THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2012 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 so 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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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II - NOVEMBER 2012
FINANCIAL REPORTING AND ETHICS

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. On the relationship between ethics and organisational behaviour, Milton Friedman and Peter Drucker suggested that economic enterprises should be

   A. Ethically biased
   B. Morally biased
   C. Unethically biased
   D. Immorally neutral
   E. Economically biased

2. Which of the following clearly explains the idea of an ethical business?

   A. Business that takes into account the interests of all who may be affected
   B. Business that takes into account the interest of shareholders
   C. Business that takes into account the interest of the community
   D. Business that takes into account the interest of the family
   E. A profitable business

3. When Corporate Social Responsibility programmes and projects are effectively managed, they create the following benefits **EXCEPT**

   A. Effective ethics committee
   B. Reputation
   C. Financial returns
   D. Employee's motivation
   E. Employee's/customer's loyalty

4. Which of these is **NOT** required for an organisation to be healthy and productive?

   A. Political capital
   B. Financial capital
   C. Technological capital
   D. Human capital
   E. Socio-spiritual capital

5. Which of the following is **NOT** a determinant of ethical and transparent culture?

   A. Laws
   B. Organizational leaders
   C. Human Resources Director
   D. Ethics Committee
   E. Social Responsibility

6. In the analysis of corporate reports of an organisation, the following factors may limit the validity of comparison **EXCEPT**

   A. The impact of inflation
   B. The effect of different business practices
   C. The size effect
   D. Relevant budgeted amount
   E. Ratio comparison

7. Which of the following is **NOT** a responsibility of the Board of Directors?

   A. Deploying the company's resources to profitable use
   B. Review management performance on a continuous basis
   C. Set the company's values and standards
   D. Preparation of the Financial Statements
   E. Auditing of the Financial Statements

8. In accordance with SAS 27 (Consolidated and Separate Financial Statements), which of the following disclosures is **NOT** required to be made in Consolidated Financial Statements?

   A. The nature of the relationship between parent and a subsidiary, when the parent does not own, directly or indirectly, through subsidiaries more than half of the voting power
   B. The reason for not consolidating a subsidiary where the ownership,

directly or indirectly through subsidiaries, is more than half of the voting or potential voting power

C. A schedule that shows the effects of any change in a parent company's interest in a subsidiary that does not result in loss of control on the equity attributable to owners of the parent

D. The nature and extent of any passive restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans or advances

E. The gain or loss suffered by the parent on a loss of control of the subsidiary

9. Which of these is part of the definitions of IAS 23 (Borrowing Costs)?

A. Interest expense calculated using the effective interest rate method
B. Finance charges in respect of finance leases recognised in accordance with IAS 17 (Leases)
C. Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs

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

10. Two or more operating segments may be aggregated if the segments are similar in each of the following circumstances, **EXCEPT** the

A. Nature of the products or services
B. Nature of the production process
C. Type or class of customer for their products or services
D. Methods available, but passive, in the distribution of their products
E. Nature of the regulatory environment

11. In accordance with IAS 31 (Interests in Joint Ventures), a Venturer does **NOT** need

A. Information about contingent liabilities relating to its interest in a joint venture
B. Information about commitments relating to its interest in joint venture

C. The method used to recognise its interest in jointly controlled entities
D. A list and description of interests in significant joint ventures
E. The proportion of non-controlling interest held in jointly controlled entities

12. Procedures for conducting a social audit include all of the following **EXCEPT**

A. Cooperation by company's personnel with auditing firm
B. Reporting of findings by the auditing firm to the company's Board of Directors
C. Reporting of findings of the auditing firm to government
D. Reviewing of results of audit by company's Board of Directors
E. Hiring of independent audit firm

13. A professional accountant in public practice entrusted with monies belonging to others must not engage in one of the following:

A. Keep such monies separately from personal monies
B. Use such monies for emergency needs
C. Use such monies for the purpose for which they are intended
D. Be ready to account for those monies at all times
E. Place such monies in an interest bearing account if it would remain with him for a significant period of time

14. Under which of the following circumstances should the principle of confidentiality be set aside by a professional accountant?

A. When it will harm the interest of some parties
B. When we need to maintain ethical duty
C. When we need to maintain an atmosphere of trust
D. When there is a need to respond to an inquiry or investigation by a regulatory body or the court
E. When it will harm the interest of all parties

15. The ability to maintain moral awareness, character and conduct that demonstrate balanced judgment and sustained moral development is termed

A. Integrity capacity
B. Moral integrity
C. Socio-ethical capacity
D. Moral development ability
E. Moral decision making capability

16. Fraud prevention technique ensures

A. That employees come to work regularly
B. Periodic job rotations
C. Effective control
D. Adequate and healthy job facilities
E. Careful operation

17. Which of the following can be regarded as an **EXCEPTION** to the limitations of Ratio Analysis?

A. The Statement of Financial Position prepared at different times cannot give much information on events after the accounting year end
B. Financial performance indicators of a firm may change from year to year
C. There is no available ratio to assess the overall financial strength and weakness of a firm
D. Not all the complete picture of the activities of the firm is captured by financial statements
E. The ability of management of a firm to take informed decisions about performance of the firm

18. Which of the following items is **NOT** included in the Statement of Profit or Loss and Other Comprehensive Income?

A. The effects of corrections of prior-period errors
B. Income gains or losses from discontinued operations
C. Income gains or losses arising from extra-ordinary items
D. Adjustments resulting from changes in accounting policies
E. Re-classification adjustments

19. Government interest grants in respect of loans at subsidized rate not recognised under the SAS is recognised in International Financial Reporting Standards (IFRS) as

A. Credit in Statement of Profit or Loss and Other Comprehensive Income
B. Debit in Statement of Profit or Loss and Other Comprehensive Income
C. Included in Current liabilities under Statement of Financial Position
D. Included in Current assets under Statement of Financial Position
E. Included in Non-Current Assets under Statement of Financial Position

20. Where there have been transactions between related parties, the reporting of the transactions should **NOT** disclose

    A. The nature of the related party relationship
    B. A description of the transactions
    C. The irrecoverable allowances for receivables in respect of the outstanding balances
    D. The recoverable allowances for receivables in respect of the outstanding balances
    E. The non-key management expenses recognised during the reporting period

PART II: SHORT-ANSWER QUESTIONS (20 MARKS)

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

1. Investment in associates, accounted for, using the equity method shall be classified as ....

2. A method of accounting whereby a venturer's share of each of the assets, liabilities, incomes and expenses of a jointly controlled entity is combined line by line with similar items in the venturer's financial statements is known as ....

3. The beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements is known as ....

4. Under the conceptual framework for Financial Reporting, relevant information is capable of making a difference in decisions made by users, if it has .... and .... or both

5. Based on IAS 38, an item can only be recognised as an intangible asset if .... and .... are expected to flow in the future from ownership of the asset

6. Under IFRS, carrying amount is net book value of which the asset is included in the Statement of Financial Position after deducting.......................... and any ....

7. The responsibilities or obligations that a company has toward its stakeholders is referred to as ....

8. **TWO** of the six main areas that are considered the "sources of inspiration" for creative accounting are .... and ....

9. The theory that an action should be judged on the basis of the moral worth of the outcome is known as ....

10. An issue of shares created by the capitalization of reserves and not for cash or other consideration is known as ....

Use the following information to answer questions 11 to 13:

Lodamap Industries Limited owns a building which it used as administrative block. As part of restructuring efforts, it moved the administrative department to the factory on 30 June 2010, and let out the administrative block. Lodamap uses the fair value model for investment property.

Other relevant details are:

Original cost	1 January 2001	₦250 million
Estimated useful life		50 years
Fair value:	31 December 2010	₦350 million
	31 December 2011	₦380 million

11. What was the carrying amount as at 30 June 2010?

12. How would the difference between the carrying amount and the fair value be treated in the financial statements as at 31 December 2010?

13. How would the increase in fair value be treated as at 31 December 2011?

14. An inventory holding strategy used to increase efficiency and decrease waste by receiving goods only as they are needed in the production process is called...

15. The tendency of investment funds and business to move beyond domestic and national market to other markets around the globe is known as ....

16. Kant holds that a maxim is morally acceptable, if and only if, one could consistently wills that it becomes a ....

17. The moral theory which claims that moral statements are nothing but expressions of one's moral feelings and at the same time, an attempt to arouse same feelings in others, is called ....

18. The criterion specifying that moral standards should be applicable at all times and in all situations is called..............................

19. The idea that people learn ethical or unethical behaviour while interacting with others who are part of their role-sets or other intimate personal group is ....

20. The set of values, beliefs, goals, norms and rituals that members or employees of an organisation share is called ....

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

QUESTION 1

CASE STUDY

TRUTH AND CONSEQUENCES

Tunde Obasi, ACA, is the senior-in-charge of the audit of Collin Industries Limited, a medium-sized client with a net assets of ₦500m. The financial controller of the company is Ngozi Tadoboh, ACA, who had been a staff accountant with Tunde's firm. Ngozi left the firm about a year ago. Tunde and Ngozi dated approximately five years ago before Ngozi's marriage. Tunde had attempted to renew their relationship after Ngozi's divorce, but Ngozi had not expressed any interest in dating him.

During the year-end audit, Tunde discovered, through his analytical review, that the gross profit ratio for the company had been materially understated. His investigation revealed that the company failed to record last year's inventory adjustment in the inventory records. Although, last year's closing inventory balance was written down, the individual inventory cost amounts were never revised downward. Therefore, this year's gross profit and pre-tax profit were understated by ₦30 million.

When Tunde presented this evidence to Ngozi, she agreed that her department had erred by not posting the prior year's adjustment to the subsidiary inventory records. Unfortunately, because the interim Financial Statements reflected these depressed earnings, the company had laid off three administrative staff, including one of Ngozi's assistants.

Ngozi was apprehensive of bringing this omission to management's attention because of the layoffs and other corrective actions that the company had pursued, including abandoning a ₦3.2 million option payment made on a parcel of land for expansion of the warehouse facilities.

Tunde was sympathetic with Ngozi's anxiety about disclosing this information since he felt that such an admission of oversight could have a detrimental effect on her career with the company. Tunde proposed that the ₦30 million correction could be disguised as a recent re-interpretation of the uniform capitalization rules. Management had never understood these rules, and Tunde knew that their ignorance, coupled with the euphoria of additional income would not lead to any additional questions regarding this windfall. Tunde suggested to Ngozi that they meet for dinner and then go over to his place later to talk about it and Ngozi agreed to the suggestion.

Required:

a. i. What are the ethical issues involved in the case? (2 Marks)

ii. How could the issues raised be resolved? (2 Marks)

iii. What do you think informed Ngozi's acceptance to meet Tunde for a dinner and later go over to his place to talk about it? (2 Marks)

iv. How could the case be viewed in terms of ethical responsibility? (2 Marks)

b. IAS 8 deals with the treatment of changes in accounting policies, changes in accounting estimates and errors.

i. Define the following terms as stated in the Standard:

- Prior period errors (2 Marks)
- Retrospective restatement (1 Mark)

ii. What are the prescribed accounting treatments and disclosures for prior period errors ? (4 Marks)

(Total 15 Marks)

QUESTION 2

In January last year, the S. S. Darwer, an oil tanker of Menders Oil Service Company Limited, ran aground in the area just North of Niger Delta, spilling millions of gallons of crude into the water and beaches of several Local Government Areas of Bayalba State. The damage to the beaches and wildlife and consequently to the tourist industry, the ecology and the quality of life of the local residents is incalculable. This will require millions of naira for even the most minimal clean-up.

The ship struck a small atoll, well-marked on the navigational maps, but it was a dark night and the tanker was well off-course. On further investigation, it was discovered that the Captain of the Darwer, Mr. Slosh, a foreigner, had been drinking heavily, leaving the navigation of the ship to his first mate, Mr. Mudd. He retired to his cabin, to "sleep it off." Mr. Mudd had never taken charge of the ship before, and he misread the map, misjudged the water, and maintained a speed that was inappropriate which led to the accident. Subsequent inquiries showed that Captain Slosh had been arrested on two occasions for drunk driving and was convicted few months before the accident. The Darwer itself, a double-hulled tanker, was long overdue for renovation and would not have cracked if the hull had been adequately reinforced, as some current tankers were.

Mr. Egolowo, the Chief Executive Officer of Menders Oil Service Company Limited, declared the accident a "tragedy" and offered ₦200m to aid the clean up exercise. The Governor of Bayalba State was outraged. Environmental groups began a consumer campaign against Menders Oil Limited, urging major oil companies to boycott Menders Oil Service Company Limited. In a recent meeting with shareholders after the accident, the CEO, Mr. Egolowo proudly announced the largest quarterly profit in the history of Menders Oil Limited. He dismissed the protests as "the outpourings of greenies and other fanatics" and assured the shareholders that his obligation was, and would always be, to assure the highest profits possible in the turmoil of today's market.

The tanker is usually hired out to International Oil Companies on short-term contracts. Its carrying value, based on depreciated historical cost, is ₦400million. A recent review of its value in use based on its forecast future cash flows was estimated at ₦500million.

The estimated selling price of the tanker after the accident is ₦250 million, with associated selling expenses of ₦5million.

Required:

a. Determine who is responsible for this disaster and state your reasons. (4 Marks)

b. What should be done, if any, to penalise the Company? (3 Marks)

c. Based on **IAS 36 Impairment of Assets**, how do impairments generally arise and state **THREE** indicators of impairment? (3 Marks)

d. What are the impairment implications of the accident on the treatment of S.S Darwer in the financial report of Menders Oil Service Company Limited? (5 Marks)

(Total 15 Marks)

QUESTION 3

Gaining stakeholders trust can become a performance multiplier for businesses thereby helping them achieve both business objective and ethics missions. Critically examine organisation's relations with the following stakeholders.

a. Employees (3 Marks)
b. Customers (3 Marks)
c. Suppliers (3 Marks)
d. Communities (3 Marks)
e. Shareholders (3 Marks)

(Total 15 Marks)

QUESTION 4

The following information relates to the business of Highend Digitals Limited for the year ended 31 March 2012:

Rate of inventory turnover (calculated using average inventory)	20 days
Gross margin	50%
Net margin	15%
Dividend paid as percentage of profit for the year	25%
Payables payment period	32 days
Receivables collection period	28 days
Current ratio	3:1

Other information given include:

Issued share capital of 500,000 ordinary shares of ₦0.50 each
Retained earnings as at 1 April 2011 was ₦73,424
Inventories as at 1 April 2011 was valued at ₦10,000
Inventories as at 31 March 2012 was valued at ₦14,000
The market price of an ordinary share in Highend Digitals Limited at 31 March 2012 was ₦0.80

The following performance ratios have been prepared by a local bank. They relate to similar businesses performance ratios in the same industry and environment as Highend Digitals Limited.

Dividend yield	5.6%
Dividend cover	3 times
Dividend per share	10.7 kobo
Earnings per share (EPS)	32 kobo
Price earnings ratio	5.9

Required:

a. Prepare the Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 March 2012 in as much detail as possible. (3 Marks)

b. Statement of Financial Position in as much as possible (Non-current assets and cash and cash equivalents are balancing figures). (3 Marks)

c. Explain what any **THREE** of the performance ratios indicate. (3 Marks)

d. Calculate any **THREE** Performance ratios for Highend Digitals Limited. Show the formulae that you have used. (3 Marks)

e. Discuss the **THREE** ratios calculated for Highend Digitals Limited and comment on what they show about the company. (3 Marks)

Note: Work to the nearest ₦ **(Total 15 Marks)**

QUESTION 5

Giftens Plc acquired 80% of Rewards Plc. on 1 January 2011. At the date of acquisition, Rewards Plc's Statement of Financial Position showed net assets at a carrying value of ₦62,550,000. Included in this total, is Freehold Land at a carrying value of ₦4,000,000 (market value ₦9,580,000), a Brand Name with a nil book value (market value ₦5,000,000), Plant and Machinery at a carrying value of ₦11,200,000 and a market value of ₦8,900,000. The fair value of all other assets and liabilities is approximately equal to their carrying value.

The Directors of Giftens Plc intend to close down one of the divisions of Rewards Plc and wish to provide for operating losses up to the date of closure, which are forecast as ₦7.29 million.

An investment in Property, Plant & Equipment will be required to bring the remaining production line of Rewards Plc up to date. This will amount to ₦4.05 million in the next 12 months.

The consideration comprised cash of ₦40 million, 15 million shares with a nominal value of ₦1.00 and fair value of ₦1.50 each as well as further cash consideration of ₦4 million to be paid one year after acquisition.

The discount rate is 10%.

Required:

a. Calculate the goodwill arising on consolidation using the proportionate share method in accordance with the provision of IFRS 3 (Business combinations).
(8 Marks)

b. Based on IFRS 3 on Business Combinations, **explain** what the acquirer should do in the "measurement period" if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs.
(7 Marks)
(Total 15 Marks)

QUESTION 6

a. Richberry Limited issues three debt instruments at ₦330,000, ₦225,000 and ₦300,000 nominal values redeemable in 3, 3 and 2 years respectively.

The effective interest rates for all the three instruments are 10%, 14.4721% and 15% respectively.

i. The first was issued at par and has a coupon rate of 0% and was redeemable at a premium of ₦109,230.
ii. The second is redeemable at par and has a coupon rate of 0% and was issued at a discount of ₦75,000.
iii. The third with a coupon rate of 2%, was issued at a discount of ₦15,000 and is redeemable at a premium of ₦64,012.50.

Required

Explain (using calculations as appropriate) how the above financial instruments should be recognised in the financial statements. (8 Marks)

(Ignore errors due to approximation within unit, but apply rates as given).

b. The company, Richberry Limited, buys an investment that is measured at fair value, through profit or loss. The investment was purchased at ₦75million. At the end of the first year, the asset had a fair value of ₦225million. Shortly after the year-end, the asset was sold at the current market value of ₦600million.

You are required to:

i. Explain how the above financial asset should be treated in the books.

ii. Show the Statement of Profit or Loss and the Statement of Financial Position Extracts. (7 Marks)

(Total 15 Marks)

SOLUTION TO SECTION A

PART I MULTIPLE CHOICE QUESTIONS

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

EXAMINERS' REPORT

The questions cover most of the topics in the syllabus with emphasis on IFRS. Candidates' performance was average. They did not quite understand some of the concepts required by the questions. They were also not acquainted with the provisions of IFRS.

Candidates are advised to update their knowledge of IFRS.

PART II SHORT ANSWER QUESTIONS

1. Non-current assets
2. Proportional consolidation
3. Date of transition to IFRS/First adoption date
4. Predictive value and confirmatory value
5. Cost of the assets and economic benefits
6. Accumulated depreciation and impairment losses
7. Corporate Social Responsibility
8. Any **TWO** of:
   (i) Flexibility in regulation
   (ii) Lack of regulation
   (iii) Scope for management that assumed some target for future
   (iv) Timing of some transactions
   (v) Use of artificial transactions
   (vi) Reclassification and presentation of financial transactions
9. Teleology/consequentialism/utilitarianism
10. Bonus/scrip issue
11. ₦202,500,000
12. Reported under Other Comprehensive Income
13. Recognise it in net profit or loss
14. Just-in-time (JIT)
15. Globalization
16. Universal law
17. Ethical emotivism/Emotivism/Emotive theory of Ethics
18. Universalisability
19. Differential association
20. Corporate culture/organisation culture

Tutorial Note on Question 11

		₦'m
	Original Cost	250.0
	Less: Depreciation $\frac{250}{50} \times 9\frac{1}{2}$*	47.5
	Carrying amount	202.5
*	1 Jan.2001 - 30 June 2010 =	9 ½ years

EXAMINERS' REPORT

The questions cut across the various topics in the syllabus. Most of the questions test the indepth and definite ability of the candidates on all the topics.

The performance of the candidates was above average.

Candidates are advised to concentrate on details of the syllabus.

SOLUTION TO SECTION B

QUESTION 1

a(i) Ethical issues in the case

- Should the accounting error and its subsequent resolution be hidden from the company's management?
- Would the admission of the error create an incentive for the company to reinstate the three people laid off?
- Should Tunde use this information to induce Ngozi to start dating him again?

(ii) How the issues could be resolved

- There should be disclosure of the accounting error committed by Ngozi to the management.
- The staff that have been laid off should be reinstated for the sake of justice.
- Tunde should not use this information to induce Ngozi to start dating him again.
- Ngozi should not have accepted Tunde's invitation.
- Tunde should expose the financial misrepresentation committed by Ngozi to the management.

- Ngozi should own up to her mistake but the penalty should not be too stringent.

(iii) What informed Ngozi's acceptance to meet Tunde

Ngozi believed that meeting with Tunde and agreeing to his proposal could make Tunde cover her up and save her career. Self-interest was a major consideration in her decision.

(iv) As professional accountants, Tunde and Ngozi are expected to

- Put service above self-interest;
- Pursue all accounting duties with integrity and objectivity;
- Exercise self-restraint in handling sensitive issues;
- Refrain from seeking personal advantage over and above the interest of the organization and shareholders;
- Refuse to give undeserved favours to anyone; and
- Show loyalty to their organisation by upholding its lawful policies and practices, and communicating same truthfully and effectively to all stakeholders, that is, exhibit professional behavior;

(bi) **Prior period errors** are omissions from and misstatements in the entity's financial statements for one or more periods arising from failure to use or misuse of reliable information that:

- was available when financial statements for those periods were authorized for issue; and
- could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Retrospective restatement corrects the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

(bii) Accounting treatments of prior period errors:

Except to the extent that it is impracticable, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:

- Restating the comparative amount for the prior period(s) presented, in which the error occurred; or
- If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Disclosure requirements of prior period errors include:

- The nature of the prior period errors, for each period presented, and to the extent practicable, the amount of the correction;
- For each financial statement line item affected, and for basic and diluted earnings per share (only if the entity is applying IAS33); the amount of the correction at the beginning of the earliest prior period presented; and if retrospective restatement is impractible, an explanation and description of how the error has been corrected.
- Financial statements of subsequent periods need to repeat these disclosures.

EXAMINERS' REPORT

The question tests a combination of the candidates' knowledge of ethical duties of a professional accountant and auditor as they relate to financial reporting.

Candidates were expected to distinguish between issues that border on self interest and professional duties. However, most of them repeated the same points in answering each part of the question, hence performance was below average.

Most candidates failed to display the technical knowledge of accounting language in answering the financial reporting part of the question. The communication skill of candidates also affected their expression of answers to the question.

Candidates are advised to adhere strictly to instructions while answering questions, take note of the detailed requirements of each part, improve their communication skill and focus on the technical details of financial reporting.

QUESTION 2

(a) There are two levels of moral responsibilities involved in the case:

Menders Oil Service Limited is responsible for the disaster for the following reasons:

(i) Failure of the company to terminate the appointment of Captain Slosh who has been arrested and convicted for drunk driving offences;
(ii) Failure to engage competent hands to handle the ship; and
(iii) Failure to renovate the double-hulled tanker that was overdue for renovation.

Mr. Slosh, the Captain, should also be held responsible for getting drunk, which Smade him guilty of professional negligence.

(b) The company has the following moral responsibilities to:

(i) Bear the cost of environmental impact assessment of the damage;
(ii) Bear the total cost of clean-up exercise carried out in the area;
(iii) Finance the total cost of restoration of the area affected by the oil spillage to its natural habitat;
(iv) Pay an agreed proportion of its annual profit for infrastructural and rural development of the locality; and
(v) Compensate government for damage to the tourism industry in the area.

The punitive measures that should be taken against the company are that:

(i) The company should be put under restricted order of surveillance for a number of years (as stipulated by law) to monitor its activities regarding compliance with environmental protection order; and
(ii) The operating licence of the company should be suspended to serve as a deterrent to other companies and to ensure that the company comply with environmental protection order.

(c) Impairment occurs when the carrying value of an asset is greater than its recoverable amount. The recoverable amount is the higher of:

(i) The fair value less cost to sell; and
(ii) The value in use.

Indicators of impairment

These include:

External sources of information

- Unexpected decrease in an asset's market value
- Significant adverse changes have taken place, or are about to take place, in the technological, market, economic or legal environment
- Increased interest rates have decreased an asset's recoverable amount
- The entity's net assets are measured more than its market capitalisation

Internal sources of information

- Evidence of obsolescence or damage
- There is, or is about to be, a material reduction in usage of an asset
- Evidence that the economic performance of an asset has been, or will be worse than expected

(d) Impairment loss implications of the accident

	₦'m	₦'m
Carrying value		400
Recoverable amount is the higher of:		
Fair value less cost to sell (₦250m – ₦5m)	245	
Value in use	500	500

NOTE: Recoverable amount (value in use) is higher than carrying value, hence, there is no impairment.

EXAMINERS' REPORT

The question examines candidates' knowledge of Corporate Social Responsibility and IAS 36 requirement on impairment of assets. It tests candidates' knowledge on assigning responsibilities on issues that border on organisations, the environment and community.

Candidates' performance was average as they did not display a good knowledge of the rudiments of answering questions of this nature. Most of the candidates did not understand that they were expected to calculate impairment loss and gain.

The grammatical incompetence of the candidates also affected the way questions were answered. There is need for candidates to articulate their ideas in answering each part of the question so as to avoid muddling up the requirements.

They are also advised to familiarize themselves with the requirements of International Financial Reporting Standards.

QUESTION 3

(a) (i) Employees are members of an organisation who carry out the main operation of the business.

(ii) Employees bring with them their personal principles and experiences to contribute to change and innovation in the workplace.

The organisation, on its part, would relate with and compensate them by providing:

- High pay;
- Job security;
- Good working conditions;
- Fair treatment;
- Fringe benefits;
- Promotion prospects; and
- Training opportunities.

(b) (i) Customers are conveyors and/or consumers of an organisation's final goods and services.

(ii) Customers can be regarded as the main reason that determines the existence of the business. They have sympathy for the business by patronising the organization.

(iii) The organisation's relation to the customers should be such that ensures:

- Fair price;
- Value for money;
- High quality products;
- Good service;
- Innovation;
- Certain and regular supply of products;

- Choice of goods i.e. variety; and
- Clear and accurate information.

(c) (i) Suppliers are individuals or businesses that provide raw materials, goods or services or other inputs to vendors or for the production process in return for the agreed compensation.

(ii) Suppliers provide or create volume discounts for vendors who place orders for large quantities of a specific good or service. They ensure reliable source and high quality.

(iii) The organisation should be related to the suppliers as follows:

- A long term relationship with the firm;
- Large size and high value of contracts;
- Frequent and regular orders;
- Fair prices; and
- Growth of the firm leading to more orders.

(d) Communities are hosts to the organizations or locations where organizations are sited for business.

These organisations exist as corporate citizens and as such have rights and responsibilities. They relate with the communities as follows:

(i) Care for the well being of the communities
(ii) Care for the well being of other individuals and corporate members
(iii) Protect and safeguard the environment
(iv) Offering of social welfare
(v) Offering of employment opportunities
(vi) Provision of high quality products and services

Communities, on the other hand, are to do the following:

(i) Protect organizational interests
(ii) Aid the government in providing conducive environment
(iii) Contribute to the work force

(e) Shareholders are capital providers for a firm and are the main risk bearers of any business. They constitute a very influential stakeholders' group ranging from the local financial community to international private investors and financial institutions.

The spirit of shareholders guides a firm's decision-making through their interest in reducing business risks and ensuring environmental safety.

The company should relate to them by ensuring

- Good returns on investment;
- Long term growth;
- Prospect of capital gain;
- A say in the businesses; and
- A positive corporate image

EXAMINERS' REPORT

The question expects candidates to focus on the fundamental and important ethical interrelationship that exists between an organisation and relevant stakeholders in order to achieve and realize the organisations' set objectives. It further tests their knowledge of the definitions of the various terms describing the stakeholders.

Very few candidates understood the question as being two-sided and this affected their performance, which was rated average. Emphasis was laid by the candidates on the relation of an organisation to the stakeholders and not vice versa.

Candidates are to be more careful in interpreting questions. Deep insight into the technicalities of answering questions is required of them at this stage.

QUESTION 4

(a) **Highend Digitals Limited**

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 March 2012

	Workings	₦
Revenue	(2)	438,000
Less: Cost of Sales	(1)	219,000
Gross Profit	(2)	219,000
Operating Expenses	(3)	153,300
Net Profit for the year		65,700
Retained Profit b/f wd		73,424
Retained Profit c/f wd		139,124

(b) **Highend Digitals Limited**

Statement of Financial Position as at 31 March 2012

	Workings	₦	₦
Non-current assets (Balancing figure)			350,022
Current assets:			
Inventories		14,000	
Receivables	(5)	33,600	
Cash and cash equivalents (Balancing figure)		11,053	
		58,653	
Current liabilities:			
Payables	(4)	19,551	
			39,102
			389,124
Ordinary share capital			250,000
Retained profit			139,124
			389,124

Workings:

(1) Inventory turnover period $= \frac{\text{Average Inventory}}{\text{Cost of sales}} \times \frac{365}{1}$

$$\text{Cost of sales} = \frac{4,380,000}{20}$$
$$= ₦219,000$$

$$= \frac{(10,000 + 14,000)/2}{219,000} \times \frac{365}{1}$$

$$= \frac{12,000}{219,000} \times 365 = 20 \text{ days}$$

(2) Revenue:

Gross Margin $=$ 50% on sales $= \frac{438,000}{2}$

$=$ ₦219,000

∴ Turnover = 219,000 + 219,000 = 438,000

(3) Net Profit = 15% of 438,000 = ₦65,700

∴ Expenses = Gross Profit – Net Profit = 219,000 – 65,700= ₦153,300

(4) Payables: Payment Period $= \frac{\text{Payables}}{\text{Purchase}} \times \frac{365}{1}$

Purchases:

Opening Stock		10,000
Purchases	223,000	
	233,000	
Less: closing stock	14,000	
	219,000	

$$= \frac{19{,}551 \times 365}{223{,}000} = 32 \text{ days}$$

(5) Receivables: Collection Period $= \frac{\text{Receivable}}{\text{Sales}} \times \frac{365}{1}$

Receivable $= \frac{438{,}000 \times 28}{365} = 33{,}600$

$$= \frac{365 \times \text{Receivable}}{438{,}000} = 28 \text{ days}$$

(6) Current Assets $= \frac{\text{Current assets}}{\text{Current liabilities}} = 3:1$

$\frac{x}{19{,}551} = 3:1 \quad x = 19{,}551 \times 3$

∴ Current Assets = 58,653

(c) Performance Ratios:

(i) Dividend Yield:

- dividend as percentage of market price of share

- indicates the return attributable to each share relative to the price paid for the acquisition of such share.

(ii) Dividend Cover:
- How many times the company can cover the dividend
- Indicates the ability of a company to pay dividend out of profit generated.

(iii) Dividend per share:

- How much dividend is paid per share
- Indicates the amount of dividend attributable to each share

(iv) Earnings per share:

- Profits attributable to each share

(v) Price/Earnings Ratio:

- Expresses the relationship between the price per share and the amount of earnings attributable to a single share
- Relates the market price to the earnings per share

(d) Calculation of performance ratios:

$$\text{Dividend Yield} = \frac{\text{Dividend per share}}{\text{Market price per share}}$$

Dividend = 25% of 65,700 = ₦16,425

$$\text{Dividend Per Share (DPS)} = \frac{16{,}425}{500{,}000} \times 100\text{k} = 3.3 \text{ Kobo}$$

Market Price Per Share (MPS) = 80 Kobo

$$\text{Dividend Yield} = \frac{\text{DPS}}{\text{MPS}} \times \frac{100}{} = \frac{3.30}{80} \times \frac{100}{1}$$

$$= 4\%$$

(ii) Dividend Cover

$$= \frac{\text{Profit after tax}}{\text{Dividend Paid}}$$

$$= \frac{65{,}700}{16{,}425}$$

= 4 times

(iii) Dividend per share = $\frac{\text{Total Dividend}}{\text{No of shares issued}}$

= $\frac{₦16,425}{500,000}$

= 3.3 kobo

(iv) Earnings per share = $\frac{\text{Profit after tax}}{\text{No of shares issued}}$

= $\frac{₦65,700}{500,000}$

= 13 kobo

(v) Price Earnings ratio = $\frac{\text{Market price per share}}{\text{Earning per share}}$

= $\frac{80}{13}$

= 6 times

(e) Comments on the Ratios calculated:

(i) Dividend Yield

Less than average, i.e., slightly lower than that of local bank.
This means that the market expectation in future growth of the company's dividend is higher than that of local bank.

(ii) Dividend cover

Is higher than the local average.
It means that the company may probably maintain dividends in the future.

(iii)&(iv) Dividend per share and earnings per share

The two ratios are extremely lower than those of the bank.
This indicates that dividends and earnings attributable to each share is lower and may send a wrong signal to the investors and potential investors, and may also have a negative effect on the

share price.

(v) Price Earnings ratio

This is more or less the same with the local bank.
The implication is that the market does not think as highly of the shares of the company as that of the local bank.

EXAMINERS' REPORT

The question tests candidates' knowledge of preparation of financial statements in the format prescribed by IFRS, computation of performance ratios and their interpretations.

Most candidates did not display clear understanding of the requirements of the question, as some candidates were still preparing balance sheet and profit and loss accounts instead of Statements of Financial Position and Profit or Loss, and Other Comprehensive Income respectively. Consequently, their performance was below average.

Candidates are advised to familiarize themselves with all accounting ratios and learn how to derive vital figures to be used in the computation of ratios from information provided.

QUESTION 5

(a) Computation of Goodwill arising on consolidation with the provision of IFRS 3 (Business Combination)

Reward Plc: Fair Value of net assets at acquisition date (1 January, 2011)

	Carrying Value	Fair Value
	₦	₦
Freehold land & building	4,000,000	9,580,000
Brand Name	-	5,000,000
Plant & Machinery	11,200,000	8,900,000
Other assets & liabilities	47,350,000	47,350,000
	62,550,000	70,830,000
PURCHASE CONSIDERATION:	₦	

Cash paid on acquisition	40,000,000	
15 million shares at ₦1.50	22,500,000	
A further cash in a year (4,000,000) 1.1	3,636,364	
Purchase consideration	66,136,364	

Goodwill on acquisition:	₦	
Purchase Consideration	66,136,364	
Less: 80% of ₦70,830,000	56,664,000	
	9,472,364	

(b) Definition of Measurement Period

The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for a business combination.

Based on IFRS 3 on business combination, the acquirer should initially assign fair values to the acquireee's identifiable net assets. If these can only be determined provisionally at the end of the first reporting period, these values may be adopted.

However, the acquirer should recognize any adjustments, after finalisaing the initial accounting to those provisional values within 12 months of the acquisition date. Also any adjustments should be recognized from the acquisition date thus:

(i) The book value of adjusted net assets should be adjusted to fair value at that date;
(ii) Goodwill should be adjusted; and
(iii) Comparative figures should be adjusted as additional depreciation.

Except for contingent consideration or finalization of any deferred tax assets, adjustments are to be made to the initial accounting after it has been completed and can only be recognized to correct an error in accordance with IAS 8 (Accounting Policies, changes in accounting estimates and errors). In that case, a prior period adjustments should be recorded.

EXAMINERS' REPORT

The question tests candidates' knowledge of Business Combination as spelt out in IFRS 3. They are expected to calculate goodwill arising on consolidation and explain what the acquirer should do in the "measurement period".

Few candidates attempted the question and their performance was poor. They did not follow the "proportionate share" method as contained in IFRS 3 and displayed a lack of adequate understanding of what the acquirer should do in the measurement period.

Candidates are advised to learn and understand the provisions, technical details and application of all IFRS released as they would continue to feature in Financial Reporting papers.

QUESTION 6

(a.) In all instances, the financial liability is initially recorded at the fair value of the consideration recited, i.e. the cash received. It is then accounted for using amortized cost.

This means the liability varies for two reasons, first an increase by the finance cost which should be charged to statement of profit or loss and Other Comprehensive Income at a constant actualized rate (Dr. Finance charge, Cr. Accrual) and second, a reduction by the actual cash paid (Dr. Accrual, Cr. cash).

RICHBERRY LIMITED

Instruments	**Yrs**	**Opening Balance**	**Finance Charge**	**Cash**	**Closing Balance**
		₦	10%		₦
1	0	330,000		-	330,000
	1	330,000	33,000	-	363,000
	2	363,000	36,300	-	399,300
	3	399,300	39,930	439,230	-
2	0	225,000	14.4721%	-	225,000
	1	(225,000-75,000)= 150,000	21,708.15	-	171,708.15
	2	171,708.15	24,849.77	-	196,557.92
	3	196,557.92	28,446.06	225,000	-

3	0	300,000	15%	-	
	1	(300,000 – 15,000) ₦285,000	42,750	(6,000)	321,750
	2	321,750	48,262.50	(370,012.50)	-

b(i) Richberry Ltd. has non-current (financial) assets which are valued at fair value with changes recognized in Statement of Profit or Loss and Other Comprehensive Income.

Initially, the financial instrument would have been recorded at cost

		₦'m
DR	Non-current Assets	75
CR	Cash	75

Being consideration paid on investment purchased.

At the end of the reporting period, the asset must be revalued to fair value following the measurement rules in IAS 39. The gain is then recorded in the Statement of Profit or Loss and Other Comprehensive Income.

		₦'m
DR	Non-current Assets	150
CR	Statement of Profit or Loss & Other Comprehensive Income	150

Being gain on revaluation of non-current assets

On disposal, the asset is derecognized and a gain or loss reported in the Statement of Profit or Loss and Other Comprehensive Income

		₦'m
DR	Cash	600
CR	Non-current Assets	225
CR	Statement of Profit or Loss and Other Comprehensive Income	375

Being disposal of non-current assets (investment)

b(ii) **STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME (EXTRACT)**

	₦'m
Items that will not be reclassified to profit or loss:	
Gains on property revaluations	150

Items that may be reclassified subsequently to profit or loss:	
Available for sale of financial assets	375

STATEMENT OF FINANCIAL POSITION EXTRACT

Non-Current Assets

Investment in financial assets	75
Addition:	
Revaluation	150
	225
Less: Disposal	(225)
	NIL

EXAMINERS' REPORT

The question tests candidates' knowledge IAS 39 (Financial Instruments recognition and measurements). Application of residual knowledge of Financial Management and Management Accounting is also required in the computation involving financial instruments, debt instruments and relevant postings of accounting generated figures.

Very few candidates attempted the question and their performance was poor as they displayed low technical ability and understanding of the question.

Candidates are advised to continually update their understanding of the technical details of all International Financial Reporting Standards issued by IFAC.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II - NOVEMBER 2012
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. Two potential securities, X and Y, are being evaluated. The expected rate of return on security X is 15.7% while its standard deviation is 2.7%. Security Y's expected rate of return is 20.4% with a standard deviation of 3.4%. Assuming that securities X and Y have a correlation coefficient of 0.64, what is the co-variance between the two securities?

   A. 8.75
   B. 7.85
   C. 7.58
   D. 5.88
   E. 5.58

Use the following information to answer questions 2 and 3:

Security A has the following probability distribution of expected returns:

Probability	Rate of Return %
0.2	20
0.4	25
0.2	10
0.1	25
0.1	15

2. What is security A's expected rate of return?

A. 20.0%
B. 15.0%
C. 10.0%
D. 5.4%
E. 4.5%.

3. The security's standard deviation is

A. 9.92%
B. 9.25%
C. 5.92%
D. 5.29%
E. 5.28%.

4. Stability Limited has maintained a dividend rate of ₦40.00 per share for many years. The same rate is expected to be paid in future years.

If investors require 8% return on similar investments, the company's share value will be

F. ₦600
G. ₦550
H. ₦500
I. ₦450
J. ₦400.

5. The following are disadvantages of Debenture as a source of long-term finance **EXCEPT**

A. Legal obligation of paying interest and principal
B. Increases the firm's financial leverage
C. Must be repaid at maturity, else liquidation may be enforced
D. Presence of restrictive covenants
E. High cost to the firm than equity financing

6. **ONE** of the advantages accruing to a company for financing with preference shares is that

A. Preference shares dividends are tax deductible
B. In the case of cumulative preference shares, the right to an unpaid dividend is carried forward to later years
C. The returns on preference shares are always higher than returns on

bonds

D. Preference shareholders always have voting rights

E. The firm can retain control and limit the profit sharing of new investors

7. A foreign exchange dealer observes that the spot exchange rate of Naira to the U. S. Dollar is ₦160.99 and Ghana cedis to the U.S dollar is 2.3395. How many Naira would exchange for 1 cedi?

A. ₦376.63

B. ₦68.95

C. ₦68.81

D. ₦0.02

E. ₦0.01.

8. Which of the following investment appraisal techniques uses accounting profit for project evaluation?

A. Profitability Index

B. Net terminal value

C. Payback period method

D. Discounted payback period method

E. Earnings per share

9. Which of the following assumptions is **NOT** considered applicable under Discounted Cash Flow Technique?

A. All cash flows can be predicted with certainty

B. All cash flows take place at the end of the year

C. The discount rate is constant over the life of the investment

D. The discount factors can be easily calculated

E. Investment in a project is normally assumed to take place at the end of the first year

10. Which of the following is **NOT** in the group of international parity relationships?

A. Cross rate parity

B. Interest rate parity

C. Purchasing power parity

D. International fisher effect

E. Forward rates and future spot rates parity

11. Which of the following would **NOT** be considered an objective in the management of trade receivables?

C. Speeding up cash inflows
D. Maximising sales volume thereby increasing credit risk
E. Maintaining an optimal level of investment in trade receivables
F. Expediting collection of trade receivables
G. Reducing credit risk

12. Which of the following symptoms would indicate that a company is overtrading?

A. Increase in current ratio
B. Increase in the proportion of total assets financed with proprietors capital
C. Increase in quick ratio.
D. Increase of current liabilities over current assets.
E. Decrease in the proportion of total assets financed by credit

13. The use of dividend policy to indicate the future prospects of a company is referred to as

A. Certainty argument
B. Asymmetric information
C. Signalling properties of dividend
D. The 'bird-in-hand' argument
E. Information value argument

14. The following are the primary types of merger **EXCEPT**

A. Friendly merger
B. Horizontal merger
C. Congeneric merger
D. Conglomerate merger
E. Vertical merger

15. A reverse merger occurs when a small company takes over a

A. Company engaged in similar activities
B. Company engaged in totally different activities
C. Bigger company
D. Smaller company
E. Loss making company

16. A written order by an exporter asking the importer to pay a specific amount of money at a specified future date is known as a

A. Time draft
B. Site draft
C. Letter of credit
D. Bill of lading
E. Sight draft

17. The price of one currency quoted in terms of another currency is known as

A. Spot exchange rate
B. Forward exchange rate
C. Cross rate
D. Currency rate
E. Foreign exchange rate

18. Which of the following is **NOT** a likely source of financing small-and medium-sized enterprises?

A. Bank loans
B. Trade credit
C. Business angel financing
D. Debenture
E. Owner financing

19. The initial cash outlay of a project is ₦400,000 and it can generate cash inflows of ₦200,000, ₦150,000, ₦250,000 and ₦100,000 in year 1 through year 4 respectively. What is the cost-benefit ratio of this project assuming the discount rate is 10%?

A. 1.63
B. 1.40
C. 1.36
D. 1.06
E. 1.03

20. A lease in which the lessor finances part of the cost of the asset by an issue of debt secured by the asset and the lease payments is known as

A. Leveraged lease
B. Dry lease
C. Finance lease
D. Capital lease
E. Operating lease

PART II: SHORT-ANSWER QUESTIONS (20 Marks)

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

1. The major objective of a corporate manager's decision is to ....

2. One broad category of strategic decision about which Finance Managers are concerned is ....

3. The concept which stipulates that management should act in the best interest of the owners of the business is referred to as ....

4. In Financial Management, the theory which says that ₦1 today is worth more than ₦1 in a year's time is known as ....

5. The future value of an uneven streams of cash flows is called ....

6. What is the present value of ₦10,000 receivable 5 years from now at 10% rate of interest?

7. A lease agreement where all risks and rewards incidental to ownership remain with the lessor is called ....

8. Xeston Limited has 17% cost of equity, the next dividend on its ordinary share is put at 40 kobo with a growth potential of 12% per annum indefinitely. Calculate the market value of the ordinary share.

9. The average cost of the individual source of capital weighted by the amount of each source within the overall capital structure of the firm is known as ....

10. A computer-based information system which gives business managers the necessary interactive information support for decision making is referred to as ....

11. The cycle which begins with the payment for purchases and services and ends with the collection of receivables is known as ....

12. State the formula for calculating work-in-progress/turnover period in days.

13. In mergers and acquisition, the excess of the premium paid over the write-up,

in the books is known as ....

Use the following information to answer questions 14 and 15:

Extracts from the books of Ground Limited and Sky Limited are as follows:

	GROUND LIMITED	SKY LIMITED
Ordinary shares	100,000	200,000
Market value	₦2.50	₦1.50
PE ratio	10	8

14. Calculate the earnings of Ground Limited and Sky Limited.

15. Calculate the post merger earnings per share (EPS) if Ground Limited and Sky Limited merge on a one for one shareholding.

16. An offer by one company to purchase the shares of another company at a fixed price which is above the market price is called ....

17. If the net aggregate market value exposure of Inter Plc is ₦200 and the market value of equity is ₦350. What is the aggregate exposure coefficient?

18. The exchange rate agreed now for exchanging one currency for another for immediate delivery is known as ....

19. The difference between the buying rate and the selling rate of a foreign currency is known as ....

20. The currency of members of the European Union is called ....

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

QUESTION 1

CASE STUDY

TABLOID PLC.

Tabloid Plc. is a company that engages in the manufacture of domestic home product. The company has been in operation for several years in Abuja, Nigeria where it markets its product across the country. In a bid to cover a wider market outside the shores of Nigeria, a subsidiary company, Linkerd Limited was established in Ghana to manufacture a similar product.

As a result of the recent economic downturn in Nigeria, the exchange rate of Naira to Cedi is being adversely affected and this has exposed the company to diverse exchange rate risks.

The balance sheet of Linkerd Limited given below shows the Naira equivalent values of the items as translated in the company's books in Nigeria. It records the book value, the market value and the assigned exposure coefficient which are based on the sensitivity of each balance sheet item to exposure risk.

Balance sheet of Linkerd Limited as at 31 December, 2009

	Book value		**Market value**		**Exposure coefficient**
	₦'m	₦'m	₦'m	₦'m	
Cash	3.0		3.0		1.0
Marketable securities	11.2		11.2		1.0
Receivables	32.6		32.6		1.0
Inventories	43.6		48.4		0.6
Value of market positioned operating capacity	68.2		143.8		0.3
		158.6		239.0	
Less: Account payable	29.8		29.8		1.0
Accruals	17.4		17.4		1.0
Debt	34.0	81.2	31.6	78.8	1.0
Net Asset		77.4		160.2	
Financed by:					
Shareholders' Equity		77.4		160.2	

The Directors of Tabloid Plc. believe that with careful analysis of the sensitivity of each variable to exchange exposure risk, a lot will be achieved on favourable economic exposure risk.

Required

a. Calculate the market value exposure for each of the items in the balance sheet. (9 Marks)

b. Use your result in "a" to calculate the aggregate exposure coefficient. (2 Marks)

c. Advise the Directors of Tabloid Plc. on the effect of market position and operating capacity exposure coefficient on the company's future operations in Ghana. (4 Marks)

(Total 15 Marks)

QUESTION 2

Badimi Limited is considering two mutually exclusive projects whose annual possible net cash flows have the following distributions:

Project	Probability	Net cash flows ₦'000
A	0.1	200
	0.6	300
	0.3	450
	Probability	Net cash flows ₦'000
B	0.2	210
	0.6	330
	0.2	450

Initial investments of ₦1.1 million and ₦1.0 million will be required for projects A and B respectively. The two projects will last for a period of five years.

You are required to

a. Calculate the expected annual net cash flows for each project. (2 Marks)

b. Calculate the Standard Deviation (SD) of the net cash flows for both projects and identify the riskier project using the following formula:

$$SD = \left(\sum_{j=1}^{m} \left(Aj - E(A) \right)^2 P(Aj) \right)^{½}$$

$$SD = \left(\sum_{j=1}^{m} \left(Bj - E(B) \right)^2 P(Bj) \right)^{½}$$

where

Aj and Bj = the cash flow attached to each outcome
P = probability attached to the cash flow
E = the expected value of all the outcomes (5 Marks)

c. Compute the coefficient of variation (CVAR) for both projects and indicate the project to select with reasons. (5 Marks)

d. Explain the term "stand alone total risk" with reference to a project. Explain **ONE** technique of measuring this type of risk. (3 Marks)

(Total 15 Marks)

QUESTION 3

Silogar Limited and Lowood Limited are two companies in the same chemical industry. While Silogar has automated its operations, Lowood is just in the process of doing so. Both however use good quality materials in their production processes and their products are well accepted in the market. For the year ended 31 December, 2011 each company had net turnover of ₦4,800,000. The actual kegs of chemical sold were: Silogar 320,000 and Lowood 300,000.

Other operating statistics for the companies for 2011 are as follows:

	SILOGAR	LOWOOD
	₦	₦
Cost of materials consumed	1,800,000	1,950,000
Direct labour cost	1,200,000	450,000
Production overheads	400,000	1,000,000
Administrative and selling expenses	420,000	420,000
Interest on debentures	100,000	180,000
Tax rate	30%	30%
Ordinary shares dividend payout ratio	50%	50%
Current market price of each ordinary share	₦3.45	₦0.70

The two companies' summarised statements of financial position as at 31 December 2011 are as follows:

	SILOGAR	LOWOOD
	₦	₦
Capital: ₦1.00 ordinary shares	1,000,000	-
25k ordinary shares	-	1,000,000,
400,000 10% preference shares	400,000	-
General reserves	1,500,000	1,600,000
Debentures	800,000	1,200,000
Accounts payable and accruals	1,300,000	1,200,000
	5,000,000	5,000,000
Non-current assets	2,000,000	3,200,000
Current assets	3,000,000	1,800,000
	5,000,000	5,000,000

Required

Assuming the market values of preferences shares and debentures are the same as their book values, you are to advise the management of the two companies on the appropriate cost of capital for purposes of project evaluation.

(Note: Use earnings method for equity cost of capital.) **(15 Marks)**

QUESTION 4

a. In appraising foreign investments, more complexities are usually encountered than in evaluating domestic projects. State **FIVE** of these complexities. (5 Marks)

b. In the conduct of cross-border transactions, the management of an international firm faces a number of financial market risks, which are inherent in the clearance and settlement of cross border financial transactions. Describe briefly **FIVE** of such risks and proffer ways of mitigating them. (10 Marks)

(Total 15 Marks)

QUESTION 5

a. What is a Foreign Exchange Market? (2 Marks)

b. List and describe briefly any **TWO** participants in the foreign exchange market. (4 Marks)

c. Government regulations in many countries do not allow foreigners to access funds from domestic financial markets. Should a prospective investor encounter a difficulty in this regard, state **FOUR** sources of cross-border finance that such investor would exploit to overcome this challenge. (4 Marks)

d. State **FIVE** features of an efficient foreign exchange management. (2½ Marks)

e. State any **FIVE** factors which may cause fluctuations in exchange rates. (2½ Marks)

(Total 15 Marks)

QUESTION 6

Kondo Koncepts Limited, a firm in the communications business, is planning to install a set of computers to facilitate the enhancement of its operations. The company is confronted with choosing an appropriate means of financing the project. The Board of Directors has directed you, as the Finance Director of the company, to work on which of the available alternative means of financing to employ. The two means of financing open to Kondo Koncepts Limited are either to lease the computers or borrow to purchase them.

The following information are made available to you:

i. Borrow and Buy at 14% rate of interest

- Purchase price ₦2,400,000
- Annual maintenance cost ₦600,000 (to be paid in advance)
- Expected economic useful life of 6 years
- Depreciation is on the straight line method with a salvage value of ₦240,000
- Loan repayment of ₦617,125 per instalment for six years

ii. Lease

Lease charges will be ₦540,000 per annum for six years (to be paid in advance). Maintenance expenses are borne by the lessee.

Applicable tax rate is 30%.

You are required to

a. Provide Management with the relevant data for the **TWO** options involved.
(11 Marks)

b. Advise management on the mode of financing to adopt.
Show your workings. (4 Marks)
(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

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

Workings

1. .64(2.7) (3.4) = 5.875

2. R_A = .2(20%) + .4(25%) + .2(10%)
+.1(25%) + .1(15%)
= (4 + 10 + 2 + 2.5 + 1.5)

$= \quad 20\%$

3. Variance $= .2\,(.2 - .2)^2$

$.4(.25 - .2)^2$

$.2(.10 - .2)^2$

$.1(.25 - .2)^2$

$.1(.15 - .2)^2$

$= .2(0) + .4(.0025) + .2(.01) + .1\,(.0025) + .1(.0025)$
$= 0 + .001 + .002 + .00025 + .00025$
$= .0035$

SD $= \quad .0035$
$= \quad 0.05916$
$= \quad 5.92\%$

4. Zero-growth stock or perpetuity

$P_o = \dfrac{D}{r_s} = \dfrac{₦40}{.08} = ₦500$

7. $/₦ = ₦160.99 or ₦/S = $^1/_{160.99}$
$/Cedes = 2.3395 or Cedes/$ = $^1/_{2.3395}$
$P_o = \dfrac{D}{r_s} = \dfrac{₦40}{.08} = ₦500$
₦/Cedes = $\dfrac{160.99}{1} \times \dfrac{1}{2.3395}$
$= \quad 68.8138$
$= \quad 68.81$

19. PV = (200,000 x 0.909) + (150,000 x 0.826)
+(250,000 x 0.751) + (100,000 x 0.680)
= ₦(181,800 + 123900 + 187750 + 68,000)
= ₦561,450

PI = $\dfrac{\text{PV of cash inflows}}{\text{Initial cash outlay}}$
= $\dfrac{₦561,450}{₦400,000}$ = 1.4036

EXAMINERS' REPORT

The questions test candidates' knowledge of reasonable aspects of the syllabus.

All candidates attempted the questions and their performance was fair.

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

PART II SHORT- ANSWER QUESTIONS

1. Maximise shareholders wealth

2. Long term investment decision or long term financing decision or Investment decision/Financing decision

3. Corporate Governance

4. Time value of money or Time value of preference for money

5. Terminal value

6. ₦6,209.20

7. Operating lease/Full service lease or Wet lease (only in the airline industry)

8. ₦8 or 800 kobo

9. Weighted Average Cost of Capital (WACC)

10. Decision Support System (DSS)

11. Operating or cash or working capital cycle

12. $\frac{\text{Average WIP}}{\text{Cost of Production/Sales}} \times \frac{365}{1}$ days

    or

    $\frac{\text{Closing WIP}}{\text{Cost of Sales}} \times \frac{365}{1}$ days

13. Goodwill

14. ₦25,000; ₦37,500

15. 20.83 kobo

16. Tender offer

17. 0.5714

18. Spot rate

19. Spread

20. Euro

Tutorials

6. $\frac{1}{(1.1)^5} \times \frac{10,000}{1} = ₦6,209.20$

8. $MV = \frac{d1}{K_e - g} = \frac{40k}{(0.17-0.12)} = \frac{40k}{0.05} =$ ₦8.00 or 80 kobo

14.

		Ground Ltd Earnings	Blue Ltd. Earnings
$\frac{MV}{\text{P/E ratio}}$	=	$\frac{100,000 \times ₦2.50}{10}$	$\frac{200,000 \times ₦1.50}{8}$
	=	₦25,000	= ₦37,500

15. Combined Shareholding = (100,000 + 200,000) shares
= 300,000 shares

Combined earnings = ₦25,000 + ₦37,500 = ₦62,500
Earnings Per Share = $\frac{₦62,500}{300,000}$ = 20.83 kobo

17. $\frac{\text{Net Aggregate Market Value Exposure}}{\text{Market Value of Equity}} = \frac{₦200}{₦350}$

= 0.5714

EXAMINERS' REPORT

The questions test candidates' knowledge of various aspects of the syllabus.

All the candidates attempted the questions and performance was average.

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

SOLUTIONS TO SECTION B

QUESTION 1 - CASE STUDY - TABLOID PLC

a. Market Value Exposure = Exposure Co-efficient x Market Value

	Asset		Exposure coefficient x	Market Value	=	Market Value Exposure
				₦'m		₦'m
i.	Cash	1.0	x	3.0	=	3.00
ii.	Marketable Securities	1.0	x	11.2	=	11.20
iii.	Receivables	1.0	x	32.6	=	32.60
iv.	Inventories	0.6	x	48.4	=	29.04
v.	Value of market position and operating capacity	0.3	x	143.8	=	43.14
						118.98

Liabilities

vi.	Account payable	1.0	x	29.80	=	29.80
vii.	Accruals	1.0	x	17.42	=	17.40
viii.	Debt	1.0	x	31.60	=	31.60
						78.80

b. Aggregate exposure coefficient for Linkerd Ltd.

$$= \frac{\text{Asset Market Exposure} - \text{Liability Market Exposure}}{\text{Market Value of Shareholders Equity}}$$

$$= \frac{118.98 - 78.80}{160.2} = 0.2508$$

or $\underline{\underline{25.08\%}}$

c. The exposure coefficient of Tabloid Plc. for market position/operating capacity is 0.3. The Directors of Tabloid Plc. are therefore advised that the value of future operations in Ghana is only moderately exposed to changes in Ghana Cedi/Nigeria naira exchange rate. Just because an operation is located in Ghana does not mean that it is highly sensitive to the value of Ghanaian Cedi. For example, labour cost could be sensitive but raw materials are likely to come from other markets. If the finished products are sold in neighboring countries to Ghana, there may be little sensitivity here as well.

EXAMINERS' REPORT

The question tests candidates' knowledge of International Financial Management with particular reference to International Financial Markets and their associated risks.

Almost all the candidates attempted the question and performance was fair.

Candidates' commonest pitfalls were

- **confusing market values with book values**
- **inability to correctly interpret the results of their computation and**
- **inability to determine the formula to use in calculating the aggregate exposure co-efficient**

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

QUESTION 2

(a)

Project A	P	Net Cash Flow	EV
		₦'000	₦'000
	0.1	200	20
	0.6	300	180
	0.3	450	135
	Expected Annual Net Cash Flow		335
Project B	P	Net Cash Flow	EV
	-	₦'000	₦'000
	0.2	210	42
	0.6	330	198
	0.2	450	90
	Expected Annual Net Cash Flow		330

(b) Calculation of the Standard Deviation of the Cash Flows

Project A

P	C/F	EV	Aj-EV	$(Aj - EV(A))^2$	$(Aj - EV(A))^2 PAj$
	₦'000	₦'000	₦'000	₦'000	₦'000
0.1	200	20	-135	18,225,000	1,822,500
0.6	300	180	-35	1,225,000	735,000
0.3	450	135	115	13,225,000	3,967,500
		335		σ Variance	6,525,000

SD = $\sqrt{6{,}525{,}000{,}000}$

= ₦80,777.47

OR

SD $\left[\left((AJ - (A) \right)^2 PAJ\right]^{½}$ = (₦6525 million)½

= ₦80,777.47

Project B

P	C/F	EV	Bj-E(B)	$(Bj-E(B))^2$	$(Bj-E(B))^2 PBj$
	₦'000	₦'000	₦'000	₦'000	₦'000
0.2	210	42	-120	14,400,000	2,880,000
0.6	330	198	0	0	0
0.2	450	90	120	14,400,000	2,880,000
		330			5,760,000

SD = $\sqrt{5{,}760{,}000{,}000}$

= ₦75, 894.66

(c) Cov = $\frac{SD}{EV}$

where: Cov is coefficient of variation
SD is standard deviation
EV is expected value

Project A Project B

COV = $\frac{₦80777.47}{₦335{,}000}$ $\frac{₦75894.66}{₦330{,}000}$

= 0.2411 = 0.2299

ADVISE:

Project A is riskier than Project B because it has a higher rate than B. Therefore, Project B is recommended for selection.

(d) A project's "stand-alone total risk" is the risk which the project would have if it were a firm's only project (as against the one within a portfolio of a firm's projects) and is measured by the variability of the projects' expected returns.

One good technique of measuring such risk is sensitivity analysis. This is a risk analysis technique in which key variables are changed and the resultant changes in the NPV and the rate of return are observed.

Another technique is scenario analysis which is an extension of sensitivity analysis whereby, instead of testing one input variable at a point in time, more than one, say two, three or more input variables are tested simultaneously and the effect on the outcome measured.

EXAMINERS' REPORT

The question tests candidates' understanding of the treatment of risk and uncertainty and their effects on investment decision under the Capital Investment Decision aspect of the syllabus.

Almost all the candidates attempted the question and performance was fair. Candidates understood parts 'a' to 'c' of the question but lacked a clear understanding of part'd' hence the fair performance.

Candidates' commonest pitfalls were their inability to effectively utilize the formular provided and interprete the outcome correctly. Other pitfalls were their inability to state the formula for covariance and lack of knowledge of the meaning of 'stand alone risk'. These shortcomings led to the drop in the candidates' scores.

Candidates are advised to cover the syllabus adequately, work on past questions and improve their knowledge on capital investment decisions particularly the treatment of risk and uncertainty and their effects on investment decisions.

QUESTION 3

Income Statement for the year ended 31 December 2011

	SILOGAR LIMITED		LOWOOD LIMITED	
	₦	₦	₦	₦
Net Turnover		4,800,000		4,800,000
Less:				
Direct Materials	1,800,000		1,950,000	
Labour	1,200,000	3,000,000	450,000	2,400,000
Contribution		1,800,000		2,400,000
Less:				
Production Overhead	400,000		1,000,000	
Admin/Selling	420,000		420,000	
Interest on Debenture	100,000	920,000	180,000	1,600,000
Operating Profit before Taxation		880,000		800,000
Less: Taxation at 30%		264,000		240,000
Net Profit after Taxation		616,000		560,000
Less: Preference Dividends		40,000		-
		576,000		560,000
Dividend Payment @ 50%		₦288,000		₦280,000
Market Price Per Share		₦3.45		₦0.70
Market Value of Equity		₦3,450,000		₦2,800,000

Calculation of Cost of Ordinary Shares using earnings method

Cost of Ordinary Shares		576,000 x 100		560,000 x 100
		3,450,000 1		2,800,000 1
		16.69%		20%

Calculation of cost of Preference Share Capital

$$Kp = \frac{d}{MVp}$$

Kp = Cost of Preference Share Capital

d = Latest/Current div paid or payable

MVp = Market Value of preference shares

i.e. Cost of Preference Share = $\frac{40,000}{400,000} \times \frac{100\%}{1} = 10\%$

Calculation of Cost of Debenture

Cost of Debenture = Kd = $\frac{i}{m}(1-t)$

i = Latest/Current Interest paid/payable
m = Market value of debenture
t = Company income tax rate

SILOGAR LIMITED

Kd = $\frac{i}{m}(1-t)$

= $\frac{100,000\ (1-0.30)}{800,000}$
= 0.125 x 0.7
= 0.0875
= 8.75%

LOWOOD LIMITED

Kd = $\frac{i}{m}(1-t)$

= $\frac{180,000\ (1-0.30)}{1,200,000}$
= 0.15 X 0.7
= 0.105
= 10.5%

COMPUTATION OF WEIGHTED AVERAGE COST OF CAPITAL (WACC)

SILOGAR LIMITED

Capital Structure	Market Value	Proportion	Cost of Capital	WACC
	₦	a	b	a x b
Ordinary Shares	3,450,000	0.742	0.1669	0.1238
Preference Shares	400,000	0.086	0.1000	0.0086
Debentures	800,000	0.172	0.0875	0.0151
	4,650,000	1.000		0.1475

Silogar Limited's Weighted Average Cost of Capital is 14.75%.

LOWOOD LIMITED

Capital Structure	Market Value	Proportion	Cost of Capital	WACC
	₦	a	b	a x b
Ordinary Shares	2,800,000	0.700	0.200	0.1400
Debentures	1,200,000	0.300	0.105	0.0315
	4,000,000	1.000		0.1715

Lowood Limited's Weighted Average Cost of capital is 17.15%.
ADVICE: The managements of Silogar Limited and Lowood Limited are advised to use

14.75 percent and 17.15 percent respectively for purposes of project evaluation.

ALTERNATIVE METHOD TO QUESTION 3

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2011

	SILOGAR LIMITED		**LOWOOD LIMITED**	
	₦	₦	₦	₦
Net Turnover		4,800,000		4,800,000
Less:				
Direct Materials	1,800,000		1,950,000	
Labour	1,200,000	3,000,000	450,000	2,400,000
Contribution		1,800,000		2,400,000
Less:				
Production Overhead	400,000		1,000,000	
Admin/Selling	420,000		420,000	
Interest on Debenture	100,000		180,000	
		(920,000)		1,600,000
Profit before Taxation		880,000		800,000
Less: Taxation at 30%		(264,000)		(240,000)
Net Profit after Taxation		616,000		560,000
Less: Preference Dividend		40,000		-
		576,000		560,000
Dividend Payment @ 50%		₦288,000		₦280,000
Market Price Per Share		₦3.45		₦0.70
Total Market Value		₦3,450,000		₦ 2,800,000

Cost of Preference Share (kp)

$$Kp = \frac{d}{MVp} \times \frac{100}{1}$$

$$= \frac{40,000}{400,000} \times \frac{100}{1}$$

$$= 10\%$$

Cost of Debt capital (kd)

SILOGAR LIMITED

$$Kd = \frac{F(1-t)}{MVd} \times \frac{100\%}{1}$$

$$= \frac{₦100,000\,(1-0.3)}{800,000} \times \frac{100}{1}$$

LOWOOD LIMITED

$$Kd = \frac{F(1-t)}{MVd} \times \frac{100}{1}$$

$$= \frac{₦180,000}{₦1,200,000} \times (1-0.30) \times \frac{100}{1}$$

= $\underline{8.75\%}$ = 10.50%

COMPUTATION OF WEIGHTED AVERAGE COST OF CAPITAL

SILOGAR LTD

TYPE	MARKET VALUE (MV)	COST	HASH TOTAL (HT)
			₦
Equity	3,450,000	16.69%	576,000
Preference Share	400,000	10%	40,000
Debt	800,000	8.75%	70,000
	4,650,000		686,000

$$Kw = \frac{HT}{MV} \times \frac{100}{1}$$

$$Kw = \frac{₦686,000}{₦4,650,000} \times \frac{100}{1}$$

Kw = 14.75%

LOWOOD LTD

TYPE	**MV (₦)**	**COST**	**HASH TOTAL (HT)**
	a	**b**	**a x b**
Equity	2,800,000	20%	560,000
Debt	1,200,000	10.5%	126,000
	4,000,000		686,000

$$Kw = \frac{HT}{MV} \times \frac{100}{1}$$

$$Kw = \frac{₦686,000}{₦4,000,000} \times \frac{100}{1}$$

Kw = 17.15%

EXAMINERS' REPORT

The question tests candidates' knowledge of the concept and measurement of the various costs of capitals – equity, preference shares and debentures – and their ability to compute the weighted average cost of capital (WACC).

Few candidates attempted the question and most of them did not understand its requirements hence the performance was poor.

Candidates' commonest pitfalls were their failure to use earnings method for cost of equity capital and non-recognition of tax in computing cost of debt capital.

Candidates are advised to read wide and cover the syllabus adequately for better result. They should also endeavour to remember key formulae.

QUESTION 4

(a) In appraising foreign investment, the following complexities are usually encountered:

i. The problem of which cashflows to use. Is it the project cashflow or those going to the parent company only?

ii. The choice of discount rate to apply. Is it the cost of capital of the company or of the parent company?

iii. Fluctuations in exchange rates during the life of the project.

iv. Levels of risk. This may be quite different from those of an equivalent project undertaken in the domestic economy.

v. Variations in economic policies of the host government. This may affect net cash flows.

vi. Different tax laws and tax treatments of foreign investment.

vii. Political risks especially those touching on the expropriation of the assets of the multi-national companies.

(b) International Financial market risks that may be encountered by participants in clearing systems and ordinary financial markets will include

i. Credit risk: This arises when one of the counter parties to a transaction does not settle in full when the funds are due or on some later date. A counter party who is merely one of the parties to a transaction may face bankruptcy if the other counter party defaults. The credit risk faced by a counter party may include loss of unrealized gains or unsettled contracts or loss of securities delivered or payments made to the defaulting counter party prior to the discovery of the default.

ii. Replacement cost risk: This is the risk of loss of unrealised gains. Unrealised gain is determined by comparing the market price of a security at one time of default with the contract price. If the market price is below the contract price, the seller of the security or other financial instrument is exposed to a replacement cost risk. The buyer is exposed to the loss if the market price is above the contract price.

iii. Liquidity Risk: This arises when clearing or settlement payments are not made as at when due. This risk may be caused by a temporary inability of a counter party to convert assets to cash or the inability of the counter party's correspondent banks to perform settlement functions of one kind or another.

iv. Operational Risk: This results from the technical failure in computer systems, telecommunication facilities or institutionalized procedures during trading and before settlement of the transaction.

v. Systemic Risk: This is the risk that the inability or failure of one participant in a payment system or financial market to meet its obligations when due will cause other participants to fail to meet their own obligations when due. In futures and options markets, systemic risk occurs when agents no longer trade through established channels.

vi. Principal Risk: This is the risk of loss of the full value of securities or funds that a firm has transferred to the defaulting counter party where settlement is made on the date or just prior to the date of default by the counter party.

In summary, International financial market risks may be reduced or eliminated by:

- the use of more efficient payment systems
- netting payments on bilateral or multi-lateral basis
- a greater reliance on global custodians, banking institutions etc

Global custodians manage clearance, settlement, tax reclamation and other activities which are part of the cross-border investments executed with agent banks in foreign currencies.

EXAMINERS' REPORT

Part 'a' of the question tests candidates' knowledge of the problems associated with the appraisal of foreign investments while the part 'b' tests their understanding of international financial markets and their associated risks.

Almost all the candidates attempted the question but most of them did not have clear and accurate understanding of part 'b' while some performed well in part 'a' which carries a lower mark hence performance was generally poor.

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

Candidates are advised to always cover the syllabus adequately and give considerations to all sections of the syllabus in their preparations for the Institute's examinations. They should also improve their knowledge on International Financial Management.

QUESTION 5

(a) A foreign exchange market is where the currency of one country is exchanged for the currency of another country.

(b) Participants in the foreign exchange market include

(i) Arbitrageurs

They are foreign market operators who seek to earn risk-less profits by taking advantage of differences in exchange rates among countries. They buy currencies that are underpriced at one centre and simultaneously sell the same set of currencies at the centres where they are overpriced thereby making risk free arbitrage profit.

(ii) Traders

These operate in the market to hedge their risk. They engage in the export or import of goods to a number of countries. Exporters receive foreign currencies which they have to convert into local currencies while importers make payments in foreign currencies by exchanging the local currency for foreign currency. They also operate in the foreign exchange market to hedge their risk.

(iii) Hedgers

These are multinational firms. They have their operations in a number of countries and their assets and liabilities are designated in foreign currencies. Since the foreign rates fluctuations can cause diminution in the home currency value of their assets and liabilities, they operate in the market as hedgers to protect themselves against the risk of fluctuations' in the foreign exchange rates.

(iv) Speculators

These people are guided by profit motive. They trade in foreign currencies to benefit from the exchange rate fluctuations. They take risks in the hope of making profits by buying a particular currency when the price is low in anticipation of selling the same when the price is higher.

(c) (i) Raising equity from a third country
(ii) Retention of earnings (Retained earnings)
(iii) Fronting Loans
(iv) Raising equity from home country
(v) Borrowing from a third country/issuing of bonds by, for example:

- Eurocurrency Loans
- Eurobonds
- Foreign Bonds
- Depositary Receipts

(d) Features of an efficient Foreign Exchange Management include
(i) Making adequate plans for foreign exchange needs of the organization
(ii) Invest export proceeds received in foreign currency e.g. on interest bearing domiciliary accounts until the funds are required.
(iii) Determining the appropriate timing of the purchase or sale of foreign exchange so as to minimize losses due to exchange rate fluctuation
(iv) Managing foreign exchange risk
(v) Controlling the usage of foreign currency received

(e) Factors affecting fluctuations in exchange rates include
(i) Supply and demand for foreign currency
(ii) Global inflation rate and its effect on domestic rate of inflation
(iii) Local economics conditions including local production of goods for export and local interest rate
(iv) Political environment at home and abroad

(v) International confidence in the local currency
(vi) Expectation in relation to movement in local and foreign exchange rates
(vii) Interest rate
(viii) Speculative activity
(ix) Supply and demand for local currency

EXAMINERS' REPORT

Part 'a' of the question tests candidates' knowledge of the problems associated with the appraisal of foreign investment while the part 'b' tests their understanding of international financial markets and their associated risks.

Almost all the candidates attempted the question but most of them did not have a clear and accurate understanding of part 'b' while some performed well in part 'a' which carries a lower mark hence performance was generally poor.

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

Candidates are advised to always cover the syllabus adequately and give considerations to all sections of the syllabus in their preparations for the Institutes examinations. They should also improve their knowledge on International Financial Management.

QUESTION 6

(a) KONDO KONCEPTS LTD

(i) Borrow and Buy Option

Schedule of Loan Repayment

Year	Schedule of Loan at the Beginning of the year	Loan Installment	Interest on loan	Principal Repayment	Principal Outstanding at the end of a year
	₦	₦	₦	₦	₦
1	2,400,000	617,125	336,000	281,125	2,118,875
2	2,118,875	617,125	296,643	320,482	1,798,393
3	1,798.393	617,125	251,775	365,350	1,433,043
4	1,433,043	617,125	200,626	416,499	1,016,544
5	1,016,544	617,125	142,316	474,809	541,735
6	541,735	617,125	75,843	541,282	-

Computation of the applicable cost of capital or Discount Factor (DF) = 14% (1-0.30) = 0.098

DF (after tax) = 9.8%

Present Value (PV) of after tax cashflows.

Year	Loan Installment	Tax advantage	Tax advantage on Depreciation	Net cashflow	DF (9.8%) after tax	PV
	₦	₦	₦	₦	₦	₦
1	(617,125)	100,800	-	(516,325)	0.9107	(470,217.18)
2	(617,125)	88,993	108,000	(420,132)	0.8295	(348,499.49)
3	(617,125)	75,553	108,000	(433,572)	0.7555	(327,563.65)
4	(617,125)	60,188	108,000	(448,937)	0.6880	(308,868.66)
5	(617,125)	42,695	108,000	(466,436)	0.6266	(292,265.04)
6	(617,125)	22,753	108,000	(486,372)	0.5707	277,572.50)
7	-	-	-	240,000	0.5707	136,968
8			108,000	108,000	0.5198	56,138.40
	PV of cost of Buy option					1,831,880.11

Year	Lease Payment	Tax savings	Cash flow after tax	DF (9.8%) after tax	PV
	₦	₦	₦	₦	₦
0	540,000	0	540,000	1.000	(540,000)
1-5	540,000	162,000	378,000	3.8103	(1,440,293)
6	0	162,000	162,000	0.5707	92,453.4
	PV of Lease payment (cost)				(1,887,839.6)

(ii) Lease Option

(b) Comment:

Since the present value of lease option is higher than that of borrowing to buy, Kondo Koncepts Ltd Finance Director is advised to choose the buy option to finance the project.

EXAMINERS' REPORT

The question tests candidates' appreciation of accounting and tax management and analysis of lease/buy and borrow in taking financial decisions.

The level of attempt was average. Most of the candidates that attempted the question did not have clear understanding of the question hence performance was poor.

Candidates' commonest pitfalls were their

- inability to calculate the after tax cost of capital thereby using wrong discount factor in their analysis
- failure to recognize the tax advantage of interest payable on loan and depreciation in the borrow and buy option.
- failure to calculate the interest payable on the anticipated loan which could only be highlighted through the preparation of a schedule of loan repayment.

Candidates are advised to adequately cover the syllabus and make use of the Institute's Pathfinder and study packs in their preparation for the Institute's examinations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II - NOVEMBER 2012
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. A capital loss on disposal of any asset is .... from capital gains on disposal of any other asset.

   A. Not assessable
   B. Assessable
   C. Not deductible
   D. Deductible
   E. Not chargeable

2. The following are Instruments that attract Fixed Duties under the Stamp Duties Act CAP S8 LFN 2004, **EXCEPT**

   A. Bank notes
   B. Life insurance policy
   C. Non-life insurance policy
   D. Debenture Trust Deed
   E. Deed of Assignment

3. The value of Imported Vatable Goods is deemed to include the following **EXCEPT**

   A. The price of the goods imported
   B. Taxes levied for importation into Nigeria
   C. Duties levied for importation into Nigeria
   D. Penalty incurred for clearing
   E. Commission paid to Clearing Agents

4. All assets bought second hand and are Qualifying Capital Expenditure attract initial allowances **EXCEPT**

   A. Motor Vehicles
   B. Furniture
   C. Fittings
   D. Buildings
   E. Equipment

5. False claims by a taxpayer, for allowances and reliefs in Personal Income Tax computation, is considered an act of Tax.................................

   A. Evasion
   B. Avoidance
   C. Planning
   D. Reduction
   E. Administration

6. Withholding tax suffered on .... by non-residents is **NOT** regarded as Final tax.

   A. Dividend
   B. Contracts
   C. Interest
   D. Rent
   E. Royalties

7. The gravity and quality of the Crude Oil exported by a Company determine the

   A. Volume and velocity
   B. Quantity in barrels
   C. Posted price
   D. Price
   E. Quantity sold

8. Which of the following is applicable to a reconstituted Company under the Nigerian tax laws?

   A. Commencement rule
   B. Cessation rule
   C. Initial allowance
   D. Annual allowance
   E. Unutilised Capital allowances

9. Application for issue of Pioneer Certificate shall not be considered unless the Qualifying Capital Expenditure to be incurred by a Non-indigenously controlled company is

A. Not less than ₦50,000.00
B. Not more than ₦50,000.00
C. Not less than ₦150,000.00
D. Not more than ₦150,000.00
E. Between ₦50,000.00 and ₦150,000.00

10. The time limit for raising a valid Notice of Objection after receipt of Notice of Assessment is .... days

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

11. A Company is resident in Nigeria, if it

A. is trading in Nigeria
B. is incorporated in Nigeria
C. is operating in Nigeria
D. has branches in Nigeria
E. has a head office in Nigeria

12. The Turnover Basis of Assessment applies when

A. The turnover is over ₦500,000.00
B. The turnover is higher than the Assessable profit
C. The business is in its first four years of operation
D. There is imported equity capital
E. The business produces nil Assessable Profit

13. The amount which shall not exceed the Capital Allowance previously claimed on the Qualifying Capital Expenditure, prior to disposal, is known as

A. Annual allowance
B. Initial allowance
C. Investment allowance
D. Balancing allowance
E. Balancing charge

14. In accordance with Petroleum Profits Tax Cap P13 LFN 2004, any write-back of a previous Provision for Bad debts is deemed

A. Non-allowable
B. Allowable
C. Taxable
D. Non-taxable
E. Adjustable

15. The relevant tax authority for a/an............................ is the State in which the deceased was resident prior to the date of death.

A. Trust
B. Executor
C. Deceased
D. Survivor
E. Next-of-kin

16. The administration of the Tertiary Education Trust Fund is vested in the

A. Federal Inland Revenue Service
B. Board of Trustees of the Tertiary Education Tax Trust Fund
C. Joint Tax Board
D. Federal Ministry of Finance
E. Federal Ministry of Education

17. The Companies Income Tax Act Cap C21 LFN 2004 recognises Companies whose Turnover do not exceed ₦1,000,000 per annum as

A. Airline
B. Special
C. Medium
D. Small
E. Standard

18. At the end of the Pioneer Status, a trade or business carried on by a Pioneer Company shall be deemed to have

A. Expanded
B. Commenced
C. Disposed
D. Stabilised
E. Ceased

19. Which of the following is zero-rated under the Value Added Tax Act CAP V1, LFN 2004?

    A. Basic food items
    B. Baby products
    C. Books and Educational materials
    D. Non-oil exports
    E. Medical and Pharmaceutical products

20. Where Qualifying Capital Expenditure is acquired on hire purchase terms, the Interest element is treated as

    A. Part of the principal portion for Capital allowance computation
    B. Borrowing cost of the asset
    C. Allowable expenses for tax purposes
    D. Investment allowance
    E. Balancing allowances

PART II: SHORT-ANSWER QUESTIONS (20 MARKS)

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

1. List the **TWO** types of Tax Audit.

2. Gratuities paid to employees on retirement both in the Public and Private Sectors are not subject to............................Tax

3. Under the Petroleum Profits Tax Act CAP P13 LFN 2004, Tertiary Education Tax is calculated as................................ of Assessable Profit.

4. State any **TWO** classes of Qualifying Capital Expenditure under the Petroleum Profits Tax Act CAP P13 LFN 2004.

5. State any **TWO** Services exempted from payment of Value Added Tax.

6. The "All Praise Assembly Church", built a block of luxury apartments in the highbrow Lekki axis of Lagos, partly to house its Pastors and to generate more revenue from rental income for maintenance of the Church. The rental income so generated is subject to........................ withholding tax (WHT)

7. Interest on a loan granted by a Bank to an organisation engaged in purely export activities, with repayment period in excess of seven years, and a moratorium of not less than two years, is subject to tax at ....

8. Ajanaku Nigeria Limited is a Company that earned foreign income that is neither from a Commonwealth Country or the Republic of Ireland when the Commonwealth rate of Tax and the Nigerian Tax rate were 50% and 30% respectively. What is the relief available with respect to rate of tax?

9. The grant of authority to search for crude Oil under the Petroleum Profits Tax Act P13 LFN 2004 is known as.....................................

10. The gains arising from the disposal of a personal dwelling house is not subject to...........................

11. State any **TWO** instruments/transactions that are exempted from the payment of Stamp Duties.

12. Persons liable to pay the tax on income from Settlements, Trusts and Estates, include the Beneficiaries, the Settlers and the....................................

13. Pensions Reform Act 2004 requires employers of labour with minimum of......................employees in the private sector to register their employees for pension.

14. A Company which is yet to commence business after...................................of incorporation shall for each year it obtains a Tax Clearance Certificate pay pre-operation levy.

15. What is the Tax Incentive available to a 100% Export-oriented undertaking located within/outside an Export Free Zone?

16. A vatable entity that fails to collect .... is liable to pay as penalty 150% of the amount not collected, plus ....interest above the Central Bank of Nigeria Rediscount Rate.

17. State any **TWO** of the main sources of Income of a company engaged in Petroleum production.

18. Gains arising from the disposal of Nigeria Treasury Bonds are not subject to..............................

19. What is the penalty for the late filing of tax returns imposed by the Federal Inland Revenue Service on a defaulting company under Section 41 of Companies Income Tax Act Cap C21 LFN 2004, as amended?

20. What proportion of Tertiary Education Trust Fund is allocated to the funding of secondary education in Nigeria?

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

QUESTION 1

CASE STUDY

CONVERSION OF ABIA, BIODUN, CLEMENT & CO TO ABC CONSULTANTS LIMITED

Abia, Biodun and Clement based in Makurdi in Benue State, have run the firm Abia, Biodun, Clement and Company as builders for several years. The Partnership Agreement provided for the following:

(i.) Salaries paid to Partners:

	₦
Abia	120,000
Biodun	240,000
Clement	480,000

(ii.) Profit sharing ratio:

Abia	$^{1}/_{5}$
Biodun	$^{3}/_{10}$
Clement	$^{1}/_{2}$

In January 2010, there was a decision to review the Partnership Agreement. Messrs Abia, Biodun and Clement have been unable to find worthy successors to take over as Partners. Rather than review the Partnership Agreement, they agreed to convert the Partnership into a Limited Liability Company. In view of this, a firm of Chartered Accountants was contacted to incorporate the name ABC Consultants Limited.

The Authorised share capital of the proposed Company was agreed at ₦10,000,000 made up of 10,000,000 ordinary shares of ₦1.00 each. The details of the Shareholding structure was agreed as follows:

Abia	20%
Biodun	30%
Clement	50%

The Certificate of Incorporation was approved by the Registrar-General of the Corporate Affairs Commission, Abuja on 1 August 2010. The Certificate of Incorporation was dated 10 August 2010. The Company commenced business on 1 October 2010.

The Cost of Incorporation include:	₦
Payment for Stamp Duty	80,000
Professional fee for Incorporation	50,000
Corporate Affairs Commission registration fees	100,000
Additional costs of Incorporation	40,000
	270,000

The financial results for the year ended 31 December 2010 are as follows:

	₦	₦	₦
Income			4,000,000
Less :			
Cost of Incorporation		270,000	
Transport and travelling		135,000	
Medical		120,000	
Hotel and accommodation		125,000	
Audit and accountancy		110,000	
Postages and telephone		150,000	
Salaries:			
Abia	120,000		
Biodun	240,000		
Clement	480,000	840,000	1,750,000
Net Profit			2,250,000

Assume: Fees and expenses were earned/incurred evenly throughout the year.

You are required to write a report to Messrs Abia, Biodun & Clement, highlighting:

(a) State any **ONE** tax implication of the decision to convert to a Limited Liability company, limiting yourself to the facts/details provided in the Case Study. (1 Mark)

(b) Your comment on the breakdown of the Cost of Incorporation of ₦270,000 and the tax Implication of **EACH** item. (2 Marks)

(c) Your computation of the tax liabilities for the relevant assessment year. (12 Marks)

(Total 15 Marks)

QUESTION 2

The Accounts of Resource Content Plc, a petroleum exploration company, for the year ended 31 December 2009, revealed the following:

(a) Crude oil exported 2,000,000 barrels.
(b) Crude oil disposed of locally @ ₦70 per barrel, 1,000,000 barrels.
(c) Exploration costs: ₦22,500,000.
(d) Management and Administration Expenses: ₦190,625,000.
(e) Incidental Income from Petroleum Operations: ₦31,250,000.
(f) Provision for Bad debts - Specific ₦21,875,500
  - General ₦17,500,000
(g) Non-Productive Rents: ₦15,625,000
(h) Depreciation: ₦10 million
(i) Qualifying Capital Expenditure are as follows:
  - Plant & Machinery acquired July 2007 and located in Territorial waters of 80 metres water depth - ₦75 million
  - Fixtures & Fittings acquired July 2007 and also located in Territorial waters of 80 metres water depth ₦25 million
  - Pipeline & Storage Tanks acquired February 2009, located in Continental Shelf of 180 metres water depth ₦50 million

  - Buildings acquired in February 2008 and located onshore ₦450 million
  There was no loss brought forward.

You are required to:

Compute the Assessable Profit, Chargeable Profit, Assessable tax, Chargeable Tax and the Tertiary Education Tax Liability of Resource Content Plc, for the year, assuming that the International Market Price of Crude Oil during the year was USD $60 per barrel, at an exchange rate of USD $1 : ₦150. **(Total 15 Marks)**

QUESTION 3

The Nigerian government usually grants reliefs to Investors, to encourage them to shift focus to less fascinating or capital intensive industries by granting incentives such as tax holidays, Duty free, etc to attract Investors into the Export Processing Zone (EPZ), thereby improving the standard of living of her citizens.

Required:

(a) i. What is the tax relief granted to an export-oriented company, inside or outside on Export Processing Zone in Nigeria? (2 Marks)

ii. State **FIVE** associated conditions for the grant of the Relief (9 Marks)

(b) What are the tax reliefs granted to a manufacturing company whose products are approved by Government and established inside an Export Processing Zone in Nigeria? (4 Marks)

(Total 15 Marks)

QUESTION 4

Compass Holding Company (CHC) is essentially a Holding entity that was only engaged in the Treasury and Finance operations of its four Subsidiaries in Logus State of Nigeria.

The following are extracts from its books of accounts in respect of the year ended 31 December 2011:

	₦'000
Net Profit per accounts	107,000
Depreciation	18,500
Balancing charge	5,200
Donations	12,500
Capital Allowances (unrestricted)	22,300
Diminution in value of Investments	25,000
Profit on Export Sales	5,200
Loss Relief	15,200
Bad debt provision	32,000

Additional notes:

i. Income from sale of assets included in the Holding Company's results for the year amounted to ₦60million.
ii. Dividend income (Net of Withholding Tax) from subsidiaries included in the Holding Company's account amounted to ₦105million.
iii. Dividend proposed to shareholders of Compass Holding Company for the year was ₦165million.

As the Tax Consultant to the Board of CHC, you are required to advise on the following:

(a) The tax implications of the dividend proposed by the Board. (9 Marks)

(b) The tax liability of the company for the relevant assessment year. (6 Marks)

(Total 15 Marks)

QUESTION 5

Glenkeny General Insurance Limited is engaged in General Insurance Business and disclosed the following results from its operations during the year ended 31 December 2010.

Statement of Financial Position as at 31 December 2010

	₦'000	₦'000
Cash and cash equivalent		315,300
Short-term Investment		1,651,540
Long-term Investment		1,181,310
Investment in Properties		1,117,205
Debtors and Prepayments		136,400
Premium Debtors	126,415	
Provision for Premium debtors	(82,500)	43,915
Statutory Deposit		300,000
Fixed Assets – Cost	226,500	
- Depreciation	(98,250)	128,250
		4,873,920
Creditors and accruals	22,120	
Taxation	82,500	
Insurance Fund	310,325	(414,945)
		4,458,975
Share Capital (6,000,000,000 Ordinary Share of ₦0.50 each		3,000,000
Share Premium		120,000
Contingency Reserve		717,345
Asset Revenue Reserve		410,000
Retained earnings		211,630
		4,458,975

Profit or Loss Account for the year ended 31 December 2010

	₦'000	₦'000
Gross Premium Income		4,125,116
Unexpired Risks		(625,025)
		3,500,091
Reinsurance Costs		(841,524)
		2,658,567
Commission received		231,419

		2,889,986
Less: Claims incurred	1,891,231	
- Acquisition costs	618,767	
- Maintenance expenses	205,116	(2,715,114)
		174,872
Investment Income		315,016
		489,888
Management expenses		(305,865)
Profit before taxation		184,023

The following additional information is provided:

i. Included in the Management expenses, is provision for the Nigerian Information Technology Development Levy.

ii Capital allowances for the year, agreed with the tax authority was ₦94.3 million.

iii. A building, included in Investment Property at a market valuation of ₦250 million was sold for ₦300 million in October 2010. The building was acquired in 2006 for ₦125 million. The sum of ₦50 million was recognised in Investment income as profit on disposal.

iv. General provision of ₦26.4 million was included in Management expenses as provision for doubtful debts on Premium debtors, in line with regulatory requirement.

v. Investment income on Government Bond of ₦75 million was received gross.

vi. Accumulated depreciation on Fixed assets was made up of:

	₦
Balance at 1 January	60,673,000
Charge for the year	37,577,000
Balance at 31 December	98,250,000

vii. Dividend of ₦0.02 per share was declared and paid during the year.

You are required to compute:

(a) The tax Liability for the relevant tax year. (10 Marks)

(b) Nigerian Information Technology Development (NITD) Levy. (1 Mark)

(c) Capital Gains Tax (2 Marks)

(d) Total tax liability for the relevant tax year (2 Marks)

(Total 15 Marks)

QUESTION 6

Tokisoki Nigeria Limited was granted Pioneer Status with Production Day as 1 April 2001. At the expiration of its initial Pioneer period, the Company did not apply for extension. The Company has been making up its accounts to 31 March of every year.

You are given the results below:

Year ended	₦
31 March 2005	15,000,000
31 March 2006	17,000,000
31 March 2007	18,000,000
31 March 2008	24,000,000
31 March 2009	30,000,000

Required:

(a) i. Compute the Assessable Profits for the relevant Years of Assessment. (7 Marks)

ii. What is the Tax Holiday available to a Pioneer Company under the Industrial Development (Income Tax Relief) Act? (2 Marks)

iii. What is the Tax Holiday for Tokisoki Nigeria Limited in a(i) above? (2 Marks)

(b) Describe **FOUR** circumstances under which a Pioneer Certificate issued to a Company can be revoked. (4 Marks)

(Total 15 Marks)

NIGERIAN TAX RATES

1. **CAPITAL ALLOWANCES**

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

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

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

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

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

4. COMPANIES INCOME TAX RATE 30%

5. EDUCATION TAX (2% of Assessable Profit)

6. CAPITAL GAINS TAX 10%

7. VALUE ADDED TAX 5%

SOLUTIONS TO SECTION A

PART I MULTIPLE-CHOICE QUESTIONS

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

EXAMINERS' REPORT

The questions adequately covered the entire syllabus. Candidates' performance was generally above average.

PART II SHORT-ANSWER QUESTIONS

1. Desk, Field
2. Personal Income
3. 2/102

4. i Plant ii Pipeline iii Storage Tanks
   iv Building other than Pipeline, v Storage
   vi Drilling third and subsequent appraisal wells

5. i Medical Services
   ii Services Rendered by Micro Finance Banks
   iii Services Rendered by Mortgage Institutions
   iv Plays and Performances by Educational Institutions
   v All Exported Services
   vi Interest on Loans and Advances
   vii Insurance Premium

6. 10%

7. Zero /Nil Percent (0%)

8. Half of Nigerian Rate of Tax

9. Oil Prospecting Licence

10. Capital Gains Tax

11. i Treaties
    ii Liquidation Sales/Transactions
    iii Company Reconstruction/Amalgamation
    iv Receipts for Government Levies and Taxes
    v Instruments of Penal Rent
    vi Transfer of Shares (TCC Required)
    vii Shipping Agreement
    viii Documents from Ministries and Parastatals

12. Trustee

13. Five (5) Employees

14. Six (6) Months

15. Tax Incentive for Export Promotion

16. VAT, 5%

17. i Crude Oil Sales
    ii Natural Gas Sales
    iii Hydrocarbon Sales
    iv Spirit /Petroleum Products Sales

18. Capital Gains Tax

19. ₦25,000 for the First Month
    ₦5,000 Per Month thereafter when the default continues.

20. Nil

EXAMINERS' REPORT

The questions covered the syllabus. All the candidates attempted over 90% of the questions, and most of them scored above average marks.

SOLUTIONS TO SECTION B

QUESTION 1

The Directors,
ABC Consultants Limited

Dear Sirs,

CONVERSION OF ABIA, BIODUN, CLEMENT & (PARTNERSHIP) TO ABC CONSULTANTS LIMITED

We write in response to your recent decision to convert your Partnership business into a Limited liability Company.

Please find below our submissions:-

(1) TAX IMPLICATIONS OF CONVERSION

(a)

- The Partnership ceases on 30th September 2010 and so all Partnership income shall be based on Personal Income Tax.

- Commencement rules will apply from 1st October 2010 when ABC Consultants Limited commences operation.

- The Incorporation expenses shall be applicable only to ABC Consultants Limited though not an allowable expense for tax purposes.

- ABC Consultants Limited will be required to register with the Federal Inland Revenue Services for VAT and CIT etc.

- ABC Consultants Limited in accepting the Incorporation expense, shall deduct and remit with-holding tax from the Professional fees at the rate of 10% if the beneficiary is a Company and 5% if the recipient is an individual partnership or incorporated entity.

(b) **TAX IMPLICATION OF COST OF INCORPORATION**

- The total cost of ₦270,000 though paid during the Partnership period, shall be considered as Pre-operational expenses of ABC Consultants Limited.

- The Pre-operational expenses when added back, will increase taxable Income, thereby increasing Tax payable by ABC Consulting Ltd

- ₦270,000, charged into ABC Consultants Limited is not an allowable expense for tax purpose even if spread over a period of years.

c(i)

ABC CONSULTANTS LIMITED
TAX COMPUTATION FOR 3 MONTHS TO 31-12 2010
2010 ASSESSMENT YEAR

	₦	₦
Profit from Accounts (see below)		360,000
Add back Incorporation Expenses		270,000
Assessable Profit		630,000
No Capital Allowances		
Tax Liability		
30% (Income Tax)	189,000	
2% (Education Tax)	12,600	
Tax Liability	201,600	

c(ii)

REVISED NET PROFIT

	PARTNERSHIP ACCOUNTS	ABC CONSULTING LIMITED	TOTAL
	₦	₦	₦
Income	3,000,000	1,000,000	4,000,000
Less: Expenses	(480,000)	(160,000)	(640,000)
Cost of Incorporation	——	(270,000)	(270,000)
Salaries	(630,000)	(210,000)	(840,000)
	1,890,000	360,000	2,250,000

COMPUTATION OF INCOME DISTRIBUTION IN PARTNERSHIP
2010 ASSESSMENT YEAR

	₦
Income from Partnership	1,890,000
Add back salaries	630,000
	2,520,000

	Salaries	Share of Profits	Total	
Distribution:	₦	₦	₦	
Abia	90,000	378,000	468,000	
Biodun	180,000	567,000	747,000	
Clement	360,000	945,000	1,305,000	
	630,000	1,890,000	2,520,000	NIL

COMPUTATION OF TAX LIABILITY – PARTNERSHIP
2010 ASSESSMENT YEAR

	Abia	Biodun	Clement
	₦	₦	₦
Income from Partnership	468,000	747,000	1,305,000
Others: Salaries	30,000	60,000	120,000
	498,000	807,000	1,425,000
Less: Personal Allowance	104,600	166,400	290,000
	393,400	640,600	1,135,000
TAX LIABILITY FOR 2010			
First ₦160,000 (W1)	22,000	22,000	22,000
Balance	58,350	120,150	243,750
TOTAL TAX LIABILITY (W_2)	80,350	142,150	265,750

COMPUTATION OF TAX LIABILITY
FIRST ₦160,000 FOR ABIA, BIODUN AND CLEMENT

W1	₦
1 ₦30,000 @ 5%	1,500
Next ₦30,000 @ 10%	3,000
1 ₦50,000 @ 15%	7,500
Next ₦50,000 @ 20%	10,000
	22,000

W2	₦
Abia ₦233,400 @ 25%	58,350
Abiodun ₦480,600 @ 25%	120,150
Clement ₦975,000 @ 25%	243,750

Please note that the Personal Allowance used is for 2010 and not the Consolidated Relief Allowance introduced in 2011 PITAM

EXAMINERS' REPORT

The question was designed to test candidates' knowledge and understanding of the tax implications of converting a partnership business into a Limited Liability Company.

All the candidates attempted the question but performance was below average. Candidates displayed poor understanding of the requirements of the question. They had difficulty apportioning Income/Expenses between the Partnership business and the Limited Liability Company. Some candidates could not correctly identify the relevant assessment year.

Candidates are expected, at this level, to be more diligent when analyzing the requirements of a question.

QUESTION 2

RESOURCES CONTENT PLC
COMPUTATIONS OF PETROLEUM PROFITS TAX
YEAR 2009

	₦'000	₦'000
INCOME		
Crude Oil Exported		
(2,000,000 x ₦150 x $60)	18,000,000	
Local Sales of Crude Oil(₦70 @ 1,000,000)	70,000	
		18,070,000

Add: Incidental Income		31,250
		18,101,250
Less: Allowable Expenses		
Exploration Cost	22,500	
Management Expenses	190,625	
Specific Provision for Bad Debts	21,876	
Non-Productive Rent	15,625	
		(250,626)
Profit before Education tax		17,850,624
Less: Education Tax (102 x 17850624)		(350,012)
Assessable Profit		17,500,612
Less: Capital Allowances:		
Capital allowance for the year (w1)	120,000	
Petroleum Investment Allowance (PIA) (w2)	7,500	
	127,500	
85% of Assessable Profits	14,875,520	
Less 170% of PIA	(12,750)	
	14,862,770	
Capital allowance claim		(127,500)
Chargeable Profits		17,373,112
PPI @ 85%		
		14,767,145

	₦'000
Education Tax	350,012
PPI	14,767,145
Total tax liability	15,117,157

Computation of Capital Allowance

Assets	Year of Acquisition	₦'000	Rate	C/Allowance ₦'000	Investment Allowance Between 100m to 200m @ 15%
Pipeline and Storage Tank	2009	50,000	20%	10,000	7,500
Building	2008	450,000	20%	90,000	
Plant and Machinery	2007	25,000	20%	5,000	
Furniture's & Fittings	2007	75,000	20%	15,000	
Total		600,000	0.80	120,000	7,500

EXAMINER'S REPORT

The question tests computation of the tax liability of a company in the Petroleum industry. Most candidates attempted the question and performance was average. Candidates displayed inadequate knowledge of the allowable expenses and the basis for computing the Tertiary Education tax which is to be derived before arriving at assessable profit.

Candidates are advised to be more careful when answering questions of this nature.

QUESTION 3

(a)i The Profits or Gains of an export oriented company located inside or outside an Export Processing Zone, are fully exempted from Company Income Tax for the first three (3) consecutive Assessment years, on condition that :

(ii) The associated conditions include:

- The company is 100% Export oriented.
- The company produces or Manufactures and Exports during the relevant year, and the Export proceeds during the year is not less than 75% of Total Turnover for the year.
- The company is using brand new plant and machinery, but if using plant and machinery previously used, the cost of acquisition should not exceed 25% of the total value of the plant and machinery in the books.
- The company is newly incorporated, that is, it did not result from a break-up or the reconstruction of an already existing business.
- The company repatriates at least 75% of earnings from its exports back to Nigeria, and deposits same in a Domiciliary Account maintained in a bank in Nigeria.

(b) The company shall be granted 100% Capital Allowance on buildings and Equipment in any year of assessment.

This Incentive which remains so long as the company's products are approved by Government and does **NOT** cover motor vehicles, furniture and fixtures.

The Company is also not entitled to the 10% Investment Allowance normally granted for Qualifying Capital Expenditure on plant and machinery.

All companies engaged in Government approved activities within an Export processing Zone are exempted from Federal, States and Local Government Taxes-including Rates and Levies, with no time limit.

EXAMINERS' REPORT

The question examines the nature of incentives to Export-Oriented Manufacturing Companies operating within or outside designated Export Processing Zones in Nigeria, as well as the conditions for granting such reliefs.

Only a few candidates attempted the question, and their performance reflected poor understanding of the question. A number of candidates misunderstood the question for a Pioneer status question.

Candidates are advised to familiarise themselves with relevant tax rules.

QUESTION 4

(a) The Chairman,
Board of Directors,
Compass Holding Company,
10, Compass Lane,
Lagos.

Date:....................

Dear Sir,

TAX IMPLICATIONS OF PROPOSED DIVIDEND

We acknowledge receipt of your letter reference CHC/Z1811V/08/2012 in respect of the above subject matter.

We have gone through the content of your letter, and our comments are as follows:

(1) On the tax implications of the dividend proposed, there is a provision in the Companies Income Tax Act (CITA) section 19, which stipulates in respect of a Nigerian Company that:

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

i. No Total profits or
ii. Total Profits which are less than the amount of the Dividend which is paid, whether or not the recipient of the Dividend is a Nigerian Company;

The company paying the dividend shall be charged to tax at the rate prescribed in sub-section (1) of section 40 of the Act (i.e 30%) as if the dividend is the total profit, of the company for the year of assessment to which the accounts relate, outs of which the dividend is declared.

(2) Based on the above provision, it is evident that the dividend proposed (₦165,000,000) is more than the total profit (NIL). It would appear that what is being proposed is the dividend income of ₦105,000,000 and the income from sale of assets of ₦60,000,000.

(3) However, there is a provision of the Act (CITA) section 80(3) which stipulates that dividend income from subsidiaries of a Holding company (net of Withholding Tax), is regarded as Franked Investment Income and therefore regarded as Final Tax.

(4) Based on point B above, the dividend income (₦105,000,000) is not to be taxed.

(5) The balance of ₦60,000,000 representing the proceeds from sale of assets is already included in the Income of the Holding Company and at the time of redistribution of the dividends to Compass Holding shareholders, the dividends would not be subjected to further tax.

(6) Compass Holding Company therefore is expected to gross-up the dividends from its subsidiaries and offset the Withholding Tax suffered at source against the Withholding Tax deductible on distribution to the shareholders.

From the explanations above, it would appear that the Inland Revenue office would expect the ₦60,000,000 to be taxed at 30% i.e ₦18,000,000 together with the Education Tax of ₦496,000.

In our opinion, the only tax payable is the Education Tax of ₦496,000. Should you require further clarification on any of the issues highlighted above, please do not hesitate to contact us.

We seize this opportunity to thank you for your patronage.

Yours faithfully,

XYY & CO
Tax Consultants

(b) **COMPASS HOLDING COMPANY (CHC)**
COMPUTATION OF TAX LIABILITY FOR 2012 TAX YEAR

	₦'000	₦'000
Net Profit per Accounts		107,000
Add Back:		
Depreciation	18,500	
Donations	12,500	
Diminution in investment	25,000	
Bad debt provision	32,000	88,000
		195,000
Less:		
Profit on Export sales	5,200	
Income from sales of Assets	60,000	
Dividend treated as franked investment Income	105,000	170,200
Assessable Profit		24,800
Education Tax @ 2%	496,000	
Add: Balancing charge		5,200
		30,000
Less: Loss Relief		15,200
		14,800
Less: Capital allowance	22,300	
Limited to 2/3 of ₦24,800	16,533	
Absorbed		(14,800)
Total Profit		NIL
Capital allowance carried forward	10,000	
Tax payable		NIL
Education Tax Payable		496,000

EXAMINERS' REPORT

The question tests candidates' understanding of the tax Implications of a Holding Company generating income from subsidiaries and at the same time paying out dividends where no Profits exist.

A fair number of candidates attempted the question. Performance was poor in part (a) whilst it was about average in part (b). At this level of the Professional Examinations, candidates should be able to present an answer in a proper Report Format. Only a handful of candidates understood the tax implications of paying dividends out of no profits.

Candidates are advised to be more thorough in their preparations.

QUESTION 5

GLENKENY GENERAL INSURANCE LIMITED
COMPUTATION OF TAX LIABILITY FOR 2011 TAX YEAR

	₦'000	₦'000
Profit before taxation		184,023
Add disallowable expenses:		
Provisions for doubtful debts	26,400	
Depreciation	37,577	63,977
		248,000
Less: non-taxable Income:		
Profit on disposal of buildings	50,000	
Interest on Government Bond	75,000	(125,000)
Assessable profits		123,000
Capital allowance	94,300	
Restricted to ($66^{2}/_{3}$ % x ₦123,000)	(82,000)	(82,000)
Unutilised Capital allowance c/f	12,300	
Total profit		41,000
Income tax thereon @ 30%		12,300
Education tax @ (2% of ₦123,000)		2,460

Alternative minimum tax: In accordance with section 19(b) of CITA, which **stipulates that "** Total profits which are less than the amount of Dividend which is paid whether or not the recipient of the dividend is a Nigerian company, is paid by a Nigerian Company , the company paying the dividend shall be charged to tax at the rate prescribed in section 40(1) as if the dividend is the total profits of the company, for the year of assessment to which the accounts relate.

Hence dividend declared	₦'000
0.02 x ₦6,000,000,000 =	120,000

Since ₦120 million is greater than total profit in the tax computations,(₦41 million) then, the tax liability is ₦120,000,000 x 30% = ₦36 million.

(ii) Nigerian Information Technology Development Levy is 1% of Profit before taxation = ₦1,840,230

(iii) Computation of Capital Gains Tax

	₦'000
Sales proceeds	300,000
Less: Acquisition cost	(125,000)
Capital Gains	175,000
Capital Gains Tax @ 10%	17,500

(iv) **Total tax liabilities for 2011 Tax year**

	₦'000
Company Income Tax	36,000
Education Tax	2,460
Capital Gain Tax	17,500
Nigerian Information Technology Development levy	1,840
	57,800

EXAMINERS' REPORT

The question tests Candidates' understanding of the general principles governing the computation of the Assessable Incomes/Tax Liabilities of a Company engaged in General Insurance business. It also tests candidates' ability to compute Nigerian Information Technology Development (NITD) Levy.

Candidates' understanding of the question was very scanty, resulting in very limited attempt at the question, and correspondingly poor scores.

Candidates are once again advised to allocate some quality study time, understanding the peculiarities of Specialised organizations-Insurance, Banking, Agricultural, Export-Oriented etc.

QUESTION 6

(a) (i) TOKISOKI NIGERIA LIMITED
COMPUTATION OF ASSESSABLE PROFIT FOR THE RELEVANT TAX YEARS

YOA	BASIS PERIOD	ASSESSABLE PROFIT ₦
2004	1/4/2004-31/12/2004	
	(9/12 x ₦15,000,000)	11,250,000
2005	1/4/2004-31/3/2005	15,000,000
2006	1/4/2004-31/3/2005	15,000,000
2007	1/4/2005-31/3/2006	17,000,000
2008	1/4/2006-31/3/2007	18,000,000
2009	1/4/2007-31/3/2008	24,000,000
2010	1/4/2008-31/3/2009	30,000,000

(ii) The Tax Holiday available to a Pioneer Company is an initial three years from Production day, extendable by an additional two years maximum in either two periods of one year each or one period of two years.

(iii) The Tax Holiday available to Tokisoki Nigeria Limited is 3 years commencing from 1 April 2001 to 31 March 2004.

(b) Pioneer Certificate can be cancelled under the following conditions:

i. Where the Production Day is extended for more than one year than that stated in the original application.
ii. Where the values of the Qualifying Capital Expenditure differ from the value stated in the original application.
iii. The Tax payer has applied for a cancellation in writing.
iv. Where any specific condition laid down by the Minister is not fulfilled or if the Pioneer Company has contravened any other provision of the Act or failed to fulfil any one estimate or proposal in its application for Pioneer Certificate or any condition contained in its Pioneer Certificate.

EXAMINERS' REPORT

The question tests candidates' knowledge of the general principles guiding the operations of a Pioneer Company under the Industrial Development (Income Tax Relief) Act 1971. Candidates' ability to compute correctly the Assessable profits of a Pioneer Company, given certain circumstances, was also tested.

Almost all the candidates attempted the question and majority of them demonstrated a good understanding, resulting in more-than-average scores.

A few candidates had problem determining the correct basis period, whilst some displayed lack of knowledge of the grounds for cancellation of a Pioneer Certificate. Candidates are advised to ensure they study the provisions of the various Tax Acts.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II- NOVEMBER 2012
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. Which of the following is **NOT** a member of the Economic and Financial Crimes Commission (EFCC)?

   A. The Postmaster-General, Nigerian Postal Services
   B. The Chairman, National Drug Law Enforcement Agency
   C. The Director-General, The Department of State Security Service
   D. The Director-General, The Nigerian Intelligence Agency
   E. The Director-General, Securities and Exchange Commission

2. Which of the following is **NOT** an agency saddled with the collection of revenue, in Nigeria?

   A. Nigerian Customs Service
   B. Nigerian Civil Aviation Authority
   C. Nigerian National Petroleum Corporation
   D. Department of Petroleum Resources
   E. Federal Inland Revenue Service

3. In accordance with Section 5 of the Central Bank of Nigeria Act 2007, which of the following statements is **NOT** true about the operating surplus and general reserve fund of the Bank?

   A. To establish a general reserve fund
   B. To make provision for the contribution of staff pension funds, in accordance with the Pension Reform Act 2004 and for any other purpose approved by the Board for the year
   C. To pay the balance of the operating surplus to the Federal Government half-yearly
   D. To determine the operating surplus which is the residual sum from its income and other receipts less all expenditure approved by the Board

E. To allocate, at the end of each financial year, one-half of the operating surplus for the year to itself.

4. Which of the following is dealt with by the International Public Sector Accounting Standard No.11?

A. Construction Contracts
B. Borrowing Costs
C. Leases
D. Cash Flow Statements
E. Investment Property

5. Which of the following represents the present value of a cash inflow of ₦2.873 million, at 12 per cent cost of capital, in four years' time?

A. ₦2.873 million x 4 x 12 x 10^{-2}
B. ₦2.873 million x 4
C. ₦2.873 million x $(1.12)^4$
D. ₦2.873 million x 4 x 12
E. ₦2.873 million x 4 x $(1.12)^4$

6. In conformity with Section 16 of Finance (Control and Management) Act LFN 2004, into which of the following shall monies appropriated and not expended lapse and accrue to, at the expiration of the financial year, in respect of which such monies are appropriated?

A. Lapsed Capital Development Fund
B. Special Fund
C. The Contingency Fund
D. Capital Development Fund
E. Consolidated Revenue Fund

7. Which of the following ratios **CANNOT** be used to highlight the short-term liquidity and soundness of a corporation or agency?

A. Debtors' payment period
B. Gearing ratio
C. Acid test ratio
D. Current ratio
E. Creditors' payment period

8. The power of the Revenue Mobilisation Allocation and Fiscal Commission (RMAFC), as contained in the 3rd Schedule, Part I (N) of the Constitution of the Federal Republic of Nigeria (1999), provides for the following **EXCEPT**

   A. Reviewing, from time to time, the revenue allocation formulae and principles in operation to ensure conformity with changing realities, provided that the formula has been accepted by an Act of the National Assembly for a period of not less than four years
   B. Determining the remuneration appropriate for political office holders and the holders of the offices stated in Sections 84 and 124 of the Constitution of the Federal Republic of Nigeria (1999)
   C. Monitoring the accruals to and disbursement of revenue from the Federation Account
   D. Advising the Federal and State governments on fiscal efficiency and methods by which it can be improved
   E. Discharging such other functions as delegated by the Constitution of the Federal Republic of Nigeria (1999) or any Act of the National Assembly

9. In accordance with the Public Procurement Act 2007, which of the following is **NOT** a function of the National Council on Public Procurement?

   A. Receiving and considering for approval, the audited accounts of the Bureau of Public Procurement
   B. Considering and approving policies on public procurement
   C. Approving changes in the procurement process to adapt to improvements in modern technology
   D. Appointing the Directors of the Bureau of Public Procurement
   E. Considering, approving and amending the monetary and prior review thresholds for the application of the provisions of the Act by procuring entities

10. In project analysis, the method of investment appraisal that considers the discounted cash inflows and cash outflows is known as

   A. Accounting rate of return
   B. Average rate of return
   C. Present Value
   D. Net present value
   E. Payback period

11. Which of the following finds least expression in the equality principle based on equity rather than on efficiency?

A. Even development
B. Independent revenue
C. Need
D. Population
E. Equality of States

12. Grants are

A. Statutory allocations
B. Exclusively for recurrent obligations
C. Proceeds on strategic development projects
D. Non-statutory allocations
E. Non-discretionary

13. Which of the following is **NOT** a feature of cost effectiveness analysis?

A. The achievement of maximum provision of goods and services from given quantities of resource inputs
B. Cost effectiveness is established as an objective when organisations have a given level of expenditure
C. A technique for enumerating and evaluating the total social costs and social benefits associated with an economic project
D. It is adopted when organisations are seeking to provide the maximum amount of service in a situation where service outputs cannot be valued in money terms
E. It is an analysis applicable to public projects with considerable intangible and non-marketable benefits

14. Which of the following tax system derives its logic from the principle of ability to pay?

A. Progressive tax
B. Regressive tax
C. Value-Added tax
D. Proportional tax
E. Ad valorem tax

15. By the policy measure taken by the Federal Government in 1993, the introduction of Value-Added Tax (VAT) replaced

A. Import duties
B. Customs duties
C. Sales tax
D. Purchase tax
E. Direct tax

16. The financing of government's deficits by the issue of financial securities such as treasury bills and bonds is referred to as ....financing.
A. Deficit
B. Debt
C. Stock
D. Bonds
E. Treasury

17. Rolling plans are closely intertwined with all of the following **EXCEPT**
A. Annual budgets
B. Medium-term plans
C. Perspective plans
D. Planning, Programming and Budgeting System
E. Long-term plans

18. A technique of managing debt crisis by encouraging the exchange of contractual debt liabilities against equity participation in local companies is classified as Debt

A. Conversion
B. Repudiation
C. Refinancing
D. Rescheduling
E. Repurchase

19. The process of comparing the actual results with planned or budgeted expectations and reporting on the variations is known as

A. Budget implementation and coordination
B. Budget communication
C. Budgetary forecasting
D. Budget monitoring and control
E. Budgeting process

20. A system of taxation and public expenditure in which revenue-raising powers and control over expenditure are vested in various levels of government within a nation, ranging from the Federal Government to the smallest unit of government is referred to as Fiscal

    A. Autonomy
    B. Federalism
    C. Diversity
    D. Efficiency
    E. Sovereignty

PART II: SHORT-ANSWER QUESTIONS (20 Marks)

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

1. What is the present value of ₦40million to be received by the Pace-Setters State Investment Corporation in 2 year's time at an interest rate of 20% per annum?

2. The alignment of cash inflows with cash outflows of government within a given period of time is...

3. The responsibility for monitoring and reporting on budget implementation by Budget Office, is vested on it by the................................. Act.

4. The set of linked accounts through which government transacts its financial operations in such a way that its financial position can be determined at any time is known as...

5. The centralised computer based payroll and management system, aimed at the elimination of payroll fraud, is..

6. The acquisition of goods and/or services, at the best possible total cost of ownership, in the right quantity and quality at the right time in the right place for the direct benefit or use of government, corporation or individual, generally through contract is referred to as...................................

7. A pension having terms that specify the amount of pension benefits to be provided at a future date or after a certain period of time is known as..

8. The Revenue agency that is responsible for the collection of penalties on gas flared is the....................................

9. The document communicated to Ministries, Departments and Agencies (MDAs), by the Minister of Finance giving instructions to them on how their budgets should be prepared and submitted to the Budget Office is known as……………………………………

10. Who is responsible for the audit of the books of accounts of government statutory Corporations, Commissions, Authorities and other bodies established by an Act of the National Assembly?

11. Elements of fiscal policy that serve to automatically reduce the impact of fluctuations n economic activity are called……………………………………..

12. Fluctuation in the level of economic activities in which boom and depression alternate is referred to as……………………………………

13. Fiscal Policy where the choice of policy measures, their extent and timing are entrusted to policy makers is…………………………….

14. An indirect tax which is capable of being imposed at different stages of production and distribution is known as………………………………

15. The fraction of the last naira of a person's income that is paid as tax is…………………………………

16. The group of ten leading industrial nations, whose leaders meet periodically to discuss economic policies and grant loans to needy countries, is known as…………………………

17. An increase in government expenditure of ₦20billion, financed from an increase in taxation of equal amount will increase national income by……………………………

18. Grants given by the Federal Government to correct distortions arising from differences in tax structure among States and Local Councils are…………………………

19. A tax that is levied as a proportion of the value of the object being taxed is………………………………

20. In relation to Personal Income Tax, investment income such as interest and dividend are referred to as………………………

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

QUESTION 1

CASE STUDY

LAGOON STEEL ROLLING MILL – LIQUIDITY PROBLEMS

INTRODUCTION

Individuals, agencies, extra-ministerial departments hold cash for various reasons. Apart from its facilitation of meeting day-to-day commitments, it also allows it to take care of unforeseen emergencies, which makes it to be precautionary in nature. Furthermore, ventures continue to break more fallow grounds when they hold money. This feature enables such entities to exploit profitable opportunities as and when they arise through speculative tendencies. The Steel Rolling Mill an agency of Lagoon State, had enjoyed these advantages, like commercial entities.

SLUMP IN ECONOMY AND CATASTROPHE

About two years ago, a gang of dare-devil armed robbers struck at the factory complex. They had a field day, as they held sway for over 6 hours. The factory lost large sum of cash, running into hundreds of millions of naira. They also left sorrow, tears and blood behind. To further compound the problems of the management, there was a downturn in the economy which caused financial difficulties. Decision made by other managers to liberalise credit policy in order to stimulate turnover heightened financial tension. The factory suffered poor quality of goods/services coupled with problems that arose from delayed deliveries. There was also an increase in competition among suppliers offering credit that was being abused by customers.
Ironically, when problems come, they plague the victim mercilessly to the extent of being overwhelmed. This is not all. Two years ago, the Apex Bank of the country, where Lagoon Rolling Mill is situated, came out with a new 'cashless policy.' This, further, drove a wedge into the factory's operations because they were cash-strapped.

RECOVERY PLANS

The Executive Administrator (EA) of the State felt he could no longer sit back and fold his arms. Urgent actions must be taken to salvage the mess. He commissioned his Personal Assistant (Judicial Matters) to conduct a forensic investigation into the operations of the Steel Factory and to report back within sixty days. Expectedly, the appropriate report got to the Executive Administrator's desk, on schedule.

HIGHLIGHTS CONTAINED IN THE REPORT

The overall influence of the operating cash cycle was fingered as being most neglected. The other line managers had slackened effective control over these key indices. He recalled the era before the slump in economy and catastrophe that enjoyed the following:

Indices	Number of days
Average inventories holding period	48
Average settlement period of debtors	50
Average settlement period for suppliers	120

The Personal Assistant (Judicial Matters) concluded that the time lapse between paying for the raw material inventories and receiving the cash from the customers owing must be improved to enable a significant impact on the amount of funds that the factory needs to apply as working capital. He also submitted the following financial statements summary for last year:

LAGOON STEEL ROLLING MILL

Income Statement for the year ended 2011	**₦** million	**₦** million
Sales revenue		3,280
Cost of sales:		
Opening inventories	568	
Purchases	2,272	
	2,840	
Closing inventories	**(664)**	**2,176**
Gross Profit		1,104
Administration expenses		**860**
Operating profit		244
Financial expenses		156
Profit for the year		**88**

Extract of Statement of financial position as at 2011

	₦million
Non-current assets	1,456
Current assets	
Inventories	664

	Trade receivables	1,056
	Cash	96
		1,816
Total Assets		**3,272**
	Current Liabilities	
	Trade payables	636

Note: All purchases and sales were on credit, and there has been no change in the level of trade receivables or payables over the period.

Required:

a. Identify any **SIX** of the problems that beset Lagoon Steel Rolling Mill. (6 Marks)

b. Based on the financial statements (extract), submitted by the Personal Assistant (Judicial Matters), compute the following:

i. The average inventories holding period. (1 Mark)

ii. The average settlement period for trade payables. (1 Mark)

iii. The average settlement period of trade receivables. (1 Mark)

c. Calculate the operating cash cycle for year 2011. (2 Marks)

d. Suggest how the top management of the Rolling Mill may seek to reduce the operating cash cycle in (c) above. (4 Marks)

(Total 15 Marks)

QUESTION 2

"Financing deficits has been shown to be a significant source of inflation and unsustainable indebtedness."

Required:

a. Explain deficit financing as a tool of fiscal policy. (6 Marks)

b. In what ways can deficit financing create inflation and indebtedness?

(9 Marks)

(Total 15 Marks)

QUESTION 3

The Nigerian government embarked on the privatisation of public enterprises when the state-owned enterprises could no longer justify the huge capital outlay on them.

Required:

a. State and explain Privatisation of public enterprises (3 Marks)

b. Explain any **TWO** of the ways by which enterprises have been privatised in Nigeria. (6 Marks)

c. Discuss any **TWO** of the problems encountered in the privatisation process in the country. (6 Marks)

(Total 15 Marks)

QUESTION 4

The following information was extracted from the records at the Office of the Accountant-General of the Federal Republic of Niminey for the year ended 31 December 2011:

	₦'million
Value Added Tax receipts	2,295,000
Miscellaneous revenue	375,000
Personal Income Tax (Direct Tax)	10,500,000
Allocation for collection costs (FIRS and Customs)	3,075,000
Personnel costs	7,200,000
Share of Statutory allocation	13,500,000
Consolidated Revenue Fund Charges	2,250,000
Grants and subventions received from foreign donors	75,000
Rent of Federal Government properties	285,000
Overhead charges	1,500,000
Subvention to parastatals	1,800,000
Federal Government Properties	375,000
Repayment of loans	870,000
Purchases and construction of non-current assets	2,500,000
Proceeds from the sale of federal government properties in Kumasi	1,050,000
Purchase of marketable securities	500,000
Cash and cash equivalents, 1 January 2011	3,750,000
Proceeds from loan and other borrowings	3,000,000
Cash and cash equivalents, 31 December	21,660,000

Required:

Prepare a cash flow statement for the year ended 31 December 2011, using the direct method. Ignore comparative figures. **(Total 15 Marks)**

QUESTION 5

a. In relation to the International Public Sector Accounting Standard (IPSAS) No.13 on 'Leases,' you are required to explain the following terms:

   i. Inception of the Lease (1 Mark)

   ii. Interest rate implicit in the Lease . (2 Marks)

b. The Corporate Finance Department of Dealwell Corporation entered into an agreement to acquire a Waste Disposal Truck on a finance lease.

   The fair value of the truck at the inception of the lease on 1 January 2011 was ₦25million. The annual lease payments is ₦5,429,000 payable in arrears. The lease term is 4 years and the guaranteed residual value is ₦10million.

   The lease agreement does not provide any services additional to the supply of the Waste Disposal Truck. The Corporate Finance Department is responsible for all running costs of the truck including fuel, insurance and maintenance. The lease agreement does not specify the interest rate implicit in the lease. The Department's incremental borrowing rate is 7 per cent per annum. Various financial institutions are advertising loans, secured by Waste Disposal Truck, at rates varying between 7.5% and 10.0%.

   You are required to:

   i. Calculate the present value of the minimum lease payments. ($2\frac{1}{2}$ Marks)

   ii. Calculate the interest rate implicit in the lease by interpolation. ($3\frac{1}{2}$ Marks)

   iii. Show the apportionment of the lease payment for the 4 years. (6 Marks)

   Use the formula

$$\text{PV(MLP)} = \frac{S}{(1+r)^{n}} + \frac{A}{(r)}\left(1 - \frac{1}{(1+r)n}\right)$$

Where:

PV(MLP) is the Present Value (PV) of Minimum Lease Payments (MLP)

A is the regular periodical payment

r is the periodic interest rate implicit in the lease expressed as a decimal

n is number of periods in the term of the lease.

s is the guaranteed residual value

(Total 15 Marks)

QUESTION 6

Part I of the Third Schedule of the 1999 Constitution established the Code of Conduct Bureau with the primary objective of receiving declaration in respect of assets of public officers.

Required

a. State the composition of the Code of Conduct Bureau? (4 Marks)

b. State the **SIX** powers the Code of Conducts Bureau (6 Marks)

c. Enumerate the **FIVE** sanctions which the Code of Conduct Tribunal can impose on errant public officers for contravening its provisions. (5 Marks)

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I - MULTIPLE CHOICE QUESTIONS

1. D
2. B
3. E
4. A
5. C
6. E
7. B

8. A

9. D

10. D

11. B

12. D

13. C

14. A

15. C

16. A

17. D

18. A

19. D

20. B

EXAMINERS' REPORT

The questions test the general understanding of candidates in both the public finance and the accounting areas of the syllabus. The questions cover the syllabus.

The performance of most candidates was above average, however, about 30% of candidates performed woefully.

Common pitfalls included inadequate knowledge of relevant Acts of the National Assembly and contemporary issues in public finance.

PART II SHORT-ANSWER QUESTIONS

1. ₦27.778m

2. Cash Budgeting/Plan

3. Fiscal Responsibility

4. Treasury Single Account

5. Integrated Personnel and Payroll Information System

6. Procurement

7. Defined Benefit Pension Plan

8. Department of Petroleum Resources

9. Budget Call Circular

10. External Auditors

11. Built-in/Automatic Stabilities

12. Trade/Business Cycle

13. Discretionary Fiscal Policy

14. Value Added Tax

15. Marginal Tax Rate

16. The Paris Club of Creditors

17. ₦20 billion

18. Selective Matching Grants

19. Ad Valorem Tax

20. Unearned Income

Tutorial

(1) $40(1.2)^{-2}$ = 40@0.694
40@1/1.44 = ₦27.7781million

EXAMINERS' REPORT

The questions cover most of the topics in the syllabus and many candidates attempted all the questions.

The performance of the candidates was poor, especially in Public Finance. They were unable to recognize definitions such as:

- **(i) Treasury Single Account**
- **(ii) Procurement**
- **(iii) Selective Matching Grants**
- **(iv) Marginal Tax Rate**
- **(v) Automatic Stabilisers, to mention a few.**

Candidates are advised to ensure that they are familiar with contemporary issues in Public Sector Accounts and Public Finance.

SOLUTION TO SECTION B

QUESTION 1

(a) The following are the problems that beset LAGOON STEEL ROLLING MILL:

i. The armed robbery incident
ii. The downturn in the economy
iii. The liberalization of credit policy in an attempt to stimulate turnover
iv. The poor quality of goods and services
v. The increase in competition among suppliers offering credit
vi. The introduction of the "cashless policy".
vii. Cash shortage as a result of the robbery incident.

(b) i) Average inventory holding period

$$= \frac{(\text{Opening Inventory} + \text{Closing Inventory}) \div 2}{\text{Cost of Sales}} \times \frac{365}{1} \text{ days}$$

$$= \frac{(568 + 664) \div 2}{2{,}176} \times 365$$

$$= \frac{616}{2{,}176} \times 365 \text{ days}$$

$$= 103.3 \text{ days}$$

$$\approx 103 \text{ days}$$

(ii) Average settlement period for trade payables

$$= \frac{\text{Trade Payables}}{\text{Credit purchases}} \times \frac{365}{1} \text{ days}$$

$$= \frac{636 \times 365}{2{,}272 \times 1}$$

$$= 102.2 \text{ days}$$

$$\approx 102 \text{ days}$$

(iii) Average settlement period for trade receivables

$$= \frac{\text{Trade Receivables}}{\text{Credit Sales}} \times \frac{365}{1} \text{ days}$$

$$= \frac{1{,}056}{3{,}280} \times \frac{365}{1} \text{ days}$$

$$= 117.5 \text{ days}$$

$$= 118 \text{ days}$$

(c) Finally, the Operating Cash Cycle is (i+ iii)-(ii)

Average Inventory Holding Period	= 103	days
Add: Average settlement period for Trade Receivables	= 118	days
Less: Average settlement period for Trade Payables	= (102)	days
Operating Cash Cycle	119	days

(d) The Management of Lagoon Rolling Steel Mill may seek to reduce the Operating Cash Cycle viz:

(i) The Average Inventories holding period appears long because the stock represents more than 3 months sales requirements. Lowering the level of inventories held, based on scientific methods like Just-in Time; Economic Order Quantity will come in handy, as it will drastically reduce holding period.

(ii) Average settlement period for trade receivables is also long, at nearly 4 months sales. The management should introduce tighter credit control, offer discounts etc.

(iii) Management may ask for longer period of credit from creditors

(iv) Management should also use accounting ratios to appraise performance and the strength of the Mill with respect to liquidity and profitability

(v) Minimising cash holding to the barest minimum as a security measure

(vi) Produce more qualitative goods that can stand competition

(vii) Embrace the "cashless policy" of government.

EXAMINERS' REPORT

The question tests the understanding of candidates on their ability to compute the number of days for which the Rolling Mill holds inventory, recovers receivables and settles trade payables and the calculation of the operating cash cycle.

All the candidates attempted the question theory because it is a Case Study and compulsory. They performed above average in the qualitative aspects (i.e (a) and (d)) of the question but most of them were unable to compute the periods correctly in the quantitative parts (b) and (c).

Although the Personal Assistant (Judicial Matters) "cried wolf" over liquidity problems because of the incident of armed robbery and the decision made by other managers to liberalise credit policy, however, a realistic analysis of the results obtained does not support his view. Candidates are advised to always answer questions in the context of scenarios painted in case, studies. Candidates are also to note that the Steel Rolling is a Government Business Entity (GBE) and could be subject to some provisions of International Public Sector Accounting Standards (IPSAS) etc.

QUESTION 2

(a) **Deficit Financing & Fiscal Policy**

(i) Deficit financing (budget deficit) is the excess of government expenditure over government revenues in any one fiscal year.

(ii) As a tool of fiscal policy, deficit financing enables government to influence the level of aggregate demand and employment in the economy.

(iii) By injecting additional aggregate demand into the economy, the budget deficits keep employment high and promote long-term economic growth.

(b) **Deficit Financing: inflation and indebtedness**

(i) Deficit financing (budget deficit) as a deliberate government intervention requires the imbalance to be financed. This could be by:

- Increasing the public sector borrowing through the issue of treasury bills and long-term bonds; and
- Increasing fiduciary issue, that is, printing more currency.

(ii) Indebtedness is automatically created once the deficit is financed by the increased public sector borrowing.

(iii) If the government borrowing is in excess of the amount required to promote long-term growth, it will ultimately result in inflation. Similarly if it is financed by printing more currency, money supply will be increased and consequently creating inflationary situation.

EXAMINERS' REPORT

The focus of the question is on deficit financing - a tool of fiscal policy and economic management. It tests candidate's understanding of how financing deficits could cause

inflation and unsustainable indebtedness.

Majority of the candidates attempted the question but the performance was below average. The understanding demonstrated by the candidates did not go beyond the definition of budget deficit. Only a few of them provided insights into the practical issues of inflation and unsustainable indebtedness as required in the question.

Candidates are advised to be much more exposed to this aspect of the syllabus by studying standard text books on Public Finance. It is expected of a professional accountant to demonstrate familiarity with public policy actions in the process of tackling contemporary economic problems such as inflation and indebtedness.

QUESTION 3

(a) Privatisation is the transfer of the publicly owned assets of a company into the ownership of the private sector. It could be partial when some part of the equity shares of a public company is sold to the private sector or full when there is complete transfer of ownership of equity shares from the public to the private sector

(b) Ways of privatizing enterprises:

(i) Private Placing. The securities are placed with a firm of brokers who then seeks out prospective buyers. Again, approval from the Securities and Exchange Commission must be sought and a prospectus printed before any share can be issued.

(ii) Sale of Assets. In some cases, liquidation of assets was done via sale of assets on a piece-meal basis to the public through public tender.

(iii) Management Buy Out (MBO). Under this method, the entire affected enterprise or a substantial part of its equity capital is sold to the workers who will organize and manage it on their own.

(iv) Deferred public offer. This method is used where less revenue is generated than the real value of the enterprise. A willing buyer/seller price is then negotiated based on the re-evaluation of the assets of the enterprise.

(c) Problems:

(i) Valuation problem: Determination of appropriate issue price of the shares of privatized companies is a challenge to the scheme. It has led to either under or over subscription.

(ii) Acquisition by Foreigners: There is the problem of transfer of ownership of enterprises to foreigners which could result in economic domination.

(iii) Emergency of Private Monopoly: There is also the problem of replacing government monopoly with a private one. This has negative effects on the economy.

(iv) Threat to public interest. The affected enterprises often retrench workers in order to reduce overhead expenses. This compounds the unemployment situation in the country.

(v) Income Inequality: The programme tends to widen the income inequality in the country.

EXAMINERS' REPORT

The question tests candidates' understanding of the way and manner public enterprises are privatized in Nigeria. The problems encountered in the privatisation process constitute another aspect of the question.

Virtually all the candidates' attempted the question with only one-third of them scoring pass marks. Most of them were able to explain what privatization is all about while they confused types of privatization with the ways the public enterprises have been privatized in Nigeria.

Candidates are advised to be familiar with this aspect of the syllabus. They need to study relevant learning materials including Study Pack and Pathfinders of the Institute.

QUESTION 4

FEDERAL REPUBLIC OF NIMINEY
CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2011

	₦ million
Receipts:	
Share of Statutory Allocation	13,500,000
Value Added Tax	2,295,000
Personal Income Tax (Direct Tax)	10,500,000
Allocation for collection costs (FIRS & Custom)	3,075,000
Grants and subventions received	75,000

Miscellaneous Revenue	375,000
TOTAL RECEIPTS	29,820,000
Payments:	
Personnel Costs	(7,200,000)
Consolidated Revenue Charges	(2,250,000)
Overhead charges	(1,500,000)
Subvention to Parastatals	(1,800,000)
TOTAL PAYMENTS	(12,750,000)
Net cash flow from Operating Activities	17,070,000
Cash Flow from Investing Activities:	
Sales of Federal Government Properties	1,050,000
Purchase and construction of non-current Assets	(2,500,000)
Purchase of marketable securities	(500,000)
Sale of Government property	375,000
Rent of government property	285,000
Net cash flow from Investing Activities	(1,290,000)
Cash Flow from Financing Activities:	
Proceeds from Loans and other borrowing	3,000,000
Repayment of loans	(870,000)
Net cash flow from Financing Activities	2,130,000
Net increase in cash & cash equivalents	17,910,000
Cash & cash equivalents 1 January 2011	3,750,000
Cash & cash equivalents, 31 December 2011	21,660,000

EXAMINERS' REPORT

The question tests candidates' ability to prepare a Cash Flow Statement using the direct method.

The performance of candidates was above average and they are admonished to maintain a good knowledge of the topic in view of global developments.

QUESTION 5

(a) (i) Inception of the lease - This is the earlier of the date of the lease agreement or of a commitment by the parties to the principal provisions of the lease.

Interest rate implicit in the lease – It is the discount rate that, at the inception of the lease, causes the aggregate present value of the minimum lease payment; and the unguaranteed residual value to be equal to the fair value of the leased asset.

(b)(i) Using the formula,

$$PV\ (MLP) = \frac{10{,}000{,}000}{(1+0.07)^4} + \frac{5{,}429{,}000}{0.07}\left(1 - \frac{1}{(1+0.07)4}\right)$$

= ₦7,629,000 + ₦18,390,000

= ₦26,019,000

(ii) Interest rate implicit in the lease, by interpolation

PV at 10% = ₦24,040,000

PV at 7% = ₦26,019,000

Difference from Target PV (MLP) of ₦25 million

PV at 7% = ₦ (26,019,000 - ₦25,000,000) = ₦1,019,000

PV at 10% = ₦(24,040,000 – ₦25,000,000) = ₦960,000

$$r = 7\% + \left((10\% - 7\%)\ \frac{1{,}019{,}000}{(1{,}019{,}000-960{,}000)}\right)$$

= 7% + (3% x 0.5)

= 7% + 1.5%

= 8.5%

(iii) The applicable interest rate of 8.5% will be used to record the lease in the books of Corporate Finance Department and apportion the lease payments between finance charge and the reduction of the lease liability viz:

APPORTIONMENT OF LEASE PAYMENT

Year	0	1	2	3	4
Unit	₦000	₦000	₦000	₦000	₦000
Opening PV of lease liability	25,000	25,000	21,696	18,110	14,221
Yearly Reduction of liability (iv)	-	3,304	3,585	3,890	4,221
Closing lease liability at year end	25,000	21,696	18,110	14,221	-
Residual Value	-		-	-	10,000

TUTORIAL

COMPUTATION OF YEARLY REDUCTION OF LIABILITY

	₦'000
Year 1 Annual Lease Payment	5,429
Less interest expenses 8.5% @ 25,000	2,125
	3,304
Year 2 Annual Lease Payment	5,429
Less interest expense805% @ 21,696	1,844
	3,585
Year 3 Annual lease payment	5,429
Less Interest expense 8.5% @ 18110	1,539
	3,890
Year 4 Annual Lease Payment	5429
Less interest expense 8.5% @ 14,221	1,209
	4,220

EXAMINERS' REPORT

The focus of the question is on the International Public Sector Accounting Standard (IPSAS) No.13 on "Leases".

The question was one of the least attempted by the candidates and the performance was below average. Notwithstanding the fact that the key formula was provided in the question, these few candidates could not interprete same effectively. Also, the answers provided for a (i) and (ii) revealed that they were not conversant with this particular standard.

Candidates are advised to be acquainted with the 32 International Public Sector Accounting Standards (IPSAS) that are currently issued because of the emerging global relevance of them. Candidates should be more exposed by reading modern test books.

QUESTION 6

(a) The Bureau shall consist of a chairman and nine other members who shall be:

- Persons of unimpeachable integrity in the Nigerian Society; and
- At the time of appointment, not less than fifty years.

(b) The powers of the Bureau, as contained in paragraph 3, Part 1 (a) of the Third Schedule of the 1999 Constitution include:

i. To receive declaration of assets by public officers.

ii. To examine the declarations in accordance with the requirements of the Code of Conduct Law.

iii. To retain custody of such declarations and make them available for inspection by any citizen of Nigeria on such terms and conditions as the National Assembly may prescribe.

iv. To ensure compliance with and, where appropriate, enforce the provisions of the Code of Conduct or any law relating thereto.

v. To receive complaints about non compliance with or breach of the provisions of Code of Conduct or any law relating thereto.

vi. To investigate complaints and where appropriate refer such cases to the Code of Conduct Tribunal

c. **Sanctions** that Code of Conduct Tribunal can impose on erring public officers for contravening its provisions are:

i. Trial at Tribunal for jail conviction
ii. Forfeiture of the affected assets
iii. Prohibition from holding public office for some time
iv. Prohibition from holding Public office permanently
v. Jail and forfeiture of assets
vi. Publication in Gazette and National dailies of convicted officers
vii. Loss of employment or job.

EXAMINERS' REPORT

The question tests the knowledge of candidates on the Code of Conduct Bureau with focus on membership, powers and sanctions for contravention.

About 90% of the candidates attempted it. Performance was fair because they were not conversant with Part 1 of the Third Schedule of the 1999 Constitution.

Most of the candidates wrongly conferred the disciplinary power of the Personnel Management Board (PMB) and the Federal Civil Service Commission upon the Tribunal.

Candidates are advised to read wide.