THE INSTITUTE OF CHARTERED ACCOUNTANTS
OF NIGERIA

# PATHFINDER

NOVEMBER 2011 PROFESSIONAL EXAMINATION I

Question Papers

Suggested Solutions

Plus

Examiners' Reports

# FOREWORD

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

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

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

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

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

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

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

## NOTES

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

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# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
# PROFESSIONAL EXAMINATION 1 – NOVEMBER 2011
# INFORMATION TECHNOLOGY
**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 technology that takes away the problems associated with managing Information Technology Systems and can help automate document based processes, so that customers can focus on growing and knowing their businesses, is known as

   A. Hosted services
   B. Bureau services
   C. Amazon services
   D. Desktop services
   E. Office assistance services

2. Which of the following is **NOT** a role usually played by the Security Officer in Systems Development Life Cycle?

   A. Ensuring controls and supporting processes to provide an effective level of protection
   B. Consulting on appropriate security test plans and reports prior to implementation
   C. Reviewing security test plans and reports prior to implementation
   D. Evaluating security- related document development
   E. Reporting to management on controls breaches

3. Neural Network is mostly used for

   A. Identification
   B. Classification
   C. Recognition
   D. Eradication
   E. Prediction

4. **ONE** of the ways an operating system manages memory is by utilising part of the hard disk for main memory usage. This process is known as

   A. Defaulting
   B. Buffering
   C. Hard disking
   D. Memory usage
   E. Multi-tasking

5. A software that provides a variety of tools for investigating a suspect's Personal Computer is known as

   A. Forensic software
   B. Computer software
   C. Cyber software
   D. Software as a Service (SaaS)
   E. Software Toolkit

6. Which **ONE** of the following is **NOT** a factor to consider when selecting a data transmission system?

   A. Speed of transmission required
   B. Accuracy and reliability required
   C. Length of the transmission system
   D. Cost of each type of data transmission
   E. System protocol that is available

7. All the following are required in establishing a Web business, **EXCEPT**

   A. Installing own server
   B. Contracting with an ISP
   C. Contracting with a Web portal
   D. Establishing an electronic storefront
   E. Designing a website

8. Which of the following activities can provide a clue to incorrect data entry in a typical transaction processing environment?

   A. Validity check
   B. Equipment validation
   C. Keyboard test

D. Response time test
E. Audit trail review

9. Which **ONE** of these best describes a computer program?

A. An input device
B. A set of instructions
C. An interactive user guide
D. A help system
E. Direct access to storage devices

10. The type of memory that can be upgraded in your Computer is known as................

A. Cache
B. Virtual
C. ROM
D. RAM
E. Middleware

11. Which of the following is the best way of protecting a computer system from unauthorised access?

A. Ensuring all users have passwords
B. Locking the office
C. Using a screen saver
D. Maintaining an audit trail
E. Locking the computer system in a strong room

12. Processing Controls include which of the following?

I Reasonableness verification of calculated amount
II Limits checks on calculated amount
III Reconciliation of file total
IV Exception reports

A. I
B. II, III, IV
C. II and IV
D. I, II, and III
E. I and IV

13. Which of these is **NOT** a protocol in information transmission?

A. TCP
B. HTTP
C. SMTP
D. IMAP
E. ICPC

14. Which of the following is /are components of a Project Management Process?

I Initiation
II Project planning
III Project controlling
IV Project closing

A. I
B. I and II
C. II, III and IV
D. I and IV
E. I, II, III and IV

15. Which of the following describes a Business Case usually made for procuring Information Technology Projects?

A. A Profit and Loss statement
B. Requirement analysis statement
C. Analysis of cost, benefit and risk associated with the proposed Information Technology project
D. Analysis of measurable benefits of the project
E. An outline of the project timetable and means of delivering the proposed Project

16. A project's success is often determined by its Critical Path. Which of the following defines a Critical Path of a project?

A. A path in the project that has Zero-Sum activities
B. A path that marks the beginning and the end of the project
C. A path whose sum of activity time is longer than that of any other path through the network
D. A path whose activity time-sum is equal to zero
E. A point of no return in the project

17. **ONE** advantage of a Tree Topology is

A. Point-to-point wiring for individual segment
B. More difficult to configure and wire than other topologies
C. It is not supported by several hardware and software vendors
D. If the backbone line breaks, the entire segment goes down
E. Overall length of each segment is limited by the type of cabling

18. A repeater

A. Allows one to segment a large network into two smaller, more efficient networks
B. Electrically amplifies the signal it receives and rebroadcasts it
C. Translates information from one network to the other
D. Is a switch
E. Provides central connection point for cables from workstations, servers and peripherals

19. All of the following are components of a Business Case **EXCEPT**

A. Post-implementation audit
B. Option analysis
C. Cost scenarios
D. Option identification
E. Risk analysis

20. Which **ONE** of these devices cannot be used to input information?

A. Scanner
B. Printer
C. Barcode reader
D. Touch screen
E. Keyboard

## PART II: SHORT ANSWER QUESTIONS (20 Marks)

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

1. An interconnection of two or more computers sharing resources is known as...............

2. An Expert System is an example of..............................

3. An application that is used to transfer data from a mobile phone to computer and vice versa is known as............................................

4. What is the name given to a program used to edit plain text files and often supplied with the operating system?

5. Application Systems Audit helps to identify the application control strength and evaluates the impact of control............................................

6. The software that is used to convert programs in high-level languages to low-level languages is called ..............................

7. Banking on-line, shopping on-line, preparing tax returns on-line and communicating using web mail are various forms of .......................

8. The presentation of.............................. evidence is a critical element in the forensic process.

9. A computer software which is neither free nor open source but owned by individual companies is known as.............................

10. Any person who accesses a website and uses its facilities and/or subscribes to his or her newsletter or requests any type of transaction is known as.....................

11. Custody of corporate assets must be determined and ....................appropriately.

12. Information Technology Activity Management is the process of creating....... and tracking the progress of multiple information technology tasks to completion.

13. Exception reporting as a compensating control for segregation of duties should be handled at the............................level and should require evidence.
14. What is the name given to a device that connects two similar networks?

15. The abstract description for layered communications and Computer Network Protocol design is.........................

16. The IT-spend ratio as an Information Technology Performance Metric, measures Information Technology.......................

17. Information Systems Security Policy will usually communicate security.........to users.

18. Information Technology controls are generally described in two categories: Information Technology General controls (ITGC) and........................

19. A key which is a column or a combination of columns whose values match the primary key of some other tables is called..............................

20. Another name given to the online code of conduct is...................................

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

**QUESTION 1**

## CASE STUDY

Mr. A. Ajekiigbe, an Executive Director of HiTechno Company, a Computer Firm, asked his colleague the questions: "How important are your data to you? What would happen if things go wrong?" His questions are based on the fact that business managers focus on solving business problems, and determine what their information systems should do, while disaster recovery consultants ask what would happen if things go wrong. Another area of interest to disaster recovery consultants is common end-users' mistakes, which could lead to loss of valuable data.

**You are required to:**

(a) Explain **TWO** ways by which consultants get involved in data recovery.
(4 Marks)

(b) Give **FOUR** reasons for data loss and explain any precaution that might be applied to each one. (8 Marks)

(c) State any **THREE** ways by which errors by end-users can be minimised. (3 Marks)

**(Total 15 Marks)**

**QUESTION 2**

(a) Explain the following information systems' activities and in each case, stating **ONE** relevant example:

- Input
- Processing
- Output
- Storage
- Control (10 marks)

(b) State any **FIVE** information systems' resources and products. (5 Marks)

**(Total 15 Marks)**

**QUESTION 3**

(a) Corroborate the fact that supply chain is a network of facilities. (3 Marks)

(b) Describe the **THREE** main flows of Supply Chain Management. (6 Marks)

(c) Enumerate **SIX** security threats of e-commerce. (6 Marks)

**(Total 15 Marks)**

**QUESTION 4**

Explain the following Business Information Systems:

(a) Executive Information System. (3 Marks)

(b) Transaction Processing System. (3 Marks)

(c) Expert System. (3 Marks)

(d) Decision Support System. (3 Marks)

(e) Neural Network. (3 Marks)

**(Total 15 Marks)**

**QUESTION 5**

(a) Enumerate **THREE** purposes of System Maintenance. (3Marks)

(b) Write short notes on each of the following:

(i) Preventive Maintenance.
(ii) Perfective Maintenance.
(iii) Adaptive Maintenance.
(iv) Corrective Maintenance. (8 Marks)

(c) Highlight the major differences between the various maintenance types in question 5(b) above. (4 Marks)

**(Total 15 Marks)**

**QUESTION 6**

Explain each of the following types of business software, stating **TWO** examples of each:

(a) Job Scheduler. (5 marks)
(b) Enterprise Resource Planning (ERP) . (5 Marks)
(c ) Customer Relationship Management (CRM). (5 Marks)

**(Total 15 Marks)**

## SOLUTIONS TO SECTION A

## PART I MULTIPLE -CHOICE QUESTIONS

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

9. B
10. D
11. A
12. C
13. E
14. E
15. C
16. C
17. A
18. B
19. A
20. B

**MULTIPLE CHOICE QUESTIONS**

**EXAMINERS' REPORT**

**The questions adequately cover the Syllabus. Majority of the candidates performed above average.**

## PART II SHORT ANSWER QUESTIONS

1. Computer network
2. Artificial intelligence or information system
3. Bluetooth
4. Text Editor
5. Weakness
6. Compiler or interpreter
7. Cloud computing
8. Digital
9. Proprietary
10. Web User
11. Assigned or Managed
12. Delegation

13. Supervisory or management
14. Bridge
15. Open System Interconnection (OSI) model
16. Total spending
17. Standards or measures
18. IT Application controls
19. Foreign
20. Web trust

**SHORT-ANSWER QUESTION**

**EXAMINERS' REPORT**

**The questions cover the Syllabus adequately. Less than half of the candidates performed above average.**

**The major pitfall was the inability of the candidates to use correct technical terms required.**

**The candidates are advised to be familiar with the technical terms in information systems.**

## SOLUTIONS TO SECTION B

## QUESTION 1 (Case Study)

(a) Consultants get involved in data recovery by

(i) Having backup copy of data files and keeping them in off-site location.

(ii) Salvaging of lost files through dynamic backup system.

(iii) Salvaging of lost files in corrupted system by running antivirus software.

(iv) Salvaging of lost files in crashed hard disks by running specialized software.

(b) Reasons for data loss and precautions for each of the losses are as follows:

| | Reasons | | Precaution |
|---|---|---|---|
| i. | Virus Attack | - | By installing up-to-date antivirus software |
| ii. | Hacking | - | By building a firewall around the system |
| iii. | Unauthorized access | - | Use of password or encryption |
| iv. | Accidental loss of data through natural disaster and physical damage | - | Provision of backup. |
| v. | Inability to save dynamically | - | Provision of enough online storage |
| vi. | Power surge | - | Use of UPS and stabilizers |
| vii. | Common end-user mistake such as mistakenly deleting a date | - | Provision of a backup |

(c) Errors may be minimized by end-users through

- Adequate training of end users in the use of the system.
- Adopting the culture of keeping backups
- Frequent use of antivirus software
- Guarding against unsolicited files in the computer environment
- Use of password and other authorized techniques
- Use of correct file at the appropriate time

## EXAMINERS' REPORT

**This question tests candidates' knowledge of what a systems developer would contribute in the event of a data recovery situation. It also demands for reasons that may cause data loss as well as how to minimize such losses.**

**Majority of the candidates attempted the question and performance was above average. All the same, some candidates exhibited poor communication Skills.**

**Candidates are advised to pay more attention to their communication skills.**

## QUESTION 2

(a) Explanations of Information System activities:

Input: Input activities take the form of data entry such as recording and editing. It can be a manual process through the keyboard or by scanners. It may also be automatic where a system is receiving transmitted data.

Processing: Processing is a systematic sequence of operations performed on data to produce information. Data processing activity is carried out electronically in the CPU. Examples include arithmetic calculation, comparing, sorting, classifying and summarizing, e.g calculating employees' emoluments, taxes and other payroll deductions.

Output: Output is the process of presenting the results of processed data in a meaningful form to the end-user. Examples include producing reports and displays about sales performance and forecasts.

Storage: Storage is the process of retaining data/information in an organized manner for later use e.g maintaining records on customers, employees and products.

Control: Control is the process of monitoring and evaluating the feedback from the system so as to determine if the system is meeting established performance standards e.g generating audible signals to indicate inproper entry of sales data date.

(b) Information System Resources and Products include the following:

- People Resources
- Hardware Resources
- Software Resources
- Data resources
- Network Resources
- Information Products.

(i) People resources are specialists such as programmers, systems analysts etc. and end-users.

(ii) Hardware Resources are computers and media such as optical disks and magnetic disks.

(iii) Software Resources include programs, utilities and procedures for data entry and error correction.

(iv) Data resources include product description, customer records and employee files.

(v) Network Resources include communications media, processors, network access and control software.

(vi) Information products include management reports and business documents using texts and graphic displays.

## EXAMINERS' REPORT

**This question requires candidates to be able to identify Information System activities that normally take place in Input, Processing, Output, Storage and Control, giving examples, as well as identifying information resources and products.**

**Though the question was straightforward, the candidates' performance was poor because the candidates gave information System devices as their answer instead of Information System activities required by the question.**

**The candidates are advised to have a good understanding of a question before attempting it.**

## QUESTION 3

(a) Supply chain can be defined as a network of facilities that include

(i) Materials flow from suppliers and their "upstream" suppliers at all levels

(ii) Transformation of materials into semi-finished and finished products and

(iii) Distribution of products to customers and their "downstream" customers at all levels.

(b) The three main flows of supply chain arrangement are

i. The product flow: This includes the movement of goods from a supplier to a customer as well as any customer returns or service needs.

ii. The Information flow: This involves transmitting orders and updating the status of the delivery.

iii. The financial flow: This consists of credit terms, payment schedules and consignment and title ownership arrangements.

(c) Security threats to e-commerce.
e-commerce may be exposed to the following security threats

- Virus infection
- Worms
- Privacy violation
- Hacking attacks
- Spyware
- Unauthorized access
- Legal problems such as failure of other parties to fulfill their obligations

## EXAMINERS' REPORT

**This question tests candidates' knowledge and understanding of the operation of Supply Chain Management and the security implication of e-commerce.**

**Majority of the candidates who attempted the question did not understand the concept and this affected their performance, which was poor.**

**Candidates are advised to be more thorough in their preparation.**

## QUESTION 4

(a) Executive Information System: This is an Information System that provides strategic information tailored to the needs of executives, top management and other decision-makers. It is a highly interactive management information system for helping managers to identify and address problems and opportunities.

(b) Transaction Processing System: This is an Information System which performs routine, daily or repetitive data processing tasks within an organization. Processing methods may be manual, automated or electronic. If processing method is electronic, then processing techniques may be on-line or real-time or off-line or Time-sharing or batch processing.

(c) Expert Systems: These are specialized software that perform the functions of a human expert e.g CAD (Computer Aided Design), CAM (Computer Aided Manufacturing) and CAI (Computer Aided Instructions)

(d) Decision Support System: This is an Information System at the management level of an organization that combines data, analytical tools and models to support semi-structured and unstructured decision-making.

(e) Artificial Neural Networks (ANN): Neural Networks (NN) are Programming constructs that mimic the properties of biological neurons. Artificial Neural Networks (ANN) may either be used to gain an understanding of Biological neural networks or for solving artificial intelligence problems without necessarily creating a model of real biological system. It is used for forecasting

## EXAMINERS' REPORT

**The question tests candidates' understanding of certain types of Information Systems. The question demands explanation of each of the systems as well as the method of usage.**

**Majority of the candidates that attempted the question performed above average. Some of the candidates displayed ignorance of the appropriate terms used to describe the familiar Business Information System. In particular, many candidates could not describe the Neural Network.**

**Candidates are advised to familiarize themselves with the exact terminologies used in the contexts of the Business Information Systems.**

## QUESTION 5

(a) Purposes of System maintenance include:

i. Dealing with unforeseen problems arising in operation such as programs requiring modification.
ii. To confirm that the planned objectives are being met and to take action if they are not.

iii. To ensure that the system is able to cope with the changing requirements of business.

iv To improve software in order to enhance processing

(b) i. Preventive maintenance. This is a type of maintenance carried out in advance of a problem occurring. Preventive maintenance may be carried out at a time most convenient to the organisation.

ii. Perfective maintenance. This type of maintenance is carried out in order to perfect the software or to improve it so that the processing is enhanced.

It is usually carried out to improve the performance, maintainability, overall effectiveness or other attributes of a System. This may be prompted by the availability of new technology, the development of new techniques or by request for system enhancement from users.

iii. Adaptive maintenance. This is carried out to take account of anticipated changes in processing environment, possibly, through.

- User requirement being changed or ill-defined as a system is being designed.
- The significant change in the system environment.
- The system grown beyond the limit that was originally envisaged for it.

iv. Corrective maintenance. This is as a result of system failure. It is carried out to correct faults in hardware and software. Corrective maintenance is reactive and is usually carried out as a result of a negative experience with the System.

(c) The major differences among the various maintenance types are as follows:

While Preventive maintenance is maintenance carried out in advance of a problem, Perfective maintenance is maintenance carried out in order to perfect or improve a software.

Adaptive maintenance is to take care of anticipated changes in processing environment while Corrective maintenance is carried out as actions in response to a system failure.

## EXAMINERS' REPORT

This question tests candidates' knowledge of System Maintenance.

The question was well understood by the candidates as majority of those that attempted the question performed well above average.

The major pitfall identified was the inability of candidates to distinguish among the Maintenance Systems.

Candidates are advised to acquire indepth knowledge of the various maintenance systems and associated topics.

## QUESTION 6

(a) Job Scheduler: This is an enterprise software application that is in charge of unattended background execution such as batch system, distributed Data Based Management System (DBMS) and Distributed Resource Manager (DRM)

The features of job scheduler software include the following:

i. Interfaces which help to define windows and/or job dependencies

ii. Automatic submission of execution

iii. Interfaces to monitor the executions

iv. Priorities and/or queues to control the execution order of unrelated jobs.

(b) Enterprise Resource planning (ERP): This is a company-wide computer software system used to manage and coordinate all the resources, information and functions of a business from shared data stores.

This type of system has a service- oriented architecture with modular hardware and software units that communicate on a local area network.

(c) Customer Relationship Management (CRM)

This consists of the processes which a company uses to track and organize its contact with the current and prospective customers. Information about customers and customer interactions can be entered, shared and accessed by employees in different company departments. This allows improvement in services to customers and the use of customer contact information for targeted marketing.

## EXAMINERS' REPORT

**This question tests candidates' knowledge and understanding of Business Software.**

**Only a few candidates attempted the question and their performance was good.**

**Candidates are advised to study and understand the concept of various Business Softwares as well as associated examples.**

**To:** Chairman,
Professional Examination 25/11/2011

### REPORT ON THE TUITION HOUSE COMMENTS

The tuition house comments and solutions are taken in good faith. 90% of the solutions are excellent and many parts are incorporated into the marking scheme used for marking by the assessors and inclusion in the Pathfinder.

Most of the observed lapses are typographical. Those observed as vague have multiple solutions, so they are not vague but they are not unique.

The only serious error is Qu.6(b) and this has been taken care of in the pathfinder.

All the same the Tuition House exercise is very fruitful, although some wrong solutions were preferred by it as we have in the objective questions.

I recommend that the Tuition House exercise should continue.

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
## PROFESSIONAL EXAMINATION I – NOVEMBER 2011
## MANAGEMENT ACCOUNTING
### Time allowed – 3 hours

## SECTION A: Attempt All Questions

## PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

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

1. The process of determining the price at which goods are transferred from one profit centre to another within the same company is

   A. Mark-up pricing
   B. Market pricing
   C. Transfer pricing
   D. Arms length pricing
   E. Pro-rata pricing

2. A manufacturing company's cost driver excludes

   A. Number of orders placed
   B. Number of set ups
   C. Number of inspections
   D. Number of hospital beds occupied
   E. Weight of materials

3. Which of the following costs can be classified as appraisal cost?
   A. Scrap
   B. Rework
   C. Material inspection
   D. Product warranty
   E. Quality training

4. A radical redesign to achieve dramatic improvements in contemporary measures of performance such as cost, quality service and speed in an organisation is called
   A. Process re-engineering
   B. Business re-engineering
   C. Activity based management
   D. Business process re-engineering
   E. Process redesign

5. An examination of every operation required in producing certain products with the existing production facilities to increase productivity is called

   A. Method study
   B. Work study
   C. Work measurement
   D. Method measurement
   E. Operation study

6. Costs that may be shifted to the future with little or no effect on the efficiency of current operation is called

   A. Avoidable cost
   B. Joint cost
   C. Out of pocket cost
   D. Postponable cost
   E. Sunk cost.

7. The best estimates that represent several possible outcomes for a particular event is

   A. Perfect result
   B. Predictive preposition
   C. Certainty equivalent
   D. Normal estimation
   E. Perfect estimation

8. Violation of the assumption of constant variance is

   A. Hamoscedasticity
   B. Hateroscedasticity
   C. Hemoscedasticity
   D. Homoscedasticity
   E. Heteroscedasticity

9. **ONE** of the following is **NOT** a correct method of appraising investment

   A. Modified internal Rate of Return
   B. Profitability Index
   C. Net Present Value
   D. Internal Rate of Return
   E. Sensitivity Analysis

10. A company's fixed overhead per annum is ₦100,000, variable expenses is ₦10 per unit and the selling price is ₦15 per unit. What is its Break-Even Point?

   A. 15,000 units
   B. 17,500 units
   C. 20,000 units
   D. 22,500 units
   E. 25,000 units

11. An investment centre's operating profit after tax minus the products of investment centre's total assets less investment centre's current liabilities and weighted average cost of capital after tax is

   A. Net Profit
   B. Investment Income
   C. Residual Income
   D. Economic Value Added
   E. Value Added

12. From the following information relating to Chika Ltd, you are required to determine the Residual Income

| | |
|---|---|
| Profit before depreciation | ₦600,000 |
| Depreciation | ₦100,000 |
| Minimum rate of return | 20% |
| Investment cost | ₦2,000,000 |

   A. ₦100,000
   B. ₦120,000
   C. ₦125,000
   D. ₦130,000
   E. ₦140,000

13. A firm has two major production departments, Tableting and Packaging. It adopts full Standard Cost pricing method for the intermediate products. Unit variable cost is ₦70, while fixed cost is ₦40 and mark-up is 25%. If Tableting is the transfer unit while Packaging is the buyer of the intermediate product, determine the unit transfer price.
   A. ₦ 136.50
   B. ₦ 137.50
   C. ₦ 140.50
   D ₦ 141.50
   E ₦ 146.66

14. A situation where managers take decisions that work for the benefit of the organisation and the objectives of the individual managers are consistent with those of the organization as a whole, is known as

   A. Slack
   B. Dysfunction
   C. Sub-option
   D. Goal congruence
   E. Systematic Congruence

15. A means of increasing customer satisfaction and managing costs more effectively, is known as
   A. Value Analysis
   B. Value Added Activity
   C. Total Quality Management (TQM)
   D. Re-engineering
   E. Value Chain Analysis

16. A situation where masses of identical units are produced and it is unnecessary to assign costs to individual units of output is
   A. Contract costing
   B. Job costing
   C. Joint costing
   D. Process costing
   E. Step costing

17. An entity or a group of independent components or parts that interact together within an environment for the purpose of accomplishing common organisational objectives is

A. Goal congruence
B. Optimisation
C. A system
D. Cybernetic control
E. Management control

18. Which of the following industries does **NOT** use job costing?
A. Ship building
B. Advertising
C. Interior decoration
D. Oil industry
E. Road building

19. The application of information and communication technologies (ICT) in aiding internet, internal and external business operations is called

A. e-business
B. e-trading
C. Extranet
D. Internet
E. e-payment

20. In which costing technique are variable cost charged to cost units and fixed costs written off against contribution?

A. Absorption costing
B. Marginal costing
C. Activity based costing
D. Process costing
E. Contract costing

## PART II: SHORT- ANSWER QUESTIONS (20 Marks)

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

1. The Restaurant Division of Kingsway Apapa Plc has assets worth ₦24 million, Net Income of ₦2.1 million and imputed interest of 12%. What is its Residual Income (RI)?
2. A method of budget setting that employs cost driver data and variance feedback process is ……………………………………….
3. Decisions that are clearly defined and tailored through computer-based management information system are……………………………….
4. A system wherein feedback is directed to a higher level is described as…………………….
5. For a project with an initial outlay of ₦250,000 and a profitability index of 1.20, the total cash inflow will be …………………………..
6. A technique whereby decisions are tested by their vulnerability to changes in any variable is………………………..
7. The technique used to determine the sensitivity of NPV to cost of capital is………………….
8. A price to be charged to cover both the incremental cost of production and opportunity cost is……………………………….

**Use the following information to answer questions 9 and 10.**

| Month | Standard Hours | Cost Incurred |
|---|---|---|
| 1 | 1,750 | ₦36,250 |
| 2 | 1,800 | ₦36,600 |
| 3 | 2,100 | ₦38,700 |
| 4 | 2,450 | ₦41,150 |

Cost estimation method in operation is the High-Low method.

9. Variable cost per standard hour is……………………………….
10. Fixed cost incurred per month is…………………………
11. A section of an organization for which a budget is prepared is called…….

12. A unit of a product is expected to take 6 hours to make. Labour is paid ₦5/hour. During 2008, actual output were 3,000 units and labour cost ₦80,000, (16,000 hours at ₦5/hour). What is the labour productivity ratio for 2008?

13. Using the details in question 12, what is actual labour cost per unit?

14. The setting of an initial low price to achieve a desired level of market acceptance is known as........................
15. When a cost varies with the cost driver, but in discrete steps, it is called ......................
16. The predicted sales value of a fixed asset at the end of its useful life is called...............................
17. Break-even point in Naira for multiproduct is calculated as fixed cost divided by .............................
18. For a cost to be relevant to a particular decision, it must......................
19. What is the Net Present Value of ₦3,791,000 investment in a plant with five years useful life, zero terminal disposal value, ₦1,350,000 annual cash savings and 8% rate of return?
20. Residual income is calculated as divisional income less.....................

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

**QUESTION 1**

**CASE STUDY**

Concord Hotels Limited is considering expanding its activities through acquisition of small hotels. As a Management Consultant, you have been engaged to use the following key accounting ratios of Concord Hotels Limited to monitor and appraise the performance of the group of hotels and individual hotels in the chain for year 2010.

Concord Hotels Limited Target Ratios (2010 Extract).

(i) Return on Capital Employed = 20%
(ii) Operational profit percentage = 15%
(iii) Asset Turnover =2.5 times
(iv) Working Capital period = $\frac{Working\ Capital}{Operating\ Costs}$ x 365 = 25 days
(v) Percentage room occupancy = $\frac{Number\ of\ Rooms\ night\ let}{Number\ of\ Rooms\ night\ available} x\ 100\% = 85\%$
(vi) Turnover per employee (full- time Equivalent) = ₦35,000

The extract of profit and loss account for the year ended 31 December 2010 for Omega Hotels Limited which is being appraised for outright purchase is as follows:

| | ₦ |
|---|---|
| Turnover | 820,000 |
| Operating costs | (754,000) |
| Operating profit | 66,000 |
| Interest payable | (4,000) |
| Profit before tax | 62,000 |
| Taxation | (18,000) |
| Profit after tax | 44,000 |
| Dividends | (22,000) |
| Retained profits | 22,000 |

The Balance Sheet of Omega Hotels Limited as at 31 December 2010 (Extract).

| | ₦ |
|---|---|
| Fixed Assets (Net) | 230,000 |
| Net Current Assets | 70,000 |
| Net Total Assets | 300,000 |
| Long term loans | (50,000) |
| Shareholders' funds | 250,000 |

Other Relevant information for Omega Hotels Limited.

(i) Number of Employees (fulltime equivalent) = 20
(ii) Number of Rooms each available for 365 nights = 18
(iii) Number of Room nights let in 2010 = 5,900

**You are required to:**

(a) Calculate all the above target ratios for Omega Hotels Limited (6 Marks)

(b) Write a letter to the Management of Concord Hotels Limited giving your assessment of Omega Hotels Limited. Your report should provide comments on the performance of Omega Hotels Limited based on the six ratios calculated above and suggest management actions which need to be taken to correct apparent adverse performance. (6 Marks)

(c) Explain the limitations, if any, in the use of the target ratios specified above in performance appraisal. (3 Marks)

**(Total 15 Marks)**

**QUESTION 2**

The following data relate to actual output, costs and variance for the four-weekly accounting period of Tope Ltd that makes only one product. Opening and closing work in progress figures were the same.

| | |
|---|---|
| Actual production of product XY | 18,000 units |
| | |
| Actual costs incurred: | (₦'000) |
| Direct materials purchased and used (150,000kg) | 210 |
| Direct wages for 32,000 hours | 136 |
| Variable production overhead | 38 |
| | |
| | (₦'000) |
| Variances: | |
| Direct materials price | 15F |
| Direct material usage | 9A |
| Direct labour rate | 8A |
| Direct labour efficiency | 16F |
| Variable production overhead expenditure | 6A |
| Variable production overhead efficiency | 4F |

Variable production overhead varies with labour hours worked

A standard marginal costing system is operated.

**You are required to calculate the standard product cost for one unit of product XY**
***Show all workings*** **(15 Marks)**

**QUESTION 3**

Bola Bolington, a shoe manufacturer, prepared the following budget data for the period ended December 2009:

Average available assets:

| | ₦ |
|---|---|
| Bills receivable | 250,000 |
| Inventories | 300,000 |
| Plant & Equipment (NBV) | 500,000 |
| | 1,050,000 |
| Fixed overhead | 450,000 |
| Variable cost per pair | 15 |

| | |
|---|---|
| Desired rate of return on average assets | 20% |
| Selling price per pair | ₦35 |

**Required:**

(a) How many pairs of shoes must be sold to obtain the desired rate of return on average assets? (3 Marks)

(b) What would be the expected capital turnover? (3Marks)

(c) What would be the operating income percentage of Naira sales? (3 Marks)

(d) If Bola Bolington has 12% cost of capital what will be the Residual Income for the Company? (3 Marks)

(e) What rate of return will be earned on available assets if sales volume is 15,000 pairs of shoes? (3 Marks)

**(Total 15 Marks)**

**QUESTION 4**

You are the Management Accountant of Fedicon Aluminium Systems Ltd. You have been asked to provide budgetary information and advice to the Board of Directors at a meeting where they will decide the pricing of an important product for the next period.

The following information is available from the records:

| **Sales** | **Previous Period** ₦'000 | **Sales** | **Current period** ₦'000 |
|---|---|---|---|
| 200,000 units at ₦26 each | 5,200.00 | 212,000 units at ₦26 each | 5,512.00 |
| Costs | 4,000.00 | | 4,309.76 |
| Profit | 1,200.00 | | 1,202.24 |

You confirmed that between the previous and current periods there was a 4% general cost inflation and it is forecast that costs will rise a further 6% in the next period. As a matter of policy, the firm did not increase the selling price in the current period, although competitors raised their prices by 4% to allow for the increased costs. A survey undertaken by economic consultants has found that the demand for the product is elastic with an estimated price elasticity of demand of 1.5. This means that volume would fall by $1^1/_2$ times the rate of real price increase. Various options are to be considered by the Board.

**You are required to:**

(a) Show the budgeted position if the firm maintains the ₦26 selling price for the next period (when it is expected that competitors will increase their prices by 6%). (5 Marks)

(b) Show the budgeted position if the firm also raises its price by 6%. (5 Marks)

(c) Write a short report to the Board, with appropriate figures, recommending whether the firm should maintain the ₦26 selling price or raise it by 6%. (2 Marks)

(d) State what assumptions you have used in your solution. (3 Marks)

**(Total 15 Marks)**

**QUESTION 5**

(a) Briefly explain the term Activity-Based Costing (ABC). (3 Marks)

(b) Plant 2 produces about one hundred products. Its largest selling product is Product X and the least Product Y. Relevant data is given thus:

| | Product X | Product Y | Total Product |
|---|---|---|---|
| Unit produced per annum | 20,000 | 4,000 | 200,000 |
| Material cost per unit | ₦3.00 | ₦3.00 | |
| Direct labour per unit | 10 min | 10 | |
| Machine Time per unit | 2 hours | 2 hours | |
| Number of set-ups p.a | 36 | 4 | 200 |
| Number of purchase orders | 40 | 8 | 3,600 |
| Number of time materia handled | 300 | 20 | 15,000 |
| Direct labour cost/hour | | | ₦7.50 |

| | |
|---|---|
| Overhead costs: | ₦ |
| Set-up | 300,000 |
| Purchasing | 200,000 |
| Material handling | 155,000 |
| Machines | 720,000 |
| | ₦1,375,000 |

Total machine hours are 750,000.

**You are required to calculate the unit cost using:**

(i) Traditional method (6 Marks)
(ii) ABC Method 6 Marks)
**(Total 15 Marks)**

**QUESTION 6**

**CARBON-COPY LIMITED** is drawing up production plans for the coming year. Four products are available with the following financial characteristics:

| **Product** | **Paster** | **Baster** | **Caster** | **Daster** |
|---|---|---|---|---|
| Amount per unit: | ₦ | ₦ | ₦ | ₦ |
| Selling price | 55 | 53 | 97 | 86 |
| Cost of materials | 17 | 25 | 19 | 11 |
| | | | | |
| Labour hours: | | | | |
| Grade A | 10 | 6 | - | - |
| Grade B | - | - | 10 | 20 |
| Grade C | - | - | 12 | 6 |
| Variable overheads | 6 | 7 | 5 | 6 |

Fixed overheads of the firm amount to ₦35,500 per annum. Each grade of labour is paid ₦1.50 per hour but skills are specific to grade so that an employee in one grade cannot be used to undertake the work of another grade. The annual labour hours is limited to the following maximum:

| | |
|---|---|
| Grade A | 9,000 hours |
| Grade B | 14,500 hours |
| Grade C | 12,000 hours |

There is no effective limitation on the volume of sales of any product.

**You are required to:**

(a) Calculate the products' contributions. (3 Marks)

(b) Formulate the objective functions of the problem and identify the constraints. (2 marks)

(c) Calculate the contributions per key factors. (3 Marks)

(d) Calculate the product mix which maximises profit for the year and state the amount of profit. (5 Marks)

(e) Calculate the minimum price at which the sale of product Paster would be worthwhile. (2 Marks)

**(Total 15 Marks)**

**SOLUTION MULTIPLE- CHOICE QUESTIONS**

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

**WORKINGS**

10 Breakeven (units) = Fixed cost/contribution per unit

$\frac{₦100,000}{₦15 - ₦10}$ = 20,000 units

| | | ₦ |
|---|---|---|
| 12 | Profit | 600,000 |
| | Less depreciation | 100,000 |
| | Operating profit | 500,000 |
| | Minimum Return 20% | (400,000) |
| | Residual Income | 100,000 |

| | ₦ |
|---|---|
| Standard Variable Cost | 70.00 |
| Unit Standard Fixed Cost | 40.00 |
| Unit Std Total cost | 110.00 |
| Unit std mark-up | 27.50 |
| | 137.50 |

**EXAMINERS' REPORT**

**The questions cover a wide area of the Syllabus. Candidates' performance was good.**

**PART II SHORT-ANSWER QUESTIONS**

1. (₦780,000)

2. Activity Based Budgeting (ABB)

3. Programmed Decisions

4. Open loop System

5. ₦300,000

6. Sensitivity Analysis

7. Internal Rate of Return (IRR) interpolation

8. Minimum Price/Strategy

9. ₦7.00 per hour

10. ₦24,000

11. Budget Centre

12. 112.50%

13. ₦26.67

14. Market Penetration

15. Stepped-Fixed Cost

16. Residual or Scrap value

17. Aggregate contribution ratio

18. Differentiate between the alternatives and be a future cost

19. ₦1,599,145.00

20. Minimum required rate of return/Imputed cost of capital

**WORKINGS**

1. Residual Income = Net Income – Imputed interest on assets

=₦2,100,000 – 12% of ₦24,000,000
=₦2,100,000 – ₦2,880,000 = (₦780,000)

5. Total Cash Inflow = ₦250,000 x 1.20 = ₦300,000

9. Using High-low Method

| Period | Hours | Cost |
|---|---|---|
| 4 | 2,450 | 41,150 |
| 1 | 1,750 | 36,250 |
| | 700 | 4,900 |

Variable Cost/hour = $\frac{4,900}{700}$ = ₦7.00

10. Fixed Cost = Total Cost – Variable Cost
= 36,250-7(1750)
= 36,250-12,250 =
= ₦24,000

12. Labour Production Ratio

$$= \frac{\text{Standard Hours of Actual Production}}{\text{Actual Hours of Actual Production}} \text{ x } \frac{100}{1}$$

$$= \left[\frac{3{,}000 \; x \; 6}{16{,}000} \, x \, \frac{100}{1} \%\right]$$

$$= \frac{18{,}000}{16{,}000} \; x \; 100 = \underline{112.5\%}$$

13. Actual labour Cost per unit

$$= \frac{\textit{Actual Labour Cost}}{\textit{Actual Production}} = \frac{₦80{,}000}{3{,}000}$$

₦26.67

19. Investment = ₦3,791,000
Annual Cash Flow = ₦1,350,000
Discount Factor = 8%
Cum. Disc Factor $= 1 - \frac{(1+r)^{-n}}{r}$

$$= 1 - \frac{(1.08)^{-5}}{.08}$$

= 3.9927

PV = 3.9927 x ₦1,350,000 = ₦5,390,145
NPV = PV-Investment
= ₦5,390,145 –3,791,000
= ₦1,599,145

**EXAMINERS' REPORT**

The questions cover a wide area of the syllabus.
Candidates' understanding of the principles was poor and performance was below average.

Candidates are advised to ensure an indept coverage of the syllabus and acquaint themselves with current developments in Management Accounting.

**SOLUTIONS TO SECTION B**

**QUESTION 1 – CASE STUDY**

(a) **OMEGA HOTELS LIMITED**
Target Ratios

(i) Return on Capital Employed (ROCE)

$$\frac{Profit}{Total\ Assets} x \frac{100}{1} = \frac{66{,}000}{300{,}000} x \frac{100}{1} = 22\%$$

(ii) Operating Profit %

$$\frac{Profit}{Turnover} x \frac{100}{1} = \frac{66{,}000}{820{,}000} = 8\%$$

(iii) Asset Turnover

$$= \frac{Turnover}{Total\ Asset} = \frac{820{,}000}{300{,}000} = 2.7\ times$$

(iv) Working Capital Period

$$= \frac{working\ capital}{Operating\ Costs} x\ 365$$

$$= \frac{70{,}000}{754{,}000} x\ 365 = 34\ days$$

(v) Percentage Room Occupancy

$$= \frac{Number\ of\ Rooms\ Night\ let}{Number\ of\ Rooms\ night\ available} x\ 100$$

$$= \frac{5{,}900}{18\ x\ 365} x\ 100 = 90\%$$

(vi) Turnover per Employee

$$= \frac{Turnover}{Number\ of\ Employee} = \frac{820{,}000}{20} = ₦41{,}000$$

(b) EAS MANAGEMENT CONSULTANTS

7 Lagbaja street,
Idimu,
Lagos
16th November 2011

The Managing Director,
Concord Hotels Limited
64 Sangotedo Street,
Lagos

Dear Sir,

**ASSESSMENT OF THE PERFORMANCE OF OMEGA HOTELS LIMITED**

We wish to bring to your notice that we have completed the assessment of Omega Hotels Limited based on the extracts of accounting information for the year ended 31 December, 2010, and the results of the key target ratios computed are as follows:

(i) **Return on Capital Employed (ROCE)**

Although the bench mark ratio under this subject head is 20%, a 22% ROCE by Omega Hotels Limited is a positive development as it provides an acceptable ground that the Hotel's profitability is healthy and encouraging.

(ii) **Operating Profit Percentage**

This ratio depicts the relationship of profit on turnover. Whereas the base rate of Concord Hotels Limited is 15%, the 8 % achieved by Omega Hotels Limited is seriously on the low side. It simply means there is need to improve turnover through price increases as well as reduction of costs of operation to improve the ratio.

(iii ) **Asset Turnover**

Whereas Concord Hotels Limited recorded an Asset Turnover of 2.5 times, the Asset Turnover for Omega Hotels Limited is 2.7times. Both ratios are close even though that of Omega Hotels Limited is slightly higher. Hence, generated higher turnover through lower prices for its services which is not translated into high profitability.

(iv) **Working Capital Period**

The Working Capital Period of 34 days is significantly on the high side as it simply means there is need to attend to the debtors control period, reduce stock as well as ensure that credits available from creditors are utilised maximally.

(e) **Percentage of Room Occupancy**

This ratio depicts in percentage the relationship between number of rooms night let and number of rooms night available. From the computation, Omega Hotels Limited recorded a healthier outcome of 90% when compared to the 85% achieved by the Concord Hotels Limited.

(f) **Turnover per employee**

The Omega Hotels Limited turnover per employee of ₦41,000 is encouraging when compared with the ₦35,000 benchmark set at Concord Hotels Limited. There is need, however, to ensure that attention is paid to the customer services, operating costs as well as management of working capital.

Whilst thanking you for the confidence reposed in us, it is hoped that you would find this memorandum useful.

Yours faithfully,

Joe Arikuyeri
For: EAS Management Consultants

(c) **LIMITATIONS IN THE USE OF TARGET RATIOS**

The following are the observed limitations in the use of target ratios

(i) **Return on Capital Employed (ROCE)**

The Return on Capital Employed (ROCE) can produce artificial returns especially when the total assets (Capital Employed) is either under-valued or over-valued.

(ii) **Operating Profit Percentage**

The ratio is dependent on two variables relating profit to sales. There is the possibility that certain facilities which are different from those available in Concord Hotels Limited may be available in Omega Hotels Limited and can impact negatively on the turnover and profit profile of Omega Hotels Limited.

(iii) **Asset Turnover**

The limitation of this ratio borders on accuracy in asset valuation and methods adopted by the two companies which could also differ.

(iv) **Working Capital Period**

The limitation of this ratio depends on how the working capital is valued. Again, the information that gives rise to the ratio are all balance sheet data which are collected on a particular day.

(v) **Percentage of Room Occupancy**

This ratio is basically derived from the relationship between the number of rooms night let and the number of rooms night available. Factors like room rate which will have overbearing influence in hotels patronage is not considered.

(vi) **Turnover Per Employee**

The ratio does not consider employment policy and the various cadres of staff available in the two hotels.

**EXAMINERS' REPORT**

**This question tests candidates' knowledge of performance ratio analysis in evaluating company's profitability.**

**About 95% of the candidates attempted the question but performance was poor. Candidates understanding of the question was very poor. Many could not even correctly apply the formulae already provided in the question.**

**Candidates are advised to recognise the inter-relationship among the subjects in the professional examinations and work through the Institute's past question papers.**

**SOLUTION 2**

| Standard product cost for one unit of product XY | ₦ |
|---|---|
| | |
| Direct materials (8kg (W2) at ₦1.50(W1) per kg | 12.00 |
| Direct wages (2 hours (W4) at ₦4 (W3) per hour) | 8.00 |
| Variable overhead (2 hours (W4) at ₦1 (W5) per hour) | 2.00 |
| | 22.00 |

**Workings:**

(W1) Actual quantity of materials purchased at standard price is (actual cost plus favourable material price variance)
₦210,000 + ₦15,000 = ₦225,000
Therefore standard price = (₦225,000/150,000kg) = ₦1.50

(W2) Material usage variance = (₦9,000/₦1.50 standard price) = 6,000kg
Therefore standard quantity for actual production = 150,000 – 6,000 kg = 144,000kg
Therefore standard quantity per unit = (144,000kg/18,000 units) = 8kg

(W3) Actual hours worked at standard rate = (₦136,000-₦8,000) = ₦128,000
Therefore standard rate per hour = (₦128,000/32,000 hours) = ₦4

(W4) Labour efficiency variance = (₦ 16,000/4) = 4,000 hours
Therefore standard hours for actual production = 32,000 + 4,000 = 36,000 hours
Therefore standard hours per unit = (36,000 hours/18,000 units) =2 hours

(W5) Actual hours worked at the standard variable overhead rate is (₦38,000 actual variable overhead less ₦6,000 favourable expenditure variance). =₦ 32,000

Therefore, standard variable overhead rate = (₦ 32,000/32,000hours) = ₦1

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the application of variance analysis in standard costing techniques.**

**About 50% of the candidates attempted the question and only about 30% of them scored above average marks. The following pitfalls were observed:**

- **Candidates did not have sufficient knowledge of standard costing principles.**
- **Inability to work back variance analysis to arrive at the standard cost per unit of a product.**
- **Lack of understanding of the relationship between standard cost, actual costs and variances.**
- **Poor layout of solutions.**

**Candidates are advised to ensure adequate preparations, pay serious attention to this technique and maintain proper layout in presenting solutions.**

**SOLUTION 3**

**BOLA BOLINGTON**

(a) No of pairs of shoes

BEP (unit) = $\frac{fixed\ cost + Desired\ Profit}{Contribution\ margin}$

Contribution margin = Selling Price – Variable Cost = ₦35 – ₦15 = ₦20
Desired profit = 20% (₦ 1,050,000) = ₦210,000

$$= \frac{₦450,000 + ₦210,000}{20} = 33,000 \text{ pairs}$$

(b) Capital Turnover = $\frac{Turnover}{Capital\ employed\ or\ average\ assets} = \frac{₦1,150,000}{₦1,050,000}$ = 1.1 times

(c) Operating Income % of Naira sales

$$\frac{Operating\ Income}{Sales} x\ 100$$

$$\frac{210{,}000}{₦1{,}155{,}000} x\ 100 = 18.18\%$$

(d) Residual Income

| | ₦ |
|---|---|
| Profit | 210,000 |
| Less Imputed charge: | |
| (12% of ₦1,050,000) | 126,000 |
| | 84,000 |

(e) If sales volume is 15,000 pairs of shoes, the rate of return to be earned on available asset is:

| | ₦ |
|---|---|
| Sales (15,000 x ₦35) | 525,000 |
| Less: VC @ ₦15 | 225,000 |
| Contribution | 300,000 |
| Less: fixed cost | 450,000 |
| Income/(Loss) | (150,000) |
| Rate of return = $\frac{(150{,}000)}{1{,}050{,}000} x\ 100 =$ | (14.29%) |

**EXAMINERS' REPORT**

**The question tests candidates' knowledge on the computation of Rate of Return on Average Assets, Capital Turnover, Cost of Capital, Residual Income and the application of Cost Volume Profit Analysis. About 80% of the candidates attempted the question.**

**Candidates understanding of the question was average. Computational mistakes were made by about 50% of the candidates as they could not correctly recall the relevant formulae.**
**Candidates are advised to have a good understanding of the topic and correctly apply requisite formulae in appropriate areas of the syllabus.**

**SOLUTION 4**

**FEDICON ALUMINIUM SYSTEMS LIMITED**

(a) Price elasticity of demand $= \frac{\%\ change\ in\ quantity\ demanded}{\%\ change\ in\ price}$

$= 1.5$

When the company price fell by 4% in real terms, demand increased by 4% x 1.5= 6%

When the company's price falls by 6% in real terms demand will increase by 6% x 1.5 = 9%

Determination of fixed and variable costs

Adjust current period's costs to previous period's prices:

$= \frac{4{,}309.76}{1+0.04} = 4{,}144$

Using high/low method to determine fixed/variable cost

| Period | Units | Cost |
|---|---|---|
| | | ₦' 000 |
| Current | 212,000 | 4,144 |
| Previous | 200,000 | 4,000 |
| | 12,000 | 144 |

Variable cost per unit = ₦12

Total Cost per unit $= \frac{₦4{,}000{,}000}{200{,}000\ units}\ x\ ₦20$

Fixed cost = 200,000 (20-12) = ₦1,600,000
Variable cost per unit next period = 12 x 1.04 x 1.06 = ₦13.2288
Fixed cost next period = 1,600,000 x 1.04 x 1.06 = ₦1,763,840

| BUDGETED POSITION | PRICE ₦ 26 | ₦ |
|---|---|---|
| SALES | 212,000 x 1.09 x ₦ 26 | 6,008,080 |
| VARIABLE COST | 212,000 X 13.2288 x 1.09 | 3,056,911 |
| CONTRIBUTION | | 2,951,169 |
| Less: | | |
| FIXED COST | | (1,763,840) |
| PROFIT | | 1,187,329 |

(b) Budgeted Position at ₦26 plus 6%

| | | ₦ |
|---|---|---|
| SALES | 212,000 x 26 x 1.06 | 5,842,720 |
| VARIABLE COST | 212,000 x 13.2288 | 2,804,523 |
| CONTRIBUTION | | 3,038,197 |
| FIXED COST | | (1,763,840) |
| PROFIT | | 1,274,357 |

(c) TO: THE BOARD OF DIRECTORS

FROM: MANAGEMENT ACCOUNTANT

DATE: 16 NOVEMBER 2011

SUBJECT: **DECISION TO INCREASE SELLING PRICE**

The above subject matter refers.

Based on the calculations above, it was reflected that profit of ₦ 1,274,357 derived from the increase in price was higher than the original profit of ₦1,187,329.00.

In view of this, it is hereby recommended that the Company should increase its selling price from ₦26.00 to ₦27.56 provided that all other things remain constant.

Signed
MANAGEMENT ACCOUNTANT

(d) Typical assumptions include:

i) Changes in volume are solely a function of price changes
ii) Changes in volume are not influenced by advertising, consumer preferences, general economic conditions, etc
iii) The decision makers i.e consumers, are rational and are making decisions on purely economic factors
iv) The fixed /variable cost split is constant over time

v) The fixed and variable costs are both affected by inflation to the same degree
vi) The estimates of the elasticity of demand are correct

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the effect of changes in demand and prices on sales budget.**

**About 25% of the candidates attempted the question. Performance was very poor as no candidate scored up to 50% of the allocated marks. Candidates did not clearly understand the requirements of the question and showed a shallow knowledge of the principles of elasticity of demand.**

**Candidates are advised to practise extensively on related topics and the application of economic principles for management decision making.**

**SOLUTION 5**

a (i) Activity-Based Costing (ABC): This system assigns overheads to each activity other than cost centres or departments. It is an approach to the costing and monitoring of activities which involves tracing resource consumption and costing final outputs. Resources are assigned to activities or cost objects based on consumption estimates.

(ii) Cost driver represents the bases for charging costs in the ABC system with a separate cost centre established for each cost driver.

Where several costs are driven by the same activity then those costs are put into " cost pools" and the total of the cost pool is absorbed by relevant cost drivers.

b(i) Calculation of unit cost using Traditional Method

| | Product X | Product Y |
|---|---|---|
| | ₦ | ₦ |
| Material cost | 3.00 | 3.00 |
| Labour cost | 1.25 | 1.25 |
| Overhead (per machine hour) | 3.67 | 3.67 |
| | 7.92 | 7.92 |

Labour cost = $₦7.50 \; x \; \frac{10 \; mins}{60 \; mins} = ₦1.25$

Overhead cost = $\frac{₦1,375,000}{750,000} = ₦1.83$

The above costing implied that we are indifferent between producing product X and Product Y

(ii) Calculation of unit cost using ABC approach

Step 1 — Direct material cost and labour under Traditional Method:

| | Product X | Product Y |
|---|---|---|
| | ₦ | ₦ |
| Materialcost | 3.00 | 3.00 |
| Labour cost | 1.25 | 1.25 |
| | 4.25 | 4.25 |

Step 2- Calculate the overhead cost per cost driver

| | Product X | Product Y |
|---|---|---|
| | ₦ | ₦ |
| Overhead Cost: | | |
| Set- up (₦300,000/200) = ₦1,500/set up | | |
| Product X = (36/20,000 x ₦1,500) | 2.70 | |
| Product Y = (4/4,000 x ₦1,500) | | 1.50 |
| Purchasing =(₦200,000/3,600) = ₦55.56 per order | | |
| Product X = (40/20,000 x ₦55.56) | 0.11 | |
| Product Y = (8/4,000 x ₦55.56) | | 0.11 |
| Material Handling = (₦155,000/15,000) = ₦10.33/time | | |
| Product X = (300/20,000 x ₦10.333) | 0.15 | |
| Product Y = (20/4000 x ₦10.333) | | 0.05 |
| Machines ₦720,000/750,000 = ₦0.96 x 2 | 1.92 | 1.92 |
| Total overhead cost | 4.88 | 3.58 |
| Material labour cost | 4.25 | 4.25 |
| Total unit cost (based on ABC method) | 9.13 | 7.83 |

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the concept of Activity-Based Costing (ABC).**

**About 50% of the candidates attempted the question. Candidates could not properly explain the term ABC. Total costs were being computed instead of unit costs. Many engaged in lengthy but irrelevant computations.**

**Candidates are advised to update their knowledge on current Management Accounting techniques.**

**SOLUTION 6**

(a) Calculation of product contributions

| | Paster | Baster | Caster | Daster |
|---|---|---|---|---|
| | ₦ | ₦ | ₦ | ₦ |
| Selling price | 55 | 53 | 97 | 86 |
| Variable costs: | | | | |
| Material | 17 | 25 | 19 | 11 |
| Labour A | 15 | 9 | - | - |
| Labour B | - | - | 15 | 30 |
| Labour C | - | - | 18 | 9 |
| Overhead | 6 | 7 | 5 | 6 |
| | 38 | 41 | 57 | 56 |
| Contribution | 17 | 12 | 40 | 30 |

(b) The objective is to maximize contribution subject to constraints on the three types of labour

Let a = the number of units of production Paster to be made
Let b = the number of units of product Baster to be made
Let c = the number of units of product Caster to be made
Let d = the number of units of product Daster to be made

Objective function:

Maximise $17a + 12b + 40c + 30d$

Subject to constraints on:
Grade A labour $10a + 6b \leq 9,000$
Grade B Labour $10c + 20d \leq 14,500$
Grade C Labour $12c + 6d \leq 12,000$

Products Paster and Baster use only grade A labour, whilst products Caster and Daster are the only users of grade B and grade C labour. In order words, production of products Paster and Baster and production of product Caster and Daster are independent of each other. The problem can be formulated then as two separate linear programming problems.

Thus:

(i) Maximise $17a + 12b$
Subject to $10a + 6b \leq 9{,}000$

(ii) Maximise $40c + 30d$
Subject to $10c + 20d \leq 14{,}500$
$12c + 6d \leq 12{,}000$

(c) The problem can be solved using the contribution per key factor. Thus:

| | | |
|---|---|---|
| Contribution from Product Paster | = | ₦17.00 |
| Key factor (constraints) | = | 10 hours of Grade A |
| Contribution per key factor | = | ₦17/10 = ₦1.70 per hour |
| | | |
| Contribution from Product Baster | = | ₦12.00 |
| Key factor (constraints) | = | 6 hours of Grade A |
| Contribution per key factor | = | ₦12/6 = ₦2.00 per hour |

It is, therefore, clearly better to manufacture product Baster in preference to product Paster and, if this is done, the 9,000 hours maximum hours of grade A labour would produce 9,000/6 = 1,500 units of product Baster given contribution of 1,500 x 12 = ₦18,000

Maximum possible output for product Caster if total available hours of grade B are devoted to its production = $\frac{14{,}500}{10} = 1{,}450\ units$

Similarly, maximum possible output for product Daster using grade B labour = $\frac{14{,}500}{20} = 725\ units$

Maximum possible output using grade C labour: Product Caster = $\frac{12{,}000}{12} = 1{,}000\ units$

Product Daster = $\frac{12{,}000}{6} = 2{,}000\ units$

(d) Optimal Strategy:

| | | | ₦ |
|---|---|---|---|
| Produce | 1,500 units of Baster (1,500 X ₦12) | = | 18,000 |
| | 850 units of Caster (850 x ₦40) | = | 34,000 |
| | 300 units of Daster (300 x ₦30) | = | 9,000 |
| | Total Contribution | = | 61,000 |
| | Less fixed overhead | = | 35,500 |
| | Profit | = | 25,500 |

(e) Since Product Baster yields ₦2 per hour of grade A labour used, then the contribution of product Paster must be the same for it to be a worthwhile item for sale. Product Paster uses 10 hours of grade A labour per unit, and therefore its contribution should be at least 10 x ₦2 = ₦20, that is an increase of ₦3. The minimum selling price should be ₦55 +₦3 = ₦58.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the application of Marginal Costing Techniques and Linear Programming for managerial decision making.**

**About 80% of the candidates attempted the question, out of which 70% of them were able to determine the products contributions and formulate the objective function of the LP. They were, however, unable to determine the appropriate product mix that will maximise profit.**

**Candidates are advised to study adequately and ensure proper understanding of the question before rushing into proffering solutions.**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
# PROFESSIONAL EXAMINATION I – NOVEMBER 2011

## FINANCIAL ACCOUNTING

**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. What do we call the option given to shareholders to convert cash dividend payment approved at Annual General Meeting to shares at current market price?

   A. Cash dividend
   B. Scrip issue
   C. Scrip dividend
   D. Bonus dividend
   E. Bonus issue

2. Which Statement of Accounting Standard (SAS) requires listed companies to prepare Cash Flow Statements?

   A. SAS 15
   B. SAS 16
   C. SAS 18
   D. SAS 20
   E. SAS 22

3. Which of the following statements regarding accrual basis of accounting is false?

   A. Expenses incurred but not yet paid are current liabilities
   B. Revenue is recognized in the period in which it is earned
   C. The basis is in accord with Generally Accepted Accounting Principles
   D. Revenue is recorded only when cash is received
   E. Basis complies with the matching concept

4. Which of the following is the main ratio used to assess the efficiency of a company management?

   A. Interest Cover
   B. Return on Capital Employed
   C. Stock Turnover
   D. Acid Test Ratio
   E. Dividend Yield

5. Benjas Plc. sold goods worth ₦120,000 to its subsidiary. The goods were invoiced at cost plus 20%. At the accounting year end, one half of the goods has been sold. What is the unrealized profit in stock for consolidation purpose?

   A. ₦30,000
   B. ₦24,000
   C. ₦10,000
   D. ₦7,500
   E. ₦6,000

6. Hat Plc owns 70% of the equity of Cap Plc., while Cap Plc. owns 30% of Tie Plc. With respect to Hat Plc., what do you consider Tie Plc's relationship to be?

   A. An Associate
   B. A Subsidiary
   C. A Partial Company
   D. Non-Controlling interest
   E. An unconsolidated Subsidiary

7. Which of the following is the most important function that the system's administrator can perform?

   A. Batch processing
   B. User support
   C. Financial reporting
   D. Sequence check
   E. Generation check

8. Which of the following is **NOT** an investment ratio?

   A. Dividend per share
   B. Price Earnings ratio
   C. Quick Ratio
   D. Dividend Cover
   E. Earnings per share

9. How are investments in associated companies recognised in Consolidated Financial Statements?

   A. Short term investment
   B. Current investment
   C. Long term investment
   D. Marketable investment
   E. Investment property

10. A joint venture that involves the establishment of a company, partnership or other entity in which each venturer has an interest is known as

   A. Jointly controlled operations
   B. Joint control equity
   C. Jointly controlled assets
   D. Proportionate consolidation
   E. Jointly controlled entities

11. The movement of data or information from one location to another is called

   A. Data processing
   B. Data preparation
   C. Data communication
   D. Data transmission
   E. Data syndication

12. What is the main responsibility of a Librarian in a computerized accounting system or department?

   A. Keeps custody of the software
   B. Looks after the program and data file
   C. Ensures security of the computer system
   D. Keeps custody of manuals relating to the computer system
   E. Issues out books on computer application

13. A date where an enterprise decides to adjust its opening Balance Sheet to comply with the International Financial Reporting Standard (IFRS) is called

A. Adjustment date
B. Acquisition date
C. Transmission date
D. Change in accounting date
E. Compliance date

14. Which of the following may **NOT** be considered a "qualifying asset" under IAS 23?

A. A toll bridge that takes a couple of years to construct
B. A power plant that takes three years to get ready for its intended use
C. A hydroelectric dam that takes three years to construct
D. An expensive car that takes few months to ship from abroad
E. A ship that takes about two years to build

15. In marketing and distribution of Oil and Gas operations, ATK overbilling claims are normally set up as a

A. Bridging cost
B. Receivable
C. Catalyst
D. Debottleneck
E. Selling cost

**Use the following information to answer questions 16 and 17**

Microsoft Excel package is an accounting package that manipulates rows and columns; the table below depicts extracts of a Group account Consolidation Schedule taken from the package.

**Microsoft Excel Sheet**

| | B | C | D | E |
|---|---|---|---|---|
| 1. | **TOTAL** | **COST OF ACQUISITION** | **POST ACQUISITION** | **NCI** |
| 2. | ₦'000 | ₦'000 | ₦'000 | |
| 3. | 50,000 | ? | | 10,000 |
| 4. | 30,000 | 8,000 | ? | |
| 5. | | ? | | |
| 6. | | 79,000 | | |
| 7. | | ? | | |

Note:

NCI = Non controlling interest
XYZ Plc is a subsidiary company

16. Generate an Excel equation that can calculate C3.

A. B3 + E3
B. B3 + C3
C. C3 + E3
D. B3 – E3
E. B2 – E3

17. An Excel equation that can calculate D4 is

A. B3 – C3 – E3
B. B4 – C4 – E4
C. Sum (D3 – D4)
D. Sum (B4 – E4)
E. B4 + C4 + E4

**Use the following information to answer questions 18 and 19.**

An extract from the books of EZINWA Commercial Bank Plc revealed the following as at 31 December.

| | ₦'million |
|---|---|
| Issued Ordinary Share Capital | 250,000 |
| Statutory Reserves | 189,000 |
| Profit Before Taxation | 102,000 |
| Taxation | 36,000 |
| Profit After Taxation | 66,000 |
| Dividend paid | 20,000 |

18. Calculate the amount of transfer to Statutory Reserve in the year:

A. ₦19,800m
B. ₦30,600m
C. ₦ 9,900m
D. ₦15,300m
E. ₦18,900m

19. Calculate how much should be transferred to reserve in relation to small and medium enterprises equity investment scheme. Assuming the bank has only been in existence for five years.

A. ₦ 5,100m
B. ₦10,200m
C. ₦ 6,600m
D. ₦ 3,300m
E. ₦ 4,600m

20. In the translation of the Profit & Loss Account of a foreign subsidiary, dividend paid is converted at

A. Forward rate
B. Closing rate
C. Floating rate
D. Average rate
E. Actual rate

## PART II SHORT-ANSWER QUESTIONS (20 Marks)

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

1. Give an example of prior period adjustments.

2. Conditions or situations existing at the Balance Sheet date, the financial effect of which will be determined by future events that may or may not occur are called ……………………..

3. Material items derived from the ordinary activities of an entity and which because of their size and incidence need separate disclosures, to give a true and fair view are known as …………………………..

4. State the general principle for the valuation of stock.

**Use the following information to answer 5 and 6.**

The following information relates to Floppy Plc, an 80% owned subsidiary of Boogie Plc. At the date of acquisition, the share capital of Boogie Plc was ₦400m.

| | ₦'000 |
|---|---|
| Book value of net asset acquired | 610,000 |
| Surplus on valuation of property | 50,000 |
| Re-organization costs | 18,000 |
| Net realizable value of stock is lower than cost by | 9,000 |
| Cost paid by Boogie to acquire Floppy | 520,000 |

Property is to be depreciated at 10% on cost per annum.

5. Calculate the pre-acquisition profits.

6. Determine the Goodwill arising on acquisition of Floppy Plc.

7. Given:
   i. Net profit for the year 2010............................................. ₦500m
   ii. Ordinary shares of ₦1each in 2010 .................................. ₦1,900m
   iii. Average fair value of one share in 2010 .............................. ₦16
   iv. Shares under option in 2010, convertible at ₦12 per share ...... ₦400m

   Calculate the diluted EPS.

8. When investments are sold cum-div, it implies that the whole of the next dividend is received by the ....................................

**Use the following information to answer Questions 9 to 10.**

Bariga Plc. has 80% and 30% interest in the Equity Shares of Ifako Plc. and Ketu Plc. respectively.

Profit & Loss Account extract for the year ended 31 December 2009 are as follows:

| | Bariga Plc | Ifako Plc | Ketu Plc |
|---|---|---|---|
| | ₦ | ₦ | ₦ |
| Profit after tax | 990,000 | 648,000 | 596,600 |
| Extra ordinary income | 68,600 | - | 24,000 |
| Interim dividend paid | (50,000) | (30,000) | (18,000) |
| General Reserve | (120,400) | (42,000) | (32,000) |
| Retained profit for the year | 888,200 | 576,000 | 570,600 |

9. Calculate the amount of extraordinary income which will appear in the Consolidated Profit & Loss Account.

10. Calculate the intergroup dividend to be adjusted for, during consolidation.

11. Voyage account in a shipping company is the equivalent of ……………………. in a trading company.

12. When an in-built logic circuit is used to check if the result of an arithmetic operation is in error, such check is called …………………….

13. What is the basic assumption required to convert gas volume to equivalent barrel of oil during joint production of Oil and Gas?

14. How is the contingency reserve for Life Assurance business calculated?

15. List **TWO** items that could be disclosed as major non-cash transactions when preparing Cash Flow Statement.

16. What is the document forwarded by a stock brokerage firm to a client immediately a transaction is concluded?

17. MOA Plc transferred equipment which it bought for ₦1.8m to one of its subsidiaries, GTEX Limited at ₦2.2m. Show the double entries required to eliminate the unrealized profit.

18. The amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arms-length transaction is called …………………..

19. Loans and advances given out by banks are classified into …………. and ………………..

20. State the **TWO** methods of calculating deferred taxation provision.

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

### QUESTION 1 CASE STUDY

Pastor Kako, a Chartered Accountant, recently attended the World Accountant Conference held in Malaysia in November 2009 in company of his friend, a Fellow Chartered Accountant – Alhaji Badamosi who is also the Chairman/CEO of Net Phone Nig. Limited, one of the Private Telecommunication Operators (PTO) licensed by the Nigerian Communication Commission (NCC).

In Malaysia, both friends took time to visit places of business interests and during one of their outings, they met an American –Mr. Paul who also operates telecommunication business in Malaysia but interested in investing in Nigeria due to the large market.

It was therefore agreed that they should enter into Joint Venture agreement to form a new Telecommunication outfit that could be registered in Nigeria and that each of them would have interest in the company as follows:

| | |
|---|---|
| Pastor Kako | 20% |
| Alhaji Badamosi | 40% |
| Mr. Paul | 40% |

Mr. Paul also proposed to Alhaji Badamosi to allow him to acquire shares in NET PHONE NIG. LIMITED. (a fixed wireless company). Thirty percent (30%) shares of NET PHONE NIG. LTD. was sold to Mr. Paul's telecommunication company – Malaysia Cell Ltd. and Mr. Paul paid on behalf of the company 150 billion Ringit (Malaysia currency)
The following is the extract of financial statements of NET PHONE NIG. LIMITED as at 30 September 2010 (before the sale of the 30% shares).

**NET PHONE NIG LTD.**

**Profit and Loss Account for the year ended 30 September 2010**

| | ₦'m | ₦'m |
|---|---|---|
| Turnover | | 66,768 |
| Cost of sales | | (22,800) |
| Gross Profit | | 43,968 |
| Administrative expenses: | | |
| Salaries and wages | 16,500 | |

| | | |
|---|---|---|
| Depreciation | 1,200 | |
| Repairs and maintenance | 350 | |
| Staff training | 700 | |
| Consultancy fee | 60 | |
| Other admin. expenses | 7,150 | (25,960) |
| Distribution and other expenses | | (2,206) |
| Operating profit | | 15,802 |
| Other Operating Income | | 42,700 |
| | | 58,502 |
| Non operating income | 88 | |
| Non operating expense (interest paid) | 80 | 8 |
| Net profit before Tax | | 58,510 |
| Taxation | | (280) |
| | | 58,230 |

**Balance sheet extract as at 30 September 2010**

| Asset employed | ₦'m |
|---|---|
| Fixed Assets | 29,580 |
| Net Current Assets | 178,650 |
| | 208,230 |
| Financed by: | |
| Ordinary shares at ₦1 each | 100,000 |
| Share Premium | 20,000 |
| Retained Profit | 88,230 |
| | 208,230 |

On returning to Nigeria, Pastor Kako could not meet up with his own share of the 20% interest in the Joint Venture and therefore decided to inform Alhaji Badamosi who later informed Mr. Paul and the interest of Pastor Kako was shared on equal basis between Alhaji Badamosi and Mr. Paul without the consent of Pastor Kako.

The Joint Venture agreement subsequently entered into provides the following:

(i) That Alhaji Badamosi shall be responsible for all the activities required to set up the new company in Nigeria.

(ii) Profit and Loss arising from the Joint Venture shall be shared equally.

(iii) Mr. Paul sent R240 billion (Ringit) on 15 November 2010 and was received on same date to provide fund for Mr. Paul's participation in the Joint Venture.

The transactions that took place are as follows:

| | | ₦'m |
|---|---|---|
| ▪ | Payment to CAC for registration | 10,000 |
| ▪ | Payment to NCC for License | 11,200 |
| ▪ | Consultancy fees | 7,500 |
| ▪ | Sundry expenses | 120 |
| ▪ | Interest received on fund placed on call | 600 |
| | Other formation expenses | 75 |

Mr. Paul also sent a technical document prepared in Malaysia at the cost of R5 billion to Alhaji Badamosi in Nigeria to facilitate the registration on the same day when the fund was remitted.

However, when Pastor Kako learnt that his interest in the Joint Venture has been taken up by Alhaji Badamosi and Mr. Paul, he decided to take up the matter legally and threatened to sue Alhaji Badamosi and Mr. Paul for breach of agreement.

Other relevant information relating to exchange rates are:

| | | |
|---|---|---|
| R6.0 to ₦1 | - | mid month of August 2010 |
| R5.5 to ₦1 | - | average for September 2010 |
| R7.5 to ₦1 | - | average for October 2010 |
| R5.0 to ₦1 | - | mid month of November 2010 |
| R6.5 to ₦1 | - | at 30 September 2010 |

**You are required to:**

(a) (i) Explain the nature of jointly controlled entity and how to account for it. (3 Marks)

(ii) List the **TWO** other types of joint venture arrangements. (2 Marks)

(b) State **TWO** basic clauses which the legal consultant will include in the Joint Venture agreement. (2 Marks)

(c) Based on the information available, prepare Net Phone Nigeria Limited's Value Added Statement as at 30 September 2010 for publication.
(3 Marks)

(d) Prepare Joint Venture Account with Mr. Paul in the ledger of Alhaji Badamosi. (3 Marks)

(e) State **TWO** items which any company carrying out telecommunication business in Nigeria must disclose as notes to the financial statements in accordance with SAS 25. (2 Marks)

**(Total 15 marks)**

**QUESTION 2**

NAPAS Plc. was incorporated with an Authorized Share Capital of ₦5,000,000, 60% of which were in Ordinary Shares of ₦1 each and the balance in 10% Preference Shares. At the year ended 31 December 2009, a third of the Ordinary Share Capital has been issued and fully paid. Jullie Plc. made the following purchases of shares in NAPAS Plc.

| Date of Purchase | No. of Shares Acquired | Balance of NAPAS Plc's Reserves (₦) |
|---|---|---|
| 2003 | 100,000 | 240,000 |
| 2004 | 150,000 | 420,000 |
| 2005 | 180,000 | 590,000 |
| 2007 | 170,000 | 730,000 |
| 2009 | 210,000 | 990,000 |

**You are required to**

(a) Calculate the Pre-Acquisition Reserves for Consolidation purposes in 2009 if:

(i) Julie Plc. had ultimate intention to gain control from the onset of shares acquisition.
(5 Marks)

(ii) Julie Plc. had no ultimate intention to gain control. (3 Marks)

(b) State any **FOUR** conditions under CAMA CAP C20 LFN 2004 that will necessitate the exclusion of a subsidiary from group accounts.
(4 Marks)

(c) Where a subsidiary is excluded from Consolidation, Schedule ii of CAMA CAP C20 LFN 2004 demands certain disclosures to be made in the notes to the accounts. State any **THREE** of such disclosures. (3 Marks)

**(Total 15 marks)**

**QUESTION 3**

(a) List any **EIGHT** contents of a published Annual Report and Accounts. (4 Marks)

(b) Financial statements are expected to be drawn up in conformity with the requirements of accounting legislation, regulations and principles. State these legislations, regulations and principles. (4 Marks)

(c) The financial statements of a private company need **NOT** include certain matters. State these matters. (4 Marks)

(d) Statement of Accounting Standards (SAS) 18 requires that companies should prepare cash flow statements to explain the use and application of cash. State any **THREE** advantages of cash flow statements normally included in the annual reports of companies. (3 Marks)

**(Total 15 marks)**

**QUESTION 4**

Oko-Oba Farms Limited is engaged in arable plantation, livestock and other gracing animals. As a result of large population in the country, the demand for cattle has risen over the years. The company is willing to determine cattle net profit for the year ended 31 November 2009 so that it can plan on how to attract further investment in the department in the nearest future. The following information is given:

| | ₦ '000 |
|---|---|
| Sale of cattle (600) heads | 1,800,000 |
| Cattle slaughtered (200) heads and meat sold | 300,000 |
| Sale of hides and skins | 105,000 |
| Sale of Offal | 80,000 |
| Cattle stock at the beginning (650 heads) | 350,000 |
| Sale of carcasses (9 heads) | 13,500 |
| Bought cattle (380 heads) | 320,000 |
| Foodstuff at the beginning | 20,000 |
| Concentrates purchased | 218,000 |
| Hay cost transferred | 32,000 |

| | |
|---|---|
| Crop cost transferred to cattle unit | 44,000 |
| Feeds grinding (cattle) | 5,000 |
| Salaries and wages (cattle unit) | 626,000 |
| Maintenance of ranch farms | 10,000 |
| Depreciation of plantation equipment | 4,000 |
| Wages (Plantation unit) | 48,000 |
| Insurance for all farms equipment (25% for cattle unit) | 150,000 |
| General expenses (25% for cattle unit) | 100,000 |

Additional information:

(i) There were 90 births of cattle, during the year ended 30 November, out of which 10 were still births.

(ii) Closing stock:

Plantation valued at ₦160m
301 cattle valued at ₦180m

**You are required to**

(a) Prepare Cattle Trading, Profit & Loss Accounts for the year ended 30 November 2009. (12 Marks)

(b) In accordance with SAS 4 on stocks, state **THREE** major problems associated with valuation of plantation. (3 Marks)

**(Total 15 marks)**

**QUESTION 5**

Your client, Mr. Goody is contemplating investing in one of the two companies in his locality. He has come to you for your professional advice. The financial statements for the two companies for the year ended 31 December 2009 are shown below:

**Trading, Profit & Loss Accounts**

| | Yetty Ltd. | | Betty Ltd. | |
|---|---|---|---|---|
| | ₦'m | ₦'m | ₦'m | ₦'m |
| Turnover | | 18,000 | | 27,000 |
| Less Cost of goods sold: | | | | |
| Opening stock | 3,000 | | 2,800 | |
| Add Purchases | 13,000 | | 22,500 | |
| | 16,000 | | 25,300 | |
| Less Closing stock | 2,000 | 14,000 | 2,400 | 22,900 |
| Gross Profit | | 4,000 | | 4,100 |
| Less Other expenses | 3,180 | | 2,800 | |
| Depreciation | 220 | 3,400 | 400 | 3,200 |
| Profit before tax | | 600 | | 900 |
| Less Taxation | | 180 | | 270 |
| Profit after tax | | 420 | | 630 |
| Add P & L bal c/f | | 230 | | 220 |
| | | 650 | | 850 |
| Interim dividend paid | | 250 | | 300 |
| | | 400 | | 550 |

**Balance Sheets**

| | Yetty Ltd. | | BettyLtd. | |
|---|---|---|---|---|
| **Assets employed:** | | | | |
| Building at cost | 4,000 | | 5,400 | |
| Less depreciation | 3,550 | 450 | 2,200 | 3,200 |
| Equipment at cost | 2,400 | | 1,800 | |
| Less depreciation | 1,190 | 1,210 | 900 | 900 |
| | | 1,660 | | 4,100 |
| **Current Assets:** | | | | |
| Stock | 2,000 | | 2,400 | |
| Accounts Receivable | 2,050 | | 1,100 | |
| Bank | 100 | 4,150 | 140 | 3,640 |
| | | 5,810 | | 7,740 |
| **Current Liabilities:** | | | | |
| Accounts Payable | 2,450 | | 2,520 | |
| Taxation | 180 | 2,630 | 270 | 2,790 |
| **Net Assets** | 3,180 | | | 4,950 |

| | | |
|---|---|---|
| **Financed by:** | | |
| Authorised and issued shares of ₦1 each | 2,400 | 4,300 |
| General Reserves | 380 | 100 |
| P & L Accounts | 400 | 550 |
| | 3,180 | 4,950 |

**You are required to**

(a) Compute the following ratios:

(i) Gross profit percentage
(ii) Net profit percentage
(iii) Current ratio
(iv) Acid test ratio
(v) Returns on capital employed
(vi) Earnings per share
(vii) Dividend cover (7 Marks)

(b) Using the ratios computed above, advise your client in which company to invest. Justify your advice. (3 Marks)

(c) Describe the incidence of duality as it relates to interpretation of Financial Accounting ratios. Illustrate your answer with **TWO** examples. (3 Marks)

(d) Explain the implication in (c) above of such ratios to the users? (2 Marks)

**(Total 15 Marks)**

**QUESTION 6**

Downtown Commercial Bank Limited factors its bad debt to Asset Management Company of Nigeria (AMCON).

The terms of the agreement are as follows:

(i) Downtown Commercial Bank Limited assigns all its bad debt to AMCON, which immediately advances Downtown Commercial Bank Limited 80% of the book value less an administration charge of 1.25% of the face value.

(ii) AMCON advances the balance due to Downtown Commercial Bank Limited after three months. Interest of 1.5% per calendar month is deducted from the amount paid.

(iii) If the bad debts become uncollectable, then AMCON can reclaim 5% of the face value of the uncollected debts from Downtown Commercial Bank Limited.

Immediately before the year-end, Downtown Commercial Bank Limited had bad debts of ₦625,000,000 and these were factored into the terms set out above.

(iv) The notes to loans and advances in the Financial Statements of Ilu-Oba Micro Finance Bank Limited (A subsidiary of Downtown Commercial Bank Limited) as at 31 December 2010 are as follows:

| | ₦'000 |
|---|---:|
| Performing Loan | 875,000 |
| | |
| Non-performing loan: | |
| Pass and watch | 125,250 |
| Substandard | 40,600 |
| Doubtful | 85,200 |
| Lost | 20,100 |
| | |
| Provision for loans & advances – 31/12/2009 | 27,650 |
| Provisions no longer required | 5,690 |
| | |
| Interest in suspense b/forward | 6,500 |
| Interest transferred to suspense in the year | 2,750 |
| Interest in suspense written back | 800 |

**You are required to**

(a) Show how the factored bad debts will be presented in Downtown Commercial Bank Limited's financial statements. (4 Marks)

(b) Show how the administrative and interest charges on (a) above will be accounted for by Downtown Commercial Bank Limited. (1 Marks)

(c) Calculate loans and advances balance to be included in the balance sheet of the Ilu-Oba Microfinance Bank Limited. (10 Marks)

**(Total 15 Marks)**

## SOLUTIONS TO SECTION A

## PART 1 MULTIPLE-CHOICE QUESTIONS

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

## TUTORIALS

Q5. UPS = $\frac{20}{120} \times \frac{120,000}{1} \times \frac{1}{2}$ = ₦10,000

Q18. Statutory Reserve 30% of PAT

$\frac{30}{100}$ x ₦66,000 million

₦19,800m

Q19. SMIEIS Reserve 5% of PAT

$\frac{5}{100} \times \frac{66,000}{1}$ million

₦3,300m

**EXAMINERS' REPORT**

**The questions cover the syllabus adequately.**

**Candidates' performance was generally above average. However, some candidates could not compute correctly, statutory transfers to reserve by banks while others showed poor knowledge of accounting packages.**

**Candidates are advised to ensure adequate coverage of the syllabus with particular emphasis on the topics related to accounting packages.**

**PART II SHORT-ANSWER QUESTIONS**

1. i. Changes in accounting principles
   ii. Correction of fundamental errors
2. Contingencies
3. Exceptional items
4. Stock is valued at lower of cost and net realizable value
5. ₦385,500,000
6. ₦108,400,000 negative goodwill
7. Diluted EPS = 25 kobo
8. Purchaser/buyer
9. Extraordinary income = ₦75,000
10. Intergroup dividend = ₦29,400
11. Profit and Loss Account
12. Parity check

13. The volume of gas is divided by 6 to arrive at oil equivalent barrels

14. The higher of 1% of gross premium or 10% of Net Profit

15. i. acquisition of assets by assuming liabilities
    ii. exchange of non monetary assets
    iii. refinancing of debt
    iv. conversion of debt or preference shares to ordinary shares
    v. issuance of equity security to retire debt
    vi. bonus issues

16. Contract note

17.

| Journal entries | DR | CR |
|---|---|---|
| Group P & L Account | 400,000 | |
| Fixed Assets | | 400,000 |

18. Fair Value

19. i. Performing and non-performing loans and advances
    ii. Secured and unsecured loans and advances
    iii. Short-term and long term loans and advances

20. i. Deferred method
    ii. Liability method

**TUTORIALS**

Q5 Pre-acquisition Profits:

| | |
|---|---|
| Full Book Value of Net Asset Acquired | = ₦610,000,00 |
| | ÷ 80% |
| | = ₦762,500,00 |
| Less | |
| Share Capital of Boogie | 400,000,000 |
| | 362,500,000 |
| Adjustments: Surplus on revaluation | 50,000,000 |
| Reorganisation cost | (18,000,000) |
| Lower of net realisable value | (9,000,000) |
| Pre-acquisition Profits | ₦385,500,000 |

| | | ₦ | ₦ |
|---|---|---|---|
| Q6 | Determination of Goodwill: | | |
| | Cost of Acquisition | | 520,000,000 |
| | Less | | |
| | Net Asset Acquired: | | |
| | Share Capital | 400,000,000 | |
| | Preacquisition profit | 385,500,000 | |
| | 80% there on: | 785,500,000 | (628,400,000) |
| | Negative goodwill on consolidation | | 108,400,000 |

Q7 Diluted EPS $= \frac{₦500m}{2000 \text{ shares}} =$ 25 kobo

Q9 Extraordinary income = ₦68,000 + 30% of ₦24,000 = ₦75,800

Q10 Intergroup dividend = 0.8 x ₦30,000 x 0.3 x ₦18,000 = ₦29,400

**EXAMINERS' REPORT**

**The questions cover the syllabus adequately.**

**Most candidates scored below the average mark because of their inability to provide correct solutions to most of the computational questions.**

**Candidates should pay more attention to application of basic accounting principles.**

**SECTION B**

**QUESTION 1**

(a)(i) This is a corporation, partnership or other entity in which two or more ventures have an interest, under a contractual arrangement that establishes joint control over the entity (IAS 31). Each venturer usually contributes cash or other resources to the jointly controlled entity. It is accounted for in the consolidated financial statements using proportionate method.

Additionally, each entity must have equal representation on the management board.

**Methods**

The income statement and balance of the venturer include its share of the income, expenses, assets and liabilities of the joint venture. IAS 31 allows for the use of the two different reporting formats for presenting proportionate consolidation (IAS 31).

- Line by line combined result: the venturer may combine its share of each item, line by line, in its financial statements; or
- Separate line item method: The venture may include separate lines for its share of each item.

ii. Other types of joint venture arrangements:

- Jointly Controlled Operation
- Jointly Controlled Assets

(b) Some of the clauses to be included in the joint venture agreements are:

i. Capital contribution
ii. Activities and duration of the venture
iii. Voting right of the venturers
iv. Procedure for settling disputes
v. Appointment of managers
vi. Financial and operating policy decision
vii. Profit sharing ratio

(c)

**NET PHONES NIGERIA LIMITED**
**VALUE ADDED STATEMENT FOR THE YEAR ENDED 30 SEPTEMBER 2010**

| | | ₦'m | % |
|---|---|---|---|
| Turnover | | 66,768 | |
| Bought in goods and services | (W1) | (33,266) | |
| Value Added from operations | | 33,502 | |
| Other income | (W2) | 42,788 | |
| Total value added from operations | | 76,290 | 100 |
| | | | |
| Applied as follows: | | | |
| Employee | (W3) | 16,500 | 21.6 |
| Government | | 280 | 0.4 |
| Providers of capital | | 80 | 0.1 |
| Provisions for growth and expansion | (W4) | 59,430 | 77.9 |
| Total value added | | 76,290 | 100 |

**Notes to the statement**

| | | |
|---|---|---|
| W1 | **BOUGHT IN GOODS AND SERVICES** | ₦'m |
| | Cost of sales | 22,800 |
| | Staff training cost | 700 |
| | Repairs and maintenance | 350 |
| | Consultancy fees | 60 |
| | Distribution and other expenses | 2,206 |
| | Other admin expenses | 7,150 |
| | | 33,266 |
| W2 | **OTHER INCOME** | |
| | Other operating income | 42,700 |
| | Non operating income | 88 |
| | | 42,788 |
| W3 | **EMPLOYEES** | |
| | Salaries and wages | 16,500 |

W4 **PROVISION FOR EXPANSION AND GROWTH**

| | |
|---|---|
| Depreciation | 1,200 |
| Retained profit for the year | 58,230 |
| | 59,430 |

(d) In the ledger of Alhaji Badamosi

Joint Venture with Mr. Paul's Account

| | ₦'m | | ₦'m |
|---|---|---|---|
| Registration with CAC | 10,000 | Bank Transfer | |
| Licence fee | 11,200 | From Mr. Paul | 48,000 |
| Consultancy fee | 7,500 | Interest Received on Fund | 600 |
| Sundry expenses | 120 | | |
| Other formation expenses | 75 | | |
| Bank | 19,705 | | |
| | 48,600 | | 48,600 |

**Working Note:**

| | | | |
|---|---|---|---|
| Fund Transfer | R240b/5 | = | ₦48b |
| Technical document fees | R5b/5 | = | ₦1b |

(e) Items to be disclosed as notes to the financial statements as required by SAS 25.

(i) Breakdown of revenue and cost of sales by significant category (including those on co-location arrangements).

(ii) The amount of any levy charged to income statement in respect of telecommunication activities by significant category.

(iii) Any impairment loss recognized in the period.

(iv) The number of active subscribers at the end of the period and the reconciliation of movement in the number of subscribers from previous year.

(v) Specific details of how active subscribers are calculated.

(vi) Different categories of telecommunication licenses indicating dates of issue and expirations.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the principles and applications of the relevant accounting standards on joint venture, value added statement, translation of foreign currencies and accounts for telecommunication companies.**

**The question was attempted by majority of the candidates but their performance was below average. The commonest pitfalls identified were inability of most candidates to correctly explain jointly controlled entity, prepare value added statement and lack of knowledge of SAS 25 (Accounting for Telecommunication business).**

**Candidates are advised to pay attention to all aspects of the syllabus as case study questions requiring application of various principles and concepts would always be examined.**

**QUESTION 2**

**JULIE PLC:**

(a)(i) Calculation of pre-acquisition reserves (ultimate intention to gain control)

| **Date of Acquisition** | **No of shares Acquired** | **Percentage of Holding (%)** | **Amount of Reserves (₦)** | **Pre-acquisition reserves (₦)** |
|---|---|---|---|---|
| 2003 | 100,000 | 10 | 240,000 | |
| 2004 | 150,000 | 15 | 420,000 x 25% | 105,000 |
| 2005 | 180,000 | 18 | 590,000 x 18% | 106,200 |
| 2007 | 170,000 | 17 | 730,000 x 17% | 124,100 |
| 2009 | 210,000 | 21 | 990,000 x 21% | 207,900 |
| | | 81 | | |
| Pre-acquisition Reserves | | | | 543,200 |

**JULIE PLC:**

ii. Calculation of pre-acquisition reserves (no ultimate intention to gain control)

| Date of Acquisition | No of Shares Acquired | Amount of Reserves (₦) | Pre-acquisition Reserves (₦) |
|---|---|---|---|
| 2003 | 100,000 | 240,000 | |
| 2004 | 150,000 | 420,000 | - |
| 2005 | 180,000 | 590,000 | - |
| 2007 | 170,000 | 730,000 x 60% | 438,000 |
| 2009 | 210,000 | 990,000 x 21% | 207,900 |
| Pre-acquisition reserves | | | 645,900 |

No of ordinary shares issued:

5,000,000 x 0.6 x 1/3 = 1,000,000 shares

(b) Conditions for exclusion of a subsidiary from group or consolidated accounts under CAMA 2004.

i. Where the Parent company itself is at the end of its financial year a wholly owned subsidiary of another company incorporated in Nigeria.

ii. It is impracticable or would be of no real value to members because of the insignificant amount involved.

iii. It would involve expenses or delays out of proportion or it is of no value to members of the company.

iv. The results would be misleading or harmful to the business of the company or any of its subsidiaries.

v. The business of the parent company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

(c) Disclosures required where subsidiaries are excluded from Consolidated or Group Accounts:

i. The reasons why the subsidiaries are not dealt with in group accounts.

ii. Any qualifications by the Auditors of the subsidiaries' accounts not covered by the company's own accounts.

iii. The aggregate amount of the total investment of the Parent Company in the Shares of the Subsidiaries:

iv. Such investment should be accounted for using the Equity Method of valuation.

v. where any of the information in (i) – (iv) above are not obtainable, a statement to that effect shall be given.

**EXAMINERS' REPORT**

**The question tests candidates' knowledge of group accounts with emphasis on piecemeal acquisition and the exclusion of a subsidiary from consolidation. Candidates are expected to calculate pre-acquisition reserves and state conditions which will necessitate the exclusion of a subsidiary from consolidation.**

**Majority of the candidates attempted the question and their performance was fair. The major pitfall observed was the candidates' inability to calculate pre-acquisition reserve under the two known basic assumptions. Also, most of candidates could not state CAMA's provision for disclosure where a subsidiary is excluded.**

**Candidates are advised to cover all aspects of the syllabus while preparing for their examinations.**

**QUESTION 3**

(a) The published Annual Report and Accounts usually contain the following:

i. Chairman's Report
ii. Directors' Report
iii. Auditors' Report
iv. Audit Committee's Report
v. Statement of Accounting Policies
vi. Profit and Loss Account or Income Statement

vii. Balance Sheet
viii. Notes to the Accounts
ix. Cash Flow Statement
x. Value Added Statement
xi. Five-Year Financial Summary
xii. In case of a holding company, the group financial statements

(b) Accounting Legislation, Regulations and Principles are:

i. IFRS – International Financial Reporting Standard
ii. IAS - International Accounting Standard
iii. SAS – Statement of Accounting Standard
iv. GAAP – Generally Accepted Accounting Principles
v. The Companies and Allied Matters Act CAP C20 LN 2004
vi. BOFIA – Banks and other financial Institutions Act CAP B3 LFN 2004
vii. Central Bank of Nigeria – Prudential Guidelines - Circulars
viii. National Insurance Commission Act 2004/Operational Guidelines
ix. Security and Exchange Commission/Operational Guidelines
x. Nigerian Deposit Insurance Corporation Act/ Operation Guidelines

(c) The financial statements of a private company need not include the following matters:

i. Statement of Accounting Policies
ii. Audit Committee's Report
iii. Cash Flow Statement
iv. Value Added Statement

(d) Advantages of Statement of Cash Flows

i. It shows the pattern of cash generation and its utilization in an entity.
ii. It shows the ability of an entity to general cash and cash equivalents from its operation which is the key to the survival of an entity.
iii. It shows the ability of an entity to settle its obligations as at when due.
iv. it shows the liquidity position of an entity as at a particular date.
v. It can be used to measure the amount of external fund that will be required to finance profitable projects.
vi. It shows the financial flexibility of an entity.
vii. It shows the solvency of an entity.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the theoretical aspect of published Financial Statements. Candidates are required to state the contents of financial statements and highlight accounting legislation and disclosure requirements of financial statements of private companies.**

**Majority of the candidates attempted the question and performance was good. However, few candidates could not state the advantages of a cash flow statement correctly.**

**Candidates are advised to pay more attention to statement of accounting standards while also ensuring that they keep up their good performance.**

**QUESTION 4**

**OKO OBA FARMS LTD**

**Cattle Trading, Profit and Loss Accounts for the year ended 30 November 2009**

| | | QUANTITY | ₦ | ₦ |
|---|---|---|---|---|
| Sale of cattle | | 600 | | 1,800,000 |
| Sale of cattle slaughtered | | 200 | | 300,000 |
| Sale of hides and skin | | - | | 105,000 |
| Sale of offal | | | | 80,000 |
| Sale of carcasses | | 9 | | 13,500 |
| | | 809 | | 2,298,500 |
| Cost of sales: | | | | |
| Opening stock-cattle | | 650 | | |
| Birth (cattle) | 90 | | | |
| Less Still Birth | (10) | 80 | | |
| Purchase of cattle | | 380 | | 320,000 |
| Closing stock – cattle | | (301) | | |
| Cost of sales – feeds | | | | |
| Opening stock – feeds | | | 20,000 | |
| - concentrates | | | 218,000 | |
| - hay transferred | | | 32,000 | |
| - Crop transferred | | 809 | 44,000 | 804,000 |
| | | | | 1,494,500 |

| | | |
|---|---|---|
| Gross Profit | | |
| OTHER EXPENSES: | | |
| Salaries and wages (cattle - staff) | 626,000 | |
| Grinding | 5,000 | |
| Maintenance - Ranch Farm | 10,000 | |
| Depreciation - cattle | 12,000 | |
| Insurance - cattle (25% x 150,000) | 37,500 | |
| General expenses (25% x 109,000) | 25,000 | 715,500 |
| Net Profit - cattle | | 779,000 |

(b) Problems associated with valuation of plantation

i. Plantation has a long gestation period
ii. The choice of amortizing the accumulated cost over the productive life of the plantation.
iii. Lack of uniformity in valuation e.g. some plantation crops, such as, sugarcane, banana e.t.c. are valued as arable stocks while some, such as, oranges, mangoes, cashew etc are valued as plantation products.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of a simple farmers' accounts and the problems associated with the valuation of plantations. Candidates are expected to prepare a trading and profit and loss accounts of a cattle farmer.**

**Majority of the candidates attempted the question and their performance was good. Nevertheless, candidates are advised to work harder for improved performance in future.**

**QUESTION 5**

(a) **Computation of ratios**

| | | YETTY LTD ₦'m | BETTY LTD ₦'m |
|---|---|---|---|
| i. | Gross Profit Percentage: | | |
| | Gross Profit X 100 / Turnover 1 | 4,000 X 100 / 18,000 1 | 4,100 X 100 / 27,000 1 |
| | | = 22.2% | = 15.2% |
| ii. | Net Profit Percentage: | | |
| | Profit before tax X 100 / Turnover 1 | 600 X 100 / 1,800 1 | 900 X 100 / 27,000 1 |
| | | = 3.3% | = 3% |
| iii. | Current Ratio: | | |
| | Current Asset / Current liability | 4,150 / 2,630 | 3,640 / 2,790 |
| | | = 1.58:1 | = 1.30:1 |
| iv. | Acid Test Ratio: | 4,150 – 2,000 | 3,640 – 2,400 |
| | Current Asset - Stock / Current Liability | 2,630 | 2,790 |
| | | = 0.82:1 | = 0.44:1 |
| v. | Return on Capital Employed: | 420 X 100 / 3,180 1 | 630 X 100 / 4,950 1 |
| | Profit After Tax X 100 / Shareholders Fund 1 | 13.2% | 12.73% |
| vi. | Earnings per share: | | |
| | Profit After Tax X 100 / No. of ord. shares issued 1 | 420 X 100 / 2,400 | 630 X 100 / 4,300 1 |
| | | 17.5 kobo | 14.65 kobo |
| vii. | Dividend Cover: | | |
| | Profit After Tax / Dividend on ord. shares | 420 / 250 | 630 / 300 |
| | | = 1.68 times | = 2.1 times |

(b) XYZ and Co.
Chartered Accountants
25 ICAN Crescents
Lagos

Dear Mr. Goody,

**Advice on Investment**

With reference to our discussion on the above subject on which you sought for our advice on your choice of investment between YETTY LTD and BETTY LTD.

Please find attached herewith the relevant accounting ratios we computed to enable us compare the performance of the two companies and advise you accordingly.

Betty Ltd. has made more profit (₦900 compared with ₦600m by YETTY LTD.). But in terms of Gross profit percentage, Returns on Capital and Earnings per share. YETTY Ltd. is more efficient in the use of its resources with a gross profit percentage of 22.2% return on capital employed of 13.2% and earnings per share of 17.5 kobo compared with Betty Ltd. of 15.2%, 12.73% and 14.65 kobo respectively.

The Net profit percentages for the two companies are the same but the current ratio and the acid test ratio for YETTY LTD. are more favourable than that of BETTY LTD. Current and liquid ratios imply the immediate conversion of asset into cash and ability to settle current liabilities as they fall due. Ability to pay dividend is 1.68 times for YETTY LTD. while that of BETTY LTD. is 2.1 times.

In conclusion, we suggest that it would be more advantageous to invest in YETTY LTD. as it shows greater profitability that BETTY LTD.

Please let us know if you require further information.

Thank you.

Yours faithfully,

XYZ & CO.

(c) Some ratios appear to have more than one implication or interpretation.

i. A high gross profit margin may indicate profitability and at the same time imply that the company is discouraging potential buyers by applying excessive mark-up.

ii. A high sales to debtors ratio may imply that the debtors figure was kept to the minimum through good credit management. On the other hand, it could also mean that the company failed to use credit policy to push sales.

iii. A high stock turnover may denote efficiency in the firm's inventory policy but it could also mean that the company is in danger of losing sales opportunities due to sufficient investment in stock.

iv. A low capital gearing may imply soundness of investment and low risk but it could also mean that the company may have lost opportunities to improve on its profitability by failing to leverage its equity capital.

(d) The implication to users of such ratios is that they must make further enquiries or investigation before coming to firm conclusion about the merit or demerit of the particular position portrayed. There is often the need to find corroborative evidence from one or more other ratios before drawing final conclusion.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of the computation and application of accounting ratios.**

**Many candidates attempted the question and their performance was good. However, most candidates could not give specific examples of incidence of duality as it relates to the interpretation and implication of financial accounting ratios.**

**Candidates are advised to place more emphasis on the application of accounting ratios as well as interpretation of financial statement in order to earn more marks in future.**

## QUESTION 6

(a) **NOTES TO BALANCE SHEET EXTRACT OF DOWNTOWN COMMERCIAL BANK LTD. AFTER FACTORING OF BAD DEBT.**

| | ₦'000 | ₦'000 |
|---|---|---|
| Loans and Advances (bad debts) | 625,000 | |
| Non Non-refundable proceeds (80% - 5%) x ₦ 625,000.... | 468,750 | 156,250 |
| Cash proceeds of factoring 80% x ₦625,000 | | 500,000<br>656,250 |
| Liabilities:<br>Recourse under factored Debts 5% x ₦625,000 | | (31,250) |
| | | 625,000 |

(b) Administrative and interest charges should be debited to the P & L account

(c) LOANS & ADVANCES BALANCE TO BE INCLUDED IN THE BALANCE SHEET

| | | ₦'000 | ₦'000 |
|---|---|---|---|
| Gross Value of Loans | (W1) | | 1,146,150 |
| Less: Provision for bad debt: | | | |
| Prov. for bad debt – 31/12/2009 | | 27,650.0 | |
| Prov. for the year | (W2) | 85,832.5 | |
| | | 113,482.5 | |
| Less: | | | |
| Prov. no longer Required | | 5,690.0 | |
| | | 107,792.5 | |
| Add: | | | |
| Interest in suspense B/fwd | | 6,500 | |
| Interest in suspense for the year | | 2,750 | |
| | | 9,250 | |
| Less: | | | |
| Int. in suspense written back | | 800 | |
| | | 8,450 | |
| Total provision and interest in suspense | | | 116,2.5 |
| Loans and advances per balance sheet | | | 1,029,907.5 |

**Notes:**

| W1 | **GROSS LOAN:** | ₦'000 | ₦'000 |
|---|---|---|---|
| | Performing | | 875,000 |
| | | | |
| | Non-performing | | |
| | Pass & Watch | 125,250 | |
| | Substandard | 40,600 | |
| | Doubtful | 85,200 | |
| | Lost | 20,100 | 271,150 |
| | | | 1,146,150 |

(W2) **PROVISION FOR LOANS & ADVANCES FOR THE YEAR:**

| | Principal Value | % | Provision | |
|---|---|---|---|---|
| | ₦'000 | | ₦'000 | |
| Performing: | 875,000 | 1 | 8.750.0 | 8,750.00 |
| Pass and watch | 125,250 | 5 | 6,262.50 | 6,262.50 |
| Substandard | 40,600 | 2 | 8,120.00 | 8,120.00 |
| Doubtful | 85,200 | 5 | 42,600.00 | 42,600.00 |
| Lost | 20,100 | 1 | 20,100.00 | 20,100.00 |
| Provision for the year | | | | 85,832.50 |
| | | | | |

EXAMINERS' REPORT

The question tests candidates' knowledge of the application of the guidelines on provision for risk assets of financial institutions (e.g. Microfinance Bank).

Majority of the candidates did not attempt the question probably because of its practical nature and non familiarity with the application of the operational guidelines of financial institutions. Performance was poor.

Candidates are advised to familiarise themselves with the application of operational guidelines of various financial institutions in order to improve on their performance in future.

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
# PROFESSIONAL EXAMINATION I – NOVEMBER 2011
# ADVANCED AUDIT & ASSURANCE
**Time allowed- 3 hours**

## SECTION A: Attempt All Questions

## PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

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

1. The final decision of the courts about auditors' liability was found to be wrongly reached in **ONE** of the following cases:

   A. Re: London General Bank (1895)
   B. Donogue v Stevenson (1932)
   C. Candler v Crane Xmas (1951)
   D. Hedley Byrne v Heller and Partners (1963)
   E. Re: Thomas Gerrard and Sons (1967).

2. In conducting the audit of an insurance company, to which **ONE** of the following should the auditor pay special attention?

   A. Provision for depreciation
   B. Provision for unearned interest
   C. Provision for loan losses
   D. Provision for outstanding claims
   E. Provision for general reserve.

3. Which **ONE** of the following is a type of audit included in the scope of responsibilities of the Auditor-General for the Federation?

   A. Regulatory audit
   B. Computer audit
   C. Operational audit
   D. Programme audit
   E. Management audit

4. Threats to objectivity include the following **EXCEPT**

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

5. Auditors can disclose the client's confidential information for the following reasons **EXCEPT**

A. Auditors know client has committed terrorist offence
B. Information is required by the auditor for another client
C. Auditors suspect client has committed treason
D. There is public duty to disclose
E. Disclosure is needed to protect auditor's own interest.

6. Which **ONE** of these services may not be appropriate for an audit firm?

A. Advising clients on corporate structures, recruitment and other human capital needs
B. Giving necessary legal advice on tax returns including negotiation with the tax authorities
C. Acting as a receiver of the company's operations on behalf of debenture holders and creditors of the company
D. Making detailed enquiries and gathering all necessary information to meet the clients' specific needs
E. Advising clients on how best the business can be run and controlled including issues of accountability and management.

7. The auditors' report should be dated on the day that the

A. Report is delivered to the client
B. Field work is completed
C. Fiscal period under which the audit ends
D. Review of the working papers is completed
E. Board meeting approves the accounts.

8. In accordance with SAS 4, which **ONE** of the following methods is appropriate in valuation of stock?

   A. Latest in, first out
   B. Base stock
   C. Specific identification
   D. Latest purchase price
   E. Weighted average.

9. The audit of financial statements in Nigeria is not affected by **ONE** of the following:

   A. Securities and Exchange Commission
   B. Auditing Standards
   C. Nigerian Accounting Standard Board
   D. The Institute of Chartered Accountants of Nigeria
   E. Auditing Exposure Drafts.

10. Which **ONE** of the following may not necessarily be a symptom of a going concern problem?

   A. Redemption of debentures
   B. Dividends in arrears
   C. Existence of long overdue debtors
   D. Heavy dependence on short-term funds for long-term needs
   E. Excessive reliance on a supplier or customer

11. The accountants' report in a prospectus may not contain **ONE** of the following items:

   A. Summarised balance sheet of the company for the last five years
   B. Evaluation of quoted and unquoted investments
   C. Principal accounting policies
   D. Movement in share premium account
   E. Particulars of preliminary expenses.

12. The method **most** appropriate for a company to change from manual-based system to computer-based accounting system is

A. Direct change over
B. Parallel change over
C. Vertical change over
D. Phased change over
E. Pilot change over.

13. Which **ONE** of the following does **NOT** affect public sector audit?

A. Financial regulation
B. The 1999 Constitution of Federal Republic of Nigeria (as amended)
C. Statement of Accounting Standard
D. Treasury and circular letters
E. Finance Act.

14. Which **ONE** of the following sanctions may **NOT** be imposed by The Institute of Chartered Accountants of Nigeria on its members for misconduct?

A. Reprimand
B. Suspension from membership
C. Expulsion from membership
D. Sealing off practice office
E. Payment of costs.

15. Quality control in audit is maintained by professional accountancy bodies through all the following **EXCEPT**

A. Publishing of auditing standards
B. Publishing of accounting standards
C. Encouraging members to be computer literate
D. Publishing code of conduct for members
E. Establishment of public practice sector.

16. Which **ONE** of the following is **NOT** an example of Computer Assisted Audit Technique?

A. Read only memory
B. System control and review file
C. Integrated test facilities
D. Snapshot
E. Mapping.

17. The computation of ratios and trends and the use of statistical formula to obtain audit evidence is

A. Hot review
B. Audit sampling
C. Substantive test
D. Analytical review
E. Audit review.

18. Which **ONE** of the following is **NOT** an example of assurance engagement?

A. Reports for lenders and other investors
B. Reports on environmental performance
C. Reports and statement of accounting policies
D. Reports on corporate social responsibility performance
E. A private audit.

19. All the following are necessary when the auditor is considering whether to rely on the work of a specialist **EXCEPT**

A. The independence of the specialist
B. The experience of the specialist
C. The fees charged by the specialist
D. The specialist relationship with the client
E. Compatibility of the data in preparing the financial statement.

20. To obtain an understanding of the internal control system, which **ONE** of the following computer documentations can assist the auditor?

A. System narrative
B. System flowchart
C. System counts
D. Record layout
E. Programme listing.

## PART II: SHORT- ANSWER QUESTIONS (20 Marks)

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

1. The application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditors obtain and evaluate evidence is known as..........................

2. Any logical process used by a system analyst to develop an information system including requirements, validation, training and user-ownership is referred to as..........................

3. The responsibility for the conduct of the audit and expressing an opinion on the financial statements in a firm of Chartered Accountants rests with the..........

4. A retired partner in a firm now managed by other members but retained by the members for the sake of continuity is known as a.............................

5. The power of The Institute of Chartered Accountants of Nigeria to initiate disciplinary action against any member who has run foul of ethical standards rests with............................

6. When the auditor sets up his own records and processes them at the same time as the client processing data, he is using a technique in computer known as...................

7. In principle, the auditor does not owe a duty of care to a third party. However, it has been held in decided cases that the auditor owes a third party a duty of care under the.................................

8. The Auditor-General for a State is appointed by the Governor on the recommendation of....................subject to the confirmation of the State House of Assembly

9. A letter written by the secondary auditor to the primary auditor explaining all the procedures used in carrying out the audit of the subsidiary company is known as.................................

10. The disclosure of information on the effect that the operation of an entity has on the natural environment can be found in................section of the annual reports and accounts.

11. Statements by professional accountancy bodies stating the basic procedures to be adopted when conducting an audit assignment are called...................

12. A person or firm possessing special skills, knowledge and experience in a particular field other than accounting, which may be used by the auditor as basis to form an opinion on the financial statements is referred to as .....................

13. Issues on Corporate Governance in Nigeria are listed in the ..................

14. A situation where public expectation is reasonable but the auditor's conduct does not meet the required standards is known as ......................

15. The use of the same accounting principles from year to year so that the successive financial statements issued by a business entity will be comparable is known as..........................

16. A member of The Institute of Chartered Accountants of Nigeria who has been indicted by the Accountants' Disciplinary Tribunal has a right of appeal to the .......................

17. The inability of a company to meet its financial obligations as and when due is called................

18. The audit procedures that ensure that transactions are recorded in the period to which they belong are known as.........................

19. Limitation in the scope of work may give rise to........... in an auditor's report.

20. An assignment in which the practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter is..............................

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

### QUESTION 1 - CASE STUDY

Fela Idaewor is auditor to Matty Co. Ltd, a fast growing retail business in Lekki. While she had previously participated in this engagement, this is her first year as the audit manager. As she planned the engagement, she identified a number of risk factors such as strong interest in maintaining the company's earnings and share price, unrealistic forecasts and high dependence on debt financing for expansion. There was strong indication that fraud might have been committed by top management.

**Required**

(a) What should Idaewor do about the possibility of fraud at the planning stage? (7 Marks)

(b) What is the required documentation for identifying risk factors? (5 Marks)

(c) If Idaewor has evidence which suggests that fraud exists, what would be her communication responsibilities to management? (3 Marks)

**(Total 15 Marks)**

### QUESTION 2

Sarbanes-Oxley Act of 2002 which was enacted in the United States as an attempt to guide and regulate the work of accountants and auditors in that country, has raised issues about the culture of self-regulation in the accounting profession.

**You are required to**

(a) State the reason for its enactment and issues covered therein. (2 Marks)

(b) State its main provisions that relate to corporate accountability. (8 Marks)

(c) List the merits of this Act. (5 Marks)

**(Total 15 Marks)**

**QUESTION 3**

(a) Outline the main objective of corporate governance. (3 Marks)

(b) One of the tools of corporate governance in Nigeria is the establishment of the Audit Committee under Section 359 (6) of Companies and Allied Matters Act Cap C20 LFN, 2004. What are the composition and functions of an Audit Committee? (6 Marks)

(c) State **SIX** instances when the corporate governance of a public company may be compromised by the Board of Directors. (6 Marks)

**(Total 15 Marks)**

**QUESTION 4**

The role of auditors is commonly misconceived. Many people argue that the auditor is expected to detect all frauds and irregularities in a client's business. Others believe that the auditor should act more like a court of justice where truth is defended. In fact, the auditor's responsibilities, powers and duties are defined by statutes, ethics and auditing standards.

**Required**:

(a) What are the provisions available in the Companies and Allied Matters Act Cap C20 LFN, 2004 which seek to reduce the communication gap between the auditor and the shareholders? (7 Marks)

(b) Explain **EIGHT** controls available to address the problem of performance gap. (8 Marks)

**(Total 15 Marks)**

**QUESTION 5**

When a company is having going concern problems, the symptoms which such company will show, can be categorised into financial and non-financial symptoms.

Required:

(a) State **FIVE** financial and **FIVE** non-financial going concern symptoms. (5 Marks)

(b) State the audit procedures you would adopt as auditor to determine whether a client company is having going concern problems. (6 Marks)

(c) What other factors will you consider in assessing if the company will continue in spite of the going concern problems? (4 Marks)

**(Total 15 Marks)**

**QUESTION 6**

Write short notes on the following:

(a) Public Accounts Committee (3 Marks)

(b) Value-for -Money Audit (3 Marks)

(c) Audit Alarm Committee (3 Marks)

(d) Due Diligence (3 Marks)

(e) Due Process (3 Marks)

**(Total15 Marks)**

## SOLUTIONS TO SECTION A

## PART I MULTIPLE-CHOICE QUESTIONS

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

9. E
10. A
11. D
12. B
13. E
14. D
15. C
16. A
17. D
18. C
19. C
20. B

## EXAMINERS' REPORT

**The questions cover all aspects of the syllabus and were attempted by all the candidates. Performance was satisfactory.**

## PART II SHORT-ANSWER QUESTIONS

1. Audit Sampling
2. System Development Life Cycle (SDLC)
3. Engagement Partner
4. Consultant
5. Accountants' Disciplinary Tribunal
6. Integrated Testing Facility
7. Tort of Negligence
8. State Civil Service Commission
9. Comfort Letter
10. Environmental

11. Auditing Standards
12. Expert or Specialist
13. Code of Best Practices on Corporate Governance in Nigeria
14. Performance Gap
15. Consistency
16. Court of Appeal
17. Insolvency
18. Cut-off Procedures
19. Qualification
20. Assurance Engagement

## EXAMINERS' REPORT

**The questions cover all sections of the syllabus and were attempted by all the candidates. Performance was satisfactory.**

**Candidates are, however, advised to prepare well for future examinations.**

## SOLUTIONS TO SECTION B

## QUESTION 1

(a) Audit plan ensures that audit risk is reduced to an acceptably low level. It ensures that appropriate attention is given to important areas of the audit, potential problems are resolved on timely basis and the audit engagement is properly organized and managed as to be performed in an efficient and effective manner. The Auditor should, therefore, plan the audit in such a manner as to reduce audit risk to an acceptably low level.

The Auditor should do the following in response to the possibility of fraud (fraud risk factors)

(i) Modify the audit approach to have an overall effect on how the audit is conducted, by having increased professional skepticism, and a response involving more general consideration apart from the specific procedures, otherwise planned.

(ii) Set out the nature, timing and extent of audit procedures to be performed.

(iii) Carry out certain audit procedures to address the risk of material misstatements due to fraud involving management override of controls.

(iv) Assign additional individuals with specialized skill and knowledge, such as forensic and IT experts, or assign more experienced individuals to the engagement as may be deemed necessary.

The fact that most of the fraudulent tendencies detected was indicative of management override of controls, the auditor should design and perform audit procedures to

(i) test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of financial statements.

(ii) review accounting estimates for biases that could result in material misstatement due to fraud.

(iii) obtain an understanding of the business, the rationale for significant transactions that the auditor becomes aware of that are outside the normal course of business of the company or that otherwise appear to be unusual, given the auditor's understanding of the entity and its environment.

(b) Documentation of the auditor's identified risk factors should include

(i) Significant decisions reached during discussions by engagement team, concerning the identified risk factors.
(ii) Overall designed responses to the assessed risk of material misstatements.

(iii) Results of audit procedures designed to address the risk of management override of controls
(iv) Communication about fraud to those charged with governance.
(v) Matters brought forward from the previous year that are of continuing relevance.

(c) Where the auditor has identified fraud involving management and employees who have significant roles in internal control, they should communicate these matters to those charged with governance as soon as practicable. The auditor needs to determine the role of the Chief Executive Officer (CEO) in the fraud and consider whether report to supervisory authority is necessary.

## EXAMINERS' REPORT

**The question tests candidates' understanding of what an auditor would do when faced with management fraud.**

**Being a case study, the question was attempted by almost all candidates. Candidates performed below average. Their commonest pitfall was misinterpretation of the question.**

**Candidates are advised to ensure coverage of the syllabus so as to perform better in subsequent examinations.**

## QUESTION 2

(a) Reasons for enactment of Sarbanes-Oxley (SOX) Act

The SOX was enacted in reaction to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, Adelphia, Peregrine Systems and WorldCom. These scandals, which cost investors billions of dollars when the share prices of affected companies collapsed, shook public confidence in the securities markets.

Issues Covered in the Act

i. Regulation of public companies under Securities and Exchange Commission.
ii. New or enhanced standards for all U.S public company boards, management and public accounting firms. It does not apply to privately held companies.

iii. The Act contains eleven titles, or sections, ranging from additional corporate board responsibilities to criminal penalties, and requires the Securities and Exchange Commission (SEC) to monitor compliance with the new law.

iv. The Enron scandal deeply influenced the development of new regulations to improve the reliability of financial reporting and increased public awareness about the importance of having accounting standards that show the financial reality of companies and enhance the objectivity and independence of auditing firms.

(b) The main provisions that relate to corporate accountability include

i. The establishment of a proper internal control system.
ii. Management taking responsibility for the truth and fairness of financial statements.
iii. At least one member of the audit committee being a financial expert
iv. Preserving audit working papers for at least seven years.

(c) Merits of SOX

SOX has been praised by a cross-section of financial industry experts, citing as justification

i) The improved investors' confidence
ii) More accurate and reliable financial statements.

- The Chief Executive Officer and Chief Finance Officer are now required to unequivocally take responsibility for their financial statements under Section 302, which was not the case prior to SOX.

- Conflict of interest has been addressed by prohibiting auditors from engaging in lucrative consulting agreements with the firms they audit under Section 201.

- It has helped restore trust in U.S. markets by increasing accountability, speeding up reporting, and making audits more independent.

- The Institute of Internal Auditors' study also indicated improvements in board, audit committee, and senior management engagement in financial reporting and improvements in financial controls.

- Requirement that at least one member of the audit committee should be a financial expert.

## EXAMINERS' REPORT

**The question tests candidates' understanding of the Sarbanes-Oxley Act of 2002.**

**Very few candidates attempted the question and performance was poor.**

**Many candidates did not understand the question hence it was avoided by most of them.**

**Candidates need to prepare adequately so as to cover all aspects of the syllabus. They should be aware of international developments affecting the accountancy profession.**

## QUESTION 3

(a) The main objective of corporate governance is to manage a business organization in an efficient, effective and transparent manner. In other words, it is the system by which companies are efficiently, effectively and transparently directed and controlled.

(b) **Composition of the Audit Committee:**
Membership of the Audit Committee usually consists of an equal number of directors and representatives of the shareholders of the company. It is subject to a maximum of six members.

**Functions of the Audit Committee**

i) Ascertain whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices.
ii) Review the scope and planning of audit requirements.
iii) Review the findings on management matters in conjunction with the external auditor and departmental responses thereon.
iv) Keep under review the effectiveness of the company's system of accounting and internal control.
v) Make recommendations to the board in regard to the appointment, removal and remuneration of the external auditors of the company.

vi) Authorize the internal auditor to carry out investigation into any activities of the company, which may be of interest or concern to the committee.

(c) It is the responsibility of the directors to install good corporate governance. But some actions of the Board members may stifle the corporate governance of a company. Such instances may include the following:

(i) Some board members having significant equity holdings.
(ii) The board being dominated by insiders.
(iii) Board members who are not independent.
(iv) Board members with little board experience.
(v) Board and Audit committees that do not hold meetings.
(vi) Audit committee members who know little or nothing about finance or audit.
(vii) Where there is no audit committee.
(viii) Top executives involvement in frauds.

**EXAMINERS' REPORT**

**This question tests candidates' understanding of corporate governance.**

**Most candidates attempted the question, but their performance was poor.**
**They were unable to provide appropriate solutions to the question. They could not state the objectives of corporate governance and the functions of the Audit Committee.**

**Adequate coverage of the syllabus by candidates is recommended for good performance.**

**QUESTION 4**

(a) The communication gap may result in the following assumptions of the users of financial statements:

(i) That unqualified audit opinion is a clean bill of health.
(ii) That auditors guarantee the continued existence of the firm.
(iii) That users of the financial statements expect all fraud to be discovered by a statutory audit.

A perception to the communication gap is that audit opinion relates to a specific period of time. The auditor states that financial statements give a true and fair view at a specific period of time. The users incorrectly expect this opinion to subsist even with passage of time. The communication gap is reduced by the provisions contained in the Companies and Allied Matters Act Cap C20 LFN, 2004. The provisions are as follows:

(i) Management has the responsibility for the preparation of financial statements.
(ii) It is management's responsibility to establish and maintain adequate accounting records for safeguarding the assets of the company and for preventing fraud, errors and other irregularities.
(iii) It is the responsibility of management to confirm suitability of accounting policies, consistency in application, reasonable prudent judgment and preparation of financial information.
(iv) Management confirmation that standards and guidelines have been followed.
(v) Basis of opinion and the audit approach are expressly mentioned in the audit report.
(vi) Requirement for mandatory annual general meeting where members interact with auditors.
(vii) Requirement under Section 359 of CAMA for members of the audit committee to review the scope and planning of audit requirement.

(b) **Controls Available to Address the Problems of Performance Gap**

i) Establishment of professional Practice Monitoring Committee.
ii) Introduction of Mandatory Continuing Professional Education .
iii) Enhancement of accountants through syllabus review.
iv) Technical committee of ICAN which serves as reference to members on technical issues.
v) Organization of seminars, debates and other enlightenment programmes by the Institute both at the national and district levels.
vi) Maintenance of technical library equipped with up to date technical materials by the Institute.
vii) Effective and efficient disciplinary tribunal of ICAN whose status is equal to that of High Court.
viii) The roles of AGM where shareholders are given the opportunity of asking the auditors questions.
ix) Establishment of Audit Committee.
x) The role of government in setting standards through Regulatory Authorities.
xi) The role of international professional agencies e.g IFAC.
xii) Publication of journals and standards to standardize audit practice.

xiii) Introduction of faculties to serve as reservoir of knowledge for members.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of communication gap and performance gap as they relate to audit.**

**Few candidates attempted the question, but performance was poor due to lack of understanding of the question.**

**Candidates are advised to study relevant Audit Standards and Guidelines for good performance in future examinations.**

**QUESTION 5**

(a) **Going Concern Symptoms**

(i) **Financial Symptoms**

These relate to the inability of the company to meet its financial obligations as they fall due. These will be indicated by the following signs:

- Recurring operating losses.
- Low liquidity ratio.
- Use of short term funds to finance long term projects.
- Working Capital Deficiencies.
- High gearing ratio.
- Default of statutory payments e.g. tax, dividends etc.
- Deterioration in relationship with the company's bankers.
- Potential loss on long term contract.
- Under capitalization, particularly if there is a deficiency of share capital and reserves.
- Excessive or obsolete stock.
- Adverse current ratio.
- Where suppliers change from credit to cash on delivery transactions with the company.
- Where it is becoming difficult for the company to comply with terms of loan agreement.

(ii) **Non-Financial Symptoms**

- Loss of key management staff.
- Loss of franchise or patent.
- Loss of principal suppliers or customers.

- Work stoppages or other labour difficulties.
- Excessive reliance on the success of a particular project.
- Changes in government policy, which adversely affect the entity or its business.
- Undue influence of market leader or competitor
- Political risk.
- Natural disaster.
- Pending litigation against the company.
- Use of obsolete technology.
- Excessive use of resources e.g. human resources.

(b) **Audit Procedures to determine whether a client company is having going concern problems**

The auditor should carry out a comprehensive review of the client's financial statements so as to satisfy himself as to the company's ability to continue in business by reviewing the financial strength by carrying out the following:

i. Review the cash flow forecast in the subsequent accounting period for improvement.
ii. Review the post balance sheet period trading and its impact on the cash flow.
iii. Generally review the management rescue plans and ensure that they are consistent with facts already known to the auditor.
iv. Review the management accounts and the financial records in the subsequent accounting period.
v. Review correspondence with creditors so as to ensure that pressure is not being mounted by creditors.
vi. Review the client's position with similar companies in the same business.
vii Where financial assistance is to be given by banks and other sister companies, review the degree of their commitment.
viii. Review the minutes of meetings of the directors and management.
ix. Request and obtain representation letter from management.

(c) Where the company has a going concern problem, the auditor should still assess the ability to continue on operational existence in the foreseeable future. For financial related symptoms, consider the ability to generate sufficient cash flows which could be done in any or a combination of the following ways:

i. Dispose of assets that will not adversely affect operations.
ii. Reschedule existing facilities.

iii. Obtain financial assistance from banks or sister companies without adversely affecting gearing.

iv. Lease assets rather than outright purchase.
v. Postpone the replacement of assets.

vi. Find an alternative market where a key supplier or customer or franchise is lost.
vii. Employment of a suitable person with the requisite qualifications and experience where a key management staff is lost.
viii. Take alternative courses of action in respect of resources.
ix. Embark on diversification exercise.
x. Keep abreast with technological developments.

**EXAMINERS' REPORT**

**The question tests candidates' understanding of going concern problems.**

**It was attempted by most candidates and performance was fair.**

**Candidates need to prepare well for the examinations by reading relevant study materials.**

**QUESTION 6**

(a) **Public Accounts Committee (PAC)**
Public Accounts Committee is a committee of the House responsible for public accounts in accordance with Section 85 (5) of the 1999 Constitution. The PAC is required to deliberate on the Auditor-General's report, consider all the queries raised by him in his report, compile a comprehensive report and recommendations for submission to the whole House.

It is a committee of the National Assembly and the States House of Assemblies responsible for the review of the Auditor-General's report. They are also responsible for handling queries raised by the Auditor-General in his report.

The committee performs the following functions:

(i) To sit and deliberate on the Auditor-General's reports submitted to the legislature.
(ii) To summon the Accounting officers to appear before the Committee, to offer explanations on the observations raised by the Auditor-General.

(iii) To examine any officer on oath if need be.
(iv) To enforce audit sanctions as required.
(v) To recommend to the executive any sanctions to be taken on any erring officers.
(vi) To carry out any other duties as required by the legislature.

(b) **Value-for-Money Audit**

Value-for-Money Audit refers to those procedures designed to assist management establish necessary controls to ensure that the desired objectives are met at the desired level of efficiency and effectiveness.

Though this emphasizes cost savings but that may not be the overriding objective. It may be applied to both private and public sectors, but it is particularly relevant in the public sector. Its application in the public sector is designed to provide to the oversight bodies an assessment of the performance of the operating arm with information, observation and recommendations designed to promote answerable, honest and productive government. It encourages accountability and best practices.

(c) **Audit Alarm Committee**

This is a committee established in each state of the Federation to monitor the financial transactions at the local government level. The committee consists of the Auditor-General for Local Government, Directors of Local Government, and representatives of the State Accountant-General's office.

The functions of the Audit Alarm Committee are as follows:

(i) To ensure that fraudulent or irregular payments are not made especially where they have been put upon enquiry.
(ii) To notify the Public Accounts Committee of audit alarm of significant importance and serious pre-payment audit queries for which the accounting officer of the local government is responsible.
(iii) To deliberate on any audit alarm brought to their notice.
(iv) To impose sanctions on any erring officers in accordance with the guidelines.

(d) **Due Diligence**

Due diligence refers to the level of judgement, care, prudence, determination, and activity that a person would reasonably be expected to bring to bear under particular circumstances. In corporate law, due diligence is the process of conducting an intensive investigation of a corporation as one of the first steps in a pending merger or acquisition. In a company acquisition, due diligence would include full understanding of all the obligations of the company, debts pending and potential lawsuits, leases, warranties, long-term customer agreements, employment contracts, distribution agreements, compensation arrangements, and so forth.

Due diligence is a process of acquiring objective and reliable information, generally on a person or a company, prior to a specific event or decision. It is usually a systematic research effort, which is used to gather the critical facts and descriptive information which are most relevant to the making of an informed decision on a matter of importance.

(e) **Due Process**

This is a mechanism put in place by Government to ensure strict compliance with rules and procedures guiding the award of contracts. The policy of due process is to ensure transparency and accountability in the award of contracts. This entails openness, competition, merit and value for money. It also monitors and controls performance of contract payments and cost of projects. Over invoicing and inflated prices in public procurement are thus minimized.

## EXAMINERS' REPORT

**The question tests candidates' understanding of some terminologies in Public Sector Accounting.**

**The question was attempted by almost all the candidates and performance was poor. They did not understand the requirements of the question.**

**Candidates are advised to study relevant textbooks on linkages subject to enhance performance in future examinations.**