THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

MAY 2013 P. E. II EXAMINATION

Question Papers

Suggested Solutions

Plus

Examiners' Reports

FOREWORD

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 subjects contained herein; and

(iv) The profession; 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 altered slightly so that some principles or application of them 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.

TABLE OF CONTENTS

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II - MAY 2013

FINANCIAL REPORTING & ETHICS

Time Allowed: 3 hours

SECTION A: PART I ATTEMPT ALL QUESTIONS (20 Marks)

MULTIPLE-CHOICE QUESTIONS

Write ONLY the alphabet (A, B, C, D or E) that corresponds to the correct option in each of the following questions/statements:

1. Which of the following qualitative characteristics of Financial Statements is violated when the information is not free from error and bias?

   A. Relevance
   B. Comparability
   C. Reliability
   D. Understandability
   E. Neutrality

2. Which of the following fairly represents an amount used as a surrogate for cost or depreciated cost at a given date?

   A. Fair value
   B. Depreciable value
   C. Amortised value
   D. Deemed cost
   E. Material cost

Use the following information to answer questions 3 and 4:

Applex Plc has just issued a zero-coupon Bond. The Bond was issued on 1 January 2010. The net proceeds amounted to ₦50 million and there were no payments of annual interest. The coupon is redeemable in four years (1 January 2014) at a premium of ₦28,675,968.

3. What is the effective rate of interest on the Bond?

   A. 68.30%
   B. 63.60%
   C. 57.35%
   D. 12.00%
   E. 10.00%

4. What is the value of finance charge that will be disclosed in the Financial Statements of Applex Plc in Year 4?

   A. ₦8,429,568
   B. ₦7,526,400
   C. ₦6,720,000
   D. ₦6,000,000
   E. ₦5,867,843

5. Under IFRS1-First-time Adoption of International Financial Reporting Standards, which of the following is **EXEMPTED** in retroactive application of the IFRS?

   A. Business Combinations that occurred prior to the transition date
   B. Assets measured at fair value or revalued amounts, which can be taken as deemed costs
   C. Employees' benefits
   D. Cumulative foreign currency translation differences
   E. Non-Financial instruments

6. Reasons which pertain to Teleology include all of the following **EXCEPT**

   A. Higher profits in business
   B. Employees' benefits in business
   C. Gaining of useful information
   D. Gaining of no information
   E. Gaining of good settlement in law

7. Whistle blowing is justified under all of the following conditions **EXCEPT** when

   A. All official channels have been tried without success
   B. The whistle blowing report will bring about change
   C. Internal resources failed to achieve constructive redress
   D. The whistle blower's job is threatened
   E. The unethical or illegal practice would damage the organisation's reputation

8. The word "expropriation" is exemplified by all the following **EXCEPT**

A. Outright theft or wrongful conversion of assets
B. Committing hard-earned resources on unproductive ventures which benefit only a priviledged few
C. Paying workers less than they deserve
D. Approving excessive executive compensation package which enriches top management at the expense of the organization
E. Entrenchment of inept management team which lacks focus and runs the corporate body ineffectively

9. Which of the following can be subsumed under the nature of good Corporate Governance?

i. Ensuring compliance and enforcement of best practices
ii. Fostering disaster recovery
iii. Facilitating compliance with corporate and company laws, code of best practices and ethical norms
iv. Promoting commercial life and profitability of a firm

A. i only
B. ii only
C. iii and iv
D. i, ii, iii and iv
E. i and ii

10. When whistle blowing is done by someone who has left an organization, it is referred to as……………………….whistle blowing

A. Internal
B. External
C. Current
D. Alumni
E. Open

11. According to IAS 7 – Statement of Cash Flows, which of the following is **NOT** arising from investing activities?

A. Cash payments to acquire property
B. Cash receipts from sales of property
C. Cash advances and loans made to other parties
D. Cash repayments of amounts borrowed
E. Cash payments for future contracts and forward contracts

12. Mooner Plc is a 70% owned subsidiary of Sooner Plc. Which of the following are related parties of Mooner Plc?

i. Star Limited, which is not part of the Sooner Group but which has at least two mutual directors with Mooner Plc.
ii. Crescent Limited which owns 25% of Mooner Plc
iii. Babyface, the Financial Controller of Mooner Plc
iv. Debbie, the wife of the Chairman of Starlite Limited, an entity in the Sooner Group

A. i, ii, iii and iv
B. i, ii and iii
C. i, iii and iv
D. i and ii
E. ii, iii and iv

13. According to IAS20-Government Grants, recognition of such grants, including non-monetary grants at fair value, shall only be done on Financial Statements after reasonable assurance of the following:

i. The grants will be received;
ii. The grants will be material;
iii. The entity will comply with the conditions attached to them ; and
iv. The grants will be at arms-length.

A. i and ii
B. ii and iii
C. i, ii and iii
D. i and iii
E. i, ii, iii and iv

14. IAS 23-Borrowing Costs, requires that capitalisation of borrowing costs should commence when all of these are met **EXCEPT**

A. All activities that are necessary to get the asset ready for use are in progress
B. Borrowing costs are being incurred
C. Expenditure for the asset is being incurred
D. All the activities that are necessary to get the asset ready for use are complete
E. Borrowing costs incurred during expended periods

15. IFRS 5-Non-current assets held for sale and discontinued operations, requires disclosure by way of notes to the accounts, a Non-current asset (or disposal group) classified as either held for sale or sold to include all of the following **EXCEPT**

A. Any impairment losses or reversal recognised
B. A description of the Non-current asset (or disposal group)
C. A description of the facts and circumstances of the sale or expected sale
D. The segment in which the Non-current asset (or disposal group) is presented (IFRS 8)
E. Disclosure of the realizable amounts on the Non-current asset held for sale

16. Regulation of the accounting profession can be implemented through

A. Financial regulation and internal regulation
B. Self-regulation and external regulation
C. External and internal regulation
D. Personal and internal regulation
E. Self-regulation and internal regulation

17. Which of the following can jeopardise the objectivity of a professional accountant?

A. Fairness and sensitivity
B. Real facts
C. Bias or prejudice
D. Moral principles
E. Legal provisions

18. Which of the following is **NOT** a safeguard against the ethical threats to the independence of members of ICAN?

A. Rotation of staff involved in professional assignments
B. Consulting ICAN in the case of any problem
C. Continued professional development
D. A policy never to enter an arrangement with a client who has any kind of business relationship with an existing client
E. Corporate Governance regulations

19. The following are notable scholars who have contributed to the debate on Corporate Social Responsibility **EXCEPT**

    A. Adolph M. Hayek
    B. Adolph A. Berle
    C. Friedman Milton
    D. Frederick Hayek
    E. Adam Smith

20. Fraud includes the following **EXCEPT**

    A. Insider dealings
    B. Cheating on expense accounts
    C. Free travels
    D. Falsifying documents
    E. Abuse of position

SECTION A: PART II ATTEMPT ALL QUESTIONS (20 Marks)

SHORT-ANSWER QUESTIONS

Write the correct answer that completes each of the following questions/statements:

1. The essential value involved in the fiduciary relationship between an auditor and his client is......................................

2. The ethical threat that results when an accountant promotes a client's interest to the point of compromising his/her objectivity is...................................

3. An ethical approach that treats people equally or proportionately is the..............

4. The method of reporting cash flow of operating activities from profit before tax and adjusting it for non-cash charges and credits is known as.............................

5. According to IAS 36- Impairment of Assets, when an active market exists for the output produced by an asset or a group of assets, that asset or group of assets should be identified as.....................................

6. According to IAS 20 - Accounting for Government Grants, the fair value of grants related to assets shall be presented in the statement of financial position either as...................... or by deducting the grant in arriving at ....

7. The systematic analysis of an entity's performance against that of another with the aim of achieving competitive advantage from others' experience and mistakes, finding best practice and translating this into use by the entity is called.......................................

8. Where a Chartered Accountant is not influenced by bias or emotion in the performance of his or her professional obligations, he/she is said to be...

9. In ICAN's Professional Code of Conduct and Guide for Members, the chapter on disciplinary procedures is entitled...

10. Under the concept of responsibility, direct responsibilities can be divided into .... and..

11. The declaration that "the proper governance of companies will become as crucial to the world economy as the proper governance of countries" was made by.....................................

12. According to IAS 40-(Investment Property), Investment Property should be derecognised when no future economic benefits are expected from its disposal or when permanently..

13. An identifiable non-monetary asset without physical substance held for use in the production and supply of goods or services or for rental to others, is referred to as................................

14. When the outcome of a long-term construction contract can be reliably estimated, the excess of revenue over costs should be recognised using......................................

15. A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity, is known as............................

16. When a public limited liability company changes its accounting policy voluntarily, the changes shall be applied.......................................

17. An advocacy threat may occur when an ICAN member promotes a client's position to the point of compromising his/her .... and.................................

18. Immanuel Kant advocates that all moral rules be obeyed without ....

19. To take on new assignments, a professional accountant needs professional skills and...................................

20. According to IAS28- Investments in Associates, how is the investor's share of profit treated in the Statement of Financial Position?

SECTION B: ATTEMPT QUESTION ONE AND ANY OTHER THREE QUESTIONS (60 Marks)

QUESTION 1

Messrs Akoaba Yomioluwa and Mahmud Gafara who have degrees in Management and Accounting respectively are friends, and have been in business together for years under the name AKOABA GAFARA, LTD,

Based on the foregoing, Mr. Gafara assumed duties as Finance Manager, while Akoaba took over duties as Managing Director. The company recorded impressive results for years. However, recent hostile business environment vitiated their efforts at recording continued resounding success.

The company took a decision to source its material input from abroad, thereby having to contend with heavy import duties. The Managing Director erroneously contracted and negotiated a loan to finance the merchandise at high interest rate without involving the Finance Manager, thus aggravating the bad business situation. Furthermore, the Personnel Officer has been allocating duties and responsibilities on the "rule of the thumb" basis, and even employed some new staff whose skills are substandard for his personal benefits. Officers not in his good books are often coerced and threatened even when they are highly skilled. These acts led to abysmal performance by the staff and a complete downturn of the company's fortune.

To redress this situation, Mr. Tunmise was hired for 3 years because of his pedigree as a renowned business mogul. He was instrumental to the successful recovery of three well-known companies that were at one time or the other at the brink of collapse. Mr. Tunmise swung into action by appointing Mr. Tunto Daadaa, a Financial Consultant, to examine the past finances of the company.

His examination revealed that:

i. The current business outlook of the company does not favour the continued existence of the manufacturing section.

ii. Some staff in other sections do not fit into proposed restructuring that would enhance the profitability of the Company.

iii. The Finance Manager misappropriated inventories to the tune of ₦20m and offered to give Tunmise one-third of it.

The Financial Consultant recommended the following:

- Management should consider closure of the manufacturing section and lay off all the staff of the section.
- Recapitalize the company by making rights issues.
- The company's Finance Manager should undertake analytical review and compare with a sister company.

Additional Information:

- Assume the existing ordinary share capital of the company is 25,000 shares of 50k each. The rights offer is one share for every five shares held at a price of ₦6 per share. The fair value of the company's share was ₦10 per share.
- Below are the financial statistics for Akoaba Gafara LTD and its sister company, Maidogo LTD.

	AKOABA GAFARA LTD	MAIDOGO LTD
	₦	₦
Price per share	6	20

EPS	4	1.50
Growth	5	3

You are required to:

a. Calculate the theoretical ex-rights price. (2 Marks)

b. Carry out a comparative analytical review of Akoaba Gafara LTD with its sister company, Maidogo, LTD with a view to determining which company's share is cheaper. (2 Marks)

c. Evaluate any **TWO** ethical implications of the actions of the Personnel Officer. (4 Marks)

d. Justify with any **TWO** reasons the laying off of the staff in the manufacturing section (4 Marks)

e. Analyse with any **TWO** reasons why Tunmise should not accept the offer of 1/3 of the proceeds. (3 Marks)

(Total 15 Marks)

QUESTION 2

a. "The determination of related party status depends on the substance of the relationship, not just the legal form."

Required

i. Define a "related party transaction" and state any **TWO** examples of such transactions. (3 Marks)

ii. Based on IAS 24-Related Party Disclosures, state any **FOUR** conditions under which an entity can be said to be related to another. (4 Marks)

b. Large Plc., has two subsidiaries, Big Limited and Small Limited. The share capital of Large Plc., is held by Chief Jejelaye and Dr. Towolawi at 60% and 40% respectively. Chief Jejelaye is the Chairman of Large Plc., while Dr. Towolawi is the Managing Director.

Big Limited is wholly owned by Large Plc. On 31 December 2012, Big Limited sold a parcel of land it vacated some years back to Small Limited for ₦2m. The latter company, owned and managed by Chief Jejelaye's son, intends to develop the potential of the site as a location for an events centre.

The net book value at that date was estimated to be ₦5m. This sale has not been reflected in the Financial Statements of Big Limited for the year ended 31 December 2012.

Required:

Outline how the above transactions should be recorded in the Financial Statements of Big Limited and the Consolidated Financial Statements of Large Plc. for the year ended 31 December 2012. (8 Marks)

(Total 15 Marks)

QUESTION 3

Chukwu works as an Accounts Assistant in the Accounts Department of Abaji & Sons where one of his responsibilities is to prepare the quarterly VAT returns for the company at the end of the financial year. The Financial Controller, Mr. Osiyemi, asked Chukwu to manipulate the figures to be included in the VAT returns so that the company's year-end VAT liability is reduced. Osiyemi further promised Chukwu some financial compensation if he accedes to his request.

You are required to:

a. Identify and evaluate two ethical duties that would be in conflict, whatever Chukwu decides to do. (4 Marks)

b. Assess any **FOUR** alternative ways by which Chukwu may respond to Mr. Osiyemi's request. (6 Marks)

c. Evaluate any **TWO** of the ethical implications of manipulating the figures to be included in the VAT returns. (5 Marks)

(Total 15 Marks)

QUESTION 4

A company which has always prepared its Financial Statements to 31 December each year, prepared its first IFRS Financial Statements for the year ended 31 December 2012. These statements show comparative figures for the year ended 31 December 2011.

You are required to:

a. Identify the first IFRS reporting period and state the date of transition to IFRS. (1 Mark)

b. Present the procedures which must be followed in order to prepare the Financial Statements for the year ended 31 December 2012. (6 Marks)

c. Identify the reconciliations which the company must include in its Financial Statements for the year ended 31 December 2012. (4 Marks)

d. State the contents of a typical Statement of Changes in Equity. (4 Marks)

(Total 15 Marks)

QUESTION 5

Mr. Ugo has just opened a manufacturing firm, in which he invested a large sum of money to enhance a quick growth of the business. Mr. Ugo also went into business believing that a company's only responsibility is to maximise profits for its investors as long as it acts within the dictates of the law.

For him, therefore, a business entity does not have any moral responsibility which exceeds the law. One morning, however, Helen, Mr. Ugo's wife, told him that there were other competing firms in the neighbourhood and advised that Mr. Ugo should not keep only to the tenets of the law without respect for moral responsibilities. She further advised Mr. Ugo that he had the prospect of succeeding in his business if he upheld high and consistent ethical standards.

You are required to:

a. Identify and evaluate any **TWO** of the major ethical issues embedded in the above scenario. (4 Marks)

b. Assess and advise on any **THREE** justifications for Helen's position. (6 Marks)

c. Explain any **TWO** ways in which Mr. Ugo can ensure that his business maintains a high ethical standard beyond a rigid compliance with legal provisions. (5 Marks)

(Total 15 Marks)

QUESTION 6

An extract from the Statement of Financial Position of Makula Limited at 31 December 2012, is as shown below:

	₦'000
Non-current assets:	
Property, Plant & Equipment	600
Goodwill	200
Development Costs	400
Other Intangible Assets	100
	1,300
Net Assets	
Equity Attributable to Owners:	
Share Capital	300
Share Premium	400
Revaluation Deficit	(200)
Retained earnings	800
Total Equity	**1,300**

Additional Information:

On 31 December 2010, Property, Plant and Equipment were revalued from their original value of ₦800,000.

Makula Limited depreciates Property, Plant and Equipment at 20% per annum on a straight-line basis.

Required:

a. Considering the provisions of S.380 of CAMA Cap C20 LFN 2004, you are required to:

i. Explain distributable profits. (2 Marks)

ii. State what determines the distributable profit of a reporting entity. (2 Marks)

b. Explain the concept of realised and unrealised profits and losses, and illustrate each with examples. (4 Marks)

c. i. Calculate the distributable profit of Makula Limited at 31 December 2012. (4 Marks)

ii. If Makula Limited was a Public Limited Liability Company (Plc), evaluate how the amount of its distributable profit would be different from c. i. above. (3 Marks)

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

1. C
2. D
3. D
4. A
5. E
6. D
7. D
8. C
9. D
10. B
11. D
12. E
13. D
14. D
15. E
16. B
17. C
18. D
19. A
20. C

TUTORIAL

3. Computation of Effective Rate of Interest on the bond issued by Applex plc.

$PV = (1+r)^n = FV$
Where:
PV = Present Value
r = Effective Rate of Interest

n = Number of years
FV = Future Value
₦50,000,000 $(1 + r)^4$ = ₦78,675,968
$(1 + r)^4 = \frac{78,675,968}{50,000,000}$

$(1 + r)^4 = 1.573.51936$
$(1+r) = \sqrt[4]{1.573,51936}$
$(1 + r) = 1.12$
$r = 1.12 - 1$
$r = 12\%$

4.

Year	Opening Balance	Finance charge@12%	Closing Balance
	₦	₦	₦
2009	50,000,000	6,000,000	56,000,000
2010	56,000,000	6,720,000	62,720,000
2011	62,720,000	7,526,410	70,246,400
2012	70,246,410	8,429,568	78,675,968

EXAMINERS' REPORT

The questions adequately cover the syllabus and performance was average. Candidates are advised to cover the whole syllabus in order to ensure better performance in future examinations.

PART II SHORT-ANSWER QUESTIONS

1. Trust

2. Advocacy Threat

3. Justice Approach/Fairness Approach

4. Indirect method

5. Cash Generating Unit

6. Deferred Income; Carrying Amount

7. Benchmarking

8. Objective

9. Enforcement Procedures or Enforcement of Ethical Standards

10. Internal direct responsibility; external direct responsibility

11. James Wolfensohn, former President of the World Bank

12. Withdrawn from use

13. Franchise or Intangible Assets

14. Percentage of Completion Method

15. Operating Lease or Financial Instrument

16. Retrospectively

17. Objectivity; Independence

18. Exception

19. Knowledge

20. Added to the cost of Investment in Associates

EXAMINERS' REPORT

The questions cover most of the topics in the syllabus and performance of the candidates was above average.

SOLUTIONS TO SECTION B

QUESTION 1

(a) CALCULATION OF THEORETICAL EX-RIGHT PRICE

₦'000		₦'000	OR	₦
25	Existing shares @ ₦10	250	5 Existing @ ₦10 =	50
5	Rights shares @ ₦6	30	1 Rights issue @ ₦6 =	6
30		280	6	56
Theoretical Ex- rights price =		280/30	Theoretical Ex-right price =	56/6
=		₦9.33	=	₦9.33

(b) COMPARATIVE ANALYTICAL REVIEW

	AKOABA GAFARA Ltd	MAIDOGO Ltd
Price per share	₦6	₦20
Earnings per share (EPS)	₦ 0.4	₦1.50
Growth per Annum	5%	3%
P/E Ratio	$\frac{6}{0.4}$ = 15	20/1.50 = 13.33

Price –to-Earnings –to- Growth Ratio (PEG)

PEG = $\frac{P/E Ratio}{Growth}$	15/5 = 3	13.33/3 = 4.44

From the above comparative analytical review, it would be observed that it is cheaper to remain in AKOABA GAFARA than being part owner of MAIDOGO since the share price of AKOABA GAFARA is cheaper at ₦6 per share than the shares of MAIDOGO at ₦20 despite having a higher P/E ratio.

The lower the PEG ratio, the cheaper the stock.

(c) Ethical implications of the actions of the Personnel Officer

(i) **The question of objectivity:** His action violated the ethical principle of objectivity which all professionals should put into practice in the dispatch of their duties. This is so by using the rule of the thumb to allocate duties and responsibilities.

(ii) **Abuse of Office:** He abused his office by employing new staff for his personal benefits. This is a violation of the principle of integrity.

(iii) **Violation of the rights of employees:** The Personnel Officer violated the rights of employees to a good working environment by his frequent threats and coercion.

(iv) **Violation of duty to the organisation:** He was not faithful to the organisation as he should be by putting his personal benefits above the well-being /profitability of the company.

(v) **Violation of the principle of professional competence and due care:** Employing incompetent staff violated the principle of professional competence and due care. The abysmal performance of such staff contributed to the low overall performance of the entity.

(d) **Justification for laying off the staff in the manufacturing section**

(i) **Restructuring:** The manufacturing section needs to be restructured so that the company can improve in terms of productivity, efficiency and profitability

(ii) **Incompetence:** The staff in the manufacturing section may be layed off on the ground of incompetence as it is clear that some of them that were employed by the Personnel Officer are actually incompetent.

(iii) **Payment of wages:** The organisation can no longer afford to pay their wages due to the abysmal performance of staff and complete downturn of the company's fortune.

(iv) To curb the involvement of inept staff in the affairs of the entity.

(v) To facilitate a smooth implementation of the Financial Consultant's recommendation.

(vi) To redress the complete downturn of the fortune of the entity.

(e) **Reasons why Mr. Tunmise should not accept the offer of one-third of the proceeds**

(i) Acceptance of the offer is unethical, unprofessional and depicts lack of integrity. The acceptance would hinder Mr. Tumise from revamping the company from the brink of collapse.

(ii) The past track record and good reputation that he has built from those companies he previously worked for would be destroyed if he accepts the offer of bribe from the Finance Manager.

(iii) Mr Tunmise would not be setting a good precept for the junior staff if he should accept the offer.

(iv) Mr. Tunmise would be an accomplice in defrauding the company

(v) Mr. Tunmise would be aiding the fraud of the Finance Manager, a situation that would aggravate the collapse of the company.

(vi) Acceptance of the offer would compromise his objectivity and independence.

EXAMINERS' REPORT

The question tests candidates' understanding of the combination of ethical duties and share valuation. It focuses on the candidates' ability to determine appropriate analytical financial tools in measuring comparative analysis of the values of the shares of sister companies with a view to determining and giving advice as to which one is cheaper.

On the ethical aspect, the question tests the candidates' ability on ethical reasoning and responsibilities of the professional accountants in the various tasks assigned to them.

Candidates were expected to use Price-Earnings –Growth (PEG) in determining the cheaper of two companies' share values. They were also expected to state the ethical implications and justifications of the various actions taken as officers in accounting engagements. This should be clearly related to the expectations of ICAN'S Professional Code of Conduct and Guide for Members.

Candidates appeared to have forgotten the calculations of theoretical ex-right price of shares. Most of the candidates were not used to the Price-Earnings-Growth ratio used in the comparative analysis. Most of the candidates understood the ethical aspect of the case study. However, they focused more on ethical theories as against the practical application required by the question.

The candidates are advised not to ignore on the use of PEG ratio as a better measure of share value.

They should be well acquainted with ICAN's Professional Code of Conduct and Guide for Members. They should understand the application of ethical theory to practical issues.

QUESTION 2

(a)(i) A related party transaction is a transfer of resources, service or obligations between parties that are connected or related, regardless of whether or not a price is charged.

Examples of such transactions include:

- Purchase or sale of goods;
- Purchase or sale of property and other assets;
- Rendering or receiving of services;
- Leases;
- Transfer of research and development;
- Transfers under license agreements;
- Transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- Provision of guarantees or collateral;
- Commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognized and unrecognized); and
- Settlement of liabilities on behalf of the entity or by the entity on behalf of another party

(ii) Under IAS 24- Related Party Disclosures, an entity is related to a reporting entity if any of the following conditions applies:

- Both entities are members of the same group thus a parent and a subsidiary and fellow subsidiary are related parties;

- One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);

- Both entities are joint ventures of the same third party;

- One entity is a joint venture of a third entity, and the other entity is an associate of the third entity;

- The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is in such a plan, the sponsoring employers are also related to the reporting entity; and.

- The entity is controlled, or jointly controlled, by a person or a close member of that person's family who,
    - ✓ has control, or joint control, over the reporting entity
    - ✓ has significant influence over the reporting entity or
    - ✓ is a member of the key management personnel of the reporting entity or its parent.

(b) **Disclosures in the Financial Statements of Big Ltd**

Since Big Ltd is a subsidiary of Large Plc, and Small Ltd is owned by the son of the chairman of Large Plc, Small Ltd and Big Ltd are therefore related parties. Details of this transaction should be disclosed in the Financial Statements of Big Ltd as follows:

(i) The nature of the related party relationship (the fact that the son of the Chairman of Large Plc is the owner and manager of Small Ltd)

(ii) The amount of the transaction (sale of the piece of land for ₦2m while the market value was ₦5m)

Disclosures in the Consolidated Financial Statements of Large Plc:

(i) The nature of the related party relationship (that Small Ltd is owned and managed by the son of the Chairman of Large Plc)

(ii) The amount of the transaction concluded (i.e ₦2m)

EXAMINERS' REPORT

The question tests candidates understanding of the definition and application of the provisions of IAS 24-Related Party Disclosures.

Majority of the candidates that attempted the question displayed poor understanding of what constitute related party transactions; consequently performance was below average. Candidates commonest pitfall was that they confused disclosure in financial reports with accounting book entries in financial records.

Candidates are advised to be conversant with the provisions of International Financial Reporting Standards and their applications for them to do well in Financial Reporting paper.

QUESTION 3

(a) Some of the ethical duties that would be in conflict irrespective of Chukwu's decision would include:

i. Duty to protect the interest of the public and the professional commitment to his company, Abaji & Sons.

Chukwu is caught between two fundamental ethical duties as an Accountant. If he decides to accept Osiyemi's offer to manipulate the figures to be included in the VAT returns, the report would be false, deceitful and unreliable; hence jeopardizing stakeholders' opportunity to make informed financial decisions.

On the other hand, if Chukwu decides to protect the interest of the general public, thus present honest and fair report, this will conflict with his professional commitment and loyalty to his company, Abaji & Sons.

ii. Professional commitment /loyalty to Abaji & Sons and commitment to the government

The professional commitment/loyalty that an employee has towards his organisation is embedded in employment contract, which includes protecting and upholding the interests of the organisation. Oftentimes, this expectation may conflict with the expectation of the government /the bodies regulating the business environment.

In the case at hand, Chukwu has both the commitment to the government to be honest and fair in reporting every financial dealings of the company to the government. This will conflict with Osiyemi's request that Chukwu manipulates the figures to be included in the VAT returns so that the company's year end VAT liability is reduced. If Chukwu accedes to the request the government would be cheated.

iii. Commitment to the principle of professional behaviour and Chukwu's duty to his direct boss, Osiyemi.

The principle of professional behaviour imposes a duty on a Chartered Accountant to comply with relevant laws and regulations and avoid any actions which would discredit the profession. In the circumstance that Chukwu finds himself, his commitment to the principle of professional behaviour which requires him to build trust, uphold integrity and objectivity is seriously threatened.

(b) **Chukwu may consider any of the following alternative decisions in response to Osiyemi's request to manipulate figures to reduce the VAT Liability:**

(i) Chukwu may appeal to reason and politely engage Osiyemi in a conversation in the bid to convince him not to falsify the reports. He could do this by pointing out the legal, ethical and social implications of the request.

(ii) Chukwu may decline Osiyemi's request to manipulate the figures and thus face the consequences of his action, which might put his job on the line.

(iii) Chukwu also has the option of resigning from his position.

(iv) Chukwu may take the issue to Osiyemi's superior, most especially those that are at the corporate governance level in the company.

(v) Chukwu also has the moral obligation to blow the whistle.

(c) (i) **Breach of Trust**

Abaji & Sons exists as a corporate citizen in strategic relationships with its stakeholders. These relationships are primarily based and built on trust. Trust requires uprightness, justice, fairness and truth. Thus, manipulating these figures will be deceitful to stakeholders. This amounts to a breach of trust.

(ii) **Lack of Integrity**

The concept of integrity in business expresses the idea that every business relationship should be straightforward and based on honesty. This implies fair dealing and truthfulness. Thus, ICAN expects its members not to be associated with reports, returns communication or other information that could be false and misleading.

If the figures included in the VAT returns are manipulated, both the organisation and the principal characters would have presented misleading reports, depicting lack of integrity.

Tax Evasion

iii. Manipulating the figures in the VAT returns would amount to defrauding the state through evasion of tax liability.

Non-Compliance with Statutory Laws

iv. Osiyemi's request, if complied with, would deny the state of the use of the tax that should have been generated through VAT to carry its duties and functions as contained in the VAT Act.

Negative Goodwill

v. If Osiyemi's request is acceded to and discovered, it would tarnish the image of the Company.

EXAMINERS' REPORT

The question requires candidates to identify ethical duties in a given real life work environment. The question also tests candidates' ability to make informed ethical decisions and identify the ethical implications of their actions.

The candidates' understanding of the question was not impressive. They could not distinguish between ethical theories and ethical duties. They could not decipher the ethical implications of the actions in the question. They generally had problems responding to applied questions, hence, performance of was average.

Candidates are advised to note the difference between ethical theories and ethical duties, and the implications of actions taken. Candidates should also learn how to respond to applied questions. They should improve on their communications skills in order to make logical and coherent presentation of relevant points.

QUESTION 4

(a) The first IFRS reporting period was the year ended 31 December 2012, and the date of Transition to IFRS was 1 January 2011.

(b) **The procedures which must be followed in order to prepare the Financial Statements for the year ended 31 December 2012, are as follows:**

(i) Choice of accounting policies to be included as part of notes to the Financial Statements

(ii) Preparation of the opening IFRS Statements of Financial Position by applying the following rules, except in cases where IFRS grants exemptions and /or prohibits retrospective application:

- Recognise all assets and liabilities required by IFRS
- Not recognise assets and liabilities not permitted by IFRS
- Reclassify all assets and liabilities and equity in accordance with IFRS
- Measure all assets and liabilities in accordance with IFRS
- Any gains and losses arising from this exercise should be recognised immediately in retained earnings as at January 2012

(iii) Since IAS 1 requires that at least one year of comparative prior period financial information be presented, the opening Statement of Financial Position will be 1 January 2011, if not earlier.

(iv) Preparation of full IFRS Financial Statements for the year ended 31 December 2012, which should include:

- Three Statements of Financial Position
- Two Statements of Comprehensive Income
- Two separate Income Statements (if presented)
- Two Statements of Cash Flows
- Two Statements of Changes in Equity
- Related notes, including comparative information

(c) The reconciliation which the company must include in its financial statements for the year ended 31 December 2102, to explain how the transition from previous GAAP to IFRS affect the reported financial position, financial performance and cashflows are as follows:

(i) Reconciliation of equity reported under previous GAAP to equity under IFRS both (a) at the date of the opening IFRS Statement of Financial Position and (b) the end of the last annual period reported under the previous GAAP.

(ii) Reconciliation of Total Comprehensive Income under IFRS for the last annual period reported under the previous GAAP to Total Comprehensive Income under IFRS for the same period.

(iii) Explanation of material adjustments that were made, in adopting IFRS for the first time, to the Statement of Financial Position, Income Statement and Statement of Cash Flows.

(iv) If errors in previous GAAP financial statements were discovered in the course of transaction to IFRS, those must be separately disclosed.

(v) If the entity recognised or reversed any impairment losses in preparing its opening IFRS Statement of Financial Position, these must be disclosed.

(vi) Appropriate explanations if the entity has elected to apply any of the specific recognition and measurement exemptions permitted under IFRS 1, for example, if the entity used fair values as deemed cost.

(d) Contents of a typical Statement of Changes in Equity are as follows:

(i) Total comprehensive Income for the period, showing separately amounts attributable to owners of the parent and to non-controlling interests.

(ii) For each component of equity, the effect of retrospective application or retrospective restatement recognised in accordance with IAS 8.

(iii) For each component of equity, a reconciliation between the carrying amount at the beginning and end of the period, separately disclosing

- Profit or loss
- Other comprehensive income
- Transactions with owners in their capacity as owners showing separately, contributions by and distributions to owners, and

changes in ownership interests in the subsidiaries that do not result in a loss of control.

EXAMINER'S REPORT

The question covers IFRS 1-First- time Adoption of International Financial Reporting Standards. Candidates are expected to enumerate the guidelines and procedures to be followed in the preparation of first IFRS Financial Statements and their contents.

Many of the candidates did not attempt the question and those who did displayed very poor understanding of its requirements. The commonest pitfalls were the procedures for preparation of and the reconciliation that must be included in the first IFRS Financial Statements.

Candidates are advised to rise up to the challenge of migration to IFRS in Nigeria and the unavoidable need for them to understand the attendant financial reporting requirements.

QUESTION 5

(a) The major ethical issues embedded in the scenario are:

(i) Tension between profit-making and moral responsibility. Should the company disregard its profit- making goal and focus on moral responsibility as it core value?

(ii) Do business have moral responsibilities? At what point should a business maximise profit?

(iii) Should the firm limit its obligations to only obedience to the law (that is, should the firm be legalistic in form)?

(iv) Should the firm accept that being ethical would pay off and consider ethical behaviour from the perspective of enlightened self interest?

(v) Should the firm be made to imbibe ethical norms as part of its core values?

(vi) Should the firm have an ethical code of conduct, which is not fully integrated into its culture?

(b) **Justification for Helen's position are as follows:**

Upholding high ethical standards:

i Contributes significantly to business effectiveness;

ii Enhances a company's reputation;

iii Encourages other firms and individual persons to trust a company which upholds such standards;

iv Tends to confer sustainable competitive advantage upon the firm which practices ethical norms over other companies that do not;

v Employees tend to show their loyalty and commitment to a company which conducts its affair in an ethically sound manner;

vi To acknowledge moral responsibilities beyond the demands of law;

vii To obtain social approval for its moral standpoints and activities;

viii Ethical firms tend to attract better employees;

ix An ethical firm would attract more investors and lenders would be more willing to provide funds; and

x Good reputation that might have been built from being ethically and socially responsible, would turn to goodwill and increase sales.

(c) **Mr. Ugo could ensure that his business maintains a high ethical standard beyond rigid compliance with legal provisions in the following ways:**

(i) Moral duties are not matters of law, Mr. Ugo should ensure that moral duties are honoured and respected in his company;

(ii) Introduction and consolidation of ethical principles, which take into consideration the interests of all stakeholders;

(iii) Set up an ethical department to ensure compliance with ethical standards;

(iv) Enforcement of ethical standards through the ethical department saddled with such responsibilities,

(v) Treating staff and customers with high level of courtesy;

(vi) Establishing very good public relations and customer care;

(vii) Codify ethical standards into a document to serve as a guide for the firm;

(viii) Sensitize the entire staff on the need to be ethically responsible;

(ix) Mr. Ugo should also display high level of ethical standards to set a precept as an ethical leader in the firm;

(x) Spell out the reward or punishment for would-be staff that behaves ethically or unethically in the firm to promote the culture of ethical responsibility; and

(xi) Educate and train staff on regular basis to ensure adequate compliance with ethical standards beyond the provision of the law.

EXAMINERS' REPORT

The question test candidates' understanding of ethics and its implication for business or corporate organizations. Candidates are expected to discuss the tension between profit making and moral responsibilities. They are also expected to know how high ethical standards can contribute to business effectiveness and also the tension between ethical standards and legal provisions.

Most candidates did not understand the question. They could not discern clearly issues that border on moral duties, profit-making and environmental ethics. Most candidates stated ethical theories rather than address the salient issues in the question, hence, performance was below average.

Candidates are advised not to ignore issues that emphasise corporate governance, environmental responsibilities and profit-making. They should learn how to apply theoretical knowledge to practical situations.

QUESTION 6

(a) (i) Distributable profit is the accumulated realized profits (so far as not previously distributed or capitalised) less its accumulated realized losses (so far as not previously written off in a reduction or re-organisation of share Capital). Thus, realized losses may not be off set against unrealized profits.

The Company may pay dividends out of the following profits:

- Profit arising from the use of the company property although it is a wasting asset;

- Revenue Reserve; and

- Realised profit on a property, plant and equipment sold, or the net realized profit on the assets sold, if more than one asset is sold.

(ii) Company legislation (CAMA) determines the amount of distributable profit.

- CAMA provides that "a Company shall not declare or pay dividend if there are reasonable grounds for believing that the company is or would be, after the payment unable to pay its liabilities, as they become due.

  The distributable profit of a Reporting Entity is determined as follows:

- The amount of accumulated realized profits less accumulated realized losses;

- The amount of profit or loss that has arisen over time since the date of a Company's incorporation; and

- Profits realized in the form of cash or other assets, the ultimate cash realization of which can be assessed with reasonable certainty.

(b) Realised gain or loss is the actual gain or loss that occurs when an asset (whose price has changed since it was purchased) is converted into cash at fair market value in an arm's length transaction.

However, the following rules may be used to distinguish between realized and unrealized profits:

REVALUATIONS

- A revaluation surplus is an unrealised profit.

- On disposal of a revalued non-current asset, any previously unrealized surplus becomes realized

- When a depreciable non-current asset is revalued upwards, this results in a higher periodic depreciation charged. However, in computing realized profit depreciation should be based only on the cost of the asset.

MISCELLANEOUS

- A provision is a realized loss
- Development Costs carried forward as an asset are treated as an unrealized loss. They become realized loss when the asset is amortised in later periods.
- Profit and losses resulting from the recognition of changes in fair values are realized profits or losses, to the extent that they are readily convertible into cash.

(c) (i) **The distributable profit of MAKULA LTD**

	₦'000
Earnings	800
Depreciation adjustments	(80)
	720

When computing distributable profit, depreciation should be based on Property, Plant and Equipment at cost. Depreciation charged on a revaluation deficit should, therefore, be deducted for the purposes of computing distributable profit.

Thus, the distributable profit of MAKULA Ltd is reduced by ₦80,000 (i.e ₦200,000 x 20% x 2 years)

(ii) If MAKULA LTD was a Plc, development costs of ₦400,000 would have to be deducted in computing distributable profit. Development costs are unrealized loss which, in the case of a Plc, must be deducted in computing distributable profit. MAKULA Ltd would, therefore, have distributable profit of ₦320,000 (i.e ₦720,000 – ₦400,000)

EXAMINERS' REPORT

The question tests candidates understanding of the term "distributable profits" in accordance with Companies and Allied Matters Act CAP c.20 LFN 2004 and the concepts of realizable and unrealizable gain or loss.

Majority of the candidates displayed lack of understanding of the requirements of the question as demonstrated in their use of layman's language in explaining professional technical terms. Few candidates attempted the questions and performance was below average.

Candidates are advised to ensure good coverage of all aspects of the syllabus.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II - MAY 2013

STRATEGIC FINANCIAL MANAGEMENT

Time Allowed: 3 hours

SECTION A: PART I MULTIPLE-CHOICE QUESTIONS (20 Marks)

ATTEMPT ALL QUESTIONS

Write ONLY the alphabet (A, B, C, D or E) that corresponds to the correct option in each of the following questions/statements:

1. The following are principles of corporate governance **EXCEPT**

   A. Recognition of the legitimate interest of stakeholders
   B. Display of sincerity of purpose in the management of risk
   C. Safeguarding the integrity of financial reporting
   D. Ensuring that the Board, as the apex organ, has unlimited powers
   E. Recognition and management of risk

2. The overall responsibility for attaining corporate governance objectives in a firm rests on the

   A. Shareholders
   B. Audit Committee
   C. Top executive officers
   D. External Auditors
   E. Board of Directors

3. A continuous process of making decisions about how outcomes are to be accomplished, what products will be produced, how success is measured and evaluated and how budgetary resources are allocated is termed ……………… planning.

   A. Tactical
   B. Strategic
   C. Long-range
   D. Functional
   E. Corporate

4. The following models are utilized by the Decision Support System (DSS) analytical modelling **EXCEPT** ……………….. model.

   A. Optimum level analytical
   B. What-if analytical
   C. Inventory control
   D. Sensitivity control
   E. Goal-seeking analytical

5. The optimal asset replacement decision making method, which examines the cash flows of all possible cycles of the asset over an equal number of years, is known as

   A. Finite horizon method
   B. Annual equivalent cost method
   C. Linear Programming method
   D. Simulation
   E. Least common multiple method

6. Mojere Plc., has a capital limit of ₦600,000 and it is estimated that capital will be limited to ₦700,000 next year. The company's cost of capital is 16% and the following projects are being considered:

	Cash Outlay		
Project	Year 0	Year 1	NPV (16%)
	₦'000	₦'000	₦'000
X	600	500	240
Y	400	600	280
Z	500	500	300

   Given that the projects are divisible, formulate the objective function of the problem.

   A. Minimise cost = 600,000X + 400,000Y + 500,000Z
   B. Maximise NPV = 240,000X + 280,000Y + 300,000Z
   C. Minimise cost = 500,000X + 600,000Y + 500,000Z
   D. Maximise cost = 240,000X + 280,000Y + 300,000Z
   E. Minimise NPV = 240,000X + 280,000Y + 300,000Z

7. Trendz Plc. is all equity financed with a cost of equity of 10%. Delux Plc. is identical to Trendz Plc. except that it is financed by 600,000 ₦1 ordinary shares currently trading at ₦2.50, and 6% ₦500,000 loan stock, which currently trades at ₦80 per ₦100.

Using Modigliani and Miller (MM) approach (ignoring taxation), what is the cost of equity capital in Delux Plc.?

A. 11.8%
B. 11.5%
C. 11.0%
D. 10.7%
E. 10.5%

8. Which of the following is **NOT** an element of the capital structure of a corporate entity?

A. Ordinary shares
B. Preferred shares
C. Right issue
D. Debenture
E. Creditors

9. The Equity/Debt ratio, cost of debt, cost of equity and the respective cost of capital for Abbey Plc. are stated as follows:

	Equity/Debt ratio	K_d	K_e	K_o
A.	100:0	-	0.1500	15.00%
B.	90:10	0.090	0.1545	14.86%
C.	80:20	0.095	0.1583	14.78%
D.	70:30	0.100	0.1615	14.73%
E.	60:40	0.105	0.1643	14.74%

From the above table, determine the option that gives the optimal capital structure.

10. The following are the attributes of a perfect capital market **EXCEPT**

    A. Divisibility of financial assets
    B. Free trading
    C. Tax differences
    D. No entry barriers
    E. Absence of transaction costs

11. The strong form of efficient market hypothesis asserts that stock prices fully reflect ………………………… information.

    A. Market
    B. Public and private
    C. Public and market
    D. Published
    E. Public, private and future

12. The Chairman/Managing Director's address in the annual report of a company can be classified as ………………………… under the efficient market hypothesis.

    A. Fundamentalist theory
    B. Semi-strong form
    C. Random walk theory
    D. Strong form
    E. Weak form

13. Which of the following is **NOT** a feature of a bond?

    A. It usually has a maturity date
    B. It has a market price which may be different from its face value
    C. It is an IOU for a fixed amount
    D. It is a debt instrument with a par value printed on the face of the selling instrument.
    D. It is a non-negotiable instrument.

14. The type of merger involving firms in the same general industry, but for which no customer or supplier relationship exists is known as ……………….. merger.

A. Congeneric
B. Concentric
C. Conglomerate
D. Horizontal
E. Vertical

15. Synergistic effects of merger arise from the following sources **EXCEPT**

A. Differential efficiency
B. Political economies
C. Operating economies
D. Increased market power
E. Financial economies

16. In the context of dividend policy, the major difference between small firm and large firm decision making is

A. Dividend payments
B. Size
C. Clientele effects
D. Information contents of dividend
E. Financial signalling

17. Which of the following is **NOT** a goal of Microfinance Banks?

A. To render payment services such as salaries, gratuities and pension on behalf of various tiers of government
B. To create employment opportunities
C. To mobilize savings for financial intermediation
D. To mobilize savings from public sector
E. To involve the poor in the socio-economic development of the country

18. The simultaneous purchase and sale of a foreign currency having two prices in two different markets in order to make short term profit is called

A. Currency dualisation
B. Currency swaps
C. Currency options

D. Currency futures
E. Currency arbitrage

19. Suppose the expected inflation rate in Nigeria in the next 12 months is 10 percent while that of UK for a similar period is 6 percent. What is the approximate expected spot price of one pound in 12 months' time if the current rate is ₦230/£1 and the Purchasing Power Parity (PPP) holds?

A. ₦239.2
B. ₦240.0
C. ₦242.0
D. ₦244.0
E. ₦246.0

20. The following exchange rates of Naira against the US dollar were quoted in a financial newspaper:

Spot	₦ /US$	₦135
Three months' forward	₦ /US$	₦142

The interest rate in Nigeria is 12% per annum for a three-month deposit or borrowing. What is the annual interest rate for a three-month deposit or borrowing in the US?

A. 6.0775%
B. 8.31%
C. 10.31%
D. 10.85%
E. 12.00%

SECTION A: PART II SHORT-ANSWER QUESTIONS (20 Marks)

ATTEMPT ALL QUESTIONS

Write the correct answer that best completes each of the following questions/statements:

1. The alternative to shareholders' wealth maximisation objective of an organization which treats all stakeholders at par is ....

2. A perfect system that would give management all the right incentives to make value maximising investments and financing decisions is ....

3. Defining a clear company mission, setting supporting objectives, designing a sound business portfolio and coordinating functional strategies are the responsibility of the ....

4. The assumption that an organization must be responsive to a dynamic and changing environment is the basis of ....

5. The formula for computing the Annual Equivalent Value (AEV) of an investment is ....

6. A mathematical exercise in which a model of a system is established and the model's variables are altered to determine the effects on other variables is called ....

7. If the cost of debt is 7%, the cost of equity is 16% and the debt-equity ratio is 40:60, what is the overall cost of capital?

8. The theory which states that companies prefer to make use of Internal Funds first, followed by debt and then external equity is known as ....

9. A company has 10% ₦10 million debt and earns ₦10 million a year before interest is paid. There are 4.5million issued shares and the weighted average cost of capital of the company is 20%. Compute the company's total market value.

10. The systematic process in which a security is valued by estimating the performance of the underlying company and the future cash flows associated with holding the security is referred to as ....

11. The theory which assumes that stock price changes from day to day such that the changes are independent of each other and have the same probability distribution is called ....

12. Efficiency of the capital market has implications for both .... and ....

13. The service that involves advancing a proportion of a selection of invoices without administration of the sales ledger of the business is known as ………………………………….

14. The type of a tender offer in which debt is used to buy the firm is known as ……………………………

15. An attempt to gain control of a firm by soliciting shareholders to vote for a new management in a hostile merger is called ……………………………….

16. Direct investment in SMEs by wealthy individuals and informal groups of individuals (in terms of a market) who are interested in assisting new businesses that will enhance the immediate community is referred to as ………………………………..

17. Mathematically, state the optimal capital structure point.

18. The foreign exchange rate quotation which states the number of units of foreign currency that will be traded for one unit of the domestic currency is called …………………………….

19. In the context of International Financial Management, state the equation that represents Expectation Theory.

20. Suppose the interest rate in Nigeria is 18% while that in the US is 8%. If ₦136 exchanges for $1, what is the forward rate, given Interest Rate Parity?

SECTION B: ATTEMPT QUESTION ONE AND ANY OTHER THREE QUESTIONS
(60 Marks)

QUESTION 1 - CASE STUDY

Ilera Loro Plc., a manufacturing company located in the Eastern part of the country, designs and manufactures Personal Stress-Monitoring Device (PSMD). The device is designed for checking individuals' stress levels. A typical device has a commercial life of three years.

As a result of wide advertisement campaign, the company recorded high sales for the first two years while the sales figure for the third year went down substantially due to low demand for the product. The marketing department of the company was assigned the responsibility of finding out the reason for the low demand. The department discovered that the consumers complained of the low quality of the product which makes it much less durable. With this information, the company decided to submit 200 samples of the devices to the Quality and Assurance department of the company for analysis. Out of the 200 devices submitted, 50 enjoyed an above average demand, 120 enjoyed average demand and the remaining 30 enjoyed below average demand. This demand pattern is applicable in all the company's products.

Recently, the company developed a new device known as "SIMPLE" and paid ₦10 million as development cost.

The following projections were made in respect of the product "SIMPLE":

SALES REVENUE

	Year 1	Year 2	Year 3
	₦m	₦m	₦m
If demand is above average	240	500	160
If demand is average	140	340	80
If demand is below average	50	180	50

Variable costs will amount to 30% of sales. Sales revenue and variable cost will be received and paid respectively on the last day of the year in which they arise.

If "SIMPLE" is produced, a special machine will have to be purchased at the beginning of Year 1 at a cost of ₦190 million, payable at the time of purchase. The machine will have a scrap value of ₦10 million at the end of the product's life. The amount is receivable one year after the last year in which production takes place. If purchased, the machine will be installed in an unused part of one of Ilera Loro Plc.'s factories. The company has been trying to let this unused factory space at a rent of ₦16 million per annum. Although, there seems to be no chance of letting the space in year 1, there is a 60% chance of letting it for two years at the beginning of year 2 and a 50% chance of letting it for one year at the beginning of year 3 provided it has not been let at the beginning of year 2. All rental income will be received annually in advance. Fixed costs, which include depreciation of the special machine on a straight-line basis, are expected to amount to ₦70 million per annum.

These costs which are all specific to the production of "SIMPLE" and with the exception of depreciation, will be paid on the last day of the year in which they arise.

Advertising expenses will be paid on the first day of each year and will amount to ₦30 million at the start of year 1, ₦20 million at the start of year 2 and ₦10 million at the start of year 3. Ilera Loro Plc. has a cost of capital of 20%.

You are required to

Analyse and evaluate the production of "SIMPLE" based on Expected Present Value. (Show all relevant calculations). **(15 Marks)**

QUESTION 2

The following information relate to Latente Plc. and Reviva Plc. each having 30,000,000 and 80,000,000 ordinary shares in issue respectively:

Day 1: The price per share is ₦3 for Latente and ₦6 for Reviva.

Day 2: The management of Reviva Plc., at a private meeting, decided to make a takeover bid for Latente at a price of ₦5 per share with settlement on day 20. The takeover will produce operating savings with a present value of ₦80,000,000.

Day 5: Reviva Plc. publicly announces an unconditional offer to purchase all shares of Latente Plc. at a price of ₦5 per share with settlement on day 20. Reviva Plc. does not announce nor make public, the operating savings of the takeover.

Day 10: Reviva Plc. announces details of the savings derivable from the takeover.

Required

Assuming that the details given are the only factors having effect on the share price of both companies, determine the day 2, day 5 and day 10 share price of Latente and Reviva if the capital market is

a. Semi-strong form efficient,

b. Strong form efficient;

given that:

i. The purchase consideration is cash as stated above.

ii. The purchase consideration, decided on day 2 and publicly announced on day 5, is five new shares of Reviva Plc. for six shares of Latente Plc.

Note: Ignore tax and time value of money. **(15 Marks)**

QUESTION 3

Saulson Plc. is a fully equity financed company. The directors are considering investment in one of two projects which are mutually exclusive. The cashflows of the two projects are as follows:

	Project A (Hire Purchase Finance)	Project B (Mortgage Finance)
Initial Outlay	₦10 million	₦24 million
Cash flow:		
Years 1 – 3	₦4.8million p.a.	₦7.8million p.a.
Years 4 and 5	₦5.6million p.a.	₦8.9million p.a.
Residual Value	₦1million	₦1 million

Other additional information is given as follows:

Current market price/share	=	₦1.50
Current annual gross dividend/share	=	15k
Expected dividend growth rate p.a.	=	10%
Beta co-efficient for company's shares	=	0.7
Expected rate of return on risk free securities	=	9%
Expected rate of return on market portfolio	=	17%

You are required to

a. Evaluate the viability of each project using Capital Asset Pricing Model (CAPM) and Dividend Growth Model (DGM). (10 Marks)

b. Identify which project to accept giving your reasons. (2 Marks)

c. Explain the **THREE** factors that must be estimated for any valuation model. (3 Marks)

Note: Cost of capital should be rounded up to a whole number. Discounting factor should be rounded up to four decimal places. **(Total 15 Marks)**

QUESTION 4

a. Rosco Construction Plc. has just won a big contract in one of the States in South West Nigeria. The company therefore needed an additional working capital of ₦9.5 billion to be able to execute the contract. Investigations carried out by the company revealed the following three feasible sources of funds:

i. Bank Loan: The company's banker "Apex Bank" has agreed to extend a loan facility of ₦10.6billion at 14%. A 10% compensating balance will be required.

ii. Trade Credit: Rosco Construction Plc. buys about ₦5billion of materials per month on terms of "3/10, net 90". Discounts are currently taken.

iii. Factoring: Here, a factor will buy the company's receivables (₦15billion per month) which have an average collection period of 30days. The factor will advance up to 75% of the face value of the receivables at 12% on an annual basis and 2% fee on all receivables purchased. It was estimated that the factor's service will save the company ₦250million per month – consisting of both bad debt expenses and credit department expenses.

You are required to determine, on the basis of annualised percentage cost, which alternative the company should select. (10 Marks)

b. Evaluate **FIVE** factors that should be considered by an organization when formulating a policy for credit control. (5 Marks)

(Total 15 Marks)

QUESTION 5

a. "The need for organisations to embrace statutory control of Corporate Governance cannot be over emphasized".
In the light of the above, evaluate **FIVE** factors on which good Corporate Governance rests. (5 Marks)

b. Assess **THREE** differences between Management Information Systems (MIS) and Decision Support Systems (DSS). (6 Marks)

c. Analyse **FOUR** characteristics of project financing. (4 Marks)

(Total 15 Marks)

QUESTION 6

Ade Plc. and Oba Plc. have the same business risk and the same Earnings Before Interest and Tax (EBIT) which is ₦10 million. Ade Plc. is not leveraged but Oba Plc. has ₦40 million 8% debenture in its capital structure. The equity capitalization rate for the firms is 10%.

You are required to

a. Determine and evaluate the implied overall capitalization rates and the values of the firms using the Net Income (NI) approach. (8 Marks)

b. Assess and advise an investor who owns 5% of Oba Plc.'s shares on how he can increase his return through the process of arbitrage assuming the Modigliani and Miller (M&M) hypothesis. (7 Marks)

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART 1: MULTIPLE-CHOICE QUESTIONS

1. D
2. E
3. A
4. C
5. E
6. B
7. D
8. E
9. D
10. C
11. E
12. B
13. E
14. A

15. B

16. C

17. D

18. E

19. A

20. B

Workings

7. $K_E(g) = K_E(u) + \left[(K_{E(u)} - Kd) \times \frac{VD(1-t)}{VE}\right]$

$Kd = 6\% \times \frac{₦100}{₦80} = 7.5\%$

$K_E(g) = 10\% + \left[(10\% - 7.5\%) \times \frac{400{,}000}{1{,}500{,}000}\right]$

$= 10\% + (2.5\ \% \times 0.2666)$

$= 0.10 + (0.025 \times 0.2666)$

$= 0.10 + 0.0066 = 0.10666 = 10.666 = 10.7\%$

19. $P_x - P_y = \frac{S_t - S_o}{S_o}$

$0.10 - 0.06 = \frac{S_t - 230}{230}$

$0.04 = \frac{S_t - 230}{230}$

$230(0.04) = S_t - 230$

$9.2 = S_t - 230$

$9.2 + 230 = S_t$

$S_t = ₦239.2$

where

P_x is the expected inflation rate (or percentage change in price index) in country x.
P_y is the expected inflation rate (or percentage change in price index) in country y.
S_t is the expected spot rate at time t.
S_o is the spot rate today.

20. Assuming \$10,000 is converted to naira at

Spot = 10,000 x ₦135	= ₦1,350,000
Invested at 12% for three months i.e.	
i.e. $\frac{0.12}{4} \times 1{,}350{,}000$	= 40,500
	₦1,390,500
Convert to US dollar at the forward rates	= $\frac{₦1{,}390{,}500}{₦142}$
	= \$9,792.25
Interest rate is $\frac{\$10{,}000 - 9792.5}{\$10{,}000} \times 100\%$	= 2.0775% for three months

For 1 year, the rate will be 2.0775 x 4% = 8.31%

EXAMINERS' REPORT

The questions cover almost all the sections of the syllabus.

All questions were attempted by nearly all the candidates and performance was fair. Some of the candidates showed good understanding of the questions while others had problems in providing appropriate solutions.

Candidates are advised to ensure adequate coverage of all sections of the syllabus for better performance.

PART II - SHORT-ANSWER QUESTIONS

1. Corporate Wealth Maximisation (CWM) or Stakeholders' Theory.
2. Corporate Governance
3. Top Level Management or Executive Management
4. Corporate Social Responsibility
5. Annual Equivalent Value = $\frac{\text{NPV}}{\text{Annuity factor}}$ i.e. $\frac{\text{Net Present Value}}{\text{Annuity factor}}$
6. Deterministic simulation or Sensitivity analysis
7. 12.4%

8. Pecking order theory
9. ₦50,000,000
10. Fundamental analysis
11. Random walk theory
12. Investors; financial managers
13. Invoice discounting
14. Leveraged buy-out
15. Proxy fight
16. Business angels
17. $K_e = K_d$
18. Indirect quote
19. $\frac{F_o - S_o}{S_o} = \frac{S_t - S_o}{S_o}$
20. ₦145.52

Workings

7. Overall cost of capital $= (0.07 \times 0.40) + (0.16 \times 0.60) \times \frac{100}{1}$

$$= (0.028 + 0.096) \times \frac{100}{1}$$

$$= 0.124 \times \frac{100}{1}$$

$$= 12.4\%$$

9. Earnings = ₦10 million

Weighted average cost of capital = 20%

$\therefore$ the company's total market value $= \frac{₦10,000,000}{0.20}$

= ₦50,000,000

20. Using the formula

$$ix - iy = \frac{F_o - S_o}{S_o}$$

$0.18 - 0.8 = \frac{F_o - 136}{136}$

Cross multiplying

$F_o - 136$	$= 0.18 - 0.08\ (136)$
	$= 0.10\ (136)$
$F_o - 136$	$= 13.6$
$\therefore F_o$	$= 13.6 + 136$
	$=$ ₦149.60

where

ix = rate in Nigeria
iy = rate in US
F_o = forward rate
K_e = cost of equity
K_d = cost of debenture

EXAMINERS' REPORT

The questions test candidates' knowledge of the various aspects of the syllabus. Almost all the candidates attempted all the questions and performance was fair. Some of the candidates did not have a good understanding of some of the questions hence they gave wrong answers or failed to answer them.

Candidates are advised to study extensively and adequately cover the syllabus when preparing for the Institute's examination.

SOLUTIONS TO SECTION B

QUESTION 1 - CASE STUDY

Calculation of expected sales of the device based on the probabilities determined by the analysis of previous experience.

The probabilities are

Above Average = $\frac{50}{200}$ = 25% i.e. 0.25

Average = $\frac{120}{200}$ = 60% i.e. 0.60

Below average = 30/200 i.e. = 15% i.e. $\underline{0.15}$

$\underline{\underline{1.00}}$

Expected sales are obtained as follows:

Year 1 = (₦240,000,000 x 0.25) + (₦140,000,000 X 0.60) + (₦50,000,000 x 0.15)
= ₦151,500,000

Year 2 = (₦500,000,000 x 0.25) + (₦340,000,000 + 0.60) + (₦180,000,000 x 0.15)
= ₦125 million + ₦204 million + ₦27 million
= ₦356,000,000

Year 3 = (₦160,000,000 x 0.25) + (₦80,000,000 x 0.60) + (₦50,000,000 + 0.15)
₦40 million + ₦48 million + ₦7.5 million
= ₦95,500,000

Expected value of rent forgone:

If the factory space is let at the beginning of year 2, rent of ₦16,000,000 each will be received in year 1 and Year 2 (rent is payable in advance). This has a probability of 0.6.

If it is not let in year 2 (probability of 0.4); it could be let at the beginning of year 3 (with a probability of 0.5). This will produce cashflow of ₦16 million in year 2. This event has a joint probability of (0.4 x 0.5) = 0.2.

Summary

		Probability	Year 1	Year 2	Year 3
		₦'m	₦'m	₦'m	₦'m
0.6	=	0.60	16	16	-
0.4 x 0.5	=	0.20	-	16	-
0.4 x 0.5	=	0.20	-	-	-
		1.00	9.6	12.8	Nil

Year	0	1	2	3	4
	₦'m	₦'m	₦'m	₦'m	₦'m
Initial Outlay	(190)	-	-	-	-
Advertisement	(30)	(20)	(10)	-	-
Fixed cost less depreciation	-	(10)	(10)	(10)	-
Scrap value	-	-	-	-	10
Rent Forgone		(9.6)	(12.8)	-	-
Contribution (70% of sales)		106.05	249.2	66.85	
Net Cash flow	(220)	66.45	216.4	56.85	10
DCF (20%)	1.00	0.83	0.69	0.58	0.48
PV	(220)	55.154	149.316	32.973	4.8

ENPV = ₦242,243,000 – ₦220,000,000
= ₦22,243,000

DECISION: Since the Expected Net Present Value is positive, the new product should be produced all things being equal.

EXAMINERS' REPORT

The question tests candidates' knowledge of evaluation of capital projects under Capital Investment Decisions aspect of the syllabus.
More than 80% of the candidates who attempted the question did not understand its requirements, hence the performance was poor.

Candidates' commonest pitfalls in answering the question were their inability to

i. compute the expected sales, using the probabilities as determined by previous demand pattern for the company's product;

ii. compute the value of the rent foregone;

iii. relate cash flows to the appropriate periods;

iv. carefully arrange the table for NPV calculations;

v. conclude with a decision based on the computations.

Candidates are advised to cover the syllabus adequately, work on past questions and make use of the Institute's study packs and pathfinders so as to improve their knowledge on capital investment appraisal. They should also endeavour to revise other subject linkages such as Management Accounting, Quantitative Techniques etc when preparing for the examination in this subject.

QUESTION 2

a(i) **Semi-Strong form efficient – Cash Offer**

In semi-strong form efficient, shareholders know all the relevant historical data and publicly available current information.

DAY 2

Value of Latente Plc. shares = (₦3 x 30,000,000) i.e. ₦90,000,000

Value of Reviva Plc. shares (₦6 x 80,000,000) = ₦480,000,000

The decision of the private meeting does not reach the market, hence share-prices will remain unchanged.

DAY 5

The takeover bid was announced, but no information is available yet about the operating savings, hence, value of Latente Plc. shares will be (₦5 x 30,000,000) = ₦150,000,000

Value of Reviva Plc.	₦
- Previous value (₦6 x 80,000,000)	= 480,000,000
- Value of Latente acquired (₦3 x 30,000,000)	= 90,000,000
	570,000,000
Less purchase consideration for Latente	150,000,000
	420,000,000

Price per share = $\left(\frac{₦420,000,000}{80,000,000}\right)$ = ₦5.25

The number of shares in Reviva Plc. after acquisition remains unchanged since cash is paid.

DAY 10

The market learns of the potential savings of ₦80,000,000. Value of Latente Plc. remains unchanged @ ₦5 per share. But value of Reviva Plc. will be (₦420,000,000 + ₦80,000,000) = ₦500,000,000.

Price per share = $\left(\frac{₦500,000,000}{80,000,000}\right)$ = ₦6.25

a(ii) **Semi-Strong form Efficient-Share Exchange Offer**

Day 5

Value of Reviva Plc.
Previous value (₦6 x 80,000,000) ₦480,000,000

Value of Lantete Plc. acquired (₦3 x 30,000,000)	₦90,000,000
	₦570,000,000

No of shares in Reviva Plc.

(80,000,000 + (5/6 x 30,000) = 105,000,000

Price per share Reviva Plc. = $\frac{₦570,000,000}{105,000,000}$ = ₦5.43

Price per share of Latente Plc. will be $^5/_6$ x 5.43 = ₦4.525
= ₦4.53

DAY 10		₦
Value of Reviva Plc.	-	500,000,000
Value of Latente Plc.		150,000,000
		650,000,000

Number of shares is 105,000,000

Price per share Reviva Plc. = $\frac{₦650,000,000}{105,000,000}$ = ₦6.19

Price per share of Latente Plc. will be $^5/_6$ x 6.19 = ₦5.16

b(i) **Strong Form Efficient – Cash Offer**

In strong form efficient, the market would become aware of all the relevant information when the private meeting takes place. The value per share would change as early as day 2 to

Latente Plc. = ₦5.00
Reviva Plc. = ₦6.25

The share prices would then remain unchanged until day 20.

b(ii) **Strong Form Efficient-Share Exchange Offer**

Also, for the same reason, the price per share would change on day 2 to Latente Plc. = ₦5.16, Reviva Plc. = 6.19 and these prices would remain unchanged till day 20.

EXAMINERS' REPORT

The question tests candidates' understanding of the forms and tests of efficiency and their implications on the efficiency of the market.

This is a practical question which requires candidates to make use of their theoretical knowledge of Efficient Market Hypothesis – weak form, semi-strong form and strong form – in providing its solution. About 90% of the candidates did not attempt the question and those that did failed to demonstrate good understanding of the question, hence performance was poor.

Candidates' commonest pitfall was their lack of in-depth knowledge of this area of the syllabus, hence the reason for the low attempt.

Candidates' are advised not to only concentrate on the theoretical aspect of this subject, they should also endeavour to have practical knowledge on some of the aspects of the syllabus. Visits to the Nigerian Stock Exchange once in a while to observe proceedings on the floor of the Exchange is a good example. In addition, candidates are advised not only to read textbooks, they should also visit the website, read local and international journals to keep abreast of current developments on this subject.

QUESTION 3

(a) Calculation of cost of equity capital using:

CAPM

Formula: $K_e = Rf + \beta(Rm - Rf)$

where K_e = cost of equity

Rf = expected rate of return on risk-free securities

β = Beta Coefficient

Rm = Expected return on market portfolio

$K_e = 9\% + 0.7\ (17\% - 9\%)$

$= 9\% + 5.6\%$

$= 14.6\% \approx 15\%$

Dividend Growth Model

where D_o is Dividend in year 0

g is rate of growth of dividend

Mv is market value

Where D_o

$$K_e = \frac{D_0 + (1 + g)}{M_v} + g$$

$$= \frac{15k\,(1.10)}{150k} + 0.10$$

$$= 0.11 + 0.10$$

$$= 0.21 \text{ i.e. } 21\%$$

Evaluation of the projects i.e. computation of NPV

(i) Using CAPM

		Project A			Project B	
Year	Details	Cash flows	PV	DF (21%)	CASHFLOW	PV
		₦	₦	₦	₦	₦
0	Initial Outlay	(10,000,000)	(10,000,000)	1.0000	(24,000,000)	(24,000,000)
1 – 3	Inflow	4,800,000	10,959,360	2.2832	7,800,000	17,008,960
4 & 5	Inflow	5,600,000	5,986,400	1.069	8,900,000	7,514,100
5	Inflow	1,000,000	497,200	0.4972	1,000,000	497,200
	NPV		7,442,960			3,820,260

(ii) Using Dividend Growth Model

		Project A			Project B	
Year	Details	Cash flows	PV	DF (21%)	CASHFLOW	PV
		₦	₦	₦	₦	₦
0	Initial Outlay	(10,000,000)	(10,000,000)	1.0000	(24,000,000)	(24,000,000)
1 – 3	Inflow	4,800,000	9,954,720	2.0739	7,800,000	16,176,420
4 & 5	Inflow	5,600,000	4,771,760	0.8521	8,900,000	7,583,690
5	Inflow	1,000,000	385,600	0.3856	1,000,000	385,600
	NPV		5,112,080			145,710

b. Under the two methods, i.e. the CAPM and the DGM, Project A has a higher Net Present Value and should therefore be selected. Assuming the two projects are not mutually exclusive, both would have been accepted on the basis of positive Net Present Values.

c. The three factors are explained as follows:

i. Life of the Asset: The life of assets can differ. For instance, bonds have a fixed maturity life, while equity has no fixed maturity life.

ii. The expected stream of cash flows/returns: for bond, the stream of return can easily be determined because it is fixed, whereas those of equity are difficult to estimate because of the discretionary nature of the dividends.

iii. Appropriate discount rate: This will reflect the risk attached to the asset. The higher the risk, the higher the discount rate. The rate of equity is subjective, but that of bond is typically determined.

EXAMINERS' REPORT

The question tests candidates' ability to apply Capital Asset Pricing Model (CAPM) and Divided Growth Model (DGM) along with Net Present Value investment appraisal technique in determining the viability of a project.

This question is tested under the capital market financing and risk management aspect of the syllabus.

About 95% of the candidates attempted the question out of which about 80% of them showed lack of understanding of its import, hence performance was very poor.

Candidates' commonest pitfalls were their

i. inability to calculate correctly the cost of equity capital using the CAPM and DGM.

ii. failure to round up the cost of equity to the nearest whole number as demanded by the question;

iii. failure to articulate the factors that are usually estimated in valuation models.

Candidates are advised to read, understand and interprete questions appropriately and note their specific requirements before attempting them. They should also make effort to remember key formulae.

QUESTION 4

a. Consideration of the three available finance options:

i. **Bank Loan Option**

The cost of obtaining bank loan with 10% compensating balance is $\frac{i}{100-c} \times 100\ \%$

where i = bank interest rate

c = compensating balance

Cost of obtaining bank loan = $\frac{14}{100-10} \times 100$

$= 14/90 \times 100$

$= 15.56\%$

ii. **Trade Credit Option**

If discounts are not taken, up to 97% x ₦5 billion per month x 2 months can be raised after the second month.

The cost, which is the same as the cost of lost cash discounts, can be estimated using the formula: cost = $\frac{d}{100-d} \times \frac{365}{t}$

where d = discount percentage

t = reduction in the payment period in days which would be necessary to obtain the early payment. i.e. 90 – 10 = 80

i.e. cost = $\frac{3}{100-3} \times \frac{365}{90-10}$

$= \frac{3}{97} \times \frac{365}{80}$

$= 14.11\%$

iii. **Cost of Factoring**

Factors fee per annum i.e. 2% x ₦15,000,000,000 x 12

= ₦3,600,000,000

Factor's finance cost: 12% x 9,500,000,000 = ₦1,140,000,000

₦4,740,000,000

Less savings in cost per annum (₦250,000,000 x 12)= ₦3,000,000,000

₦1,740,000,000

Rate Per Annum = $\frac{1,740,000,000}{9,500,000,000} \times \frac{100}{1}$

$= 18.3\%$

Decision: From the computations above, trade credit is the cheapest source of finance, hence ROSCO CONSTRUCTION Plc should take advantage of the discount.

b. Factors that should be considered when formulating credit control policy are stated as follows:

i. Cost (administrative) of debt collection.
ii. Procedures for controlling credit to individual customers and for debt collection.
iii. Any saving or additional cost of operating the credit policy.
iv. The amount of extra capital required to finance total credit extended/extension.
v. Way of implementing the credit policy e.g. credit could be eased by giving debtors longer period for settling their accounts.
vi. The cost of additional finance required for any increase in the volume of receivables (or the savings from a reduction in receivables). The cost might be bank overdraft interest, or the cost of long-term finance.

EXAMINERS' REPORT

Part 'a' of the question tests candidates' ability to evaluate various sources of finance particularly trade credit, bank loan and factoring while part 'b' tests their knowledge of things to consider in formulating credit control policy.

About 95% of the candidates attempted the question, out of which about 80% of them did not have a clear and accurate understanding of its two parts, hence performance was very poor.

Candidates' commonest pitfalls in part 'a' of the question were their inability to determine the formulae to use in computing the costs of each of the three sources of fund and their inability to calculate the costs correctly. In part 'b', their candidates commonest pitfall was their inability to understand the specific requirements of the question.

Candidates are advised to read, understand and interprete questions appropriately and note their specific requirements before attempting them. They should also endeavour to remember key formulae.

QUESTION 5

a. Essence of Good Corporate Governance include the following:

i. Permitting the promotion of culture in which directors will give privacy to the ethical pursuit of shareholders' best interest.
ii. Allowing a review of audit regulation, corporate disclosure framework and shareholders' participation to improve transparency and accountability of companies.
iii. Rendering companies to be more credible (domestically and internationally) and ensure managerial entrepreneurship.
iv. Providing ways whereby providers of finance are assured of getting a return on their investment.
v. Ensuring that audit committee assists the board of directors in its oversight of the integrity of the financial statements of the company as well as compliance with legal and regulatory requirements and the performance of internal audit.
vi. Helping to maximise corporate value by enhancing the transparency and efficiency of the company for the future.
vii. Preventing expropriation of investors by managers.
viii. Preventing theft and fraud through mechanisms designed by the board and management.

b. The advancement in technologies in the area of information and communication accounts for some differences between the traditional Management Information Systems (MIS) and Decision Support Systems (DSS).

The differences between the two systems are tabulated as follows:

S/No	Basis	MIS	DSS
i.	Type of support given	It provides information on performance of sections, divisions and the whole organisation.	Provides information on unique one-off problems and the decision supports technique to be used in the analysis of the problem.

ii.	Nature and timing of information	It provides periodic and exceptional reports and feedback,	There are interactive enquiries and resources between the financial manager and the computer. This enhances the problem solving process.
iii.	Format of presentation of information	It is pre-determined and in a fixed format.	Information products are ad-hoc and in adaptable formats.
iv.	Processing technology	Gathering, recording, analyzing and manipulating business data.	Information is produced by analytical modelling of financial data,
v.	Nature of problem(s)	Structured problems such as stock control.	Semi-structured problems such as make or buy decision problem.

c. Characteristics of project financing include the following:

i. A separate project entity is created to receive loans from lenders and equity from sponsors.

ii. The component of debt is very high in project financing.

iii. The project funding and all its cash flows are separated from the parent company's statement of financial position.

iv. Debt service and repayments entirely depend on the projects cash flows.

v. Projects assets are used as collateral for the loan repayments.

EXAMINERS' REPORT

Part 'a' of the question tests candidates' understanding of the principles of good corporate governance while the part 'b' tests their knowledge of the significance of Information Technology in Financial Management with particular reference to Management Information System (MIS) and Decision Support Systems (DSS). Part 'c' however, tests their knowledge of project financing.

About 90% of the candidates attempted the question, out of which about 75% of them did not have a clear and accurate understanding of its parts 'b' and 'c', whereas about 60% did well in part 'a' which carries a lower mark. Performance was generally poor.

Candidates' commonest pitfalls were

i. their inability to differentiate between Management Information System (MIS) and Decision Support System (DSS),

ii. lack of in-depth knowledge of the requirements of the question.

Candidates are advised to read wide and cover the syllabus adequately for better result in future.

QUESTION 6

(a) ADE PLC.

		₦
Earnings before interest and tax		10,000,000
Less interest		NIL
Net Income		10,000,000
K_e		10%
Value of equity: $\left(\frac{NI}{K_e}\right) = \frac{₦10,000,000}{0.10}$	=	₦100,000,000
Value of Debt		NIL
Value of Ade Plc ($V_d + V_e$)		10,000,000

$$= K_d\left(\frac{D}{V}\right) + K_e\left(\frac{E}{V}\right)$$

$$= 0 + 0.10\left(\frac{₦100,000,000}{₦100,000,000}\right)$$

$$= 0 + 0.10$$

$$= 0.10$$

K_o i.e. overall capitalization rate = 10%

where V_d is value of Debenture
V_e is Value of Equity
K_d is Cost of Debenture
K_e is Cost of Equity

OBA PLC.

V_E i.e. Value of Equity: $\frac{(NI)}{Ke}$ i.e. $\frac{₦6,800,000}{0.10}$	₦ 68,000,000
Add value of debt	40,000,000
Value of OBA Plc. ($V_D + V_E$)	108,000,000

K_o (capitalization rate) $= K_d \left(\frac{D}{V}\right) + K_e \left(\frac{E}{V}\right)$

$= 8\% \left(\frac{40,000,000}{108,000,000}\right) + 10\% \left(\frac{68,000,000}{108,000,000}\right)$

$= 2.963\% + 6.296\%$

$= 9.259\%$

$= 9.26\%$

		₦
b.	Switch from Oba Plc. to Ade Plc. (5% x ₦68,000,000)	3,400,000
	Home-made leverage (5% x ₦40,000,000)	2,000,000
	Total investment in Oba Plc.	5,400,000
	Return on total investment (10% x ₦5,400,000)	540,000
	Interest on home-made leverage (8% x ₦2,000,000)	(160,000)
		380,000
	Opportunity cost (5% x ₦6,800,000)	340,000
	Gain on Arbitrage	40,000

Advice:

An investor who owns 5% of the shares in Oba Plc. is advised to switch from Oba Plc. to Ade Plc., as this will give the investor an opportunity of an increased return of ₦40,000. In effect, the investor's wealth will increase by ₦40,000 despite maintaining the same level of risk.

EXAMINERS' REPORT

The question tests candidates' knowledge of the evaluation and determination of financial requirements of corporate entities using Net Operating Income (NOI) approach of Modigliani and Miller (M & M) theory.

About 90% of the candidates attempted the question out of which about 80% of them did not understand its requirements, hence performance was poor.

Candidates' commonest pitfalls were their inadequate knowledge of the Net Operating Income (NOI) approach theory of capital structure and switching of investments under arbitrage system.

Candidates are advised to cover the syllabus adequately, work on past questions in the Institute's Pathfinders and improve their knowledge on capital structure and value of the firm aspects of the syllabus. They should also make effort to remember key formulae and theories.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II – MAY 2013

ADVANCED TAXATION

Time Allowed: 3 hours

SECTION A: PART I ATTEMPT ALL QUESTIONS (20 Marks)

MULTIPLE-CHOICE QUESTIONS

Write ONLY the alphabet (A, B, C, D or E) that corresponds to the correct option in each of the following questions/statements.

1. Under the Petroleum Profits Tax Act CAP P13 LFN 2004, the actual quantity of Natural Gas expressed in MMcf (million cubic feet) actually taken or paid for by a customer in the accounting period under an individual Gas Sales Contract between the Company and its customers is known as………..

   A. Downstream Gas
   B. Upstream Gas
   C. Gas take
   D. Exploration Gas
   E. Casing point Gas

2. Any rent for which provisions exist for its deduction from the amount of any royalties under an Oil Prospecting License or Mining Lease to the extent that rent is so deducted, is

   A. Oil Mining lease
   B. Non-Productive Rent
   C. Oil Prospecting License
   D. Royalty
   E. Refinery and Storage Rent

3. Loss relief under Section 14 of the Petroleum Profits Tax Act, is available for deduction from the Adjusted Profit of the Company in the

   A. Previous accounting period
   B. Preceding assessment year
   C. Following accounting period

D. Following accounting period up to a maximum of four accounting periods
E. Following accounting periods without time limit

4. Not later than .... months after the commencement of each accounting period of any company engaged in Petroleum Operations, the company shall submit to the Board, a Return, the form of which the Board may prescribe, of its estimated tax for such accounting period

A. 2
B. 3
C. 6
D. 9
E. 12

5. An Industry where the creation of products and services is home based, rather than factory based is

A. Agriculture business
B. Small and Medium Enterprises
C. Public Liability Companies
D. Plantation Industry
E. Cottage Industry

6. Under the Companies Income Tax Act, penultimate year computation is peculiar to

A. Commencement of business
B. Merger and Acquisition
C. Cessation of business
D. Adjustment of Profits
E. Dissolution of Partnership

7. Income Tax currently applicable to Companies under the Companies Income Tax Act, is 30% of .... Profit.

A. Total
B. Adjusted
C. Assessable
D. Chargeable
E. Distributable

8. The amount of Capital Allowances calculated, is to be restricted to a percentage of the Assessable Profits and not being in Agricultural business, the percentage currently applicable is

   A. 75%
   B. $66^2/_3$%
   C. $33^1/_3$%
   D. 85%
   E. 50%

9. The Assessable Profit of a Company assessable to tax under the Petroleum Profits Tax Act, is the

   A. Chargeable Profits
   B. Adjusted Profits of the period after adjusting for the effect of any loss relief available to the Company
   C. Profit for the period after relief for Capital Allowances
   D. Adjusted Profit of the period
   E. Adjusted Profit of the period before adjusting for the effect of any Loss Relief available to the Company

10. Under the review of Self Assessment Tax Returns, a tax payer is

   A. Assessed on the Best of Judgement Basis
   B. Always charged to Court
   C. At times, assessed to additional tax
   D. At times, censured for Tax Evasion
   E. Always asked for re-presentation of Tax Returns

11. An individual Tax payer is expected to make Tax Returns

   A. At the beginning of every Tax Year
   B. When a notice of request from the Revenue Office is received
   C. Not later than the end of March every year
   D. At the end of every year
   E. Not later than six months after the end of the Accounting Year

12. Tax Audit has compelled tax payers to

    A. Keep proper Books of Accounts
    B. Develop tax evasive tactics
    C. Change locational addresses
    D. Delay Tax payment
    E. Change Accounting dates

13. Which of the following Software is most frequently used for Tax Planning Computations and Administration?

    A. Microsoft Word
    B. Microsoft Excel
    C. Microsoft Power point
    D. Computer Assisted Program
    E. Corel draw

14. Which of the following tasks **CANNOT** be performed using an Electronic Spreadsheet?

    A. Planning worksheet objectives
    B. Display information visually
    C. Calculate data accurately
    D. Re-calculate updated information
    E. Allowing values to include formulae

15. A major objective of a Tax Audit exercise is to

    A. Educate tax payers on various provisions of the Tax Laws
    B. Show that a Tax Office has wide powers
    C. Demonstrate the powers of the Board to take tax payers to Court
    D. Force tax payers to pay additional taxes
    E. Increase the tax revenue of Government

16. What is the time limit under Double Taxation Agreements for claiming an Allowance by way of Credit, after the end of the Financial Year?

    A. Six months
    B. Three years
    C. Two years

D. One year
E. Six years

17. Government owned enterprises

A. Pay taxes as at when due
B. Pay only Pay as You Earn (PAYE), on the employees' income
C. Are charged to tax at a lower Corporate tax rate
D. Are known to be good tax payers
E. Pay more Education Tax to Government than private enterprises

18. IAS 12 (Revised) on Computation of Deferred Tax, prefers

A. The use of Deferral or Income Statement Liability method
B. The Balance Sheet Liability approach
C. The Timing Differences between items in arriving at Taxable profit and Accounting profit
D. Accounting profit that originates in one period and reverses in subsequent periods
E. Calculation of differences in Taxable Profit

19. Stamp Duties on Corporate Bodies and Residents of the Federal Capital Territory- Abuja, are collected by the

A. Federal and State Governments
B. States and Local Governments
C. Federal Government
D. State Governments
E. Federal and Local Governments

20. What is the Capital Gains Tax rate on the gains resulting from the disposal of a personal dwelling house?

A. 20%
B. Normal rate
C. 5%
D. 7½
E. NIL

SECTION A: PART II ATTEMPT ALL QUESTIONS (20 Marks)

SHORT-ANSWER QUESTIONS

Write the correct answer that best completes each of the following questions/statements:

1. Casinghead Petroleum Spirit and Crude Oil won or obtained by a Company from Petroleum operations is known as.............................

2. What is Projection Cost Adjustment Factor in Petroleum Operations?

3. Gas obtained in Nigeria from Boreholes and Wells consisting primarily of Hydrocarbons is known as.......................................

4. Under the Capital Gains Tax Act, CAP C1 LFN 2004, transactions which are carried out at the Open Market prices are called........................

5. Chargeable Capital Gains are assessed on the ....year basis under CGTA CAP C1 LFN 2004.

6. What is the substitute for depreciation of assets allowable as expenditure for tax purposes?

7. What is the restriction on Capital Allowances granted to a company engaged in agricultural business?

8. Who is answerable to the Federal Inland Revenue Service, under the provisions of the Act, for the tax of a Company in liquidation?

9. Tax attributable to timing differences is termed......................

10. Under the Petroleum Profits Tax Act, the Adjusted Profit after adjusting for the effect of any Loss Relief available to the Company is termed..................

11. Under the Tax Laws, Expenditure incurred in an accounting period for all classes of fixed assets is referred to as.............................

12. The basis of Capital Gains Tax, chargeable on that part of the gains, received or brought into Nigeria when they are so dealt with, is termed................
13. The assessment year before the year of cessation is termed......................

14. What is the restriction on Capital Allowances granted to a company engaged in the trade or business of manufacturing?

15. What is the penalty payable by a tax payer who fails to pay Tax at due date?

16. The conscious effort to take advantage of any of the loopholes in the provisions of the various tax laws with a view to minimizing total tax liability is referred to as......................

17. The period of time, when a Company is exempted from payment of tax is referred to as.................................

18. What is the reason for making provisions for deferred tax?

19. A computer program that simulates a Paper Worksheet for tax computation and displays multiple cells which together make up a grid consisting of rows and columns is called.......................

20. A situation where the tax payer arranges his financial affairs in a form that would make him pay the less tax is called...................

SECTION B: ATTEMPT QUESTION ONE AND ANY OTHER THREE QUESTIONS (60 Marks)

QUESTION 1

BOLING NIGERIA LIMITED

The Managing Director of Boling Nigeria Limited attended a workshop during which he came across the following tax matters under the Companies Income Tax Act CAP C21 LFN 2004:

- Payment of dividend by a Nigerian company
- Treatment of losses in the ascertainment of Total Profits, and
- Incentives, with particular reference to Research and Development

When he returned to the office, he requested the Finance Director to explain these matters to him. The Finance Director rather than explain, presented the Managing Director with two tables as shown below:

Table I

Information already agreed with the Federal Inland Revenue Service with respect to the 2012 Assessment year

	₦'000
Assessable Profits	26,000
Loss b/f	9,000
Balancing Charge	4,500
Capital Allowances	4,200

Table II

Year	Total Profit	Tax	Capital Reserves	Dividend Paid
	₦'000	₦'000	₦'000	₦'000
2009	10,000	3,000	-	5,000
2010	-	-	-	5,000
2011	3,000	900	4,000	5,000

Not satisfied, the Managing Director called a Tax Consultant, whom he met at the workshop, to explain the three items. The Tax Consultant then asked the Managing Director to send the two tables presented to him by the Finance Director.

As the Tax Consultant, you are required to:

a. Explain the provisions of the Companies Income Tax Act CAP C21 LFN 2004 dealing with the three areas of interest identified by the Managing Director. (10 Marks)

b. Using the information contained in Table I, determine the Tax Payable by the company in 2012 Assessment Year. (2½ Marks)

c. Based on the Dividend paid in the Assessment Years 2009 to 2011 in Table II, determine the adequacy of the taxes for all the years. (2½ Marks)

(Total 15 Marks)

QUESTION 2

Banony Insurance Nigeria Plc, a Company engaged in Non-Life business, had the following details of its transactions for the year ended 30 June 2012.

		₦
Premiums received		6,750.000
Dividends received (Net)		75,000
Profit on Sales of Fixed Assets		27,500
Re-Insurance premium		1,725,000
Subscription to Nigeria Insurance Association		25,000
Contributions to State Education Fund		75,000
Unexpired Risk 01-07-2011		1,375,000
Unexpired Risk	30-06-2012	1,550,000
Claims		600,000
Amount recovered under Re-insurance		375,000
Salary and other Administrative Expenses		725,000
Capital Allowances are:		
Initial Allowance		200,000
Annual Allowance		390,000
Balancing charge		27,500

You are required to:

a. Calculate the Tax payable by the Company for the relevant year of assessment. (10 Marks)

b. State the Requirements for Filing Annual Returns at the Federal Inland Revenue Service as stipulated by Company Income Tax Act 2004. (5 Marks)

(Total 15 Marks)

QUESTION 3

a. The following sales and purchases were made during the month of May 2012 by the understated Companies.

- Soji Limited supplied raw materials to Boyo Limited for ₦1,312,500

- Boyo Limited used the raw materials to manufacture finished products and sold them to Class Limited, a wholesaler for ₦1,968,750

- Class Limited sold the goods to a retailer Oyo Limited for ₦2, 362,500

- Oyo Limited sold the goods to the final consumers for ₦2,598,750.

You are required to:

Calculate the amount of VAT payable by each of the Companies, to the Federal Inland Revenue Service (FIRS) assuming that.

i. The prices quoted above are exclusive of VAT (6 Marks)

ii. The prices quoted above are inclusive of VAT (6 Marks)

b. Identify **THREE** services that are exempted from VAT and justify their exemption. (3 Marks)

(Total 15 Marks)

QUESTION 4

Zixony & Co Limited has been operating as a manufacturer of Plastic Baby Toys for a number of years. In recent years, however, the fortunes of the Company began to dwindle as a result of the activities of merchants who import container loads of Toys from the Far East and dump them in the market at prices below Zixony & Co. Limited's cost of production. The Company's year end has always been 31 December every year. The management then decided to carry out some modifications to the plant and machinery and go into the manufacture of a special type of high pressure pipe for the new industry. The Company then applied for and was subsequently granted Pioneer Status effective 1 January 2010.

The following information was extracted from the Company's records.

		Assessable Profit	Capital Allowance
		₦	₦
For the year ended	2006	475,000	105,000
" " " "	2007	206,000	90,250
" " " "	2008	(245,000)	80,205
" " " "	2009	(601,000)	45,210
" " " "	2010	(282,800)	175,250
" " " "	2011	950,000	120,750
" " " "	2012	1,867,050	108,010

An extension of the Initial Pioneer period was neither sought nor granted.
Assume a Tax Rate of 40% for all Tax years.

You are required to:

a. Evaluate the criteria for the grant of Pioneer Status. (5 Marks)

b. Calculate the Tax Liabilities for all the Relevant Years of Assessment. (10 Marks)

(Total 15 Marks)

QUESTION 5

Mrs. Adewale who acquired a two-wing Duplex at Festac Town at a cost of ₦50 million, later disposed one wing at ₦30 million and the part left was valued at ₦80 million. The cost of valuation was ₦5 million and the Estate Agent's commission was ₦3 million.

You are required to:

a. Calculate the Capital Gains Tax payable. 7 Marks)

b. Identify a Chargeable Person and the bodies to which Capital Gains taxes can be remitted. (4 Marks)

c. Describe Partial Disposal of an asset and how the cost of the Partial Disposal is calculated. (4 Marks)

(Total 15 Marks)

QUESTION 6

Transition adjustments of Extractive Bank Limited include a reclassification of some of its investment in Shares under "Long Term Investment" into "Fair Value through Profit or Loss (FVTPL)" valued at ₦20.15 bn. Actual cost was ₦25bn and Carrying Value under Nigerian GAAP (NGAAP) before reclassification was ₦21.15bn.

You are required to calculate the:

a. Deferred Tax on the unrealized Loss under NGAAP and give reasons (if any). (5 Marks)

b. Transition adjustment to the Carrying Value. (5 Marks)

c. Transition adjustment required to the Deferred Tax account with respect to the Financial Instruments. (5 Marks)

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART 1 MULTIPLE-CHOICE QUESTIONS

1. C
2. D
3. E
4. A
5. E
6. C
7. A
8. B
9. B
10. C
11. C
12. A
13. B
14. A
15. E
16. C
17. B
18. B
19. C
20. E

EXAMINERS' REPORT

The questions cover a wide spectrum of the syllabus and majority of the candidates attempted all the questions and performance was above average.

PART II SHORT-ANSWER QUESTIONS

1. Chargeable oil
2. G. Factor
3. Natural Gas
4. Transactions "At Arms Length"
5. Actual
6. Capital allowance
7. None
8. Liquidator
9. Deferred Tax
10. Assessable Profit
11. Qualifying Capital Expenditure
12. Remittance basis
13. Penultimate year
14. None
15. 10% per annum + Interest at Commercial Rate
16. Tax Avoidance
17. Tax Holiday
18. Timing Difference – To provide for Tax Liability as a result of Timing Difference
19. Spreadsheet
20. Tax Planning

EXAMINERS' REPORT

The questions reflect a good coverage of the syllabus and many of the candidates attempted almost all the questions. Performance was good.

SOLUTIONS TO SECTION B

QUESTION 1

(a) **XYZ & CO. CHARTERED ACCOUNTANTS**

May 18, 2013
The Managing Director
Boling Nigeria limited
Airport Road
Ikeja
Lagos

Dear Sir,

RE: TAX MATTERS

Further to our discussions at the last workshop, please find below our explanations on the three areas of interest as identified.

i. **PAYMENT OF DIVIDEND BY A NIGERIAN COMPANY** Section 19 of CITA stipulates
that:

Where a dividend is paid out of profits on which no tax is payable due to:

No total profits

Total profits which are less than the amount of dividend which is paid, whether
or not the recipient of the dividend is a Nigerian company, by a Nigerian company, the company paying the dividend shall be charged to tax at the existing rate of 30%, as if the dividend is the Total Profits of the company for the year of assessment to which the accounts relates out of which the dividend is declared.

This means that dividends paid out of exempted profits from pioneer company, capital or reserves will be treated as business profits. This is an anti-avoidance provision which seeks to exclude dividends from a pioneer company, and Revaluation Reserves, and other Reserves as Franked Investment Income.

ii. **TREATMENT OF LOSSES IN THE ASCERTAINMENT OF TOTAL PROFITS**

In ascertaining the Total Profits of any company, losses are deductible from the Total Assessable Profits from all sources.

The conditions to be met for losses to be so deductible as contained in Section 31 of CITA CAP C21 LFN 2004 are:

- the Board must be satisfied that the loss has been incurred by the company in any trade or business during any preceding year of assessment.
- the aggregate deduction from the assessable profits or income must not exceed the amount of the loss.
- the loss can be carried forward and deducted from the same trade or business without restriction on period.
- the loss sustained by a Non-resident Company that indigenizes its Nigerian operations shall be deemed to be a loss of the re-constituted company in its trade or business during the year of assessment in which it commenced business, and it shall be deducted from the profits of subsequent assessment year(s).

iii. **TAX INCENTIVES WITH PARTICULAR REFERENCE TO RESEARCH AND DEVELOPMENT:**

Section 26 (1), (2) and (3) stipulate that:

- In ascertaining the profits or loss of any company, from any source, chargeable to tax, there shall be deducted, the amount of reserve made out of the profits of that period.
- The deduction is 10% of Total Profits of the company for that year, before any deduction is made.
- Where the company or organisation is engaged in Research and Development for commercial purpose, the incentive is 20% Investment Tax Credit of the qualifying expenditure.

(b) **TAX PAYABLE IN 2012 ASSESSMENT YEAR**

	₦'000
Assessable profits	26,000
Add: Balancing charge	4,500
	30,500
Loss Relief	(9,000)
	21,500
Capital Allowance	(4,200)
Total Profits	17,300
Income tax payable @ 30%	5,190
Education tax 2% of ₦26,000.000	520
Total liability	5,710

2009 - Since the dividend payable is less than the Total Profits, the dividend will only suffer withholding tax in the hands of the recipients.

2010 - There was no Total Profits hence no Tax Payable. However dividend paid will be taken as business profits, and so will be regarded as Total Profits and taxed at 30%, resulting in the tax payable of ₦1,500,000 payable.

2011 - There was Total Profits of ₦3,000,000 and a Tax of ₦9,000,000. Since the Total Profits are less than the dividend paid, the dividend of ₦5,000,000 will be treated as Total Profits and will be taxed at 30%, which is ₦1,500,000.

This means that additional tax of ₦600,000 will be paid.

(c) Summary of taxes payable.

Year of Assessment	Total Profit	Dividend	Tax paid	Tax on Dividend	Tax underpayment
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**
2009	10,000	5,000	3,000	1,500	NIL
2010	-	5,000	-	1,500	1,500
2011	3,000	5,000	900	1,500	600
Total					**2,100**

We hope the above satisfies your enquiry. Please feel free to revert to us if you require further clarification.

Yours faithfully,

XYZ & Co.
Chartered Accountants'

EXAMINERS' REPORT

This is a Case Study question designed to test candidates' knowledge and understanding of the treatment of Total Profits and payment of dividend, treatment of Losses in Computing Total Profits, as well as their knowledge of the incentives related to Research and Development Expenditure. All the candidates attempted the question and performance was just average.

A major pitfall observed was the inability of most candidates to present their answers in a report format, as required of Case Study questions. Some candidates could not determine the correct assessment year whilst some candidates deducted the Balancing Charge from the Assessable Profit, instead of adding. Candidates are advised to prepare adequately for future examinations.

QUESTION 2

(a) **BANONY INSURANCE NIGERIA PLC**
TAX COMPUTATION FOR 2013 YEAR OF ASSESSMENT

	₦	₦
Premium Received		6,750,000
Less: Reinsurance Premium		1,725,000
		5,025,000
Less:		
Increase in unexpired Risk:		
Balance 01/07/2011	(1,550,000)	
Balance 30/06/2012	1,375,000	(175,000)
		4,850,000
Less:		
Claims Incurred		
Paid	600,000	
Recovered	(375,000)	225,000
		4,625,000

Less: Expenses		
Salary & Admin Exp.	725,000	
Subscription to NIA	25,000	
Contribution-to-State Education Fund	75,000	
		(825,000)
ASSESSABLE PROFIT		3,800,000
CAPITAL ALLOWANCE		
Initial Allowance	200,000	
Annual Allowance	390,000	(590,000)
		3,210,000
Add: Balancing Charge		27,500
Total Profit		3,237,500
Income Tax @ 30%		971,250
Tertiary Education Tax @ 2% of ₦3,800,000		76,000
Total Tax liability		1,047,250

b (i) Every company including a company granted exemption from incorporation shall, whether or not a company is liable to pay tax under this Act for a year of assessment, with or without notice from the service, file a self Assessment Returns with the service in the prescribed form at least once a year and such returns shall contain

- The Audited Accounts, Tax and Capital Allowances computation for the year of assessment and a true and correct statement, in writing, containing the amount of profit from each and every source computed thereof.

- A duly completed Self Assessment Form as may be prescribed by the service, from time to time attested to by a Director or Secretary of the company and attestation shall contain a true and correct statement of the amount of its true profits computed in respect of all sources, in accordance with CITA 2004 and any rules made there-under and that the particulars given in such returns are true and complete.

- Evidence of payment of the whole or part of the tax due into the Bank designated for the collection of the tax.

(iii) Subject to CITA 2004 or any regulation made there-under, the time of filing returns shall be:

- In the case of a company that has been in business for more than 18 months or more, not later than 6 months after the end of the accounting year.

- In the case of a newly incorporated company within 18 months from the date of its incorporation or not later than 6 months after the end of its first accounting period whichever is earlier.

- The form of returns shall be signed by a Director who must be the Chairman or the Managing Director, or the Secretary of the company.

EXAMINERS' REPORT

This is a question under the specialized class of businesses (in this case Insurance), within Corporate Taxation. Candidates were expected to compute Tax Payable, as well as state the requirements for Filing Annual Returns at the FIRS, under Companies Income Tax Act 2004 as amended.

A good number of the candidates attempted this question and performance was a little above average.

The major pitfall was the inability of some candidates to present their solutions to Part (a) of the question in the prescribed format.

Majority of the candidates displayed poor understanding of the requirements for filing Annual Returns with the FIRS as provided for by the amended Act.

Candidates are advised to be more painstaking in their coverage of topics in the syllabus while preparing for examinations.

QUESTION 3

a **COMPUTATION OF VAT PAYABLE**

(i)

Taxable Person	Sales Price (VAT Exclusive)	VAT at 5% collected (Output Tax)	VAT at 5% on Input (Input Tax)	Net VAT payable to FIRS
	₦	₦	₦	₦
Soji Ltd	1,312,500	65,625.00	-	65,625.00
Bayo Ltd	1,968,750	98,436.50	65,625.00	32,812.50
Class Ltd	2,362,500	118,125.00	98,437.50	19,687.50
Oyo Ltd	2,598,750	129,937.50	118,125.00	11,812.50
		412,125.00	282,187.50	129,937.50

(ii) The formula to be used to calculate VAT is 5/105 X sales price since the sales price is
inclusive of VAT

Taxable Person	Sales Price (VAT Inclusive)	VAT collected (Output Tax)	VAT on Input (Input Tax)	Net VAT payable to FIRS
	₦	₦	₦	₦
Soji Ltd	1,312,500	62,500	-	65,500
Bayo Ltd	1,968,750	93,750	62,500	31,250
Class Ltd	2,362,500	112,500	93,750	18,750
Oyo Ltd	2,598,750	123,750	112,500	11,250
		392,500	268,750	123,750

b. Services exempted for VAT

i. Medical services
ii. Exported services
iii. Plays and performances by educational Institutions as part of learning
iv. Services rendered by Community Banks and Mortgage Institutions.

EXAMINERS' REPORT

This is a straightforward question on Value Added Tax (VAT). Majority of the candidates attempted this question and performance was above average.

A major pitfall observed was the inability of some candidates to distinguish between Sales Prices quoted Exclusive of VAT and those quoted Inclusive of VAT.

Some candidates could not also distinguish between VAT exempted Goods as against VAT exempted Services.

Candidates are advised to prepare better for future examinations by working through several worked examples in the Institute's Study Packs and past editions of the Pathfinder.

QUESTION 4

(a) **ZIXONY & CO LIMITED**

Criteria for granting Pioneer Status

i. Application for Pioneer Status must be submitted to the Federal Executive Council

ii. The goods and services are required in public interest

iii. The industry must have favourable prospects of further development in Nigeria

iv. The goods and services are in existence, but have not been developed to a state suitable for economic development

v. The estimated cost of qualifying expenditure must be as follows:
(a) ₦50,000 in the case of an indigenously controlled company
(b) ₦150,000 in the case of any other company

vi. Goods and Services that qualify for the grant are usually on the Pioneer list

vii. The industry must give particulars of the assets on which qualifying capital expenditure will be incurred

viii. State the probable Production Day

viii. Specify the place in which the assets are to be situated

x. Give particulars of Loan and Share Capital of the company b.

ZIXONY & CO. LIMITED
COMPUTATION OF TAX LIABILITIES

Tax Year	Basis Period		₦
2007	1/1/2006 - 31/12/2006		
Assessable Profit			475,000
Less: Capital Allowance			(105,000)
Total profit			370,000
Income Tax @ 40%			148,000
Tertiary Education Tax @ 2% of assessable profit			9,500
Tax Liability			157,500
PENULTIMATE YEAR I			
2008 The higher of Actual	1/1/2008 - 31/12/2008	(245,000)	
Preceeding year	1/1/2007 - 31/12/2007		
		206,000	
Assessable profit			206,000
Less: Capital allowances			
			90,250)
Total Profit			115,750
Income Tax @ 40%			46,300
Tertiary Education Tax @ 2% assessable profit			4,120
Total Liability			50,420
2009	1/1/2009 – 31/12/2009		
	Loss for the year		(601,000)
	Loss B/F		(245,000)
			(846,000)
Terminal Capital Allowance	1/1/2008 – 31/12/2008		80,205
	1/1/2009 – 31/12/2009		45,210
			125,415

ZIXONY LIMITED

The terminal Capital Allowance is available for carry backward for five (5) years to be recouped from available Total Profit of those years. Any amount not recouped within the five years period is lost. The effect of the carried back allowance is a refund of tax equal to the amount recouped, multiplied by the tax rate.

The terminal unutilized Capital Allowance in this case can be carried backwards and relieved from available profits for the preceeding years – up to the fifth year, before the year of permanent cessation.

Effect of the carry-back:

Year of Assessment	₦	₦
2008		115,750
Total profit		
Terminal capital allowance	125,415	
Amount recouped	(115,750)	(115,750)
	9,665	
Tax refundable (₦115,750 x 40%)		46,300
2007		370,000
Total profit		
Terminal capital allowance	9,665	
Amount recouped	(9,665)	
Tax refundable: ₦9,665 @ 40%		3,866

Production Day 1/1/2010

Pioneer period 1/1/2010 - 31/12/2012

Aggregate Profit/Loss of Pioneer Period

1/1/2010 - 31/12/2010	(282,800)
1/1/2011 - 31/12/2011	950,000
1/1/2012 - 31/12/2012	1,867,050
Net profit of Pioneer Period	2,534,250

This profit is exempted from tax

ZIXONY LIMITED

Accumulated Capital Allowance of Pioneer period available for absorption after Pioneer period

		₦
	2010	175,250
	2011	120,750
	2012	108,010
Amount carried to post Pioneer Period		404,010

EXAMINERS' REPORT

This question tests the candidates' knowledge and understanding of the provisions guiding the grant of Pioneer Status to Companies operating in or desiring to operate in Nigeria. It tests candidates' ability to compute the Tax Liabilities of a Company already under the Pioneer Status.

About half of the candidates attempted the question.
Performance was good for part (a) of the question, but very poor for part (b).

Candidates' commonest pitfall was their inability to identify correctly the relevant Years of Assessment vis a vis the Profit/Loss figures given. Many candidates did not know how to treat the resulting Capital Allowance, whilst some still generated Tax Payable during the Pioneer period.

Candidates are advised to identify the technical principles being examined, before proffering solutions.

QUESTION 5

(a) MRS ADEWALE

CALCULATION OF CAPITAL GAINS TAX PAYABLE

	₦	₦
Sales proceeds		30,000,000
Deduct:		
Cost of valuation	5,000,000	
Estate Agents commission	3,000,000	(8,000,000)
Net proceeds		22,000,000
Less: Apportioned cost (W. 1)		(13,636,364)
Capital Gains		8,363,636
Capital Gains Tax @ 10%		836,364

Workings

Cost of disposed part $= \frac{A}{A+B} \times$ ₦50,000,000

Where A = ₦ 30,000,000 → Sales proceeds of the disposed part
and B = ₦80,000,000 → market value of the undisposed part

$= \frac{₦30,000,000}{₦30,000,000 + ₦80,000,00} \times$ ₦50,000,000

= ₦13,636,364

b. Chargeable persons and bodies to which Capital Gains Tax can be remitted

	Chargeable persons	Bodies for remittance
(i)	Corporate bodies	Federal Inland Revenue Service
(ii)	Individuals	State Board of Internal Revenue
(iii)	Residents of Abuja	Federal Inland Revenue Service
(iv)	Non-residents	Federal Inland Revenue Service

c. (i) Partial disposal of an asset occurs where a person acquired a set of properties or articles at a time, but disposed them in parts or bits at different times. Any part disposed of at a time is regarded as partial.

(ii) The cost to be apportioned to the disposed part shall be in the proportion that the consideration for the disposal bears to the total value of the whole asset on the date of disposal.

(iii) The value of the whole asset on that date is the consideration received in respect of the part disposed plus the market value of the part of the asset which remains undisposed.

(iv) The formula for the computation of the part disposed of in a Part Disposal is:

$$\frac{A}{A + B} \times C$$

Where A is Sales proceeds of the disposed part
B is Market value of the undisposed part
and C is initial cost of acquisition of the whole Asset

EXAMINERS' REPORT

The question tests candidates' knowledge and understanding of some of the provisions of the Capital Gains Tax Act, CAP C1 LFN 2004.

A good number of the candidates attempted the question and displayed good understanding and performance was above average.

The only pitfall was the inability of some candidates to correctly identify a chargeable person and the relevant bodies to which such tax should be remitted.

Candidates are advised to work through several past questions in the Institute's Pathfinders as well as examples in the Study Packs.

QUESTION 6

(a) Under the (NGAAP) (Nigerian "Generally Accepted Accounting Practices"), the unrealised loss on the Investment is ₦3.85bn (₦25bn – ₦21.15bn). Where a loss on disposal of investment constitutes an allowable expense, the value of the Deferred Tax Asset will be ₦1.155b and will be available for use in the future as a relief, when the loss arises.

(b) The value of the Transition Adjustment of the Carrying Value is ₦1bn (₦21.15bn – ₦20.15bn)

The accounting entries will be:

(i) Dr. Financial Asset at Fair Value through Profit or Loss ₦21.15bn
Cr. Long Term Investment

(ii) Dr. Retained Earnings/Reserves
(With Loss on Financial Asset at Fair Value through Profit or Loss ₦1.0bn
Cr. Financial Asset at Fair Value through Profit or Loss ₦1.0bn

(c) Transition adjustment required to the Deferred Tax Account with respect to the Financial Instrument.
(₦25bn – ₦20.15bn) x 30% = ₦1.46bn

This is the Deferred Tax required since Financial Investments classified as Fair Value Through Profits or Loss (FVTPL) is taxable under the Companies Income Tax Act CAP C21 LFN 2004, as Trading Income rather than Capital Gain.

EXAMINERS' REPORT

This question examines candidates' knowledge of some of the provisions of the International Financial Reporting Standards (IFRS) as they impact on Taxation with particular reference to Deferred Taxation.
Only about 5% of the candidates attempted this question and performance was very poor.

It was clear that candidates were yet to comprehend the current global implications and relevance of IFRS, particularly as it impacts on Taxation issues.
Candidates are advised to pay attention to current issues - IFRS as it relates to taxation.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II – MAY 2013

PUBLIC SECTOR ACCOUNTING AND FINANCE

Time Allowed: 3 hours

SECTION A: PART I ATTEMPT ALL QUESTIONS (20 Marks)

MULTIPLE-CHOICE QUESTIONS

Write ONLY the alphabet (A, B, C, D or E) that corresponds to the correct option in each of the following questions/statements:

1. Which of the following is a source of oil revenue in Nigeria?

   A. Grants and Aids
   B. Royalties on Production
   C. Loans
   D. Rent on Government Properties
   E. Returns on Investments

2. The principle of revenue allocation which requires that growth and development should be spread in order to reduce serious inequality in the Federation is the principle of

   A. National Interest
   B. Equality of States
   C. Even Development
   D. Population
   E. Equal Access to Development

3. Which of the following is **NOT** a member of Multilateral Creditors?

   A. International Monetary Fund
   B. International Financial Corporation
   C. Official Development Assistance
   D. African Development Bank
   E. International Development Assistance

4. A tax imposed as a given percentage of the value of the item being taxed is

   A. Ad Valorem Tax
   B. Specific Tax
   C. Capital Gains Tax
   D. Import Duty
   E. Excise Duty

5. Which of the following is **NOT** an economic role of a Government?

   A. Creation and maintenance of social and economic infrastructure
   B. Redistribution of income
   C. Reallocation of resources
   D. Promotion of macroeconomic objectives
   E. Curbing insecurity in the Nation

6. A debt system of taking a new loan to pay off an existing one, by a nation is known as

   A. Debt conversion
   B. Debt rescheduling
   C. Debt refinancing
   D. Public debt
   E. Debt cancellation

7. Debts for which Sinking Funds have been provided in order to reduce the risk of default are referred to as

   A. Funded debts
   B. Unfunded debts
   C. Floating internal debts
   D. Project-tied loans
   E. Trade debts

8. Which of the following is an advantage of the Net Present Value?

   A. It takes into consideration time value of money
   B. It disregards total cash inflows and so could favour projects
   C. It does not consider risks
   D. It is relatively more difficult to calculate
   E. It relies heavily on the estimation of Cost of Capital

9. The internal debt of a country is usually contracted through which of the following?

   A. Promissory Note creditors
   B. Treasury Certificates
   C. Private sector creditors
   D. Bilateral creditors
   E. African Development Bank

10. The manipulation of government revenue and expenditure in order to influence economic activity is referred to as

    A. Income policy
    B. Government policy
    C. Fiscal policy
    D. Monetary policy
    E. Stabilisation policy

11. Which of the following is **NOT** one of the moneys accruing to the Capital Development Fund as established by Section 25 of the Finance (Control and Management) Act of 1958?

    A. External loan
    B. Internal loan
    C. External grant
    D. Excise Duty
    E. Contribution from the Consolidated Revenue Fund

12. To facilitate the processing of payment of sums due on contracts, the following items should be ascertained and attached **EXCEPT**

    A. Copy of minutes of Tenders Board awarding the contract
    B. Copy of Letter of Award and Contract Agreement
    C. Bill or Invoice submitted by the firm requesting for payment
    D. Completion Certificate of work done
    E. Irrevocable Letter of Commitment to the contractor

13. Which of the following is responsible for "continuous and prepayment audit" in a Ministry and/or Department?

A. External Auditor
B. Auditor General
C. Internal Auditor
D. Accountant General
E. Accounting Officer

14. Which of the following is **NOT** a tool of external control of expenditure?

A. The 1999 Constitution as amended
B. Treasury Board
C. Public Accounts Implementation Tribunal
D. Quarterly Allocation of Resources
E. Audit Alarm

15. A procuring entity may for reasons of economy and efficiency, engage in procurement by means of restricted tendering if

A. The time required to examine and evaluate a large number of tenders is disproportionate to the value of the goods, works and services to be procured
B. The cost required to examine and evaluate a large number of tenders is disproportionate to the value of the goods, works and services to be procured.
C. The procedure is used as an exception rather than the norm
D. The goods, works or service are available only from a limited number of suppliers and contractors
E. The procedure is adopted for high valued contracts

16. According to the Public Procurement Act 2007 Section 55, Public Property is defined as resources in the form of tangible and non tangible assets and include the following **EXCEPT**

A. Acquired as a gift or through Deeds
B. Created through private expenditure
C. Created through public expenditure
D. Acquired on Financial Instruments (including shares, stocks, bonds etc)
E. Acquired in respect of intellectual or proprietary rights

17. Which of the following is **NOT** a member of the Federation Accounts Allocation Committee (FAAC)?

A. Permanent Secretary (Ministry of Finance)
B. Federal Minister of Finance
C. Accountant General of the Federation
D. Commissioner for Finance of each State of the Federation
E. Two persons to be appointed by the President

18. Which of the following is **NOT** a function/power of the Fiscal Responsibility Commission?

A. Monitor and enforce the provisions of the Fiscal Responsibility Act in order to promote the national economic objective
B. Arrest and prosecute non-conformists to the provisions of the Act
C. Disseminate such standard practices including international good practice that will result in greater efficiency in the allocation and management of public expenditure, revenue collection, debt control and transparency in fiscal matters
D. Make rules for carrying out its functions under the Act
E. Undertake fiscal and financial studies, analysis and diagnosis and disseminate the result to the general public.

19. In accordance with International Public Sector Accounting Standard 31, Section 12, on 'Intangible Assets', which of the following is **NOT** a characteristic of Intangible Heritage Assets?

A. Legal or Statutory obligations may impose prohibitions or severe restrictions on disposal by sale
B. Their value may increase over time
C. Their value may decrease over time
D. Their value in cultural, environmental and historical terms is unlikely to be fully reflected in a financial value based purely on market price
E. It may be difficult to estimate their useful lives, which, in some cases could be several years.

20. Which of the following statements is **NOT** correct with respect to payment in the Public Sector?

A. When it is impractical to obtain receipts for petty disbursement, the beneficiary must inform the cashier verbally

B. When a payment to a firm is in doubt due to loss of relevant documents, the payee shall be made to issue a Certificate of Indemnity to indemnify the government against double payment

C. Where a payee is an illiterate, his or her mark must be witnessed by a literate

D. Any payment due to or receipted by any government officer in his official capacity shall be paid to the Treasury for which official receipt shall be obtained

E. When payments are made to a legal representative, authorities such as Power of Attorney shall be presented.

SECTION A: PART II ATTEMPT ALL QUESTIONS (20 Marks)

SHORT-ANSWER QUESTIONS

Write the answer that best completes each of the following questions/statements.

1. The authorisation granted by a legislative body to allocate funds for purposes specified by the legislative or similar body is known as ....

2. The public revenue of the Federation and moneys held in official capacity whether temporarily or otherwise and whether subject to any trust or specific allocation or not are referred to as.................

3. In accordance with IPSAS 19 on Provisions, Contingent Liabilities and Assets, a possible asset that arises from the past events and whose existence will be confirmed only by occurrence or non-occurrence of one or more uncertain future events, not wholly within the control of the entity, is known as ....

4. In appraising investment projects, using the Discounted Cash Flow (DCF) principles, which of the two main methods should prevail where there is a conflict of reason for choice, especially in the case of mutually-exclusive investment project?

5. In accordance with Section (162)(i) of the 1999 Constitution, a special account, into which are paid all revenue collected by the Government of the Federation, except proceeds from the Personal Income Tax of the Nigeria Police Force, Armed Forces, the Ministry of External Affairs as well as Residents of the Federal Capital Territory, Abuja is known as ....

6. As contained in Section 10 of IPSAS No. 25, the class of post-employment benefit plans, under which an entity pays fixed contributions into a separate entity (a fund) and will have no constructive obligation to pay further contributions, if the fund does not hold sufficient assets to pay all employee benefits in respect of service in the current or prior period is known as..........

7. The cycle of events which occurs sequentially every year where all monies to be spent and to be sourced by a government is termed ....

8. Enquiries commissioned by government to find out the cause or causes of an event, so that remedial actions may be taken is ....

9. In accordance with Financial Regulations (FR) No. 1120 (Year 2009) on security of cash overnight, the officer personally responsible for ensuring that the balance of cash with the cashier is locked in a strong-room or safe at the close of business daily is....................................

10. As contained in Section 24 (2) of the Public Procurement Act of 2007, the process by which a procuring entity, based on previously defined criteria, effects public procurements by offering to every interested bidder, equal simultaneous information and opportunity to offer the goods and works needed is known as ....

11. The excess of the Public Sector's spending over its revenue is referred to as ....

12. The principle of revenue allocation which compensates a State from which the bulk of government revenue is obtained is called..............

13. A development planning approach which focuses on a 15-20 year planning horizon is....................

14. Debt obligation which the government of a country contracts from the government of another country is.................

15. To determine the least cost of achieving a well-defined objective, the relevant project appraisal technique is the.................

16. The long-term Debt Instrument of government which enhances debt redemption is usually managed through the establishment of............

17. The institution vested with the statutory responsibility to take custody and manage Nigeria's foreign reserves is the........................

18. The document indicating the total and composition of government expenditure and sources from which such expenditure is expected to be financed in the course of the year is known as..................

19. The sharing of revenue among the jurisdictions at different levels of government is known as..................

20. The effects of an activity which are pleasant or profitable for other people who cannot be charged for such benefits are referred to as..................

SECTION B: ATTEMPT QUESTION ONE AND ANY OTHER THREE QUESTIONS (60 Marks)

QUESTION 1

OIL AND GAS FREE ZONE PROJECT

Tugeria is a member of the Organisation of Petroleum Exporting Countries (OPEC) by virtue of the fact that it is endowed with 'the black gold' in abundance. Consequent upon this fact, the country, through its Central Ministry of Commerce and Tourism, commissioned an American-based Free Zone Management Consultancy firm to undertake a feasibility study on the establishment of a Free Trade Zone, specifically dedicated for the Oil and Gas Industry. The study identified and recommended Ebute as a suitable location for the Free Zone project thus conferring the status of free port on the location since the government had begun the development of the complex. Literature issued by experts in the industry showed also, that the Ebute Oil and Gas Free Zone is the only Free Zone, in Africa, dedicated to Oil and Gas.

IMPACT OF THE PROJECT

On creation of the Zone, the Central Ministry employed Technical Managers to manage the Zone. The bidding system was used. However, the consultancy firm that earlier undertook the study as well as two other bidders (that are its sister companies/subsidiaries) were the only bidders. The selection of Technical Managers was done without advertising in any International Technical Journal. Bid price was quoted in US Dollars. Legal documentation and a statement of qualifications of the consultant to provide the service were jettisoned.

The project also led to an increased revenue yield to the Tugerian government because the Customs Service realised more duties and taxes paid on Free Zone goods imported into the mainland/customs territory. The Tugerian Port Authority realised more freight movement fees like harbour, ship and cargo dues, wharfage and container facility charges.

Furthermore, investment activities of companies in the Free Zone generated gainful employment opportunities which led to an improvement in the standard of living. In addition to this, the Free Zone witnessed increased economic activities which has so far resulted in a capital investment of about Tunerian ₦10 trillion on infrastructure and facility development. Other sectors that provide aids to trade such as banking, insurance, warehousing and transportation, to mention but a few, also experienced an upward surge in activities.

MAJOR AREAS OF CONCERN

Certain basic infrastructures that were part and parcel of this project, had been incorporated into the country's national budget every year from 2007 to 2011, but there was no visible evidence of such being executed. As a result of the disposition of the Board, the Technical Managers could not justify the huge provisions in the Budget. This was highly inimical to the quick achievement of the project objectives. A Free Zone without good roads, heliport, rail-link with other neighbouring towns and villages would not experience the desired rapid growth.

CONCLUSION

At the expiration of the up-coming four years, the procedure for the employment of the Consultant should be done through the open public tendering and competitive bidding.

You are required to:

a. Assess the ethical and legal issues involved as they relate to the Technical Managers. (5 Marks)

b. Analyse the **FOUR** major impacts occasioned by the execution of the Free Zone project. (8 Marks)

c. Evaluate how the major areas of concern highlighted in respect of the Technical Managers can be remedied. (2 Marks)

(Total 15 Marks)

QUESTION 2

The government of Kingsley State embarked on a road construction and maintenance in major cities of the State as part of developmental programmes. In the process, some costs were incurred by the government while some benefits equally accrued to the government as well as to the citizens from the project.

You are required to:

a. Analyse and evaluate the following in the context of the foregoing:

i. direct and indirect costs
ii. direct and indirect benefits. (10 Marks)

b. Assess the costs and benefits of the project to its immediate physical environment. (5 Marks)
(Total 15 Marks)

QUESTION 3

The Debt Management Office (DMO) was established by the Debt Management Office (Establishment) Act 2003.

You are required to:

a. Present any **TWO** powers and **THREE** functions of the DMO. (5 Marks)

b. Assess and evaluate the performance of the DMO in the last five years.
(10 Marks)
(Total 15 Marks)

QUESTION 4

The following is a list of some items (Revenue and Expenditure) in respect of Consolidated Revenue Fund (CRF) and other receipts of Federal Republic of Yobaria for the years ended 31 December 2011 and 2012 respectively:

	2011	2012
	₦'000	₦'000
Revenue received through the Statutory Federation Account Allocation	1,200	1,005
Total Internally Generated Revenue	690	610
Overhead cost	225	218
Personnel cost	1,305	1,061
Value-Added-Tax (VAT)	380	290
Opening balance of Capital Receipts as at 1 January	50	50
Grants and reimbursement from Developed Nations	55	50
External loans	675	577
Consolidated Revenue Fund charges	325	268

You are required to:

a. Prepare Consolidated Revenue Fund (CRF) and determine the surplus of Revenue over Expenditure or Deficit of Expenditure over Income. (10 Marks)

b. Identify any **FIVE** sources of revenue that are credited to Consolidated Revenue Fund (CRF) other than those listed in the question above. (5 Marks)

(Total 15 Marks)

QUESTION 5

The following statements were extracted from the published Financial Statements of National Institute of Enterprise for the period ended 31 December 2012:

NATIONAL INSTITUTE OF ENTERPRISE
STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012

	2012		2011	
	₦	₦	₦	₦
STATEMENT OF CHANGES IN ASSETS				
Non-Current Assets		371,835,382		237,094,064
Library Books		9,675		9,675
		371,845,057		237,103,739
CURRENT ASSETS				
Inventories	3,435,261		3,866,928	
Receivables and Prepayments	11,292,106		7,621,220	
Cash and Cash Equivalents	57,889,451		84,591,193	
	72,616,818		96,079,341	
CURRENT LIABILITIES				
Payables and Short-Term Borrowings	(8,704,771)		(9,987,791)	
		63,912,047		86,091,550
Net Assets		435,757,104		323,195,289

NATIONAL INSTITUTE OF ENTERPRISE
STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012

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		63,912,047		86,091,550
Net Assets		435,757,104		323,195,289

NATIONAL INSTITUTE OF ENTERPRISE
STATEMENT OF FINANCIAL PERFORMANCE FOR THE PERIOD ENDED 31 DECEMBER 2012

	₦	₦
REVENUE	2012	2011
Annual grant from government entities	87,659,273	60,067,130
Other revenue	1,657,069	231,454
Total revenue	89,316,342	60,298,584
EXPENSES		
Education	20,316,310	19,174,456
General public services	47,670,155	35,295,896
Finance costs	5,279,384	1,712,737
Total expenses	73,265,849	56,183,089
Surplus for the period	16,050,493	4,115,495
Attributable to:		
Owners of the controlling entity	16,050,493	4,115,495
Minority interest	-	-

16,050,493	4,115,495

You are required to:

a. Analyse and evaluate the relevant ratios in conformity with the modern presentation requirement of IPSAS No. 1. (10 Marks)

b. Assess the significance of the stated ratios to Management. (5 Marks)
(Total 15 Marks)

QUESTION 6

In a free enterprise economic system with the concept of the 'invisible hand', the price mechanism is expected to be capable of moving the economy to great heights.

You are required to:

a. Describe the concept of the "invisible hand". (3 Marks)

b. Explain the role of government in a modern economy. (12 Marks)
(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

1. B
2. C
3. C
4. A
5. E
6. C
7. A
8. A
9. B
10. C
11. D

12. E
13. C
14. B
15. D
16. B
17. A
18. B
19. C
20. A

EXAMINERS' REPORT

The questions test candidates' understanding substantial parts of the entire syllabus.

The questions were fairly attempted by the candidates and performance was good.

PART II SHORT-ANSWER QUESTIONS

1. Appropriation
2. Public moneys/Fund
3. Contingent asset
4. Net Present Value
5. Federation Account
6. Defined Contribution Plan
7. Budgeting Process
8. Board of Enquiry
9. Sub-Accounting Officer
10. Open-Competitive bidding/tender

11. Fiscal deficit/Budget deficit

12. Derivation

13. Perspective planning /Long-term Planning

14. Bilateral credit /debt/loan

15. Cost Effectiveness Analysis (CEA)

16. Sinking Fund

17. Central Bank of Nigeria (CBN)

18. Budget

19. Vertical Revenue Allocation

20. Externalities /External benefits /External economies

EXAMINERS' REPORT

The questions test candidates' understanding of candidates of the syllabus. The questions were spread over the entire syllabus.

The questions were well attempted by the candidates and performance was good. Some of the candidates could not differentiate between 'Appropriation' and 'Budget ' and could not appreciate that debt instruments of government are generally redeemed through the creation of a sinking fund. Candidates are advised to prepare adequately for future examinations.

SOLUTIONS TO SECTION B

QUESTION 1

(a) The ethical issues involved as they relate to the Technical managers are:

i. The entire population from which the preferred bidder selected as Technical Managers was picked are related parties which could impair objectivity.

ii. Advertisement of the process was not done in both national and international journals.

iii. Bid price was quoted in US$ instead of in the Tugerian local currency.

iv. Legal documentation of the entire award was jettisoned.

v. Statement of Qualifications' of the Consultants to provide the service was jettisoned.

(b) The four major impacts occasioned by the execution of the project by the Tugerian government are:

(i) There was an increase in revenue yield to the government
(ii) The project generated gainful employment opportunities
(iii) The project led to increased economic activities
(iv) Other sectors that aid trade experienced a surge in activities

(c) The major areas of concern highlighted in the passage can be remedied by:

(i) Open public tendering /competitive bidding
(ii) Communication links with neighbouring towns and villages should be improved.

EXAMINERS' REPORT

The case study tests candidates' understanding of ethical and legal issues involved in public procurement procedure as contained in the Public Procurement Act, 2007, major impact of the creation of an Oil & Gas Export Processing Zone by a country and recommendation of solution for the scenario created.

The candidates showed a good understanding of the concepts embedded in the case study and performance was good.

Candidates are advised to prepare as well for future examinations.

QUESTION 2

The question is all about road construction and maintenance project in Kingsley State. The question therefore requires a public project appraisal as it relates to:

(i) Direct and Indirect Costs:

Direct costs are costs that can be identified specifically with a particular project. In this case, the reference is to the road construction and maintenance project executed in major cities in Kingsley State. Direct costs include:

- Salaries, wages and fringe benefits of workers directly involved in the road construction and maintenance project.
- Costs of materials and supplies for the project
- Costs of travel, consultancy services, purchase/hiring of equipments /machineries, etc.

Indirect costs are those costs that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with the project in question. These include:

- Overhead costs such as costs of utilities, rent, fuel, space, security, etc
- Depreciation on buildings and equipments
- Interest Costs
- Salaries of personnel engaged in a broad range of support services of the inspecting organisation.

(ii) Direct and Indirect Benefits

Direct benefits are those output (benefits) characteristics that either flow or will flow from the project of road construction and maintenance when it is fully executed or completed. Direct benefits are sometimes referred to as explicit benefits. These benefits include the following:

- Reduction in travel time
- Reduction in traffic congestion and hence increased comfort of driving
- Reduction in road accidents
- Reduction in the rate of wear and tear of vehicles

Indirect benefits are extra output (benefits) flows over and above those that may be directly associated with the project. Their values may or may not depend on market prices. Indirect benefits are sometimes referred to as implicit benefits. Such benefits include:

- Employment opportunities in the process of construction
- Improved accessibility could encourage economic activities around the newly constructed/improved road network in the cities.

(b) Impact on the Physical Environment:

Most public projects like road construction and maintenance usually impact on their immediate physical environment. The impact which could be positive (benefits) or negative (costs) are generally referred to as spill-over effects or externalities.

The benefits in this case include the following:

- Beautification of the immediate environment
- Urban renewal arising from good roads
- Promotion of economic opportunities due to improved accessibility to the area
- Improved opportunities in the cities where the projects are executed.

The costs associated with the project as they relate to immediate environment are:

- Risk to human lifes in the process of crossing the road
- Costs of restoring the properties destroyed in the process of construction i.e, widening the road
- Heavy traffic could give rise to noise pollution to the immediate environment
- The disturbance to traffic flow in the process of road construction.

EXAMINERS' REPORT

The question tests candidates' understanding of the methodology of Cost Benefit Analysis (CBA). Candidates are to identify and analyze the elements of costs and benefits associated with public road construction and maintenance. The likely impacts of the project on the immediate physical environment are also to be analyzed by the candidates.

The question was fairly attempted as a little above 50% of the candidates answered it. The pass rate was average. Majority of the candidates failed to provide relevant definitions on notion of direct and indirect costs/benefits.

Candidates need to be much more exposed to the practical application of CBA in public project appraisal. In particular, they need to demonstrate clear understanding of the types of costs and benefits identifiable with a public project as well as its spill-over effects (i.e., externalities) on the environment.

QUESTION 3

(a) Powers of the Debt Management Office (DMO) are as follows:

(i) To issue and manage the Federal government loans publicly issued in Nigeria upon such terms and conditions as may be agreed between the Federal Government and the Office.

(ii) To issue guidelines for the smooth operation of the debt conversion programme of the Federal Government.

(iii) To do such things which, in the opinion of the Board, relate to the management of the external debts of the Federal government.

Functions of the Debt Management Office are the following:

(i) Maintain a reliable database of all loans taken or guaranteed by the Federal or State government or any of their agencies.

(ii) Prepare and submit to Federal Government, a forecast of loan service obligations for each financial year.

(iii) Prepare and implement a plan for the efficient management of Nigeria external and domestic debt obligations at sustainable levels compatible with desired economic activities for growth and development, and participates in negotiations aimed at realising these objectives.

(iv) Verify and service external debts guaranteed or directly taken by the Federal Government.

(v) Set guidelines for managing Federal government financial risks and currency exposure with respect to all loans.

(vi) Advise the Federal Government on the restructuring and re-financing of all debt obligations.

(vii) Submit to the Federal Government, for consideration in the annual budget, a forecast of borrowing capacity in local and foreign currencies.

(viii) Prepare a schedule of any other Federal Government obligations such as trade debts and other contingent liabilities, both explicit and implicit, and provide advice on policies and procedures for their management.

(ix) Establish and maintain relationships with international and local financial institutions, creditors and institutional investors in government debts.

(x) Collect, collate, disseminate information, data and forecasts on debt management with the approval of the board.

(xi) Administer the debt conversion programme of the Federal Government.

(b) Prior to the establishment of the Debt Management Office in 2003, Nigeria's debt profile was uncoordinated thus it led to inefficiencies in the country's debt profile. This problem was accentuated by the proliferation of agencies within the Federal Ministry of Finance and the Central Bank of Nigeria.

Consequent upon the operational inefficiency and poor coordination, the Debt Management Office Establishment (Etc) Act was passed in 2003. As an autonomous body, the DMO is expected to improve upon the country's past shortcomings so as to:

- Enhance good debt management practices aimed at reducing the debt stock and cost of public debt servicing
- Prudently raise finance to fund government deficits and manage risks in the medium- and long-term
- Achieve positive impact on the overall macroeconomic management, including monetary and fiscal policies
- Consciously avoid debt crisis
- Improve the nation's borrowing capacity and its ability to manage debt efficiently

- Project and promote the image of Nigeria as a disciplined and organised nation

- Provide opportunity for professionalism and good practice in nation building.

Within the last five years, the Debt Management Office can be said to have been able to achieve the following:

- The Office has successfully updated the framework for monitoring developments in Nigeria's debt profile thus making its composition and structure to be more favourable.

- The Debt Management Office has been able to broaden Debt Sustainability Analysis (DSA) to include State Governments' domestic debt.

- The Debt Management Office has ensured that Nigeria's debt profile has remained at low risk of debt distress through constant debt servicing and exit from the Paris Club.

- The Debt Management Office has been able to build up the requisite skills in debt management through its Debt Data Reconstruction (DDR) programme.

- The Debt Management Office, for the first time in the history of debt management in Nigeria, successfully issued the sovereign debt in the International Capital Market (ICM) in 2011. This achievement has enabled Nigeria to substantially attract foreign investments into the country for growth and development.

EXAMINERS' REPORT

The question tests candidates' understanding of the powers, functions as well as the role and assessment of the performance of the Debt Management Office (DMO) in Nigeria in the last five years.

Though a topical issue but, interestingly, only a few candidates attempted it. Performance was below average. A few of the candidates that attempted it displayed a shallow knowledge of the role of the DMO in the management of the country's debt profile within the last five years hence their performance was poor.

Candidates are advised to be much more exposed to practical accounting and fiscal issues on the country's economy, moreso that they are aiming to become financial experts and analysts.

QUESTION 4

(a)

Federal Republic of XYZ
Consolidated Revenue Fund (CRF) for the year ended 31 December 2011 and 2012

	2011	2012
	₦'000	₦'000
Total Internally Generated Revenue	690	610
Revenue allocation from Federation Account	1,200	1,005
Value Added Tax (VAT)	380	290
Total Recurrent Revenue	2,270	1,905
Consolidated Revenue Fund Charges	325	268
Personnel Cost	1,305	1,061
Overhead Cost	225	218
Total Recurrent Expenditure	(1,855)	(1,547)
Surplus of Revenue over Expenditure	415	358

(b) The sources of revenue that are credited to the CRF other than those listed in the question are:

(i) Direct Taxes
(ii) Mining
(iii) Earnings and Sales
(iv) Rent of Government Properties
(v) Interest and Repayment
(vi) Reimbursements (from States and Local Governments)
(vii) Sale of Armed Forces properties.

EXAMINERS' REPORT

The question tests the quantitative ability of candidates on the preparation of the Consolidated Revenue Fund (CRF) and identification of sources of revenue that flow into CRF.

Majority of the candidates attempted it. Performance in 4(a) was good, however, 4(b) was poorly attempted as only a few of the candidates could identify five other sources of revenue that are credited into the CRF other than those listed in the question. Common pitfalls observed include:

- Inability to interpret the word 'respectively' appropriately in the context of the data provided
- Inability to identify direct taxes, mining, earnings and sales, rent of government properties, interest and repayment, reimbursements (from States and Local Governments), Sale of Armed Forces properties as the relevant sources required.

Candidates are advised to be conversant with Revenue Heads of government.

QUESTION 5

RATIO ANALYSIS OF NATIONAL INSTITUTE OF ENTERPRISE

(a) (i) LIQUIDITY RATIOS

		2012	2011
A	Current Ratio = Current Asset / Payables	72,616,818 / 8,704,771	96,079,341 / 9,987,791
		8.34 : 1	9.62: 1
B	Acid Ratio = Cash and Receivables / Payables	69,181.557 / 8,704,771	92,212,413 / 9,987,791
		7.94:1	9.23:1

Ii SUBVENTION RATIOS

		2012	2011
A	Increase in Non-Current Assets: Subvention =	371,835,382- 237,094,064 / 87,659,273	
		1.53:1	
B	Decrease in Current Assets: Subvention =	72,616,818 - 96,079,341 / 87,659,273	
		0. 2.67 : 1	
C	General Public Service: Subvention =	47,670,155 / 87,659,273	35,295,896 / 60,067,130
		0.54 :1	0.587 :1
D	Finance Cost: Subvention =	5,279,384 / 87,659,273	1,712,737 / 60,067,130
		= 0.06 : 1	= 0.028 : 1
E	Total Revenue: Subvention =	89,316,342	60,298,584

			87,659,273	60,067,130
			= 1.0189 : 1	= 1.004 : 1
F	Other Revenue: Subvention =		1,657,069	231,454
			87,659,273	60,067,130
			= 0.018 : 1	= 0.004 : 1
G	Surplus: Subvention =		16,050,493	4,115,495
			87,659,273	60,067,130
			0.183 : 1	0.068 : 1
iii	REVENUE RATIOS			
A	Surplus: Total Revenue	=	16,050,493	4,115,495
			89,316,342	60,298,584
		=	0.180 : 1	0.068 : 1
B	Current Liabilities :Total Revenue	=	8,704,771	9,987,791
			89,316,342	60,298,584
			0.097 : 1	0.166 : 1

(b) (i) **Liquidity Ratio**

Current Ratio determines whether the current assets can pay current liabilities.

Acid Ratio determines how cash and receivables can repay current liabilities.

(ii) **Subventions Ratio**

Increase in Non-Current Assets: Subvention – It is to determine whether subvention was used in the acquisition of non-current assets.

Decrease in Current Asset: Subvention – This ratio tests the percentage of current asset used from subvention. In this case, none was used.

General Public Service: Subvention– This ratio is to determine the percentage of subvention used to pay for General Public Service.

Finance Cost: Subvention– This is to determine the percentage of subvention used for finance cost.

Total Receivable: Subvention– This ratio is to determine percentage of subvention to Total Receivables.

Other Revenue: Subvention– This is to determine the percentage of other Revenue to Subvention.

Surplus: Subvention– This reveals the percentage of surplus to subvention.

(iii) **Revenue Ratios**

Surplus: Total Revenue:
This is to determine the percentage of surplus to the total revenue.

Current Liabilities: Total Revenue:
This is to determine the percentage of current liabilities to the total revenue.

EXAMINERS' REPORT

The question tests the computational and interpretational ability of candidates on financial ratios.

Majority of the candidates attempted the question and performance was below average. The commonest pitfall was the inability of the candidates to identify that institutions of learning rely on subventions or grants to survive hence they could not compute the relevant ratios appropriate to the educational Industry.

Candidates are advised to cover the entire syllabus and study Pathfinders and other relevant texts when preparing for future examinations.

QUESTION 6

(a) Invisible hand, a concept introduced by Adam Smith, means the working of markets which allows economic activities to be co-ordinated without any central organisation. The self interest of economic agents working through markets induces people to produce goods and services to meet the needs of people whom they may never meet and for whom they need feel no goodwill. Equally, the market system allows people to satisfy their own wants.

(b) **Role of government in a modern economy:**

(i) Provision of public goods: Goods such as roads, street light etc have the attributes of non-divisibility, non-excludability and nonappropriability and therefore amenable only to provision by the public sector.

(ii) Problem of externality: The negative spill-over effects or externalities of economic agent on others and the society at large need be controlled. Such negative externalities include environmental, marine and atmospheric pollution. Government is necessary to levy taxes on the economic agents that cause the pollution.

(iii) Maintenance of law and order: For the smooth running of economic activities to take place, it is necessary to have government that will maintain law and order.

(iv) Market imperfection/failure: The existence of market imperfection like monopoly cannot allow the price mechanism to function properly in a modern economy. As a solution to the problem, the existence of government becomes inevitable to control monopoly and resolve other rigidities.

(v) Economic stability and growth: It is not possible for price mechanism alone to achieve the goals of economic stability and growth. A price mechanism driven economy is likely to be prone to inflation. Government is necessary to put in place appropriate measures – fiscal, monetary etc.- to control inflation and ensure growth.

(vi) Divergence between private benefit and social cost: In a free enterprise economy where the price mechanism co-ordinates economic activities, there is no harmony between private benefit and social cost. It is necessary to have a government that will introduce taxation and subsidy that will harmonise the two.

EXAMINERS' REPORT

The focus of the question is on the price mechanism and its underlying concept of the "invisible hand." The requirements of the question include showing understanding of the notion of the 'invisible hand' and providing the bases for government intervention in the economy.

Majority of the candidates attempted the question and the general performance was well above average. Virtually all the candidates could only see the concept of 'invisible hand' in the context of laws of supply and demand. They did not make much reference to the idea of self-interest of economic agents as propounded by its proponent, Adam Smith. However, candidates were able to identify and explain the bases for government intervention in the economy.

Candidates are advised to have deeper understanding of the notion of the 'invisible hand' in its right perspective. They may need to consult basic texts in economic theory, paying particular attention to the assumptions and working of the invisible hand.