PATHFINDER

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2011 PROFESSIONAL EXAMINATION II

Question Papers

Suggested Solutions

Plus

Examiners' Reports

FOREWORD

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

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

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

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

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

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

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

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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ICAN/112/V/2 EXAMINATION NO.......................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II – NOVEMBER 2011
FINANCIAL REPORTING AND ETHICS
Time allowed – 3 hours

SECTION A: Attempt All Questions

PART 1: MULTIPLE-CHOICE QUESTIONS (20 MARKS)

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

1. Which of the following items should be disclosed in the notes to the financial statements in respect of intangible assets?

   (i) The economic lives of intangible assets capitalised in the statement of financial position.
   (ii) Impairment losses written off intangible assets during the year.
   (iii) List of intangible assets purchased or developed in the period.
   (iv) Details of development projects undertaken during the period.

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

2. Which of the following statements are correct?

   (i) If certain conditions are met, research cost should be capitalised and possibly amortised.
   (ii) Development costs should be capitalized, if and only if, all the criteria are met.
   (iii) Capitalised development expenditure must be amortised over a period not exceeding five years.
   (iv) Goodwill should not be amortised, but subjected to annual impairment test or review.

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

3. Which **ONE** of the following is a holding gain that should **NOT** be recognised in the income statement?
A. Revaluation surplus of investment properties
B. Revaluation surplus of property, plant and equipment
C. Gains and losses on revalued property, plant and equipment
D. Unwinding cost arising from cancellation of finance lease
E. Foreign exchange gain on translation of year- end assets and liabilities

4. In line with the IFRS framework, at which of the following stages should revenue on sale of goods and services in the ordinary course of business be recognized?

A. At any stage in the operating cycle of an entity
B. On full performance of the critical event
C. On receipt of cash
D. On transfer of significant risk and rewards of ownership to the buyer
E. On delivery and acceptance of goods

5. Which **ONE** of the following is **NOT** a matter covered by the IFRS framework for the preparation and presentation of financial statements?

A. Concept of capital maintenance
B. Qualitative and threshold qualities of financial statements
C. Lease agreements
D. Elements and components of financial statements
E. Measurement, presentation, recognition and disclosure of elements of financial statements

6. Your company could not conduct its inventory count until five days after the year-end. The following information has been obtained concerning inventory immediately after the year-end but before the sixth day thereafter.

	₦'m
Value of inventory in the warehouse	16.0

Normal sales of a mark-up of 40%	1.4
Sales of obsolete inventory at a mark-up of 25%	1.2
Goods secured after the year-end	6.8

Using the cut-off procedure, what is the amount of inventory that should be recognised in the financial statements?

A. ₦11.56
B. ₦16.00
C. ₦24.76
D. ₦11.16
E. ₦20.76

7. Which of the following does **NOT** fall within the concept of confidentiality in professional services?

i. Disclosing confidential information obtained in the course of business relationship to third parties without proper authority.
ii. Using confidential information obtained as a result of business relationship for personal advantage.
iii. Disclosing confidential information where there is a professional duty to disclose

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

8. Demonstration of sound professional behaviour by professional accountants includes:

i. Compliance with all relevant laws and standards
ii. Avoiding disparaging comments on the work of colleagues
iii. Manifesting deep spiritual background and involvement
iv. Avoiding actions which impinge on the profession's integrity

A. iv only
B. i and ii

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

9. Which **ONE** of the following problems would be solved by effective integration of ethics in business decision-making?

A. Ethical uncertainty
B. Ethical dilemma
C. Moral inconsistency
D. Moral non-productivity
E. Ethical laxity

10. Which of the following is **NOT** true of whistle-blowing?

i. Drawing the attention of the public to the issue
ii. Informing authorities of some breach
iii. Reporting to authorities as a statutory requirement

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

11. A financial expectation which will unduly influence the professional accountant's behaviour gives rise to

A. Self-review threat
B. Self-interest threat
C. Familiarity threat
D. Intimidation threat
E. Advocacy threat

12. The following statements are true of capital reduction and capital reconstruction **EXCEPT**

A. Capital reconstruction is a part of, and includes capital reduction
B. Capital reduction is a part of, and includes capital reconstruction
C. Capital reconstruction is embarked upon in severe financial difficulties
D. Capital reduction involves the existing shareholders only

E. Capital reduction and capital reconstruction have the effect of reducing the balance sheet size.

13. In Corporate Governance, which **ONE** of the following groups of stakeholders is protected from expropriation?

A. Management and Board members
B. Taxpayers and general public
C. Government and regulators
D. External investors and minority shareholders
E. Staff and Trade Unions

14. When a complaint is received by The Institute of Chartered Accountants of Nigeria alleging a case of misconduct against a member, such a member shall furnish his defence or reaction within

A. 7 days
B. 10 days
C. 12 days
D. 14 days
E. 21 days

15. Which **ONE** of the following Statements of Accounting Standards discusses Research and Development costs?

A. SAS 10
B. SAS 15
C. SAS 20
D. SAS 21
E. SAS 22

16. Recognition of income on investment is done on which of the following bases?

i. Actual basis, and credited to the P & L account
ii. Accrual basis, and credited to the P & L account
iii. A basis that provides a constant yield on the outstanding balance

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

17. When an organisation decides that compliance with a particular policy or Accounting standard will not give a true and fair view of events, then such treatment may be departed from and the financial statements must disclose all of the following **EXCEPT:**

    A. That the particular accounting standard is not applicable to the financial statements
    B. That the financial statements show a true and fair view
    C. That all accounting standards are complied with, except for the departure from a standard in order to achieve a fair presentation
    D. The accounting standard departed from and explanation of the circumstances
    E. The financial impact of the departure

18. Which **ONE** of the following is **NOT** an element of corporate governance?

    A. Accountability not just to shareholders, but also to stakeholders
    B. Framework for an organisation to pursue its strategy in an ethical and effective manner which offers safeguards against misuse of resources
    C. Less emphasis on the management awareness and evaluation of risk
    D. Enhancing overall performance through good performance and management within a set of best practice guidelines
    E. Board structure and responsibility

19. The ethical threats to compliance with the fundamental principles for accountants in practice do **NOT** include

    A. Advocacy
    B. Independence
    C. Intimidation
    D. Self-Review
    E. Self-Interest

20. Which **ONE** of the following codes is a rule-based approach to compliance with ethical behaviour?

    A. Accountants' Code of Ethics
    B. Code of Best Polices for Public Companies
    C. Sarbanes-Oxley Act, 2002
    D. IFAC Code of Ethics
    E. OECD Framework

PART II: SHORT ANSWER QUESTIONS (20 MARKS)

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

1. In the choice and application of the appropriate accounting policies, the principle that requires that the reports prepared do **NOT** favour any particular user-group is called ………………………

Use the following information to answer questions 2-4.

Small Company Limited and Big Company Limited have decided to combine their business operations to become Large Company Limited.

The balances in the terminal balance sheets of the combining businesses are as follows:

	Small Co. Ltd.	Big Co. Ltd.
	₦'m	₦'m
Fixed Assets	27.50	35.00
Goodwill	10.00	3.00
Other Assets	2.50	21.00
	40.00	59.00

Large Company Limited is to take over all the assets of the combining businesses by the issuance of its shares on the basis of 3 new shares of ₦1.00 each for existing ₦2.50 worth of Net Tangible Assets in each of the combining companies.

2. How many shares are due to the shareholders of Small Company Limited?

3. What is the total number of shares issued by Large Company Limited?

4. What is the value of purchased goodwill from the transaction?

5. The business strategy that shapes the values underpinning a company's mission and choices made each day by its executives, managers and employees is called …………………………

6. The ethical theory that holds that there is an unchanging set of ethical principles that will apply in all situations, at all times and in all societies is called ....

7. A situation where a set of the financial statements is prepared and audited by the same firm is said to be capable of constituting .... threat.

8. The collective well-being of the community of people and interests that the accountant serves is called ....

9. As a field concerned with human conduct of "what ought to be" rather than "what is", ethics is said to be ....

10. The Accountants' Disciplinary Tribunal of The Institute of Chartered Accountants of Nigeria (ICAN) has powers which are equivalent to those of a..............................

11. The set of ratios that measures the skill with which management utilizes the assets of a business is called ....

12. According to IAS 20, "Accounting for Government Grants and Government Assistance", when grants received are credited directly to shareholders interest than recognized in the profit and loss account, the method is described as..................

Use the following information to answer questions 13-14.

St. Jude Plc acquired a 12-year lease on a property on 1 January 2009 at a cost of ₦480,000. The company's policy is to revalue its assets to their market values at the end of each year. Accumulated depreciation is eliminated and each asset is restated to a new carrying value. Depreciation charge is based on the carrying value of the asset at the beginning of each year. The market value of the property on 31 December 2009 and 2010 were ₦462,000 and ₦350,000 respectively. The existing balance in the revaluation reserve relating to a non-depreciable asset as at 1 January 2009 amounted to ₦100,000.

13. Compute the revaluation surplus or deficit in 2009 and 2010.

14. The over-depreciation charge and related accounting entries are:

    (i) Debit .... with ₦.............................
    (ii). Credit .... with ₦ ....

15. IAS 36 requires that an entity should carry out impairment test or review of its assets:

    (i) .... or (ii) ....

16. The practice of taking an action that will offset an exposure to a risk by incurring a new risk in the opposite direction is referred to as ....
17. Corporate governance extends beyond corporate law. Its objective is not mere fulfilment of legal requirements but ensuring commitment to .... and ....
18. The standard of behaviour that groups expect of their members is referred to as ....
19. Ethics must be promoted and institutionalised in an organisation in order to build credibility and ....
20. Ethical challenges in companies are often triggered by ....

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

QUESTION 1 – CASE STUDY

In 2004, Mr. Alexim was employed as the Managing Director/CEO of Texlon International Hotels Ltd. following the resignation of Mr. Chukwuma. Mr. Alexim had his University education in Britain and graduated in second class upper (Hons) in Hotel Management. He worked as a director with Barastas Hotel Limited in Ghana for 8 years. He is highly experienced in hotel management.

In November 2006, the Managing Director called a meeting of all departmental heads to inform them of a need to carry out a reorganization of the company in order to make the company more efficient and increase yearly profits. Two months later, he transferred the purchasing manager to sales department.

He appointed Mr. Otoye, his primary school mate, as Purchasing Commissioned Agent who agreed to take 5% commission on all purchases made monthly. The Receiving/Inspection Manager, Mr. Isong, was sacked unjustly.

The Chief Accountant, Mr. Ebong, was promoted as Financial Controller, and Mr. Okafor was employed as Chief Accountant. Alhaji Abubakar who was the Purchasing Manager was transferred to Logistics Department.

Often, invoices were sent to the company without accompanying goods. The invoices were received by the Receiving/Inspection Department. On receipt of such invoices by this Department, it prepared Goods Received Note (GRN) and sent copies to appropriate departments.

On receiving its copies, the stores prepared Stores Received Notes (SRN) and sent copies to appropriate departments. All invoices received from suppliers by the Receiving/Inspection Department were forwarded to the store. The Stores Department entered the quantities received on appropriate bin cards and started to monitor the movement of fictitious stocks purported to have been received. The invoices were later sent to the accounts to which were attached SRN.

The Kitchen Department was responsible for requisitioning stocks from the stores. To cover up the fictitious items entered on bin cards, the stores manipulated the stores copy of the kitchen requisition form. For example, if the kitchen requisitioned for 1 bag of rice, the stores clerk would cleverly alter the quantity to read either 10, 11, 4 or 7 as the case might be, and would update bin cards accordingly. Before stock-taking at the end of the month, the fictitious receipts posted to bin cards would have been totally issued out.
The financial year-end of the company is 31 December. At the end of the financial year of 2007, an extract from the company's Profit and Loss Account was as shown below:

Profit &Loss Account Extract for the year	**2007**		**2006**	
	₦ m	₦ m	₦m	₦ m
Sales		3,486		3,180
Trading Profit		1,170		986
Surplus on disposal of trade investment		25		9
Debenture interest paid	4		2	
Dividends paid	21		11	
Debenture Redemption Reserve	5		2	
		(30)		(15)
Unappropriated profit for the year		1,165		980

Messrs Daniel Adedayo & Co. (Chartered Accountants) were re-appointed as auditors having declared their intention to continue in office as required by Section 357(2) of the Companies and Allied Matters Act CAP C20 LFN 2004.

During the audit, the following facts came to light:

i. Closing stock at 31 December was overstated by ₦23,000,000;

ii. The value of false stocks purported to have been issued to the kitchen amounted to ₦3,000,000. This amount increased the cost of food sent to all restaurants;

iii. Total sales made in the first week of January 2008 amounting to ₦30,000,000 was included in the sales for the year ended 31 December 2007. The company made 50% margin on cost;

iv. On 10 July 2007, there was a fire outbreak which destroyed part of the store. The cost of stocks destroyed was ₦4,000,000, but this amount was not taken care of in the profit and loss account. The amount is to be written off;

v. The total commission paid to the Purchasing Commission Agent during 2007 amounted to ₦1,500,000.

You are required to:

(a) State any **THREE** of the ethical issues in this case. (3 marks)
(b) Define management fraud as it relates to this case and explain **TWO** examples of such a fraud. (6 marks)
(c) Redraft the Profit and Loss Account after taking into consideration notes (i)–(v). (6 marks)

(Total 15 marks)

QUESTION 2

Fagba Limited has recently acquired four large subsidiaries. These subsidiaries manufacture products which are of different lines from those of the parent company. The parent company manufactures plastics and related products whereas the subsidiaries manufacture the following:

	Product	**Location**
Subsidiary 1	Textiles	Kaduna
Subsidiary 2	Car products	Lagos
Subsidiary 3	Fashion garments	Onitsha
Subsidiary 4	Furniture items	Benin

The directors have purchased these subsidiaries in order to diversify their product base but do not have any knowledge of the information required in the financial statements regarding these subsidiaries other than the statutory requirements. The directors of the company realised that there is a need to disclose segmental information but do not understand what the term means or what the implications are for the published accounts.

You are required to:

(a) Explain to the directors the purpose of segmental reporting of financial information. (3 marks)

(b) Explain to the directors the criteria which should be used to identify the separate reportable segments. (You should illustrate your answer by reference to the above information) (9 marks)

(c) Critically evaluate IFRS 8, Operating segments, setting out the major problems with the Standard. (3 marks)

(Total 15 marks)

QUESTION 3

Players Plc prepares accounts to 31 December yearly. On 1 September 2008, the Company acquired 8 million ₦1 shares in Success Plc at ₦2 per share. The purchase was financed by the issue of an additional loan stock at an interest rate of 10%. At that date, Success Plc. produced the following interim financial statement.

	₦ m		₦ m
Share Capital (₦1 share)	12.00	Property, Plant & Equipment	
Reserves	6.60	(Note i)	24.00
Long Term Loans (Note iii)	6.00	Stocks (Note ii)	6.00
Trade Creditors	4.80	Debtors	4.35
Taxation	0.90	Cash in hand	1.80
Bank Overdraft	5.85		
	36.15		36.15

Notes:

(i) The following information relates to the tangible long-term assets of Success Plc. at 1 September 2008.

	₦ m
Gross replacement cost	42.60
Net replacement cost	24.90
Economic value	27.00
Net realisable value	12.00

The property, plant and equipment of Success Plc at 1 September 2008 had a total cost of ₦40.5m. They were all being depreciated at 25% per annum pro rata on that cost. This policy is also appropriate for the Consolidated Financial Statements of Players Plc. No long-term assets of Success Plc which were included in the Interim Financial Statements drawn up as at 1 September 2008 were disposed of by Success Plc prior to 31 December 2008. No long-term asset was fully depreciated by 31 December 2008.

(ii) The stock of Success Plc which were shown in the Interim Financial Statements are raw materials at cost to Players Plc of ₦6m. They would have cost ₦6.3m to replace at 1 September 2008. Of the inventory of Success Plc on hand at 1 September 2008 and 31 December 2008, goods costing Success Plc ₦4.5m were sold for ₦5.4m between 1 September 2008 and 31 December 2008.

(iii) The long term loan of Success Plc carries a rate of interest of 10% per annum, payable on 31 August annually in arrears. The loan is redeemable at par on 31 August 2012. The interest cost is representative of current market rates. The accrued interest payable by Success Plc at 31 December 2008 is included in the trade payables of Success Plc at that date.

(iv) On 1 September 2008, Players Plc took a decision to rationalise the group so as to integrate Success Plc. The costs of the rationalisation were estimated to total ₦4.5m and the process was due to start on 1 March 2009. No provision for these costs were made in any of the Financial Statements given above.

You are required to:

Compute the goodwill on Consolidation of Success Plc that will be included in the consolidated financial statements of Players Plc group for the year ended 31 December 2008, explaining your treatment of the items stated above. You should refer to the provisions of relevant accounting standards.

(15 marks)

QUESTION 4

Rilwan Adewale is an accountant in Dankale Plc where he has the responsibility to prepare the tax returns for the company. At the end of the financial year,the Financial Controller asked Adewale to manipulate the figures to be included in the tax return so that the company's year-end tax liability is reduced.

Required:

(a) What are the moral issues arising from the above situation? (5 marks)
(b) Would it be right for Adewale to accede to the Financial Controller's request to falsify the data to be included in the tax return? Justify your answer. (5 marks)
(c) What should he do in this circumstance to resolve the problem? (5 marks)

(Total 15 Marks)

QUESTION 5

(a) Discuss the concept of independence as it relates to the professional accountant. (4 marks)

(b) Discuss any **THREE** threats to the independence of an accountant. (6 marks)

(c) How best can independence be sustained in the accountancy profession? (5 marks)

(Total 15 marks)

QUESTION 6

Set out below are the draft accounts of Wole-Adura Plc and its subsidiaries and of Maseru Associates. Wole-Adura acquired 40% of the equity capital of Maseru Associates three years ago when the latter's retained earnings stood at ₦140m.

ABRIDGED BALANCE SHEETS

	Wole-Adura Plc & Subsidiaries	Maseru Associates
	₦ m	₦m
Property, plant and equipment	990	595
Investment in Maseru Associates at cost	270	-
Loan to Maseru Associates	90	-
Current Assets	450	175
Loan from Wole-Adura Plc.	-	(70)
	1800	700
FINANCED BY:		
Ordinary shares of 50k each	1,125	350
Retained Earnings	675	350
	1800	700

ABRIDGED INCOME STATEMENTS

	Wole-Adura Plc & Subsidiaries	Maseru Associates
	₦ m	₦ m
Net Profit	427.50	280.00
Less: Tax	157.50	105.00
	270.00	175.00

ADDITIONAL INFORMATION

(i) Wole-Adura proposed a dividend of ₦225m
(ii) Total Market Capitalisation is ₦5,625m.

You are required to:

(a) Calculate each of these ratios for Wole-Adura Plc and its Subsidiaries.
 (i) Earnings Per Share
 (ii) Dividend Cover
 (iii) Earnings Yield
 (iv) Dividend Yield (4 marks)

(b) Using the equity method, compute the earnings of Wole-Adura Plc & subsidiaries and Associate (Maseru Associates). (4 marks)
(c) Compute the above ratios for Wole-Adura Plc and its subsidiaries and associate (Maseru Associates). (4 marks)
(d) Comment on the ratios calculated by pair wise comparison between ratios in (a) and (c) above. (3 marks)

(Total 15 marks)

SOLUTIONS TO SECTION A

PART I - MULTIPLE CHOICE QUESTIONS

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

20. C

TUTORIAL

Q.6 Calculation of Value of Inventory

	₦'m
Value of inventory in the warehouse	16.00
Cost of inventory at normal sales (₦1.4m) / 1.4	1.00
Cost of abnormal sales (₦1.2m) / 1.25	0.96
Cost of goods received	(6.80)
Value of inventory to the statement of financial position	11.16

EXAMINERS' REPORT

The questions cover the syllabus.

Candidates' performance was below average as they displayed a shallow knowledge of the bulk of the questions.

Candidates are advised to be better prepared in subsequent examinations.

PART II – SHORT ANSWER QUESTIONS

1. Fairness
2. 36 million
3. 103.2million
4. ₦17.2million
5. Operational Strategy
6. Absolutism
7. Self-Review
8. Public interest
9. Normative or Prescriptive
10. High Court

11. Turnover / Activity / Efficiency Ratios
12. Capital Approach
13. ₦22,000 and ₦70,000
14. DR. Revaluation reserve (with ₦2,000)
    CR. Retained Earnings/Profit & Loss Account (with ₦2,000)
15. Annually or whenever a factor triggers it off
16. Risk Integrity
17. (i) Management transparency
    (ii) High ethical standard
    (iii) Stakeholders values (Any two)
18. Group Norms/Code of Ethics
19. Public Trust/Public Confidence
20. Financial Problems.

TUTORIAL

Q. 2 Total net Tangible Assets of Small Co. Limited

	₦
Fixed Assets =	27.5
Other Assets	2.5
Total net Tangible Assets	30.00

No of shares = $\frac{30.00}{2.5} \times 3$

= 36 million

Q.3 Shares to Big Co. Limited 35 + 21 = 56

$\frac{56}{2.5} \times 3$

67.2 million
\+ 36.0 million
103.2 million

Q.4 Small ₦27.5m +₦2.5m.= 30 million
Big 56 million

<u>86 million</u>

₦103.2m - ₦86m = ₦17.2million

Q. 13 Calculation of Revaluation surplus/deficit and depreciation

	2009	2010
	₦	₦
1/1/09/& 10, cost/FV	480,000	462,000
31/12/09 & 81/12/10 Dep.	(40,000)	(42,000)
	440,000	420,000
Revaluation surplus/(Deficit)	22,000	(70,000)
31/12/09 & 31/12/10 carrying value	462,000	350,000

Over-depreciation charge = ₦(42,000 -40,000) = ₦2,000

EXAMINERS' REPORT

The questions cover the syllabus.

Candidates' performance was below average.

Candidates are advised to have a thorough knowledge of the provisions of the Accounting Standards (SAS, IAS, IFRS). Similarly, the application of ethics to accounting practice requires an in-depth understanding by candidates. They are advised to have a wider coverage of the syllabus in order to enhance their performance in future examinations.

SOLUTION TO SECTION B

QUESTION 1

(a) The ethical issues in this case are as follows:

i. Violation of Rights – The unjust termination of Mr. Isong's appointment;

ii. Deception – Manipulation of stock requisition forms in the Kitchen Department to inflate the value of closing stock and thereby increasing profit fictitiously;

iii. Corruption - Over-invoicing on contract of supplies and lack of due process in the procurement of raw materials.

iv. Fraud - Inclusion of January 2008 sales figure of ₦30million in 2007 total sales is a clear indication of "creative accounting", thus fraudulently increasing profit for the year 2007 by ₦10million.

(b) Management fraud is defined as an intentional misrepresentation of financial statements or improper use of company resources by directors and top level managers for underserved financial benefits.

Examples include:

(i) Window dressing – this refers to a type of fraud where financial results are falsely reported to deceive stakeholders (i.e managers, shareholders, regulators or more often, potential investors); and

(ii) Overstatement of Stock Sheets -
- Closing stock was overstated by ₦23million, thereby, fictitiously increasing profit by the same amount.
- Fraudulent manipulation of stock records to achieve desired objective (financial gains).

(iii) Manipulation of cut-off procedure -
- Fraudulent inclusion of January 2008 sales in 2007 financial period.

(iv) Non-Compliance with prudence concept -
- The suppression of the actual loss of ₦4million caused by fire incidence which should have been recognized in the financial statements, is a violation of the prudence concept, which requires recognition of all known losses.

(c)**REDRAFTED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER, 2007**

	2007		2006	
	₦'m	₦'m	₦'m	₦'m
Sales		3,456		3,180
Trading Profit (see workings)		1,130		986
Surplus on disposal of trade investment		25		9
		1,155		995

Debenture Interest Paid	4		2	
Dividends Paid	21		11	
Debenture redemption reserve	5	(30)	2	(15)
Unappropriate profit for the year		1,125		980

WORKINGS	₦'m	₦'m
Sales		3,486
Sales in first week of January 2008		(30)
		3,456
Trading Profit		1,170
Less:		
Closing Stock overstated	23	
Falsified stock issued to kitchen	3	
Amount w/off in respect of fire outbreak	4	
Profit on sales of January 2008 which was added to December 2007 (30 x 50/150)	10	40
		1,130

EXAMINERS' REPORT

The question tests candidates' understanding of the ethical and financial reporting issues in the case study. They are required to redraft the profit and loss account for the period after adjusting for identified accounting misstatements.

Candidates displayed very shallow understanding of the requirements of the question and overall performance was poor. Ethical issues were mostly treated superficially and profit and loss account was not correctly redrafted by majority of the candidates.

Candidates are advised to improve on the level of their preparedness and coverage of the syllabus. It is also very helpful for them to read the questions emanating from the case study before reading the case.

QUESTION 2

(a) The purposes of segmental information are:

i. to provide users of financial statements with sufficient details for them to be able to appreciate the different rates of profitability, different opportunities for growth and different degrees of risk that apply to an entity's classes of business and various geographical locations.

ii. to appreciate more thoroughly the results and financial position of the entity by permitting a better understanding of the entity's past performance and thus a better assessment of its future prospects.

iii. to create awareness of the impact that changes in significant components of a business may have on the business as a whole.

2(b) IFRS 8 defines an operating segment as a component of an entity:

- that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity).

- whose operating results are regularly reviewed by the entity's chief operating decision-maker to make decisions about resources to be allocated to the segment and assess its performance.

- for which discrete financial information is available.

In order to identify the separate reportable segments, the following criteria should be adopted:

(i) The reported revenue of the segment in Fagba Limited, including both sales to external customers and inter-segment sales, is ten percent or more of the combined revenue of its four operating segments.

(ii) The Assets of the segment in Fagba Limited are ten percent or more of the combined assets of its four operating segments.

(iii) The reported profit or loss of the segment in Fagba Limited should be ten percent or more of the greater, in absolute amount, of:

- the combined reported profit of all its operating segments that did not report a loss and
- the combined reported loss of all operating segments that reported losses.

(c) IFRS 8 lays down some very broad and inclusive criteria for reporting segments. Unlike earlier attempts to define segments in more quantitative terms, segments are defined largely in terms of the breakdown and analysis used by management. This is, potentially, a very powerful method of ensuring that preparers provide useful segmental information.

There will still be problems in deciding which segments to report, if only because management may still attempt to reduce the amount of commercially sensitive information that they produce.

The growing use of executive information systems and data management within businesses makes it easier to generate reports on an ad hoc basis. It would be relatively easy to provide management with a very basic set of internal reports and analyses and leave the individual managers to prepare their own more detailed information using the interrogation software provided by the system.

If such analyses become routine then they would be reportable under IFRS 8, but that would be very difficult to check and audit.

There are problems in the measurement of segmental performance if the segments trade with each other. Disclosure of details of inter-segment pricing policy is often considered to be detrimental to the good of a company. There is little guidance on the policy for transfer pricing.

Different internal reporting structures could lead to inconsistent and incompatible segmental reports, even from companies in the same industry.

EXAMINERS' REPORT

The question tests candidates' understanding of segmental reporting of financial information as well as critical examination of the provisions of IFRS 8.

Majority of the candidates did not attempt the question, while the few that did performed poorly. Candidates demonstrated lack of knowledge of the requirements of IFRS 8 consequently they could not apply the provisions in answering the question.

With the adoption of International Financial Reporting Standards (IFRS) by Nigeria from 2012, every prospective Chartered Accountant must keep abreast of all IFRS as questions on same will continue to feature in future examinations.

QUESTION 3

GOODWILL ON CONSOLIDATION OF SUCCESS PLC FOR THE YEAR ENDED 31 DECEMBER, 2008

	₦'m	₦'m
Purchase Consideration (₦2 x 8m)		16.00
Group's share of fair value of net assets acquired:		
Share Capital	12.00	
Pre-acquisition Reserves	6.60	
Fair Value adjustments:		
Tangible non-current assets (24.9 – 24)	0.90	
Inventories (6.3-6)	0.30	
	19.80	
Controlling Interest (67% of ₦19.8 m)		(13.20)
Goodwill		**₦2.80**

Notes on treatment

(a) It is assumed that the market value (i.e fair value) of the loan stock issued to fund the purchase of the shares of **Success Plc**. is equal to the price of ₦16million. SAS 26 and IFRS 3 (Business Combinations) require goodwill to be calculated by comparing the cost of acquisition with the fair value of the acquirer's interest in the identifiable net assets of the acquired business or company.

(b) Share Capital and pre-acquisition profits represent the book value of the net assets of **Success Plc.** at the date of acquisition. Adjustments are then required to this book value in order to give the fair value of the net assets at the date of acquisition. For short-term monetary items, fair value is their carrying value on acquisition.

(c) SAS 26 and IFRS 3 state that the fair value of property, plant and equipment should be determined by market value or, if information on a market price is not available (as is the case here), then by reference to depreciated replacement cost, reflecting normal business practice. The net replacement cost (i.e ₦24.9million) represents the gross replacement cost less depreciation based on that amount, and so further adjustment for extra depreciation is unnecessary.

(d) SAS 26 also states that raw materials should be valued at replacement cost. In this case, that amount is ₦6.3million.

(e) The fair value of the loan is the present value of the total amount payable, i.e on maturity and interest. If the quoted interest rate was used as a discount factor, this would give the current par value.

(f) The rationalization costs cannot be reported in pre-acquisition results under SAS 26 as they are not a liability of **Success Plc**. at the acquisition date.

EXAMINERS' REPORT

The question tests candidates' knowledge of computation of Goodwill on consolidation and the provisions of relevant accounting standards.

Very few candidates attempted the question and the performance was poor. Candidates displayed lack of understanding of the principles of consolidated accounts and how these relate to the computation of Goodwill and the relevant accounting standards.

Candidates are advised to ensure adequate preparation as well as sufficient coverage of the syllabus for better performance in future.

QUESTION 4

(a) The moral issues arising in this case include:

i. A problem of conflict of loyalty: As an employee of Dankale Plc, Adewale has a duty of loyalty to the company and also to his Financial Controller, who is his line manager. But in this case, these conflict with his duty of loyalty to the accountancy profession.

There is also a case of conflict of loyalty between the duty to be loyal to the company on one hand, and to the government/public on the other hand. As a professional, the Financial Controller has an obligation to enhance the well-being of the public. This would be impaired because the manipulated tax return would deny the government of the revenue needed for the provision of social amenities.

ii. More specifically, the case on hand raises moral questions that relate to some of the fundamental ethical principles guiding the accountancy profession, especially the principles of objectivity, integrity and professional behavior.

- objectivity requires accountants to make their decisions and reports based on real facts and should not be influenced by any form of feelings or bias.
- integrity is the quality of being honest and having strong moral principles that should not be compromised.
- professional behavior requires accountants to ensure that they never do anything that would bring the profession to disrepute.

(b)

i. Given the moral problems generated by the request of the Financial Controller, it would be wrong for Adewale to agree to falsify the data as doing so would violate three of the core ethical principles of the accountancy profession identified in (a.ii) above.

ii. It would also be wrong for Adewale to falsify the data because doing so amounts to being more loyal to the Financial Controller and his company than to the accountancy profession. In cases of such conflict of loyalty, the integrity of the profession and his own personal integrity as a professional accountant should be given priority.

iii. It would also be wrong to falsify the data because this is illegal and might generate more problems for the company and its officials if this is later detected by relevant authorities.

(c) In the first instance, Adewale should explain to the Financial Controller his misgivings about falsifying data and why he cannot do it. He should take care to explain to him the moral issues involved.

If the Financial Controller agrees with Adewale, the matter should be rested there. However, if there is still a disagreement, Adewale should raise the issue with a higher level of management, perhaps the Managing Director or the board.

If the matter is not resolved at this point, Adewale might consider two alternatives: resigning or whistle blowing. But before deciding on which course of action to take, it would be wise for him to seek legal counsel and advice from his professional colleagues.

EXAMINERS' REPORT

The question tests candidate's ability to identify some of the moral issues that an accountant may face in the performance of his or her professional duties. It also tests their ability to arrive at acceptable ethical decisions.

Majority of the candidates attempted the questions.

Their performance was average.

Many of them had difficulties providing correct answers to part (a) of the question.

The common pitfall of the candidates was their inability to identify the precise ethical problems arising from the question.

Candidates should pay special attention to the specific ethical problems that are common to the accounting profession as well as how they can be effectively resolved in real life situations.

QUESTION 5

(a) The concept of independence in the accounting profession require that when carrying out their professional functions, accountants should only take and be seen to take into consideration points and issues that are relevant to the job without being subject to any form of control, pressure or influence, be it personal or external.

(b) (i) Self-interest (financial) threats: These are threats caused by the existence of a financial relationship between the professional accountant and the client. This includes where an accountant has direct or indirect financial interest in a client, for instance, if a loan has been received or given to the client, or when the receipt of fees from a client or group of connected clients represent a large proportion of the total fees of the accountant or practice.

(ii) Self review threats: This is caused by a professional accountant being or having been a director or employee of a client company or by actively working for a client. It arises when an accountant has to review his/her own work.

(iii) Familiarity and Intimidation threats: These are threats to independence caused by a close family relation of the member being a key member of the client's staff, or when a client exerts undue pressure on the professional accountant. This might make the professional more sympathetic than objective. Alternatively, the accountant may be bullied or put under pressure by the client. These might result in the accountant's reporting being biased in favour of the client.

(iv) Advocacy threats: These are caused by a member going beyond an advisory role and publicly supporting the client in a way that compromises objectivity.

(c) Independence is important in the accounting profession for accountants to be able to state facts objectively and also base their professional judgement on real facts and not just sentiments or personal prejudices.

To sustain independence, a professional accountant should:

(i) avoid undue familiarity with clients;
(ii) ensure that his interest in the company or with clients is strictly professional and not personal;
(iii) at all times, subscribe to the basic principles of professional ethics such as
  - due diligence and professional care
  - integrity; and
(iv) consult regularly with professional colleagues.

EXAMINERS' REPORT

The question tests candidates' understanding of the need for professional accountants to be independent and how this can be effectively sustained in practice.

Majority of the candidates attempted the question and the overall performance was average. A common pitfall in answering the question was the inability of candidates to properly articulate the concept of independence and how this can be sustained by a professional accountant.

Candidates are advised to specifically study basic ethical concepts that are relevant to the accounting profession.

QUESTION 6

COMPUTATION OF RATIOS FOR WOLE ADURA PLC AND IT'S SUBSIDIARY

i) Earnings per share:

$$\frac{\text{Earnings/PAT}}{\text{No of ordinary shares outstanding}} \times \frac{100}{1} = \frac{₦270,000,000}{2,250,000,000} \times \frac{100}{1} = 12\text{kobo}$$

ii) Dividend cover:

$$\frac{\text{Earnings/PAT}}{\text{Dividend per share}} \times \frac{100}{1} = \frac{12}{10}\text{kobo} = 1.2 \text{ times}$$

Note: $$\text{DPS} = \frac{\text{dividend}}{\text{No of ord. shares}} = \frac{₦225\text{m}}{2,250\text{m}} \times \frac{100}{1} = 10\text{kobo}$$

(iii) Earnings yield:

$$\frac{\text{EPS}}{\text{MPS}} \times \frac{100}{1} = \frac{12\text{kobo}}{250\text{kobo}} \times \frac{100}{1} = 4.8\%$$

Note: $$\text{MPS} = \frac{\text{market capitalisation}}{\text{no of ord. shares}} = \frac{₦5,625}{2,250\text{m}} = ₦2.50$$

(iv) Dividend yield:

$$\frac{\text{DPS}}{\text{MPS}} \times \frac{100}{1} = \frac{10\text{kobo}}{250\text{ kobo}} \times \frac{100}{1} = 4\%$$

<u>NOTE</u>
PAT = Profit after Tax
DPS = Dividend per share
EPS = Earnings per Share
MPS = Market Price per Share.

(b) **WOLE ADURA PLC AND SUBSIDIARIES AND ASSOCIATES**

COMPUTATION OF EARNINGS USING EQUITY METHOD

		₦'m
Net profit:	Group	427.5
	Associate	112.0
		539.5
Taxation:	Group	(157.5)
	Associate	(42)
Profit after tax		340

(c) EPS $= \frac{340}{2250m} \times 100/1 = 15.1$kobo

Dividend Cover $= \frac{15.11}{10} = 1.51$ times

Earnings Yield $= \frac{15.11}{250} \times \frac{100}{1} = 6.044\%$

Dividend Yield $= \frac{10}{250} \times \frac{100}{1} = 4.0\%$

(d)

	Group	Group and Associate	Changes
EPS	12kobo	15.11kobo	3.11k
Dividend Cover	1.2 times	1.51 times	0.31
Earnings Yield	4.8%	6.044%	1.244
Dividend yield	4%	4%	-

Comments:

i) There is an increase of 3.11 kobo in earnings per share of Wole Adura Plc and subsidiary and associates. This is in excess of 12kobo EPS of Wole Adura Plc and subsidiaries.

ii) There is an increase of 0.31 times in dividend cover of Wole Adura Plc and subsidiary and associates. This is in excess of 1.2 times Dividend Cover of Wole Adura Plc and subsidiaries.

iii) There is an increase of 1.244% in earnings yield of Wole Adura Plc and subsidiary and associates. This is in excess of 4.8% earnings yield of Wole Adura Plc and subsidiaries.

iv) The dividend yield for the two entities remains constant.

EXAMINERS' REPORT

This question tests candidates' understanding of the principles of group accounts and interpretation of financial statements including ratio analysis. Specifically, candidates are expected to undertake comparative analysis of group accounts.

Candidates' performance was below average. Commonest pitfall was candidates' inability to compute and interpret financial ratios.

Candidates are advised to study adequately and practise with past questions.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II – NOVEMBER 2011
STRATEGIC FINANCIAL MANAGEMENT
Time allowed – 3 hours

SECTION A: Attempt All Questions

PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

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

1. The most important financial objective of a business firm is maximisation of

   A. Market price per share
   B. Earnings per share
   C. Dividend per share
   D. Profits
   E. Social responsibility.

2. The concept that best defines the relationship between management and shareholders of a firm is referred to as

   A. Agency theory
   B. Agency problem
   C. Stewardship theory
   D. Corporate governance theory
   E. Agency relationship theory

3. Which of the following decisions does **NOT** assist the financial manager in achieving the financial objectives of a corporate organisation?

   A. Determination of sources of funds
   B. Determination of the optimal financing mix
   C. Determination of the company's optional capital structure

D. Determination of distributable profits to the shareholders
E. Deciding on whether to buy or lease

4. Which of the following is **NOT** traded on the Nigerian Stock Exchange?

A. Industrial preference stocks and bonds
B. State government development stocks
C. Industrial and commercial equities
D. Industrial loans
E. Federal Government Development Stocks

5. The following are symptoms of overtrading **EXCEPT**

A. Rapid increase in sales
B. Rapid increase in profits
C. Rapid increase in the volume of current assets
D. Declining ratio of working capital
E. Declining ratio of debtors to trade creditors

6. The following are consistent with an aggressive approach to financing working capital **EXCEPT Financing**

A. Short-term needs with long-term debt
B. Short-term needs with short-term funds
C. Seasonal needs with short-term funds
D. All needs with a mixture of long and short term funds
E. Long-term needs with short-term funds

7. The introduction of Just-In-Time inventory policy might bring the following potential benefits **EXCEPT**

A. Reducing manufacturing lead times.
B. Improving labour productivity.
C. Reducing material purchase costs.
D. Reducing the number of accounting transactions.
E. Reducing stock holding costs.

8. Olumide Limited decided to pass on the opportunity of a cash discount of $2^1/_2$% in return for a reduction in its average payment period from 80 days to 40 days, What would be the implied cost in interest per annum?

A. 1.28%
B. 5.13%
C. 22.26%
D. 23.40%
E. 26.20%

9. The restriction imposed on a borrower by a lender is known as

A. Pledge
B. Fixed charge
C. Floating charge
D. Accord
E. Covenant

10. Which of the following is **NOT** a suitable basis for the valuation of a firm for merger or acquisition purpose?

A. Net asset
B. Benefit/Cost
C. Cash flow technique
D. Price/ Earning Ratio (PE Ratio)
E. Realisable value method

11. The following are objectives of establishing Microfinance banks in Nigeria **EXCEPT**

A. As a development strategy
B. To improve the social economic conditions of the poor
C. To provide credit to the low income group
D. To provide long-term capital for microeconomic activities
E. To provide microfinance services to the low income clients for income Generating activities

12. Which of the following is **NOT** a characteristic of customers of a microfinance bank ?

    A. Small business usually employing between 1 and 10 people
    B. Informal, usually owner operated
    C. Do not keep formal records
    D. Limited or no access to formal bank loans
    E. Inactive poor

13. What is the terminology used for an anti-take-over strategy in which the target company tries to buy up the shares of the predator company?

    A. Suicide pill
    B. Poison pill
    C. People pill
    D. Pacman defence
    E. Crown Jewels

14. In deciding between cash or share offer, the shareholders of a target company will consider the following factors **EXCEPT**

    A. Taxation
    B. Income
    C. Future investments
    D. Share price
    E. Dilution of EPS

15. Advantages of Accounting Rate of Return (ARR) include all the following **EXCEPT** that it

    A. Is simple to calculate and understand
    B. Considers the profit over the entire life of the project
    C. Uses readily available accounting data
    D. Serves as a simple initial screening process for new projects
    E. Could be used to compare performance of many companies

16. The Forward Exchange rate in international financial management is also known as the rate

A. Today for exchanging one currency for another at a specific location on a specific future date
B. Today for exchanging one currency for another at a specific location for immediate delivery
C. Today for exchanging one currency for another for immediate delivery
D. Today for exchanging one currency for another at a specific future date
E. Today for exchanging one currency for another for future delivery

17. Which of the following is **NOT** true of a capitalisation issue?

A. All original shares must have been duly paid-up
B. Amount of capitalisation issue should not exceed the paid-up capital
C. The company's shareholders should pass a resolution approving the issue
D. The total net worth of the company is increased by the amount of capitalisation issue
E. Maximum capitalisation share ratio is one for one

18. The following are used to appraise the performance of a bank **EXCEPT**

A. Asset value
B. Management efficiency
C. Capital adequacy
D. Earnings strength
E. Liquidity

19. What is the present value of ₦40,000 due annually from the end of year 6 to infinity at 20%?

A. ₦ 80,375
B. ₦ 81,075
C. ₦ 82,360
D. ₦ 85,000
E. ₦ 89,250

20. Which of the underlisted methods can **NOT** be used to hedge against foreign currency risk?

    A. Forward contracts
    B. Matching
    C. Foreign Currency Invoicing
    D. Interest Rate Parity
    E. Pricing Policy

PART II: SHORT-ANSWER QUESTIONS (20 MARKS)

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

1. The theory that explains the possible conflicts of interest between the shareholders and the managers and how such conflicts are overcome is referred to as ....

2. In deciding the optimal level of short-term finance, a financial manager must strike a balance between ....and...................

3. Systematic risk is a pivot element to an investor holding a well-diversified portfolio. Present a simple financial model to calculate the expected rate of return when unsystematic risk is diversified away from the portfolio.

4. Roll-Ross in arbitrage pricing theory states some factors to which security returns are sensitive. State **ONE** of such factors.

5. The orderly relationship between spot and forward currency exchange rates and the rates of interest between countries is known as...........................

6. A system for assigning a numerical value to credit applicants to determine their risk of default is referred to as.......................................

7. A loan package by a group of creditors agreeing to come together to provide credit facilities to a company, an individual or government is called..................

8. A combination of two firms in the same industry but at different stages in the process of producing and selling of products is known as...........................

9. Computer programs that enable a user to create and update files, to select and retrieve data and to generate various outputs and reports for financial management decisions is called.................................

10. A branch of applied morality which deals specifically with the behaviour of firms and the norms they should follow is called..............................

11. The responsibilities that arise as a result of a moral imperative for companies to operate in an equitable and fair manner is known as............................

12. The entire flexible structures and processes by which financial services are delivered to Micro-entrepreneurs on a suitable basis is called....................

13. The model for determining the value of a share using the present value of an expected stream of future dividends is referred to as...............................

14. A company's reserves can be converted into share capital through.................

15. The proportion of earnings paid to ordinary shareholders in the form of cash dividends is called..............................

16. The relationship between two foreign currencies expressed in terms of a third currency is known as...................................

17. The amount by which the forward price of a foreign currency exceeds its spot price is referred to as.............................

18. In the merger of two companies, X Ltd. and Y Ltd, the expression PV (x+y) > (PV_x + PV_y) refers to...................................

19. A method of analysing the risk elements in a capital expenditure project which enables an assessment to be made of how the project's NPV is responsive to changes in the variables used to calculate that NPV is called.....

20. What is the most appropriate criterion for ranking projects when there is fund constraint?

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

QUESTION 1 - CASE STUDY

Babayaro Plc. has been experiencing difficult trading conditions over the past few years. In the current year, net earnings are likely to be ₦20 million, which will just be sufficient to pay a dividend of ₦1 per share. The earnings and dividends for the company over the past five years are shown below:

Year	Net Earnings per share ₦	Net Dividend per share ₦
2004	1.40	0.84
2005	1.35	0.88
2006	1.35	0.90
2007	1.30	0.95
2008	1.25	1.00

There are 20,000,000 ordinary shares in issue, majority of which, are owned by private investors. There is no debt in the capital structure. Members of the Board of Directors are considering a number of strategies for the company, some of which, will have an impact on the company's future dividend policy. The company's shareholders require a return of 15% on their investment.

The following four dividend payment options are being considered:

(i) Pay out all earnings as dividend

(ii) Pay a dividend of 50% out of earnings and retain the remaining 50% for future investment

(iii) Pay a dividend of 25% out of earnings and retain the remaining 75% for future investment.

(iv) Retain all earnings for an aggressive expansion programme and pay no dividend at all.

The directors have not been able to agree on any of the four options. Some of them prefer option (i) because they believe that doing anything else would have an adverse impact on the share price. Others favour either option (ii) or option (iii) because the company has identified some good investment opportunities and they believe one of these options would be in the best long-term interest of the shareholders. An adventurous minority favours option (iv) and thinks that the option will allow the company to take over a relatively small but vibrant competitor.

In the light of the above exposition, you are required to:

(a) Discuss the Company's dividend policy between 2004 and 2008 and its possible consequences on earnings. (5 Marks)

(b) Advise the directors of Babayaro Plc. on the share price which might be expected immediately following the announcement of their decision if they pursue each of the four options, using an appropriate valuation model
Note: (Make necessary assumptions). (10 Marks)

(Total 15 Marks)

QUESTION 2

Globally, defining Small and Medium Scale Enterprises based on size and scale of operations is not easy. They however, have some special features.

You are required to:

(a) Enumerate any **TEN** features of Small and Medium Scale Enterprises. (10 Marks)

(b) Itemize the advantages which might accrue to a Small or Medium Scale Enterprises from the application of e-commerce. (5 Marks)

(Total 15 Marks)

QUESTION 3

Since political risk has a serious influence on the overall risk of an investment project, it (political risk) must be assessed realistically.

In the light of the above statement, you are required to:

(a) List any **EIGHT** factors you would consider as constituting the political risk inherent in a foreign investment. (8 Marks)

(b) State any **SIX** financial problems which a Multinational company faces but which a domestic company does not face. (6 Marks)

(c) Explain the term "Currency futures". (1 Marks)

(Total 15 Marks)

QUESTION 4

Laraba Plc. is considering an investment which it intends to finance by the issue of new ordinary shares and debentures in a mix which will hold its gearing ratio approximately constant.

The company has an issued share capital of 1 million ordinary shares of ₦1 each and also issued ₦700,000 8% debentures. The market price of the ordinary shares is ₦3.76 per share and the debentures are priced at ₦75. Dividends and interest are payable annually. An ordinary dividend has just been paid while the next instalment of interest is payable in the near future. Debentures are redeemable at par in twenty years time.

A summary of the company's balance sheet as at 31 December 2009 is as follows:

	₦'000	₦'000
Fixed Assets		1,276
Current Assets	4,066	
Less: Current liabilities	1,925	
		2,141
		3,417
Financed by:		
Ordinary share capital		1,000
Reserves		1,553
Deferred taxation		164
Debentures		700
		3,417

Dividends and Earnings have been as follows:

	Dividends	Earnings (before tax)	Earnings (after tax)
	₦'000	₦'000	₦'000
2005	200	575	350
2006	230	723	452
2007	230	682	410
2008	260	853	536
2009	300	906	606

The new investment which has the same risk characteristics as the existing projects, would require an immediate outlay of ₦1,500,000 and would generate an annual net cash inflow of ₦500,000 indefinitely.

You are required to:

(a) Calculate Laraba Plc's Weighted Average Cost of Capital (WACC). (7 Marks)

(b) Discuss briefly any difficulties and uncertainties in your estimation. (3 Marks)

(c) Prepare calculations showing whether or not acceptance of the new project is worthwhile. (3 Marks)

(d) Appraise the dividend policy of the company. (2 Marks)

(Total 15 Marks)

QUESTION 5

The hotel division of Ikenga Resources Plc is experiencing considerable financial difficulties. The management is prepared to undertake buy-out, and the company is willing to sell for ₦30 million. After an analysis of the division's performance, the management concluded that the division requires a capital injection of ₦20 million.

Possible funding sources for the buy-out and the additional capital injection are as follows:

From management:	
Equity shares at 25 kobo per share	₦12 million
From venture capital providers:	
Equity shares at 25 kobo per share	₦5.5 million
Debt: 9.5% fixed rate loan	₦7.5 million

The fixed rate loan principal is repayable in 10 year's time. Forecast of Earnings Before Interest and Tax (EBIT) for the next five years following the buy-out are as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
	₦'000	₦'000	₦'000	₦'000	₦'000
EBIT	2,200	3,100	3,900	4,200	4,500

Company income tax is charged at 30%. Dividends are not expected to be more than 12% of profits for the first five years.

Management has a forecast that the value of equity capital is likely to increase by approximately 15% per annum for the next five years.

Required:

(a) On the basis of the forecast above, determine whether or not the management estimate that the value of equity will increase by 15% per annum is a viable one. (8 Marks)

(b) Discuss the potential problems associated with management buy-out. (7 Marks)

(Total 15 Marks)

QUESTION 6

The summarised budget of Samanda Oil Mill Limited for the year to 31 December 2009 is as follows:

	₦'000	₦'000
Budgeted sales		20,000
Budgeted variable costs	18,400	
Budgeted fixed costs	800	
		(19,200)
Budgeted Net profit		800

The company allows debtors four weeks credit. The sales manager of the company believes that because this credit control policy is more severe than that of the company's major competitors, the company is not realising its sales potentials, and that if debtors were given eight weeks credit, sales could be increased by 15%.

You are required to:

(a) Briefly outline for management the implications of the sales manager's proposal. Note: Cost of capital is 13% and all sales are on credit. (7 Marks)

(b) List **FOUR** factors which should be taken into consideration in determining a policy for the control of credit extended by a company. (2 Marks)

(c) Explain **FOUR** points which should be taken into consideration when granting credit to a particular customer. (6 Marks)
Note: 52 weeks a year is assumed. State your assumptions.

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

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

Tutorials

8. cost = $\frac{\%\text{discount}}{100\% - \%\text{discount}} \times \frac{365}{\text{Maximum payment Period less maximum Discount period.}}$

$= \frac{2\frac{1}{2}\%}{100-2\frac{1}{2}} \times \frac{365}{80-40}$

$= \frac{2\frac{1}{2}}{97\frac{1}{2}} \times \frac{365}{40}$

= 23.40%

19. $\frac{40,000}{0.20} \times (1.2)^{-6+1} = \frac{40,000(1.2)^{-5}}{0.20}$

= ₦80,375 or ₦80,376 appr.

EXAMINERS' REPORT

The questions test candidates' knowledge of the various aspects of the syllabus. All the candidates attempted most of the questions and performance was fair.

Candidates are advised to prepare more adequately to achieve better performance in future examinations.

PART II SHORT- ANSWER QUESTIONS

1. Agency theory

2. Profitability; liquidity

3. $E(rj) = rf + \left[E(rm-rf)\right]\beta$; or $R_f + \beta(R_m - R_f)$
   where
   R_f = Risk free rate of return
   β = Risk measurement (systematic risk of the security)
   R_m = Market portfolio expected rate of return

4. (i) Unanticipated inflation
   (ii) Changes in the expected level of industrial production.
   (iii) Changes in the risk premium on bonds (debentures)

(iv) Unanticipated changes in the term structure of interest rates.

5. Interest Rate Parity.
6. Credit-scoring system or Credit rating
7. Syndicated loan
8. Vertical integration
9. Database Management System
10. Business Ethics
11. Ethical responsibilities
12. Microfinancing
13. Dividend Valuation Model or Dividend Discount Model
14. Scrip Issue/Bonus issue
15. Dividend pay-out ratio
16. Cross Rates
17. Premium
18. Synergy
19. Sensitivity analysis, Deterministic Simulation, What-if-Analysis, Switch-Test-Analysis
20. Profitability Index or Benefit/Cost Ratio

EXAMINERS' REPORT

The questions test candidates' understanding of the various aspects of the syllabus. All the candidates attempted the questions and performance was above average. Candidates are advised to read widely for better result in future examinations.

SOLUTIONS TO SECTION B

QUESTION 1

(a)

Year	Net Earnings per share (₦)	Net dividend per share (₦)	Dividend as % of Earnings %
2004	1.40	0.84	60
2005	1.35	0.88	65
2006	1.36	0.90	67
2007	1.30	0.95	73
2008	1.25	1.00	80

Change in EPS $= \frac{0.15}{1.40} \times 100 = 10.7\%$ DPS $\frac{0.16}{0.84} \times 100 = 19\%$

During this period, earnings per share have declined by 10.7%, while at the same time, dividend per share has increased by 19.0%

The payment ratio has increased from 60% in 2004 to 80% in 2008, and thus the proportion of earnings retained has fallen to 20%. If it is assumed that the capital structure has not changed over the period, then it can be seen that both actual earnings and return on capital employed have declined over the period.

One possible implication of this policy is that insufficient earnings have been retained to finance the investment required to at least, maintain the rate of return on capital employed. It then means that the Company is falling behind its competitors, which could have a serious impact on the long-term profitability of the business. However, ₦1.00 dividend per share in the current year will result in a fall in the share price.

(b) Rate of Return

For the purposes of calculation, it is assumed that any new investment will earn a rate of return equivalent to that required by the shareholders (i.e 15%), and that this will also be the level of return that is earned on existing investments for the foreseeable future. It is further assumed that investors are indifferent as to whether they receive their returns in the form of dividend or as capital appreciation.

Option 1

The amount of dividend per share is ₦1.00 with no growth forecast. The rate of return required by shareholders is 15%. The theoretical share price can be estimated using the dividend valuation model.

$$K_e = \frac{d_1}{p_o}$$

where k_e = Cost of equity
d_1 = Dividend per share
P_o = Market price per share

$$0.15P_o = ₦1.00$$

$$\therefore P_o = \frac{₦1.00}{0.15} = ₦6.67 \text{ ex-div or } ₦7.67 \text{ cum-div}$$

100% of the total return will be paid as dividend.

Option 2

In this case, 50% of the expected return is in the form of dividend and 50% as capital appreciation.

A numerical example will clarify the position.

The rate of growth of dividend g may be expressed as:

$g = rb$
where r = required rate of return
b = proportion of profits retained

Therefore, with dividend at 50 kobo per share;
$g = 0.15 \times 0.5 = 0.075$

NOTE $P_o = \frac{d_1}{r-g}$
where $d_1 = d_o(1+g)$

$$P_o = \frac{0.5 \times 1.075}{0.15 - 0.075} = ₦7.17$$

or ₦7.17 plus 50k = ₦7.67 cum-div

Option 3

In this case, 25% of the expected return is paid in form of dividend while 75% is retained.

Therefore,
$g = 0.15 \times 0.75 = 0.1125$

$$P_o = \frac{0.25 \times 1.1125}{0.15 - 0.1125} = ₦7.416$$

= ₦7.42 ex-div.

or

₦7.42 plus 25 kobo dividend
= ₦7.67 cum-div.

Option 4

In this case, for a share price of ₦6.67, investors would need to believe that retained profits will be invested in projects yielding annual growth of 15% and that the share price will be at this rate. 100% of the expected return is provided in the form of capital appreciation under this option.

EXAMINERS' REPORT

The question tests candidates' knowledge of dividend policy. Part (a) of the question places emphasis on the consequences of dividend policy on earnings of a company, while part (b) focuses on the dividend valuation model.

Many candidates attempted the question but most of them did not have adequate knowledge of the requirements, hence performance was poor. Candidates' commonest pitfalls were their failure to interprete questions correctly. They seem to understand 'discussion' to mean more of expression than calculations. In part (a) of the question, instead of candidates to compute the increase in pay-out ratios over the relevant years with a view to commenting on the dividend policy, they were just making comments without reference to the figures. The same was done in part (b) of the question. Most candidates did not know that they needed to calculate price per share based on the various options provided, using the appropriate dividend models, for the advice and necessary discussions.

Candidates are advised to always read, understand and interprete questions appropriately and note their specific requirements before they are attempted. They are also advised to always perform necessary computations using relevant figures provided in the question in arriving at decisions.

QUESTION 2

(a) Some of the features of the Small and Medium Scale Enterprises are:

i. Compared with large companies, SMEs have low set up costs.
ii. Reliance on local raw materials.
iii. Generation of employment/creation of job opportunities.
iv. Addition of value.
v. Acceleration of rural development and helping to stem rural-urban. migration and problems of congestion in large cities.
vi. Stimulation of indigenous entrepreneurship.
vii. Providing links between agriculture and industries.
viii. Mobilisation of private savings and harnessing them for productive purposes.
ix. Supplying parts and components for large – scale industries.
x. Contribution to domestic capital formation.
xi. Retaining competitive advantage over large enterprises by serving dispersed local markets and producing various goods with low scale economies for niche markets.
xii. Inadequate accounting records.
xiii. Poor corporate governance.
xiv. Inadequate capital for expansion purposes.
xv. High mortality rate.

(b) Some of the advantages that might accrue to a Small or Medium Scale Enterprise from the application of e-commerce to its business activities include:-

i. Access to information relating to financial assistance is made possible.
ii. Access to information on existing and available right sources of finance is enhanced.
iii. High quality reports such as projected cash flow and so on, can be presented on request to other institutions e.g. banks, tax authorities.

iv. Through application of e-commerce to the business activities of Small and Medium Scale Enterprises, investment projects can be easily appraised and feedback can be quickly obtained using sophisticated investment appraisal methods.

v. Relationship with major Chambers of Commerce will be enhanced.

vi. Increases brand or product awareness.

EXAMINERS' REPORT

The question tests candidates' knowledge of Financial Management of Small and Medium Scale Enterprises. Part (a) of the question deals with the features while part (b) tests candidates' knowledge of the application of e-commerce to Small and Medium Scale Enterprises.

Most of the candidates attempted the question but performance was poor, as many of them did not comprehend the question very well. Candidates' commonest pitfalls were their inability to distinguish between Small and Medium Scale Enterprises (SMEs) and Sole Proprietorship. They also take e-commerce to mean computerization of SMEs.

Candidates are advised to read widely and also cover the syllabus adequately for better result.

QUESTION 3

(a) Factors that generally constitute political risk to a foreign investment include:

i. Interference with the transfer pricing arrangement and making the host country's currency not freely convertible.

ii. Insisting on joint ventures with a certain percentage of the shares of the company to be held by the nationals.

iii. Special taxes on the profits of foreign-owned firms or on dividends and interest remittances.

iv. Discriminatory sanctions that make it difficult for the multinationals to operate profitably which might lead to a closure of the firm e.g ending the multi-national's right to remit profits.

v. Variations in macro-economic policy which affects all companies operating in the country.

vi. Wealth deprivation: takeover of the multinational with or without compensation.

vii. Employment legislation: work permit for expatriate staff.

viii. Political influences by overseas government.

ix. Restriction on the right to remit proceeds of interest, dividend and so on.

x. Dictating the shareholding pattern so that the nationals will be able to participate effectively.

(b) Financial problems which multinational company faces but which a domestic company does not face include:

i. Managing exchange rate risk arising from the use of different currencies, the relative values of which are subject of unexpected change.

ii. Non-compliance risk, that is failure to deliver goods according to specification by the exporter or failure to make payment according to the contract by the importer arising from distance and lack of familiarity with the customer or the legislation of the country of importation or exportation.

iii. Technicalities involved in investing in the international market.

iv. Technicalities involved when raising capital in international capital market.

v. Country or Sovereign risk arising from economic, political or social factors.

vi. Differences in Tax Systems.

vii. Difference in inflation rate.

viii. Control of Remittances.

(c) Currency futures are standardized for the purchase and sale of foreign currency where delivery takes place at a specified future date at a specific price. They are closely related to forward contract but with minor differences.

EXAMINERS' REPORT

Part (a) of the question tests candidates' knowledge of International financial markets and their associated risks, while part (b) examines candidates' knowledge on international financing. Part (c) however, focuses on candidates understanding of currency options.

Most of the candidates attempted the question and performance was poor. Failure of candidates to put forward valid points required in parts (a) and (b) of the question contributed to their failure. Candidates' commonest pitfalls were their inability to state the factors that would be regarded as political risk to foreign investment and the identifiable problems of Multinational companies.

Candidates are advised to always read widely to cover the syllabus and make use of the Institute's Pathfinders and Study Packs in their preparation for the examinations for better result.

QUESTION 4

(a) The net dividend has increased by 1.5 times from the end of 2005 to the end of 2009, a period of 5 years. This represents an approximate annualized growth rate of:

$$g = \left[\sqrt[n-1]{\frac{\text{Latest dividend}}{\text{Earliest dividend}}} - 1 \right] \times 100\%$$

$$= \left[\sqrt[5-1]{\frac{300}{200}} - 1 \right] \times 100\%$$

$$= \left\{ \sqrt[4]{1.5} - 1 \right\} \times 100\ \%$$

$$= \underline{10.6\%}$$

$$K_e = \frac{d_1}{P_o} + g$$

Where $d_1 = do\ (1 + g)$

$$K_e = \frac{d_o (1 + g)}{P_o} + g$$

$$= \frac{30\ (1.1067)}{376} + 0.1067$$

$$= \underline{\underline{0.195}} \text{ OR } \underline{\underline{19.5\%}}$$

Cost of debenture (k_d) (Tax Ignored)

Workings: determination of relevant cashflows.

Year	MV	Interest	Cashflow
	₦		₦
0	(75)	8	(67)
1-20		8	8
20		100	100

Using 10% and 20% discount rates for the IRR

Year	CF	DF	PV	DF	PV
	(₦)	(10%)	₦	(20%)	₦
0	67	1.00	(67)	1.00	(67)
1-20	8	8.5136	68.11	4.8696	38.96
20	100	0.1486	14.86	0.0261	2.61
	NPV		15.97		(25.43)

$$\therefore K_d = 10\% + \frac{₦15.97}{₦15.97 + ₦25.43} \times \frac{(20 - 10)\%}{1}$$

$$= 10 + 0.3857\ (10)$$

$$= \underline{\underline{13.86\%}}$$

WACC Computation

Source of Capital	Market Value	Cost (%)	Total
	₦'000		₦'000
Equity (1m x ₦3.76)	3,760	19.50	733.20
Debenture (700,000 x 0.67)	469	13.86	65.00
	4,229		798.20

$$WACC = \frac{₦798.20}{₦4,229.00} \times \frac{100}{1}$$

$$= 18.87\%$$

(b) Difficulties and uncertainties that should be mentioned are:

(i) Will the growth rate in dividend remain the same as in previous years?

(ii) Should a premium for risk be added to the weighted average cost of capital?

(iii) The existing gearing ratio will be maintained and the optimal capital structure of the company already attained.

(iv) The market values used for the computation of the WACC can never remain constant but subject to changes due to market forces particularly that of debentures when approaching the redemption time.

(c) Calculation of NPV of the project

Initial outlay		(₦1,500,000.00)
PV of cash inflow (indefinitely)	$= \frac{₦500,000}{0.1887} =$	₦2,658,160.55
		₦1,158,160.55

Recommendation: The NPV of the project is positive, hence its acceptance is worthwhile (NPV of ₦1,158,160.55).

(d) Company's Dividend Policy.

Year	Dividends ₦'000	Earnings before tax ₦'000	Earnings after tax ₦'000	Dividend as a % of earnings after tax (%)
2005	200	575	350	57
2006	230	723	452	51
2007	230	682	410	56
2008	260	853	536	49
2009	300	906	606	50

The policy is only suitable when a company achieves a stable EPS or steady EPS growth.

This appears not to be the case with this company as the earnings have revealed, particularly that of year 2007.

EXAMINERS' REPORT

The question tests candidates' knowledge of capital structure and dividend policy. Parts (a), (b) and (c) place emphasis on candidates knowledge on one of the factors of evaluation and determination of financial requirements of corporate entities and organisations which influence the choice of capital structure – Weighted Average Cost of Capital (WACC). Part (d) of the question however, focuses on factors influencing dividend policies.

Many candidates attempted the question but they did not show proper understanding of it, hence performance was poor. Candidates' commonest pitfall was their inability to compute the cost of capital as they could not determine the cash flow required for cost of irredeemable debenture.

Candidates are advised to work on past questions by making use of the Institute's Pathfinders, Study Packs and any other relevant materials when preparing for the examinations. They should pay particular attention to the concept of cost of capital which is an important aspect in Strategic Financial Management.

QUESTION 5

(a) In order to estimate the change in the value of equity, we can use forecast retained earnings figures, assuming dividends to be at the maximum of 12%

(All figures are in ₦'000)

	0	1	2	3	4	5
EBIT	-	2,200	3,100	3,900	4,200	4,500
9.5% interest		713	713	713	713	713
Earnings before tax	-	1,487	2,387	3,187	3,487	3,787
Tax	-	446	716	956	1,046	1,136
Earning after tax	-	1,041	1,671	2,231	2,441	2,651
Dividend (12%)	-	125	201	268	293	318
Retained earnings	-	916	1,470	1,963	2,148	2,333
Equity	17,500	18,416	19,886	21,849	23,997	26,330

Compound growth rate of equity interest = $\left[\sqrt[4]{\frac{26,330}{17,500}} - 1\right]$

Compound growth rate of equity interest = $\left[\sqrt[4]{1.505} - 1\right]$ = 0.1076
= 10.8%

The 10.80% growth rate is considerably less than the 15% rise predicted by management, it can therefore be concluded that the management's estimate does not appear to be viable.

(b) Potential problems with management's buy- out include:

(i) Deciding on a fair price – management will obviously want to pay lowest price possible whilst the vendor will want to secure the highest possible price.
(ii) Any geographical relocation may result in the loss of key workers.
(iii) Key suppliers and customers may decide to leave as a result of the buy-out.

(iv) Availability of sufficient cash flow to maintain and replace fixed assets. This is one of the main problems with buy-out as cash is often very tight at the beginning of the venture.
(v) Changes in work practices may not suit all employees.
(vi) Maintaining financial arrangements with previous employees may be difficult – particularly in the area of retirement benefits.
(vii) Some providers of funds may insist on representation on the board in order to maintain some control over how their funds are being utilized.

EXAMINERS' REPORT

The question tests candidates' knowledge of corporate restructuring with emphasis on management buy-out. Part (a) of the question focuses on the ability of candidates to estimate value of growth rate in equity in taking viable decision on management buy-out, while part (b) tests the candidates on its potential problems.

Few candidates attempted the question and most of them could not understand the right approach to solve the problem, hence the performance was very poor. Candidates' commonest pitfalls were their inability to compute the equity value and

the growth rate of the equity needed to take decision on the buy-out arrangement. They were also unable to identify the potential problems associated with management buy-out and were, therefore, unable to discuss them.

Candidates are advised to always cover the syllabus adequately and also read widely to have a good understanding of this type of question for better performance.

QUESTION 6

(a) Let us assume that fixed costs will remain constant. The increased contribution (profit) from the extension of the credit period will be:

	₦'000
Increase in Budgeted sales (15% of ₦20,000)	3,000
Increase in Budgeted variable costs (15% of 18,400)	2,760
Additional contribution	240
	₦240,000

Computation of Additional investment in working capital

(i) Based on Variable Costs:

	₦
Average debtors in respect of the old policy will be $18{,}400{,}000 \times {}^{4}/_{52}$ =	(1,415,385)
Average debtors in respect of the new policy will be $(18{,}400{,}000 + 2{,}760{,}000) \times {}^{8}/_{52}$	3,255,385
Additional investment in working capital	1,840,000

	₦
Required returns = cost of capital x additional Investment = 13% x ₦1,840,000	239,200

(ii) Based on sales values:

	₦
Average debtors in respect of the old policy will be 20,000,000 x $^{4}/_{52}$	(1,538,462)
Average debtors in respect of the new policy will be (20,000,000 + 3,000,000) x $^{8}/_{52}$	3,538,462
Additional investment in working capital	2,000,000

Required returns = cost of capital x additional investment	₦
= 13% x 2,000,000	260,000

Valued at variable cost of finance (required return), the additional investment is basically the same as increase in profits. Based on sales value, the cost of the additional investment ₦260,000 is higher than the increase in profit ₦240,000.

Therefore, the change in policy is not worthwhile unless there are other strategic reasons.

(b) Extending credit implies giving interest free loans to customers. This involves striking a balance between the advantage of increasing sales, (and thereby profits) and the costs of giving credits (administrative costs, finance costs and risk of bad debts).

Specifically, the following factors need to be considered:

(i) Type of product or service being offered by the company. Where the product or service is unique or its demand inelastic, there will be no need for credit.

(ii) A review of the credit terms offered by competitors will form a basis for credit policy development.

(iii) The administrative cost of debt factoring and invoice discounting.

(iv) The amount of extra capital required to finance an increase in working capital and the related costs.

(v) The risk of bad debts and the cost of offering discounts to reduce such risks.

(vi) Longer credits may be offered to enable the company capture a larger share of the available market or break into a new market.

(vii) Establishment of procedures for controlling credits to individual customers including issues of who to sell to, credit period and credit limits.

(c) Points to be considered when granting credit to a particular customer include:

(i) Assessment of the credit worthiness of a particular customer to determine whether credit sales should be made to him and the maximum amount allowable.

(ii) Collection of facts about the customer's business including profitability, generation of sufficient assets to meet liabilities and availability of suitable assets.

(iii) Investigation of the customer's business and the people running it, from third parties e.g, accountants or other companies with which the customer has done business.

(iv) Where the customer is a company, relevant ratio analysis of its latest published accounts will be necessary.

(v) A new customer's credit limit should be fixed at a relatively low level and only be increased if payment record warrants it. Suitable references should be obtained on these customers.

(vi) A review of credit limits of large-value debtors and age analysis of debts.

(vii) In respect of foreign customers, status reports from foreign bankers and information on exchange control restriction and political environment should be obtained.

EXAMINERS' REPORT

The question tests candidates' knowledge of management of debtors with emphasis on analysis and evaluation of various credit terms and the factors that determine credit control policies of an organization.

Most of the candidates attempted the question but demonstrated shallow knowledge of its concept and thus failed to answer it appropriately, hence performance was poor.

Candidates' commonest pitfalls were their inability to carry out necessary calculations to determine the costs and savings of an increase in credit period. Many candidates assumed granting of credit to a customer is the same as granting of loans by Financial Institutions. They were also confused as to factors that determine credit control policy.

Candidates are advised to read widely to cover every aspect of the syllabus. They should also endeavour to take time to read, understand and interprete questions appropriately and note their specific requirements before attempting them.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II – NOVEMBER 2011
ADVANCED TAXATION
Time allowed- 3 hours

SECTION A: Attempt All Questions

PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

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

1. Under which **ONE** of the following groups does the **THREE** main tax bases used in the Nigerian tax system fall?

   A. Capital, income and company tax
   B. Consumption, capital and capital gains tax
   C. Income, capital and consumption
   D. Income, capital and expense
   E. Capital, direct and indirect

2. Which **ONE** of the following is an example of Indirect tax?

   A. Profit tax
   B. Company tax
   C. Capital Gains tax
   D. Education tax
   E. Custom and Excise duties

3. Which **ONE** of the following is **NOT** a member of the Joint State Revenue Committee?

   A. The Chairman of the Revenue Allocation Committee of a State Assembly
   B. Chairman of the State Internal Revenue Service
   C. State Sector Commander of the Federal Road Safety Commission
   D. Legal Adviser of the State Internal Revenue Service
   E. Chairman of the Local Government Revenue Commission

4. What is the principal place of residence of a Partner under the Personal Income Tax Act CAP P8 LFN 2004?

   A. His place of work
   B. His State of origin
   C. That place in which he resides as at 1st January of an assessment year
   D. That place nearest to his usual place of work
   E. His father's residence within Nigeria

5. An appeal against the decision of the Tax Appeal Tribunal is made to the

   A. Court of Appeal
   B. Joint Tax Board
   C. Federal High Court
   D. Supreme Court
   E. Joint sitting of the Joint Tax Board and Federal Inland Revenue Service

6. A worker that does not have a permanent principal place of residence in a year of assessment is referred to as a/an .... worker.

   A. Non-taxable
   B. Non-resident
   C. Itinerant
   D. Transit
   E. Moveable

7. Any person who has a right to the Capital of a Settlement when the Life Interest terminates is referred to as the

   A. Life tenant
   B. Administrator
   C. Legatee
   D. Remainder man
   E. Testator.

8. Which of these is **NOT** exempted from Value Added Tax in Nigeria?

   A. All exports
   B. Baby foods and products

C. Services rendered by Commercial Banks located in an Export Processing Zone
D. Pharmaceutical Products
E. Services rendered by Microfinance Banks

9. On what basis are Chargeable Capital Gains assessed in Nigeria?

A. Preceding year basis
B. Actual year basis
C. Penultimate year basis
D. Ultimate year basis
E. Current year basis

Use the following information to answer questions 10 to 13.

XYL Limited which commenced business on 1 February 2009 with accounting year-end as 31 December, had the following results for:

	Assessable Profit
	₦
Period ended 31/12/2009	145,000
Year ended 31/12/2010	960,000

10. What is the Basis period for 2009 year of assessment?

A. 1/01/2009 - 31/12/2009
B. 1/02/2009 - 31/01/2010
C. 1/02/2009 - 28/02/2010
D. 1/02/2009 - 31/12/2009
E. 1/02/2009 - 31/07/2010

11. What is the Normal Basis period for the second year of assessment?

A. 1/01/2010 - 31/12/2010
B. 1/02/2009 - 31/01/2010
C. 1/02/2009 - 28/02/2010
D. 1/02/2009 - 31/12/2009
E. 1/02/2009 - 31/07/2010

12. What is the Assessable Profit for 2010 assessment year?

A. ₦145,000
B. ₦370,000
C. ₦960,000
D. ₦552,500
E. ₦225,000

13. What is the Education Tax Payable for 2010 assessment year?

A. ₦9,000
B. ₦4,500
C. ₦11,050
D. ₦7,400
E. ₦19,200

14. Identify which **ONE** of the following can **NOT** be regarded as a Pioneer company.

A. Manufacturer of office furniture and equipment
B. Agricultural company engaged in processing of food crops
C. Manufacturer of cocoa products
D. Manufacturer of iron and steel from iron ore
E. Company engaged in integrated dairy products

15. With reference to Instruments not under seal, "Executed and Execution" means

A. Signed and implemented
B. Signature and seal
C. Signed and signature
D. Signature and implemented
E. Seal and implemented

16. What is the penalty under PPTA, for preparation of incorrect accounts? A fine of

A. ₦5,000
B. ₦1,000 and double the amount of tax which has been undercharged as a result

C. ₦1,000 and imprisonment for two years for the Company's Directors on conviction
D. ₦5,000 plus imprisonment for two years for the Company's Directors on conviction
E. ₦150,000

17. Under PPTA, what is the penalty for failure to deduct and remit to the Federal Inland Revenue Service within 30 days, withholding tax deducted? A fine of

A. 100% of the tax not withheld or remitted plus interest at the prevailing commercial rate.
B. 300% of the tax not withheld or remitted plus interest at the prevailing commercial rate.
C. 200% of the tax not withheld or remitted plus interest at the prevailing commercial rate.
D. ₦500,000.
E. ₦500,000 plus 10% of tax not withheld or remitted.

18. In relation to Production Sharing Contracts (PSC), oil recovered in the contract area is split into which **ONE** of the following groups?

A. Royalty oil, queen oil, revenue oil and profit oil
B. Royalty oil, oil well, revenue oil, and base oil
C. Royalty oil, cost oil, tax oil and profit oil
D. Royalty oil, queen oil, production oil and tax oil
E. Royalty oil, cost oil, revenue oil and profit oil

19. Under the Nigerian Information Technology Development Agency Act (NITDA) 2007, what is the percentage of levy imposed on the profit of specified companies with annual turnover of ₦100 million and above?

A. 1% of the profit before tax
B. 2% of the profit before tax
C. 2% of the profit after tax
D. 4% of the profit before tax
E. 1% of the profit after tax

20. In computing capital allowance for tax purposes, an electronic spreadsheet cannot be useful for which **ONE** of the underlisted tasks?
    A. Re-calculating updated information
    B. Calculating data accurately
    C. Planning worksheet objectives
    D. Displaying information visually
    E. Allowing values to include formulae

PART II: SHORT-ANSWER QUESTIONS (20 MARKS)

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

1. A conscious effort to consider the tax payable by a taxpayer at a future date and how such tax can be minimized is referred to as ....

2. Who is the Chairman of the Joint State Revenue Committee?

3. Which of the Revenue Authorities administers the collection of Value Added Tax in the States in Nigeria?

4. What is the statutory date stipulated as deadline for filing self assessment returns to the Federal Inland Revenue Service for a Company's accounts made up to 31 December 2010?

5. **TWO** types of Tax Audits carried out by the Integrated Tax Offices of the Federal Inland Revenue Service are .... and ....

6. In any tax system, the deliberate understatement of income or overstatement of expenditure and making of false claims for allowances and reliefs is referred to as ....
7. In the context of Personal Income Tax Computation, dividend, rents, interests and non-executive directors fees are good examples of .... Income.

8. State **TWO** items that will constitute taxable income in the hands of partners in a Partnership.

9. A person who is entitled to both Capital and Income of an Estate, where rights usually terminate after a specific period of his life time, is called a ………………..

10. Which Revenue Authority has the right to collect VAT on a contract won by Victoria Falls Partners based in Lagos?

11. When an asset is acquired on hire purchase terms, interest element thereon is ……………………..

12. Under the Capital Gains Tax Act CAP CI LFN 2004, gains accruing to Trade Unions not registered under the Trade Unions Act are ……………………….. from Capital Gains Tax.

13. All expenses of a Company that are wholly, exclusively ………….. and …………… incurred in the production of the profits are allowable deductions.

14. What is the significance of "Production day" to a Company that has been granted a Pioneer Status for the first time?

15. The tax attributable to timing differences in the incidence of Revenue and Expenditure included in tax computations for an Accounting period is referred to as ……………………….

16. The "World Income" of a Nigerian Company engaged in air transportation business will be subjected to income tax, subject to the provisions of ……………… agreement.

17. A lease granted to a Company under the Minerals Act for the purpose of winning petroleum or any assignment of such lease is called …………………………..

18. What is the due date for the payment of the first instalment of tax due under the Petroleum Profits Tax Act?

19. State **TWO** Instruments that attract fixed Duties with respect to Stamp Duties payment in Nigeria.

20. Under what condition will tax authorities grant full Roll-over relief on Capital Gains Tax?

SECTION B: ATTEMPT QUESTION 1 AND ANY OTHER 3 (60 MARKS)

QUESTION 1 - CASE STUDY

The Managing Director of Kaduna Limited, a trading Company registered with the Federal Inland Revenue Service, just received a letter from the Area Tax Controller, Integrated Tax Office, Lagos.

The letter was passed to you for expert advice and guidance, in your capacity as the Company's new Tax Consultant.

You later discovered that Kaduna Limited's Accountant has been in charge of the Company's tax matters without input from any professional Tax Consultant.

An extract of the letter from the Federal Inland Revenue Service reads thus:

The Managing Director
Kaduna Limited
Kaduna Way
Lagos

Dear Sir,
KADUNA LIMITED
RE: TAX AUDIT EXERCISE FOR 2009 AND 2010 ACCOUNTS

I write to inform you that the Lagos Integrated Tax Office Audit team will be visiting your Company for routine tax audit exercise.

The audit is scheduled to hold from 16 December to 20 December 2011.

You are requested to provide relevant documents and schedules in respect of the Company's tax and VAT returns and also co-operate with the Audit team to ensure a hitch free exercise.

Yours truly,

Signed
Mr. Rufus Abanikanda

As the company's Tax Consultant you are required to:

(a) Explain the purpose of a Tax Audit. (2 Marks)
(b) Distinguish between Desk Audit and Field Audit. (2 Marks)
(c) Provide adequate checklist of documents and information to be made available in respect of the Tax Audit coming up in December 2011. (11 Marks)

(Total 15 Marks)

QUESTION 2

The Profit and Loss Account of Alhaja Abiona, proprietor of Glorious Super Stores for the year ended 31 December 2009 is as follows:

	₦	₦
Gross profit for the year		1,200,000
Expenses:		
Salaries and wages	465,000	
Depreciation	330,000	
Repairs and maintenance	100,000	
Bad debts (net)	18,000	
Interest	10,000	
Rent	80,000	
Advertising	58,000	
Loss on sale of car	22,000	
Office expenses	46,000	
General expenses	37,000	
Legal expenses	18,000	
Entertainment	44,000	
Motor expenses	25,000	(1,253,000)
		(53,000)
Profit on sale of delivery van		2,000
Interest		5,000
Net loss		(46,000)

You are provided with the following information:

(i) Allowable expenses of ₦12,000 had been omitted from the accounts.

(ii) The rent is in respect of a building which is used for both business and private occupation by the proprietor and 25% of the building is used for private purposes.

(iii) The cost of goods taken by the proprietor for her personal use has been deducted from Purchases in the Trading Account. The selling price of the goods was ₦15,000. The business prices its goods at cost plus 20%.

(iv) Entertainment consists of ₦24,000 incurred on private holiday of Alhaja Abiona, ₦8,000 for entertaining her friends and ₦12,000 for entertaining customers.

(v) Interest received is in respect of investment in OLUN State Government Development Bond.

(vi) General expenses include cost of installation of an Electric Generator for the business of ₦1,500.

(vii) The interest expense is in respect of a loan of ₦100,000 obtained by the proprietor from a Bank. She used ₦75,000 of this loan to purchase a Van for her business and the balance in paying for the expenses incurred in sending her son on a visit to Italy.

(viii) Loan interest amounting to ₦9,000 which had in the past years been charged in the profit and loss account was waived by the lender during the period under consideration. The amount of ₦9,000 was credited to Retained Earnings Account.

(ix) Motor expenses include ₦5,000 for running the proprietor's personal car. The Inspector of Taxes has agreed 50% as representing business use.

(x) Advertising consists of:

	₦
Cost of neon lighting for the business	8,000
Business advertisement on radio	10,000
Others (all allowable)	40,000
	58,000

(xi) Salaries and Wages consist of the following:

	₦
Wages of proprietor's houseboy	12,000
Wages of messengers and cleaners	40,000
Proprietor's salary	160,000
Salary of office staff	63,000
Shop assistant's salary	130,000
Manager's salary	60,000
	465,000

(xii) Bad debts include recovery of a specific debt of ₦4,000, a general provision of ₦2,000 and ₦1,500 granted to an employee who was in financial difficulties and left before he could repay the amount due.

(xiii) Legal expenses consist of the following:

	₦
Cost of income tax appeal	4,000
Cost of settling dispute with customers	5,000
Business advice to proprietor	6,000
Cost of debt collection	3,000
	18,000

(xiv) Repairs and maintenance include the following:
Cost of making good the defects in an electric generator, for the business, at the time of purchase ₦1,000.
Painting of business premises ₦8,000.
Restructuring and improving the roof and walls of the business premises ₦6,000.
Provision of Iron Gate for the business premises ₦7,000.

You are required to:

Compute the Adjusted Profit of Alhaja Abiona for the relevant year of assessment.

(15 Marks)

QUESTION 3

(a) With respect to Petroleum Profits Tax Cap P13 LFN 2004, explain briefly:
(i) G-Factor
(ii) Chargeable oil
(iii) Chargeable Natural Gas
(iv) Posted Price (4 Marks)

(b) Sadery Petroleum Limited presented the following report for the year ended 31 December 2007

	₦'000	₦'000
Net fiscal value of sales	124,315	
Sundry income	14,352	138,667
Less:		
Operating expenses	52,305	

Intangible drilling cost	44,765	
Royalties	12,750	
Custom duties	975	
Rentals	1,352	(112,147)
Net profit		26,520

It is also given that:

(i) The Company is entitled to an Investment Tax Credit of ₦230,000.
(ii) Capital allowance for the year is ₦23,564,000.
(iii) Balancing charge available is ₦200,000.
(iv) Memorandum of Understanding credits is ₦1,000,000.

You are required to compute the Chargeable Tax. (11 Marks)
(Total 15 Marks)

QUESTION 4

(a) What is the composition and functions of the Joint Tax Board? (5 marks)

(b) What is the composition and functions of the Local Government Revenue Committee? (6 marks)

(c) State **FOUR** taxes administered by the Federal Inland Revenue Service.(4 Marks)
(Total 15 Marks)

QUESTION 5

(a) Bancork Insurance Plc has been operating composite Insurance business since 1950. The following results were presented for the year ended 31 December 2007.

		₦'000	₦'000
Underwriting result-	General business	7,500	
	Life business	3,800	11,300
Other income			3,640
Profit before tax			14,940
Transfer to contingency reserve		3,340	
Dividend		6,000	(9,340)
Transfer to General reserve			5,600

General Insurance Revenue Accounts

	Accident	Fire	Marine	Motor	Total
	₦'000	₦'000	₦'000	₦'000	₦'000
Gross premium	11,658	8,976	14,320	22,542	57,496
Changes in unexpired risks	(2,345)	(543)	(3,245)	(8,745)	(14,878)
Earned premium	9,313	8,433	11,075	13,797	42,618
Commission received	1,659	325	2,341	2,314	6,639
Total Income	10,972	8,758	13,416	16,111	49,257
Claims incurred	4,945	3,276	6,532	8,758	23,511
Acquisition costs	1,134	1,289	3,468	5,437	11,328
Maintenance costs	986	1,255	3,245	1,432	6,918
Total expenses	7,065	5,820	13,245	15,627	41,757
Underwriting profit	3,907	2,938	171	484	7,500

Life Insurance Revenue Accounts

	₦'000	₦'000
Gross premium		12,315
Life fund at the beginning		32,764
Commission received		4,553
Investment income		8,542
Total income		58,174
Claims incurred	4,432	
Commission paid	5,412	
Administrative expenses	2,074	
Life fund at the end	42,456	(54,374)
Transfer to General reserve		3,800

Notes to the accounts revealed the following:

(i) Included in the maintenance costs are:

	General Insurance	Life Insurance
	₦'000	₦'000
Depreciation	3,234	975
General provision for Bad debts	1,543	432
Penalty for late filing of SEC returns	2,065	576

(ii) Capital allowances brought forward is ₦13,543,000 while the capital allowances for the year amounted to ₦7,050,000

(iii) Included in Other Incomes are dividend of ₦587,000 received from NMT during its Pioneer period and ₦432,000 as Interest on Federal Government Bond.

Required:

(a) Compute the tax liability for the relevant tax year. (10 Marks)

(b) Discuss briefly the distinct differences in basis of computation of Assessable profits of a Life Insurance Company and a Non-Life Insurance Company. (5 Marks)

(Total 15 Marks)

QUESTION 6

(a) What are the functions of the Commissioner of Stamp Duties? (2 Marks)

(b) Discuss briefly the term "Adjudication" and its importance in Stamp Duties Administration in Nigeria. (3 Marks)

(c) Ewupe Realty Limited is a company that deals in Properties and other Investments. During the year ended 31 December 2007, the following transactions took place.

(i) The company sold one Generator for ₦10,000,000, which originally cost ₦3,200,000. Advertising cost was ₦60,000. Payment is to be made in four equal bi-annual instalments commencing 1 June 2008.

(ii) One wing of a two-wing Duplex which was completed in 2002 for ₦2,230,000 was sold for ₦5,500,000. An Estate Valuer has valued the unsold wing at ₦4,400,000 in the open market and 3% of the consideration for the part sold, was paid to the Estate Agent as commission while the Estate valuer received a fee of 7.5% of the valuation. Additional cost incurred in improving the disposed wing prior to sale was ₦325,000.

(iii) One of its Buildings constructed in 2003 for ₦850,000, was disposed of for ₦3,200,000 during the year. The cost of advertising was ₦75,000 while the Estate Agent received 3% of the sales value as commission. A new Building was built during the year for ₦2,000,000.

You are required to compute the Capital Gains Tax Payable for each of the transactions. (10 Marks)

(Total 15 Marks)

TAX RATES

1. **CAPITAL ALLOWANCES**

	Initial %	Annual %
Office Equipment	50	25
Motor Vehicles	50	25
Office Building	15	10
Furniture & Fittings	25	20
Industrial Building	15	10
Non-Industrial Building	15	10
Plant and Machinery:		
– Agricultural Production	95	NIL
– Others	50	25

2. **INVESTMENT ALLOWANCE** 10%

3. **TAX – FREE ALLOWANCES:**

	Maximum Per Year
	₦
Rent	150,000
Transport	20,000
Utility	10,000
Meal Subsidy	5,000
Entertainment	6,000
Leave	10% of Annual Basic Salary

4. **PERSONAL INCOME TAX RELIEFS/ALLOWANCES**

(a) Personal Allowance	–	₦5,000 plus 20% of Earned Income
(b) Children Allowance	–	₦2,500 per annum per unmarried child subject to a maximum of four children.
(c) Dependent Relative	–	₦2,000 each
(d) Disabled Persons	–	₦5,000 or 10% of Earned Income (which ever is higher)
(e) Life Assurance	–	Actual Premium paid

5. **RATES OF PERSONAL INCOME TAX:**

	Taxable Income	Rate of Tax
	₦	%
First	30,000	5
Next	30,000	10
Next	50,000	15
Next	50,000	20
Over	160,000	25

Note: Annual income of ₦30,000 and below is exempted from tax but a minimum tax of 0.5% will be charged on the total income.

6. **COMPANIES INCOME TAX RATE** 30%
7. **EDUCATION TAX** 2%
8. **CAPITAL GAINS TAX** 10%
9. **VALUE ADDED TAX** 5%
10. **WITHHOLDING TAXES**

Type of payment	**Rates (Companies)**	**Rates (Non- corporate)**
Dividend, Interest, Rent	10%	10%
Royalties	15%	15%
Contract supplies	5%	5%
Building construction activities	5%	5%
Consultancy/Professional services	10%	5%
Management services	10%	5%
Commissions	10%	5%
Technical services	10%	5%
Directors fees	10%	10%

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

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

EXAMINERS' REPORT

The section covers a sizeable proportion of the syllabus.

All the candidates attempted this section of the paper and performance was fairly good as about half of the entire candidates scored 50% and above.

The major problem encountered by candidates was their confused understanding of tax terminologies which made some of them to lose marks.

Performance will be improved in future if candidates cover the entire contents of the syllabus and use the right texts including the pathfinder for their study.

PART II SHORT-ANSWER QUESTIONS

1. Tax Planning
2. Chairman of the State Internal Revenue Service
3. Federal Inland Revenue Service
4. 30 June 2011
5. Desk Audit and Field Audit
6. Tax Evasion
7. Unearned
8. Salaries, share of profit, interest on capital
   - Benefits-in-kind, passage allowance, earned income
9. Beneficiary or legatee
10. Federal Inland Revenue Service.
11. Allowable expense
12. Not exempted
13. Necessarily and reasonably
14. The period of the Tax Holiday/Pioneer Status commences on that day
15. Deferred tax
16. Double taxation

17. Oil Mining Lease
18. 31 March of the accounting year
19. i. Deeds of Assignment
    ii. Insurance Policy
    iii. Mortgages
    iv. Debenture Trust Deed
    v. Proxy Form
    vi. Bank Notes
    vii Cheque Leaves
20. Full re-investment of the sales proceeds in the same class of asset

TUTORIAL NOTES

12.	Year of assessment	Basis Period	₦
	2010	1/02/09 - 31/01/10	
		145,000 + $^1/_{12}$ x ₦960,000	
		= ₦45,000 + ₦80,000	225,000

13. 2% of ₦225,000 = ₦4,500

EXAMINERS' REPORT

The questions cover the whole syllabus.
All candidates attempted this part of the paper. Performance was poor as about 70% of the candidates scored below 50%.

Major pitfalls include:

- **insufficient understanding of common taxation terminologies.**
- **Candidates' inability to address the questions asked.**

It is recommended for future examination that candidates should

- **cover more extensively the contents of the syllabus.**
- **familiarise themselves with relevant texts and legislations.**

SOLUTION TO SECTION B

QUESTION 1 CASE STUDY

15 November, 2011
The Managing Director
Kaduna Limited
Kaduna Way
Lagos

Dear Sir,

RE: FEDERAL INLAND REVENUE SERVICE (FIRS) TAX AUDIT EXERCISE - 2009 AND 2010 ACCOUNTS

We write to acknowledge the receipt of the letter from the Federal Inland Revenue Service to you, in respect of the proposed tax audit on 2009 and 2010 audited accounts.

We state below professional advice and guidelines you require during the visit:

(a) **TAX AUDIT**

Tax audit is usually additional statutory audit carried out by FIRS officials.

The tax audit exercise is carried out to enable the Revenue further satisfy itself that audited financial statements and related tax computations submitted by the tax payer agree with the underlying records.

The objectives of the tax audit to be carried out on your company are to enable the tax auditors determine if:

(i) adequate accounting books and records exist for the purpose of determining the profit or loss of Kaduna Limited for the relevant years and the tax payable;

(ii) financial statements and the tax computations thereon agree with underlying records; and

(iii) all applicable tax legislations have been complied with.

(b) **DESK AND FIELD AUDIT**

Desk audit and field audit are the two types of audits carried out by the Federal Inland Revenue Service.

DESK AUDIT

Desk Audit is usually carried out by the Federal Inland Revenue Service in their office, to ensure completeness and accuracy of the items submitted for tax purposes. The outcome of a Desk Audit may lead to the conduct of a field audit where additional information is required.

FIELD AUDIT

A field audit is considered more comprehensive than a Desk Audit. It is usually carried out in the Tax payer's business premises. The Tax Auditors carry out thorough examination of the company's documents and Books of accounts.

(c) **CHECK LIST**

For the purpose of the tax audit coming up in December 2011, we advise that you make available the following documents before the arrival of the Audit team.

(i) The Financial Statements and Tax Returns
(ii) The Trial Balance
(iii) The Ledgers (hard and soft copies)
(iv) Fixed Assets Register
(v) Evidence of purchase of Fixed Assets acquired and Acceptance Certificate obtained from Federal Ministry of Industries, for each asset costing ₦500,000 and above.
(vi) Withholding Tax receipts on Rents, Contracts, Dividend etc
(vii) Value Added Tax monthly Returns and receipts
(viii) Evidence of Input VAT claimed
(ix) Sales and Purchases details with receipts and invoices
(x) Cash and Cheque payment vouchers
(xi) Bank Statements and reconciliation statements
(xii) Audit and adjustment journals
(xiii) Stock count records and valuations
(xiv) Management accounts and Ratio analysis
(xv) Board of Directors meetings' Minutes Book

(xvi) Litigation details, if any
(xvii) Share Capital and Shareholding structures
(xviii) External Auditors' and Internal Auditor's reports.

We shall visit you some days before the arrival of the staff of FIRS to ascertain that all the above-mentioned documents are readily available.

If you require further clarifications on this issue, please feel free to contact us.

Thank you.

Yours faithfully,

XYZ & Co.
(Tax Practitioners)

EXAMINERS'REPORT
The question tests candidates understanding of Tax Audit requirements.

Almost all the candidates attempted the question and performance was poor as about 80% of the candidates who attempted the question scored below 50% of the marks obtainable.

Major pitfalls are:

- **Poor understanding of the content of the checklist.**
- **Confusion of Tax Audit with annual statutory audit**

It is recommended that:

- **Candidates should read and understand the requirements of a question before attempting to proffer solutions.**
- **Candidates should consult current texts including the Institute's study pack.**

QUESTION 2

ALHAJA ABIONA
COMPUTATION OF ADJUSTED PROFIT FOR 2010 YEAR OF ASSESSMENT

	Workings	₦	₦
Net loss per account			(46,000)
Add Disallowable expenses:			
Salaries & wages	1	172,000	
Depreciation		330,000	
Repairs & maintenance	2	14,000	
Bad debts	3	3,500	
Interest	4	2,500	
Rent	5	20,000	
Advertising	6	8,000	
Loss on sale of car		22,000	
Loan interest waived		9,000	
Profits on goods taken	7	2,500	
General expenses	8	1,500	
Legal expenses	9	15,000	
Entertainment	10	32,000	
Motor expenses	11	2,500	
			634,500
			588,500
Deduct Allowable expenses:			
Expenses omitted in the account			(12,000)
			576,500
Deduct Non-taxable income:			
Interest on Government Bond		(5,000)	
Profit on sale of van		(2,000)	
			(7,000)
Adjusted Profit			569,500

Workings

		₦
1.	Disallowable Salaries and Wages:	
	Proprietor's salary	160,000
	Wages of proprietor's house boy	12,000
		172,000

2.	Disallowable Repairs and Maintenance:	
	Defect in generator at time of purchase	1,000
	Improvement of roof	6,000
	Provision of iron gate	7,000
		14,000
3.	Disallowed Bad debts:	
	General provision	2,000
	Loan to past employee	1,500
		3,500
4.	Disallowed Interest:	
	Son's travelling expense $\frac{₦25,000}{₦100,000}$ X ₦10,000	2,500
5.	Disallowed Rent:	
	Private occupation $^{25}/_{100}$ X ₦80,000	20,000
6.	Disallowed Advertising:	
	Cost of neon lighting	8,000
7.	Profit on goods taken for personal use:	
	by the Proprietor $^{20}/_{120}$ X ₦15,000	2,500
8.	Disallowed general expenses:	
	Cost of installation of an electric generator for the business (Capital in nature)	1,500
9.	Disallowed legal expenses:	
	Cost of income tax appeal	4,000
	Cost of settling disputes with customers	5,000
	Business advice to proprietor	6,000
		15,000
10.	Disallowed entertainment:	
	Private holiday	24,000
	Entertainment of friends	8,000
		32,000
11.	Disallowed motor expenses – private $\frac{50}{100}$ x ₦5,000	2,500

EXAMINERS' REPORT

The question tests candidates' understanding of the computation of Adjusted Profit.

About 90% of the entire candidates attempted this question and performance was average as about 50% of the candidates who attempted the question scored 50% and above.

The major cause of this performance was that many candidates were unable to differentiate between allowable and disallowable expenses.

For improved performance in future, it is recommended that candidates should:

- **try to cover the syllabus**
- **understand fully the requirements of a question before starting to give solution**
- **practise past questions while preparing for the examination.**

QUESTION 3

(a) (i) **G-Factor**

This means Gas Projection Cost Adjustment Factor. It defines the level of discount to be granted for losses before sales proceed is charged to tax, depending on the quality of the gas declared and paid.

(ii) **Chargeable Oil**

These are Casinghead Petroleum Spirit and Crude Oil won or obtained by a Company from Petroleum Operations.

(iii) **Chargeable Natural Gas**

This is the Natural Gas actually delivered by a Company to the Nigerian National Petroleum Corporation under a Gas Sales Contract, but does not include Natural Gas taken by or on behalf of the Government of the Federation.

(iv) **Posted Price**

Posted price is "The Price Free on Board", at the Nigerian Port of Export for Crude Oil, as it is regularly agreed between the Nigerian National Petroleum Corporation and the Oil Companies Operating in Nigeria.

(b)

Sadery Petroleum Limited
Computation of Chargeable Tax for 2007 year of assessment

	₦'000	₦'000
Net profit		
Less: Education tax		26,520
($^2/_{102}$ x ₦26,520)		(520)
Assessable profit		26,000
Add: Balancing charge		200
		26,200
Less: Capital Allowance – The lower of:		
Capital Allowance for the year	23,564	
85% of Assessable Profit	22,100	
Less: 170% of PIA	-	
	22,100	
Capital allowance c/f	1,464	
Capital allowance claimed		(22,100)
Chargeable profit		4,100
Assessable Tax at 85%		3,485
Less: Investment Tax Credit		(230)
		3,255
Less: MOU Credit		(1,000)
Chargeable Tax		2,255

EXAMINERS' REPORT

The question tests candidates' knowledge of some oil and gas industry terminologies as they relate to taxation.
About 60% of the candidates attempted the question and performance was poor as about 70% of the candidates who attempted the question scored below 50%.
The common mistake was that candidates did not show understanding of the contents of the relevant Act.
Candidates should sufficiently practice with past questions and solutions to improve on future performance. They are also advised to read quality texts and current legislations.

QUESTION 4

(a) **Composition of the Joint Tax Board**

(i) The Executive Chairman of the Federal Inland Revenue Service Board as Chairman.

(ii) One member from each State of the Federation including the Federal Capital Territory who must be knowledgeable/experienced in Taxation and nominated by the Commissioner for Finance of each State (usually Chairman of each State Internal Revenue Service).

(iii) A Secretary of the Board appointed by the Federal Civil Service Commission who shall be an ex-officio member.

(iv) A Legal Adviser, who shall also be the Legal Adviser of the Federal Inland Revenue Service Board.

(v) A representative of the Federal Road Safety Commission (FRSC)

(vi) A representative of the Revenue Mobilization Allocation & Fiscal Commission (RMAFC)

(vii) A representative of the Honourable Minister of Finance.

Functions of the Board

(i) To exercise all the powers conferred upon it by any express provisions of the Personal Income Tax Act of 1993 as amended to date.

(ii) To exercise any powers and duties conferred on it by any law enacted by the Federal Government of Nigeria regarding Incomes and Profits of Business Enterprises.

(iii) To advise the Federal Government of Nigeria on Double Taxation Agreements with other Countries.

(iv) To advise on Capital Allowances rates as well as any proposed amendments to the Personal Income Tax Act 1993 as amended to date.

(v) To promote uniformity in the application of the Personal Income Tax Act 1993 as amended to date, nationwide.

(vi) To ensure that the States comply with the decisions of the Board on matters of procedures and interpretation of the Personal Income Tax Act 1993 as amended to date.

(vii) Resolve tax disputes amongst States.

(b) The Local Government Revenue Committee has the following composition
- (i) The supervisor for Finance as Chairman
- (ii) Three Local Government Councillors as members
- (iii) Two other members experienced in revenue matters to be nominated by the Chairman of the Local Government on their personal merits.

The following are the functions of the Local Government Revenue Committee:

- (i) They are responsible for the assessment and collection of taxes, fines and rates under their jurisdiction and shall account for all amounts so collected in a manner to be prescribed by the Chairman of the Local Government.
- (ii) They are responsible for the day-to-day administration of the Local Government Treasury.

(c) Taxes administered by the Federal Inland Revenue Service:

- (i) Petroleum Profits Tax
- (ii) Companies Income Tax
- (iii) Education Tax
- (iv) Withholding Tax on Companies, residents of the Federal Capital Territory, Abuja, and non-resident individuals.
- (v) Capital Gains Tax on residents of FCT Abuja; Bodies Corporate and non-resident individuals
- (vi) Stamp Duties on Bodies Corporate and residents of FCT Abuja
- (vii) Value Added Tax
- (viii) Personal Income tax in respect of
  - (a) Members of the Armed Forces of the Federation
  - (b) Residents of the FCT Abuja
  - (c) Members of the Nigeria Police Force
  - (d) Staff of the Ministry of Foreign Affairs and Non-Resident Individuals.

EXAMINERS' REPORT

The question tests candidates' knowledge of the composition, functions, and taxes administered by units of Joint Tax Board (JTB).
About 85% of the candidates attempted the question and performance was average as about 60% of the candidates who attempted the question scored 45% and above.

The common shortcoming was the inability of some of the candidates to state correctly the composition and functions of the Joint Tax Board and the Local Government Revenue Committee.

It is recommendation that candidates should spend more time on preparation for future examination.

QUESTION 5

(a)

BANCORK INSURANCE PLC
COMPUTATION OF TAX LIABILITY FOR 2008 YEAR OF ASSESSMENT

	Workings	₦'000	₦'000
Adjusted profit: General Insurance	1		14,342
Life Insurance	2		5,609
			19,951
Other income	3		2,621
			22,572
Capital allowance:			
Brought forward		13,543	
For the year		7,050	
		20,593	
Utilized		(15,048)	(15,048)
Carried forward		5,545	
Taxable profit			7,524
Tax liability at 30%			2,257
Education tax at 2%			399

Workings	₦'000	₦'000
1. Adjusted profit for General Insurance		
Underwriting profit per the account		7,500
Add: Depreciation	3,234	
General provision for Bad Debts	1,543	
Penalty for late filing of returns	2,065	6,842
Adjusted profit		14,342

2. Adjusted profit for Life Insurance	₦'000	₦'000
Investment income		8,542
Commission received		4,553

		13,095
Less: Commission paid	5,412	
Administrative expenses	2,074	(7,486)
		5,609

3. Other income	₦'000	₦'000
As per the account		3,640
Less: Dividend from Pioneer company	587	
Interest on Federal Government Bond	432	(1,019)
		2,621

NOTE: Information Technology levy of 1% is not applicable in this case because the turnover of the company is below ₦100m

(b) (i) Life Insurance Company

- The profits on which tax will be imposed shall be the Investment Income less Management expenses including commission.
- Dividend from actuarial revaluation of unexpired risks or from any other revaluation shall also be deemed to be part of Total Profits of the Company.

(ii) Non-Life Insurance Company

The profits on which tax will be imposed shall be on Premium and Investment incomes, Reserves for Unexpired risks and Claims settlements.

EXAMINERS' REPORT

The question tests candidates' knowledge and understanding of the Corporate Tax Liability of an Insurance company engaged in both general and life business.
Over 90% of the candidates avoided this question and performance was very poor.
The commonest pitfalls include:

- **Lack of knowledge of the distinction between life and non-life business**
- **Inability to compute the Assessable Profit**

Candidates are advised to devote more time to studying taxation of specialized businesses including insurance, banking, air and sea transportation, etc.

QUESTION 6

(a) Functions of the Commissioner of Stamp Duties:

(i) He is the administrative head

(ii) He is responsible for assessing the Instruments and for imposing penalties where applicable

(iii) He is responsible for Stamping or Embossing the Instruments with the appropriate Stamp denomination.

(iv) He is responsible for keeping custody of the Stamping Instruments such as Dies or the Adhesive Stamps, Postage Stamps etc.

(v) He is responsible for Adjudication.

(b) Adjudication is the process of determining the correct amount of Stamp Duties payable on an Instrument, by the Commissioner of Stamp Duties.
Importance of Adjudication in Stamp Duties administration in Nigeria are:

(i) It satisfies the Statutory requirement

(ii) It is admissible for all purposes

(iii) It is the best that can be done to convince third parties that an Instrument is genuine.

(iv) It is the first step in resolving any dispute in an assessed amount of Duty.

(c) **EWUPE REALITY LIMITED**

COMPUTATION OF CAPITAL GAINS TAX PAYABLE FOR 2007 YEAR OF ASSESSMENT

(i) Payment of Capital Gains Tax by Instalments.	₦
Sales Proceeds	10,000,000
Less Advertisement Cost	(60,000)
Net Sales proceeds	9,940,000
Less Acquisition cost	(3,200,000)
Capital Gains	6,740,000
Capital Gains Tax @ 10%	674,000

Apportionment of Capital Gains Tax payable

Instalment	Date	Tax Year	CGT Payable ₦
1	1/6/2008	2008	168,500
2	1/12/2008	2008	168,500
3	1/6/2009	2009	168,500
4	1/12/2009	2009	168,500

(ii) Partial Disposal	₦	₦
Sales Proceeds	5,500,000	
Less Estate Agent Comm.		
(3% x ₦5,500,000)	(165,000)	
Estate Valuer's fee	(330,000)	5,005,000
Less Cost of Asset		
₦5,500,000 / (₦5,500,000 + ₦4,400,000) x ₦2,555,000 =		(1,419,444)
		3,585,556
C G T @ 10%		358,555.6

(iii) Building	₦	₦
Sales Proceeds	3,200,000	
Less Advertising Cost	(75,000)	
Estate Agent's fee	(96,000)	3,029,000
Less Acquisition cost		(850,000)
		2,179,000
Less Roll-Over Relief:		
Amount Re-invested	2,000,000	
Less Cost of Asset	(850,000)	(1,150,000)
Chargeable Gains		1,029,000
CGT @ 10%		102,900

EXAMINERS' REPORT

The question tests candidates' understanding of the provisions of the Stamp Duties Act and the Capital Gains Tax Act.

Over 80% of the candidates attempted this question and performance was above average as over 55% of them scored above 40% of the allotted marks.

Candidates are advised to ensure thorough coverage of the various sections of the syllabus and practise worked examples in relevant text books, Institute's Study Pack and Pathfinders.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II - NOVEMBER 2011
PUBLIC SECTOR ACCOUNTING AND FINANCE
Time allowed - 3 hours

SECTION A: Attempt All Questions

PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

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

1. A Property Development Corporation's balance sheet should disclose **ONE** of the following:

   i. Debtors and creditors
   ii. Movement of the Grand Redemption Fund
   iii. Deficit Grants Receivable

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

2. Which **ONE** of the following regulatory frameworks is **NOT** applicable to Public Sector Accounting?

   A. Financial Regulations
   B. Companies and Allied Matters Act, Cap C20, LFN 2004
   C. Public Procurement Act, 2007
   D. Fiscal Responsibility Act 2007
   E. The Nigerian Constitution

3. An accounting basis which records financial transactions even when payment has not been made is known as

   A. Cash basis
   B. Modified commitment basis
   C. Accrual basis

D. Modified cash basis
E. Modified accrual basis

4. International Public Sector Accounting Standard (IPSAS) 14 relates to

A. Borrowing costs
B. Accounting for investments and associates
C. Revenue from exchange transactions
D. Events after reporting date
E. Construction contracts

5. Which **ONE** of the following is **NOT** a revenue collection agency?

A. Nigeria Police Force
B. Nigerian National Petroleum Corporation
C. Federal Inland Revenue Service
D. Department of Petroleum Resources
E. Nigerian Customs Service

6. Which **ONE** of the following is **NOT** a generally accepted accounting assumption underlying the preparation of the financial statements of a parastatal?

A. Entity concept
B. Matching concept
C. Accrual concept
D. Historical cost concept
E. Consistency concept

7. According to S.35 of Public Procurement Act 2007, the mobilization fee sum shall not exceed ....percent of the contract.

A. 10
B. 15
C. 20
D. 25
E. 30

8. Which **ONE** of the following represents the present value of a cash inflow of ₦400,000.00 in 3 years' time at 10% cost of capital?

A. ₦400,000 x 3 x 10%
B. ₦400,000 x $(1.1)^3$
C. ₦400,000 x 3
D. ₦400,000 x 3 x $(1.1)^3$
E. ₦400,000 x 3 x $^1/_{10}$

9. Which **ONE** of the following is **NOT** a source of inflow into the Development Fund Account?

A. Internal loan
B. Internal grants
C. External grants and aid
D. External loan
E. Internal receipt

10. The Economic and Financial Crimes Commission (EFCC) is charged with the enforcement of the

(i) Money Laundering Act, 2004
(ii) Federal Inland Revenue Establishment Act, 2007
(iii) Banks and Other Financial Institutions Act, 1991 (as amended)
(iv) Advanced Fee Fraud and Other Related Offences Act 1995

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

11. Non-oil sources of government revenue comprise all the following, **EXCEPT**

A. Returns on government investments
B. Grants and aids
C. Royalties
D. Loans
E. Taxes

12. A development plan that spans over a period of three years is a
   - A. Medium-term plan
   - B. Supplementary budget
   - C. Perspective plan
   - D. Long-term plan
   - E. Rolling plan

13. Advantages of the Net Present Value (NPV) technique of project appraisal include the following, **EXCEPT**
   - A. It takes the risk involved in each project into consideration
   - B. It facilitates optimal allocation of scarce resources
   - C. It is useful in ascertaining which project(s) should be undertaken
   - D. It is useful in ranking projects in a capital rationing situation
   - E. It recognizes the time value of money

14. The economic role of the public sector includes

   (i) Securing the socially desired rate of economic growth.
   (ii) Promoting price level stability
   (iii) Securing high employment level

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

15. Which of the following is **NOT** an example of a direct tax?

   - A. Personal Income Tax
   - B. Value Added Tax
   - C. Capital Transfer Tax
   - D. Company Income Tax
   - E. Petroleum Profit Tax

16. In project analysis, the method of investment appraisal which considers the cash inflows and cash outflows is known as

A. Net Present Value
B. Profitability index
C. Internal rate of return
D. Average rate of return
E. Cost benefit analysis

17. The combination of measures designed to influence the level of aggregate economic activities by controlling the quantity of money and credit availability is know as

A. Commercial policy
B. Fiscal policy
C. Monetary policy
D. Physical policy
E. Incomes policy

18. An example of recurrent expenditure is
A. Maintenance of social services
B. Motor vehicle acquisition
C. Expenditure on land and building
D. Turn-around maintenance of machineries;
E. Construction of bridges

19. The entire burden of tax can be shifted to the final consumer if the demand for the product is
A. Perfectly elastic
B. Fairly elastic
C. Fairly inelastic
D. Perfectly inelastic
E. Unitary elasticity

20. External public debts are sourced from the following, **EXCEPT**

A. Purchase of government debt instruments by the commercial bank
B. Paris club
C. London club of creditors

D. Loans obtained from the government of another country
E. Multilateral creditors

PART II: SHORT- ANSWER QUESTIONS (20 MARKS)

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

1. The supervision of the activities of a government entity, with the authority and responsibility to control or exercise significant influence over its decisions is known as ……………………………..

2. What method is adopted where the implementation of a project is to be accelerated?

3. Under Financial Regulation 3203, who authorizes the opening of bank accounts by the Federal parastatals and agencies of government?

4. What tax is imposed on the gain realized on the sale of a property item?

5. State the instruments of domestic borrowing which are floated by the States and Local Government Councils, and are backed up by the pledge of revenue to be generated from the project being financed.

6. Discretional financial assistance given by the Federal Government to the State and/or Local Governments to supplement statutory allocation is packaged as ……………………..

7. An arrangement whereby lower tiers of government have statutory powers to raise some taxes and carry out spending activities within specified legal criteria is referred to as ……………………..

8. State bases for compilation of the financial statements of the public sector enterprises are ------------and -------------------

9. The Act which provides for the prudent management of the nation's resources, encourages and ensures accountability and transparency in handling the nation's resources is ……………………..

10. The summary of the total receipts and payments as posted in the cash book at the end of each month, stating opening and closing balance is referred to as ....

11. Which of the techniques of project analysis enables management to determine the cheapest strategy to meet a well defined objective of a government owned enterprise?

12. A set of procedures based on welfare economics for guiding public expenditure decisions is known as ....

13. A statement of intended expenditure and expected revenue of the government during a particular period, usually a year is referred to as ....

14. To which main head of government expenditure do education and health belong?

15. Which Fund does Section 29(1) of the Pension Reform Act, 2004 empower the Central Bank of Nigeria to establish, invest and manage in respect of the Federal Public Service and Federal Capital Territory?

16. The funds used to account for the resources derived from the business activities of government parastatals and agencies are referred to as..................................

17. The transfer of funds to lower levels of government either directly or indirectly is known as ....

18. The legitimate effort made by a tax payer to reduce his tax liability by taking advantage of the law is known as ....

19. The spill-over effects of the production and consumption activities of economic agents on others are called ....

20. A summary of total receipts and payments as posted in the cash book of self accounting unit is a ....

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

QUESTION 1

CASE STUDY

AKEJU GOVERNMENT COLLEGE

Mr. John Udoh hails from Oron. He was born in 1954. He was employed by the National Teachers' Commission in 1995 and has served in various institutions. He has just attended a course at the Administrative Staff College of Nigeria (ASCON), where he went through a financial accounting course for non-accountants.
Mallam Suhaib has been the Bursar of Akeju Government College for about ten years. He was the one in charge of collecting revenue, issuing receipts, lodging money into the bank, keeping tellers and collecting bank statements. He did the postings to the Cash Book and prepared the bank reconciliation statements in arrears.
Recently, it was observed, that Mr. Suhaib's life style had changed from "low-profile" to one of ostentation. He had exhibited recklessness in his spending and caused "tongues to start wagging". Many people, including Mr. Udoh, were suspicious of Mr. Suhaib's sudden source of wealth.

Consequently, the Head Teacher decided to beam search-light on Mr. Suhaib. Mr. Udoh commissioned a firm of Chartered Accountants to look into the accounting books of the college. The examination revealed the following:

(i) Cheques issued but not presented to the bank valued ₦150,000,000.00
(ii) Uncredited cheques amounted to ₦265,000,000.00
(iii) Bank charges amounted to ₦50,000,000.00.
(iv) Cash collections that were not yet banked amounted to ₦65,000,000.00
(v) There were direct transfers into the bank account of ₦33,000,000.00.
(vi) Cash book balance was ₦375,000,000.00
(vii) Subscriptions paid directly to bank valued ₦1,000,000.00.
(viii) The 'Standing Order' in respect of standard pension payment of ₦10,000,000.00 had been effected at the bank only.
The bank statement revealed a balance of ₦178,000,000.00.

You are required to

(a) State **ONE** basic problem faced by the operational system adopted by Malam Suhaib. (1 Mark)

(b) List **SIX** issues or information that are contained in a bank statement. (6 Marks)

(c) Prepare Akeju Government College's bank reconciliation statement from the information above, and comment on differences observed, if any. (8 Marks)

(Total 15 marks)

QUESTION 2

(a) State any five objectives of Budgetary Control. (5 marks)

(b) Explain briefly the following budgeting concepts:
   (i) Rolling Budget
   (ii) Perspective Planning
   (iii) Periodic Budgeting
   (iv) Flexible Budget
   (v) Zero-Based Budgeting. (10 marks)

(Total 15 marks)

QUESTION 3

The following are the information extracted from the records of the Federal Ministry of Mines and Power, for the month of August, 2010:

(i) Balance b/f from July, 2010:

	₦'000
Bank	4,500,000 Dr
Cash	7,200 Dr

(ii) **Revenue collected during the month:**

Classification	**Description**	**Amount** ₦'000
8/1	Licences	300,000
8/2	Internal Revenue	180,000
9/1	Rent on mineral licenses	18,000
9/2	Royalty on Gold	12,000
10/14	Cash received for tenders	42,000
11/26	Contractors' registration	30,000
12/3	Rent on Quarters - Junior	10,800
12/4	Rent on Quarters - Senior	15,000

	Below the line:	
2001	Salary Advance Repayments	18,000
3001	Spectacle Advance Repayments	6,000

(iii) **Payments made during the month:**

34/1	Personnel Cost	1,800,000
34/2	Local Transport and Travelling	300,000
34/3	Stationery	600,000
34/4	Utility Services	24,000
34/6	Maintenance of Motor Vehicles	18,000
	Below the Line:	
2001	Salary Advances	24,000
3001	Spectacle Advances	9,000

You are required to

Prepare the monthly transcript of accounts for August 2010. **(15 Marks)**

QUESTION 4

The Treasury Department of WOLUS State of Nigeria has furnished the following ledger balances in respect of its operations for the year ended 31 December, 2009

Head of Account	Description	Amount ₦'000
1009	Rural Development	200,000
1110	Transportation	150,000
1220	General Administration	500,000
1500	Housing	130,000
1600	Delivery of Health Care	250,000
1650	Environmental Management	315,000
1700	Education	256,000
1701	External Loan	3,500,000
1705	Internal Loan	2,500,000
1805	External Grant	5,800,000
1810	Contribution from Consolidated Revenue Fund (CRF)	8,700,000
1824	Mining and Quarrying	150,000
1830	Defence	650,000

The following are the additional information extracted from the State's approved capital budget.

Head of Account	Amount	Head of Account	Amount
	(₦'000)		(₦'000)
1701	4,118,000	1009	216,000
1705	2,000,000	1110	170,000
1805	5,700,000	1220	350,000
1810	6,000,000	1500	140,000
		1600	700,000
		1650	450,000
		1700	200,000
		1824	190,000
		1830	690,000

The funds flow evenly during the year.

You are required to

Prepare the Development Fund Statement of Account of Wolus State for the year ended 31 December 2009. **(15 marks)**

QUESTION 5

(a) Describe a development plan. (5 Marks)

(b) Explain **FIVE** objectives of development planning. (10 Marks)

(Total 15 Marks)

QUESTION 6

Discuss **FIVE** factors that have been responsible for the phenomenal increase in the size of public expenditure in any developing economy. **(15 Marks)**

SOLUTIONS TO SECTION A

PART I - MULTIPLE CHOICE QUESTIONS

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

EXAMINERS' REPORT

The questions cover most of the topics contained in the syllabus.

The performance of most candidates was above average. However, some of the candidates could not

(i) identify the formula for the present value of the given cash inflow.

(ii) identify when the final consumer bears the burden of tax on a product.

Candidates are advised to continue to refresh their knowledge of subjects in the other levels of the examination.

PART II SHORT-ANSWER QUESTIONS

1. Oversight (function)
2. Selective or Limited Tender Procedure
3. Accountant-General
4. Capital Gains Tax
5. Revenue Bonds
6. Grant(s)
7. Fiscal decentralisation
8. Cash Basis, Accrual Basis or Commitment Basis
9. Fiscal Responsibility Act, 2007
10. Balance statement
11. Cost Effectiveness Analysis (CEA)
12. Cost Benefit Analysis (CBA)
13. A budget or Traditional Budget
14. Social sector or Social and community services
15. Retirement or Benefits Bond Redemption Fund
16. Proprietary funds
17. Inter-governmental transfers

18. Tax avoidance
19. Externalities
20. Transcript of accounts.

EXAMINERS' REPORT

The questions cover most of the topics in the syllabus.

Many candidates attempted all the questions and the performance was average. The commonest pitfalls identified include:

- **inability to recognize 'oversight functions'**
- **inability to identify the 'fiscal decentralisation' powers of lower tiers of government within certain specified legal criteria**
- **mistaking 'cost benefit analysis' for 'cost effectiveness analysis' concept**
- **inability to recognize the Fund which the Central Bank of Nigeria should maintain with respect to S.29(1) of the Pension Reform Act, 2004.**

Candidates are advised to ensure that the short answers provided by them fit into the context of every question and should be familiar with contemporary issues in both the Public Sector Accounts and Public Finance.

SOLUTION TO SECTION B

QUESTION 1

(a) The basic problem faced by the operational system being adopted is that there was no effective internal control or segregation of duties.

(b) Issues or information that are contained in a bank statement are

i. Particulars of the customer e.g name, address
ii. Type of Account
iii. Account number
iv. Name of the bank
v. Date of transaction
vi. Period of the transactions

vii. All debit transactions
viii. All credit transactions
ix. Items in cash book/bank not in bank/cash book e.g bank charges, standing order
x. Balance column.

(c) Akeju Government College
Bank Reconciliation Statement for the period

	₦' million	₦' million
Balance as per cash book		375
Add:		
Unpresented cheques	150	
Receipts in Bank Statement	34	
		184
		559
Less:		
Payments in Bank Statement not in Cash Book	50	
Standing Order	10	
Uncredited cheques	265	
Receipts in Cash Book not in Bank Statement	65	
		390
		169
Balance as per Bank Statement		178
Amount not accounted for		9

This balance of ₦169 million naira is not in agreement with the Bank Statement Balance of ₦178 million naira. There is a difference of ₦9 million naira.

EXAMINERS' REPORT

The question tests the candidates' understanding of internal control system, contents of a typical bank statement as well as ability to compute amount involved in defalcation.

All the candidates attempted the question and the general performance was impressive. However, some of the candidates could not

- **highlight the problems of poor internal control system or lack of segregation of duties.**

- **understand the requirement of the question which asked for details contained in a bank statement as opposed to bank reconciliation statement.**

- **compute the amount involved in the defalcation.**

Candidates are advised to be mindful of the other subject linkages of Public Sector Accounting and Finance so as to improve performance in future.

QUESTION 2

(a) **OBJECTIVES OF BUDGETARY CONTROL**

The objectives of budgetary control include the following:

i) To combine the ideas of all levels of management in the preparation of budgets.

ii) To coordinate all the activities of a business or organisation.

iii) To centralize control.

iv) To decentralize responsibility to each manager.

v) To act as a guide for management decision when unforeseeable conditions affect the budgets.

vi) To plan and control income and expenditure so that maximum benefit is achieved.

vii) To channel capital expenditure in the most profitable manner.

viii) To ensure that sufficient working capital or cash is available for the efficient operation of the business or organization.

ix) To provide a yardstick against which actual results can be compared.

x) To show management where action is needed to remedy a situation.

(b) i) **Rolling Budget**

Any budget prepared from within the Rolling Plan is referred to as a Rolling Budget. It is the yearly provision of funds to prosecute the capital projects spelt out in the plan period. Achievements made, as documented, are compared with the yearly targets set. Attention of government is particularly drawn to the areas of difficulties when making use of management by exception. Reports of progress made are furnished by the Ministry or Extra-Ministerial Department concerned to the National Planning Commission.

ii) **Perspective Planning**

Perspective Planning is long-term in nature. It covers fifteen or more years. It provides the broad view of a country's development process. Perspective planning aims at addressing fundamental and broad issues of development. It serves as a framework for designing and implementing Rolling Plans. A perspective plan is always split into many medium-term plans of four or five years in order to achieve long term objectives.

iii) **Periodic Budgeting**

This is the operation of a fixed budget over a certain period of time, usually a year. The budget becomes fixed for the duration of the period concerned and revisions are not allowed till the end of the period.

iv) **Flexible Budget**

This is a budget that recognizes the difference between the fixed and variable costs and gives room for result determination and evaluation under the varying levels of activities. Thus, it accommodates changing levels of production and facilitates the production of control reports for the prevailing levels of activities. It is a budget which takes cognisance of cost behavior and adjusts according to the level of activities attained. It is used for control purposes.

v) <u>Zero-Based Budgeting</u>

This is a budget that requires each cost element to be specifically justified, as though the activities to which the budget relates were being undertaken for the first time. Without approval, the budget allowance is zero. Zero-Based Budgeting, according to Peter Phyrr, involves the following four basic steps:

- formulation of operational plan that identifies each decision unit.
- description of each decision unit as a decision package.
- appraisal and ranking of decision packages, using the cost benefit analysis.
- allocation of resources to each of the decision packages.

EXAMINERS' REPORT

The question tests candidates' understanding of concepts of budgeting and budgetary control. It is a comprehensive question as the candidates are required to explain the objectives of the budgetary control and, at same time, discuss five sundry budgeting concepts.

Many candidates attempted the question, but the general performance was not particularly impressive. Most of the candidates attempting the question did not demonstrate sufficient understanding and in-depth knowledge of the budgeting concepts.

Candidates are advised to consult standard texts and have an in-depth study of these budgeting concepts for better performance. Candidates should be more insightful in their answers to questions.

QUESTION 3

Federal Ministry of Mines and Power
Transcript of Accounts for the Month of August, 2010

Head	Sub Head	Description/ Transactions	Amount ₦'000	Sub-Total ₦'000	Total ₦'000	Head	Sub Head	Description/ Transactions	Amount ₦'000	Sub-Total ₦'000	Total ₦'000
		Bal b/f						**Payments**			
		Bank			4,500,000	34	1	Personnel cost	1,800,000		
		Cash			7,200		2	Local transport & travel	300,000		
		Receipts:					3	Stationery	600,000		
8	1	Licence	300,000				4	Utility services	24,000		
	2	Internal Revenue	180,000	480,000			6	Maintenance of Motor vehicles	18,000	2,742,000	2,742,000
9	1	Rent on water Licences	18,000					Below the line:			
	2	Royalty on Gold	12,000	30,000		2001		Salary advances	24,000	24,000	
10	14	Cash (tenders)	42,000	42,000		3001		Spectacle advance	9,000	9,000	33,000
11	26	Contractors Reg.	30,000	30,000							
12	3	Rent-Qtrs. Junior	10,800								
	4	Rent-Qtrs. Senior	15,000	25,800	607,800			Bal c/d			2,364,000
		Below the line:									
2001		Salary Advance Repayments	18,000	18,000							
3001		Spectacle Advance	6,000	6,000	24,000						

	Repayments									
				5,139,000						5,139,000
	Bal b/d			2,364,000						

EXAMINERS' REPORT

The question tests candidates' knowledge of Transcripts of Accounts.

Most of the candidates understood the question and performance was above average. Candidates, who performed below average, misinterpreted the question as income and expenditure account or cash book.

Candidates are advised to read relevant textbooks and to make use of the Pathfinders of the Institute.

QUESTION 4

WOLUS STATE OF NIGERIA
DEVELOPMENT FUND STATEMENT OF ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER, 2009

Head of Account	Description	Estimates ₦' 000	Actual ₦' 000	Variance %
1701	External loan	4,118,000	3,500,000	-15.01
1705	Internal loan	2,000,000	2,500,000	+25.00
1805	External grant	5,700,000	5,800,000	+1.75
1810	Contribution from consolidated revenue fund (CRF)	6,000,000	8,700,000	+28.33
	(a)	17,818,000	20,500,000	
1009	Rural Development	216,000	200,000	-07.41
1110	Transportation	170,000	150,000	-11.76
1220	General Administration	350,000	500,000	+42.86
1500	Housing	140,000	130,000	-07.14
1600	Delivery of Health Care	700,000	250,000	-64.29
1650	Environmental Management	450,000	315,000	-30.00
1700	Education	200,000	256,000	+28.00
1824	Mining and Quarrying	190,000	150,000	-21.05
1830	Defence	690,000	650,000	-05.80
	(b)	3,106,000	2,601,000	
	Surplus (c) = (a) - (b)	14,712,000	17,899,000	

EXAMINERS' REPORT

The question tests candidates' ability to prepare Development Fund Statement.

Many candidates attempted the question and the performance was very impressive.

Candidates are advised to improve on this level of performance in future examinations.

QUESTION 5

(a) A Development Plan is a specific set of quantitative and qualitative economic target to be achieved in a given period of time. It is a conscious effort on the part of the central government of a country to maximise the social and economic welfare of the people through efficient allocation of resources.

The main types of Development Plan are

(i) The Rolling Plan - A flexible medium-term plan rolled in the course of implementation overtime within the framework of a perspective plan

(ii) The Medium-Term Plan – Covering five years.

(iii) The Perspective Plan – covering not less than fifteen years.

(b) The objectives of development planning include

(i) Efficient utilisation of resources to promote sustainable economic growth.

(ii) Equitable distribution of income to ensure that everybody has access to essential goods and services as well as to reduce the gap between the rich and the poor.

(iii) Full Employment - To reduce the rate of unemployment to the barest minimum thus improving the living standard of the people living in the country

(iv) Macroeconomic Stability – To promote stability of prices of goods and services, interest rates, foreign exchange of domestic currency thereby encouraging savings and investment.

(v) To diversify economic activities and develop the agricultural and industrial sectors

(vi) To prevent foreign control of the economy and promote self reliance.

EXAMINERS' REPORT

The focus of the question is on development planning. Candidates are required to describe and explain five objectives of development planning.

The question was one of the least attempted by the candidates and the performance was below average.

Most of the candidates who attempted the question were not able to identify the required number of objectives of development planning.

Candidates are advised to consult relevant textbooks on development planning to gain understanding and familiarity with this area of the syllabus.

QUESTION 6

The following factors have been responsible for the phenomenal increase in the size of public expenditure in any developing economy:

i. Population growth: As the population increases, there will be an increase in the provision of social amenities supplied by the Government; hence, an increase in government spending.

ii. Natural crisis or War: When there is national crisis, a lot of government funds are used in providing arms and ammunition, training of soldiers etc. This will eventually increase the size of public expenditure.

iii. Development Projects: Developing countries embark on development projects and technology which require large government expenditure. Some of these development projects include construction of dams, roads as well as agriculture.

iv. Increased Public Debt: In less-developed countries, there have been an increase in public debt which makes the government to spend more on loan servicing and repayment.

v. Commitment to economic development: Governments of developing countries have realized the need for development; therefore, governments desired to raise the level of productivity through spending on social amenities.

vi. Urbanisation: This is a shift of the population from rural to urban areas which invariably increases the expenditure of government as a result of the expansion of the existing amenities.

vii. Inflation: The rising general price level in the developing economy has the tendency of contributing to the phenomenal increase in the size of public expenditure in nominal terms.

EXAMINERS' REPORT

The question tests candidates' understanding of the factors behind the phenomenal increase in public expenditure in developing countries.

Majority of the candidates attempted the question and the pass rate was good. However, some of the candidates could not organize or arrange their points well. In most cases, points were duplicated.

Candidates are advised to prepare adequately for this paper and cultivate the habit of organizing their points in a logical manner.