



**THE INSTITUTE OF CHARTERED ACCOUNTANTS
OF NIGERIA**

PATHFINDER

MAY 2014 P. E. II EXAMINATION

Question Papers

Suggested Solutions

Plus

Examiners' Reports

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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 edited so that some principles or their application may be more clearly demonstrated.

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

NOTES

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

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TABLE OF CONTENTS

SUBJECT	PAGES
FINANCIAL REPORTING AND ETHICS	3 - 42
STRATEGIC FINANCIAL MANAGEMENT	43 - 73
ADVANCED TAXATION	74 - 101
PUBLIC SECTOR ACCOUNTING & FINANCE	102 - 123

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II - MAY 2014

FINANCIAL REPORTING & ETHICS

Time Allowed: 3 hours

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

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. Corporate governance failures can be traced to the following **EXCEPT**
 - A. Poorly designed remuneration packages
 - B. Excessive use of share options
 - C. Aggressive earnings management to achieve share price targets
 - D. Window-dressing situations
 - E. Ability to earn the target earnings
2. Ethical decision making in business that emphasises consequences is **PRIMARILY** concerned with
 - A. Profit
 - B. Fiduciary duty
 - C. Cost-risk adjustment
 - D. Benefits
 - E. Environmental impact
3. In taking a business decision, an executive should give the least consideration to issues relating to
 - A. Market values
 - B. Legal values
 - C. Social values
 - D. Environmental values

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- E. Personal values
4. The report that came into being as a reaction to continuing public agitation against the excessive remuneration and perquisites which directors are paying themselves is the
- A. Hampel report
 - B. Turnbull report
 - C. Cadbury report
 - D. Guinness report
 - E. Greenbury report
5. An action taken to expose a misconduct, alleged dishonest or illegal activity occurring in an organisation is called
- A. Crime report
 - B. Ethical misconduct report
 - C. Whistle-blowing
 - D. Ethical safeguard
 - E. Crime prevention
6. A company's Memorandum of Association stipulates the following **EXCEPT**
- A. Name of company
 - B. The number of members
 - C. Restriction on the powers of the company
 - D. Whether the company is a private or public company
 - E. The liability of its members
7. An impairment review on a previously revalued asset resulted in an impairment loss of ₦360,000. The existing revaluation surplus relating to this is ₦500,000. What is the amount of impairment loss to be shown in the income statement in the current year?
- A. Nil
 - B. ₦140,000
 - C. ₦360,000
 - D. ₦500,000
 - E. ₦720,000

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8. A professional duty to disclose confidential information is justified by any of the following **EXCEPT** when it is
- A. In response to an ethical or disciplinary inquiry by a regulatory body
 - B. To protect the professional interests of the accountant in legal proceedings
 - C. Permitted by the law
 - D. Permitted by the client
 - E. In response to an inquiry by another firm or organization
9. Following Car and Wellenberg's suggestions, which of the following is **NOT** a way to impart value-based education?
- A. Assisting the students to grasp the importance of values
 - B. Enforcing value-based assignments on the students
 - C. Teaching the students how to be good examples
 - D. Showing the students how to evaluate everyday experiences that express desirable personal values
 - E. Helping the students to assess conflict situations in order to be able to develop constructive values
10. At the most general level, an accountant's professional obligation is governed by his/her responsibilities to
- A. Stakeholders
 - B. Shareholders
 - C. Colleagues
 - D. ICAN
 - E. Government
11. When preparing the opening Statement of Financial Position, for a first time adopter, which of these assets and liabilities will have to be removed as its recognition is **NOT** permitted by IFRS when converting from Nigerian GAAP?
- A. Pension liabilities and assets
 - B. Deferred taxes on revaluation of assets
 - C. Deferred hedging gains and losses
 - D. Leases
 - E. Fair value of shares

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12. The following is an extract from the Statement of Financial Position of Golis Plc. What amount should be disclosed as Financing activities in the statement of cash flow?

<u>FINANCED BY</u>	2012 N'000	2011 N'000
Ordinary shares of N1 each	2,500	2,000
15% Debenture	1,000	1,500

- A. Nil
- B. N500
- C. N1,000
- D. N1,500
- E. N2,500

Use the following information to answer questions 13 and 14:

A firm sold a land for N70,000 and bought a vehicle for N30,000. The firm also paid a dividend of N5,000 and borrowed N25,000.

13. What is the net change in cash flow?

- A. N5,000
- B. N30,000
- C. N40,000
- D. N60,000
- E. N65,000

14. What is the net cash flow from Investing activities?

- A. N5,000
- B. N20,000
- C. N25,000
- D. N30,000
- E. N40,000

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15. In consolidation of financial statements, additional financial statements are required from a subsidiary whose reporting period differs from the Group's by
- A. One month
 - B. Two months
 - C. Three months
 - D. Four months
 - E. Six months
16. A financial instrument that derives its value from an underlying price or index is referred to as
- A. Financial asset
 - B. Financial liability
 - C. Equity instrument
 - D. Financial instrument
 - E. Derivative
17. Which of the following should appear in a company's Statement of Changes in Equity?
- (i) Amortisation of capitalised development costs
 - (ii) Total comprehensive income for the year
 - (iii) Surplus on revaluation of non-current assets
- A. (i) and (ii)
 - B. (i) and (iii)
 - C. (ii) and (iii)
 - D. (i), (ii) and (iii)
 - E. (ii) only
18. The IFRS approach to standard setting focuses more on the business or the economic purpose of a transaction and lays down guidance in the form of
- A. Rules
 - B. Precepts
 - C. Principles
 - D. Conventions
 - E. Concepts

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19. In compliance with IFRS, a complete set of financial statements includes all the following **EXCEPT**
- A. Statement of Financial Position
 - B. Statement of Comprehensive Income
 - C. Statement of Value Added
 - D. Statement of Changes in Equity
 - E. Statement of Cash Flows
20. Which of the following appropriately reflects the basis of measurement which values assets at the amount of cash and cash equivalents that would be obtained by selling the assets in an orderly disposal?
- A. Historical cost
 - B. Realisable value
 - C. Current cost
 - D. Present value
 - E. Future value

SECTION A: PART II SHORT-ANSWER QUESTIONS

(20 Marks)

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. The beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements is known as
2. The basic principles and concepts that underpin the preparation and presentation of financial statements under the IFRS are encompassed in
3. In accordance with IAS 24 (Related Party Disclosures), the power to participate in the financial and operating policy decisions of an entity which has no control over those policies is called
4. In accordance with IAS 28 (Investment in Associates and Joint Ventures), an investment in an associate should be accounted for in the investor's financial statements using the method.

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5. Sun Limited owns 80% equity of Moon Limited. During the year ended 31 December 2013, Moon Limited sold goods to Sun Limited for ₦1.8million. This included a mark-up of 25% on cost. At 31 December 2013, a third of these goods were included in the inventory of Sun Limited. The value of unrealised intra-group profit is
6. Builders Limited tendered a successful bid for a construction work which commenced on 1 January 2013. The following are costs and revenues incurred up to 31 December 2013.

	₦'000
<u>Costs</u>	
Materials	2,250
Labour	1,200
Overhead	200
<u>Revenue</u>	

Value of work done to 31 December 2013 was ₦4million.
 Total contract price is ₦10million and total cost is estimated at ₦7.5million.
 What is the value of profit recognised at 31 December 2013 based on value of work certified?

7. The type of risk that the Fair Value of Cash Flows of a financial instrument will fluctuate due to changes in its market price is referred to as
8. In a business combination, the fair value of a long term debt acquired is made up of and
9. Short term deposits, loan notes and bank deposit accounts are examples of items that can be treated as cash equivalents in a Statement of Cash Flows if they are
10. The consideration transferred in a business combination shall be measured as the acquisition-date fair values of assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the issued by the acquirer.
11. In governance framework, the accountant and auditor should execute their functions with

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12. Total cost assessment can also be referred to as
13. A Director is required to act as a trustee on behalf of a corporation and its.....
14. The idea that individual organisations have fundamental values that govern their behaviour or their desired behaviour is known as
15. A situation where taxation advice affects matters to be shown in the financial statements may give rise to threat.
16. The concept which best describes the act of being able to shoulder responsibilities and carry the correlative burden of performance is
17. A debenture which is not secured by any charge over a company's property is debenture.
18. The auditor to an organisation can be regarded as a third party to the
19. ICAN's ethical standards of behaviour for professional accountants are designed as
20. The power to enforce ICAN's ethical standards is conferred on the

SECTION B: ATTEMPT QUESTION 1 AND ANY OTHER THREE QUESTIONS (60 Marks)

QUESTION 1

CASE STUDY

IFEDOLAPO LIMITED

The Management Accountant of Ifedolapo Limited presented the first two years accounts to the Board of Directors for discussion and possibly to use them to plan ahead for the next five years. Considering the fact that the Management Accountant is not a qualified Chartered Accountant, the Chairman invited you, a newly qualified Accountant, to review and comment on the accounts presented below.

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Profit and Loss Account

	2013 N'000	2012 N'000
Turnover	<u>23,000</u>	<u>20,000</u>
Gross Profit	3,750	3,900
Profit before tax	700	1,920
Tax	<u>(250)</u>	<u>(520)</u>
Profit after tax	450	1,400
Retained profit b/f	1,900	1,100
Dividend paid	<u>(600)</u>	<u>(600)</u>
Retained profit c/f	<u>1,750</u>	<u>1,900</u>

Balance Sheet

	2013 N'000	2012 N'000
<u>Fixed Assets</u>		
Property, Plant & Equipment	17,000	9,500
Accumulated Depreciation	<u>(5,000)</u>	<u>(3,000)</u>
	12,000	6,500
<u>Current Assets</u>		
Stock	2,900	1,500
Trade debtors	100	50
Bank	<u>-</u>	<u>450</u>
	<u>15,000</u>	<u>8,500</u>

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Capital and Reserves

Issued Share Capital @ ₦1 each	5,000	3,000
Share premium	1,000	-
Retained profit	1,750	1,900
Long term loans	3,000	1,000
Bank overdraft	930	-
Trade creditors	3,100	2,150
Current tax payable	<u>220</u>	<u>450</u>
	<u>15,000</u>	<u>8,500</u>

In your review, the underlisted anomalies were discovered:

- (i) The two years financial statements were prepared using Nigerian GAAP and Statement of Accounting Standards (SAS) respectively.
- (ii) The Chairman single handedly appointed as auditors Messrs PFAO& Co and agreed to a fee of ₦5million per annum with them. This firm is owned by the son-in-law of the Chairman and his brother.
- (iii) Fixed assets which include building, plant and machinery, vehicles, furniture and fittings valued at ₦16.5million were financed through the bank but were omitted from the accounts.
- (iv) Though stocktaking exercise was conducted at the end of the period, valuation was based on Last-in-First-Out (LIFO) because that would be the price at the next purchase. Net realisable value of the stock is ₦3.5million.
- (v) A forklift machine valued at ₦2.2million was imported from abroad, but the company borrowed a sum of ₦600,000 to pay demurrage and other clearing charges before the equipment could be brought for use after six months of landing at the port. During the period, a sum of ₦60,000 was paid to the Chairman in error. All these were deliberately omitted from the books.

You are required to:

- a. Redraft the financial statements in accordance with the requirements of IFRS, correcting the anomalies listed and reflecting the accounting and reporting concepts of fair presentation and true and fair view. (8 Marks)

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- b. Discuss the principles of professional ethics violated by the management accountant in his preparation of the financial statements of Ifedolapo Limited. (3 Marks)
 - c. Clarify the ethical problems the audit firm appointed by the Chairman is likely to be confronted with. (2 Marks)
 - d. Specify the ways the auditor ought to be appointed. (2 Marks)
- (Total 15 Marks)**

QUESTION 2

Golden Touch Plc has been discussing with two companies with a view to taking them over and turning them around to meet stakeholders' expectations. On 1 January 2012, the company acquired the following non-current investments in the investee companies:

- 80% of the equity share capital of Midas Limited at a cost of ₦27.2million
- 50% of Midas Limited's 10% loan at par.
- 1.6million equity shares in Grapeville Limited at a cost of ₦12.50 each.

The summarised Statement of Financial Position (SFP) of the two companies at 30 June 2012 are as follows:

	Midas Limited ₦'000	Grapeville Limited ₦'000
<u>Non-Current Assets</u>		
Property, Plant and Equipment	17,000	33,000
Investments	-	3,000
	<u>17,000</u>	<u>36,000</u>
Current Assets	<u>16,000</u>	<u>22,000</u>
Total Assets	<u><u>33,000</u></u>	<u><u>58,000</u></u>
<u>Equity and Liabilities</u>		
Equity Shares @ ₦1.00 each	6,000	8,000
Retained Earnings	<u>16,000</u>	<u>40,000</u>
	22,000	48,000
<u>Non-Current Liabilities</u>		
10% Loan	4,000	-
Current Liabilities	<u>7,000</u>	<u>10,000</u>
	<u><u>33,000</u></u>	<u><u>58,000</u></u>

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The following information is relevant:

- (i) The fair values of Midas Limited's assets were equal to their carrying amounts with the exception of land and plant. Midas Limited's land had a fair value of ~~₦~~8million in excess of its carrying amount and plant had a fair value of ~~₦~~3.2million in excess of its carrying amount. The plant had a remaining life of four years (straight-line depreciation) at the date of acquisition.
- (ii) In the post acquisition period, Golden Touch Plc sold goods to Midas Limited at a price of ~~₦~~12million. These goods cost Golden Touch Plc ~~₦~~8million. Half of these were still in the inventory of Midas Limited as at 30 June 2012. Midas Limited had a balance of ~~₦~~3million owing to Golden Touch Plc at 30 June 2012 which agreed with Golden Touch Plc's records.
- (iii) The net profit after tax for the year ended 30 June 2012 was ~~₦~~4million for Midas Limited and ~~₦~~16million for Grapeville Limited. Profit accrued evenly throughout the year.
- (iv) An impairment test at 30 June 2012 concluded that consolidated goodwill was impaired by ~~₦~~800,000 and the investment in Grapeville Limited was impaired by ~~₦~~400,000.
- (v) No dividends were paid during the year by any of the companies.

You are required to:

- a. Explain how the investments purchased by Golden Touch Plc on 1 January 2012 should be treated in its consolidated financial statements. (6 Marks)
- b. Calculate the amounts that will appear in the books of Golden Touch Plc in respect of the following:
 - (i) Goodwill in Midas Limited.
 - (ii) Carrying amount of Investment in Grapeville Limited as at 30 June 2012.
 - (iii) The unrealised profit in inventories.

(9 Marks)

(Total 15 Marks)

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QUESTION 3

The Extract from the Statement of Financial Position of Edobor Limited as at 31 December 2012 revealed the following:

	N'000	N'000
<u>Assets</u>		
Non-Current Assets		11,900
<u>Current Assets</u>		
Inventories	500	
Trade receivables	8,600	
Other receivables	1,200	
Cash and cash equivalents	<u>2,900</u>	<u>13,200</u>
		<u>25,100</u>
<u>Equity and Liabilities</u>		
<u>Equity</u>		
Share Capital	10,000	
Retained Earnings	<u>3,200</u>	
Total Equity		13,200
<u>Non-Current Liabilities</u>		
Loan notes		2,400
<u>Current Liabilities</u>		
Trade Payables	5,600	
Other Payables	2,700	
Bank Overdraft	<u>1,200</u>	
		<u>9,500</u>
		<u>25,100</u>

Other Information

At the board of directors meeting held of 30 June 2013, a decision was taken to raise an additional capital of ₦15million and source for a bank loan of ₦10million to enable the company go into production of building materials.

The additional capital is to be raised as follows:

- (i) Rights issue of 5,000,000 ordinary shares of ₦1 each to be issued at par to existing shareholders at 1 share for every 2 shares held.
- (ii) Offer of 8,000,000 ordinary shares at ₦1.25 each to the general public. The directors are of the opinion that it would be oversubscribed.

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You are required to:

- a. Comment on the financial position of Edobor Limited's liquidity, solvency and leverage. (6 Marks)
 - b. Comment briefly on rights issue and public issue of shares. (3 Marks)
 - c. Prepare the Statement of Financial Position of Edobor Limited after the transactions above. (6 Marks)
- (Total 15 Marks)**

Note: Ignore issuing cost.

QUESTION 4

Ikoko Plc started business 3 years ago following a research breakthrough that motivated large scale customers to order for the company's new product. Extracts from the financial statements recently published are as follows:

Statement of Profit or Loss for the year ended 31 December 2013

	2013	2012
	N'm	N'm
Revenue	360	20
Cost of sale	<u>(150)</u>	<u>(12)</u>
Gross profit	210	8
Operating expenses	<u>(50)</u>	<u>(3)</u>
Operating profit	160	5
Interest expense	(10)	-
Tax expense	<u>(60)</u>	<u>(2)</u>
Profit for the year	<u><u>90</u></u>	<u><u>3</u></u>

Statement of Financial Position as at 31 December 2013

	2013	2012
	N'm	N'm
Non-Current Assets		
Property, plant & equipment	80	20
Current Assets		
Inventory	200	40
Trade receivables	70	25
Bank	<u>(50)</u>	<u>30</u>
Total Assets	<u><u>300</u></u>	<u><u>115</u></u>

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Equity & Liabilities

Ordinary shares of ₦1 each	60	40
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Current Liabilities

Trade Payables	190	60
Current tax	<u>50</u>	<u>15</u>
	<u>300</u>	<u>115</u>

You are required to:

- a. Identify the nature of financial problems Ikoko Plc suffered during the year ended 31 December 2013 from the published financial statements. (6 Marks)
 - b. Identify any **FOUR** possible causes of the problems from the published financial statements. (4 Marks)
 - c. Recommend any **FIVE** possible solutions to the problems. (5 Marks)
- (Total 15 Marks)**

QUESTION 5

The accounting profession has recognised the significance of ethics to the actualisation of the ideals and principles of the profession.

- a. Identify and discuss any **THREE** reasons why the study of ethics is necessary for accountants. (6 Marks)
 - b. Discuss deontology as an ethical theory for accountants. (4 Marks)
 - c. Discuss any **FIVE** forms of behaviour that ICAN's professional Code of Conduct requires of accountants. (5 Marks)
- (Total 15 Marks)**

QUESTION 6

Omega Energy Solutions Provider is the largest integrated energy solution group in the whole of Sub-Saharan Africa listed on the Nigerian Stock Exchange. It has recently invested over ₦60billion in acquiring four swamp drilling rigs in Okra town in the eastern part of Nigeria.

Okra town is highly under-developed with no basic amenities like pipe-borne water and electricity. The people of Okra town are optimistic that the presence of Omega will solve their problem of lack of electricity. On the part of Omega, the global economic outlook remains clouded with uncertainties and this may affect their

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ability to assist the Okra community as expected because doing so will impair the company's profitability.

You are required to:

- a. Briefly discuss the idea of Corporate Social Responsibility. (3 Marks)
 - b. Specify whether or not Omega Energy Solutions Provider has any Corporate Social Responsibility to provide Okra town with electricity. (3 Marks)
 - c. What does Carroll Archie's Four Part Model suggest about Corporate Social Responsibility? (4 Marks)
 - d. Apart from the demand for electricity, state and discuss any other **FIVE** areas in which Omega Energy Solutions Provider can be socially responsible to Okra community. (5 Marks)
- (Total 15 Marks)**

SOLUTIONS TO SECTION A

PART I MULTIPLE CHOICE QUESTIONS

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

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- 15. C
- 16. E
- 17. C
- 18. C
- 19. C
- 20. B

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Tutorial

7.	Revaluation Surplus	-	<u>₦500,000</u>
	Impairment Loss	-	<u>₦360,000</u>

Since revaluation Surplus is higher than Impairment Loss \therefore Impairment Loss chargeable to income statement for the year is NIL.

12. Cash flow from financial activities in 2012:

	₦'000
Ordinary shares	500
15% Debenture	<u>(500)</u>
	<u>NIL</u>

13. Net cash flow from financing activities:

	₦
Financial debt	25,000
Dividend paid	<u>(5,000)</u>
	<u>20,000</u>

Net change in cash flow:

	₦
Investing activities	40,000
Financing activities	<u>20,000</u>
	<u>60,000</u>

14. Net cash flow from investing activities:

	₦'000
Proceed from sale of land	70,000
Purchase of vehicle	<u>(30,000)</u>
	<u>40,000</u>

EXAMINERS' REPORT

The questions cover the syllabus.

All the candidates attempted the questions and their performance was slightly above average.

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Candidates should ensure an adequate coverage of the syllabus to enhance their performance in future examinations.

PART II SHORT ANSWER QUESTIONS

1. Transition date
2. Conceptual Framework for the preparation of the financial statements
3. Significant influence
4. Equity
5. ₦120,000
6. ₦550,000
7. Market risk
8. Principal/capital and interest
9. Readily convertible/easily convertible/short maturity
10. Equity/share
11. Professionalism
12. Eco-accounting
13. Shareholders/members/owners
14. Corporate culture/ground-rule ethics
15. Self-review
16. Accountability
17. Naked/unsecured
18. Public
19. Professional code of conduct/professional code of ethics/pillars of guidance
20. Disciplinary tribunal

TUTORIAL

5. Mark-up of 25% on cost = 20% of selling price
Cost of intercompany supplies = 20% x ₦1.8million = ₦360,000
Cost or inventory of intercompany supplies = $\frac{1}{3}$ x 360,000
= ₦120,000

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6.	N'000
Value of work done	4,000
Cost of work done (2,250 + 1,200)	(3,450)
Profit recognisable	<u>550</u>

EXAMINERS' REPORT

The questions cut across the whole syllabus and all candidates attempted them. Performance was average.

Candidates can enhance their performance in future examinations by paying adequate attention to the basic concepts, principles, theories and standards of Financial Reporting and Ethics.

SOLUTIONS TO SECTION B

QUESTION 1

IFEDOLAPO LIMITED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2013

	2013	2012
	N'000	N'000
<u>Assets</u>		
<u>Non-current assets</u>		
Property, Plant & equipment (Wk IV)	31,300	6,500
<u>Current Assets:</u>		
Inventories	3,500	1,500
Trade receivables	100	50
Other receivables	60	-
Bank	<u>-</u>	<u>450</u>
	<u>3,660</u>	<u>2,000</u>
Total Assets	<u>34,960</u>	<u>8,500</u>
<u>Equity and Liabilities</u>		
Share capital	5,000	3,000
share premium	1,000	-
Retained profit	<u>2,410</u>	<u>1,900</u>
	8,410	4,900
<u>Non-Current Liabilities</u>		
Long term loan (wk v)	<u>5,800</u>	<u>1,000</u>
	<u>14,210</u>	<u>5,900</u>
<u>Current Liabilities</u>		
Bank overdraft (wk vi)	17,430	-
Trade payables	3,100	2,150
Current tax payable	<u>220</u>	<u>450</u>

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	<u>20,750</u>	<u>2,600</u>
Total Equity & Liabilities	<u>34,960</u>	<u>8,500</u>

Statement of Profit and Loss for the year ended 31 December 2013

	2013	2012
	₦'000	₦'000
Revenue	23,000	20,000
Gross profit	<u>3,750</u>	<u>3,900</u>
Operating profit (wk vii)	1,360	1,920
Income tax expense	<u>(250)</u>	<u>(520)</u>
Profit for the year	1,110	1,400

Statement of changes in Equity for the year ended 31 December 2013

	Capital	Revenue Reserve	Total
	₦'000	₦'000	₦'000
Balance b/fwd	5,000	1,900	6,900
Profit for the year	<u>-</u>	<u>1,110</u>	<u>1,110</u>
	5,000	3,010	8,010
Dividend paid	<u>-</u>	<u>(600)</u>	<u>(600)</u>
Balance c/fwd	5,000	2,410	7,410

Workings

(i) **Non-current assets**

Property, Plant & Equipment **~~¥~~16.5million**

These assets should be stated at replacement cost, but should be at carrying amount, hence the treatment in the books should be:

DR -	Property, Plant & Equipment	₦16.5million
------	-----------------------------	--------------

CR - Bank N16.5million

(ii) **Inventories**

Inventories should be stated at net realizable value and not LIFO. The difference between the values is taken into the account as follows:

$$\text{Net realisable Value – LIFO} = \text{£3,500,000} - \text{£2,900,000}$$

= ~~₹~~600,000

DR - Inventories ₦600,000

CR -	Operating profit	N600,000
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PATHFINDER

(iii) **Forklift Machine**

Cost	₦2,200,000
Demurrage and other charges	<u>600,000</u>
	<u>₦2,800,000</u>

Accounting Entries

(a)	DR Property, Plant & Equipment	₦2,800,000
	CR Loan notes (current)	₦2,200,000
	CR Loan notes (non-current)	₦600,000
(b)	DR Other receivables	₦60,000
	CR Operating profit	₦60,000
(iv)	Property, Plant & Equipment b/f	₦17,000,000
	Additions: Building, Plant & Machinery etc	16,500,000
	Forklift machine	<u>2,800,000</u>
		36,300,000
	Less: Accumulated depreciation	<u>(5,000,000)</u>
		<u>31,300,000</u>
(v)	Loan notes (non current)	₦3,000,000
	Addition: Demurrage	600,000
	Cost of Forklift	<u>2,200,000</u>
		<u>5,800,000</u>
(vi)	Bank overdraft b/f	₦930,000
	Additional bank overdraft	<u>16,500,000</u>
		<u>₦17,430,000</u>
(vii)	Operating profit	
	Balance b/f	₦700,000
	Add: Payment to Chairman in error	60,000
	Add: Undervaluation of inventories	<u>600,000</u>
		<u>₦1,360,000</u>

- (b) The principles of professional ethics violated by the management accountant in the preparation of the financial statements of Ifedolapo Limited are the principles of integrity, professional competence and due care.

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- (i) **The principle of integrity:** This imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships.

All deliberate omissions in the financial statements call to question the integrity of the management accountant. In other words, a professional accountant should not be associated with a materially false or misleading statement and should not knowingly omit or obscure information required to be included where such omission or obscurity would be misleading.

- (ii) **The principle of professional competence and due care:** This requires professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques.

The management accountant violated this principle by using and quoting Nigerian GAAP and Statement of Accounting Standards which are obsolete in preparing the financial statements of Ifedolapo Limited.

- (c) The audit firm appointed by the Chairman is likely to be confronted with the following ethical problems:

- (i) Familiarity threat which occurs where the auditor, by virtue of a close relationship with an assurance client, its directors, officers or employees, becomes too sympathetic towards the interests of his client.

Appointing a firm which is owned by the chairman's son-in-law poses a familiarity threat to the auditor's compliance with the fundamental principles of professional ethics.

- (ii) The independence and objectivity of the audit firm are likely to be compromised because of the close relationship it has with the client.

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In other words, the chairman could influence the independent opinion of the firm owned by his son-in-law and his brother. That is, the son-in-law and the brother might be unduly influenced in the process of carrying out the audit assignment.

- (d) The ways the auditor can be appointed:
- (i) The external auditors are appointed by the shareholders at the Annual General Meeting (AGM) of the company and should hold office until the next AGM.
 - (ii) At the next Annual General Meeting (AGM) the auditors are re-appointed by the shareholders or different auditors are appointed.
 - (iii) Directors may be allowed to appoint auditors in order to fill a casual vacancy, for example, where the current auditor can no longer act.
 - (iv) Directors may appoint the first auditor of a newly-formed company or a company previously exempted from audit.

EXAMINERS' REPORT

The question examines candidates' ability to prepare financial statements in compliance with International Financial Reporting Standards (IFRS) and the identification and resolution of certain ethical issues on the inappropriate appointment of external auditors.

Almost all the candidates attempted the question, being compulsory, but performance was generally poor.

The commonest pitfall was the inability of candidates to redraft the GAAP/SAS – based financial statements in accordance with the requirements of IFRS. Some candidates failed to distinguish between principles of professional ethics and what qualifies as ethical problem.

Candidates are advised to have a full grasp of IFRS in the preparation of financial statements and improve their knowledge of business ethics for a better future performance.

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QUESTION 2

GOLDEN TOUCH PLC

The investments of Golden Touch Plc could be analysed as follows:

Holdings at:	EQUITY	LOAN
MIDAS LIMITED	80%	50%
GRAPEVILLE	20%	-

- (a) (i) The investment in shares of Midas Limited represents 80% of the total Equity of Midas. This gives the required Control of that company to Golden Touch Plc. **Control** is the ability to direct the operating and financial policies of an Entity. This proportion of shareholding would make Midas a **subsidiary** of Golden Touch Plc and would also require Golden Touch to prepare **group financial statements** which would require that the consolidated financial statements are prepared on this basis that the group is a **single economic entity**.
- (ii) The acquisition of 50% of the 10% loan in Midas Limited is effectively a loan from a parent to a subsidiary. On consolidation, Golden Touch's proportion of the loan of Midas Touch would be **cancelled out** with 50% of Midas total loan liability, leaving a net liability of ~~₦~~2million in the Consolidated Statement of Financial Position.
- (iii) The investment of 1.6million shares in Grapeville represents 20% of that company's equity shares. This is generally regarded as not being sufficient to give Golden Touch Plc Control of Grapeville Limited, but is likely to give it **significant influence** over Grapeville policy decisions, that is, in such area as determining the level of dividends paid by Grapeville. Such investments are generally classified as **Investments in Associates**. IAS 28, (Investment in Associates) requires the investment to be included in consolidated financial statement using **equity method of accounting**.

(b) (i)

GOLDEN TOUCH PLC Goodwill in Midas Limited		₦'000	₦'000
Investment at cost			27,200
Less: Equity shares of Midas (80% x 6,000)		4,800	
∴ Pre-acquisition reserves			

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At 30 June 2012	16,000	
Post-acquisition		
(4 x 6/12)	<u>(2,000)</u>	
	<u>14,000</u>	
Pre-acquisition reserve 80%		11,200
Fair value adjustments		
- Land	8,000	
- Plant	<u>3,200</u>	
	<u>11,200</u>	
Share of fair value @ 80%		<u>8,960</u>
		<u>24,960</u>
Goodwill on acquisition		2,240
Less: Impairment of Goodwill		<u>(800)</u>
Consolidated Goodwill		<u>1,440</u>
OR		

Computation of Goodwill in Midas Limited

	₦'000	₦'000
Purchase consideration		27,200
NCI at acquisition date (20% of ₦31,200,000)		<u>6,240</u>
		33,440
Net assets at acquisition date:		
Ordinary share capital	6,000	
	14,000	
Pre-acquisition reserves		
	₦'000	₦'000
Fair value adjustment:		
Land	8,000	
Plant	<u>3,200</u>	
		<u>(31,200)</u>
Goodwill on consolidation		2,240
Goodwill impairment		<u>(800)</u>
Goodwill to be recognised in the Statement of Financial Position		<u>1,440</u>

(ii) Carrying amount of Investment in Grapeville Limited at 30 June 2012

	₦'000
Investment at cost (1.6m x ₦12.50)	20,000
Share of post Acquisition Profit	
(16m x 6/12 x 20%)	<u>1,600</u>
	21,600
Less: Impairment loss	<u>(400)</u>
Carrying amount of Investment in Grapeville Limited	<u>21,200</u>

(iii) Unrealised profit in inventories:

	₦'000
Intra-group sales (Transfer value of goods)	12,000

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Cost of the goods	<u>8,000</u>
Profit (Golden Touch Plc)	<u>4,000</u>
50% of ₦4,000,000 to be accounted for in the books (i.e. half still in inventory as unrealized profit) as at 30 June 2012.	- <u><u>₦2million</u></u>

EXAMINERS' REPORT

The question tests candidates' understanding of the applications of the provisions of IAS 28 (Investments in Associates and Joint Ventures), IFRS 3 (Accounting for Business Combination) and IFRS 10 (Consolidated Financial Statements).

Few candidates attempted the question and performance was above average. The main pitfall was the inability of candidates to compute goodwill in a subsidiary and carrying amount of investment in the associate.

Candidates should study and understand all aspects of the syllabus to enhance their performance in future examinations.

QUESTION 3

(i) Liquidity Ratio:

- Current ratio

$$= \frac{C/Assets}{C/Liabilities} = \frac{₦13,200,000}{₦9,500,000} = 1.40 : 1$$

- Acid Test ratio

$$= \frac{C/Assets - Inventories}{C/Liabilities} = \frac{₦12,700,000}{₦9,500,000} = 1.34 : 1$$

Comments

With current ratio of 1.40 : 1 and acid test ratio of 1.34 : 1 for Edobor Limited, its liquidity position could be adjudged to be better based on the nature of its operation; although no basis of comparism is supplied, but when compared with average industry norm which put the current ratio and the acid test ratio at 2 : 1 and 1 : 1 respectively, the liquidity position are not out of order. Therefore, with this ratio, it appears the company or entity may not have liquidity problem.

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(ii) Solvency ratio

$$\begin{aligned} \text{Debt/Equity ratio} &= \frac{\text{Non-current debt}}{\text{Equity}} \\ &= \frac{\text{N2,400,000}}{\text{N13,200,000}} = 18.2\% \end{aligned}$$

Comments

The existence of the company in the foreseeable future (going concern concept) is guaranteed. Potential investors are safe to a greater extent for the fact that long term debt is only 18.2% of shareholders fund.

(ii) Leverage ratio

$$\begin{aligned} &= \frac{\text{Non-current debts}}{\text{Capital employed}} \\ &= \frac{\text{N2,400,000}}{\text{N15,600,000}} = 15.4\% \end{aligned}$$

Comments

The Leverage (gearing) ratio of 15.4% implies that the business relied so much on self-financing. It should be noted that nothing is wrong in having low gearing ratio. However, if the business could employ debt to magnify the shareholders wealth, the level of gearing may be increased.

If the debt holders demand for their fund, the company can still survive. The advantage seems to be the non existence of the fear of repayment of the loan.

(b)(i) Rights Issue

This is one of the methods of raising funds for the company by issuing shares at a price below the normal market price (i.e. at discount) to the existing shareholders.

Shareholders have pre-emptive right to take up the offer, so as to maintain their proportionate shareholding in the company. However, shareholders can renounce their right or sell the right in part or whole.

Rights are issued below the normal market price to ensure its success.

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(ii) Public Issue

This is also a method of raising funds for the company through issuing shares by public subscription at the existing market price.

Though, the existing shareholders can take up such issues, before it is available to the general public. These shares can dilute the control of the existing shareholders.

EDOBOR LIMITED Statement of Financial Position as at 30 June 2013

	<u>workings</u>	₦'000	₦'000
<u>Assets</u>			
Non-current assets			11,900
<u>Current assets</u>			
Inventories		500	
Trade receivables		8,600	
Other receivables		1,200	
Cash & cash equivalents	1	<u>27,900</u>	
			<u>38,200</u>
			<u>50,100</u>
<u>Equity and Liabilities</u>			
Share capital	2	23,000	
Retained earnings		3,200	
Share premium		<u>2,000</u>	
			28,200
<u>Non-current liabilities</u>			
Loan notes	3		12,400
<u>Current liabilities</u>			
Trade payables		5,600	
Other payables		2,700	
Bank overdraft		<u>1,200</u>	
			<u>9,500</u>
			<u>50,100</u>

Workings

	₦
Rights issues	5,000,000
Public issues	<u>8,000,000</u>
Total share capital	13,000,000

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Share premium	<u>2,000,000</u>
	15,000,000
Loan notes	<u>10,000,000</u>
Total cash received	<u>25,000,000</u>

(1) **Cash and cash equivalents**

Balance b/fwd	2,900,000
Total cash received	<u>25,000,000</u>
	<u>27,900,000</u>

(2) **Share capital**

Balance b/fwd	10,000,000
Additional issue	<u>13,000,000</u>
	<u>23,000,000</u>

(3) **Loan notes**

Balance b/fwd	2,400,000
Additional loan	<u>10,000,000</u>
	<u>12,400,000</u>

EXAMINERS' REPORT

The question tests candidates understanding of:

- (a) Computation and Interpretation of liquidity, solvency and leverage ratios;
- (b) Salient features of rights and public issue of shares; and
- (c) Preparation of statement of financial position of a company.

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

Commonest pitfalls include the use of wrong formulae in the computation of solvency and leverage ratios and the inability to properly interpret derived ratios.

Candidates are advised to cover all aspects of the syllabus for improved performance in future examinations.

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QUESTION 4

IKOKO PLC

- (a) To fully identify the financial illness IKOKO suffered, there is the need to match revenues with production cycles on the one hand and assess the cash on the other hand.
- (i) With a revenue base of ₦20m in 2012 to ₦360m in 2013, there was an increase of ₦340m. This is a clear case of a large volume of business which requires large working capital to be able to meet orders.
 - (ii) IKOKO Plc's working capital deteriorated deeply from (₦95m – ₦75m) ₦20m positive in 2012 to ₦20m (₦270m – ₦290m) negative in 2013.
 - (iii) There was interest expense of ₦10m in 2013 as against NIL in 2012 as a result of heavy borrowing. This impacted negatively on the company's net profit.

Conclusion

IKOKO Plc is over-ambitious by doing too much quickly with too little capital. This is technically termed **over-trading**.

(b) POSSIBLE CAUSES OF OVER-TRADING

- i) Fall in liquidity ratios (Current and Acid Test Ratios)
- ii) Rapid increase in revenue
- iii) Sharp increase in sales to non-current assets ratio
- iv) Increase in inventory in relation to revenue
- v) Increase in the accounts payable period
- vi) Increase in short-term borrowing and/or a decline in cash balance
- vii) Increase in gearing
- viii) Decrease in the profit margin
- ix) Decline in current ratio and acid test ratio
- x) Increase in receivable in the current year's relative to the preceding year

(c) POSSIBLE REMEDIES FOR OVER-TRADING

- i) Speed up collection from customers
- ii) Slow down payment to suppliers
- iii) Maintain lower inventory levels

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- iv) Increase the capital through equity
- v) Increase cash sales
- vi) Rectify mismatch between Non-current and current assets
- vii) Increase bank funding
- viii) Reduce business funding
- ix) Raise long term debt capital
- x) Speed up work-in-progress into finished goods and sell to reduce the working capital needed
- xi) Lease or hire purchase non-current assets

EXAMINERS' REPORT

The question requires candidates to demonstrate their knowledge of interpretation of Financial Statements and ability to identify the symptoms and proffer solutions to the problems of over-trading and undercapitalisation.

Few candidates attempted the question and performance was very poor. Most candidates approached the financial statements interpretation using ratio analysis instead of principles of over-trading and capital adequacy.

Candidates should appreciate the need to go beyond the theoretical level to develop the skill of solving various organisational problems.

QUESTION 5

- (a) Reasons why the Study of Ethics is necessary for Accountants include:
- (i) **The extent of unethical practices**
In recent times, there has been an increase in the spate of corporate scandals involving major accounting firms such as Arthur Andersen, Akintola Williams Deloitte and KPMG, coupled with the alleged unethical acts committed by Lever Brothers Plc, Cadbury Nigeria Plc, Enron, Adephia Communications, Tyco and Worldcom, etc which have aroused public concern on the moral disposition or posture of accountants. The study of ethics by accountants has become necessary to help them have the right perspective on ethical issues and behaviours.
 - (ii) **To enhance adherence to professional Code of Conduct**
The study of ethics by accountants has become necessary as a major way of directing or helping them to abide by the profession's Code of Conduct.

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(iii) **Ethical modelling**

The study of ethics by accountants will help promote ethical leadership in the profession. This will enhance the promotion of basic ethical values such as honesty and respect for legitimate authority from one generation of accountants to the next.

(iv) **To promote informed ethical decision making in the profession**

Accountants are faced with a myriad of ethical challenges on a daily basis. The main reason for ethical guidelines is not to produce a “cook-book solution” to these practice-related problems and challenges, but to equip or aid accountants in the process of making informed ethical decision.

The study of ethics would allow accountants to achieve some level of consistency and coherence among numerous values and conflicting beliefs. It also empowers accountants to provide moral justification for their actions and decisions.

(v) **The clarify complex ethical issues**

The study of ethics by accountants will help to clarify some of the complex issues that confront them in practice. Ethics as it were, furnishes the accountant with principles, rules and frameworks with which to make sense of these issues.

(vi) **Resolving ethical conflicts**

The study of ethics assists practicing accountants to adjudicate between conflicting professional principles as well as determine which courses of action are more desirable than others.

(vii) **Enhancing ethical sensitivity**

Personal moral values and beliefs alone cannot suffice in dealing with professional ethical issues in accounting; thus the need for training in professional ethics. This enables accountants to subject their own values, beliefs and ideas to critical ethical scrutiny. Ethics, therefore, makes accountants more knowledgeable and conscientious on ethical issues in professional practice.

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(viii) Ethical Reasoning

Training accountants in ethics introduces them to the underlying structure of ethical reasoning that would enable them to identify and deploy basic ethical principles to specific professional actions and situations.

- (b) **Deontology**, as an ethical theory, rejects any attempt by accountants to make decisions or take actions based on either the consequentialist or Aristotelian approach. The consequentialist believes that moral actions or decisions are those that promote best consequences or maximize greatest happiness. Aristotle's virtue ethics holds that an action is right if it is what a virtuous person or agent would do in the given circumstance.

Deontologists argue that there are certain moral imperatives that ought to guide all human actions irrespective of circumstances or consequences. In other words, decisions and actions must be taken on the basis of duty, subject to the dictates of reason. In this regard, the categorical imperative according to Kant, supplies the theoretical framework that grounds the unqualified principles of human conduct.

Thus, with reference to accounting ethics, deontology specifies that accountants should act in accordance with the professional duties prescribed in their profession's code of conduct without giving primary consideration to consequences. Put differently, from the deontological perspective, the right decision and action for an accountant would be those that are intrinsically good and this in turn will be a function of what accords with the guiding principles of the profession.

- (c) Forms of behaviour that ICANS's Professional Code of Conduct requires of accountants include:
- (i) **Integrity** – This implies that accountants should be straight-forward and honest in all professional and business relationships. The accountant is expected at all times to carry out all responsibilities with the highest sense of integrity, which requires that accountants should be honest and candid with clients.
 - (ii) **Objectivity** – this implies the absence of bias or undue influence of others which can override professional judgments. In the discharge of professional responsibilities, the accountant is expected to maintain objectivity in the face of conflicts of interests. Professional objectivity requires that the accountant be fair.

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intellectually honest and free from conflicts of interests. It also requires that the accountant be free from relationships that may impair objectivity in rendering attestation services.

(iii) **Professional competence and due care**

This implies that accountants must strive at all times to improve competence and quality of services in the discharge of professional duty.

An accountant is required to maintain professional and technical knowledge and skill at the level required to ensure that a client or employer receives, competent professional services based on current developments in practice, legislation and techniques. He is expected to act diligently and in accordance with applicable technical and professional standards.

- (iv) **Confidentiality** – an accountant is required to respect the confidentiality of information acquired as a result of professional and business relationships by not disclosing such information to third parties without proper and specific authorization, unless there is a legal or professional right or duty to disclose. The accountant is also not expected to use such information for personal advantage.
- (v) **Professional behaviour** – an accountant is expected to comply with relevant laws and regulations and avoid any action that discredits the profession. He is required to adhere to the profession's code of conduct that guides the scope and nature of professional services to be provided.
- (vi) **Sensitive professional and moral judgement** - as professionals, accountants are expected to exercise sensitive professional and moral judgment in carrying out their professional responsibilities.
- (vii) **Public Interest** - Accountants are also obligated to act in manners that will serve the public interest, honour the public trust and demonstrate commitment to professionalism.

EXAMINERS' REPORT

The question tests candidates' understanding of the relevance of ethics to the accounting profession as well as their knowledge of ICAN's Code of Conduct.

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Most candidates attempted the question and performance was slightly above average. While many of the candidates did very well in the section that tested their knowledge of ICAN's Code of Conduct, they did not do well in the section that tested their understanding of the relevance of ethics to the accounting profession.

Candidates are advised to pay attention to the nature of ethics and its relevance to the accounting profession today.

QUESTION 6

(a) The idea of Corporate Social Responsibility includes:

- i) The responsibilities that corporate organisations take for the impact of their activities on customers, suppliers, employees, shareholders and all stakeholders.
- ii) The obligations that corporate organisations have to society which is beyond law and economics or profits as a result of their operations in society.
- iii) The commitments an organisations has as a result of its business existence in society which aims to improve the quality of life of the workforce, their families, the local community and society at large.
- iv) The voluntary activities undertaken by an organisation or company to operate in economically, socially and environmentally sustainable ways.
- v) Balancing shareholders' interest against the interest of the wider community.
- vi) Being a good citizen in the community.
- vii) The organisation's obligations to all stakeholders and not just shareholders.
- viii) A willingness to act ahead of any regulatory confrontation.
- ix) How corporate entities should respond positively to emerging societal priorities and expectations.
- x) How a company manages its business process to produce an overall positive impact on society.

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- xi) The responsibilities organisations take for their impact on environmental activities, employees, local communities and members of the public in general.
 - xii) How an organisation obeys environmental laws, regulatory laws and promotes public interest by voluntarily avoiding activities that are harmful.
- (b) **Omega Energy Solutions Provider has a Corporate Social Responsibility to provide electricity to Okra Town because:**
- i) The organisation is directly located in Okra town; hence, the need to contribute to the development of the town.
 - ii) The investment of four swamp drilling rigs in Okra town may threaten the environment. Hence, the organisation may need to compensate the town by providing some facilities to the community.
 - iii) The provision of electricity will improve the quality of life of the people. This is expected to be one of the benefits of locating an organisation within a community.
 - iv) Although Omega Energy Solutions Provider is right in maximising its profit, yet the organisation should have considerations for the community in which it is operating by providing some basic facilities for the people, from the utilitarian perspective,
 - v) Omega Energy Solutions Provider needs to take the interest of the community into consideration because it relies on their contributions for its economic success.
- (c) **Carroll Archie's Four Part Model suggests that corporate organizations have four responsibilities to fulfil in society:**
- i) **Economic:** This is the responsibility to earn profit for its owners or generate revenue for its investors. It is also about how resources for the production of goods and services should be distributed within a social system.
 - ii) **Legal:** This refers to the responsibility to comply with laws and regulations established by governments to set minimum standards for responsible behaviour. That is, laws regulating competitions

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that prevent the establishment of monopolies and inequitable pricing practices, and laws protecting consumers and the environment.

- iii) **Ethical:** Corporations should act in conformity with the expectations of relevant organisations, the local community or the larger society even though these behaviours or actions may not be codified into law. The ethical responsibilities of corporations also include the obligations to do what is just and fair and to avoid harm to employees, consumers and environment.
 - iv) **Philanthropic and voluntary:** This is about the responsibilities of corporations to make contributions towards the enhancement of the quality of life and overall welfare of society, with specific reference to the local community where it is operating.
- (d) Omega Energy Solutions Provider can be socially responsible to Okra community in these other areas:
- i) **Construction and maintenance of motorable roads:** This will improve the quality of life for the people and development of the community.
 - ii) **Economic empowerment (provision of employment):** Omega can economically impact on the local community by employing the people both at the skilled and semi-skilled levels. This will economically empower and impact on the level of development of the community directly or indirectly.
 - iii) **Provision of educational innovations:** These include scholarships, remedial studies and adult literacy education. These would ensure that the literacy level of the community is enhanced and in the process reduce the financial burden of members on the community. The scholarship agenda would ensure that children enrol, stay in school and transit to higher levels of learning.
 - iv) **Sporting and recreational activities:**
 - To ensure good quality of life
 - To ensure mental and physical fitness
 - v) **Construction of bridges and drainages:**
 - To improve the quality of life in the community
 - To enhance the development of the community and its environs.

PATHFINDER

- vi) **Construction of ultra-modern markets:**
 - To facilitate sustainable development in the community
 - To provide economic empowerment for members of the community.
- vii) **Sinking of boreholes or provision of pipe-borne water:**
 - To provide basic amenities for good quality living
- viii) **Transportation services:** Transportation services at all levels would ensure good quality of life and enhance development of the community.
- ix) **Establishment of foundations:** These would fund projects that are urgent and necessary for the direct development of members of the community.
- x) **Health programmes:** Sponsoring of health initiatives and programmes. This can be in the forms of awareness, treatment, and provision of facilities that are health based. All these will improve the quality of life of the people and address the health hazards that the existence of Omega might have on the people or the community.
- xi) **Partnership with NGOs:** The organisation can also partner with NGOs on projects that directly impact on the quality of life of the people.
- xii) **Security outfits:** The organisation can also build fire stations or police stations for the community. This will enhance a safe environment and protection of lives and property.
- xiii) **Housing (shelter):** Omega can embark on housing projects on medium and large scales at affordable cost. This will also improve the quality of life of members of the community and enhance the general development of the community.
- xiv) **Skills Acquisition Programmes:** Omega can embark on skills acquisition programmes designed to train and empower youths in the host community. This will prevent hooliganism and other indecent acts.

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EXAMINERS' REPORT

The question test candidates understanding of Corporate Social Responsibility and how it should be practised in real terms.

Most of the candidates attempted the question and performance was above average. Their major pitfalls, however, were that many of them could not give an adequate account of the idea of Corporate Social Responsibility. They could not also effectively apply their theoretical knowledge of the idea of Corporate Social

Responsibility to practical scenarios.

Candidates are advised to develop the skill of applying basic concepts, principles and theories to real life situations that are relevant to the accounting profession.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II – MAY 2014

STRATEGIC FINANCIAL MANAGEMENT

Time Allowed: 3 hours

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

ATTEMPT ALL QUESTIONS IN THIS SECTION

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 stakeholders' interest does Corporate Governance aim to promote?
 - A. Shareholders
 - B. Management
 - C. Government
 - D. Customers
 - E. Employees
2. Under the new clearing and settlement arrangements, which of the following refers to the system by which shareholders exchange their certificates for accounts with the Central Security Clearing System (CSCS)?
 - A. Conversion system
 - B. Dematerialisation system
 - C. Computer Security Clearing System
 - D. Automated Trading System
 - E. Call-over system
3. Which of the following is **NOT** required in creating a well governed business entity?
 - A. The Board should consist of members who are experts or professionals in the industry in which the company operates
 - B. Some of the Board members must have the highest number of shares
 - C. There should be formal and periodic evaluation of the executive officers of the company i.e. Chief Executive and Directors
 - D. The Audit Committee of the Board should be strengthened

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- E. Board meeting procedures should focus on debating new strategies and policies
4. Which of the following does **NOT** influence the amount of dividend payable to the shareholders of a firm?
- A. Access to the capital market
 - B. Issuance of new shares
 - C. Liquidity position
 - D. Legal constraints
 - E. Company Income Tax Policy
5. The following are characteristics of Advanced Manufacturing Technology (AMT) projects **EXCEPT** that
- A. Returns grow over the estimated life of the project
 - B. Returns are generated for a very long period of time
 - C. Returns are usually generated for one year or less
 - D. Initial costs are very high
 - E. Initial costs may spread over two years
6. In a market equilibrium, the linear relationship between an individual security's expected rate of return and its systematic risk as measured by beta is known as
- A. Beta line
 - B. Security market line
 - C. Characteristic line
 - D. Capital market line
 - E. Alpha line
7. If Treasury Bills rate is 15% and the expected market return is 21%, calculate the cost of equity of Adipas Limited, given that its share has a beta of 1.8.
- A. 24.0%
 - B. 25.8%
 - C. 27.0%
 - D. 36.0%
 - E. 37.8%
8. The following data relates to Abolore Limited:

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Earnings per share: ₦5.00

Dividend per share (recent payment): ₦3.00

Number of shares: 1 million

Current market price per share: ₦15.00

If the cost of equity is 15% and a constant perpetual growth rate of 5% in earnings and dividends is expected, what is the expected value of Abolare Limited share?

- A. ₦22.00
 - B. ₦30.50
 - C. ₦31.50
 - D. ₦61.00
 - E. ₦63.00
9. In the long run, a successful acquisition is one that
- A. Enables the acquirer to identify its asset base
 - B. Enables the acquirer to make an all-equity purchase, thereby avoiding additional financial leverage
 - C. Increases financial leverage
 - D. Increases the market price of the acquirer's ordinary shares over what it would have been without acquisition
 - E. Increases the tax payable by the acquirer
10. Which of the following merger motives makes the most economic sense?
- A. Achieving economies of scale
 - B. Reduction of risk by diversification
 - C. Redeployment of cash generated by a firm with ample profits but limited growth opportunities
 - D. Increased competition
 - E. Improved management effectiveness
11. Which of the following is **NOT** a direct source of finance to Small and Medium Enterprises in Nigeria?
- A. Microfinance banks
 - B. Central Bank of Nigeria
 - C. Bank of Industry
 - D. Co-operative Societies
 - E. Friends and relatives

PATHFINDER

12. Which of the following is **NOT** a Regulatory Institution within the Nigeria Financial System?
- A. Central Bank of Nigeria (CBN)
 - B. Nigerian Stock Exchange (NSE)
 - C. Securities and Exchange Commission (SEC)
 - D. National Insurance Commission (NAICOM)
 - E. National Pension Commission (NPC)
13. Which of the following sources of finance is known as Vendor Credit?
- A. Leasing
 - B. Hire purchase
 - C. Bank term loan
 - D. Project finance
 - E. Overdraft
14. The following are the most important assumptions of Capital Asset Pricing Model (CAPM) **EXCEPT** that
- A. Investors have different expectations about the expected returns and risks of securities
 - B. Investors are risk-averse
 - C. Investors have homogenous expectations
 - D. Investors decisions are based on single time period
 - E. All investors can lend and borrow at a risk-free rate of interest
15. Adeoye Plc. and Moonshine Limited are two firms similar in all respects except that Adeoye Plc is quoted while Moonshine Limited is not quoted. The P/E ratio of Adeoye Plc. is 20 while the after-tax earnings per share of Moonshine Limited and Adeoye Plc. were ₦1.50 per annum and ₦2.00 per annum respectively in recent years. Calculate the value of each share of Moonshine Limited.
- A. ₦1.50
 - B. ₦2.00
 - C. ₦3.00
 - D. ₦30.00
 - E. ₦40.00

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16. A credit obligation that a customer is **NOT** likely to meet is known as
- A. Bad debt
 - B. Lost debt
 - C. Sure debt
 - D. Forgone debt
 - E. Doubtful debt
17. A complete financial plan includes all the following **EXCEPT**
- A. Detailed profile of all management staff
 - B. Clearly stated strategic, operating and financial objectives
 - C. The assumption on which the plan is based
 - D. Description of the underlying strategies
 - E. Contingency plans for emergencies
18. A measure of how well the returns of two risky assets move together is referred to as
- A. Covariance
 - B. Variance
 - C. Range
 - D. Semi-variance
 - E. Standard deviation
19. The following are methods of raising capital from existing and prospective shareholders **EXCEPT**
- A. Offer for subscription
 - B. Tender offer
 - C. Rights offer
 - D. Offer for sale
 - E. Stock Exchange Introduction
20. Which of the following factors is **NOT** significant when deciding whether to borrow on short-term or long-term basis?
- A. Yield curve
 - B. Availability of collateral
 - C. Rate of interest
 - D. Maturity structure of current debt
 - E. Predicted availability of finance in the future

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SECTION A: PART II

SHORT-ANSWER QUESTIONS

(20 Marks)

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. The combination of processes, structures and relationships through which business organisations are directed and controlled is referred to as
2. The guiding principle for determining the portion of a company's net profit after tax to be paid out to the residual shareholders as dividend during a particular financial year is called
3. The hypothesis which states that "a firm that chooses to pay higher current dividends will enjoy higher share prices because shareholders prefer current dividends to future ones" is known as
4. A combination of investments/securities which gives the highest expected return for a given standard deviation is referred to as
5. A relationship which links spot exchange rates, forward exchange rates and interest rates is called.....

Use the following information to answer questions 6 and 7:

Tapida Limited has just received an invoice from its supplier for ₦100,000 at "2/10 net, 45"

6. If Tapida refuses the cash discount, calculate the implied cost of interest per annum. (Assume 365 days in a year)
7. If Tapida can invest cash to obtain a return of 25% per annum, compute Tapida's Net payment. (Assume 365 days in a year)
8. An informal group of official creditors, whose role is to find co-ordinated and sustainable solutions to the payment difficulties experienced by debtor nations, is the.....
9. In the context of the 5Cs of lending by commercial banks, the particular problem which small firms face in obtaining loans from commercial banks is called.....

PATHFINDER

10. The process of searching for two similar assets having different prices and buying in the market where the price is low and simultaneously selling in a market where the price is high in order to make short-term riskless profit is known as.....
11. A reduction in trade payable offered to customers to induce them to meet credit obligation within a specified period of time, usually less than the normal credit period, is known as
12. The model that provides a framework for determining the required rate of return on an asset and indicates the relationship between return on and the risk of the asset is known as
13. AB Limited which currently has 5 million ordinary shares of ₦1.00 each, a market value of ₦64.00 per share and earnings per share of ₦4.00 intends to acquire XY Limited which currently has 2 million ordinary shares of ₦1.00 each with a market value of ₦35.00 per share and earnings per share of ₦2.50. If the acquisition is through offer of shares based on the current market values, how many AB Limited's shares will need to be issued to acquire XY Limited?
14. A large, stable, well-known, widely acclaimed and seasoned company with a strong financial position, which usually pays a reasonable dividend is referred to as
15. The theory which assumes that the return on a security is based on a number of independent factors, to which a particular risk premium is attached is known as.....
16. A method of increasing the number of outstanding shares through a proportional reduction in the par value of the share is known as
17. If two projects are completely and positively linearly dependent, the measure of correlation between them is
18. The dividend policy in which payment of dividends is accorded priority before the company commits itself to its capital needs, is referred to as
19. A situation where someone has information that is not available to the public and then uses this information to profit from trading in a company's ordinary shares is referred to as

PATHFINDER

20. The capitalisation of the reserves of a company by the issue of additional shares to existing shareholders in proportion to their holding and at no cost is referred to as

SECTION B: ATTEMPT QUESTION 1 AND ANY OTHER THREE QUESTIONS (60 Marks)

QUESTION 1 CASE STUDY

The entire share capital of WAZOBIA Limited, an unlisted company, is held by the three directors of the company – Chief Oyomesi, Alhaji Katagun and High Chief Agbor. They have decided to sell their shares in order to complete a divestment proposal agreed with management and, as such, wish to know the likely value of the shares before approaching prospective buyers. Should they fail to get buyers for the shares, the company will go into liquidation.

The following information is provided in respect of the company:

- a. Statement of Financial Position of WAZOBIA Limited as at 31 December, 2011.

Non-current Assets:	₦'000	₦'000
Freehold properties at cost		6,500
Equipment at cost less depreciation		15,600
Current Assets:		
Inventories	6,975	
Accounts Receivables	4,825	
Cash Equivalent – Bank	<u>650</u>	
	12,450	
Less: Current Liabilities	<u>4,150</u>	
		<u>8,300</u>
		<u>30,400</u>

- b. Extracts from the published Statement of Profit or Loss and Other Comprehensive Income for the last three years are

	2009	2010	2011
	₦'000	₦'000	₦'000
Depreciation	2,250	2,250	2,250
Directors remuneration	2,500	2,900	3,000
Profit for the year	3,250	3,600	4,175
Dividends	2,250	2,250	2,250

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It was discovered that inventories were over-valued at the end of 2008 by ₦600,000. The directors have increased their remuneration in order to reduce the company's tax liability. A realistic charge for services rendered would be ₦1,875,000. The equipment is old and it is in need of replacement. The annual depreciation, based on current replacement cost, is in the region of ₦3,000,000.

- c. Each of the directors expressed different opinions on the valuation method to be adopted. To Chief Oyomesi, it is most appropriate to value the shares on the basis of price/earnings ratio. For this purpose, he argues that earnings should be defined as the average reported profits for the last three years, after making proper charges for depreciation and directors' remuneration and correcting the error made on inventories in 2008.

In his own opinion, Alhaji Katagun recommends break-up basis using liquidation values as provided by experts.

High Chief Agbor, on the other hand, believes that dividend yield basis be used, with available data obtained from two similar but listed companies where he is a shareholder.

- d. The relevant data of the two listed companies engaged in similar line of business as WAZOBIA Limited are as follows:

	Dividend Yield	Price Earnings
Company 1	9%	5.4
Company 2	11%	6.6

- e. Figures obtained from experts for items appearing in the Statement of Financial Position of WAZOBIA Limited as at 31 December 2011 are as stated below:

	Replacement	Liquidation
	Values	Values
	₦'000	₦'000
Freehold properties	15,000	15,000
Equipment	8,650	5,400
Inventories	4,350	8,000

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You are required to

Compute the value for the entire share capital of WAZOBIA Limited using

- (i) Price/Earnings basis (with earnings computed on the basis proposed by Chief Oyomesi)
- (ii) Liquidation (break-up) basis and
- (iii) Dividend yield basis

Note: Assume you are making the valuation as at 31 December, 2011. Ignore taxation and liquidation costs. (Show all workings). (9 Marks)

- b. Identify any **TWO** limitations associated with each of the methods above. (6 Marks)
(Total 15 Marks)

QUESTION 2

A Limited and B Limited are two companies in the Sports Promotion Industry. The companies have the same business risk and are identical in all respects except for their capital structures and total market values. The companies' capital structures are summarised below:

<u>A Limited</u>	<u>₦'000</u>
Ordinary shares (25k par value)	50,000
Share premium	112,500
Retained earnings	<u>90,000</u>
Equity attributable to owners	<u>252,500</u>
A Limited's ordinary shares are trading at 140k per share	
<u>B Limited</u>	
Ordinary shares (₦1 par value)	62,500
Share premium	20,000
Retained earnings	<u>110,000</u>
Equity attributable to owners	192,500
12% Loan Notes (newly issued)	<u>62,500</u>
	<u>255,000</u>

B Limited's ordinary shares are trading at 400k per share and Loan Notes at ₦100. Annual Earnings Before Interest and Tax (EBIT) for both companies is ₦62.5m. Company income tax rate is 30%.

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Required:

- a. If Mr. Ronalmessi holds 4% of the ordinary shares of Company B, what action should he take to improve his financial position without increasing his risk assuming:
- (i) Additional income is desired?
 - (ii) His existing income is to be maintained?

In each case, calculate by how much his financial position is expected to improve.
(Show all Workings) (9 Marks)

- b. If company A was to borrow ₦50million
- (i) Calculate the effect this would have on the company's cost of capital according to Modigliani and Miller.
 - (ii) What implications would this suggest for the company's choice of Capital structure? (6 Marks)
- (Show all workings) (Total 15 Marks)

QUESTION 3

"Ascertaining exactly who owns a company's shares and what, if any, are their particular preferences and objectives" is a basic piece of information needed by management, if it is to ensure that, as far as possible, it is acting in the shareholder's interest.

- a. Explain why a publicly quoted company might seek to know the detailed composition of its shareholders and their objectives in investing in the company. (5 Marks)
- b. Explain any **FIVE** the major advantages which may accrue to the corporate finance manager from obtaining this information. (10 Marks)
- (Total 15 Marks)

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QUESTION 4

A number of investigations have been undertaken into the use by shareholders of the Annual Reports and Financial Statements of Companies in which they have invested. Several of these show that the Annual Reports and Financial Statements are regarded as important sources of information for making decisions on equity investment. Other types of studies indicate that the market price of the shares in a company does not react in the short term to the publication of the Company's Annual Reports and Financial Statements.

- a. Explain briefly the concept of the Efficient Market Hypothesis (EMH) and each of its forms and the degree to which existing empirical evidence supports them. (5 Marks)
 - b. State and explain the implication of each of the Efficient Market Hypotheses for investment policy as it applies to
 - (i) Technical analysis in form of charting.
 - (ii) Fundamental analysis. (5 Marks)
 - c. Explain any **TWO** major roles or responsibilities of portfolio managers in an efficient market environment. (5 Marks)
- (Total 15 Marks)**

QUESTION 5

- a. "The major objective of financial management is to maximise the value of the firm."

Analyse how the achievement of the above objective might be compromised by the conflicts which may arise between the management and the other stakeholders in an organisation. (9 Marks)
 - b. "Strategic planning is said to be a creative process such that fresh insight received today could very well alter the decision made yesterday".

Outline the steps involved in the process of strategic planning in corporate organisations. (6 Marks)
- (Total 15 Marks)**

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QUESTION 6

The objective of dividend policy should be to maximise the shareholders' return so that the value of their investment is maximised.

- a. State and explain any **SEVEN** factors which determine the dividend policy of a large public company whose shares are quoted on the Stock Exchange. (7 Marks)
- b. State why a stable dividend policy might be expected to lead to a higher market valuation of a company's share. (3 Marks)
- c. You are given the following exchange rates:
Spot Rate (SFr|\$) = 1.3598
3 Months Forward Rate (SFr|\$) = 1.3471
 - (i) Is the dollar trading at discount or premium?
 - (ii) Calculate the annualised forward premium or discount.
 - (iii) Distinguish between a direct quote and an indirect quote. (5 Marks)(Total 15 Marks)

SOLUTIONS TO SECTION A

PART 1: MULTIPLE-CHOICE QUESTIONS

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

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- 13. B
- 14. A
- 15. D
- 16. E
- 17. A
- 18. A
- 19. E
- 20. A

Tutorials

$$\begin{aligned}
 7. \quad E(R)_p &= R_f + \beta(R_m - R_f) \\
 &= 0.15 + 1.8(0.21 - 0.15) \\
 &= 0.15 + (1.8 \times 0.06) \\
 &= 0.15 + 0.108 \\
 &= 0.258 = 25.8\%
 \end{aligned}$$

$$\begin{aligned}
 8. \quad Mv_e &= \frac{d_0(1+g)}{K_e - g} = \frac{3(1 + 0.05)}{0.15 - 0.05} \\
 &= \frac{3.15}{0.10} = \text{N}31.50
 \end{aligned}$$

$$\begin{aligned}
 15. \quad \text{P/E ratio} &= \frac{MV}{EPS} \\
 MV &= \text{P/E} \times \text{EPS} \\
 &= 20 \times \text{N}1.50 \\
 &= \text{N}30.00
 \end{aligned}$$

MV = Market Value

P/E = Price/Earnings Ratio

EPS = Earnings Per Share

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 some had problems in providing appropriate solutions.

PATHFINDER

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

PART II - SHORT-ANSWER QUESTIONS

1. Corporate Governance
2. Dividend Policy
3. Bird-in-Hand Argument or Dividend Supremacy Theory or Dividend Relevance
4. Efficient Portfolio
5. Interest Rate Parity
6. 21.28%
7. ~~₹~~97,650.69
8. Paris Club
9. Collateral/Security Problem
10. Arbitrage
11. Cash Discount
12. Capital Asset Pricing Model (CAPM)
13. 1,093,750 shares
14. Blue Chip Company
15. Arbitrage Pricing Theory - APT
16. Share Split/Stock Split
17. +1
18. Active Theory of Dividend/Active Dividend Policy
19. Insider Trading
20. Bonus Issue/Scrip Issue/Capital Issue

PATHFINDER

Tutorials:

$$\begin{aligned}
 6. \quad \text{Implied Cost of Interest} &= \left(\frac{\% \text{discount}}{100 - \% \text{ discount}} \times \frac{365}{\text{Maximum period less Maximum discount period}} \right) \times \frac{100}{1} \\
 &= \left(\frac{2}{98} \times \frac{365}{35} \right) \times 100 \\
 &= \underline{\underline{21.28\%}}
 \end{aligned}$$

7. Payment to supplier	N 100,000.00
Returns on investment of	
N98,000 between 11 and 45 days = $\left(98,000 \times \frac{35}{365} \right) \times 25\%$	<u>2,349.31</u>
Net Payment	<u><u>97,650.69</u></u>

$$\begin{aligned}
 13. \quad \text{Number of shares} &= \frac{\text{N}35 \times \underline{\underline{2,000,000}}}{\text{N}64} \\
 &= 1,093,750 \text{ shares}
 \end{aligned}$$

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 average. 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 examinations.

SOLUTIONS TO SECTION B

QUESTION 1 - CASE STUDY

Computation of the value of WAZOBIA Limited's share capital as at 30/12/2011

(i) **Price/Earnings' Basis:**

$$\begin{aligned}
 \text{Value of Business} &= \text{P/E ratio} \times \text{Earnings} \\
 &= 6 \times \text{N}4,050,000 \\
 &= \underline{\underline{\text{N}24,300,000}}
 \end{aligned}$$

PATHFINDER

Computation of earnings:

	2009	2010	2011
	₦'000	₦'000	₦'000
Profit	3,250	3,600	4,175
Overvaluation of opening inventory	600	-	-
Overcharge of directors remuneration	625	1 025	1 125
Undercharged depreciation (3000 – 2250)	(750)	(750)	(750)
Adjusted Profit	<u>3,725</u>	<u>3,875</u>	<u>4550</u>
Earnings (Average) $\frac{₦3,725 + ₦3,875 + ₦4,550}{3}$	= ₦4,050,000		

Computation of P/E ratio:

Company 1	5.4
Company 2	<u>6.6</u>
Total	<u>12.0</u>
Average	$\frac{12}{2} = 6$

ii. Liquidation/Break-up Basis as at 31/12/2011

Non-Current Assets:	₦'000	
Freehold Properties	15,000	
Equipment	5,400	
Current Assets:		
Inventories	8,000	
Account Receivables	4,825	
Cash Equivalent/Bank	<u>650</u>	
	33,875	
Less: Liabilities	<u>4,150</u>	
	<u>29,725</u>	i.e. ₦29,725,000

(iii) Dividend Yield Basis:

$$\text{Value of Business: } \frac{\text{Total Dividend}}{\text{Dividend Yield}} = \frac{₦2,250,000}{10\%} = \frac{₦2,250,000}{0.10} = \underline{\underline{₦22,500,000}}$$

$$\text{*Dividend yield} = \frac{9\% + 11\%}{2} = 10\%$$

(b) (i) Limitations of P/E ratio method

- It assumes that current earnings will continue. The value computed will be overstated if there is reduction in earnings.
- It used the P/E ratio of a similar company. This may not correctly reflect the true position of Wazobia Ltd.

PATHFINDER

- It makes use of accounting profit whereas cash profit is more useful.
- It ignores the time value of money.

(ii) Limitations of Liquidation basis

- It ignores the future potential earnings of an entity.
- It is only used when a company's going concern is threatened. It cannot be used for a continuing business.
- The break up values may not be readily available.
- Liquidation costs that need to be deducted may be omitted.

(iii) Limitations of Dividend Yield basis

- Value may be understated if earnings are substantially higher than dividend.
- It used the dividend yield of a similar entity which may not reflect the true position of Wazobia Ltd.
- It is only useful for the valuation of non-controlling interest or small holding
- It will not be usable if a company pays no dividend
- There may be difficulty of finding a comparable firm.

EXAMINERS' REPORT

The question tests candidates' understanding of the various methods of valuing shares/stocks.

Almost all the candidates attempted the question but most of them did not have a clear and accurate understanding of both parts of the question hence performance was poor.

Candidates' commonest pitfall was their lack of in-depth knowledge of the requirements of the question hence their failure to proffer correct solutions.

Candidates are advised to cover the syllabus adequately, work on past questions in the Institute's Study Packs and Pathfinders. They should also improve their knowledge on valuation of shares.

PATHFINDER

QUESTION 2

Workings:

	A Limited	B Limited
	₦'000	₦'000
EBIT	62,500	62,500
Interest	—	<u>7,500</u>
	<u>62,500</u>	<u>55,000</u>
Less Tax @ 30%	<u>18,750</u>	<u>16,500</u>
Earnings after tax = Dividend	<u>43,750</u>	<u>38,500</u>

	A Ltd.	B Ltd.
	'000	'000
No of shares (₦ 50m ÷ ₦ 0.25)	200,000	₦ 65.5m ÷ ₦ 1.00) 62,500
Value per share	₦ 1.40	₦ 4
	₦'000	₦'000
Total value of equity (V_E)	280,000	250,000
Add: Value of debt (V_D)	—	<u>62,500</u>
	<u>280,000</u>	<u>312,500</u>

A Limited	B Limited
$WACC = \frac{\cancel{₦}43,750 \times 100\%}{\cancel{₦}280,000}$ $= 15.63\%$	$\text{Debt } (0.12 \times 0.7) \times \frac{\cancel{₦}62.50m}{\cancel{₦}312.50m} = 1.68\%$ $\text{Equity: } \frac{\cancel{₦}38.5m}{\cancel{₦}250m} \times \frac{\cancel{₦}250m}{\cancel{₦}312.50m} = 12.32\%$ $\text{TOTAL } \underline{14.00\%}$

In accordance with MM, the two companies will be in equilibrium when

$$V_g = V_E + V_{Dt}$$

where: V_g = Value of geared company

i.e. $V_E + V_D$ in the geared company i.e. B Limited above

V_E = Value of equity

V_D = Value of debt

t = Tax rate

Thus, the expected value of B Limited = $V_g = \cancel{₦}280m + \cancel{₦}62.5m (0.30) = \cancel{₦}298.75m$

Actual value of B Limited as shown above = $\cancel{₦}312.5m$

PATHFINDER

Thus B, Limited is over-valued hence shareholders will engage in arbitrage.

(a) Action to be taken by Ronalmessi:

(i) If additional income is desired:

Step 1: He should sell 4% of his investment in B Limited i.e. 4% of 62,500,000 shares i.e. 2,500,000 shares @ ₦4.00 each to realise ₦10m

Step 2: He should then borrow the equivalent of 4% @ 12% interest of the value of debt, after tax of B Limited.
i.e. 4% of ₦62,500,000 (1-0.3)
₦1,750,000

$$\begin{aligned}\text{Total fund available} &= \text{₦10m} + \text{₦1.75m} \\ &= \text{₦11.75m}\end{aligned}$$

Step 3: He should invest the ₦11.75m in the equity of A Limited (the objective here is to ensure that the investor will still bear the proportionate interest he is currently bearing in B Limited).

Check: After tax total interest of B Limited

$$\text{₦7.5m} (1 - 0.3) = \text{₦5.25m}$$

$$4\% \text{ of } \text{₦5.25m} = \text{₦0.21m}$$

$$\begin{aligned}\text{This is equal to the interest @ 12\% on } \text{₦1.75m} &= 0.12 \times \text{₦1.75} = \\ &= \text{₦0.21m}\end{aligned}$$

Calculation of Income:

$$\text{Existing Income from B Limited} = \text{Dividend} = 4\% \text{ of } \text{₦38.5m} = \text{₦1.54m}$$

$$\text{Proposed Income from A Limited} = \frac{\text{₦11.75m}}{\text{₦280.0m}} \times \text{₦43.750m} = \text{₦1,835,937.50}$$

$$\begin{aligned}\text{Less: Interest on amount borrowed gives 12\% of } \text{₦1.75m} &= \text{₦210,000.00} \\ &\underline{\text{₦1,625,937.50}}\end{aligned}$$

$$\begin{aligned}\text{Increase in income} &= \text{₦1,625,937.50} - \text{₦1,540,000} \\ &= \underline{\underline{\text{₦85,937.50}}}\end{aligned}$$

(ii) If existing income is to be maintained, apply Steps 1 and 2 as above,

Step 3: Buy 4% of the equity share of A Limited for ₦11,200,000 i.e. 4% of ₦280m

Calculation of new income:

$$\text{Expected income from A Limited} = 4\% \text{ of } \text{₦43.750m} = \text{₦1,750,000}$$

$$\text{Less interest on amount borrowed gives 12\% of } \text{₦1.750m} \quad \underline{\text{210,000}}$$

$$\text{Net Income} \quad \underline{\underline{\text{₦1,540,000}}}$$

b. If A Limited borrows ₦50m, according to MM, the new total market value of A Limited will be, $V_g = V_A = V_U + V_{Dt}$

PATHFINDER

$$\text{i.e. } V_A = \cancel{\text{N}280\text{m}} + \cancel{\text{N}50\text{m}} (0.3) = \cancel{\text{N}295\text{m}}$$

Value of Equity (V_E) will be the overall value of the company less the value of debt

$$\text{i.e. } \cancel{\text{N}280\text{m}} - \cancel{\text{N}50\text{m}} = \text{N}230\text{m}$$

Using MM formula, then $K_{Eg} = K_{Eu} + (K_{Eu} - K_D) \frac{V_D}{V_{EU}} (1-t)$

$$= 15.63 + (15.63 - 12.0) \frac{50}{230} (1-0.3) = 16.17\%$$

$$\begin{aligned} \text{WACC} &= K_o = \left(\frac{230}{280} \times 16.17 \right) + \left(\frac{50}{280} (12)(.70) \right) \\ &= 13.2825 + 1.5 \\ &= 14.78\% \end{aligned}$$

The result of borrowing ~~N~~50m will lead to a reduction in the cost of capital from 15.63% to 14.78%.

The implication for the company's choice of capital structure is that the cost of capital will fall as gearing increases, and that a capital structure of almost 100% debt will minimise the company's cost of capital.

ALTERNATIVE SOLUTION

- (a)(i) If additional income is desired, he should borrow sufficient fund in order to buy 4% of the stake in Company A as demonstrated below:

MARKET VALUES

	Company - A	Company - B
	N'000	N'000
Equity	280,000	250,000
Debenture	<u>NIL</u>	<u>62,500</u>
Total	<u>280,000</u>	<u>312,500</u>

	N'000	N'000
EBIT	62,500	62,500
INTEREST	<u>-</u>	<u>(7,500)</u>
PBT	62,500	55,000
TAX @ 30%	<u>(18,750)</u>	<u>(16,500)</u>
EAT	<u><u>43,750</u></u>	<u><u>38,500</u></u>

MR. RONALMESSI'S CURRENT INCOME

$$4\% \text{ of Company B's PAT (dividend) i.e. } 4\% \times \text{N}38,500,000 = \text{N}1,540,000$$

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INVESTMENT IN COMPANY – A

	N
TO BUY 4% OF COMPANY A's EQUITY	11,200,000
SELL 4% OF COMPANY B's EQUITY i.e. 4% of N 250m	<u>10,000,000</u>
BORROWS	<u><u>1,200,000</u></u>

EARNINGS IN COMPANY A

	N
DIVIDEND FROM COMPANY A i.e. 4% of N 43,750,000	1,750,000
LESS INTEREST N 1,200,000 X 12%	<u>144,000</u>
RESULTANT NET INCOME	1,606,000
PRE-ARBITRAGE INCOME	<u>1,540,000</u>
GAIN	<u><u>66,000</u></u>

- (ii) If his existing income is to be maintained, he will need to invest an appropriate amount i.e (~~N~~9,856,000) that will earn him the same income of ~~N~~1,540,000 as at present. This implies.

$$\frac{A}{\text{N}280,000,000} = \frac{1,540,000}{43,750,000}$$

$$\frac{A}{\text{N}280,000,000} = \frac{0.0352}{1}$$

$$A = \text{N}280,000,000 \times 0.0352$$

$$= \text{N}9,856,000$$

- (b)(i) According to MM, the WACC of a geared company will be lower than that of its ungeared counterpart as demonstrated below:

K_e of Company A pre–arbitrage is

$$K_e = d/mv$$

$$= \frac{\text{N}43,750,000}{\text{N}280,000,000} \times 100\%$$

$$= 15.625\% \text{ (which doubles as its WACC)}$$

$$K_w(g) = K_w(u) \left(1 - \frac{Vdt}{Vd + Ve} \right)$$

$$K_w(g) = 15.625 \left(1 - \frac{\text{N}50 \times 0.3}{\text{N}50 + \text{N}280} \right) = 14.91\%$$

PATHFINDER

EXAMINERS' REPORT

The question tests candidates' knowledge of the Modigliani and Miller (M&M) (Post-tax) theory on capital structure and the value of the firm with emphasis on arbitrage transaction by a shareholder.

The level of attempt was very low as the number of candidates that attempted the question was less than 30 per cent. It appears that most of the candidates that sat for the examination did not understand the import of the question hence the low level of attempt. However, the few candidates that attempted the question have just a fair knowledge of the topic, hence performance was poor.

Candidates' commonest pitfalls were their

- lack of understanding of the process of arbitrage transaction by a shareholder,
- inability to apply relevant formulae in solving the problem and
- inadequate knowledge of the M&M (Post-tax) theory on arbitrage transaction by a shareholder.

Candidates are advised to always cover the syllabus adequately and also endeavour to remember key formulae for better result in future.

QUESTION 3

- (a) A publicly quoted company seeks to know the detailed composition of its shareholders and their objectives in investing in the company for the following reasons:
- (i) To enable it take various decisions in accordance with the preferences of such shareholders.
 - (ii) To prevent the occurrence of conflict of interest as related to principal and agents.
- (b) Advantages that may accrue to the corporate finance manager include the following:
- (i) **Dividend Policy** - The knowledge of shareholders' preferences with regards to dividends or capital appreciation and marginal tax rates will assist in the determination of the company's optimal dividend policy.

PATHFINDER

- (ii) **Risky Investment** - Shareholders' preferences may assist corporate management when making decisions concerning risky capital investments. Depending on their attitude to risk and their specific circumstances, they may dislike, or prefer the company to undertake risky investments with the possibility of a higher return.
- (iii) **Financing Decisions** – With respect to the level of debt to employ, the risk attitude of shareholders can again be useful; generally speaking, a risky approach is to employ more and more debt, since in the event of default, the shareholders are paid last. However, a high level of risk is matched by a high potential return to equity holders.
- (iv) **Rebuffing a take-over:** A company whose shares are held by a few may find an unwanted take-over bid less easy to rebuff as the bidder needs to convince only a few shareholders for the bid to be successful. However, if shares are held by a few key shareholders, it may be easier to provide these shareholders with the type of return they require with a possible reduction in their likely acceptance of any take-over.
- (v) **Measurement of performance:** Ascertaining how shareholders judge performance may enable management to optimise this measure or measures, when making decisions, although this measure may not be in the prime interest of the company in terms of value maximisation.
- (vi) **Religious Belief:** Knowing the religious belief of the shareholders will assist in deciding the type of business to be involved in. For example, some religion forbids investment in alcoholic business. Such information will enable corporate finance managers to tailor their performance to satisfy the expectations of the shareholders.

EXAMINERS'REPORT

The question tests candidates' knowledge of the duties and responsibilities of the management of a publicly quoted company to other stakeholders of the company in relation to the details of the composition of the shareholders and their objectives in investing in the company.

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About 80% of the candidates attempted the question but almost all of them appeared not to understand its requirements, hence performance was poor.

Candidates' commonest pitfall was their inability to interpret the question correctly.

Candidates are advised to read, understand and interpret questions appropriately before attempting them.

QUESTION 4

- a. Capital markets are said to be efficient when prices of securities in such markets fully reflect all information about the company, the industry to which it belongs and the economy as a whole. This means that any new information about a company coming into the market is immediately reflected in the price of the share of the company such that no investor can make above average return on an investment.

In a supposedly efficient market, the price of a security is expected to fluctuate randomly around its true or intrinsic value. Efficient simply means security is price efficient. The price is right and represents the best estimate of the security's true value based on the available information.

Forms of efficiency:

The Weak Form: This form of efficiency implies that information about past share price movement is already reflected in the current market price. Therefore, the ability to forecast future prices cannot be enhanced based on the use of past information alone.

The Semi-Strong Form: This form states that the current market price of a security, fully and immediately reflects all publicly available information including information from financial statements, Chairman's report and news items. Here, insider information is excluded.

The Strong Form: This form of efficiency implies that all pieces of information both public and private (including insider information) are fully and immediately reflected in the current market price of the security. Insider information is said to be information that is known to management but unknown to the public.

- b(i) **Technical analysis in form of charting:** This states that future patterns of share prices are a repetition of the same pattern of price movements which has occurred in the past, i.e. historical price patterns are repeated in the future. The proponents of this theory believe that share prices/values can be measured in the following ways:

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- Primary trends show the upward or downward movement of share prices over a year or more.
- Secondary trends show the fluctuations over a period of one a month
- Tertiary trends show fluctuations over a period of days.

(ii) **Fundamental Analysis**

The theory states that, at any point in time, a share has an intrinsic value which is the discounted present value of the expected future cash receipts from the share.

The expectation of future receipts may relate to

- Past results of the company.
- Ratio analysis of the latest published accounts.
- Future plans or expectations of the company, possibly as a result of published statements i.e. the company reports.
- Influences affecting the economy or industry as a whole.

As investors' expectations about future earnings change, the intrinsic value of the shares, and therefore their market price, moves up or down.

c. **Roles or responsibilities of portfolio managers in an efficient market environment include:**

- Portfolio managers should be prepared to always release information about their activities to the market as any such information, particularly the positive one, will immediately be incorporated into the share price and result in an upward price movement for the benefit of the shareholders.
- Portfolio managers should not waste their time waiting for a recovery of the price of the security in a depressed market before they come with new issues.

If the market is efficient and security prices emerge in a random fashion, there is no reason to believe that just because they were high in the past, they will move back to the old levels.

- Portfolio managers should not waste their time looking for a security that would provide returns in excess of the normal or expected returns simply by analysing past information on the direction of share price or by analysing new economic information about the security or the company.

It is only when an investor has access to information which has not come to the knowledge of the investing public at large that an above average return can be made.

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EXAMINERS' REPORT

The question tests candidates' knowledge of capital market efficiency with emphasis on Efficient Market Hypothesis (EMH).

About 60% of the candidates attempted the question and performance was generally fair. However, some of the candidates that attempted the question demonstrated poor understanding of the principles and requirements of parts of the question and therefore performed poorly.

The commonest pitfall of those candidates that performed poorly in the question was their lack of in-depth knowledge of the requirements of the question hence their failure to proffer correct solutions to all the parts.

Candidates are advised to always cover the syllabus adequately by giving consideration to all sections of the syllabus during their preparations for the Institute's examination. They should also improve their knowledge on capital market efficiency.

QUESTION 5

- a. Achievement of the objective of maximisation of the value of a firm might be compromised by conflicts which may arise between the managers and the other stakeholders in an organisation. Such conflicts include:
- (i) Managers might not work industriously to maximise shareholders' wealth if they feel that they will not have a fair share in the benefits of their labour.
 - (ii) There might be little incentive for managers to undertake significant creative activities, including looking for profitable new ventures or developing new technology.
 - (iii) Managers might be giving themselves high salaries and perks.
 - (iv) Managers might be providing themselves with larger empires, through merger and organic growth, thus increasing their opportunity for promotion and social status.
 - (v) Reducing risk through diversification which may not necessarily benefit shareholders, but may well improve the managers' security and status.

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- (vi) Managers might take a more short-term view of the firm's performance than the shareholders would wish.
 - (vii) Management acting on behalf of shareholders, might also reduce the wealth and or increase the risk of creditors e.g by selling off assets of the company.
- b. The following are the steps involved in the process of strategic planning in corporate organizations:
- Establishing company's objectives and targets to be achieved within a time horizon
 - Examining the environment for possible opportunities
 - Appraising the strengths, weaknesses, opportunities and threats (SWOT)
 - Formulating strategies, with alternatives
 - Implementing strategies and action plans
 - Performance Evaluation

EXAMINERS' REPORT

Part 'a' of the question tests candidates' knowledge of the relationship between a company's management and other stakeholders while the part 'b' tests candidates' understanding of strategic planning.

Over 80% of the candidates attempted the question and performance was average. Part 'b' of the question was well understood while the part 'a' was not.

Candidates' commonest pitfall in part 'a' of the question was candidates' inability to correctly interpret and note the requirements of the examiner.

Candidates are advised to read, understand and interpret questions appropriately and note their specific requirements before attempting them.

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QUESTION 6

- (a) The factors that determine the dividend policy of a large public company whose shares are quoted on the stock exchange include:
- (i) **Legal Constraints:** The management of a company must recognise the existence of laws guiding payment of dividends. For example, a company should not pay dividend out of capital and may only pay dividends according to Companies and Allied Matters Act (CAMA), 2004, as amended) out of:
 - Profits arising from the use of company's property;
 - Revenue reserves, and
 - Realised profit on a fixed asset soldCAMA also specifies that dividends can only be declared on the recommendations of the directors, and any amount so recommended cannot be increased by the general meeting; although it can be reduced.
 - (ii) **Future Financial Requirement:** Once the legal constraints have been cleared, management should focus on its future financial needs including future investment opportunities. This should be done via budgeted sources and application of funds statements, budgeted cash flow statements and cash budget.
 - (iii) **Liquidity:** Dividends are usually paid out of cash. Therefore, the amount of dividend paid by the company is largely influenced by the available cash resources. Cash has alternative uses within the firm; management may, therefore, want to recognise these important alternatives (and also be protected against the future) and may, therefore, decide not to have a high target dividend-payment.
 - (iv) **Capacity for borrowing:** A firm may not be liquid, but may be in a strong position to borrow at short notice. This ability can be by arranging a line of credit. The ability of a firm to borrow often largely influences its ability to meet its short-term obligations as and when due, including payment of cash dividends.
 - (v) **Access to the Capital Market:** If the company is large enough and has good access to the corporate bond market, it needs not bother much about its liquidity situation for the purpose of paying cash dividends.

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- (vi) **Existence of Restrictive Covenants:** Restrictions on payment of cash dividends may be entrenched in a loan agreement.
 - (vii) **Dilution of Control:** Payment of cash dividends, supported by subsequent rising of external finance may dilute the controlling interest of the existing shareholders, if they do not partake in the provision of such finance.
 - (viii) Dividend policy decision of other similar firms
 - (ix) Stock market reaction
 - (x) Taxation
 - (xi) Attitude of company's board of directors
 - (xii) Repayment of debt
 - (xiii) Liquidity preference of the dominant shareholder
- (b) A stable dividend policy is expected to lead to a higher market valuation of a company's share because this policy usually attracts a premium due to preference for current regular income by certain investors. It gives rise to positive signalling effects and also facilitates conformity with directives issued by regulatory authorities to certain institutions like the Pension Fund Administrators.
- (c) (i) The dollar quotes at a discount
- (ii) Annualised forward premium/(discount)
- $$= \frac{FR - SR}{SR} \times \frac{12}{\text{No of months}} \times 100\%$$
- $$= \frac{1.3471 - 1.3598}{1.3598} \times \frac{12}{3} \times \frac{100\%}{1}$$
- $$= -3.7\%$$
- Because this result is negative, it confirms that the dollar trades at a discount of 3.7%. The dollar's discount is the Swiss Franc's premium and the annualised percentage premium of the Swiss Franc
- $$= \frac{1.3598 - 1.3471}{1.3598} \times \frac{12}{3} \times 100 = 3.7\%$$
- (iii) Direct quote is a method of quoting an exchange rate in which a specified number of units of domestic currency will exchange for one unit of foreign currency. For example, ₦163/US\$ means that ₦163 is required to buy 1.US\$.

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Indirect quote on the other hand is the amount of a foreign currency that could be exchanged for one unit of the local currency. For example, an indirect quote between the Nigerian Naira and US\$ will be stated as US\$0.0062/₦1. That is, US\$0.0062 will be required to buy ₦1.00

EXAMINERS' REPORT

Parts 'a' and 'b' of the question test candidates' understanding of dividend policy while part 'c' tests candidates' knowledge on the identification and determination of exchange rates.

About 80% of the candidates attempted the question. Whilst part 'a' of the question which carries the highest mark was well attempted, parts 'b' and 'c' were poorly attempted, hence the overall performance of candidates' in the question was average.

Candidates' commonest pitfalls were their

- inability to distinguish between a direct quote and an indirect quote,
- inability to remember the appropriate formula to use in determining the annualised forward premium/discount,
- repetition of points using different expressions.
- confusing dividend payment with dividend policy.

Candidates are advised to read wide and cover the syllabus adequately for better result. They should also endeavour to remember key formulae and improve their knowledge on foreign exchange.

PATHFINDER

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II-MAY 2014

ADVANCED TAXATION

Time Allowed: 3 hours

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

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. Every company is required to file income tax return in the prescribed form, with the relevant tax authority
 - A. Once every year
 - B. Once every two years
 - C. Once every three years
 - D. Twice every year
 - E. Thrice every year
2. Which of the following is **NOT** assessable under the Companies Income Tax Act Cap C21 LFN 2004? A company engaged in
 - A. The down-stream business operation only
 - B. The up-stream business operation only
 - C. The mid-stream business operation only
 - D. Manufacturing
 - E. Agricultural business
3. The Authority responsible for the collection of Stamp Duties relating to Instruments executed between persons or individuals at such rates to be imposed or charged as may be agreed with the Federal Government is the
 - A. Local Government
 - B. State Government
 - C. Federal Government
 - D. Corporate Body
 - E. Individual

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4. In respect of taxation of income from Settlements or Trusts, who is a person receiving an annuity which may be charged on an Estate?
 - A. Trustee
 - B. Beneficiary
 - C. Executor
 - D. Administrator
 - E. Annuitant
5. An advance payment of tax deducted from a contract sum before payment is made to a contractor is referred to as
 - A. Advance Tax
 - B. Tax Deposit
 - C. Tax Credit
 - D. Withholding Tax
 - E. Contract Tax
6. Which of the following is **NOT** an allowable expense in the computation of Petroleum Profits Tax?
 - A. Bad debts written off
 - B. Capital expenditure
 - C. Royalties and local export sales
 - D. Customs duties on non-essentials
 - E. Drilling costs
7. The assessable profit of a company subject to tax under the Petroleum Profits Tax Act is known as
 - A. Adjusted profit of the period
 - B. The adjusted profit of the period after adjusting for the effect of any loss relief available to the company
 - C. The adjusted profit of the period before adjusting for the effect of any loss relief available to the company
 - D. The chargeable profit
 - E. The profit for the period after relief for capital allowances

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8. Under the Companies Income Tax Act CAP C21 LFN 2004, penultimate year computation is peculiar to
 - A. Cessation of business
 - B. Commencement of business
 - C. Merger and acquisition
 - D. Dissolution of partnership
 - E. Adjustment of profit
9. Unearned Income shall not include
 - A. Dividend
 - B. Interest on savings
 - C. Bonuses and tips
 - D. Income from property
 - E. Income/gains from investments
10. To include an Industry in the list of Pioneer Industries, the President of the Federal Republic of Nigeria must be satisfied that
 - A. The Industry is being carried on in Nigeria on a scale which is not suitable to the economic requirements of Nigeria
 - B. The Industry has favourable prospects of further development in Nigeria
 - C. The Industry will also employ Nigerians
 - D. The Industry is not being carried on in Nigeria at all
 - E. It is in the public interest to encourage the development or establishment of such Industry in Nigeria
11. Which of the following is **NOT** an allowable expense deductible from the income of a Trust or of an Estate?
 - A. Any annuity paid out of the income of the Settlement, Trust or Estate
 - B. Agreed capital allowances
 - C. Any fixed annual amount paid out of the income of the Settlement, Trust or Estate
 - D. Any expenses which the administrator incurs on behalf of the Estate and at his discretion
 - E. Any expenses of the Trustee or Executor relating to the Settlement, Trust or Estate

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12. Donations to **ONE** of the underlisted Bodies/Organisations in Nigeria will be subjected to tax, under the Companies Income tax Act, CAP C21 LFN 2004
- A. The Boys Brigade of Nigeria
 - B. The Nigerian Governors' Forum
 - C. The Nigeria Red Cross
 - D. The National Youth Council of Nigeria
 - E. The Nigerian Youth Trust
13. An appeal against a decision of the Tax Appeal Tribunal is made to the
- A. Joint Tax Board
 - B. Supreme Court of Nigeria
 - C. State Revenue High Court
 - D. Court of Appeal
 - E. Federal High Court
14. In relation to Companies Income Tax (Amendment) Act 2007, which of the following statements is **TRUE** about Commencement rule?
- A. The taxpayer may exercise power of election in the second and third tax years
 - B. The taxpayer may exercise power of election in the penultimate tax year
 - C. The taxpayer may revoke the power of election at anytime
 - D. The tax authorities may exercise the power of election in the year of cessation
 - E. The tax authorities may exercise the power of election in the penultimate tax year
15. The Petroleum Profits Tax Act CAP P13 LFN 2004 listed the following as "expenses not allowed" **EXCEPT**
- A. Any Capital withdrawn or any sum employed or intended to be employed as Capital
 - B. Any sum recoverable under any insurance or contract of indemnity
 - C. All non-productive rents, the liability for which was incurred by the company during that period
 - D. Rent or cost of repairs to any premises or part of any premises not incurred for the purpose of those operations
 - E. The depreciation of any premises, building, structures, work of a permanent nature, plant, machinery or fixtures

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16. Which of the following is a condition for the imposition of Minimum Tax for an on-going business as specified in section 28A of Companies Income Tax Act?
- A. The company is involved in agricultural business
 - B. The company has been in business operation for less than four years
 - C. Tax on normal basis is less than the Minimum Tax
 - D. The Turnover is below ₦500,000
 - E. The Turnover is below ₦400,000
17. Under the Stamp Duties Act CAP S8 LFN 2004, which of the following does **NOT** fall under Fixed Duties?
- A. Mortgages
 - B. Insurance Policy (Non-Life)
 - C. Cheque Leaves
 - D. Memorandum and Articles of Association of Companies
 - E. Debenture Trust Deeds
18. Disposal of Chargeable Oil includes which of the following?
- A. Delivery, without sale of chargeable oil
 - B. Chargeable oil not delivered
 - C. Delivery to petrol station
 - D. Delivery to a farm
 - E. Delivery authorised by NNPC
19. Which of the following is charged with the Administration of Tax in Nigeria?
- A. The Presidency, Senate and House of Representatives
 - B. The Legislative, Executive and Judiciary
 - C. The Federal, State and Local Government Authorities
 - D. Federal Inland Revenue Service
 - E. Joint Tax Board
20. Year of assessment in relation to Capital Gains Tax Act CAP C1 LFN 2004 means
- A. A year beginning 1 January and ending 31 December of the same year
 - B. A year commencing 1 April and ending 31 March of the following year
 - C. A year beginning 1 July and ending 30 June of the following year
 - D. A year beginning 1 October and ending 30 September of the next year
 - E. The accounting year of the company

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SECTION A: PART II SHORT-ANSWER QUESTIONS

(20 Marks)

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. What is the legal implication of an Instrument that is not properly Stamped?
2. An agricultural business that ceases operation will carry backward any unutilised capital allowances for a maximum period of years.
3. In relation to Companies Income Tax Act CAP C21 LFN 2004, state **ONE** item to be included in the withholding tax remittance schedule.
4. In accordance with Companies Income Tax Act CAP C21 LFN 2004, cottage industry means an industry where the creation of.....and..... are home-based, rather than factor-based.
5. State any **TWO** operating or financing arrangements in the Nigerian Upstream sector of the oil industry.
6. State the treatment of Tertiary Education Tax under Petroleum Profits Tax Act CAP P13 LFN 2004.
7. All capital investment relating to the gas-to-liquids facilities shall be treated asand recovered against the income from crude.
8. In relation to the Capital Gains Tax Act CAP C1 LFN 2004, a personal representative that assents to a legacy is known as.....
9. What is the penalty for failure to register for Value Added Tax within the time limit specified under the Value Added Tax Act CAP V1 LFN 2004?
10. A person who has a right to the Capital of a settlement when the life interest terminates is known as.....
11. What percentage of VAT proceeds is due to the Federal Government?
12. On what condition can an extension of time for Filing Returns by a Company be granted by the Federal Inland Revenue Service?

PATHFINDER

13. The three main tax bases used in the Nigerian tax system, are classified into Income,and
14. A conscious effort of a Taxpayer in minimising total tax payable at a future date is known as.....
15. Within the context of Capital Gains Tax Act CAP C1 LFN 2004, transactions carried out at open market prices of the items involved, are referred to astransactions.
16. Unearned incomes are derived from sources other than employment. State one example.

Use the following data to answer questions 17 and 18:

A man disposed part of his property costing ₦15million. The proceeds of the disposal amounted to ₦8million, while the market value of the remainder at the time of disposal was ₦24million.

17. What is the cost of the part disposed?
18. What is the Capital Gain on the transaction?
19. Small companies are assessable to Tax at a lower rate for a maximum period of..... from the date of commencement of business.
20. G – Factor in relation to Petroleum Profits Tax Act CAP P13 LFN 2004, is.....

SECTION B: ATTEMPT QUESTION 1 AND ANY OTHER THREE QUESTIONS

(60 Marks)

QUESTION 1

CASE STUDY

The Federal Government of Nigeria is encouraging Nigerians in diaspora to return home and invest in the economy in order to create jobs.

In response to the patriotic call, NNEOCHI OK Ltd was incorporated to engage in Petroleum operations.

The company operates a joint venture with NNPC.

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The Chief Executive of the company is uncertain as to which tax statute regulates companies engaged in Upstream Petroleum Operations. He was also confused when the issue of Basis of Assessment and what constitutes the profit of an accounting period including treatment of losses were raised at one of the heated Board meetings of the company. He is desirous of updating his knowledge in these areas.

The Company commenced its operation immediately after incorporation, it bided for and was granted Oil Mining Lease (OML) by the Federal government. After some years of prospecting, the company successfully struck oil and its first year of production data are given below:

The following information is provided for the year ended 31 December 2012

	₦' 000
Direct lifting costs	70,000
Direct handling/transportation costs	40,000
Other direct production costs	20,000
Field overheads	30,000
Environmental protection	11,000
Safety	7,000
Personnel amenities	14,000
Materials handling and storage expenses	19,000
Other general and administrative expenses	9,000
Exploration costs	36,000
First two Appraisal Well costs	26,000
Intangible drilling and development costs	60,000
Capital allowances	98,000
Fees received for services ancillary to petroleum operations	22,000
Production of crude oil for the year	- 44,000,000 barrels

You are required to:

As Tax Consultant, state briefly the points to be raised in a Tax Advisory Memorandum addressed to the Chief Executive of the company by providing a clearer understanding of the issues raised above, using the following as a guide in analysing the data.

- a. Computation of the Operating Cost per barrel (T1) (4 Marks)

PATHFINDER

- b. Computation of the Capital Investment Costs (T2) (4 Marks)
 - c. The tax statutes regulating the Upstream and Downstream operations (2 Marks)
 - d. The Basis Year applicable to the Upstream operations (1 Mark)
 - e. The components of profit of an accounting period for Upstream operations (2 Marks)
 - f. The treatment of losses in Upstream operations (2 Marks)
- (Total 15 Marks)

QUESTION 2

The Federal Inland Revenue Service Board is a creation of statute, with responsibility for overseeing the administrative and technical requirements of the Federal Inland Revenue Service.

You are required to:

- a. Itemise **FIVE** members of the Federal Inland Revenue Service Board as contained in the Companies Income Tax Act CAP C21 LFN 2004 as amended. (5 Marks)
 - b. List **FIVE** reasons under which a member so appointed shall cease to hold office. (5 Marks)
 - c. State **FIVE** powers of the Federal Inland Revenue Service Board. (5 Marks)
- (Total 15 Marks)

QUESTION 3

- a. Under the Capital Gains Tax Act CAP C1 LFN 2004;
 - (i) When is a disposal deemed to have taken place? (2 Marks)
 - (ii) How can a part disposal of an asset take place? (3 Marks)
- b. Adanma Abia Limited bought a building on 28 February 2005 for ₦975,000 and incurred ₦195,000 on immediate improvement of the building.

On 1 August 2012, the company sold part of the building for ₦650,000 and paid ₦39,000 as professional charges on the sale.

The market value of the unsold part of the building was put at ₦1,300,000

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You are required to:

- (i) Compute the Capital Gains Tax payable by the company. (8 Marks)
 - (ii) Compute the cost of the part of the building not disposed. (2 Marks)
- (Total 15 Marks)**

QUESTION 4

Double Taxation Agreement is an understanding and agreement between two or more countries. It details the issues to be contained in such Agreements on a reciprocal basis.

- a. Explain the concept of Double Taxation Agreement. (5 Marks)
 - b. List **FIVE** objectives of entering into a Double Taxation Agreement. (5 Marks)
 - c. State and explain the forms of Double Taxation Agreement. (5 Marks)
- (Total 15 Marks)**

QUESTION 5

DAHIRU Integrated Oil Limited is an indigenous oil company incorporated in 1996. The following result was presented for the year ended 31 December 2008.

	₦'000	₦'000
<u>Income</u>		
Value Of Crude Oil Exported		205,000
Value Of Domestic Sales		135,000
Other Income		9,000
<u>Expenses</u>		
Rent Paid	70,000	
Royalty On Export Sales	30,000	
Royalty On Local Sales	9,000	
Interest Paid	20,000	
Transportation Cost	40,000	
Intangible Drilling Cost	30,000	
Non-Productive Rent	6,000	
Bad Debts Written Off	10,000	
Operating Cost	30,000	
Administrative Expenses	25,500	

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Other Information

- (i) Depreciation of ₦6,000,000 is included in Administrative expenses.
- (ii) Capital allowances was agreed at ₦10,500,000
- (iii) A sum of ₦20,000,000 was paid to acquire new assets used during the year and the company operates at 350 meters above continental shelf areas.
- (iv) Custom Duty on Plants and Storage Tanks of ₦1,500,000 was included in the Operating Cost.
- (v) The cost of drilling the first 3 appraisal wells totalling ₦45,000,000 was not included in the figures above.
- (vi) The API gravity of exported crude was 25° although the standard API gravity was agreed at 35°. All crude oil that meet the standard specification was sold at ₦40.50 per barrel. There is an allowance of ₦0.10 for every degree rise or fall in API gravity. Six million barrels of crude oil were exported in 2008.
- (vii) Contracts under natural gas sale with the NNPC were carried out. The sales proceeds for gas with a load factor of 67% was ₦45,000,000.

You are required to:

- a. Compute the tax liability of DAHIRU Integrated Oil Limited. (11 Marks)
 - b. Using data provided, explain briefly the issue of transportation business by an oil company. (4 Marks)
- (Total 15 Marks)**

QUESTION 6

The Federal Government introduced some measures to promote industrialisation by collaborating with local and foreign investors.

You are required to:

State the tax incentives for investors under the under-listed headings:

- a. Small Manufacturing Companies (6 Marks)
- b. Solid Minerals (3 Marks)

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- c. Hoteliers and Tourism (3 Marks)
- d. Research and Development (3 Marks)
- (Total 15 Marks)

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NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

	Initial %	Annual %
Office Equipment	50	25
Motor Vehicles	50	25
Office Buildings	15	10
Furniture and Fittings	25	20
Industrial Buildings	15	10
Non-Industrial Buildings	15	10
Plant and Machinery - Agricultural Production	95	Nil
- Others	50	25

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

Graduates tax rates with consolidated relief allowance of ₦200,000 or 1% of Gross Income whichever is higher + 20% of Gross income.

	Taxable Income ₦	Rate of Tax %
First	300,000	7
Next	300,000	11
Next	500,000	15
Next	500,000	19
Next	1,600,000	21
Over	3,200,000	24

After the relief allowance and exemption had been granted, the balance of income shall be taxed as specified in the tax table above.

- 4. COMPANIES INCOME TAX RATE 30%
- 5. TERTIARY EDUCATION TAX (2% OF Assessable Profit)
- 6. CAPITAL GAINS TAX 10%
- 7. VALUE ADDED TAX 5%

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SOLUTIONS TO SECTION A

PART 1 MULTIPLE-CHOICE QUESTIONS

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

EXAMINERS' REPORT

The questions cover the entire syllabus and candidates' performance was above average. Few candidates displayed inadequate knowledge of some specific provisions of the various tax acts, as well as terminologies. Candidates are advised to be more painstaking in their preparations.

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PART II SHORT ANSWER QUESTIONS

1. It is not admissible as evidence in the Court of Law
2. Four (4) years
3.
 - (i) The gross amount of the payment
 - (ii) The name and address of the recipient
 - (iii) The amount of tax withheld
 - (iv) In respect of rent, the address or accurate description of the property and the period covered by the rent (Any one)
 - (v) Tax identification number (TIN) of the recipient
4. Products and Services
5.
 - (i) Joint Venture
 - (ii) Production Sharing Contract
 - (iii) Sole Risk (Any one)
6. It is treated as an allowable/deductible expenditure
7. Chargeable Capital Allowance
8. Legatee
9. ₦10,000 for the 1st month in which the failure occurs and ₦5,000 for each subsequent month in which the failure continues
10. Remainder Man
11. 15%
12.
 - Make an application
 - Application must come before the expiration of the time stipulated for making the returns
 - Shows good cause for the inability to make the returns
13. Expenditure and Capital
14. Tax Planning
15. Arms length

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16. Dividend Income, Rental Income, Interest income, Royalty
17. ₦3,750,000
18. ₦4,250,000
19. Four (4) years
20. Gas Production Cost Adjustment Factor

Tutorials:

17.
$$\frac{₦8,000,000}{₦8,000,000 + ₦24,000,000} \times ₦15,000,000 = ₦3,750,000$$
18.
$$₦8,000,000 - ₦3,750,000 = ₦4,250,000$$

EXAMINERS' REPORT

The questions cover a wide area of the syllabus. Performance was average. A few candidates displayed poor knowledge of some the questions. Candidates should improve on their preparations for future examinations.

SOLUTIONS TO SECTION B

QUESTION 1

NNEOCHI OK LIMITED

The points to be raised in a Tax Advisory Memorandum are:

(a)

Computation of the Operating cost per barrel (T1)

	₦'000
Direct Lifting Costs	70,000
Direct Handling/Transportation Costs	40,000
Other Direct Production Costs	20,000
Field Overheads	30,000
Environmental Protection	11,000
Safety	7,000
Personnel Amenities	14,000
Materials Handling & Storage Expenses	19,000
Other General & Administrative Expenses	<u>9,000</u>
Total Operating Costs	(220,000)
<u>Less:</u> Fees received for ancillary services	<u>(22,000)</u>

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Net Operating costs 198,000

Production for the year 44,000,000 Barrels

Therefore:

$$\frac{\text{T1}}{\text{Barrels}} = \frac{\text{N198,000,000}}{44,000,000}$$

$$= \text{N4.50/Barrel}$$

(b) Computation of Capital Investment Costs (T2)

	N'000
Exploration costs	36,000
First two Appraisal Well Costs	26,000
Intangible Drilling & Development costs	60,000
Capital allowances	<u>98,000</u>
	<u>220,000</u>

(c) Petroleum Profits Tax Act CAP P13 LFN 2004 regulates tax imposition on the profits of companies engaged in Petroleum operations – upstream activities. Profits of companies engaged in Petroleum operations – downstream activities are taxed based on Companies Income Tax Act CAP C21 LFN 2004.

(d) Profits arising from petroleum operations upstream activities are assessable to tax on current or actual year basis.

(e) The profit of an accounting period for companies engaged in upstream activities is the aggregate of:

- (i) Proceeds of sales of chargeable oil;
- (ii) Value of chargeable oil disposed of;
- (iii) Value of chargeable natural gas, and
- (iv) Incidental income from petroleum operations

(f) The losses sustained in upstream activities are deducted from adjusted profit. There is no restriction on the number of years that losses can be carried forward.

A company may elect to defer the deduction of losses that should have been made from the adjusted profit of one accounting period to the succeeding accounting period(s).

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EXAMINERS' REPORT

This is a case study relating to companies engaged in the Petroleum Industry.

Almost all the candidates attempted the question and majority of them displayed good understanding of the requirements of the question.

Some of the candidates displayed poor understanding of what constitutes Income and related Operating Costs for companies engaged in the Upstream Sector of the Petroleum Industry. Candidates are advised to be more painstaking in discerning correctly the Tax Act being examined, as well as the requirements.

QUESTION 2

(a) MEMBERS OF THE FEDERAL INLAND REVENUE SERVICE BOARD (FIRSB)

- (i) The Executive Chairman of the Service as Chairman to be appointed by the President and subject to the confirmation of the Senate.
- (ii) A representative of the Attorney-General of the Federation.
- (iii) The Governor of the Central Bank of Nigeria or his representative.
- (iv) A representative of the Ministry of Finance not below the rank of a Director.
- (v) The Group Managing Director of the NNPC or his representative who shall not be below the rank of a Group Executive Director of the Corporation or its equivalent.
- (vi) The Comptroller-General of the Nigerian Customs Service or his representative not below the rank of Deputy Comptroller-General.
- (vii) The Chairman of the Revenue Mobilization Allocation and Fiscal Commission or his representative who shall be any of the Commissioners representing the 36 States of the Federation.
- (viii) The Registrar-General of the Corporate Affairs Commission or his representative not below the rank of a Director.
- (ix) The Chief Executive Officer of the National Planning Commission or his representative, not below the rank of a Director.

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(x) Six members with relevant qualifications and expertise, who shall be appointed by the President, to represent each of the six geo-political zones.

(b) A member of the FIRSB shall cease to hold office if:

(i) He resigns his appointment as a member of the Board by notice under his hand addressed to the President.

(ii) He becomes of unsound mind.

(iii) He becomes bankrupt or makes a compromise with his creditors.

(iv) He is convicted of a felony or of any offence involving dishonesty or corruption.

(v) He becomes incapable of carrying on the functions of his office either arising from an infirmity of mind or body.

(vi) The President removes him from office in the interest of the Service or the Public.

(vii) He has been found guilty of contravening the Code of Conduct Bureau and Tribunal Act of gross misconduct in relation to his duties.

(viii) He is disqualified by his professional body.

(ix) In the case of a person who becomes a member by virtue of the office he occupies, he ceases to hold such office.

(x) If the member dies.

The Power of (FIRSB) are to,

(i) Provide the general policy guidelines relating to the functions of the Service.

(ii) Manage and superintend the policies of the service on matters relating to the administration of the revenue assessment, collection and accounting systems under the Act or any enactment of law.

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- (iii) Review and approve the strategic plans of the Service.
- (iv) Employ and determine the terms and conditions of service including disciplinary measures of the employees of the Service.
- (v) Stipulate remuneration, allowances, benefits and pensions of staff and employees in consultation with the National Salaries, Income and Wages Commission.
- (vi) Do such other things which in its opinion are necessary to ensure the efficient performance of the functions of the Service under the Act.

EXAMINERS' REPORT

The question tests candidates' knowledge and of both the membership of, appointment into as well as the powers of the Federal Inland Revenue Service Board (FIRSB).

Performance was good in Parts (a) and (b) of the question, whilst a good number of the candidates performed poorly in Part (c) of the question. Many candidates mistook Functions for Powers.

Candidates are expected to update their knowledge of the composition and scope of the various Tax Authorities as well as their functions and powers.

QUESTION 3

- (a) (i) A disposal is deemed to have taken place when a capital sum is obtained from the sale, transfer, assignment, lease, compulsory acquisition or any other disposition of an asset, notwithstanding that no asset is acquired by the person paying the capital sum.
- (ii) Part disposal of an asset can take place where a person who has acquired two or more assets of any description as a set at an all inclusive cost and decides to dispose part of the assets so acquired, in bits. The cost of the part disposed is arrived at as:
Where; $\frac{A}{A+B} \times C$
 - A is the sales proceeds;
 - B is the market value of the unsold part; and
 - C is the cost of the whole assets before the sale.

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(b) (i)

ADANMA ABIA LIMITED COMPUTATION OF CAPITAL GAINS TAX 2012

	N'000
Sales Proceeds of part disposed off	650,000
Less: Professional charges	<u>(39,000)</u>
Net sales proceeds	611,000
Less: Cost of part disposed off	
$\text{N} \left(\frac{650,000}{650,000 + 1,300,000} \right) \times \text{N}(975,000 + 195,000)$	<u>(390,000)</u>
CAPITAL GAINS	<u>N221,000</u>
Capital Gains Tax Payable at 10%	N22,100

(ii)

Computation of the Cost of the part of the building not disposed

	N'000
Total cost of building	1,170,000
Less: Cost attributable to part of building disposed of	<u>390,000</u>
Cost of part of building not disposed of	<u>780,000</u>

EXAMINERS'REPORT

This is a question on Capital Gains Tax Virtually all the candidates attempted the question and performance was good.

Few candidates performed poorly in Part (a) of the question, which was theoretical, but performed well in Part (b) of the question, which was computational. Some candidates displayed poor understanding of the Formula/Ratio used in the computation of Cost of a Part-Disposal of an Asset under the Act. Candidates are advised to ensure adequate coverage of key sections/provisions of relevant Acts in their preparations for future examinations.

QUESTION 4

(a) Concept of Double Taxation Agreement

Double taxation is a situation where an income or capital is being subjected to tax by more than one tax authority in different Countries. This usually occurs where countries insist on their taxing right to tax any or all the transactions that occur within their countries.

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In order to reduce or eliminate the impact of double tax on an income. Double Taxation Agreements or Tax Treaties are entered into between Countries.

Tax Treaty is the term used to denote an agreement between two or more Countries for avoidance of double taxation of income and capital and it is usually aimed at the prevention of fiscal evasion.

A comprehensive Double Taxation Agreement will cover the scope of general definition of terms, basis of taxation of income and capital, methods for the elimination of double tax and assistance in collection of taxes.

Where there is a Double Taxation Agreement between two Countries, credit is granted for foreign tax suffered, restricted to tax payable on the income in Nigeria.

(b) Objectives of entering into Double Taxation Agreements

The purpose of entering into a Double Taxation Agreement in Nigeria is to achieve the following objectives:

- (i) Avoidance of Double Taxation of Income
- (ii) Grant of Tax Treaty benefits
- (iii) Prevention of fiscal evasion and avoidance
- (iv) Co-operation on tax matters
- (v) Exchange of information
- (vi) Non-discrimination
- (vii) Mutual agreement procedure, with respect to resolution of disputes

(c) Forms of Double Taxation Agreements

Double Taxation can be classified into two:

- (i) **Juridical Double Taxation:** This is a situation where the same Income is taxed twice in the hands of the same Taxpayer. For example, tax on dividend by withholding tax at the source State or Country and then taxed again in the Country of residence of the recipient.
- (ii) **Economic double taxation:** This is a situation where the same income is taxed twice in the hands of two different taxpayers. For example,

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taxing profit on the company and also taxing dividend distributed out of the profits, in the hands of the recipient shareholders.

EXAMINERS' REPORT

This question is on Double Taxation Agreements with respect to two or more Countries.

Many candidates displayed poor understanding of the requirements of the question. Some of the candidates that attempted the question were referring to Double Taxation Agreements between Commonwealth Countries rather than between countries in general, whilst some others were raising the issue of residents and non-residents. Some candidates could not state correctly the objectives of countries entering into Double Taxation Agreements or the forms of such agreements.

Candidates are advised to be more thorough in their preparations for examinations.

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QUESTION 5

(a)(i)

Dahiru Integrated Oil Limited Computation of Petroleum Profits Tax for 2008 Year of Assessment

	N'000	N'000	N'000
Fiscal value of oil sold (Wki)		237,000	
Value of Domestic sales		135,000	
Other income		<u>9,000</u>	
Total Income			381,000
Less: Allowable Expenditure:			
Rent paid		70,000	
Royalty on Export sales		30,000	
Royalty on Local sales		9,000	
Interest paid		20,000	
Transport cost		40,000	
Intangible drilling cost		30,000	
Cost of Drilling 1 st two appraisal wells N $\left(\frac{45,000}{3} \times 2 \right)$		30,000	
Non-productive rent		6,000	
Bad debts written off		10,000	
Operating cost (custom duties on plant and tank is allowed)		30,000	
Administrative expenses	25,500		
Less: Depreciation	<u>(6,000)</u>	<u>19,500</u>	<u>(294,500)</u>
			<u>86,500</u>
Less: Tertiary Education Tax (2/102 x N 86,500)			<u>(1,696)</u>
Assessable Profit			84,804
Less: Capital Allowance (restricted to the lower of (a) or (b)			
(a) For the year as agreed		10,500	
Petroleum investment allowance (wk ii)		<u>7,000</u>	
		<u>17,500</u>	
(b) Restricted to 85% of Assessable profit		72,083	
Less: 170% of PIA i.e. (N 7,000 @ 170%)		<u>11,900</u>	
		<u>60,183</u>	
Capital allowance claim			<u>(17,500)</u>
Chargeable profit			<u>67,304</u>
Chargeable tax @ 85%			<u>57,208</u>
Tertiary Education Tax @ 2% of Assessable Profit			<u>1,696</u>

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(b) Treatment of Issue of Transportation Business

Income from the transportation business by a company engaged in Petroleum operations does not form part of petroleum operations income.

Consequently, income received from the business cannot be subjected to tax under the provisions of the Petroleum Profits Tax Act. Indeed transportation business is similar to trading and so the income is chargeable to tax only under the Companies Income Tax Act.

It should be noted that any attendant expense incurred to earn the transportation income will not be allowed for Petroleum Profits Tax Computation purposes. Consequently, such an expense is used to reduce the transportation income for tax purpose.

Computation of CIT on Sale of Gas

	N'000
Gross proceed of Gas sale	45,000
Less G. Factor allowance	
Lead factor of 67	
G. factor % =	
$15.5 - (15.5 - 14.3) \times \frac{60 - 67}{60 - 70}$	
= $15.5 - 1.2 \times 7/10$	
= $15.5 - 0.84 = 14.66\%$	
G. factor allowance (N 45,000 x 14.66%)	(6,597)
Net proceeds of Gas sale	38,403
Less: Gas sale expenses	<u>0</u>
Chargeable profit from Gas sale	38,403
CIT @ 30%	11,520
Tertiary Education Tax @ 2% of Chargeable profit	768

Workings

(i) Fiscal value of oil exported	
APP	
Posted price at agreed APi – 35 ⁰	40.50
Less: adjustment:	
$(35^0 - 25^0) \times 0.10$	<u>(1.00)</u>
Adjusted ported price	<u>N39.50</u>

Fiscal value of oil sold = 6,000,000 x N39.50 = N237,000,000

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(ii)	Petroleum Investment allowance (PIA)	N
	Acquisition during the year	20,000,000
	Add: Capitalized cost of 3 rd Appraisal Well	<u>15,000,000</u>
		<u>35,000,000</u>
	PIA @ 20%	<u>7,000,000</u>

EXAMINERS' REPORT

This question tests candidates' knowledge and understanding of the provisions of some aspects of the Petroleum Profits Tax Act CAP P13 LFN 2004 and the incidence of Income earned by Companies operating under the Act, which is subject to tax under the Companies Income Tax Act CAP C21 LFN 2004.

Performance was very poor. Candidates are advised to be more painstaking whilst scrutinizing questions, before attempting them.

QUESTION 6

Tax Incentives for Investors:

(a) Small Manufacturing Companies:

Small manufacturing companies are those with less than ~~N~~1million Turnover.

- (i) They are to pay Income Tax at 20% for the first four years of commencing business.
- (ii) Dividends from small manufacturing companies are exempted from tax for the first four years of business operations.
- (iii) No tax is payable on interest charged by banks for manufacturers of Export goods.
- (iv) Dividend derived from manufacturing Companies in the Petrochemical and Liquefied Natural Gas sub-sectors are tax exempt.
- (v) There are no restrictions on Capital Allowances claimable by Small Manufacturing Companies.

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(b) **Solid Minerals**

- (i) Companies engaged in the mining of solid minerals are entitled to claim Initial and Annual Allowances as follows:

Initial Allowance	95%
Annual Allowance	Nil

- (ii) In addition, they are to enjoy tax-free holiday for the first three years of operation.
- (iii) Low rate of tax of 20% is payable by small companies in the mining of solid minerals for the first four years from commencement.

(c) **Hoteliers and Tourism**

Twenty-five percent (25%) of income derived from tourism by hotels in convertible currencies will be exempted from tax with effect from 1996, provided such incomes are set aside and put in a reserve fund to be utilised within five years in expansion of the construction of new Hotels. The amount to be allowed as deductible shall not exceed 15% of total profit or 25% of taxable profit, whichever is higher.

(d) **Research and Development**

- (i) Companies and other organisations that engage in Research and Development activities for commercialisation are to enjoy 20% Investment Tax Credit (ITC) on their qualifying capital expenditure.
- (ii) Donations to Universities and Research Institutions are tax deductible
- (iii) Reserve made out of the profits of a period, which shall not exceed an amount equal to 10% of the total profits of that company as ascertained before any deduction is made.

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EXAMINERS' REPORT

This question tests candidates' knowledge of the peculiarities regarding tax Incentives aimed at encouraging Investors under the listed sectors in Nigeria.

Less than 20% of the candidates attempted this question. Majority of them concentrated on incentives to Pioneer Industries. Almost all of them did not understand incentives to Hoteliers and the Tourism Industry. Performance was therefore poor.

Candidates are advised to ensure they cover the entire syllabus and make use of standard texts.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL EXAMINATION II – MAY 2014

PUBLIC SECTOR ACCOUNTING AND FINANCE

Time Allowed: 3 hours

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

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. International Public Sector Accounting Standard No 23 deals with
 - A. Impairment of Non-Cash-General Assets
 - B. Presentation of Budget Information in Financial Statements
 - C. Disclosure of Financial Information about the General Government Sector
 - D. Revenue from Non-Exchange Transactions (Taxes and Transfers)
 - E. Related Party Disclosures
2. Authority for the abandonment of arrears of revenue in Government is vested in the
 - A. Permanent Secretary
 - B. Accountant-General of the Federation
 - C. Auditor-General for the Federation
 - D. Director of Finance and Accounts
 - E. Minister of Finance
3. The instrument which is used to re-vote capital expenditure vote which had lapsed over the years is known as
 - A. Development Fund General Warrant
 - B. Development Fund Virement Warrant
 - C. Development Fund Reserve Expenditure Warrant
 - D. Development Fund Supplementary Warrant
 - E. Development Fund (Special) Warrant

PATHFINDER

4. The Federal Executive Council has power to award contract of goods in excess of
 - A. ₦10 million
 - B. ₦75 million
 - C. ₦80 million
 - D. ₦90 million
 - E. ₦100 million
5. Which of the following is **NOT** a Government Business Enterprise (GBE) as recognised by International Public Sector Accounting Standards?
 - A. Central Bank of Nigeria
 - B. Federal Civil Service Commission
 - C. Securities and Exchange Commission
 - D. Nigerian Communications Commission
 - E. Nigerian Ports Authority
6. The following bases are used to assert the matching concept which states that all relevant income must be matched with relevant expenditure **EXCEPT**
 - A. Accrual basis
 - B. Cash basis
 - C. Sum-of-digit basis
 - D. Modified cash basis
 - E. Commitment basis
7. Purchase of a non-current asset is
 - A. Recurrent expenditure
 - B. Below-the-line expenditure
 - C. Emergency expenditure
 - D. Revenue expenditure
 - E. Capital expenditure
8. The Annual Cash Plan shall be prepared by the
 - A. Federal Minister of Finance
 - B. Federal Pay Officer
 - C. Federal Minister of State for Finance

PATHFINDER

- D. Accountant-General of the Federation
 - E. Auditor-General for the Federation
9. Which of the following is **NOT** an External Control of Expenditure?
- A. The 1999 Constitution of Federal Republic of Nigeria
 - B. Budget procedure
 - C. Quarterly allocation of expenditure
 - D. Control by warrant
 - E. Approval of the expenditure by the officer controlling vote
10. An example of indirect tax on spending expected to be borne by the final consumer of goods and services is known as
- A. Petroleum Profit Tax
 - B. Commission Tax
 - C. Capital Gains Tax
 - D. Companies Income Tax
 - E. Value Added Tax
11. Which of the following refers to the changing of the maturity structure of a public debt to cover a longer period until it is finally settled?
- A. Debt rescheduling
 - B. Debt conversion
 - C. Debt buy-back
 - D. Debt servicing
 - E. Debt refinancing
12. A tax on the increase in the value of an asset when the asset is disposed off is called
- A. Valued added tax
 - B. Capital transfer tax
 - C. Capital gains tax
 - D. Company profit tax
 - E. Multiple stage tax

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13. Which of the following is **NOT** a demerit of cost-benefit analysis approach to public sector project appraisal?
- A. It emphasis economic and social costs and benefits of a project on the society
 - B. Alternative methods of valuing benefits yield different outcomes
 - C. The necessity to distinguish between technological and pecuniary spill over
 - D. The likelihood of double counting of costs of a project
 - E. The ability to determine the appropriate interest rate for discounting future costs and benefits
14. Which of the following can be grouped under government independent revenue sources in Nigeria?
- A. Petroleum profit tax
 - B. Companies income tax
 - C. Excise duties
 - D. Rent on government property
 - E. Earnings of Nigerian National Petroleum Corporation
15. All the following are features of a public good **EXCEPT**
- A. Its marginal cost is zero or close to zero
 - B. The existence of externalities
 - C. Its use by one more member of the society does not reduce its availability to the others
 - D. It is subject to the principle of exclusion
 - E. An additional member of the society can derive benefit without appreciably adding to its total cost
16. "The States require financial as well as other resources to maintain existing facilities and develop additional capacities". This statement relating to revenue allocation applies to the principle of
- A. Independent revenue
 - B. Equality of states
 - C. Even development
 - D. Derivation
 - E. Need

PATHFINDER

17. Development planning spanning a period of 15 – 20 or 25 years is
- A. Rolling planning
 - B. Perspective planning
 - C. Indicative planning
 - D. Short-term planning
 - E. Medium-term planning
18. Which of the following is **NOT** an advantage of a surplus budget?
- A. It can be used by the government to solve the problem of balance of payments deficit
 - B. It enables government to conserve resources for future use
 - C. It can be used to stimulate economic growth
 - D. It is an anti-inflation device
 - E. It discourages government borrowing
19. Which of the following is a discounting technique which equates the Present Value (PV) of future cash flows to the initial outlay?
- A. Payback Period (PBP)
 - B. Profitability Index (PI)
 - C. Internal Rate of Return (IRR)
 - D. Net Present Value (NPV)
 - E. Accounting Rate of Return (ARR)
20. Which of the following is **NOT** a purpose of taxation in a modern economy?
- A. To generate revenue
 - B. To encourage local production
 - C. To promote income inequality
 - D. To promote economic growth
 - E. To promote price stability

PATHFINDER

SECTION A: PART II

SHORT-ANSWER QUESTIONS

(20 Marks)

ATTEMPT ALL QUESTIONS IN THIS SECTION

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

1. The spill-over effect from the production or use of some public goods to other parties or economic units refers to
2. Given a rate of interest in project appraisal, what is the process of ascertaining the value of future expenditure in today's worth?
3. The period of time it takes for an investment project to generate net incremental cash that would be sufficient to recover its initial investment capital outlay in full is referred to as
4. The instrument of debt management set up and managed by the establishment of sinking fund to facilitate the redemption of a matured instrument is known as
5. A type of debt which may not have any specific maturity but part of which may be repayable subject to specific terms and conditions is referred to as
6. The tax system where the percentage of income paid in tax varies inversely with the level of income is known as
7. The management of the Federal budget to attain price stability, relative full employment and a satisfactory rate of economic growth is termed
8. Tax paid by individuals on their earnings from wages and salaries, rents, profits and interests is
9. The rate of return that gives the Net Present Value (NPV) of zero is
10. A fixed three to five-year development planning is classified as
11. A document that provides specific accounting operational guidelines to the Accounts Officers for use as well as training materials in order to enhance the competence level of the accounting staff is

PATHFINDER

12. A discretionary financial assistance from the Federal Government to a State Government which is neither statutory nor tied to a particular project is known as
13. The framework which sets out the macroeconomic projections for the next three financial years and underlying assumptions for the projections is
14. The agency responsible for the collection of penalties on gas flared is
15. Where a financial officer refuses to bank daily receipts with the intention of converting same to personal use and make up from subsequent receipts, he is said to be involved in.....
16. A circular used in amending existing rules and regulations or introducing new rules and regulations where there is none in place is called circular.
17. The warrant which authorises the release of funds included in the approved Annual or Supplementary Capital Estimates, but excluded from the Development Fund Annual General Warrant and Development Fund Supplementary General Warrant is known as
18. Under the Pension Reform Act, 2004, the number of years of service for an employee to qualify for pension is
19. In accordance with IPSAS 19, goods, services and other benefits provided by a government without equivalent consideration for the value of goods and services provided directly in return from the recipient of these benefits are
20. A member of the Code of Conduct Tribunal shall be removed from office by the President supported by an address of majority of each House of the National Assembly.

PATHFINDER

SECTION B: ATTEMPT QUESTION 1 AND ANY OTHER THREE QUESTIONS

(60 Marks)

QUESTION 1

CASE STUDY – BRIDGE CONSTRUCTION IN IFESOWAPO LOCAL GOVERNMENT AREA (LGA)

There is a river in Ifesowapo Local Government Area (LGA), which for now is being crossed only by ferry. The Chairman of the LGA considers building a bridge, which being rather upstream would take the same time to cross. The ferry is a privately owned monopoly and charges ₦200 per crossing, while its total cost per crossing is ₦150. The ferry is used for 50,000 crossings per year. Also, the bridge would cost ₦30 million to build, but would be open free of charge.

A total of 250,000 crossings a year are expected, and the ferry would go out of business if the bridge is constructed. The Chairman sends for you as a Cost-Benefit Analyst to advise him on whether to go ahead with the construction of the bridge or not.

You are required to:

- a. Identify the parties that will be affected in the bridge construction project.
(2 Marks)
 - b. If construction of the bridge is financed by extra taxes, how much would the tax payers lose?
(2 Marks)
 - c. What would the ferry owner lose in each future year, if the bridge is eventually constructed?
(2 Marks)
 - d. What would the existing travellers gain, if the bridge is constructed?
(2 Marks)
 - e. Enumerate any **THREE** benefits likely to accrue to Ifesowapo LGA from this project.
(3 Marks)
 - f. Advise the Chairman of the LGA on what action to take, giving justification for your advice.
(4 Marks)
- (Total 15 Marks)**

PATHFINDER

QUESTION 2

Federal Republic of Agatu presented its revenue and expenditure summary for 2009 as follows:

REVENUE:	₦'000
Statutory Allocation: Federation Account Allocation Committee	900,000
Value Added Tax Allocation	75,000
Internally Generated Revenue	<u>100,000</u>
Total Recurrent Receipts	<u>1,075,000</u>
RECURRENT PAYMENTS	
Personnel costs	360,000
Overhead charges	<u>25,000</u>
Total Recurrent Expenditure	<u>385,000</u>
CAPITAL RECEIPTS	
Transfer from Consolidated Revenue Fund	516,000
Internal Loans: Treasury Bonds	<u>14,000</u>
Total Capital Receipts	<u>530,000</u>
CAPITAL PAYMENTS	
Capital Expenditure: Economic Sector	210,000
Capital Expenditure: Law & Justice	160,000
Capital Expenditure: Admin Sector	<u>220,000</u>
Total Capital Expenditure	<u>590,000</u>

Note I – Percentage increase over previous year figures are as follows:

2013	2012	2011	2010	2009
25%	20%	15%	10%	-

You are required to:

Prepare a five-year summary of Revenue and Expenditure of Federal Republic of Agatu from 2009 to 2013. (15 Marks)

QUESTION 3

The Public Procurement Act, 2007 was introduced to ensure transparency, probity, accountability, competitiveness, efficiency and effectiveness in Federal Government procurement of works, goods and services.

PATHFINDER

You are required to:

- a. State any **FIVE** members of the Procurement Planning Committee. (5 Marks)
 - b. State any **TEN** functions of Bureau of Public Procurement. (10 Marks)
- (Total 15 Marks)**

QUESTION 4

The Management of Success Polytechnic in Obudu State decided on 2 January, 2013 to introduce a Contributory Pension Scheme to its staff, where members were provided with a list of approved Pension Fund Administrators (PFA) from which they may choose to manage their Pension Fund. Consequently, it was realised that all the members of staff chose one of them; Better Retirement Pension Limited.

The following contributions are to be paid and credited into the Fund every month:

- (i) 7.5% of the salary to be contributed by each employee.
- (ii) 7.5% to be contributed by the employer.

As at 31 December 2013, Better Retirement Pension Limited had received both employees' and employer's contributions amounting to ₦25,000,000 for twelve (12) months. Of this sum, the following investments were made by Better Retirement Pension Limited:

- a. 1 April 2013, 5% ₦5 million Okun State Government Stock;
- b. 1 July 2013, 7% ₦5 million Biko State Government Stock

The following expenses were incurred on the investments: stamp duty, ₦75,000 and brokerage ₦55,000.

₦4million annual instalment payable per annum in respect of past services of employees was also paid into the Fund on 2 January 2013. Sundry expenses of ₦40,000 was incurred up to 31 December 2013. Pension of ₦5million was also paid in the year.

PATHFINDER

You are required to:

Write up the Investment Account and the Pension Fund Account as they will appear in the books of the Pension Fund Administrator. **(15 Marks)**

QUESTION 5

- a. Explain the main types of planning on the basis of periodisation. **(6 Marks)**
- b. Describe the characteristic features of Rolling Plans. **(9 Marks)**
(Total 15 Marks)

QUESTION 6

“Borrowing necessarily implies living beyond one’s means and hence it is undesirable in any circumstances for a nation to borrow”. Evaluate this statement.
(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

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

PATHFINDER

- 15. D
- 16. E
- 17. B
- 18. C
- 19. C
- 20. C

EXAMINERS' REPORT

The questions covered wide area of the syllabus and performance was above average.

PART II SHORT-ANSWER QUESTIONS

- 1. Externalities
- 2. Discounting
- 3. Payback
- 4. Funded debt
- 5. Floating debt
- 6. Regressive tax
- 7. Fiscal policy
- 8. Personal income tax
- 9. Internal Rate of Return
- 10. Medium-term Plan
- 11. Financial Regulation/Accounting Manual
- 12. General grant
- 13. Medium-Term Expenditure Framework
- 14. Department of Petroleum Resources
- 15. Teeming and Lading
- 16. Treasury Fund
- 17. Development Fund Reserved Expenditure Warrant
- 18. 10 years

PATHFINDER

- 19. Social Benefits
- 20. Two-thirds ($\frac{2}{3}^{\text{rd}}$)

EXAMINERS' REPORT

The questions were attempted by all the candidates and the performance was average.

SOLUTIONS TO SECTION B

QUESTION 1

- (a) The parties that will be affected in the bridge construction project are:
 - (i) The taxpayers
 - (ii) Ferry owners
 - (iii) Existing consumers/travellers
 - (iv) New consumers/travellers
 - (v) The contractor that will construct the bridge
 - (vi) The Local Government
- (b) The taxpayers would lose ₦30 million, assuming the bridge is financed by extra taxes.
- (c) The ferry owners would lose their excess profit of $(\text{₦}200 - 150) \times 50,000$ crossing
 - = ₦50 x 50,000
 - = ₦2,500,000
- (d) Since the travellers now cross the bridge at no cost; they will gain the amount charged earlier multiplied by the number of crossing.
 $\text{₦}200 \times 50,000 = \text{₦}10,000,000$
- (e) Other likely benefits accruable to the community are:
 - i. Easy accessibility to the community
 - ii. Easy transportation of agricultural produce in and out of the community
 - iii. Provision of employment opportunity for other members of the community that are not ferry owners
 - iv. Gearing up the economic activities of that community

PATHFINDER

- v. Reduction in the level of risk through the use of the bridge rather than the river
- (f) In the short run, the costs to the tax payers and ferry owners are ₦30,000,000 and ₦2,500,000 respectively. The sum of these is ₦32.5million, while the direct benefits accruable to the travellers is ₦10 million. These give a net benefit of ₦22.5 million (a loss).

However, over time much more direct benefits would accrue to the future travellers which would invariably eliminate the loss. Furthermore, based on the likely socio-economic benefits derivable from the bridge construction, the community in the Ifesowapo Local Government Area might benefit more in the long run. These are externalities that could come in the form of accessibility to the area, greater economic activities and employment opportunities all leading to improved wellbeing of the dwellers in the area.

Hence, in view of the long-term benefits, both direct and indirect, the Chairman of the Local Government Area is advised to go ahead with the construction of the bridge.

EXAMINERS' REPORT

The case study tests candidates' understanding of the application of the Cost Benefit Analysis (C.B.A.) to a public project appraisal – that is, assessing socio-economic viability of bridge construction in Ifesowapo Local Government Area(LGA).

The requirements of the question include enumerating costs and benefits of the project as a public concern) quantifying the costs and benefits and advising the Chairman of the LGA as appropriate.

Being a compulsory question, all the candidates attempted it. The general performance question was average. Many of the candidates failed to provide numerical values as required in (b), (c) and (d). Their answers were general and not related to the content of the case study.

Candidates are advised to read and understand what the case study is all about. They should always answer questions in the context of the case.

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QUESTION 2

FEDERAL REPUBLIC OF AGATO SUMMARY OF FIVE-YEAR REVENUE AND EXPENDITURE (2009 – 2013)

	2013	2012	2011	2010	2009
	N'000	N'000	N'000	N'000	N'000
REVENUE					
Statutory allocation: FAAC	1,707,750	1,366,200	1,138,500	990,000	900,000
Value Added Tax Allocation	142,313.5	113,850	94,875	82,500	75,000
Internally Generated Revenue	<u>189,750</u>	<u>151,800</u>	<u>126,500</u>	<u>110,000</u>	<u>100,000</u>
TOTAL RECURRENT RECEIPTS	2,039,813	1,631,850	1,359,875	1,182,500	1,075,000
RECURRENT PAYMENTS					
Personal Costs	683,100	546,480	455,400	396,000	360,000
Overhead Charges	<u>47,438</u>	<u>37,950</u>	<u>31,625</u>	<u>27,500</u>	<u>25,000</u>
TOTAL RECURRENT PAYMENTS	730,538	584,430	487,025	423,500	385,000
CAPITAL RECEIPTS					
Transfer from CRF	979,110	783,288	652,740	567,600	576,000
Internal Loans: Treasury Bonds	<u>26,565</u>	<u>21,252</u>	<u>17,710</u>	<u>15,400</u>	<u>14,000</u>
TOTAL CAPITAL RECEIPTS	1,005,675	804,540	670,450	583,000	530,000
CAPITAL PAYMENTS					
Capital Expenditure: Economic Sector	398,475	318,780	265,650	231,000	210,000
Capital Expenditure: Law & Justice	303,600	242,880	202,400	176,000	160,000
Capital Expenditure: Admin Sector	417,450	333,960	278,300	242,000	220,000
TOTAL CAPITAL EXPENDITURE	1,119,525	895,620	746,350	649,000	590,000

Tutorials:

- (i) 2010: 110% of 2009
- (ii) 2011: 115% of 2010
- (iii) 2012: 120% of 2011
- (iv) 2013: 125% of 2012

EXAMINERS' REPORT

The question tests candidates' understanding of a five-year summary of Revenue and Expenditure of Government.

PATHFINDER

Almost all the candidates attempted the question and performance was very good. Few of the candidates mis-interpreted the question by using the first base year (2009) for all the years instead of using each year as the base for the next year.

Candidates are advised to read the context of the question very well.

QUESTION 3

a. The Procurement Planning Committee

Section 21 of Public Procurement Act, 2007 requires procuring entity to establish procurement planning committee consisting of:

- i. The accounting officer or his representative as the Chairman
- ii. A representative of the procuring unit as Secretary
- iii. A representative of the unit directly making the procurement request
- iv. The financial unit of the procuring entity
- v. The planning, research and statistics unit of the procuring unit
- vi. A technical personnel of the procuring entity with expertise in the subject matter.
- vii. The legal unit of the procuring entity

b. Functions of Bureau of Public Procurement

- i. Formulate the general policies and guidelines relating to public sector procurement for the approval of the Council,
- ii. Supervise the implementation of established procurement policies
- iii. Publicise and explain the provisions of the Act
- iv. Monitor the prices of tendered items and keep a national database of standard prices
- v. Publish the details of major contracts in the procurement journal
- vi. Undertake procurement research and surveys.

PATHFINDER

- vii. Organise training and development programmes for procurement professionals.
- viii. Certify Federal procurement prior to the award of contract, subject to thresholds as may be set by the Council.
- ix. Maintain a national database of the particulars and classification of Federal contractors and service providers.
- x. Prepare and update standard bidding and contract documents.
- xi. Prevent fraudulent and unfair procurement and where necessary apply administrative sanctions.
- xii. Review the procurement and award of contract procedures of every entity to which the Act applies.
- xiii. Perform procurement audits and submit such report to the National Assembly bi-annually.
- xiv. Introduce, develop, update and maintain related database and technology.
- xv. Co-ordinate relevant training programmes to build institutional capacity.

EXAMINERS' REPORT

The focus of the question is on good understanding of the context of Procurement Act, 2007 as it relates to the composition of the membership of Procurement Planning Committee and the function of Bureau of Public Procurement.

The question was poorly attempted and the performance was poor. Most candidates did not understand the question very well especially part (a) of the question which deals with the composition of the Procurement Planning Committee.

Candidates are advised to study the syllabus very well. There is the need to consult relevant laws that affect Public Sector Accounting in Nigeria as well as study pack of the Institute.

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QUESTION 4

INVESTMENT ACCOUNT									
Dates	Particulars	Nominal	Income	Capital	Dates	Particulars	Nominal	Income	Capital
		₦	₦	₦			₦	₦	₦
1/4/13	5% Okun State Stock	5,000,000		5,000,000	31/12/13	Bank (Interest)		187,500	
1/7/13	Biko State Stock	5,000,000		5,000,000	31/12/13	Bank (Interest)		175,000	
31/12/13	Stamp Duty	-		75,000		Bal/cd	10,000,000	-	10,130,000
31/12/13	Brokerage	-		55,000					
31/12/13	Pension Rev. (w-1)		187,500						
31/12/13	Pension Rev. (w-2)		175,000						
		<u>10,000,000</u>		<u>10,130,000</u>			<u>10,000,000</u>	<u>362,500</u>	<u>10,130,000</u>
			<u>362,500</u>						
V									
1/1/13	Bal b/d	10,000,000		10,130,000					

WORKINGS: COMPUTATION OF INTEREST

- Interest 5% Okun State Stock = ₦5,000,000 @ 5% ÷ ($\frac{9}{12}$) = ₦187,500
- Interest 5% Biko State Stock = ₦5,000,000 x 5% ÷ ($\frac{6}{12}$) = ₦175,500

PENSION FUND ACCOUNT

	₦		₦
Expenses (Sundry)	40,000	Contribution – Bank	4,000,000
Pension paid	5,000,000	- Bank	12,500,000
Balance c/d	24,322,500	- Bank	12,500,000
		Investment Income	
		Okun State Stock	187,500
		Biko State Stock	<u>175,000</u>
	<u>29,362,500</u>		<u>29,362,500</u>
		Balance b/d	24,322,500

EXAMINERS' REPORT

The question tests candidates' understanding of Investment Account and Pension Fund Account.

The question was poorly attempted and performance was below average. Majority of the candidates could not prepare Investment Account. There was also wrong treatment of expenses that needed to be capitalized.

Candidates are advised to understand miscellaneous accounting principles and consult relevant texts on the topic.

PATHFINDER

QUESTION 5

- a. Three types of planning can be identified on the basis of time frame or periodisation. These are short-term, medium-term and perspective plans.
- (i) **The short-term plan** is also known as an annual budget. It is a kind of plan that spans a period of one year. It spells out the main sources of current revenues and outgoings of government expenditure for the period of one year.
 - (ii) **The medium-term plan** usually has a time span of 3 to 5 years within which the development objectives of a nation are expected to be met. The medium-term plan articulates as well the strategies and policies for the achievement of the objectives.
 - (iii) **The perspective plan** is also referred to as a long-term plan. Its period spans over and above 10 years. It is expected to articulate the vision of a country and the long-term view of the growth and structure of the economy.
- b. **Characteristic features of Rolling Plans**
- (i) Rolling plans are essentially medium-term plans. However, they are drawn in consonance with the dictates of the perspective plans.
 - (ii) Rolling plans serve as the reference point in the preparation of annual budgets.
 - (iii) The time-horizon (or terminal year) is usually rolled (kept moving) on a continuous basis.
 - (iv) Rolling plans emphasise continuity in planning process and incorporate considerable measure of flexibility as hedge against uncertainty.

EXAMINERS' REPORT

The focus of the question is on development planning. Candidates are expected to demonstrate understanding of the types of planning on the basis of periodisation and the main features of Rolling Plans.

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

PATHFINDER

Most of the candidates identified the main types of planning, but had problem communicating their understanding of the concepts. Only a few of them were able to describe the characteristic features of Rolling Plans.

Candidates are advised to be familiar with this aspect of the syllabus. They need to consult relevant and standard texts on Public Finance.

QUESTION 6

a. Evaluation of the Assertion

The statement “borrowing necessarily implies living beyond one’s means” may not be true in all circumstances, especially when extended to nations. Some nations of the world borrow despite their affluence. In other words, for strategic reasons many nations (both rich and poor ones) could find it expedient to borrow, at least to advance the overall development of their countries.

b. Desirability of Borrowing

Borrowing is desirable by any nation whether rich or poor for the following reasons:

(i) Financing Large Capital Project:

Development projects generally require huge capital that could need to be financed by means of domestic debts as well as external debts. Such include road projects, rail lines and other infrastructural projects. Governments may decide to take advantage of this method of financing, especially where the terms and conditions of debt obligations are affordable and generous.

(ii) Debt Rescheduling:

To allow for some respite on debt repayments, nations may take to debt rescheduling. It is a kind of borrowing that allows for changing the maturity structure of a public debt to cover a longer period until it is finally settled.

PATHFINDER

(iii) **Financing emergency Programmes:**

Natural disasters like fire outbreak, floods, war, epidemics do occur in most cases unexpectedly, calling for emergency programmes. Borrowing may be resorted to finance such programmes, especially where foreign assistance is not forthcoming in sufficient magnitude.

(iv) **Financing Budget Deficit**

Budget deficit refers to a situation when government spends (or decides to spend) in excess of what it receives in taxes and other revenue items. This fiscal action could be adopted as a strategy to reflate or stimulate the economy and generate employment opportunities. The deficit/a short fall in budget could be financed by means of borrowing locally (domestic debt) or externally (external debt).

(v) **Correcting Balance of Payments deficit**

Balance of payments deficit implies nations spending more on imports than they receive as receipts on exports both on current and capital accounts. Being a shortfall, it amounts to debt obligations which may need to be financed in one way or the other. Such financing becomes necessary otherwise the nations run the risk of fundamental disequilibrium in the balance of payments position.

(vi) **Financing Public Sector Enterprises**

There are certain public sector enterprises that have been found strategic to the economy and hence need to be adequately financed for them to have the desired impact. Such enterprises include airports, seaports, mineral exploration, irrigation projects, etc. Such ventures and projects often require huge capital outlay that could be financed by borrowing from the World Bank and other international financial institutions.

(vi) **Financing Recurrent Expenditures**

Government borrows when it is difficult to increase taxes or generate enough revenue to meet immediate needs on recurrent expenditures, notably salaries and emoluments of public servants and maintenance

PATHFINDER

of public utilities. The urgency in such spending necessitates such borrowing from domestic sources.

c. Problems of Public Borrowing

Much as public borrowing could be desirable, there are however some problems associated with public borrowing. These are:

(i) Loss of independence:

A debtor nation could find itself at the mercy of the creditor nations, thereby losing its sovereignty in the process. He who pays the piper dictates the tune.

(ii) Future generation could be affected:

Endless accumulation of debts could compromise or sacrifice the well being of future generation. The debt obligations put the future generation at risk of debt burden.

EXAMINERS' REPORT

The question tests candidates' understanding of the rationale and essence of public borrowing. Candidates are expected to evaluate the assertions in the question, namely whether borrowing necessarily have to do with living beyond the means of the nation, and whether debt is necessarily undesirable.

Many of the candidates attempted the question but the general performance was below average. There was gross misinterpretation of the requirements of the question by many of the candidates. Many of them, discussed why nations should not borrow, which they ought to have challenged in their presentation.

Candidates are advised to have sufficient reflection on the requirements of questions before attempting them. The word 'evaluate' is key to the question, requiring a critical discussion of the essence of public borrowing.