii. Income could be a risk area, particularly where money is donated or raised informally;
iii. There may be a limitation on the scope of the audit if obtaining audit evidence is a problem;
iv. There may be a lack of predictable income or identifiable relationship between expenditure and income which could make analytical review less appropriate;
v. Restricted funds may exist where the organisation is only allowed to use certain funds for specific purposes;
vi. There may be sensitivity to key statistics such as the proportion of revenue used in administration (particularly for a charity);
vii. The nature of the audit, that is whether it is required by law or on voluntary basis;
viii. The possibility of fund misuse; and
ix. Completeness of recording transactions, assets and liabilities.

## Examiner's report

The question tests the candidates' knowledge of the audit of not-for-profit-organisation (NFPO) and how to generate sufficient appropriate audit evidence in such audits. Additionally, candidates are required to identify the factors of concern to the auditor in the audit.

The question was attempted by about 80% of the candidates, but performance was less than average.

The commonest pitfall was the candidates' inability to explain the procedures for the audit of NFPOs.

Candidates are advised to read the Institute's Study Text and Pathfinders to enhance performance in future.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | **Activities to be carried out in performing the audit** | | |
| | (1 mark each subject to a maximum of 2 points from each of 5 activities) | | 10 |
| b. | **Key audit arrears to focus on for audit evidence** | | |
| | (½ mark each subject to a maximum of 5 key audit areas) | 2½ | |
| | (½ mark each subject to a maximum of 5 discussions) | 2½ | 5 |
| c. | **Factors that should be of concern in the audit** | | |
| | (1 mark each subject to a maximum of 5 factors) | | 5 |
| | **Total** | | **20** |

**SOLUTION 4**

a. **The rights of the auditor are as follows:**

i. The right of access to all accounting books and records at all times;

ii. The right to all information and explanations (from management) necessary for the proper conduct of the audit;

iii. The right to receive notice of all meetings of the shareholders (such as the annual general meeting) and to attend those meetings;

iv. The right to speak at shareholders' meetings on matters affecting the audit or the auditor. This can be important when the auditors disagree with the directors of the client entity and are unable to communicate with the shareholders effectively by any other method; and

v. The right to receive a copy of all written resolutions if the company uses written resolutions.

**The duties of the external auditor are as stated below:**

The primary duty of the external auditor is to:

i. Examine the financial statements, and
ii. Issue an auditor's report on the financial statements, which is then presented to the shareholders together with the financial statements.

This auditor's report will set out the auditor's opinion as to whether (or not) the financial statements:

i. Give a true and fair view (or "present fairly") the financial position and performance of the company;

ii. Have been prepared in accordance with the applicable financial reporting framework;

iii. In Nigeria, Section 404 of CAMA 2020, requires the auditor to also form an opinion on matters stated in schedule VI of the CAMA as provided and state:

- Whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purpose of their audit;
- Whether, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them;
- Whether the company's statement of financial position and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report agree with the books of account and returns; and
- Whether, in their opinion and to the best of their information and according to the explanations given them, the said statements give the information required by the Act in the manner so required and give a true and fair view.

In the case of the statement of financial position, of the state of the company's affairs as at the end of its year.

In the case of the income statement account, of the profit and loss for its year; or as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which, by virtue of Part I of the Second Schedule of the Act, are not requires to be disclosed.

In the case of a holding company submitting group financial statements whether, in their opinion, the group financial statements have been properly prepared in accordance with the provisions of the Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries and associates. The auditor's report must state if any of the provisions were not met.

The outcome of the statutory audit is an **opinion** on the truth and fairness of the financial statements. The word 'opinion' implies that the auditor has applied his professional judgement in reaching his conclusion.

This point is arguably one of the limitations of the statutory audit. The audit report expresses an opinion, not a statement of fact. It is therefore open to disagreement.

In carrying out his audit work, the auditor is unlikely to check every transaction undertaken by the company during the period. There is, therefore, a risk that the judgement he forms may be inappropriate.

b. **Responsibility of management and those charged with governance**

With respect to the audit and contrary to what many members of the public think, it is the management and those charged with governance who are responsible for:

i. Prevention and detection of fraud;

ii. Preparation of the financial statements;

iii. Design and implementation of effective internal controls for example authorising payments above a certain amount, monthly bank reconciliation and a monthly trade payables control account reconciliation;

iv. Providing the auditor with:

- Access to information relevant to the preparation of the financial statements;
- Additional information relevant to the audit;
- Unrestricted access to persons whom the auditor needs access to in order to complete the audit; and
- Providing written representations to the auditor at the end of the audit.

c. **The reasons that may lead to the resignation of auditors include:**

i. A consistent lack of integrity, as demonstrated by management as they have been accused of lack of transparency, with the directors and fraudulent financial reporting by a director of the company. This is in accordance with Section 412 and 413 of CAMA 2020;

ii. Where the auditor is unable to obtain reasonable assurance and a qualified opinion is necessary as in this case, or where supporting documents are lacking and some transactions and significant information are missing and not disclosed;

iii. Significant fees remain unpaid;

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

v. The management team of the Phil Plc is also in disagreement with each other, making it difficult to properly perform the audit and to form an opinion. This situation allows for the resignation of the auditor according to ISA 200;

vi. With the dwindling prospects of Phil Plc as a result of COVID-19, the client may no longer be profitable for our firm; and

vii. All the conditions that warrant resignation by our firm are present in the engagement with Phil Plc.

**Examiner's report**

The question tests the candidates' knowledge of the rights and duties of auditors, the responsibilities of management and those charged with governance. Candidates are also required to discuss the reasons for the resignation of appointment as auditors.

The question was attempted by about 90% of the candidates, but the performance was about average.

The common pitfall was the candidates' inability to differentiate between the responsibilities of those charged with governance and those of the auditors on the financial statements.

Candidates are advised to be conversant with the duties and responsibilities of the directors and auditors on the financial statements.

**Marking guide**

| | | | Marks | Marks |
|---|---|---|---|---|
| a. | i. | **The rights of auditors**<br>(1 mark each subject to a maximum of 3 rights) | 3 | |
| | ii. | **The duties of auditors**<br>(1 mark each subject to a maximum of 7 duties) | 7 | 10 |
| b. | | **The responsibilities of management and those charged with governance**<br>(1 mark each subject to a maximum of 5 responsibilities) | | 5 |
| c. | | **Reasons for resignation of appointment as company's auditors**<br>(1 mark each subject to a maximum of 5 reasons for resignation of appointment) | | 5 |
| | | **Total** | | **20** |

**SOLUTION 5**

a. **Purposes of COBIT (Control Objectives for Information and Related Technologies) include:**

i. COBIT is to provide management and business process owners with an information technology (IT) governance model that helps in understanding and managing the risks associated with Information Technology;

ii. COBIT helps to bridge the gaps between business risks, control needs and technical issues;

iii. It is a control model to meet the needs of Information Technology (IT) governance and ensure the integrity of information and information system; and

iv. COBIT is a framework for the governance and management of enterprise information and technology aimed at the whole enterprise.

b. **COBIT comprises of six specific components:**

i. **Management guidelines**

To ensure a successful enterprise, one has to effectively manage the union
between business processes and information systems. The Management guidelines for these are composed of:

- Maturity models, to help determine the stages and expectation levels of control and compare them against industry norms;
- Critical success factors, to identify the most important actions for achieving control over the IT processes; and
- Key goal indicators, to define target levels of performance; and key performance indicators, to measure whether an IT control process is meeting its objective.

These management guidelines will help answer the questions of immediate concern to all those who have a stake in enterprise success.

ii. **Executive summary**

Sound business decisions are based on timely, relevant and concise information. Specifically designed for time pressed senior executives and managers, COBIT includes an executive overview which provides thorough awareness and understanding of COBIT's key concepts and principles.

Also included is a synopsis of the Framework providing a more detailed understanding of the concepts and principles, while identifying COBIT's four domains (Planning & Organisation, Acquisition & Implementation, Delivery and Support, and Monitoring) and 34 Information Technology processes.

iii. **Framework**

A successful organisation is built on a solid framework of data and information. The Framework explains how IT processes deliver the information that the business requires to achieve its objectives. This delivery is controlled through 34 high-level control objectives, one for each IT process, contained in the four domains.

The Framework identifies which of the seven information criteria (effectiveness, efficiency, confidentiality, integrity, availability, compliance and reliability), as well as which IT resources (people, applications, technology, facilities and data) are important for the IT processes to fully support the business objective.

iv. **Control Objectives**

The key to maintaining profitability in a technologically changing environment is how well control is maintained. COBIT's Control Objectives provide the critical insight needed to delineate a clear policy and good practice for Information Technology controls.

Included are the statements of desired results or purposes to be achieved by implementing the specific and detailed control objectives throughout the 34 Information Technology processes.

v. **Audit Guidelines**

To achieve desired goals and objectives one has to constantly and consistently audit one's procedures. Audit guidelines outline and suggest actual activities to be performed corresponding to each of the high level IT control objectives, while substantiating the risk of control objectives not being met.

Audit guidelines are an invaluable tool for information system auditors in providing management assurance and/ or advice for improvement.

vi. **Implementation tool set**

Implementation tool set contains:

- Management awareness and IT control diagnostics;
- Implementation guide FAQs;
- Case studies from organisations currently using COBIT; and

- Slide presentations that can be used to introduce COBIT into organisations.

The tool set is designed to facilitate the implementation of COBIT, relate lessons learned from organisations that quickly and successfully applied COBIT in their work environments, and lead management to ask about each COBIT process:
Is this domain important for our business objectives? Is it well performed? Who does it and who is accountable? Are the processes and control formalised objectives for information and related technologies?

c. **The application of (COBIT) in business process include:**

i. COBIT is business process oriented and therefore addresses itself in the first place to the owners of these processes;

ii. Generic business model refers to core processes such as procurement, operations, marketing, sales, etc, as well as support processes (human resources, administration and information technology);

iii. COBIT provides the business process owners with a framework which should enable them to control all the different activities underlying IT deployment. As a result, they can gain reasonable assurance that IT will contribute to the achievement of their business objectives;

iv. COBIT provides the business process owners with a generic communication framework to facilitate understanding and clarity among the different parties involved in the delivery of IT services;

v. The addition to the Management Guidelines of COBIT provides management with a new set of tools;

vi. These guidelines allow self-assessment in order to make choices for control implementation and improvements over IT, measure the achievement of goals and the proper performance of IT processes; and

vii. The Management Guidelines include maturity models, critical success factors, key goal indicators and key performance indicators to support managerial decision making.

## Examiner's report

The question tests the candidates' knowledge of the requirements of COBIT (Control Objectives for Information and Related Technologies).

The question was attempted by about 50% of the candidates but the performance was just about average.

The commonest pitfall was the candidates' inability to explain the specific components of COBIT.

Candidates are advised to be abreast of the developments in information technology to enhance their performance in future examinations.

**Marking guide**

| | | | Marks | Marks |
|---|---|---|---|---|
| a. | | **The purposes of COBIT**<br>(1 mark each subject to a maximum of 3 purposes of COBIT) | | 3 |
| b. | i. | **Identification of components of COBIT**<br>(½ mark each subject to a maximum of 6 points) | 3 | |
| | ii. | **Explanation of the components of COBIT**<br>(½ mark each subject to a maximum of 10 explanation from the 6 components) | 5 | 8 |
| c. | | **The application of COBIT in business process**<br>(1 mark each subject to a maximum of 4 applications) | | 4 |
| | | **Total** | | **15** |

## SOLUTION 6

a. Suitable control activities and the assessment of its degree of effectiveness include:

i. **Authorisation controls**: These require that all significant transactions must be authorised by a manager at an appropriate level in the organisation;

ii. **Physical controls over assets** These are controls for safeguarding assets from unauthorised use, or from theft or damage. An example is limiting access to inventory areas to a restricted number of authorised personnel;

iii. **Arithmetic controls**: These are checks on the arithmetical accuracy of processing. An example is checking invoices from suppliers, to make sure that the amount payable has been calculated correctly;

iv. **Accounting controls**: These are controls that are provided within accounting procedures to ensure the accuracy or completeness of records. An example is the use of control account reconciliations to check the accuracy of total trade receivables or total trade payables;

v. **Management controls**: These are controls applied by management. They include supervision by management of the work of subordinates, management review of performance and control reporting (including management accounting techniques such as standards setting, variance analysis, budgeting and budgetary control); and

vi. **Segregation of duties:** This means dividing the work to be done between two or more individuals, so that the work done by one individual acts as a check on the work of the others. This reduces the risk of error or fraud.

The degree of effectiveness of an internal control system will depend on the following two factors:

i. The design of the internal control system and the individual internal controls. Is the control system able to prevent material misstatements, or is it able to detect and correct material misstatements if they occur? Do the internal controls appear to be adequate and effective 'on paper'?; and

ii. The proper implementation of the controls. Controls are not effective unless they are implemented properly. So, are the controls operated properly by the client's management and other employees.

The outcome of this evaluation helps the auditor to assess the control risk which could lead to the following:

i. If the auditor assesses the control risk as **very high**, he will probably take the view that a systems-based audit approach will not be appropriate. He will therefore move on to detailed testing of transactions and balances (and take a **substantive testing** approach to the audit); and

ii. Before he can assess the control risk as **low**, the auditor must be satisfied that the controls are well-designed and should be effective (in other words, they seem effective 'on paper'). Even if the controls appear to be acceptable on paper, the auditor cannot rely on them and perform a systems-based audit unless he is confident that the controls are actually working in practice. In this situation, the next stage in the audit process is to carry out **tests of controls**.

b. In the course of the audit, ISA 315 requires the auditors to:

i. Gain an understanding of the five components of the client's internal control system;

ii. Document the relevant features of the control systems;

iii. Note that most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit;

iv. Observe that it is a matter of the auditor's professional judgement whether a control, individually or in combination with others, is relevant to the audit;

v. Confirm that his understanding of the internal control system is correct by performing **'walk-through' procedures** on each major type of transaction (for example, sales transactions, purchase transactions, payroll);

vi. Perform walk-through testing involves the auditor selecting a small sample of transactions and following them through the various stages in their processing in order to establish whether his understanding of the process is correct; and

vii. Assess the effectiveness of the controls that are in place and the extent to which he can rely on those controls for the purpose of the audit.

**Examiner's report**

The question tests the candidates' knowledge of internal control, the effectiveness of internal control procedures, and the expectations from the external auditor in an engagement.

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

The commonest pitfall of the candidates was the display of lack of understanding of the concepts of control in an audit.

Candidates are advised to read relevant materials on control processes in an organisation when preparing for subsequent examinations.

**Marking guide**

| | | Marks |
|---|---|---|
| a. | **Control activities required for effectiveness of internal control** (2 marks each subject to a maximum of 5 suitable control activities) | 10 |
| b. | **Identification and explanation of the responsibilities of the external auditor** (1 mark each subject to a maximum of 5 points) | 5 |
| | **Total** | **15** |

**SOLUTION 7**

a. **The main audit strategies are as follows:**

i. **Statement of financial position approach**
This audit approach concentrates on the statement of financial position figures using substantive testing, on the argument that if the opening and closing statements of financial position are accurate, then the profit or loss for the year must also be stated accurately.

ii. **Substantive testing approach**

This approach focuses on applying substantive tests to a large number of transactions and account balances recorded in the accounting system of the client.

This focus on recorded transactions and balances means that under-statements may not be detected. (The auditor may ignore transactions that have not been recorded).

This approach is time-consuming and costly for the audit of large companies. This approach is appropriate where systems and controls are weak or not operating. Substantive tests on transactions and balances are therefore necessary to reach an opinion about the financial statements.

It is widely used for the audit of smaller entities where controls are likely to be weak.

There is a danger of spending too much time auditing transactions or balances that are not material.

There is a risk that misstatements in the financial transactions will not be detected unless all transactions and balances are tested, not just a sample.

iii. **Systems-based approach**

The audit focus is on the application of tests of control to the systems that produce the figures in the financial statements, rather than on the figures themselves.

A systems-based approach is supported by some degree of substantive testing, because of the unavoidable limitations or weaknesses in internal control systems. (The amount of substantive testing required will depend on the auditor's judgement about the effectiveness of the internal controls).

It is also supported by the use of analytical procedures.

It is more cost-effective than a full substantive testing approach, but there is still a danger of doing too much unnecessary auditing of areas where controls are operating well.

iv. **Risk-based approach and business risk approach**

An assessment is made of the likelihood of material misstatements existing in each area of the audit.

Areas that are assessed as high-risk are audited extensively (using substantive tests, a systems based approach and analytical procedures).

Areas assessed as low-risk are given a low level of attention in the audit.

These auditing methods (applied mainly by large audit practices) focus on 'business risk' rather than overall 'audit risk'.

b. **The selection of the audit strategy will depend on a number of factors, including:**

   i. The size of the client's business: a business risk approach is best-suited for large companies, and a statement of financial position approach is usually the most suitable for small companies;

   ii. The control procedures and control environment in place: A systems-based approach is most suitable when there is a strong control environment and internal control system;

   iii. The audit methods and techniques favoured by the audit firm: For example, larger audit firms may favour a business risk approach; and

   iv. The Nature of the client's business: The nature and sector of the client's business plays a major role in selecting an audit strategy. A system based approach will be more suitable for a client in the e-commerce sector than a financial position audit approach.

c. **Explanations of the differences between Audit strategy and Audit plan**

   i. Audit strategy sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

   ii. The audit plan is more detailed than the overall audit strategy.

   iii. Planning for audit procedures takes place over the course of the audit as the audit activities for the engagement develops or events unfold. Audit Plan refers to the scheme formulated by the auditor that comprises of strategy or approach, that is followed for carrying out audit.

**Examiner's report**

The question tests the candidates' knowledge of the approaches to the main audit strategies, the factors to consider in the selection of strategy, and the difference between strategy and plan.

About 70% percent of the candidates attempted the question but the performance was below average.

The commonest pitfall was the candidates' inability to properly differentiate between audit strategy and audit plan.

The candidates are advised to study relevant materials on audit planning.

**Marking guide**

| | | Marks | Marks |
|---|---|---|---|
| a. | **The main audit strategies to be adopted in the audit** | | |
| | (½ mark each for the four audit approaches) | 2 | |
| | (1 mark each subject to a maximum of 7 points not exceeding 2 points from one audit strategy). | 7 | 9 |
| b. | **Factors to be considered in solution of audit strategies** | | |
| | (1 mark each subject to a maximum of 4 factors in selection of audit strategy). | | 4 |
| c. | **Explanation of differences between audit strategy and audit plan** | | |
| | (1 mark each subject to a maximum of 2 differences between strategy and plan). | | 2 |
| | **Total** | | **15** |

ICAN/232/V/C5 Examination No..........................

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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, NOVEMBER 16, 2023**

**DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 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/student.

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 analysis 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 any other paper **WILL NOT** be marked/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% |

Of the total marks available, 20% are awarded for the executive summary and approximately 10% for the relevant discussion of ethical issues within your answer to the requirements. Although 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 it 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.

Candidates that omit any one of these will have a slim chance of success in the examination.

**November 2023 Case Study: Adalat Products Nigeria Limited**

**List of exhibits**

1 About you (John Ogbeide) and your employer, Adalat Products Nigeria Limited.

2 Nigerian economic and business environment.

3 Adalat Products Nigeria Limited: History and Products.

4 Adalat Products Nigeria Limited: Strategy and Sustainability.

5 Adalat Products Nigeria Limited - Summarised Consolidated Financial Statements (2019-2021).

**Exhibit 1**

**About you (John Ogbeide) and your employer, Adalat Products Nigeria Limited**

You are John Ogbeide, writing the Professional level of ICAN examination. You are employed as System and Control Accountant at the group head office of Adalat Products Nigeria Limited which has three Strategic Business Units (SBUs). You are reporting to James Olaitan, Group Finance Director. Your responsibilities include:

- Preparing detailed financial analyses and reports on the performances of the Strategic Business Units;
- Analysing the SBUs' financial statements to identify areas of weakness and proffering likely solutions to correct the anomalies;
- Assessing operational and strategic business proposals to see how each aligns with the group's objectives and its impact on its business and financial risks;
- Assessing the group's financial and business forecasts together with the assumptions upon which they are based, to form judgements and recommendations to the board;
- Review the SBUs' sustainability practices and reporting; and
- Drafting reports for the Group Finance Director to be submitted to the board on the result of the SBUs' financial, operational and strategic business analyses you have carried out.

Your responsibilities demand that you keep yourself abreast with the global and national developments in the industries in which the group operates in order to carry out the above tasks effectively.

**Exhibit 2**

## Nigerian economic and business environment

The Nigerian economy is the largest in Africa and has experienced significant growth over the past decade. However, it faces a number of challenges and uncertainties that have impacted the business environment.

One of the most pressing issues in the Nigerian economy is the over-reliance on oil as a primary source of revenue. This has made the economy vulnerable to fluctuations in global oil prices and has resulted in a lack of diversification to other sectors. Additionally, corruption, political instability, and security challenges in some regions of the country have also impacted economic growth.

Despite these challenges, Nigeria has made some progress in improving its business environment. In recent years, the government has implemented several reforms aimed at improving the ease of doing business in the country, such as reducing bureaucracy and improving access to credit. However, there is still room for improvement in areas such as tax administration, regulatory enforcement, and infrastructural development.

One potential bright spot for the Nigerian economy is its large and growing population, which presents significant opportunities for businesses in sectors such as consumer goods, financial services, and technology. Additionally, the current government has prioritised investment in agriculture and manufacturing as part of its efforts to diversify the economy.

Overall, while Nigeria faces significant challenges in its economic and business environments, there are also opportunities for growth and development. Continued efforts to address corruption, improve infrastructure, and diversify the economy will be important for ensuring sustainable growth in the long term.

### Nigerian future economic outlook

Nigeria's economy has been struggling in recent years due to a combination of factors, including falling oil prices, security challenges, and poor economic policies. The COVID-19 pandemic has also had a significant impact on the economy, leading to a contraction in GDP in 2020.

However, the government has taken steps to address these challenges and improve the economic outlook. In 2022, the government implemented economic reforms aimed at diversifying the economy away from oil and promoting non-oil exports.

The government has also been working to improve the business environment, attract foreign investment, and increase access to credit for small and medium-sized enterprises.

Additionally, the government has announced plans to increase spending on infrastructural projects such as roads, railways and power plants, which could stimulate economic growth and create job opportunities.

The Nigerian economic outlook for 2023 depends on several factors, including the global economic environment, the government's ability to implement its economic policies, and the success of its infrastructural projects. If these factors align positively, Nigeria could experience an economic rebound and sustained growth in the coming years.

## The state of agricultural business in Nigeria

Agriculture is a critical sector in Nigeria's economy, employing a significant proportion of the population and contributing to the country's Gross Domestic Product (GDP). Nigeria has abundant natural resources, fertile land and a favourable climate for agriculture. However, the state of agricultural business in Nigeria is a mixed picture.

On one hand, the agricultural sector has grown significantly in recent years, with Nigeria becoming the largest producer of cassava, yams, and cowpeas in the world. The government has also introduced various initiatives to boost the sector, including the Agricultural Transformation Agenda (ATA), which aims at increasing productivity, reducing food imports, and creating jobs.

On the other hand, the sector is still facing numerous challenges, including inadequate infrastructure, insufficient funding, low mechanisation, and low access to technology. These challenges have hampered the growth and development of agricultural business in Nigeria.

Another significant challenge is the high level of post-harvest losses due to poor storage facilities, inadequate transportation systems, and inadequate processing facilities. These losses reduce the profitability of agricultural businesses and discourage investment in the sector.

Moreover, the sector is heavily reliant on smallholder farmers who face various challenges, including low access to credit, lack of hybrid inputs, and inadequate market access. These challenges limit their productivity and profitability, which ultimately affect the entire value chain.

In conclusion, while there have been significant strides in the agricultural sector in Nigeria, there are still significant challenges that need to be addressed to enhance the growth and development of agricultural business. The government needs to invest in infrastructure, increase funding, promote mechanisation, and provide better access to technology to overcome these challenges. Additionally, stakeholders in the sector must work together to create a conducive environment for investment, promote innovation, and provide support to smallholder farmers.

**Exhibit 3**

## Adalat Products Nigeria Limited: History and Products

Adalat International is a global leader in the food, feeds and fibre Agri-business. The company focuses on high growth emerging markets with strategic objective of delivering superior returns to its shareholders, and at the same time maximising the value of its other stakeholders.

Adalat International was established in 2005, with just one product in one country, trading in cashew from Nigeria to India. Today, Adalat is a leading Agri–business, operating from seed to shelf in 72 countries, supplying food and industrial raw materials to over 15,000 customers worldwide.

The company specialises in the food, feeds and fibre products and is aligned to the key trends of meeting the rising demands for staple food and fibre in high growth markets, as well as the shift to protein-based diets in these jurisdictions. The international headquarters of the company is now in Gopal, India.

### Products

The company produces grains, integrated food and protein, edible oils, rice, specialty grains and seeds, cotton, wood products and rubber.

### Geographical locations

Adalat has operations in Europe, Middle East, East Africa and West Africa. Adalat evolved from engaging in the procurement of several primary commodities, like shea nut, cocoa and cashew, before expanding its operations to include branded packaged food, imports and exports.

### Adalat Products Nigeria Limited

Adalat Products Nigeria Limited (APNL) was established in Nigeria in 2015. It has its operational presence in all the six geo-political zones of the country. These operational offices are involved with a host of customers and service providers, local buying agents, wholesalers, suppliers and farmers. APNL is presently dealing with over 400,000 farmers, thereby generating a lot of indirect employment for the Nigerian populace.

APNL sources, procures, grades, processes and exports various agricultural products, such as cotton, sesame, cashew, cocoa and coffee. The company is also into rice farming and milling operations. The headquarter of APNL is located at Nos 7-11, ACME Road, Ogba Industrial Zone, Ikeja, Lagos State.

APNL presently has up to 4,000 staff members in its employment and these staff are involved in the distribution, marketing, processing and originational activities of the company.

APNL manufactures and distributes packaged food products to African markets, addressing local nutrition needs by offering affordable and fortified products. The company offers good quality, inexpensive feeds, and day-old chicks to farmers, which also contributes to food security.

APNL generates tens of thousands of indirect jobs through its network of farmers, suppliers, wholesalers, local buying agents and service providers. In addition to the company's internal sourcing and markets, it also has significant import and export operations.

**Exhibit 4**

## Adalat Products Nigeria Limited: Strategy and Sustainability

### Our strategic focus

We are set to offer tomorrow's products and services today. We play a pivotal role in agricultural value chain – sourcing raw materials and transforming them to deliver food, feeds and fibre to the world. Consumer preferences for food and ingredients are rapidly evolving with greater emphasis on health & nutritional value, clean labelling, authenticity, supply chain visibility, and sustainability. These preferences are driving a rethink towards products that are 'right-for-me', 'right-for-the-planet', and 'right-for-producers'. We refreshed our strategy to meet this changing consumer landscape as we continue to invest in our capabilities and capitalise on the key emerging trends of health and wellness, traceability and sustainability.

We are focused on furthering our leadership in our chosen businesses and creating greater value for our shareholders, customers, suppliers, employees & partners.

### Our capabilities and how we are differentiated

Our strategy is to deploy the following:

- Differentiated value-added solutions and services based on key industry trends (health and wellness, sustainability and digital), creating significant opportunities for growth;
- Network of millions of farmers and own farms: unrivalled origination capabilities in the producing countries;
- Leaders in sustainability, with ability to drive from source;
- Proof of concept digital pilots now scaling up competitiveness;
- Best global talents-Specialist skills and deep expertise - Passionate and entrepreneurial mindsets - High engagement and retention rates;
- Cross-cutting programmes to develop excellence and share learnings;
- Strong shareholder base with long-term orientation;
- Uniquely shaped portfolio with selective integration across value chain to capture value;
- Unique Africa footprint and operating capabilities portfolio; and
- Refocus on our strengths and capitalise on new opportunities.

**Objective:** To maximise long-term intrinsic value for our continuing shareholders.

**Vision**: To be the most differentiated and valuable global food and agri-business (by 2030).

**Purpose:** Re-imagine Global Agriculture and Food Systems. Transitioning to position us well to meet evolving consumer preferences in the next 10 years. To hone our winning business model.

**Goals:** By 2030, we will be a global food and agri-business that delivers food, feeds and fibre along with innovative solutions to support our customers' growing need for sustainable and transparent supply chains, with a clear focus on tomorrow's consumer preference.

To achieve this goal, we have set the following targets:

- ROE ≥12% from 2021;
- EBITDA/Invested Capital (working capital + fixed capital); >15% from 2023; and
- Net Debt / Equity; < 2.0 throughout the plan period.

**Strategy slogan**

We have three slogans to drive our business strategy. These are:

**Right for me:**

- Healthy eating
- Customisation
- Premiumisation
- Authenticity
- Natural ingredients (flavour, colour)
- Cool/niche brands

**Right for the planet:**

- Environmental concerns (planetary boundaries)
- Social equity
- Assurance (certification)
- Supply chain provenance and traceability
- Direct link to producer

**How I live and consume:**

- Out-of-home/snacking
- Omni-channel purchasing
- Mobile connectivity
- Social media influencers

**Market focus**

Our strategy is to focus on:

- Strong business platforms with leading positions in attractive market segments, including global food ingredients, global agri-businesses, Africa food, and Africa Infra and logistics, etc.;
- Balanced capital allocation with selective integration in the value chain. Special thrust on midstream and added value ingredients (~50% of our internal capital allocated to midstream/ingredients in 2024 from the current 39%); and
- Global presence and leadership to serve global customers.

**Products**
Our overall strategy is to work closely with our customers, share our fresh ideas to inspire new product concepts and sustainability impact projects. This co-creation delivers value, supports their business growth and creates real change for people and planet.

Specifically, our strategy is to offer products that are:

**Natural, Nutritious and Delicious:**

- Enable health, wellbeing, and nutritional benefits;
- Offer new and indulgent sensory experiences;
- Create a wide range of plant-based alternatives; and
- Provide natural and clean-label properties.

**Reliable, Traceable and Tailored:**

- Leverage our global network and on-the-ground intel;
- Manage quality, food safety, traceability and security of supply across the integrated value chain; and
- Focus on continuous innovation and customisation, from plant to palate.

These will enable us to have a business that is sustainable, collaborative and transparent, so as to:

- Constantly improve data and insight to offer transparency across the supply chain;
- Build collaborative partnerships to deliver sustainability impact at scale; and
- Define metrics, set targets, track and report on continuous progress.

**How to win**
During the plan period, we will strive to offer:

- Leadership and talent;
- Operational excellence;
- Strengthen, streamline and focus our portfolio;
- Improve margin;
- Offer differentiated products/services in existing and new channels;
- Explore investments in new engines for growth; and
- Digital marketing innovation.

## Sustainability Strategies, Practices and Reporting

Our sustainability mission is to leave the world a better place than we met it.

Therefore, we are re-inventing global agriculture through our operational ability to make material impact on improving farmer livelihoods, increasing community wellbeing, and regenerating our living world. We recognise that we succeed or fail together, which is why we have set ourselves an ambitious goal and why sustainability is a key enabler of our Strategic Plan – It is our way of doing business, and it is what we expect from our business partners.

Our goals and milestones are signposts along a continuous journey that is intended to strengthen our company, as it strengthens the people we meet, and the communities and environment in which we operate.

Our revolutionary sustainability insights platform for agricultural supply chains at source, provides customers with a single view across their supply chain sustainability parameters, as well as insights into how to influence these elements for the better.

The end-to-end metrics, action plans and corresponding narratives can be used by customers to meet sustainability requirements, build brand trust and confidence, report on sustainability initiatives and transform supply chains.

## Innovation and Technology

Technology helps us to collect data, improve transparency, and give farmers the information needed to grow the volumes and quality of crops, and meet customers need, whilst enhancing their livelihoods.

## Reporting

Adalat believes that sustainability should sit at the heart of the business. It is one of four key enablers to deliver our Strategic Plan.

We report on our sustainability goals in our Annual Reports in summary, while detailed sustainability report is prepared as a stand alone report on a yearly basis.

We use the Global Reporting Initiative as a guidance framework. We also endeavour to incorporate how we manage and engage our stakeholders.

We take a multiple capitals' approach, reporting under Manufactured, Human, Social, Natural, Intangible and Intellectual Capital. Our Finance for Sustainability Function (F4S) has also developed the Adalat Integrated Impact Statement (AIIS) – a tool for multi-capital accounting.

**Exhibit 5**

**Adalat Products Nigeria Limited**

**Summarised Consolidated Financial Statements – 2019-2021**

**Income statement**

| | 2021 ₦m | 2020 ₦m | 2019 ₦m |
|---|---|---|---|
| Sale of goods and services | 47,002.0 | 35,8 | 32,99 |
| | | 20.0 | 2.7 |
| Other income | 77.4 | 136.2 | 188.5 |
| Cost of goods sold | (43,095.1) | (32,663.0) | (30,053.8) |
| Net gain/(loss) from changes in fair value of biological assets | 69.2 | (60.3) | 1.9 |
| Depreciation and amortisation | (627.2) | (561.3) | (500.6) |
| Other expenses | (2,271.3) | (2,147.6) | (1,822.6) |
| Finance income | 92.3 | 102.8 | 88.6 |
| Finance costs | (530.4) | (518.5) | (629.5) |
| Share of results from joint ventures and associates | 19.8 | 113.9 | 67.9 |
| Profit before taxation | 736.7 | 222.2 | 333.1 |
| Income tax expense | (133.9) | (44.0) | (55.9) |
| Profit for the financial year | **602.8** | **178.2** | **277.2** |
| Attributable to: | | | |
| Owners of the Company | 686.4 | 245.7 | 316.2 |
| Non-controlling interests | (83.6) | (67.5) | (39.0) |
| | **602.8** | **178.2** | **277.2** |

**Statement of financial position**

| | 2021 ₦m | 2020 ₦m | 2019 ₦m |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 5,867.1 | 5,904.5 | 6,187.0 |
| Right-of-use assets | 782.6 | 712.3 | 719.2 |
| Intangible assets | 2,578.3 | 1,242.8 | 1,165.2 |
| Biological assets | 489.0 | 473.2 | 531.2 |
| Deferred tax assets | 266.8 | 227.8 | 183.3 |
| Investments in joint ventures and Associates | 572.3 | 664.9 | 661.1 |
| Long-term investment | 31.3 | 24.3 | 71.5 |
| Other non-current assets | 25.7 | 34.4 | 45.0 |
| | **10,613.1** | **9,284.2** | **9,563.5** |
| **Current assets** | | | |
| Trade receivables | 2,441.4 | 1,910.4 | 2,316.5 |
| Margin accounts with brokers | 555.3 | 121.7 | 00.0 |
| Inventories | 8,857.2 | 7,380.6 | 7,211.5 |
| Advance payments to suppliers | 543.4 | 621.9 | 563.5 |
| Cash and short-term deposits | 4,317.5 | 3,115.9 | 3,179.6 |
| Derivative financial instruments | 3,594.8 | 3,243.0 | 1,847.7 |
| Other current assets | 1,001.7 | 985.6 | 1,129.8 |
| | **21,311.3** | **17,379.1** | **16,248.6** |
| Non-current assets held for sale | **136.3** | **39.3** | **00.0** |
| **Current liabilities** | | | |
| Trade payables and accruals | 4,679.7 | 3,070.1 | 3,983.5 |
| Margin accounts with brokers | 00.0 | 00.0 | 13.0 |
| Borrowings | 6,937.6 | 6,466.5 | 6,675.5 |
| Lease liabilities | 138.0 | 96.5 | 118.5 |
| Derivative financial instruments | 2,335.9 | 2,276.7 | 1,162.1 |
| Provision for taxation | 180.1 | 203.7 | 259.1 |
| Other current liabilities | 740.0 | 533.7 | 596.9 |
| | **15,011.3** | **12,647.2** | **12,808.6** |
| Net current assets/(liabilities) | **6,436.3** | **4,771.2** | **3,440.0** |
| **Non-current liabilities** | | | |
| Deferred tax liabilities | 583.3 | 369.2 | 407.3 |
| Borrowings | 8,794.7 | 6,780.9 | 5,403.4 |
| Lease liabilities | 839.8 | 815.6 | 881.8 |
| Other non-current liabilities | 52.9 | 53.8 | 17.7 |
| | **10,270.7** | **8,019.5** | **6,710.2** |
| **Net assets** | **6,778.7** | **6,036.0** | **6,293.3** |

| | | | |
|---|---|---|---|
| Equity attributable to owners of the Company | | | |
| Share capital | 4,339.5 | 3,749.0 | 3,749.0 |
| Treasury shares | (114.4) | (140.2) | (158.8) |
| Capital securities | 906.8 | 1,045.8 | 1,045.8 |
| Reserves | 1,639.3 | 1,307.9 | 1,549.2 |
| | 6,771.2 | 5,962.5 | 6,185.2 |
| Non-controlling interests | 7.5 | 73.5 | 108.1 |
| Total equity | **6,778.7** | **6,036.0** | **6,293.3** |

# UN-SEEN

**November 2023 Case Study: Adalat Products Nigeria Limited**

List of exhibits

The following exhibits are newly provided and did not form part of the materials provided as Pre-seen:

6. Email from James Olaitan to John Ogbeide

7. Adalat Products Nigeria Limited – Strategic Business Units Report

8. Adalat Products Nigeria Limited – Geographical Business Report

9. Adalat Products Nigeria Limited - Proposed Ofada Rice Production and Distribution (Ofada Rice Project)

## Adalat Products Nigeria Limited: Case Study requirement

You are John Ogbeide, writing the Professional level of ICAN examination, working as System and Control Accountant at the group head office of Adalat Products Nigeria Limited. You are reporting to James Olaitan, the Group Finance Director.

### Requirement

You are required to prepare a draft report, as set out in the email dated 15 March 2023 from James Olaitan to you (**Exhibit 6**). Your report should comprise the following:

- An executive summary.
- Responses to the two detailed requirements as set out in exhibits 7 and 8, 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 analyses | 1 hour |
| ▸ Drafting report | 2 hours |

### Marks allocation

All marks in the Case Study are awarded for 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% |

Of the total marks available, 20% are awarded for the executive summary and approximately 10% for relevant discussion of ethical issues within your answers to the requirements.

Ensure that you address the two requirements in your report or failure to address any requirement including not submitting an executive summary will adversely affect your chances of success. In addition, as indicated above, all four skill 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 6**

## Email from James Olaitan to John Ogbeide

From: James Olaitan
Sent: 15 March 2023
To: John Ogbeide

Subject: Board meeting

As you are aware, the next board meeting, at which the company's performance and strategic plans for the coming year will be considered, is in two weeks. At this meeting, the board will review the performance of each of the strategic business units, the geographical performance and take decision whether to go ahead with the decision on the Ofada Rice Project.

Therefore, I will like you to carry out:

i. A detailed review of the strategic business units' performance from 2019 to 2021, noting the trend in performance and returns on capital invested. You are also to carry out a review of the geographical performance of the company for the period.
ii. An evaluation of the Ofada Rice Project. Your appraisal should cover the two phases of the project and provide advice to the board on whether to go ahead with the project or not. Also, indicate whether the company should stop at phase one of the project or should implement the two phases.

I attach herewith Exhibits 6 to 9 to assist you. Other information about the Nigerian economic and business environments, details about the company, its strategy and sustainability practices are available in the files in the office. You can consult these documents as they will assist you in your review and evaluation.

Please draft for my review, a report to be submitted to the board. Your report should comprise:

1. A review of the strategic business units' performance from 2019 to 2021, noting the trend in performance and returns on capital invested. You are also to carry out a review of the geographical performance of the company for the period;
2. . An evaluation of the Ofada Rice Project. Your appraisal should cover the two phases of the project and provide advice to the board on whether to go ahead with the project or not. Also, indicate whether the company should stop at phase one of the project or should implement the two phases. Assume a rate of return equal to the target set by the company on its invested capital.

I look forward to receiving your draft report.

James

**Exhibit 7**

# Adalat Products Nigeria Limited
## Strategic Business Units report

| | Food ingredients | | | Agric products | | | International business | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2021** | **2020** | **2019** | **2021** | **2020** | **2019** | **2021** | **2020** | **2019** | **2021** | **2020** | **2019** |
| | **₦m** | **₦m** | | **₦m** | **₦m** | | **₦m** | **₦m** | | **₦m** | **₦m** | |
| **Revenue** | | | | | | | | | | | | |
| External customers | 14,606.3 | 12,290.4 | 12,546.8 | 31,276.9 | 22,407.9 | 18,850.3 | 1,118.8 | 1,121.8 | 1,997.6 | 47,002.0 | 35,820.1 | 33,394.7 |
| EBIT | 875.3 | 749.5 | 793.7 | 752.9 | 497.0 | 329.5 | (205.6) | (176.9) | (65.8) | 1,422.6 | 1,069.6 | 1,057.4 |
| Finance costs | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | (530.4) | (518.5) | (629.5) |
| Finance income | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 92.3 | 102.8 | 88.6 |
| Exceptional items | 7.4 | (40.2) | 88.9 | 00.0 | (5.9) | (9.5) | (255.2) | (385.6) | (262.8) | (247.8) | (431.7) | (183.4) |
| Profit before tax expense | | | | | | | | | | 736.7 | 222.2 | 333.1 |
| Tax expense | | | | | | | | | | (133.9) | (44.0) | (55.9) |
| Profit for the year | | | | | | | | | | 602.8 | 178.2 | 277.2 |
| Segment assets | 14,540.2 | 11,682.8 | 11,727.3 | 8,558.2 | 6,658.5 | 4,892.1 | 3,183.0 | 3,933.7 | 4,585.6 | 26,281.4 | 22,275.0 | 21,205.0 |
| Unallocated assets | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 5,779.3 | 4,427.6 | 4,607.1 |
| | | | | | | | | | | 32,060.7 | 26,702.6 | 25,812.1 |
| Segment liabilities | 3,348.4 | 2,370.6 | 2,830.9 | 3,316.2 | 2,448.2 | 1,920.5 | 351.0 | 528.1 | 423.1 | 7,015.6 | 5,346.9 | 5,174.5 |
| Unallocated liabilities | 00.0 | 00.0 | | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 00.0 | 18,266.5 | 15,319.8 | 14,344.3 |
| | | | | | | | | | | 25,282.1 | 20,666.7 | 19,518.8 |
| Other segmental information | | | | | | | | | | | | |
| Depreciation and amortisation | 341.9 | 292.6 | 269.7 | 176.7 | 152.0 | 100.5 | 108.6 | 116.7 | 130.4 | 627.2 | 561.3 | 500.6 |
| Share of result from joint businesses | 2.2 | 7.7 | 11.4 | 9.2 | 00.0 | (0.5) | 8.3 | 106.2 | 57.0 | 19.7 | 113.9 | 67.9 |
| Investments in joint businesses | 15.0 | 105.9 | 112.0 | 50.9 | 32.6 | 37.3 | 506.4 | 526.4 | 511.8 | 572.3 | 664.9 | 661.1 |
| Capital expenditure | 427.0 | 346.6 | 236.0 | 83.0 | 71.5 | 61.4 | 156.6 | 223.1 | 312.9 | 666.6 | 641.2 | 610.3 |

**Exhibit 8**

## Adalat Products Nigeria Limited
## Geographical Business Report

| | Africa | | | Europe | | | Other countries | | | Elimination | | | Consolidated | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2021 | 2020 | 2019 | 2021 | 2020 | 2019 | 2021 | 2020 | 2019 | 2021 | 2020 | 2019 | 2021 | 2020 | 2019 |
| | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m | ₦m |
| **Segment revenue** | | | | | | | | | | | | | | | |
| External customers | 22.085.8 | 16,515.8 | 16,409.3 | 9,266.8 | 7,239.9 | 6,599.2 | 15,649.4 | 12,064.3 | 9,984.2 | 00.0 | 00.0 | 00.0 | 47,002.0 | 35,820.0 | 32,992.7 |
| Intersegment sales | 11,580.0 | 9,744.1 | 10,057.1 | 393.7 | 214.6 | 186.9 | 5,156.8 | 3,966.5 | 2,940.3 | (17,130.5) | (13,925.2) | (13,184.3) | 00.0 | 00.0 | 00.0 |
| | **33,665.8** | **26,259.9** | **26,466.4** | **9.660.5** | **7,454.5** | **6,786.1** | **20,806.3** | **16,030.8** | **12,924.5** | **(17,130.5)** | **(13,925.2)** | **(13,184.3)** | **47,002.0** | **35,820.0** | **32,992.7** |
| **Non-current assets** | **4,041.7** | **4,056.7** | **4,001.1** | **756.2** | **736.0** | **686.9** | **5,815.2** | **4,491.5** | **4,875.6** | **00.0** | **00.0** | **00.0** | **10,613.1** | **9,284.2** | **9,563.6** |

**Exhibit 9**

## Adalat Products Nigeria Limited
## Proposed Ofada Rice Production and Distribution (Ofada Rice Project)

As part of APNL's growth strategy and desire to produce food items from plant to palate, the board has decided to go into Ofada rice cultivation, production and distribution. The plant is to be in Ofada town, Ogun state of Nigeria. A group of Ofada rice farmers have been recruited and organised as "Ofada Cooperative Farmers Association" (OCFA). The number of farmers in the association is 500 and they have been allocated farmlands by the state government for the purpose of Ofada rice cultivation.

Each farmer has been allocated a portion of the farmland, according to each farmer's expressed capacity for rice cultivation. APNL would provide rice seedlings, fertiliser, tractors, ridge makers and other farming implements to the farmers' association, to be used by the farmers as the need arises. Land charges were settled by APNL. Also, farmhouses would be built by APNL for the farmers' and their workers' uses. Roads are to be constructed by APNL to link the farmers together and to allow easy transportation of harvested rice to the location of the Rice Milling Plant, which is to be built in the middle of the land areas allocated by the state government for the Ofada Rice Project.

The project will be in two phases, as follows:

a. Processing of Ofada rice for local consumption;
b. Re-processing of Ofada rice for export to other countries.

### First Phase – Processing of Ofada rice for local consumption

### Processes involved in Ofada Rice Project

The processes involved in cultivation, production and distribution of Ofada rice are:

a. Land Preparation: The land is cleared of any debris or previous crop residues and ploughed to create ridges;
b. Seed Selection: Quality Ofada rice seeds are selected and prepared for planting;
c. Planting: The Ofada rice seeds are planted in the prepared ridges at a spacing of about 20-25 cm apart;
d. Weeding: The rice farm is weeded regularly to remove any unwanted weeds that could stunt the growth of the rice plants;
e. Harvesting: The Ofada rice is harvested when the grains are matured, and the paddies turn brown. This is usually done by cutting the rice stalks and threshing the paddies to separate the grains;
f. Parboiling: The harvested Ofada rice is soaked in hot water for about 24 hours to soften the outer layer of the grains;

g. Drying: The parboiled rice is spread out to dry under the sun for a couple of days until the moisture content is reduced or a dryer would be used to remove moisture from the rice;
h. Milling: The dried rice grains are milled to remove the outer husk and reveal the inner rice grains; and
i. Packaging: The Ofada rice is packaged in sacks or bags for distribution and sale in local markets.

**Terms of Agreement between APNL and the OCFA**

The agreement between APNL, the company, and OCFA, the farmers, specifies the duties of the company and those of the farmers in the project.

**Responsibilities of farmers**

The farmers are responsible for:

a. Land Preparation: Clearing of the land of any debris or previous crop residues and ploughing to create ridges;
b. Planting: Planting the Ofada rice seeds provided by the company in the prepared ridges at a spacing of about 20-25 cm apart;
c. Weeding: Regularly removing any unwanted weeds that could stunt the growth of the rice plants;
d. Harvesting: Harvesting the grains when they are matured, and the paddies turn brown. This is done by cutting the rice stalks and threshing the paddies to separate the grains; and
e. Transportation of harvested rice to the Milling plant.

**Responsibilities of the company**

The company is responsible for:

a. Provision of seedlings: Providing the Ofada rice seedlings for farmers to plant;
b. Production: The company will parboil, dry, mill and package the rice for distribution;
c. Payment: The company will pay the farmers, through the Cooperative Association, as follows:
    - Initial payment for labour in respect of land preparation, planting and weeding; and
    - Final payment, based on the quantity of rice transported to the Milling plant.

**Project costs**

The following cost projections have been prepared by the company:

a. Land fees: Being an agricultural business, the State government did not charge for the land, but the company paid land allocation fee, which is ₦5m, for a total of 5,000 hectares of land allocated.
b. Farmers' Cooperative Association: Payments to farmers, through their association are as follows:

- Initial payment – ₦100,000 per hectare; and
- Final payment – ₦500 per kg of rice harvested.

c. Milling and packaging: Materials, labour and direct overheads, excluding the depreciation of plant and factory building has been estimated at ₦250 per kg.

d. Buildings:
   - Farmhouses for farmers - ₦50m
   - Factory - ₦150m

e. Plants
   - Rice milling machine: $100,000
   - Parboiler: $60,000
   - Destoner: $50,000
   - Weighing scale: $10,000
   - Bagging machine: $50,000
   - Tractor: $200,000

   The company has got approval from the Central Bank of Nigeria to import the plants at the official exchange rate of ₦750 to $1.

f. Lorries for transportation of rice from the farm to the Mill – 2 Lorries @ ₦100m each.

g. Construction of roads will cost ₦100m.

h. Working capital: It is projected that a working capital of ₦200m would be enough for the project.

i. Project life: Project life is estimated at ten (10) years, after which the non-current assets would have no economic value.

**Plant capacity**

The expected annual yield from the Ofada Cooperative Farmers Association is projected at 3,500,000kgs of rice, out of which 3,200,000kgs would be available for milling. A normal loss of 5% is projected from the milling to bagging processes.

**Revenue projections**

Market survey reveals the following sales projections:

| Price per kg | Probability |
|---|---|
| ₦ | % |
| 1,000 | 50 |
| 1,200 | 30 |
| 1,400 | 20 |

**Agricultural tax incentives**

Ignore agricultural business tax incentives in your evaluation.

**Second Phase – Reprocessing Ofada rice for export**

This second phase requires further processing to make Ofada rice acceptable in the global market. The additional processes required are as follows:

a. Rice Whitening: To remove all or part of the bran layer and germ from the brown rice;
b. Rice Grading: To separate broken rice from whole rice; and
c. Rice Polishing: To improve the appearance of milled rice by removing the remaining bran particles and by polishing the exterior of the milled kernel.

These additional processing will result in additional variable costs of ₦150 per kg.
The following additional plants would be purchased:

a. Rice Whitener - $30,000
b. Rice Grader - $25,000
c. Rice Polisher - $35,000

**Export sales price**

The following export prices have been projected through market research:

| Price per kg | Probability |
|---|---|
| $ | % |
| 2.5 | 50 |
| 2.75 | 30 |
| 3.0 | 20 |

Ignore export incentives in your calculations.

It is expected that the quantities of Ofada rice produced would be divided as follows, between local sales and export sales:

| | |
|---|---|
| Local sales | 60% |
| Export sales | 40% |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | ICAN CASE STUDY NOV 2023 | | | | |
| | | | | | | |
| | **First Marking** | | | | | |
| | | | | | | |
| **DATE** | | | **CANDIDATE NO** | | | |
| | | | | | | |
| **TIME** | | **MARKER NUMBER** | | | | |
| | | | | | | |
| | | **Exc. Summary** | **Req. 1** | **Req. 2** | **Overall** | **TOTAL** |
| | **SA** | | | | | |
| | **CA** | | | | | |
| | **BC** | | | | | |
| | **NC** | | | | | |
| | **V** | | | | | |
| | **Total** | 5 | 8 | 8 | 4 | 25 |

**Executive Summary: Adalat Products Nigeria Limited**

**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**

- The International Business unit is dragging the company's profitability downwards.
- The performance of Food Ingredients SBU, in terms of profitability is steadily going down.
- The Agric Products unit performance is steadily increasing year on year.
- Africa is the highest contributor to the company's revenue during the years.
- The non-current assets turnover of Africa business is very low compared to other geographical locations.

**V NC BC CA SA**

**3. Requirement 1: Recommendations**

- The company should restructure its International Business Unit to make it profitable.
- The company should evolve strategies to stem the downward trend in the performance of Food Ingredients Unit.
- The company should evolve strategies to increase Africa's contribution to the company's revenue.
- The company should invest more on the Agric Products Business Unit, as its profitability has been improving year on year.
- The company should evolve strategies to increase the utilisation of its non-current assets in Africa.
- The company should restructure its International Business Unit to make it profitable.
- The company should evolve strategies to stem the down trend in the performance of Food Ingredients SBU.

**V NC BC CA SA**

**4. Requirement 2: Conclusions**

- Contribution from the first phase of the project is positive.
- The first phase has a positive NPV.
- Contribution from the export business is positive.
- The export business has a positive NPV.

**V NC BC CA SA**

**5. Requirement 2: Recommendations**

- The company should invest on the first phase.
- The company should pursue the export business as it has a positive NPV.
- The company should take advantage of the Federal Government's agricultural business incentives.
- The company should take advantage of the Federal Government's export business incentives.

**V NC BC CA SA**

## Requirement 1: Financial statement analysis (APNL)

**1. USES DATA AND INFORMATION APPROPRIATELY**

- Uses information on exhibit 3, - Adalat products.
- Uses information on exhibit 4, - Adalat's products' strategy and sustainability.
- Uses information on exhibit 5, - summarised consolidated financial statements.
- Uses information on exhibit 6, - Email from James Olaitan.
- Uses information on exhibit 7 - Strategic business units report.

**V NC BC CA SA**

**2. USES PROFESSIONAL TOOLS AND KNOWLEDGE**

- Calculates EBIT to revenue ratio for each strategic business unit.
- Calculates return on assets ratio for each strategic business unit.
- Calculates returns on capital employed for each strategic business unit.
- Calculates each strategic business unit's contribution to total profit.
- Calculates each geographical location's contribution to revenue from external customers.
- Calculates each geographical location's contribution to total revenue.
- Calculates non-current assets turnover for each geographical location.
- Calculates EBITDA to capital employed for each strategic business unit.

**V NC BC CA SA**

3. **USES ANALYTICAL SKILLS (material points) written report**

- Determines trend in EBIT to Revenue ratio for each strategic business unit.
- Determines trend in returns on assets for each strategic business unit.
- Determines trend in returns on capital employed for each strategic business unit.
- Determine the trend in EBITDA to capital earned for each SBU.
- Determines trend in each strategic business unit's contribution to total profit.
- Determines trend in each geographical location's contribution to revenue from external customers.
- Determines trend in the total revenue of each geographical location.
- Determines trend in non-current assets turnover for each geographical location.

**V NC BC CA SA**

**4. IDENTIFIES ISSUES AND OPTIONS**

- Identifies that the company's International business units has not been performing well, as it is accumulating losses.
- Identifies that the EBIT to revenue ratio of Food Ingredients business unit is gradually being eroded year on year.
- Identifies that the Agric Products business unit's performance is improving gradually, so the company should invest more on this unit.
- Identifies that, though Food Ingredients unit is the greatest contributor to the company's profit, but this is being gradually eroded.
- Identifies that, Africa geographical region has the largest contribution to the company's revenue year on year.
- Identifies that Africa geographical region has the lowest non-current assets turnover year on year.

**V NC BC CA SA**

**5. APPLIES PROFESSIONAL SCEPTICISM AND ETHICS**

- Recognises that the financial statements might not have been audited.
- Recognises that there is no indication that necessary regulatory approvals were secured for the company's products.
- Recognises that the company's contributions to the society in which it is operating are not documented.
- Recognises that the company's statement on the environment and society may be a mere rhetoric or greenwashing.

| V | NC | BC | CA | SA |
|---|---|---|---|---|

**6. EVALUATIVE SKILLS AND JUDGEMENT**

- Recognises that EBIT to revenue of Food Ingredients business unit is gradually being eroded from 2020.
- Recognises that EBIT to revenue of Agric Products business unit is gradually increasing from 2020.
- Recognises that EBIT to revenue of International Business unit is negative and getting worse yearly.
- Recognises that returns on assets of Food Ingredients business unit is gradually being eroded from 2020.
- Recognises that returns on assets of Agric Products business unit is gradually increasing from 2020.
- Recognises that returns on assets of International Business unit is negative and getting worse yearly.
- Recognises that returns on capital employed of Food Ingredients business unit is gradually being eroded from 2020.
- Recognises that returns on capital employed of Agric Products business unit is gradually increasing from 2020.
- Recognises that returns on capital employed of International Business unit is negative and getting worse yearly.
- Recognises that contribution to total profit of Food Ingredients business unit is gradually being eroded from 2020.
- Recognises that contribution to total profit of Agric Products business unit is gradually increasing from 2020.
- Recognises that contribution to total profit of International Business unit is negative and getting worse yearly.
- Recognises that revenue from external customers from each of the geographical locations is fairly stable over the years.
- Recognises that non-current assets turnover from each of the geographical locations has been reducing over the years.

| V | NC | BC | CA | SA |
|---|---|---|---|---|

**7. CONCLUSIONS**
**(Draws distinct conclusions under a heading)**

- Concludes that the International Business unit is dragging the company's profitability downwards.
- Concludes that the performance of Food Ingredients, in terms of profitability is steadily going down.
- Concludes that Agric Products unit profitability is steadily increasing year on year.
- Concludes that Africa is the highest contributor to the company's revenue during the years.
- Concludes that the non-current assets turnover of Africa business unit is very low compared to other geographical locations.

| V | NC | BC | CA | SA |
|---|---|---|---|---|

**8. RECOMMENDATIONS (commercial/relevant)**

- Recommends that the company should restructure its International Business unit to make it profitable.
- Recommends that the company should evolve strategies to stem the down trend in the performance of Food Ingredients business unit.
- Recommends that the company should evolve strategies to increase Africa's contribution to the company's revenue, as this has been dropping.
- Recommends that the company should invest more on the Agric Products business unit, as its profitability has been improving year on year.
- Recommends that the company should evolve strategies to increase the utilisation of its non-current assets in Africa.

| V | NC | BC | CA | SA |
|---|---|---|---|---|

## Requirement 2: Appraisal of Ofada Rice Project

**1. USES DATA AND INFORMATION APPROPRIATELY**

- Uses information in exhibit 2, Nigerian economic and business environment.
- Uses information in exhibit 3, Adalat's History and products.
- Uses information in exhibit 4, Adalat's strategy and sustainability.
- Uses information in exhibit 6, Email from James Olaitan.
- Uses information in exhibit 9 on Ofada Rice Project.

**V NC BC CA SA**

**2. USES PROFESSIONAL TOOLS AND KNOWLEDGE**

- Calculates capital outlay for the first phase.
- Calculates revenue from the first phase.
- Calculates total cost of production for the first phase.
- Calculates the contribution from the first phase.
- Calculates the net present value for the first phase.
- Calculates capital outlay for the second phase.
- Calculates revenue from the second phase.
- Calculates total cost of production for the second phase.
- Calculates the contribution from the second phase.
- Calculates the net present value for the second phase.

**V NC BC CA SA**

**3. USES ANALYTICAL SKILLS (material points) written report**

- Determines the contribution from the first phase.
- Determines that the payment of N5m to Ogun State for land allocation is a sunk cost.
- Recognises that the net present value of the first phase must be determined first.
- Determines the contribution from the export business.
- Recognises that the net present value of the second phase can be determined as a standalone or combined with the first phase.

**V NC BC CA SA**

**4. IDENTIFIES ISSUES AND OPTIONS**

- Identifies that there are some agricultural business incentives which the company will enjoy.
- Identifies that there are some export incentives the company will enjoy.
- Identifies that the business is in line with the current government objective of encouraging local production of rice to conserve foreign exchange.
- Identifies that the location of the farm is a natural location for rice farming in Ogun State.

**V NC BC CA SA**

**5. APPLIES PROFESSIONAL SCEPTICISM AND ETHICS**

- Discusses how realistic are the figures used in the projections.
- Discusses that the welfare of farmers on the project was not planned for.
- Discusses that no social responsibility expenditure was planned for the society in which the farm is.
- Discusses the possibility of losing the entire rice farm to pest, this has not been provided for.
- Discusses that sales and marketing expenses were not provided for in the projections.

**V NC BC CA SA**

**6. EVALUATIVE SKILLS AND JUDGEMENT**

- Evaluates the viability of the first phase.
- Evaluates the viability of the export business.
- Evaluates the net present value of the first phase.
- Evaluates the net present value of the export business.

**V NC BC CA SA**

7. **CONCLUSIONS**
   **(Draws distinct conclusions under a heading)**

- Concludes on the contribution for the first phase of the project.
- Concludes that the first phase has a positive NPV.
- Concludes on the contribution from the export business.
- Concludes that the export business has a positive NPV.

| V | NC | BC | CA | SA |
|---|---|---|---|---|

8. **RECOMMENDATIONS (commercial / relevant)**

- Recommends that the company should invest on the first phase.
- Recommends that the company should pursue the export business as it has a positive NPV.
- Recommends that the company should take advantage of the Federal Government's agricultural business incentives.
- Recommends that the company should take advantage of the Federal Government's export business incentives.

| V | NC | BC | CA | SA |
|---|---|---|---|---|

# Appendices: Main Report

**1. Appendices R1: Content and style**

- Shows EBIT to Revenue ratio for each of the business units.
- Shows return on assets ratio for each of the business units.
- Shows each business unit's contribution to total profit.
- Shows return on capital employed for each of the business units.
- Shows each geographical division's contribution to total revenue from external customers.
- Shows each geographical division's contribution to total revenue from external customers.
- Shows each geographical division's non-current assets turnover.

**V NC BC CA SA**

**2. Appendices R2: Content and style**

- Shows capital outlay for the first phase.
- Shows revenue from first phase.
- Shows total cost of production for the first phase.
- Shows the contribution from the first phase.
- Shows the net present value for the first phase.
- Shows capital outlay for the second phase.
- Shows revenue from the second phase.
- Shows total cost of production for the second phase.
- Shows the contribution from the second phase.
- Shows the net present value for the second phase.

**V NC BC CA SA**

**3. Report: Structure**

- Sufficient appropriate headings
- Appropriate use of paragraphs / sentences
- Legible/clear handwriting
- Correctly numbered pages

**V NC BC CA SA**

**4. 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**

**Adalat Products Nigeria Limited**
**Business segment's performance analysis**

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| **EBIT to revenue ratio:** | | | |
| Food Ingredients | 875.3/14,606.3% 6.0% | 749.5/12290.4% 6.1% | 793.7/12,546.8% 6.3% |
| Agric products | 752.9/31,276.9% 2.4% | 497.0/22,407.9% 2.2% | 329.5/18,850.3% 1.7% |
| International business | (205.6)/1,118.8% -18.4% | (176.9)/1,121.8% -15.8% | (65.8)/1,997.0% -3.3% |
| Adalat Products Nigeria Limited | 1,422.6/47,002.0% 3.0% | 1,069.6/35,820.0% 3.0% | 1,057.4/32,881.7% 3.2% |
| **Return on assets** | | | |
| Food Ingredients | 875.3/14,540.2% 6.0% | 749.5/11,682.8% 6.4% | 793.7/11,727.3% 6.8% |
| Agric products | 752.9/8,558.2% 8.8% | 497.0/6,658.9% 7.5% | 329.5/4,892.1% 6.7% |
| International business | (205.6)/3,183.0% -6.5% | (176.9)/3,933.7% - 4.5% | (65.8)/4,585.6% -1.4% |
| Adalat Products Nigeria Limited | 1,422.6/32,060.7% 4.4% | 1,069.6/26,702.6% 4.0% | 1,057.4/25,812.1% 4.1% |
| **Return on capital employed** | | | |
| Food Ingredients | 875.3/11,191.8% 7.8% | 749.5/9,312.2% 8.0% | 793.7/8,896.4% 8.9% |
| Agric products | 752.9/5,242.0% 14.4% | 497.0/4,210.7% 11.8% | 329.5/2,971.6% 11.1% |
| International business | (205.6)/2,832.0% -7.3% | (176.9)/3,405.6% - 5.19% | (65.8)/4,162.5% -1.6% |
| Adalat Products Nigeria Limited | 1,422.6/6,778.7% 21.0% | 1,069.6/6,035.9% 17.7% | 1,057.4/6,293.2% 16.8% |
| **EBITDA to Capital employed ratio:-** | | | |
| Food Ingredients | 1,217.20/11,191.80 % 10.9% | 1,042.10/9,312.20% 11.2% | 1,063.40/8,896.40% 12% |
| Agric products | 929.60/5,442% 17.7% | 649/4,210.30% 15.4% | 430/2971.6.3% 15.4% |
| International business | (97)/2,832% -3.4% | (60.20)%/3,405.6% -1.8% | 64.60/4,162.5% 1.6% |
| Adalat Products Nigeria Limited | 2,049.8/19,265.8% 10.6% | 1,630.9/16,928.1% 9.6% | 1,558/16,030.5% 9.7% |

| Segments' contribution to total profit (EBIT) | 2021 | 2020 | 2019 | |
|---|---|---|---|---|
| | **Food Ingredients** | **Agric products** | **International business** | **Total** |
| 2021 | 61.530% | 52.92% | -14.45% | 100.00% |
| 2020 | 70.07% | 46.47% | -16.54% | 100.00% |
| 2019 | 75.06% | 31.16% | - 6.22% | 100.00% |

**Geographical performance**

| | Africa | Europe | Other countries | Adalat |
|---|---|---|---|---|
| **Segments' contribution to revenue:** | | | | |
| External customers | | | | |
| 2021 | 46.990% | 19.72% | 33.29% | 100.00% |
| 2020 | 46.11% | 20.21% | 33.68% | 100.00% |
| 2019 | 49.74% | 20.00% | 30.26% | 100.00% |
| **Total revenue by segment** | | | | |
| 2021 | 71.63% | 20.55% | 44.27% | 100.00% |
| 2020 | 73.31% | 20.81% | 44..78% | 100.00% |
| 2019 | 80.22% | 20.57% | 39.17% | 100.00% |

| Non-current assets turnover | Total | Africa | Europe | Other countries |
|---|---|---|---|---|
| 2021 | 47002.0/10,613.1<br>4.4times | 33,665.8/4,041.7<br>8.3 times | 9,660.5/756.2<br>12.8 times | 20,806.3/5,815.2<br>3.6 times |
| 2020 | 35,820.0/9,284.2<br>3.9 times | 26,259.9/4,056.7<br>6.5 times | 7,454.5/736.0<br>10.1 times | 16,038.8/4,491.5<br>3.6 times |
| 2019 | 32,992.7/9,56.63.5<br>3.4times | 26,466.4/4,001.1<br>6.6times | 6,786.1/686.9<br>9.9 times | 12,924.5/4,875.6<br>2.7 times |

**Appendix 2**
**Adalat Products Nigeria Limited**
**Evaluation of Ofada rice production and distribution**
**Phase I**

| Capital outlay: | | **₦m** | **₦m** |
|---|---|---|---|
| Farmhouse | | 50 | |
| Factory building | | 150 | 200 |
| Plants: | $ | | |
| Rice milling | 100,000 | | |
| Parboiler/Destoner | 60,000 | | |
| Weighing scale | 50000 | | |
| Bagging | 10000 | | |
| Tractor | 50000 | | |
| | 200,000 | | |
| | 470,000 | | |
| Exchange rate | 750 | | 352.5 |
| Lorries | | | 200 |
| Road | | | 100 |
| Total | | | 852.5 |

**Revenue**
Price per kg

| | **₦** | **Probability (%)** | **₦** |
|---|---|---|---|
| | 1000 | 50 | 500 |
| | 1200 | 30 | 360 |
| | 1400 | 20 | 280 |
| | | | 1140 |
| Quantity (3,200,000 X 95%) | | | 3,040,000 |
| **Revenue (a)** | | | **3,465,600,000** |

**Cost of production**

| | |
|---|---|
| Payment to farmers | |
| Initial (100,000 X 5,000) | 500,000,000 |
| Final (3,500,000 X 500) | 1,750,000,000 |
| Milling and packaging (3,200,000 X 250) | 800,000,000 |
| **Total (b)** | 3,050,000,000 |
| **Contribution (a-b)** | **415,600,000** |

| **Net Present value** | | **₦m** | **Disc Factor @15%** | **Present value (₦m)** |
|---|---|---|---|---|
| Capital cost | Year 0 | - 852.50 | 1.000 | - 852.50 |
| Working capital | Year 0 | - 200.00 | 1.000 | - 200.00 |
| Contribution | Years 1 - 10 | 415.60 | 5.019 | 2,085.90 |
| Working capital | Year 10 | 200.00 | 0.247 | 49.40 |
| **NPV** | | | | **1,082.80** |

**Evaluation of Ofada rice production and distribution**
**Phase II**

| | |
|---|---|
| Quantity available for sale (3,200,000 X 95%) | 3,040,000kgs |
| Export sales (3,040,000 X 40%) | 1,216,000kgs |
| Local sales (3,040,000 X 60%) | 1,824,000kgs |
| Capital requirement for further processing: | |
| Rice whitening machine | $30,000 |
| Rice Grader | $25,000 |
| Rice polisher | $35,000 |
| | $90,000 |
| Exchange rate | ₦750 |
| Cost in Naira | ₦67,500,000 |
| | |
| Additional processing cost | |
| Quantity | 1,216,000kgs |
| Processing cost per Kg | ₦150 |
| Total cost (1,216,000 X 150) | ₦182,400,000 |

**Calculation of export price**

| | $ | Probability (%) | $ |
|---|---|---|---|
| | 2.50 | 50 | 1.25 |
| | 2.75 | 30 | 0.825 |
| | 3.00 | 20 | 0.6 |
| | | | 2.675 |
| Exchange rate | | | 750 |
| Price per kg in naira | | | 2,006.25 |
| Export value (1,216,000 X 2,006.25) (c) | | | ₦ |
| | | | 2,439,600,000 |
| Total cost | | | |
| First processing | | | 3,050,000,000 |
| Total quantity | | | 3,040,000 |
| Cost per Kg | | | 1003.289474 |
| Export quantity | | | 1,216,000 |
| Total cost | | | 1,220,000,000 |
| Additional processing cost | | | 182,400,000 |
| Total cost (d) | | | 1,402,400,000 |
| **Contribution (c - d)** | | | **1,037,200,000** |

| **Net Present value** | | **₦m** | **Disc Factor @ 15%** | **Present value (₦m)** |
|---|---|---|---|---|
| Capital cost | Year 0 | - 67.50 | 1.000 | - 67.50 |
| Contribution | Years 1 - 10 | 1,037.20 | 5.019 | 5,205.71 |
| Net present value | | | | **5,138.21** |

**Alternative computation**

| **Total revenue** | **₦** |
|---|---|
| Local sales (1,824,000 X 1,140) | 2,079,360,000 |
| Export sales | 2,439,600,000 |
| (A) | 4,518,960,000 |
| **Total cost** | |
| First phase | 3,050,000,000 |
| Second phase | 182,400,000 |
| (B) | 3,232,400,000 |
| Contribution (A - B) | 1,286,560,000 |

| **Total capital cost** | **₦m** |
|---|---|
| First phase | 852.50 |
| Second phase | 67.50 |
| | 920.00 |

| **Net Present value** | | **₦m** | **Disc Factor @15%** | **Present value (₦m)** |
|---|---|---|---|---|
| Capital cost | Year 0 | -920.00 | 1.000 | -920.00 |
| Working capital | Year 0 | -200.00 | 1.000 | -200.00 |
| Contribution | Years 1 - 10 | 1,286.56 | 5.019 | 6,457.24 |
| Working capital | Year 10 | 200.00 | 0.247 | 49.40 |
| **NPV** | | | | **5,386.64** |

## Examiner's report

The case scenario is on Adalat Products Nigeria Limited, with its strategic and geographical business units. The Pre-seen case scenario include: Details about the Nigerian economic and business environment; History and products; Strategy and sustainability; and 3 years summarised consolidated financial statements of Adalat Products, while the Un-seen introduces Adalat strategic business units report; geographical business report and details of Adalat proposed Ofada rice production and distribution project. As usual, there are two requirements that candidates are to address. These are:

- A review of the strategic business units' performance from 2019 to 2021, noting the trend in performance and returns on capital invested. They are also to carry out a review of the geographical performance of the company for the period; and
- An evaluation of the Ofada Rice Project. The appraisal covers the two phases of the project and they are to provide advice to the board on whether to go ahead with the project or not. Also, candidates are to indicate whether the company should stop at phase one of the project or should implement the two phases.

To perform very well in the Case Study, candidates must prepare the following appendices:

- Appropriate ratios to evaluate the performance of Adalat strategic business units and geographical business units; and
- Evaluation of Ofada rice production and distribution – phases I and II.

Candidates' performance was very poor as only a 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;
- Evaluation of Ofada rice production and distribution – phases I and II;
- Some candidates could not identify the relevant ratios to evaluate the performance of the company's strategic business units and the geographical business units;
- 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 have gained in other subjects when preparing for future examination.