THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

MAY 2024 DIET
SKILLS LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Marking Guides

and

Examiners' Reports

FOREWARD

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 subject contained herein; and

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

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

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

NOTES

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

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EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

TUESDAY, MAY 14, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

FINANCIAL REPORTING

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Badary PLC statement of financial position as at March 31, 2021

	31-03-21	31-03-20
Assets:		
Non-current assets:	**₦'000**	**₦'000**
Property, plant and equipment	350,000	110,000
Investments	60,000	30,000
	410,000	**140,000**
Current assets:		
Inventories	295,000	120,000
Trade receivables	90,000	60,000
Bank	15,000	40,000
	400,000	**220,000**
Total assets	**810,000**	**360,000**
Equity and liabilities		
Ordinary share capital of 80 kobo per share	220,000	120,000
Share premium	60,000	30,000
Retained earnings	280,000	119,000
	560,000	**269,000**
Non-current liabilities:		
10% Redeemable loan notes	**50,000**	**10,000**
Current liabilities:		
Trade payables	65,000	14,000
Taxation	70,000	12,000
Bank overdraft	25,000	5,000
Accrued expenses	40,000	50,000
	200,000	**81,000**
Total liabilities	**250,000**	**91,000**
Total equity and liabilities	**810,000**	**360,000**

Statement of profit or loss for the year ended March 31, 2021

	₦' 000
Revenue	490,000
Cost of sales	(222,000)
Gross profit	**268,000**
Administrative expenses	(90,000)
Distribution cost	(40,000)
Finance cost	(5,000)
Dividend received	153,500
	18,500
Profit before taxation	286,500
Income tax expense	(70,000)
Profit for the year	**216,500**

Additional Information

(i) During the year ended March 31, 2021 plant and equipment with a carrying amount of ₦40,000,000 was sold for ₦55,000,000. The profit or loss on disposal was charged to distribution expenses.

(ii) Dividend of 2 kobo per share was paid in the year ended March 31, 2021 and there were also bonus issues.

(iii) Depreciation charged for the year was ₦10,000,000 on furniture and ₦30,000,000 on plant and equipment.

(iv) During the year, an investment which cost ₦12,500,000 some years ago was disposed for ₦20,000,000. The profit or loss on disposal was charged to administrative expenses.

(v) Dividends received were from investment in shares and immediate disposal of rights issue from the investment in shares in a blue-chip company.

You are required to:

a. Prepare statement of cash flows of Badary Plc for the year ended March 31, 2021 using direct method in accordance with IAS 7. (20 Marks)

b. Discuss the profitability, gearing and investors' stake in Badary Plc and recommend strategies for improving or sustaining them. (10 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

The following are the statements of financial position of Sokoto Nig. PLC and Niger Nig. LTD for the year ended October 31, 2023.

	Sokoto Nig. PLC	Niger Nig. LTD.
	₦'000	**₦'000**
Non-current assets:		
Plant and machinery	2,600	560
Furniture and fittings	1,600	400
	4,200	**960**
Investment:		
Shares in Niger. Nig. LTD at cost	1,600	-
Current assets:		
Inventories at cost	1,760	560
Trade receivables	1,160	840
Cash and cash equivalents	800	-
	3,720	1,400
Total assets	**9,520**	**2,360**
Equity and liabilities:		
Equity:		
₦1 ordinary shares	5,600	1,360
Retained earnings	1,720	400
	7,320	**1,760**
Current liabilities:		
Trade payables	2,200	440
Bank overdraft	-	160
	2,200	600
Total equity and liabilities	9,520	2,360

Additional information:

i. Sokoto Nig. PLC purchased 70% of the issued ordinary share capital of Niger Nig. LTD four years ago, when the retained earnings of Niger Nig. LTD were ₦160,000. There had been no impairment of goodwill.

ii. For the purpose of the acquisition, plant and machinery in Niger Nig. LTD with carrying amount of ₦400,000 was revalued to its fair value of ₦480,000. The revaluation was not recorded in the accounts of Niger Nig. LTD. Depreciation is charged at 20% using the straight-line method.

iii. Sokoto Nig. PLC sells goods to Niger Nig. LTD at a mark-up of 25%. At October 31, 2023 the inventories of Niger Nig. LTD included ₦360,000 of the goods purchased from Sokoto Nig. PLC.

iv. Niger Nig. Ltd owes Sokoto Nig. PLC ₦280,000 for goods purchased and Sokoto Nig. PLC owes Niger Nig. LTD ₦120,000.

v. It is the group policy to value non-controlling interests at fair value.

vi. The market price of the shares of the non-controlling shareholders just before the acquisition was ₦1.50 per share.

Required:

a. Prepare consolidated statement of financial position of Sokoto group as at October 31, 2023. (17 Marks)

b. Explain how investment in a subsidiary should be accounted for in the separate financial statements of the parent. (3 Marks)

(20 Marks)

QUESTION 3

Lamido Limited is a courier service company which operates in Nigeria and West Africa.

Initially, Lamido Limited experienced strong growth, but in recent periods the company has been criticised for under investing in its non-current assets.

Lamido Limited statement of financial position as at December 31

	2022	2021
	₦'000	**₦'000**
Non-current assets		
Property, plant and equipment	317,000	174,000
Intangible assets	20,000	16,000
	337,000	**190,000**
Current assets		
Inventories	580	490
Trade and other receivables	6,100	6,300
Cash and equivalents	9,300	22,100
Total current assets	15,980	28,890
Total assets	**352,980**	**218,890**
Equity and Liabilities		
Equity		
Ordinary share capital	3,000	3,000
Retained earnings	44,100	41,800
Revaluation surplus	145,000	NIL
Total equity	**192,100**	**44,800**
Liabilities:		
Non-current liabilities		
6% loan notes	130,960	150,400
Current liabilities		

Trade and other payables	10,480	4,250
6% loan notes	19,440	19,440
Total current liabilities	29,920	23,960
Total equity and liabilities	**352,980**	**218,890**

Other extracts from Lamido Limited financial statements for the years ended December 31.

	2022 ₦'000	2021 ₦'000
Revenue	154,000	159,000
Profit from operations	12,300	18,600
Finance cost	(9,200)	(10,200)
Cash generated from operation	18,480	24,310

The following information is also relevant:

i. Lamido Limited had exactly the same delivery volumes in 2022 as in 2021 with customers' base being the same in both years.

ii. In October 2022, Lamido Limited had to renegotiate its operating licenses in three of its countries of operation. This led to increase in the fees Lamido Limited had to pay to operate in these countries. The operating licenses in five other countries are due to expire in December 2022 and Lamido Limited is currently negotiating with the concerned authorities of these countries.

Required:

a. Calculate the following ratios for the years ended December 31, 2021 and 2022:
   i. Operating profit margin
   ii. Return on capital employed
   iii. Net asset turnover
   iv. Current ratio
   v. Interest cover
   vi. Gearing (Debt/equity)

(6 Marks)

Note:

For calculation purposes, all loan notes should be treated as debt.

b. Comment on the performance and position of Lamido Limited for the year ended December 31, 2022 and highlight any issues which Lamido Limited should be considering in the near future. (14 Marks)

(Total 20 Marks)

QUESTION 4

a. Differentiate between impairment and depreciation. (5 Marks)

b. Discuss the following as contained in IAS 36-Impairment of Assets.

   i. Indicators of impairment.

   ii. How to identify and account for impairment of assets. (6 Marks)

c. A non-current asset in the statement of financial position of Zamfara LTD, an SME, at the beginning of the financial year had a carrying amount of ₦800,000. The asset had previously been revalued, and there was a revaluation surplus of ₦50,000 relating to it in the revaluation reserve. At the end of the financial year, Zamfara LTD suspected that the asset had been impaired. It therefore estimated the recoverable amount of the asset and found this to be ₦600,000. The depreciation charge on the asset for the year would be ₦80,000.

Required:

As the finance manager of Zamfara LTD, explain with relevant computation the accounting treatments required in line with the provisions of IAS 36. (9 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

a. Errors might happen when preparing financial statements. If such errors are discovered quickly, they are corrected before the finalised financial statements are published. When this happens, the correction of the error is of no significance for the purpose of financial reporting.

   However, when an error is discovered that relates to a prior accounting period, a problem may arise.

   Required:

   Explain prior period errors giving examples and discuss how such errors are corrected in accordance with IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors. (7 Marks)

b. During year 2022, Lagos Company Nig. Limited discovered that certain items had been erroneously included in inventory at December 31, 2021, the amount was valued at ₦16.8million which had been sold before the year-end.

The following figures for year 2021 (as reported) and 2022 (draft) are available as follows:

	2022(Draft)	**2021 (Published)**
	₦'000	**₦'000**
Revenue	268,800	189,600
Cost of sales	(223,200)	(138,280)
Profit before tax	45,600	51,320
Income tax expense	(13,600)	(15,520)
Profit for the year	32,000	35,800

The retained earnings at January 1, 2021 were ₦52million. The cost of sales for year 2022 includes ₦16.8million error in the opening inventories. Company income tax rate is 30%.

Required:
Prepare statement of profit or loss and other comprehensive income for the year ended December 31, 2022 and retained earnings extracts showing comparative figures. (8 Marks)

(Total 15 Marks)

QUESTION 6

Akwa Nig. Limited is a private limited company planning to be registered with the Nigeria Exchange Limited (NGX). The company is engaged in the conversion of petrol engine into compressed gas engine.

The following are the transaction of the company in respect of its debts and equity instruments.

Transaction 1
Akwa Nig. Limited issued 40million non-redeemable ₦1 preference share at par value. Under the terms relating to the preference shares, a dividend is payable on the preference shares only if Akwa Nig. Limited also pays a dividend on its ordinary shares for the same period. (5 Marks)

Transaction 2
Akwa Nig. Limited entered into a contract with a supplier to buy a significant item of equipment. Under the terms of the agreement the supplier will receive ordinary shares with an equivalent value of ₦5million one year after the equipment is delivered. (5 Marks)

Transaction 3
The directors of Akwa Nig. Limited on becoming director are required to invest a fixed agreed sum of money in a special class of ₦1 ordinary shares that only directors hold. Dividend payments on the shares are discretionary and are ratified at the Annual General Meeting (AGM) of the company. When a director's service contract

expires, Akwa Nig. Limited is required to repurchase the shares at their nominal value. (5 Marks)

A senior accountant in your company (Akwa Nig. Limited) has asked for your advise on how the above transactions should be treated in the financial statements of your company in accordance with IAS 32 – Financial Instruments: Presentation.

Required:

Write a memo on the above request, discussing and justifying how each of the transactions should be treated in the financial statements, in accordance with IAS 32 – Financial Instruments: Presentation. **(Total 15 Marks)**

QUESTION 7

a. IAS 38 - Intangible Assets allows a business to choose one of two measurement models as its accounting policy for intangible assets after acquisition. However, the same model should be applied to all assets in the same class.

Required:

Discuss the **TWO** measurement models for intangible assets (3 Marks)

b. Olumo-Taxi Limited's financial year ends on December 31. The company adopted the revaluation model for its intangible assets and revalues them on a regular three-year cycle.

However, for intangible assets with a finite life, Olumo-Taxi Limited transfers the relevant amount from revaluation reserve to retained earnings each year.

During year 2019 Olumo-Taxi Limited incurred ₦700,000 on the process of preparing an application for licences for 15 taxis to operate in an holiday resort very close to Abeokuta, In order to prevent congestion and excessive traffic pollution, the licencing authority only allowed a small number of taxi to operate.

The outcome of the company's application was uncertain up to November 30, 2019 when the local government authority accepted its application. In December 2019, Olumo-Taxi Limited incurred a cost of ₦90,000 in registering its licences. The licences were for a period of 9 years from January 1, 2019.

The licences are freely transferable and an active market in them exists. The fair value at December 31, 2019 was ₦94,500 per taxi and Olumo-Taxi Limited carried them at fair value in its statement of financial position at December 31, 2019.

At December 31, 2022 Olumo Taxi Limited undertook its regular revaluation. On that date the licensing authority announced that it would triple the number of licences offered to taxi operators and there were transactions in the active market for licences which has six years to run at ₦45,000.

Required:

Calculate, with explanations, the carrying amount and revaluation surplus of the intangible assets of Olumo-Taxi Limited according to IAS 38 as at:

i. December 31, 2019
ii. December 31, 2022 (before regular revaluation)
iii. December 31, 2022 (after regular revaluation)

(12 Marks)
(Total 15 Marks)

SECTION A

SOLUTION 1

a. **Badary Plc**
Statement of Cash flows for the year ended March 31, 2021

Operating activities:	**₦'000**	**₦'000**
Cash received from customers (Wk 3)		460,000
Cash paid to suppliers (Wk 11)		(346,000)
Cash paid for other operating expenses (Wk 9)		(122,500)
Cash flow from operation		(8,500)
Finance cost paid		(5,000)
Taxation paid (Wk 1)		(12,000)
Net cash flows from operating activities		(25,500)
Investing activities:		
Dividend received	153,500	
Purchase of plant and machinery by cash (Wk 4)	(320,000)	
Proceeds from disposal of investment (Wk 10)	20,000	
Proceeds from disposal of plant (Wk 5)	55,000	
Purchase of investment by cash (Wk 6)	(42,500)	
Net cash flows from investing activities		(134,000)
Financing activities:		
Proceeds from issue of shares (50,000 + 30,000)	80,000	
Proceeds from issue of 10% Redeemable loan notes	40,000	
Dividends paid by cash	(5,500)	
Net cash flows from financing activities		114,500
Net increase in cash and cash equivalents for the year		(45,000)
Cash and cash equivalents at the beginning		35,000
Cash and cash equivalents at the end		(10,000)

Working notes

Wk 1: Taxation paid	**₦'000**
Opening balance	12,000
Income tax expense (SOPL)	70,000
Expected closing balance	82,000
Actual closing balance	70,000
Taxation paid	12,000
Wk 2: Proceeds from issue of shares	**₦'000**
Opening balance (120,000 + 30,000)	150,000
Closing balance (220,000 + 60,000)	280,000
Proceeds from issue of shares	130,000
Less: Bonus issue	(50,000)
	80,000
Wk 3: Cash received from customers	₦'000
Opening balance	60,000
Revenue for the year	490,000
Expected closing balance	550,000
Actual closing balance	90,000
Cash received from customers	460,000

Wk 4: Plant and machinery	₦'000
Opening balance	110,000
Disposal	(40,000)
Depreciation (10,000 + 30,000)	(40,000)
Expected closing balance	30,000
Actual closing balance	350,000
Acquisition by cash	(320,000)

Wk 5: Disposal of plant	₦'000
Carrying amount	(40,000)
Proceeds from disposal	55,000
Profit on disposal of plant	15,000

Wk 6: Investments	₦'000
Opening balance	30,000
Disposal	(12,500)
Expected closing balance	17,500
Actual closing balance	60,000
Acquisition by Cash	(42,500)

Wk 7: Cash and cash equivalents	2021	2020
	₦'000	₦'000
Bank	15,000	40,000
Bank overdraft	(25,000)	(5,000)
Cash and cash equivalent	(10,000)	35,000

Wk 8: Retained earnings/bonus issue

	N'000
Opening balance	119,000
Profit for the year	216,500
Expected closing balance	335,500
Actual closing balance	280,000
	55,500
Dividend declared and paid	(5,500)
Bonus issue	**50,000**

Wk 9: Cash paid for other operating expenses	**₦'000**	**₦'000**
Accrued expenses b/f		50,000
Administrative expenses		90,000
Distribution cost		40,000
		180,000
Add(Less):		
Profit of disposal	15,000	
Depreciation on furniture	(10,000)	
Depreciation on plant and equipment	(30,000)	
Profit on disposal of Investment	7,500	
Accrued expenses c/d	(40,000)	(57,500)
Cash paid		122,500

Wk 10: Disposal of investment	₦'000
Carrying amount	12,500
Proceeds from disposal	20,000
Profit on disposal of plant	(7,500)

Wk 11: Cash paid to suppliers	₦'000
Cost of sales	222,000
Closing inventories	295,000
Opening inventories	(120,000)
Purchases for the year	397,000
Opening balance of trade payables	14,000
Expected closing balance	411,000
Actual closing balance of trade payables	65,000
Cash paid to suppliers	346,000

Wk 12: Dividend paid

Ordinary share capital = $\frac{₦\ 220,000,000}{0.8}$ = 275,000,000 shares

= 275,000,000 shares × 0.02

= **₦ 5,500,000**

b. Analysis of the profitability, gearing and investor's stake in Badary Plc and recommended strategies for improving or sustaining them

Profitability:

The profit for the year is ₦216,500,000, indicating strong profitability.

i) The company has a high gross profit margin of 54.7% (₦268,000/ ₦490,000);
ii) A net profit margin of 44.2% (₦216,500/₦490,000) to sustain the profitability level;
iii) Badary Plc should continue to focus on cost control, particularly in administrative and distribution expenses; and
iv) The company should explore new revenue streams and maintain its investment in profitable ventures

Gearing:

The gearing ratio, measured as non-current liabilities to equity:

i) Is relatively low at 8.9% (₦50,000/₦560,000);
ii) Indicates low financial leverage and a conservative capital structure; and
iii) The company can consider taking an additional debt if needed for expansion, given its low gearing ratio. However, it should ensure that any new debt is manageable and contributes to revenue growth.

Investors' Stake:

The investors' stake is:

i) well-represented with a substantial share capital of ₦220,000,000 and retained earnings of ₦280,000,000;
ii) The company paid dividends, indicating good returns for shareholders, thus enhancing investors' confidence; and
iii) Badary Plc should maintain a consistent dividend policy and provide transparent financial reporting.

Examiner's report

The question tests candidates knowledge of preparation of statement of cash flows in accordance with IAS 7 using direct method while Part B of the question is on interpretation of financial statement with particular emphasis on profitability, gearing and determination of investor's stake in the business.

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

The candidates pitfalls include the following:

- Some candidates used indirect method to prepare the statement of cash flows when the question specifically requested for direct method;
- Most of them that used the direct method could not correctly calculate cash received from customers and cash paid to suppliers under the operating activities; and

- Others could not properly interpret the financial statement of the company and make necessary recommendation for strategies required to improve or sustain the company.

Candidates are advised to pay attention to all areas of preparation and interpretation of published accounts and also be conscious of the fact that the examiner may require the candidates to use a particular method to solve a problem, once the method is in the syllabus and permitted by the financial reporting standards.

	Marking guide	**Marks**	**Marks**
a.	Preparation of statement of cash flows		
	- Correctly stating title of the statement	¼	
	- Stating operating activities items	1¾	
	- Workings for operating activities items	7¾	
	- Stating investing activities items	1½	
	- Workings for investing activities items	2	
	- Stating financing activities	1½	
	- Workings for financing activities items	3	
	- Stating cash and cash equivalents	¾	
	- Workings for cash and cash equivalents	1½	20
b.	Analysis of the profitability, gearing and investors stake in Badary Plc		
	- Analysis of profitability		
	Four points at 1 mark each	4	
	- Analysis of gearing		
	Any three points at 1 mark each	3	
	- Analysis of investor's stake		
	Any three points at 1 mark each	3	10
	Total		**30**

SECTION B

SOLUTION 2

a. **SOKOTO NIG. PLC**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT OCTOBER 31, 2023

Non-current assets:	**₦'000**	
Plant and machinery (2,600+560+80-64)	3,176	
Furniture and fittings (1,600+400)	2,000	
Goodwill (Wk3)	612	
Total non-current assets	5,788	
Current assets:		
Inventories (1,760+560-72)	2,248	
Trade receivables (1,160+840-280-120)	1,600	
Cash and cash equivalents	800	
Total current assets	4,648	
Total assets	10,436	
Equity:		
Ordinary shares of ₦1 each	5,600	
Retained earnings (Wk 6)	1,771	
	7,371	
Non-controlling interests (Wk5)		665
Total equity		**8,036**
Current liabilities:		
Trade payables (2,200+440-120-280)		2,240
Bank overdraft		160
Total current liabilities		2,400
Total equity and liabilities		10,436

Working notes

Wk 1: Group structure

Sokoto Nig. PLC ---------------70% --------------- Niger Nig. LTD

NCI = 30%

Wk 2: Net asset of subsidiary	At rep. date ₦'000	At acq. date ₦'000	Post-acq. ₦'000
Ordinary shares	1,360	1,360	
Retained earnings	400	160	240
Fair value adjustments:			
Plant and machinery	80	80	-
Depreciation (80 x 20% x 4years)	(64)	-	(64)
	1,776	1,600	176

Wk 3: Determination of goodwill on acquisition

	₦'000	₦'000
Fair value of consideration transfer:		
Cost of investment		1,600
NCI at fair value (30% x 1,360 x N1.50)		612
		2,212
Less: Net assets of subsidiary at acquisition		(1,600)
Goodwill at acquisition		612

Wk 4: Unrealised profit	₦'000
URP = 360 × 25/125	72

Wk 5: Valuation of NCI	₦'000
NCI at acquisition (Wk 3)	612
Add: Share of Post-acquisition profit (30% x 176)	52.8
	664.8

Wk 6: Consolidated retained earnings	₦'000
Sokoto Plc	1,720
Add: Share of post-acquisition profit (70% x 176)	123.2
Unrealised profit	(72.0)
Consolidated retained earnings	1,771

b. Accounting for investment in subsidiary in parent's separate financial statements

i) **Cost method:** In accordance with IAS 27-Separate Financial Statements, the investment in a subsidiary is recorded at cost in the parent's separate financial statements. Dividends received from the subsidiary are recognised as income.

ii) **Fair value method:** In accordance with IFRS 9-Financial Instruments, the investment can also be measured at Fair Value through Profit or Loss (FVTPL) or Fair Value Through Other Comprehensive Income (FVOCI) depending on the parent's business model.

Examiner's report

The question tests candidates knowledge of preparation of consolidated financial statements and how to account for investment in subsidiary in the separate financial statements of the parent.

Most of the candidates attempted the question and performance was above average. The candidates that attempted the question were able to carry out the consolidation of the subsidiary and the parent, however some of them could not correctly determine the net assets of the subsidiary and the goodwill arising from consolidation as well as the consolidated retained earnings. Also, others could not explain how to account for the investment in subsidiary in the separate financial statement of the parent.

Preparation of consolidated financial statements of simple group is a section of the syllabus that is examined regularly at this level of the institute examination, hence candidates are advised to pay special attention to the provisions of IFRS 10 – Consolidated Financial Statements.

	Marking guide	Marks	Marks
a.	Preparation of consolidated statement of financial position		
	- Correctly stating of the title of the statement	¼	
	- Presentation of consolidated non-current assets	1	
	- Determination of goodwill on acquisition	5	
	- Workings for consolidated non-current assets	1½	
	- Presentation of consolidated current assets	1	
	- Workings for consolidated current assets	1¾	
	- Stating consolidated total assets	¼	
	- Stating the equity	¾	
	- Workings for consolidated retained earnings	1¼	
	- Determination of non-controlling interests	1½	
	- Presentation of consolidated current liabilities	¾	
	- Workings for consolidated current liabilities	1	
	- Stating total equity and liabilities	¼	
	- Determination of unrealised profit in inventory	¾	17
	Accounting for investment in subsidiary's separate financial statements		
	- Stating cost method	½	
	- Explanation of cost method	1	
	- Stating fair value method	½	
	- Explanation of fair value method	1	3
	Total		**20**

SOLUTION 3

Lamido Limited

a. **Computation of relevant ratios for the year ended December 31, 2021 and 2022**

Ratios	Formula	2022	2021
Operating profit margin	PBIT x 100 / Revenue	12,300 x 100 / 154,000 = **7.99%**	18,600 x 100 / 159,000 = **11.7%**
Return on capital employed	PBIT x 100 / Capital employed	12,300 x 100 / 342,500 = **3.6%**	18,600 x 100 / 214,640 = **8.7%**
Net asset turnover	Revenue / Net asset/equity	154,000 / 192,100 = **0.8 times**	159,000 / 44,800 = **3.55 times**

Current ratio	Current assets / Current liabilities	15,980 / 29,920 = **0.53:1**	28,890 / 23,960 = **1.21:1**
Interest cover	PBIT / Fixed interest	12,300 / 9,200 = **1.34 times**	18,600 / 10,200 = **1.82 times**
Gearing Ratio	Debt equity	(130,960+19,440)x100 / 192,100 = **78.3%**	(150,400+19,440)x100 / 44,800 = **379%**

b. **Comments on performance and position of Lamido Ltd for the year ended December 31, 2022**

Performance:

i) Lamido LTD'S revenue has declined in the year. As Lamido has had exactly the same delivery volumes in the year, the decline in revenue must be due to company's reducing units prices of certain courier packages. To substantiate this, it would be helpful to see the number of packages delivered by Lamido LTD during the year.

ii) In addition to the decline in revenue, there has been a decline in the operating profit margin in the year. As the volumes delivered by Lamido LTD has remained the same, it would appear that some costs incurred by Lamido LTD were relatively fixed and may not have changed significantly during the year. It has been noted that there has been an increase in the operating licence fees incurred by Lamido Ltd during the year. This would again cause the operating profit margin to fall.

iii) Return on capital employed has declined significantly due to a decline in the profit from operations, and the revaluation of non-current assets in the year by the company. This means that there is a large revaluation surplus in year 2022 which was not the case in year 2021. This will have the effect of reducing the return on capital employed due to a much larger total balance in equity. If the return on capital employed is calculated without this, it would be 6.2%, which still represents a decline in performance.

iv) Net assets turnover declined from 3.55 times to 0. 8 times. This will again be affected by the revaluation surplus, making the two years incomparable. If this is removed from the calculation, the net asset turnover will decrease slightly to 3.27 times, which is still a decrease in performance.

Position:

i) The value of non-current assets rose significantly in the year by ₦147 million. A large proportion of that will be due to the revaluation which took place, leading to an increase of ₦145 million. This suggests that Lamido LTD acquired some new assets in the year, which was not defined.

ii) The level of debt in the business is a concern, as this forms a significant portion of the company's financing, and appears to incur a large annual repayment. The reduction in the current ratio can be attributed to the large decrease in cash, which is likely to be due to the debt repayment made.

iii) It is worth noting that Lamido LTD is almost completely funded by debt with a relatively small amount held in share capital. Therefore, there is an opportunity for a new investor to consider putting more money into the business in a forms of shares, the investing company then repaying some of the loans held by Lamido LTD. As the company is currently repaying ₦19.44 million a year on the loans, it may be more sensible to repay loan, if possible, freeing up a lot more cash for growing the business or to be returned annually in the form of dividends, also saving ₦9.2 million a year in interest.

Areas of concern for the future:
There are a number of things to consider regarding the future performance of Lamido LTD.

i) Operating licences in five countries which are due for renegotiation. If the fees are raised, this will lead to reduction in profit being made by Lamido LTD.

ii) The debt appeared to being repaid in annual installments of N19.44 million, meaning that Lamido LTD needs to generate sufficient cash to repay loan each year before returning profit to the owner. In addition to this, ₦9.2 million interest means that the business appears currently unable to return any cash to investors.

Finally, Lamido LTD'S business model is heavily depended on large expensive items of non-current assets. There has been criticism of under-investment in these, which could lead to large potential outlays in the near future to replace the assets.

Conclusion:
Lamido LTD has not shown a weakened performance in the current year, but appears to be profitable business at its core. The major issue with the business is the level of debt, which is resulting in ₦19.44 million annual repayments and ₦9.2 million annual interest. A new investor who will be able to reduce these debts as part of any future purchase, would be able to put the business in a much stronger cash position and profit performance.

Examiner's report

The question is on ratio analysis and interpretation of financial statements. Candidates are required to calculate profitability, liquidity and long term financial stability ratios, they are expected to comment on the financial performance and highlight qualitative future consideration issues that may affect the company.

Most of the candidates attempted the question and performance was average.
The candidates were able to correctly calculate the ratios however, most of them could not give correct interpretations to the ratios computed and they also failed to identify the qualitative future considerations.

Candidates are advised to pay attention to all sections of the syllabus and make use of the Institute Pathfinder and Study Text for better performance in future examinations.

	Marking guide	**Marks**	**Marks**
a.	Computation of relevant ratios		
	- Calculation of operating profit margin	1	
	- Calculation of return on capital employed	1	
	- Calculation of net asset turnover	1	
	- Calculation of current ratio	1	
	- Calculation of interest cover	1	
	- Calculation of gearing ratio	1	6
b.	Comments on performance and position Lamido LTD		
	i) Comments on performance		
	- Identifying four correct points at ½ mark each	2	
	- Explanation/Justification of the points at ½ mark each	2	
	ii) Comments on position		
	- Identifying four correct points at ½ mark each	2	
	- Explanation/Justification of the points at ½ mark each	2	
	iii) Comments on areas of concern for the future		
	- Identifying four correct points at ½ mark each	2	
	- Explanation/Justification of the points at ½ mark each	2	
	iv) Conclusion		
	- Stating any two correct conclusion at 1 mark each	2	14
	Total		**20**

SOLUTION 4

a. **Differences between impairment and depreciation**

i. Impairment occurs when the carrying amount of an asset exceeds its recoverable amount, resulting in an economic reduction in the value of the asset.

ii. Impairment is recognised when there is evidence that an asset's value has declined below its carrying amount, and the asset must be written down to its recoverable amount.

iii. Impairment losses are typically unexpected and result from specific events or circumstances, such as market declines, technological obsolescence, or legal restrictions.

While

iv. Depreciation is the systematic allocation of the depreciable amount of an item of property, plant and equipment over its estimated useful life.

v. It represents the estimated portion of the depreciable amount of an asset consumed on a yearly basis over the number of years with which the asset will generate economic benefit to the entity.

vi. Depreciation is accounted for annually, based on the asset's estimated useful life and residual value.

b. **Indicators of impairment:**

IAS 36 requires that at each reporting date, an entity must assess whether there are indicators of impairment. Indications that impairment might have happened can come from external or internal sources:

Internal sources:	**External sources:**
• Evidence of obsolescence or damage.	• Unexpected decrease in an asset's market value.
• There is, or about to be, a material reduction in the usage of an asset.	• Significant adverse changes have taken place, or are about to take place, in the technological market, economic or legal environment.
• Evidence that the economic performance of an asset has been, or will be worse than expected.	• An increase in interest rates affecting the value-in-use of the asset.
• There is a reduction in the assets expected remaining useful life.	• The carrying amount of the net assets of the entity is more than its market capitalisation

i) **Identifyi.ng and accounting for impairment of assets**:

- At the end of each reporting period, the entity should assess whether there are any indications that an asset may be impaired;

- If there are such indications, the entity should estimate the asset's recoverable amounts;
- When the recoverable amount is less than the carrying amount of the assets, the entity should reduce the assets' carrying amount to its recoverable amount. The amount by which the value of the assets is written down is an impairment loss;
- The impairment loss shall be recognised immediately in the statement of profit or loss;
- However, an impairment loss on a revalued asset is recognised in other comprehensive income to the extent that the impairment loss does not exceed the amount in the revaluation surplus for that same asset;
- Such an impairment loss on a revalued asset reduces the revaluation surplus for that asset; and
- After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

c. According to IAS 36, an asset is said to be impaired when its recoverable amount is less than its carrying amount in the statement of financial position. The recoverable amount of an asset is the higher of its fair value less costs of disposal and its value-in-use.

Zamfara LTD non-current asset recoverable amount of ₦600,000 is less than its carrying amount of ₦720,000 (wk 1) hence there is an impairment loss. See computation below.

	₦
Carrying amount (wk. 1)	720,000
Recoverable amount	(600,000)
Impairment loss	120,000

The non-current asset must still be written down by ₦120,000. However, ₦50,000 of this would be recognised in other comprehensive income and the remaining ₦70,000 (₦120,000 – ₦50,000) would be charged to the statement of profit or loss as an impairment loss.

The accounting entry is as follows:

	Debit	Credit
	₦	₦
Impairment loss (Statement of profit or loss)	70,000	
Revaluation surplus (other comprehensive income)	50,000	
Non-current asset		120,000

The recoverable amount of the non-current asset of ₦600,000 will be subject to depreciation going forward over the remaining useful life on a systematic basis.

Working 1:
Calculation of carrying amount of non-current asset

	₦
Carrying amount at the beginning	800,000
Depreciation for the year	(80,000)
Carrying amount at the end of the year	**720,000**

Examiner's report

The question tests candidates knowledge of the provisions of IAS 36- Impairment of Assets and the differences between depreciation and impairment.

Few candidates attempted the question and performance was below average.
Most candidates could not explain the accounting treatments of impairments and others could not state the differences between impairment and depreciation.

Candidates are advised to pay more attention to the provisions of relevant International Financial Reporting standards (IFRS) as well as its applications for better performance in future examinations.

Marking guide	Marks	Marks
a. Differences between impairment and depreciation		
- Stating any five differences at 1 mark each		5
b. Discussion of IAS 36- Impairment of Assets		
i) Indicators of impairment		
- Identifying any six indicators at ½ mark each	3	
ii) How to identify and account for impairment		
- Discussion of any six points on identification and accounting for impairment at ½ mark each	3	6
c. Explanation with computation of accounting treatment of the given scenario		
- Any nine points at 1 mark each		9
Total		**20**

SOLUTION 5

a. **Explanation of prior-period errors**

Prior-period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior-periods arising from a failure to use, or misuse of, reliable information that:

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

Correction of prior-period errors

i. According to the provision of IAS 8, an entity shall correct material prior-period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:
   - Restating the comparative amounts for the prior period(s) presented in which the error occurred; or
   - If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities, and equity for the earliest prior period presented.
ii. The correction of a prior period is excluded from the statement of profit or loss in the period when the error was discovered.

Examples of prior-period errors:

i. The effects of mathematical mistakes;
ii. Mistakes in applying accounting policies;
iii. Oversights or misinterpretations of facts; and
iv. Fraud.

b. **Lagos Company Nigeria Limited**

Statement of profits or loss and other comprehensive income for the year ended December 31

	2022	2021
	₦'000	₦'000
Revenue	268,800	189,600
Cost of sales (Wk 1)	(206,400)	(155,080)
Profit before tax	62,400	34,520
Income tax expenses (Wk 2)	(18,640)	(10,480)
Profit for the year	43,760	24,040

Statement of movement in retained earnings for the year ended December 31

	2022	2021
	₦'000	₦'000
Balance at January 1 (wk 3)	76,040	52,000
Profit for the year	43,760	24,040
Balance at December 31, 2021	119,800	76,040

Working note

Wk 1: Cost of sales

	2022	2021
	₦'000	₦'000
Balance b/f	223,200	138,280
Adjustment for inventory overcast	(16,800)	16,800
Balance to SOPL	206,400	155,080

Wk 2: Income tax expense

	2022	2021
	₦'000	₦'000
Balance b/f	13,600	15,520
Tax effect of Inventory overcast at 30%	5,040	(5,040)
Balance to SOPL	18,640	10,480

Wk 3: Opening retained earnings

	₦'000
January 1, 2021 (per question)	52,000
Add: profit for the year 2021	35,800
	87,800
Less: Error in inventory 2021	(16,800)
Add: Related tax at 30%	5,040
	76,040

Examiner's report

The question tests candidates knowledge of the provisions and applications of IAS 8-Accounting Policies, Changes in Accounting Estimates and Errors. The part (a) of the question requires candidates to explain prior period errors and to discuss how such errors are corrected, giving examples. part (b) deals with the application of the correction of prior period errors in the books of a company and disclosure of such correction in the statements of profit or loss.

Most candidates attempted the question but performance was below average.
The candidates performance in part (a) of the question was fair, however, majority of the candidate could not apply the provisions and principles in part (a) to solve the question in part b and this led to loss of valuable marks.

Candidates are advised to pay special attention to relevant accounting standards at this level of the Institute's examination for better performance in future.

	Marking guide	**Marks**	**Marks**
a.	Explanation, correction and examples of prior-period errors		
	i) Explanation of prior-period errors		
	- Any three points at 1 mark each	3	
	ii) Correction of prior-period errors		
	- Any three points at 1 mark each	3	
	iii) Examples of prior-period errors		
	- Any two examples at ½ mark each	1	7
b.	Preparation of statement of profit or loss and other comprehensive income and retained earnings Extracts with comparative figures		
	i) Presentation of statement of profit or loss		
	- Correct stating of the title	¼	
	- Stating of revenue	½	
	- Determination and stating the cost of sales	1½	
	- Stating profit income tax	½	
	- Computation of income tax expense	1½	
	- Stating the profit for the year	½	
	ii) Presentation of statement of movement in retained earnings		
	- Correctly stating of the title	¼	
	- Stating the opening balances	½	
	- Workings for determination of opening balance 2022	1½	
	- Stating the profit for the year	½	
	- Stating closing balances of retained earnings	½	8
	Total		**15**

SOLUTION 6

MEMO

From: Accountant

To: Senior Accountant

Subject: **Treatment of financial Instruments in accordance with IAS 32**

Transaction 1

i. IAS 32 requires a financial instrument to be classified as a liability if there is a contractual obligation to deliver cash or another financial assets to another entity.
ii. In the case of the preference shares as they are non-redeemable, there is no obligation to repay the principal.
iii. In the case of the dividends, because of the condition that preference dividend will only be paid if ordinary dividend are paid in relation to the same period, the preference shareholders has no contractual right to a dividend. Instead the distributions to holders of the preference shares are at the discretion of the issuer as Akwa Nig. Ltd. can choose whether or not to pay an ordinary dividend and therefore a preference dividend. Therefore, there is no contractual obligation in relation to the dividend.
iv. As there is no contractual obligation in relation to either dividend or principal, the definition of a financial liability has not been met and the preference shares should be treated as **equity** and initially recorded at fair value of ₦40million.
v. The treatment of dividends should be consistent with the classification of the shares and should be charged directly to retained earnings in the statement of changes in equity.

Transaction 2

i. The price of the equipment, a non-current asset is fixed at ₦5million one year after delivery. In terms of recognition and measurement of the equipment, the ₦5million price would be discounted back one year to its present value.
ii. The company is paying for the equipment by issuing shares. However, this is outside the scope of IFRS 2-Share Based Payments because the payment is not dependent on the value of its shares, it is fixed at ₦5million.
iii. This is an example of a contract that will be settled in an equity instruments and is non-derivative for which the entity is or may be obliged to deliver a variable number of equity's own equity instrument i.e. it is a **Financial Liability**.
iv. Therefore, it is a financial liability and initially measured at the present value of the ₦5million.
v. Subsequently, as it is not measured at fair value through profit or loss (as it is not held for a short-term profit making or a derivative) it should be measured at amortise cost.

vi. As a result, interest will be applied to the discounted amount over the period until payment are recognised in statement of profit or loss with corresponding increase in the financial liability.

Transaction 3

i. Most ordinary shares are treated as equity as they do not contain contractual obligation to deliver cash.
ii. However, in the case of the directors shares, a contractual obligation to deliver cash exists on specific date as the share are redeemable at the end of service contract of the directors.
iii. The redemption is not discretionary and Akwa LTD has no right to avoid it. The mandatory of the repayment make the capital a **Financial Liability**.
iv. The dividend payment are discretionary as they must be ratified at the Annual General Meeting (AGM). Therefore no liability should be recognised for any dividend until it is ratified. When recognised the classification of the dividend should be consistent with that of the shares and therefore, the dividends should be classified as a finance cost rather than as a deduction from retained earnings hence the dividend should be charged to the statement of profit or loss as finance cost.

Conclusion

Hope the above explanation is clear. If you need further explanation do not hesitate to contact me.

Thank you.

Accountant

Examiner's report

The question tests candidates knowledge of the provisions of IAS 32 – Financial Instruments: Presentation. Candidates are required to apply the provisions of this standard to determine how various transactions should be disclosed and accounted for in the financial statements of an entity.

Few candidates attempted the question and performance was poor.
Majority of the candidate did not understand the question and could therefore not determine the nature of the type of financial instruments in the transactions, while few that could identify it were unable to give any justifiable reason for the identification of the financial instrument.

Most candidates appeared not to be familiar with this area of the syllabus, hence the poor performance. They are therefore advised to cover all sections of the syllabus for better performance in future examination of the Institute.

Marking guide	**Marks**	**Marks**
Treatment of Financial Instruments in accordance with IAS 32		
i) Transaction 1		
- Any five points on justification of treatment of the financial instrument at 1 mark each		5
ii) Transaction 2		
- Any five points on justification of treatment of the financial instrument at 1 mark each		5
iii) Transaction 3		
- Any four points on justification of treatment of the financial instrument at 1 mark each		4
- Memo format of presentation	½	
- Conclusion of report	½	1
Total		**15**

SOLUTION 7

a. (i) **Cost model**

- An intangible asset is carried at cost less accumulated amortisation and any accumulated impairment losses after initial recognition.

(ii) **Revaluation model**

- Intangible assets can be revalued according to the same rules as those applied to the revaluation of property, plant and equipment.
- An intangible asset is carried at a revalued amount (its fair value at the date of the revaluation less any subsequent accumulated amortisation and any accumulated impairment losses).
- This is only allowed if the fair value can be determined by reference to an entire market in that type of intangible assets.

b. **Calculation and explanation of the carrying amount and revaluation surplus of the intangibles**

i) **Carrying amount as at December 31, 2019**

	₦
Cost of registering licence	90,000
Revaluation surplus account [₦94,500 x 15 – ₦90,000]	1,327,500
Carrying amount Dec 31, 2019 (Fair value)	1,417,500

Explanations:

- The initial cost of ₦700,000 incurred should be written off into the statement of profit or loss because the generation of its future economic benefits is not probable then.
- The fair value of the licence as at December 31, 2019 would be ₦1,417,500

[₦ 94,500 x 15 taxis] since the cost is ₦90,000 the revaluation reserve account will be credited with ₦1,327,500 and intangible asset debited with same amount.

ii) **Calculation as at December 31, 2022 (Before regular revaluation)**

Explanations:

- The accumulated amortisation on the revalued amount for 3 years will be; (₦1,417,500 x 3/9) = ₦472,500 whereas, the accumulated amortisation would have been (₦90,000 x 3/9) = ₦30,000

Carrying amount:

	₦
Bal. B/fwd (Jan 1. 2020)	1,417,500
Less: Amortisation	(472,500)
Carrying amount	945,000
Revaluation surplus (Jan 1, 2020)	1,327,500
Transfer to retained earnings (₦1,327,500 x 3/9)	(442,500)
Revaluation surplus bal. Dec 31, 2022	885,000

iii) **Calculation as at December 31 2022 (After regular revaluation)**

- Carrying amount of the licence immediately before revaluation is ₦945,000
  (₦1,417,500 – ₦472,500)
- The revalued carrying amount is ₦675,000 (₦45,000 x 15)

:. There is a deficit of (₦945,000 – ₦675,000) = ₦270,000 which should be recognised in the revaluation reserve.

:. Revaluation reserve:

	₦
Bal. B/fwd regular revaluation	885,000
Less deficit	(270,000)
Revaluation reserve Dec 31, 2022	615,000
Carrying amount	₦675,000

Examiner's report

The part (a) of the question tests candidates knowledge of the measurement models of intangible assets, while part b requires practical application of the measurement of the intangible assets.

Few candidates attempted the question and performance was poor.

Some candidates were able to explain the two measurement models of intangible assets but majority of them could not correctly answer the part (b) of the question which requires practical application of the provisions of IAS 38 – Intangible Assets.

Candidates are advised to note that examiners will sometimes require practical application of the provisions of relevant accounting standards, hence attention should not only be placed on learning the provisions but also on its practical applications for better performance in future examinations.

	Marking guide	**Marks**	**Marks**
a.	Discussion of two measurement models for intangible assets		
	- Stating and discussing cost model	1	
	- Stating and discussing revaluation model	2	3
b.	Calculation and explanation of the carrying amount and revaluation surplus of the Intangibles		
	i) Carrying amount at December 31, 2019		
	- Calculation of carrying amount	2	
	- Explanation of the calculation	1	
	ii) Carrying amount at December 31, 2022 (before regular revaluation)		
	- Calculation of carrying amount	1½	
	- Explanation of the calculation	2	
	- Calculation of revaluation surplus	1½	
	iii) Carrying amount at December 31, 2022 (after regular revaluation)		
	- Calculation of carrying amount	2	
	- Explanation of calculation	1	
	- Calculation of revaluation surplus	1	12
	Total		**15**

ICAN/241/Q/B2 **Examination No..........................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

AUDIT AND ASSURANCE

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

WEDNESDAY, MAY 15, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

AUDIT AND ASSURANCE

Time Allowed: $3^{1}/_{4}$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

FINPAY FINANCIAL SOLUTIONS LIMITED

FinPay, an innovative payment service bank, operates from its office on Lagos Island, overseeing all financial transactions, customer interactions, and relationships nationwide. The bank streamlines its processes for customer convenience, embracing the digital age.

Customers' bank accounts are linked to their GSM phone numbers, with the initial zero removed. All banking operations, from account creation and deposits to withdrawals and account closure, are conducted seamlessly through the bank's mobile App, which can be easily downloaded from popular App stores.

Access to the bank's mobile App is allowed using an account number and a private six-digit PIN. A prospective customer completes the onboarding process by uploading scanned passport photos, ID card, utility bill, alongside providing other essential personal information, like name, NIN, telephone number, email address, and residential address.

To facilitate transactions, a four-digit PIN linked to the customer's debit card is activated at Automated Teller Machines (ATMs). Additionally, customers can leverage USSD codes for payments. Customers are required to use their registered phone numbers on their smartphones when transacting businesses with the bank.

In the event of a declined transaction, swift resolution is a priority. Debits are promptly reversed, ensuring customer satisfaction. Customers can report issues directly through the mobile App or via email, and FinPay's responsive support team resolves matters without necessitating a visit to the bank's physical office. This efficiency cements FinPay's reputation as a leading online bank in Nigeria.

FinPay expedites the delivery of debit cards to customers, ensuring they reach their designated addresses within 48 hours of account creation. Furthermore, a proactive follow-up call is made just 24 hours after opening an account, enhancing the overall customer experience.

With a focus on catering for tech-savvy Nigerian youths, FinPay is steadily expanding its customer base. The bank even offers small, easily accessible loans over a six-month period, further attracting and retaining a young clientele. Some customers instruct FinPay to pay monthly DStv subscriptions or send amounts to third parties on regular basis, by activating a prompt on the mobile App.

For added convenience, FinPay features a responsive chatbot, named Bobo. Customers can engage with Bobo through the bank's mobile App, website, and social media channels, providing another layer of support and accessibility. This comprehensive approach positions FinPay as a forward-thinking financial institution at the forefront of digital banking in Nigeria.

Required:

a. Highlight **FOUR** of the benefits an online system offers to FinPay and its customers. (8 Marks)

b. Identify and explain **FIVE** General controls and **FIVE** Application controls embedded in FinPay's system. (10 Marks)

c. Explain **THREE** areas the auditors will give special considerations because of the the audit risks associated with the online real-time system that dominates FinPay's operations. (12 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

In the audit of organisations, auditors often place importance on cash and cash equivalents because of the risk of misstatement associated with them. There have been cases of unreported bank balances and bank accounts opened in the names of organisations and operated secretly without the knowledge of management.

The audit work performed on cash balances will usually depend on materiality considerations. In this context, materiality should be considered not only in terms of the amount in the statement of financial position, but also in terms of the value of individual transactions passing through the cash account during the period.

Required:

a. Explain **THREE** risks of misstatement associated with cash and cash balances. (3 Marks)

b. Enumerate and explain **SIX** areas covered by a bank confirmation letter. (6 Marks)

c. State and explain **FIVE** audit steps you will perform after obtaining the confirmation replies from banks. (7 Marks)

c. State and explain **FOUR** main audit steps involved in a physical count in verifying cash balances. (4 Marks)

(Total 20 Marks)

QUESTION 3

You are the Audit Senior-in-charge of the audit of Edinburg Nigeria Limited. The management of the company made some representations to you, which include:

- Inventory worth ₦15 million in its only branch in Niger Republic, which you couldn't visit because of the ongoing civil unrest in that country;
- A donation of ₦500,000 was made to a motherless babies home by the Chairman but it was not receipted; and
- The chairman received medical treatment amounting to ₦600,000 during his official visit to Germany to negotiate with equipment vendors, and he did not come back with any documentary evidence.

You have reported these matters to the partner of your firm, Olumisi Oregun & Co.

Required:

a. Explain **TWO** reasons for obtaining letters of representation from clients' management. (4 Marks)

b. Explain **THREE** steps you will take if a representation by management is contradicted by other audit evidence. (6 Marks)

c. Draft a letter of representation, which the management of Edinburg Nigeria Limited will present to your firm. (10 Marks)

(Total 20 Marks)

QUESTION 4

MetroPower Limited, a major public utility company, was entrusted with providing electricity to millions of residents and businesses. Mr. Mark, the Lead Technician, at MetroPower for many years is responsible for maintaining the electrical grid to ensure reliable supply of electricity to the city. MetroPower's financial statements were subjected to annual audits.

When Mrs. Jennifer assumed her role as the department's supervisor, she implemented cost-cutting measures aimed at reducing the budget allocated for routine maintenance. This decision raised significant ethical concerns, as Mr. Mark believed it would compromise the safety and reliability of the electrical grid. He knew that such actions could lead to power outages and electrical hazards.

Mr. Mark found himself in a dilemma, torn between his responsibility to make electricity available and the potential consequences of opposing his new supervisor's cost-cutting measures. Mr. Mark documented his concerns, maintaining detailed records of previous maintenance schedules and their impact on the grid's reliability.

The auditors came across the evidence of reduced costs of maintenance and inspections in MetroPower.

Required:

a. Describe "public interest", using MetroPower as example. (2 Marks)
b. Identify **FIVE** matters with which public interest can be associated. (5 Marks)
c. In setting codes of ethics, it is stated that principle-based ethics are better than rule-based ethics. Justify this assertion. (5 Marks)
d. Explain why the concept of "due care" or "reasonable care" is important in a contract for the provision of services. (4 Marks)
e. State **TWO** likely implications of the auditors' failing to act on the information they got in relation to reduced costs of maintenance and inspections at MetroPower. (4 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

The International Standards on Auditing 200 (ISA 200) made some important pronouncements on the independent Auditor.

Required:

a. Explain **TWO** objectives of the Independent Auditor as specified in ISA 200. (4 Marks)
b. Explain **FOUR** tasks ISA 200 requires the Independent Auditor to perform. (8 Marks)
c. Explain the roles of auditing standards in the accounting profession. (3 Marks)

(Total 15 Marks)

QUESTION 6

Each assurance engagement is classified on two dimensions: It is either a reasonable assurance engagement or a limited assurance engagement; and either it is an attestation engagement or a direct engagement.

Required:

a. Specify the **TWO** channels through which an assurance can be provided. (2 Marks)
b. Differentiate a reasonable assurance from a limited assurance. (3 Marks)

c. Explain the **FIVE** elements of an assurance engagement performed by a practitioner. (10 Marks)

(Total 15 Marks)

QUESTION 7

Abati Quarries Limited was registered with the Corporate Affairs Commission in 2017 and it commenced operations in 2019. The beginning was rough, as the property, plant and equipment costs were beyond the initial projections, and the company had to make do with fairly used equipment, which kept breaking down along the line.

Products were meant for supply to its parent company, Abati Estates, which is into large scale development of residential and commercial property in Lagos. As a result, Abati Quarries Limited hardly had substantial finished goods (granites) as closing inventory. The Audit Manager later insisted that boulder rocks blasted at the site should be regarded as unfinished inventory or work-in-progress.

In addition, the performance of Abati Quarries Limited was at variance with the performance of competitors in the industry, as the company had been returning losses from inception. The Audit Manager then required that the audit team should intimate the General Manager of the company of the decision to determine the cost of the boulder rocks and include it in the financial statements as closing work-in-progress. The General Manager, however, disagreed.

The Audit Manager therefore, instructed you, the Audit Senior, to draft appropriate paragraph(s) on Key Audit Matters (KAMs), suitable for inclusion in the Independent Auditor's report, to bring this matter to the attention of the company's shareholders.

Required:

a. Explain "Key Audit Matters" (KAMs) in relation to the Audit Report. (2 Marks)

b. Explain **TWO** types of audit in which the auditor is required to communicate Key Audit Matters, in accordance with ISA 701. (3 Marks)

c. Draft the "Key Audit Matters" section for inclusion in the auditor's report of Abati Quarries Limited to capture the "boulders" issue. (6 Marks)

d. Highlight **TWO** important matters the auditor will consider before determining if a matter is a Key Audit Matter. (4 Marks)

(Total 15 Marks)

SOLUTION 1

a. The benefits an online system offers to Finpay and its customers include:

i. Immediate entry of transactions into the system (for example, transfer to or from the customer done on smart phones, electronic point of sale (POS) terminals, ATMs, or direct from other banks);
ii. Immediate updating of the customers' accounts (such as the immediate updating of the customer's records as soon as a transfer is made);
iii. Effective enquiry system (such as immediate answers to balance enquiries from customers);
iv. Offer of uninterrupted banking services to customers round the clock, even on public holidays and at night;
v. Enabling real-time engagement, with the use of its Bobo chatbot;
vi. Immediate access to credit, with the use of data analytics, without human intervention;
vii. Enhancing automatic handling of routine transactions, for example, payment of monthly utility bills and DStv subscriptions, regulate payments to third parties;
viii. Cost effectiveness to customers and the bank;
ix. Provision of banking services at any location; and
x. Resolution of issues without physical attendance at bank's physical office.

b. Controls embedded in FinPay system

i. General controls include:

- Access controls: Customers' transactions are processed immediately by the online systems. All unauthorised access to the programs and data files are prevented since the customer has a six-digit password;
- Programming controls are in-built to prevent or detect unauthorised changes to standing data, like monthly loan deductions, or monthly payments to DStv;
- Transaction logs are available on FinPay's General Ledger Application System. This is even accessible on the customers' devices. This can be used to create an 'audit trail';
- Firewalls are used. These protect FinPay's General Ledger Application System from unauthorised access via the internet; and
- FinPay complies with regulatory KYC (Know You Customer) requirement by collecting NIN, telephone number, passport photograph, ID card, utility bill, and residential address.

ii. Application controls include:

- Before opening any account for any customer, FinPay's system digitally verifies the customer's NIN information, telephone number, ID card, and utility bill with issuing authorities;
- There is pre-processing authorisation. A customer is required to log

on to FinPay system with his/her telephone number and password before s/he can use the mobile App;

- Program checks (for example confirmation of customer's account balance and the transaction PIN before transactions are consummated. This includes checking the number of digits in the password and PIN);
- 'Balancing'. This is evident in the fact that when a transfer is declined, the debit entry is reversed;
- Customer's account number is derived from his/her registered telephone number; and
- FinPay links all transactions with the customer's registered telephone number or the bank's debit card.

c. **Areas the auditors will give special consideration because of audit risks associated with Finpay's operations**

i. The skills and knowledge needed by auditor to understand Finpay's fully automated banking system are very high. This knowledge is to help in identifying the operational risks to which Finpay is exposed and how to mitigate them.

ii. The Finpay's system covers a very broad geographical market (even beyond Nigeria). The remote access granted customers exposes the system to potential high cyber security risks. The auditor should be aware of industry practices on how this risk is mitigated.

iii. Transaction integrity may be lost in the Finpay's system. The auditor should obtain knowledge of CBN's regulatory sandbox and guidelines and should examine that Finpay complies with these laws and guidelines. This can result in reputational damages if it occurs.

iv. There is the risk of inadequate audit trail. The auditor should test and confirm that this risk is mitigated by adequate logs, backups and a robust ERP system.

Examiner's report

The question tests candidates' knowledge of computer-based information system as applicable to on-line system in a banking environment.

Being a compulsory question, about 100% of the candidates attempted the question. The general performance was below average.

The commonest pitfalls were the inability of the candidates to differentiate between General controls and Application controls, and application of their knowledge of audit risks to practical scenarios.

Candidates are advised not to shy away from the knowledge of Information Technology (IT) and its unavoidable application to audit profession in the modern dispensation.

Marking guide

			Marks	Marks
a.		**Benefits of an online system to Finpay and its customers** 2 marks each for a correct solutions subject to a maximum of 4 points		8
b.	(i)	**Identifying and explaining General controls for in Finpay system** 1 mark each for each point, subject to a maximum of 5 points	5	
	(ii)	**Identifying and explaining Application controls in the Finpay system** 1 mark each for each point, subject to a maximum of 5 points	5	10
c.		**Areas the auditor will give special considerations because of the audit risks associated with online real-time system of Finpay operations.** 4 marks for a correct explanation subject to a maximum of 3 points		12
		Total		**30**

SOLUTION 2

a. **Principal risks**

The principal risks of misstatement of the bank and cash balances in the financial statements are that:

i. Not all bank balances are disclosed (the rights and obligations, and existence assertions);
ii. Reconciliation differences between bank statements and the client's cash book balances are incorrectly dealt with (the valuation assertion); and
iii. Material cash balances are omitted (the completeness assertion).

b. **Typical areas covered by a confirmation letter include the following:**

i. Confirmation of balances on all bank accounts at the end of the reporting period;
ii. Details of any unpaid bank charges;
iii. Loans granted to the organisation;
iv. Details of any liens (charges) over assets of the client entity;
v. Details of any assets of the client entity held by the bank as security for loans and advances;
vi. Details of accrued interests;
vii. Details of any other client bank accounts that are known to the bank but not listed on the request to the bank for confirmation of balances; and

viii. Names of signatories and their mandates.

c. **Audit work on the banks' confirmation replies**

i. **Bank reconciliation statement:** Obtain or prepare a bank reconciliation statement for each bank account.

ii. **Arithmetic accuracy of reconciliation:** If the reconciliation is prepared by the company, check it for arithmetical accuracy.

iii. **Comparison with bank reconciliation:** Check the bank balance confirmed in the bank's confirmation letter against the balance used in the bank reconciliation statement.

iv. **Other information on the confirmation letter:** Relate other information contained in the confirmation letter to other areas of the audit (for example, accrued bank charges must be provided for in the financial statements).

v. **Check the bank reconciliation against available evidence:** Check items appearing in the bank reconciliation statement against any available supporting evidence (for example, unpresented cheques in the bank reconciliation statement should be shown as having been presented in a subsequent bank statement).

vi. **Unusual items:** Review the cash book and bank statements for unusual items, including unusual delays between cash book and bank statement entries. Investigate the reasons for any unusual item.

vii. **Review of the confirmation letter in relation with disclosure on the financial statements:** Review the confirmation letter from the bank for any other information to be disclosed in the financial statements (for example, charges on assets and security for loans).

d. **The main audit steps involved in verifying cash balances in a physical count include the following:**

i. The auditor should count cash at all locations simultaneously and in the presence of a company official. (Simultaneous counting is necessary, to prevent the client from moving cash that has been counted at one location to another location ready for the next count);

ii. After the count, the auditor should obtain a signed receipt for the amount of cash returned to the official, after the count;

iii. The auditor should check the cash balance obtained from the count against the client's cash records and cash balance in the draft financial statements; and

iv. The auditor should also investigate the treatment of any money advanced to employees (for example, against wages or salary).

Examiner's Report

The question tests candidates' knowledge of substantive audit procedures on cash and cash equivalents.

About 20% of the candidates attempted thee question and their performance was poor.

The commonest pitfall was the exhibition of poor knowledge even in the common area of audit procedures, such as confirmation of bank balances.

Candidates are advised to adequately cover the syllabus and make use of the Institute's Study Text for their preparations.

Marking Guide

		MARKS	**MARKS**
a.	Explanation of risks of misstatement associated with cash and cash balances		
	1 mark for each point, subject to a maximum of 3 points		3
b.	Explanation of areas covered by bank confirmation letter		
	1 mark for each point, subject to a maximum of 6 points		6
c.	Stating and explaining steps to be performed after obtaining confirmation replies from the banks		
	½ mark for each correct statement, subject to maximum of 4 points	2	
	1 mark each for explanation of a step, subject to a maximum of 5 points	5	7
	Explanation of main audit steps involved in a physical count in verifying cash balances		
	1 mark each, subject to a maximum of 4 points		4
	Total		**20**

SOLUTION 3

a. **Reasons for obtaining letters of representation from client's management include:**

i. To support the auditor's understanding of management's intention or judgment (for example, in respect of future plans for the business or a specific matter, such as the net realisable value of inventory);

ii. To support the completeness of a specific item (for example, that all liabilities have been provided for); and

iii. To provide additional source of audit evidence in the overall auditing process.

b. **If a representation by management is contradicted by other audit evidence, the auditor should:**

i. Consider whether his risk assessment of that area is still appropriate;
ii. Consider whether additional audit procedures are needed; and
iii. If he has concerns about the integrity of management, document those concerns and consider withdrawing from the audit.

c. **Draft letter of representation**

EDINBURG NIGERIA LIMITED
172, Idowu Taylor Street
Victoria Island, Lagos

18 April, 2024

The Managing Partner
Bim Abubakar & Co.
(Chartered Accountants)
432 Broad street
Lagos

Dear Sir,

RE: AUDIT OF OUR COMPANY'S ACCOUNTS FOR THE YEAR ENDED DECEMBER 31, 2023

In addition to the disclosures in the financial statements and other information presented to you for the audit of our company's accounts for the year ended December 31, 2023, we wish to provide the following confirmations:

Financial statements

We have fulfilled our responsibilities for the preparation and presentation of the financial statements as set out in the terms of the audit engagement dated November 12, 2023 and, in particular, the financial statements are fairly presented in accordance with International Financial Reporting Standards.

Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

We have provided you with:

- All information, such as records and documentations, and other matters that are relevant to the preparation and presentation of the financial statements;
- Additional information that you have requested from us; and
- Unrestricted access to our staff.

All transactions have been recorded in the accounting records and are reflected in the financial statements.

We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations, whose effects should be considered when preparing financial statements.

We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

Inventory worth ₦15 Million in Niger Republic
Your firm is unable to visit Niger Republic because of the ongoing civil unrest in that country. We confirm to you that our inventory is safe and comprehensively insured against all risks, hence no loss is expected on the inventory since the inventory are tangible assets, not perishable or threatened by obsolescence.

Donation of ₦500,000.00 to Ojota Motherless Baby's Home (The Home)
We were unable to obtain a receipt as the Home, we were informed, was currently out of stock of receipt booklets. However, we confirm that the donation was approved by our company's board and the receipt will be obtained once the Home has stock of receipt booklets. The Home has already verbally confirmed to your staff of the receipt of the donation.

Chairman's medical treatment of ₦600,000.00
We confirm that our Chairman received medical treatment during his visit to Germany, but did not come back with any documentary evidence. The amount is relatively material, but still within the medical limit of the Chairman as approved by the board. We have written to the hospital in Germany to send to us all documents related to the treatment, We are positive that the documents will be received very soon.

If you require confirmation on any item not included above, please do not hesitate to contact us.

Thank you.

Yours faithfully,
For:- EDINBURG NIGERIA LIMITED

Edwin Olusoga
Managing Director/CEO

(NOTE: The letter should be on Edinburg Nigeria Limited's official letterhead)

Examiner's Report

The question tests candidates' understanding of letter of representation, as a part in the finalisation stage in an auditing process.

About 85% of the candidates attempted the question, but the performance was average.

The commonest pitfalls of candidates were their failure to differentiate between ordinary memorandum (memo) and official letters. Some candidates who attempted to write a letter of representation did a poor job of it.

Candidates are advised to prepare well for the examinations and make good use of the Institute's Study Texts. They should also endeavour to meet the requirements of the questions.

Marking guide

		Marks	Marks
a.	Explanation of reason for obtaining letters of representation from client's management		
	2 marks each for a point, subject to a maximum of 2 points		4
b.	Steps to be taken if a representation by management is contradicted by other audit evidence		
	2 marks for each correct step, subject to a maximum of 3 steps		6
c.	Draft of a letter of representation		
	Introduction	2	
	Body of letter	2½	
	Special representation issues	4½	
	Conclusion & closing	1	10
	Total		20

SOLUTION 4

a. **Public interest**

An obligation of professional bodies, which separates a profession from a trade is that members of the profession are expected to act in the public interest. It is, therefore, a responsibility of an accountant "not to act exclusively to satisfy the needs of a particular client or employer".

When the demands or needs of a client or employer appear to be contrary to the public interest, accountants should consider the public interest. The auditors should, therefore, report their observations on the reduced costs of maintenance and inspections at MetroPower.

b. **It is usual to associate the public interest with the following matters:**

i. Detecting and reporting any serious misdemeanour or crime;
ii. Protecting health and public safety;
iii. Preventing the public from being misled by a statement or action by an individual or an organisation;
iv. Exposing the misuse of public funds and corruption in government; and
v. Revealing the existence of any conflict of interests of those individuals who are in positions of power or influence.

c. **Principles-based versus rules-based code of ethics**

A principles-based code of ethics for accountants is a code that specifies general principles of ethical behaviour, and requires the professional accountant to act in accordance with the principles. The accountant is required to use his judgement in deciding whether in each case a particular course of action is a 'proper' or 'ethical' one. Both the IFAC and ICAN codes of ethics are principles-based codes.

The rules-based code of ethics is one in which a regulatory body issues a code of ethics for accountants that contains specific rules about how they should act in specific situations.

The principle-based codes of ethics are considered better than the rules-based code of ethics, especially because of the several weaknesses of the rules-based code of ethics, which include:

i. Complex and varied circumstances an accountant might face. It is impossible to plan for all types of ethical problems that will arise, making rules in advance, without knowing the exact details of the situations and of what courses of action the accountant must take;

ii. Differences in situations (ethical dilemmas) that an accountant might face over time could change as the business environment changes. It might, therefore, be necessary to review and update the rule book regularly; and

iii. Differences in ethical views amongst countries and cultures. Behaviour or disposition that might be considered unethical in one country might be perfectly normal and acceptable in another country. A rule book cannot easily make allowances for national and cultural differences in ethical viewpoints.

d. **Importance of the concept of "Due care" or "Reasonable care"**

It is a fundamental principle that ICAN members should carry out their work with professional competence and due care. This requirement reinforces a basic principle of the law of contract as it operates in many countries – that a contract for the provision of services should be performed with a reasonable degree of skill and care. The concept of 'due care' or 'reasonable care' is obviously important.

The implication is that audit work performed by an auditor for a client must be adapted to the specific circumstances and characteristics of the client. Thus, there is no such thing as a 'standard' audit.

e. Likely implications of the auditors' failure to act on the information they got in relation to the reduced costs of maintenance and inspections at MetroPower

   i. There may be legal claims against the auditors in the law of contract or the law of tort. There may also be disciplinary proceedings against the auditor by ICAN.

   ii. The audit firm may earn a reputation in the business community for poor work and may, therefore, lose clients.

Examiner's Report

The question test candidates' understanding of Professional Ethics and Code of Conduct.

About 90% of the candidates attempted the question and the general performance was above average.

The commonest pitfall was the failure of the candidates to describe "Public interest" relating to matters of MetroPower.

Candidates should adequately cover the syllabus and make use of the Institute's Study Text and Pathfinder.

Marking guide

		Marks	Marks
a.	**Description of "Public Interest"**		2
b.	Matters with which "Public Interest" can be associated		
	1 mark for each point to a maximum of 5 points		5
c.	Justification of "principles based ethics" being better than "rule based ethics"		
	1 mark for each point, subject to a maximum of 5 points		5
d.	**Explanation why concept of "due care" or "reasonable care" is important in the contract for provision of services**		
	- Why the concept is important with reference to accounting	1	

- The Provision of the concept in the law of contract	1	
- Implication for the audit work	2	4
e. Likely implications of the auditor's failing to act on the information on reduced maintenance and inspection at Metropower		
2 marks each for a point, subject to maximum of 2 points		4
Total		**20**

SOLUTION 5

a. **The objectives of the independent auditor, as specified in ISA 200 are:**

i. To obtain reasonable assurance that the financial statements are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework; and

ii. To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings. Where the auditor is unable to obtain reasonable assurance, and a qualified opinion is insufficient, the auditor must disclaim an opinion or resign.

b. **ISA 200 requires the Independent Auditor to:**

i. Comply with all ISAs relevant to the audit;
ii. Comply with relevant ethical requirements;
iii. Plan and perform an audit with professional scepticism;
iv. Exercise professional judgement in planning and performing an audit; and
v. Obtain sufficient and appropriate audit evidence to allow him to obtain reasonable assurance.

c. **Roles of auditing standards in the accounting profession**

i. Auditing standards provide a framework that assures audits of financial statements are conducted consistently and with a high level of quality and established standards of practice.
ii. Auditing standards offer comprehensive guidance on the audit process from planning to reporting.
iii. Auditing standards provide the benchmark against which auditors are held accountable for their work.
iv. Auditing standards help in laying the rules and the guidelines for protecting the public interest and promoting transparency.
v. The users of financial statements have confidence that the consistent

application of auditing standards give assurance of the quality and integrity of the financial statements.

Examiner's report

The question tests the understanding of candidates on auditing standards (ISAs).

About 95% of the candidates attempted the question and the performance was generally above average.

The major pitfall was the inability of the candidates to state the tasks ISA 200 requires the Independent Auditor to perform.

Candidates are advised to understand the requirements of audit standards in their study for the examination and make judicious use of the Institute's Study Text.

Marking guide

		Marks
a.	**Objectives of the external auditor per ISA 200**	
	2 marks for each point, subject to a maximum of 2 points	4
b.	**Tasks ISA 200 requires the auditor to perform.**	
	2 marks for each point, subject to a maximum of 4 points	8
c.	**Role of auditing standards in the accounting profession.**	
	1 mark for each point, subject to a maximum of 3 points	3
	Total	**15**

SOLUTION 6

a. Assurance can be provided by:

   i. An audit: this may be external audit, internal audit or a combination of the two; and
   ii. A review: this is a 'voluntary' investigation into or review of an aspect of the financial statements.

b. Differences between a reasonable assurance and a limited assurance

	Reasonable assurance	**Limited assurance**
Level	High	Moderate
Expression of conclusion	Positive	Negative
Objective	To provide reasonable assurance	To provide limited assurance
Time	More time consuming	Less time consuming
Cost	More costly	Less costly
Example	"In our opinion the financial statements give a true and fair view or	"Based on our review, nothing has come to our attention that causes us to believe that the

	are presented fairly in all material respects"	accompanying financial statements do not give a true and fair view".
Evidence required	High level of audit evidence required	Lower level of audit evidence required.

c. An assurance engagement performed by a practitioner will consist of the following five elements:

i. A three-party relationship:
- ✓ Practitioner – the individual providing professional services that will review the subject matter and provide the assurance, for example, the audit firm in a statutory audit;
- ✓ Responsible party – the person(s) responsible for the subject matter, for example, the directors are responsible for preparing the financial statements to be audited; and
- ✓ Intended users – the person(s) or class of persons for whom the practitioner prepares the assurance report, for example, the shareholders in a statutory audit.

ii. Subject matter: This is the data such as the financial statements that have been prepared by the responsible party for the practitioner to evaluate. An example might be a cash flow forecast to be reviewed by the practitioner;

iii. Suitable criteria: This can be referred to as 'the rules' against which the subject matter is evaluated to reach an opinion. In a statutory audit, this would be the applicable reporting frameworks (for example, IFRS and CAMA);

iv. Evidence: Information used by the practitioner in arriving at the conclusion on which their opinion is based. This must be sufficient (enough) and appropriate (relevant); and

v. Assurance report: The report (normally written) containing the practitioner's opinion. This is issued to the intended user following the collection of evidence.

Examiner's report

The question tests candidates' knowledge of assurance engagements.

About 96% of the candidates attempted the question and the performance was good.

Candidates are advised to adequately cover the subject syllabus.

Marking guide

		Marks
a.	**Channels through which an assurance can be provided**	
	1 mark each for a point, subject to a maximum of 2 points	
		2
b.	**Differences between a reasonable assurance and a limited assurance**	
	1 mark for each point, subject to a maximum of 3 points	3
c.	**Elements of an assurance engagement**	
	2 marks each for an element explained, subject to a maximum of 5 points	10
	Total	**15**

SOLUTION 7

a. Key audit matters (KAMs) are, according to ISA 701, those matters that, in the auditor's professional judgement were of most significance in the audit of the financial statements of the current period. KAMs are selected from matters communicated with those charged with governance.

b. Types of audits requiring KAM communication are:

   i. Audits of all listed companies; and
   ii. Audits of entities where KAMs are required by law or regulations to be communicated in the auditor's report.

c. **Key Audit Matter**

   Inventory

   Our audit of the financial statements of Abati Quarries Limited for the year ended (Date) included an evaluation of the company's accounting for boulders. Boulders are a significant by-product of the company's quarrying operations and their valuation and subsequent sale can materially affect the financial statements. We believe non-recognition of the value of boulders as work-in-progress could affect the profitability position of the company and its overall state of affairs.

d. **The matters which the auditor will consider before determining if a matter is a Key Audit Matter, include:**

   i. Areas of higher assessed risk of material misstatement, or significant risks;
   ii. Significant auditor's judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimated uncertainty; and
   iii. The significant events or transactions that are capable of impacting on the financial statements.

Examiner's report

The question tests candidates' knowledge of "Key Audit Matters".

About 10% of the candidates attempted the question and the performance was poor.

The candidates commonest pitfall was their display of a poor knowledge of provisions of "Key Audit Matters" as per ISA 701.

Marking guide

		Marks
a.	What are "Key Audit Matters"? 1 mark for each point, subject to a maximum of 2 points	2
b.	Two types of audit in which the auditor is required to communicate "Key Audit Matters" according to ISA 701 1½ marks for each point, subject to a maximum of 2 points	3
c.	Draft of "Key Audit Matters" to capture the 'boulders" issue (Abati Quarries Limited)	6
d.	Important things the auditor would consider before determining if a matter is a "Key Audit Matter" 2 marks each, subject to a maximum of 2 points	4
	Total	**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

PERFORMANCE MANAGEMENT

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

8. A formula sheet and discount tables are provided with this examination paper.

WEDNESDAY, MAY 15, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

PERFORMANCE MANAGEMENT

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Tani Kamac (TK) makes three products A, B, and C. All the three products must be offered for sale each month in order to be able to provide a complete market service. The products are fragile and their quality deteriorates rapidly once they are manufactured.

The products are produced on two types of machine and worked on by a single grade of direct labour. Five direct employees are paid ₦80 per hour for a guaranteed minimum of 160 hours each per month.

All the products are first moulded on machine type 1 and then finished and sealed on a machine type 2.

The machine hours requirements for each of the products are as follows:

	Product A Hours per unit	Product B Hours per unit	Product C Hours per unit
Machine type 1	1.5	4.5	3.0
Machine type 2	1.0	2.5	2.0

The capacity of the available machines type 1 and 2 are 600 hours and 500 hours per month respectively.

Details of the selling prices, unit costs and monthly demand for the three products are as follows:

	Product A ₦ per unit	Product B ₦ per unit	Product C ₦ per unit
Selling price	910	1,740	1,400
Component cost	220	190	160
Other direct material cost	230	110	140
Direct labour cost at ₦80 per hour	60	480	360
Overheads	240	620	520
Profit	160	340	220
Maximum monthly demand (units)	120	70	60

Although TK uses marginal costing and contribution analysis as the basis for its decision making activities, profits are reported in the monthly management accounts using the absorption costing basis. Finished goods inventories are valued in the monthly management accounts at full absorption cost.

Required:

a. Calculate the machine utilisation rate per month for each machine and explain which of the machines is the bottleneck/limiting factor. (4 Marks)

b. Using the current system of marginal and contribution analysis, calculate the profit maximising monthly output of the three products. (4 Marks)

c. Explain why throughput accounting might provide more relevant information in TK's circumstances. (6 Marks)

d. Using a throughput approach, calculate the throughput-maximising monthly output of the three products. (5 Marks)

e. Explain the throughput accounting approach to optimising the level of inventory and its valuation. Contrast this approach to the current system employed by TK. (5 Marks)

f. Explain the importance of identifying scarce resources when preparing budgets and the use of linear programming to determine the optimum use of resources. (6 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Kenny Katuma (KK) manufactures standard engine components. It operates a costing system based on absorption costing and standard costs, and the management control system is based on monthly variance analysis reports.

KK has recently appointed a new CEO, who has begun to introduce changes to the manufacturing systems. He believes in lean manufacturing principles, and has begun to establish a just-in-time manufacturing system, with a focus on reducing inventories and production cycle times, and eliminating waste. Discussions are in progress with major suppliers to introduce just-in-time purchasing arrangements.

The CEO has informed the management accountant that changes will be needed to the company's internal accounting systems, he has also indicated that KK will need a lean management accounting system to support its lean manufacturing system. The CEO is dissatisfied with many of the features of the current management accounting system. There are many errors in data capture for the cost accounting system, and monthly variance reports are not produced until two weeks after the end of each month. He also considers that wrong information is being reported.

Required:

a. Explain the main principles of a lean information system. (6 Marks)

b. Discuss the reasons why KK's current cost and management accounting systems do not fulfil the requirements of lean information systems. (7 Marks)

c. Identify the changes that should be made to KK's management accounting system in order to turn it into a lean information system. (7 Marks)

(Total 20 Marks)

QUESTION 3

Ogbunigwe Nigeria Limited is a big and reputable publishing firm established in the early 1970's. The company has recently been taken over by Wisdom International Publishing Company (WIPC) – a multinational company operating in several countries of the world.

Mr. Pampam who is the Managing Director of WIPC has been sent from the company's headquarters to review, among other things, the budgeting and reporting system used by Ogbunigwe Nigeria Limited.

During his visit to all the departments, he discovered that monthly budgets are prepared for each department in the company. Upon request, the newly acquired company submitted the last budget statement for the note book production which covered Quarter 3 of 2022 as shown below:

The budget statement presented was as shown below:
Budget statement for Quarter 3
Department: Note Book Production:

Particulars	Actual results:	Units produced	75,000
	Labour hours:		212,100
	ACTUAL RESULTS	**BUDGET**	**VARIANCES**
	₦'000	**₦'000**	**₦'000**
Direct materials	1,512	1,440	(72)
Direct Labour	738	720	(18)
Variable production overhead	474	432	(42)
Fixed production overhead	354	336	(18)
Variable admin. Overhead	246	240	(6)
Fixed admin overhead	300	288	(12)
Total costs	3,624	3,456	(168)
Sales value of production	4,650	4,464	186
Profit	1,026	1,008	18

The Head of Department of Note book Production department - Mr. Josiah Okoli-in his comment on the state of affairs of the department, revealed that the budget statement presented was based on 72,000 units with a standard labour processing time of 2.85 hours per unit.

Mr. Pampam observed that Mr. Josaih Okoli was not in any way enthusiastic about the budget system. He saw it as a pressure system imposed by the company to permit some Departmental Managers in bad light. He pointed out that the system was hurriedly introduced by Dynamic Financial Konsult about twelve months ago. The consultant did not take time to provide explanation that could assist users of the budget to understand the budgeting system. The Head of Department of Note book Production department who was very experienced doubt the competence of the consultant. He was of the opinion that the system introduced in Ogbunigwe Nigeria Limited was either a ready-made one developed for another company and not suitable for the company or that the consultant did not understand the system well enough to give him the needed confidence to educate the users. He concluded by stating that he was sure his department made a loss as against the positive figure recorded in the report and there was the possibility of reporting a loss at another period when profit was actually made. The situation reported above cuts across virtually all the departments and so the need to nip the issue in the bud became very imperative and urgent.

The task of making budgeting system more useful and acceptable in a biased environment like this, no doubt, seems difficult but your advice to Mr. Pampam will assist tremendously in getting the company out of the quagmire resulting from various contraception of this budget system.

You are required to:

a. Redraft the budget statement in a more informative manner, showing the relevant variances. (12 Marks)

b. State the general behavioural problems associated with budgeting and in particular, relate such issues with this situation. (4 Marks)

c. State the steps that Mr. Pampam should take in order to revitalise the budget system. (4 Marks)

(Total 20 Marks)

QUESTION 4

Some time ago Robert launched a new product some years ago at first, sales were good but now the figures are causing concern. Robert wants a more accurate sales forecast to produce detailed cash forecasts.

Since there is some seasonality present in the raw data, the series for sales shown below represents the underlying trend based on an averaging process:

Year	**Quarter**	**Trend point** X	**Sales (cartons)** y
2016	3rd	1	10,000
2016	4th	2	10,790
2017	1st	3	10,920
2017	2nd	4	11,000
2017	3rd	5	11,050
2017	4th	6	11,080
2018	1st	7	11,085
2018	2nd	8	11,095
2018	3rd	9	11,120
2018	4th	10	11,130

On average, quarters, 1 and 3 are 5% and 6% respectively above trend whilst quarters 2 and 4 are respectively 2% and 9% below trend. Some preliminary calculations on the above ten observations have been carried out and the results are summarised below:

Results from ten periods' observations:

Linear regression	$y = a + bx$
Slope	= 82.67
Intercept	= 10,472.33
Coefficient of determination	= 0.535

It is required to make forecasts of sales for quarters 3 and 4 in 2019 and for quarters 1 and 2 in 2020 but there is some discussion on whether the ten-period data shown above are suitable for forecasting or whether only the last five periods would provide a better basis for forecasting. Linear analysis of the last five periods only gives the following intermediate results:

Results of last five periods' observations:

$\Sigma y = 555.10$
$\Sigma x^2 = 330$
$\Sigma y^2 = 61,627.40$
$\Sigma xy = 4,442.15$

Note: the y values have been scaled down by 100 times for ease of calculation.

Required:

a. Forecast the sales of the four quarters required using the ten-period observations results. (6 Marks)

b. Prepare similar forecasts based on the last five periods' observations. (8 Marks)

c. Explain which forecasting basis produces the better forecast. (6 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Zona Tango (ZT) plc is a holding company with four divisions, including Alba and Beta Divisions. Alba Division produces a component that it sells externally, and can also transfer to other divisions within the group.

Beta Division uses the components from Alba Division as a raw material for its final product. The division can also obtain the components from external suppliers. The components, when obtained from Alba Division undergoes further processing at a cost of ₦4.50 per unit, before it is sold to the external market.

The Board of Directors in order to implement a new Appraisal Review has set up a performance scheme for the divisional managers. A performance target for the next financial year has been set and the following budgeted information relating to the two divisions has been prepared.

	Alba Division	Beta Division	
Maximum production/Sales capacity	900,000 units		
Sales to external customers	700,000 units	(no constraints)	
(Selling price)	₦6.80	Variable Unit Cost	₦4.90
Divisional fixed cost	₦160,000	₦140,000	
Capital employed	₦4m	₦3m	
Residue Income	₦700,000	₦500,000	
Divisional cost of capital	12%	10%	

Beta Division has asked Alba Division to quote a transfer price for units of the components.

Required:

a. Calculate the transfer price per unit which Alba Division should quote to Beta division in order that its budgeted residual income target will be achieved. (3 Marks)

b. Calculate the selling price per unit which Beta Division should quote to external market in order that its budgeted residual income target will be achieved, based on the transfer price quotation state clearly your assumptions (3 Marks)

c. Explain why the transfer price calculated in (a) may lead to sub-optimal decision making from the point of view of ZT plc, taken as a whole. (5 Marks)

d. In what circumstances will a negotiated transfer price be used instead of a market based price? (4 Marks)

(Total 15 Marks)

QUESTION 6

Many firms still focus on profitability as their main measure of performance, despite increasing evidence that non-financial measures are often more important.

Required:

a. Explain the arguments for using the profit measure as the all-encompassing measure of the performance of a business. (5 Marks)

b. An insurance company is considering introducing a balanced scorecard. State the **FOUR** perspectives of the balanced scorecard and recommend, with explanations, two performance measures for each perspective. (10 Marks)

(Total 15 Marks)

QUESTION 7

Jumbo Tailors Nigeria Limited manufactures three unique wears for which the maximum revenue for the coming year is estimated as follows:

	₦
Trousers	8,250,000
Jackets	9,880,000
Skirts	12,390,000

Summarised unit cost data are as follows:

Product	**Trousers**	**Jackets**	**Skirts**
	₦	**₦**	**₦**
Direct material	1,000	900	700
Direct Labour	500	450	350
Variable costs	800	1,600	1,000
Fixed costs	250	500	400
Total costs	2,550	3,450	2,450

The allocation of fixed costs was derived from last year's production level and this may be reviewed, if current output plans are different.

Estimated selling prices are:

Product	**Price**
	₦
Trousers	3,300
Jackets	3,800
Skirts	2,950

The products are processed on sewing machines housed in a building of three blocks.

Block A contains type I machine which has an estimated maximum machine hour capacity of 39,200 hours available in the forthcoming year with fixed overhead cost of ₦1,960,000 per annum.

Block B contains type II machine of which 20,000 machine hours are estimated in the forthcoming year with a fixed overhead cost of ₦1,500,000 per annum.

Block C also contains type II machine which also has an estimate of 16,000 machine hours available in the forthcoming year. The fixed overhead cost of ₦740,000 is estimated per annum for Block C.

The required machine hours for one unit of output for each Jeans on each type of machine are as follows:

Product	**Trousers**	**Jackets**	**Skirts**
Type I machine	2 hours	4 hours	6 hours
Type II machine	3 hours	6 hours	2 hours

You are required to:

a. Determine the optimal production plan which Jumbo Tailors Nigeria Limited should adopt. (12 Marks)

b. Calculate the total profit that would be made, if the production plan in (a) above is adopted. (3 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

Where Y = cumulative average time per unit to produce x units

a = the time taken for the first unit of output

x = the cumulative number of units produced

b = the index of learning (log LR/log2)

LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

$$b = \frac{\text{change in price}}{\text{change in quantity}}$$

a = price when Q = 0

$MR = a - 2bQ$

The linear regression equation of Y on X is given by:

$$Y = a + bX$$

where $$b = \frac{n\sum XY - (\sum X)(\sum Y)}{n\sum X^2 - (\sum X)^2}$$

$$a = \frac{\sum y}{n} - \frac{b\sum x}{n}$$

Coefficient of determination (r^2)

$$r^2 = \frac{(n\sum XY - \sum x \sum Y1)^2}{(n\sum X^2 - (\sum X)^2 \; (n\sum y^2 - (\sum X)^2}$$

The Miller-Orr Model

$$Spread = 3 \text{ x} \left(\frac{\frac{3}{4} \text{x Transaction Cost x Variance of Cash flows}}{\text{Interest rate (as a proportion)}} \right)^{\frac{1}{3}}$$

Annuity Table

Present value of an annuity of 1 i.e. $\frac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate

n = number of periods

Discount rate (r)

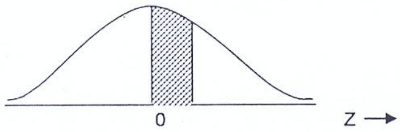
Periods

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2.487	3
4	3·902	3·808	3.717	3·630	3.546	3.465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3.890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4.486	4·355	6
7	6·728	6.472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7.435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6.418	6·145	10
11	10·368	9·787	9·253	8·760	8·306	7·887	7.499	7·139	6·805	6.495	11
12	11·255	10·575	9·954	9·385	8·863	8·384	7·943	7·536	7'161	6·814	12
13	12·134	11·348	10·635	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·004	12·106	11·296	10·563	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·865	12·849	11·938	11·118	10·380	9·712	9·108	8·559	8·061	7·606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2.444	2.402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2.690	2·639	2.589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3.498	3.410	3·326	6
7	4·712	4·564	4.423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4.799	4·639	4.487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4.451	4·303	4·163	4·031	9
10	5·889	5·650	5.426	5·216	5·019	4·833	4·659	4.494	4·339	4·192	10
11	6·207	5·938	5·687	5.453	5·234	5·029	4·836	4·656	4.486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4.439	12
13	6·750	6.424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5.468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6.462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

NORMAL DISTRIBUTION

This table gives the area under the normal curve between the mean and a point Z standard deviations above the mean. The corresponding area for deviations below the mean can be found by symmetry.



$Z=\frac{(x-\mu)}{\sigma}$	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	.0000	.0040	.0080	.0120	.0159	.0199	.0239	.0279	.0319	.0359
0.1	.0398	.0438	.0478	.0517	.0557	.0596	.0636	.0675	.0714	.0753
0.2	.0793	.0832	.0871	.0910	.0948	.0987	.1026	.1064	.1103	.1141
0.3	.1179	.1217	.1255	.1293	.1331	.1368	.1406	.1443	.1408	.1517
0.4	.1554	.1591	.1628	.1664	.1700	.1736	.1772	.1808	.1844	.1879
0.5	.1915	.1950	.1985	.2019	.2054	.2088	.2123	.2157	.2190	.2224
0.6	.2257	.2291	.2324	.2357	.2389	.2422	.2454	.2486	.2518	.2549
0.7	.2580	.2611	.2642	.2673	.2704	.2734	.2764	.2794	.2823	.2852
0.8	.2881	.2910	.2939	.2967	.2995	.3023	.3051	.3078	.3106	.3133
0.9	.3159	.3186	.3212	.3238	.3264	.3289	.3315	.3340	.3365	.3389
1.0	.3413	.3438	.3461	.3485	.3508	.3531	.3554	.3577	.3599	.3621
1.1	.3643	.3665	.3686	.3708	.3729	.3749	.3770	.3790	.3810	.3830
1.2	.3849	.3869	.3888	.3907	.3925	.3944	.3962	.3980	.3997	.4015
1.3	.4032	.4049	.4066	.4082	4099	.4115	.4131	.4147	.4162	.4177
1.4	.4192	.4207	.4222	.4236	.4251	.4265	.4279	.4292	.4306	.4319
1.5	.4332	.4345	.4357	.4370	.4382	.4394	.4406	.4418	.4430	.4441
1.6	.4452	.4463	.4474	.4485	.4495	.4505	.4515	.4525	.4535	.4545
1.7	.4554	.4564	.4573	.4582	.4591	.4599	.4608	.4616	.4625	.4633
1.8	.4641	.4649	.4656	.4664	.4671	.4678	.4686	.4693	.4699	.4706
1.9	.4713	.4719	.4726	.4732	.4738	.4744	.4750	.4756	.4762	.4767
2.0	.4772	.4778	.4783	.4788	.4793	.4798	.4803	.4808	.4812	.4817
2.1	.4821	.4826	.4830	.4834	.4838	.4842	.4846	.4850	.4854	.4857
2.2	.4861	.4865	.4868	.4871	.4875	.4878	.4881	.4884	.4887	.4890
2.3	.4893	.4896	.4898	.4901	.4904	.4906	.4909	.4911	.4913	.4916
2.4	.4918	.4920	.4922	.4925	.4927	.4929	.4931	.4932	.4934	.4936
2.5	.4938	.4940	.4941	.4943	.4945	.4946	.4948	.4949	.4951	.4952
2.6	.4953	.4955	.4956	.4957	.4959	.4960	.4961	.4962	4963	.4964
2.7	.4965	.4966	.4967	.4968	.4969	.4970	.4971	.4972	.4973	.4974
2.8	.4974	.4975	.4976	.4977	.4977	.4978	.4979	.4980	.4980	.4981
2.9	.4981	.4982	.4983	.4983	.4984	.4984	.4985	.4985	.4986	.4986
3.0	**.49865**	.4987	.4987	.4988	.4988	.4989	.4989	.4989	.4990	.4990
3.1	**.49903**	.4991	.4991	.4991	.4992	.4992	.4992	.4992	.4993	.4993
3.2	**.49931**	.4993	.4994	.4994	.4994	.4994	.4994	.4995	.4995	.4995
3.3	**.49952**	.4995	.4995	.4996	.4996	.4996	.4996	.4996	.4996	.4997
3.4	**.49966**	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4998
3.5	**.49977**									

SOLUTION 1

a.

	Product			
Machine hours required	**A**	**B**	**C**	**Total**
Type 1	180	315	180	675
Type 2	120	175	120	415

Machine utilisation rate:
Machine type 1 = 675/600 = 112.5%
Machine type 2 = 415/500 = 83.0%

Machine type 1 has the highest utilisation rate and the rate is above 100. Therefore, machine type 1 is the bottleneck/limiting factor.

b.

		Product	
	A	**B**	**C**
Contribution per unit	₦400	₦960	₦740
Machine type 1 hours	1.5	4.5	3.0
Contribution per hour	₦266.67	₦213.33	₦246.67
Ranking	1	3	2

Allocation of machine type 1 hours according to this ranking:

Product A	120 units using	180	hours
Product C	60 units using	180	hours
		360	hours used
Product B (240/4.5) 53 units using		238.5	hours
		598.5	hours used

c. A major concept underlying throughput accounting is that the majority of costs, with exception of material and component costs, are fixed.
In ABC's case it is clear that the labour cost, which is treated as a variable cost in traditional marginal costing, is indeed a fixed cost. The employees are paid for a guaranteed 800 hours (160 × 5) each month, whereas the number of labour hours required to meet the maximum demand can be calculated as 780 hours as follows.

	Product			
	A	B	C	Total
Labour hours per unit	0.75	6	4.5	
Maximum demand (units)	120	70	60	
Total hours required per month	90	420	270	780

Therefore, labour is a fixed cost that will not alter within the relevant range of activity. Throughput accounting recognises this in the calculation of throughput.

Furthermore, given the perishable nature of ABC's products, the throughput accounting approach to inventory minimisation and maximisation of throughput would be more appropriate.

d.

	Product		
	A	B	C
	₦ per unit	₦ per unit	₦ per unit
Sales revenue	910	1,740	1,400
Component cost	220	190	160
Other direct material	230	110	140
Throughput per unit	460	1,440	1,100
Machine type 1 hours	1.5	4.5	3.0
Throughput per hour	₦306.67	₦320.00	₦366.67
Ranking	3	2	1

Allocation of machine type 1 hours according to this ranking:

Product C	60 units using	180 hours
Product B	70 units using	315 hours
		495 hours used
Product A (105/1.5)	70 units using	105 hours
		600 hours used

e. **Throughput accounting approach**

The conventional cost accounting approach used by ABC views inventory as an asset.

In the throughput accounting approach inventory is not viewed as an asset, but rather as a result of unsynchronised manufacturing. The existence of inventory is thus viewed as a breakdown in synchronisation and a barrier to generating profits.

In throughput accounting the ideal inventory level is zero, with the exception that a buffer inventory should be held prior to the bottleneck machine.

As regards the valuation of inventory, the throughput philosophy is that no value is added to inventory items and no profit is earned until the items are actually sold. Thus inventory is valued at its material cost only until it is sold.

Contrast the approach

The marginal costing approach currently used in TK differs from throughput accounting in the following areas:

This approach to inventory valuation is in contrast to the full absorption costing system used by ABC. The latter approach encourages managers to produce output just to add to work in progress or finished goods inventory, since this helps with the absorption of overheads and boosts reported profits. This behaviour will be avoided, and managers will be more likely to be willing to minimise inventory if it is valued at material cost only.

Variable and fixed costs: Marginal costing divides costs into variable costs (which vary with production volume and include materials, labour, and variable overheads) and fixed costs (which remain constant regardless of production volume).

Throughput accounting considers materials cost as the only variable cost. All other costs, including labour are considered as factory cost of operating expenses and are treated as costs for the period.

Contribution margin: The key metric in marginal costing is the contribution margin, which is sales revenue minus variable costs. This margin contributes to covering fixed costs and generating profit.

The key metric in throughput accounting is throughput contribution, which is sales revenue minus material cost only. This margin contributes to covering the operating expenses and generating a profit.

Inventory valuation: Inventory is valued based on variable costs only (as defined above). Fixed costs are treated as period costs and are expensed in the period they are incurred.

In throughput, inventory is valued based on variable costs only, specifically direct material costs, avoiding complex overhead allocations.

f. The importance of identifying scarce resources when preparing budgets

   i. If an organisation produces just one product, the budget for the scarce resources is usually the starting point in the budget preparation process.
   ii. If an organisation produces two or more products and there is only one scarce resource, limiting factor analysis must be used to determine the most profitable use of the scarce resource.

iii. When there is more than one scarce resource, linear programming must be used to identify the most profitable use of resources.

iv. **To optimise resource allocation to competing products**
Prioritisation: By identifying scarce resources, companies can prioritise their allocation to the most impactful activities, ensuring that these constraints do not hinder overall production or service delivery.

v. **To Enhance decision-making**
Informed Planning: Knowing which resources are scarce allows for more informed and strategic decision-making, enabling better planning and utilisation of available resources to meet production targets and customer demand.

vi. **For cost efficiency**
Minimised Waste: Effective management of scarce resources reduces waste and inefficiencies, leading to cost savings and improved profitability.

vii. **To improve bottleneck management**
Focus on constraints: Identifying scarce resources helps in focusing efforts on managing and alleviating bottlenecks, which can significantly enhance throughput and overall system performance.

viii. **Risk mitigation**
Contingency Planning: Understanding resource limitations allows for better risk management and the development of contingency plans to mitigate potential disruptions.

ii. **The use of linear programming to determine the optimum use of resources**

- Linear programming is applicable when the scare resource is more than one resource.
- Decisions about what mix of product should be manufactured and sold in order to maximise profit or minimise costs are formulated and solved as linear programming problem.
- It allows optimal solution that satisfy several constraints at once.
- It is used in many industries e.g. agriculture where farmers can generate more revenue from their limited land; transportation (for cost and time efficiency) etc.
- It is used to determine the price of a scarce resources.
- It is used to determine shadow prices.
- Linear programming is a technique which determines the most profitable production mix, taking into account resources constraints and limitations. faced by an organisation. All costs are assumed to be a either fixed or variable in a relation to a single measure of activity (usually units of output).

The problem is formulated in terms of an objective function and constraints are then graphed. This process highlights all possible output combinations given the resources constraints and limitations and allows for the identification of the output combination which would maximise contribution (the optimal solution). If there are more than two types of output, the graphical approach is not possible and the simplex method must be used instead.

Examiner's report

This is a compulsory question which tests candidates' ability to determine a company's machine utilisation rate for each machine and also establishes the machine that is the bottleneck and limiting factor. The second part of the question is on conventional marginal and contribution analysis to determine the profit maximising output. The third part is on throughput accounting and throughput maximising quantity while the final is on the importance of identifying scarce resources for optimality in budgeting and linear programming activities.

The question being a compulsory question was well attempted.

The performance of the candidates was average.

The major pitfall inability of most candidates to differentiate between the use of limiting factors in conventional marginal and contribution analysis and the throughput analysis.

It is hereby recommended that candidates use ICAN study manual and other Performance Management textbooks in preparing for future Institute's examination.

Marking guide

Section	**Description**	**Mark**	**Mark**	**Total**
a.	Machine utilisation			
	Rate (8 ticks @ ½ mark = 4marks)		4	
b.	Profit maximisation quantity using			
	Marginal and contribution analysis.			
	12 ticks @ 1/3 mark = 4 marks)		4	
c.	Importance of throughput accounting.			
	(3 points @ 2marks) = 6marks)			
			6	
d.	Profit maximisation quantity using			
	throughput accounting.			
	15 ticks @ 1/3 mark = 5marks)		5	
e.	Importance of throughput in inventory			
	(Any two points @ 1 mark = 2marks)			
	Importance of throughput in inventory	2		
	valuation.			
	(Any two points @ 1½ marks =			
	3 marks)	3	5	

f. Importance of identifying scarce resources in budgeting (Any 3 points @ 1 mark = 3 marks)	3		
Importance of identifying scarce resources on linear programming. (Any 2 points @ 1½ marks= 3 marks)	3	6	30

SOLUTION 2

a. A lean information system should provide value to the users of the system. Key principles are the elimination of waste, speed of information flow, and clarity.

Elimination of waste – A lean system seeks to eliminate all waste. In an information system, waste is created by errors in the information, which means that incorrect information is used and wrong decisions may be taken. Alternatively the information has to be corrected when the error is identified, and this results in a cost of correction. Correcting errors does not add value, because the error should not have occurred, and correcting errors is a wasted effort.

Efficiency in the flow of information – A lean manufacturing system is one in which there is an efficient flow of items though the manufacturing process. In a lean information system, there should be an efficient flow of information. Information should be available to individuals when they need it, and there should not be unnecessary delays in providing it or making it available.
While efficiency in the flow of information means that information should be available when it is needed, it should not be provided before it is needed. Information should be available 'just in time'. This is the concept of pulling items through the system rather than pushing them through. If information is provided before individuals are ready to use it, it does not have value.

Clarity is also an element of lean information. Information must be clear to the people who use it and should therefore be presented in a form that they can understand and use. If information is presented in a form that is difficult to understand, it will be difficult to use. Unless it is used for its intended purposes, information has no value.

Together, the elimination of waste, efficiency of information flow, and clarity of information are qualities of an information system that give value to the information that the system produces.

b. There are several reasons why KK's current management accounting system does not fulfil the requirements of a lean information system.

Errors – There are many errors in the data capture from the cost accounting system. Errors represent waste in the system, by providing incorrect information about costs, or requiring correction when the errors are found. Errors also reduce the confidence of users in the information that the system provides.

'Push' system – Monthly variance reports are provided but not until two weeks after the end of the month. There are two weaknesses in this reporting system. The first is the delay in making information available if required. The information about performance is being held by accountants and is not made available to the managers who can use it.

The second problem is that the information is pushed out to management in the form of monthly variance reports, when it would be more appropriate to make the information available when management want to use if for monitoring and control purposes. The information system is dictating how and when the information should be used, whereas management should be doing this.

Not encouraging lean manufacturing – more fundamentally, it can be argued that traditional cost and management accounting methods provide managers with inappropriate information that encourages the wrong sorts of management for an organisation that uses lean manufacturing methods. A key feature of lean manufacturing is the elimination of inventory, because holding inventory is wasteful. Absorption costing, however, encourages manufacturing at full capacity, even if this means manufacturing items that are not yet needed by customers, so that inventory will build up. This is because high volumes of production reduce the unit costs of manufacture by spreading overhead costs over a larger volume of output.

Variance reporting of efficiency also encourages greater volumes of output, because greater efficiency means faster production. When the work force is paid a fixed wage or salary, attempts to improve efficiency will result in greater production quantities, and a build-up of inventory.
The current reporting systems therefore encourage managers to control operations in a way that is inconsistent with lean manufacturing.

Error reduction – To create a lean management accounting system, waste must be eliminated, and information flow improved. The causes of the data errors in data capture are not known. The problem may be the use of manual documentation for recording costs, or errors in input by inadequately trained staff. Methods of recording costs should be investigated, and the target should be to eliminate input errors entirely.

Flows of information – The flow of information must be improved, so that up-to-date information is available to management when they want it. The speed of entering data into the accounting system should be reviewed, and the aim should be to minimise the delay between recording data and inputting it into the accounting system. Automated methods of monitoring inventory movement or recording labour times may be considered.

User access to information – The accounting system should also allow managers on-line access to information about costs, so that they can obtain and use the information they need at a time that they need it. This should apply to senior management as well as to management at the operational level.

Cost allocation – The information provided by the accounting system should be reviewed, and absorption costing should be abandoned. There may be some value in using activity-based management to monitor and control overhead costs, but the most important requirement should be to value inventory at direct materials cost. This means that there will be no incentive to produce at high-capacity volumes or operate at unnecessary levels of efficiency. Favourable capacity and efficiency variances will not affect inventory costs and so will not improve management performance.

Performance measures – Different items of information should be provided for performance measurement purposes. Traditional performance measurement methods for materials – price and usage variances – should be used to control materials costs. For labour, however, non-financial measures of performance may be appropriate, such as production cycle times of throughput times and the ratio of idle time to active time for the work force. The company is considering JIT purchasing for its main suppliers: if so, a suitable measure of performance may be the order-to-delivery cycle time for purchase orders.

In a lean information system, information should have a practical use and support the aims of management. The management accounting system should be changed so that it provides value – a practical purpose, with no waste, rapid information flow and clarity of meaning.

Examiner's report

The question is on Lean Information System. This question is deduced from a broad management information system. It tests candidates' knowledge of the principles and importance of adopting a lean management information system.
The question was well attempted.

The Performance of the candidate was average.

The major pitfall observed was the inability of candidates to understand fully the meaning of Lean Information System and the differences between it and what is currently in use by KK.

It is recommended that candidates use the ICAN Study Text and other approved text books on Performance Management when preparing for future Institute's examination.

Marking guide

Section	Description	Marks	Total
a.	Principles of Lean information system. (Any 3 points @ 2 marks = 6 marks)	6	
b.	Why the current system in KK is unable to meet the lean information requirements. (Any 2 points @ 3½ marks = 7 marks)	7	
c.	What changes are required to adopt the lean information system in KK., (2 points @ 3½ marks = 7 marks)	7	**20**

SOLUTION 3

a. Redraft budget using flexible budgeting concept

S/N	Particulars	Original Budget 72,000 units	Flexible Budget 75,000 units	Actuals 75,000 units	Variances
		₦'000	₦'000	₦'000	₦'000
1	Sales	4464	4650	4650	-
	Less				
	Direct material	1440	1500	1512	(12)
	Direct labour	720	750	738	12
	Variable overhead:				
	Production	432	450	474	(24)
	Administration	240	250	246	4
	Total variable cost	2832	2950	2970	(20)
	Contribution	1632	1700	1680	(20)
	Less				
	Fixed cost:				
	Production	336	336	354	(18)
	Administration	288	288	300	(12)
		624	624	654	(30)
	Net Profit	1008	1076	1026	(50)

Note:
Variances in bracket are adverse.
Computation of relevant variances:
Sales related variances (Sales department):
Sales Price variance = (ASP – SSP)AQ=(₦62 - ₦62)75,000 = nil
Sales Quantity variance = (BQ - AQ) SSP = (75000 - 75,000) ₦62 = nil.
Direct material Variances (Purchases department):
Material Price variances= AQ (AC - SC) = 75,000(₦20.16-N20.00)= ₦12,000 A
Material Usage variance = (AQ - SQ) ₦20 = ₦20.00 (75,000 – ₦75,000)=Nil
Direct Labour Variances (Personnel departments):
Direct Labour rate variance = (AR - SR)x AH = (₦3.47949 - ₦3.50877) 212,100= ₦6210.29 F
Direct labour efficiency variance = (AH - SH)SR = (212100 - 213750) ₦3.50877 =₦5789.71F
Labour cost variance = ₦6210.29F + ₦5789.71F = ₦12,000F
Variance production overhead variance (Production department)
Expenditure variance = AH (AR - SR) = 212,100 {(₦474,000/212100) – (₦450,000/213750)} = 212100 (₦2.23479 - ₦2.10526) = ₦27,473.31A
Efficiency variance = SR (AH - SH) = ₦2.10526 (212100 – 213750) = ₦3,473.31F
Variable Production Overhead variance = N24,000 A

Other variances:

S/N	Particulars	Actual Costs	Flexed costs	Variances
1	Variable Administration costs	₦246,000	₦250,000	₦4000F
2	Fixed Production Costs	₦354,000	₦336,000	₦18,000A
3	Fixed Administration costs	₦300,000	₦288,000	₦12,000A

b. State the general behavioural problems associated with budgeting and in particular relate such issues with this situation. Such problems include:

- Use of past record to estimate is not realistic;
- Budget may contain slacks/dummies leading to over-bloated budget estimates;
- Budget may be realistic or unrealistic due to source of data and information;
- They may originate from incorrect or inaccurate records/data;
- It could be seen as a pressure device especially if prepared with sentimental

Attachments;

- Personnel resistance, especially, if the budget preparation is top down driven;
- Lack of participation may introduce lack of acceptance to the budget;
- Sub optimisation where departments work for their individual goals not for Company goal;
- Budget slack or budget bias; and
- Fundamental misunderstanding about cost cutting especially where management see budget control as cost cutting.

c. Ways of addressing the negativities of behavioural issues in budgeting

- Introduce a realistic budgeting approach such as zero Based Budgetting approach.
- Introduce incentive schemes like bonuses.
- Train and develop management and staff members in the application of budget and budgeting control system and Total Quality Management Techniques.
- Amend the reward system.
- Set up fair unit to resolve disputes emanating from petitions, disputes, resentment and resistances.
- Ensure a change in management culture.
- Put in place a participative/negotiated approach to budgeting

Examiner's report

The question tests candidates' ability to answer questions on flexible budgeting.

The question was well attempted.

The Performance was above average.

The major pitfall observed was candidates' inability to decipher the flexible nature of the budget required and interpretation of variances therefrom.

It is recommended that candidates use the ICAN Study Text on Performance Management when preparing for future Institute's examination.

Marking guide

Section	Description	Marks	Total
a.	Re-drafted flexible budget (24 ticks @ ½ mark = 12marks)	12	
b.	What are the behaviourial issues in the budgeting system of the company. (Any 4 point @ 1mark = 4 marks)	4	
c.	Steps Pampam will take to address the anomalies. (Any 4 points @ 1 mark = 4 marks)	4	20

SOLUTION 4

a.

Year	Quarter	Trend point x	Sales trend (cartons) y = a + bx
2019	3	13	10,472.33 + (82.67 × 13) = 11,547
2019	4	14	10,472.33 + (82.67 × 14) = 11,630
2020	1	15	10,472.33 + (82.67 × 15) = 11,712
2020	2	16	10,472.33 + (82.67 × 16) = 11,795

The seasonally adjusted forecasts are therefore as follows:

Year	Quarter	Seasonally adjusted forecast sales (cartons)
2019	3	11,547 × 1.06 = 12,240
2019	4	11,630 × 0.91 = 10,583
2020	1	11,712 × 1.05 = 12,298
2020	2	11,795 × 0.98 = 11,559

b. We need to calculate the regression line of the last five periods' observations. This line is

y = a + bx

$$\text{where} b = \frac{n\sum xy - \sum x \sum y}{n\sum x^2 - (\sum x)^2}$$

$$\text{and} a = \frac{\sum y}{n} - \frac{b\sum x}{n}$$

$$\text{So} \quad b = \frac{(5 \times 4{,}442.15) - (40 \times 555.1)}{(5 \times 330) - (40 \times 40)} = \frac{6.75}{50} = 0.135$$

$$a = \frac{555.1}{5} - \frac{0.135 \times 40}{5} = 111.02 - 1.08 = 109.94$$

We need to multiply the “a and b” values back up by 100 to compensate for the fact that the y values were scaled down by 100 before the sigma calculations were carried out.

So, the regression line is y = 10,994 + 13.5x

Year	Quarter	Trend point x	Sales trend (cartons) y = a + bx
2019	3	13	10,994 + (13.5 × 13) = 11,169.5
2019	4	14	10,994 + (13.5 × 14) = 11,183.0
2020	1	15	10,994 +(13.5 × 15) = 11,196.5
2020	2	16	10,994 + (13.5 × 16) = 11,210.0

The seasonally adjusted forecasts are therefore as follows:

Year	**Quarter**	**Seasonally adjusted forecast sales (cartons)**
2019	3	11,169.5 × 1.06 = 11,840
2019	4	11,183.0 × 0.91 = 10,177
2020	1	11,196.5 × 1.05 = 11,756
2020	2	11,210.0 × 0.98 = 10,986

c. One common method of deciding on which forecasting basis produces the better result is to compare the coefficients of determination. With ten periods' observations we are told that $r^2 = 0.535$.

With five periods' observations we have to calculate the coefficient of determination from the equation given in the tables provided.

$$r^2 = \frac{(n\sum xy - \sum x \sum y)^2}{(n\sum x^2 - (\sum x)^2)(n\sum y^2 - (\sum y)^2)}$$

$$= \frac{(5 \times 4{,}442.15) - (40 \times 555.1)^2}{(5 \times 330) - (40 \times 40)(5 \times 61{,}627.4) - (555.1 \times 555.1)} = \frac{6.75^2}{50 \times 0.99}$$

$$= 0.92$$

Prima facie the forecasting method using five periods' observations is much better than the other using ten periods, since the coefficient of determination of the former is 0.92 compared with 0.535 for the latter.

We can explain 92% of the variations in sales by the passage of time using the former method but can explain only 53.5% of the variations in sales using the latter method.

Examiner's report

The question tests candidates' ability to answer questions on forecasting.

The question was well attempted since it is a popular statistical question.

The Performance was above average.

The major pitfall observed was the candidate's inability to incorporate trend issues that affect different quarters of the year.

It is hereby advised that candidates use the ICAN Study Text on Performance Management when preparing for future Institute's examination.

Marking guide

Section	Description	Marks	Marks	Total
a.	Quarterly Sales forecast using 10-period observations.			
	Statistical observation:			
	(4 ticks @ 1 mark = 4 marks)	4		
	Statistical variation:			
	(4 ticks @ ½ mark = 2 marks)	2	6	
b.	Quarterly Sales Forecast using 5 – Period Observations			
	Regression formula computation			
	(4 ticks @ ½ mark = 2 marks)	2		
	Statistical Observation:			
	(4 ticks @ 1 mark = 4 marks)	4		
	Statistical variation:			
	(4 ticks @ ½ mark = 2 marks)	2	8	
c.	Forecasting basis using Coefficient of correlation			
	(4 ticks @ 1½ marks = 6marks)		6	**20**

SOLUTION 5

a. Zonal Tango (ZT) Plc

Transfer price per unit for Alba Division:	₦
Residual Income	700,000
Notional interest (12% x 4,000,000)	480,000
Net profit	1,180,000
Divisional fixed cost	160,000
Contribution	1,340,000
Variable cost (900,000 x 4.90)	4,410,000
Total revenue	5,750,000
Less: External revenue (700,000 x 6.80)	(4,760,000)
Internal revenue (a)	990,000
Excess/idle capacity (900,000 – 700,000) (b)	200,000unit
Transfer price (a/b)/unit	₦4.95

Therefore the transfer price that Alba division should quote is ₦4.95/unit as computed above.

b. Selling price of Beta Division:

	₦
Residual income	500,000
Notional interest (10% x 3,000,000)	300,000
Net profit	800,000
Divisional fixed cost	140,000
Contribution	940,000
Plus Variable cost further of processing cost (200,000 x ₦4.50)	900,000
Plus Transfer price (200,000 x ₦4.95) - input cost	990,000
Total revenue (c)	2830,000
Quantity to sell (D)	200,000unit
External selling price (c/d)	₦14.15

c. **Assumptions**

i. Beta Division gets all inputs internally from Aba.
ii. The applicable variable costs for both Alba and Beta are the same.
iii.There is no transfer from Beta to Alba.

The transfer price to Beta Division will be sub-optimal for the company as a whole because ₦6.80 is sold to other customers and ₦4. 95 is the price charged to the division as required to provide ₦1.85 per unit. The sub-optimal decision making also can be due to the buying division recognising the fixed cost of ₦160,000 and mark-up (Profit –residual income and imputed capital cost) as selling division variable cost of ₦4.95 when it should have been ₦4.90 regarding the transfer price.

d. **Circumstances in which a negotiated transfer price should be used instead of market based price**

Negotiated transfer prices are prices agreed between managers of profit centres. Negotiatedtransfer prices are used in situations where profit centre managers are given autonomy to agree transfer prices. This is usually in circumstances where an external intermediate marketprice does not exist.

An advantage of this is that if the negotiations are fair and honest, the managers should be willing to trade with each other on the basis of the transfer prices agreed.

A negotiated transfer price can be used instead of a market-based price in the following specific circumstances:

i. **Absence of a market price**: When there is no external market for the product or service being transferred, or the market is not well-established, finding a comparable market price can be difficult or impossible. In such cases, negotiation between the divisions becomes necessary;

ii. **Custom or unique products**: When the product or service being transferred is customised or unique to the company's operations, there may not be a comparable product available in the market. This uniqueness necessitates a negotiated price that reflects the specific characteristics and costs associated with the item;

iii. **Internal performance measurement**: When a company uses transfer prices for internal performance evaluation and management purposes. A negotiated price can be tailored to better reflect the performance of the divisions involved, aligning with the company's internal performance metrics and incentive structures;

iv. **Temporary market conditions**: When external market prices are volatile or influenced by temporary conditions that do not reflect the long-term value of the product or service. A negotiated transfer price can provide stability and predictability in such cases;

v. **Capacity utilisation**: When the supplying division has excess capacity, it may be willing to negotiate a lower transfer price to utilize its resources more effectively. Conversely, if the supplying division is at full capacity, it might negotiate a higher price to reflect opportunity costs; and

vi. **Regulatory and tax considerations**: When there are tax implications, especially in multinational corporations. Transfer pricing can affect the allocation of income and expenses between different tax jurisdictions. Negotiating transfer prices may help in compliance with international transfer pricing regulations and in minimizing tax liabilities.

Examiner's report

The question tests candidates' ability to provide solutions on issues relating to divisional transfer pricing and divisional performance appraisal.

The question was well attempted.

The Performance was above average.

The major pitfall observed was the candidates' inability to reconcile residual income of each division to its generated revenue and net profit.

It is advised that candidates use the ICAN Study Text on Performance Management when preparing for future Institute's examination.

Marking guide

Section	Description	Marks	Total
a.	Transfer price for ALBA (12 ticks @1/4 mark = 3 marks)	3	
b.	Selling price for Beta (12 ticks @ ¼ mark = 3 marks)	3	
c.	Sub-optimality in using transfer prices (2 points @ 2½ marks = 5 marks)	5	
d.	Negotiated transfer price and market based price (Any 2 points @ 2 marks = 4 marks)	4	15

SOLUTION 6

Arguments in favour of using the profit measure in evaluating the performance of a business

1. Profit (however calculated) is a generally accepted measure to evaluate a business both internally and externally. Internal users of financial information identify profit-as the reward for the skills of being a successful entrepreneur.

   This measure is still a major determinant of the reward systems of managers of decentralised units. If they meet certain quantified performance targets they obtain the financial rewards that recognise their entrepreneurial skills.

2. External users of accounts recognise profit as a measure for identifying the success or failure of the policies of the directors who, as stewards of the assets, are entrusted with the task of increasing the wealth of shareholders. Why do an investor invest? Generally to improve their financial position over time. How do investors improve their financial position over time? Hopefully the stock market's system of intelligence identifies the important factors in the performance of a business and this is reflected in the share price. How do market analysts identify performance? Certainly the measure of 'earnings' is a major determinant in the influential commentaries that can influence investor behaviour.

3. The concept of profit is intuitive. A street trader buys inventory at ₦100 and sells it at the end of the day for ₦500. He makes a gain of ₦400 out of which he replenishes his inventory, pays his living expenses and has a surplus to demonstrate that his wealth has increased after meeting all necessary expenditure.

4. 'Profit' is the maximum amount that the company can distribute during the year and still expect to be as well off at the end of the year as at the beginning. Consequently profit-based measures such as return on capital employed and earnings per share recognise this all-encompassing need to measure how wealth (or capital) grows or is maintained.

5. **Simplicity and Clarity:** Profit is a straightforward and easily understood metric. It provides a clear and unambiguous indicator of financial success, making it accessible for a wide range of stakeholders, including investors, employees, and management.

6. **Comprehensive Financial Performance:** Profit encapsulates the overall financial health of a business by reflecting revenues, costs, and expenses. It shows the net effect of a company's operations and financial decisions, providing a comprehensive view of its economic performance.

7. **Stakeholder Focus:** For shareholders and investors, profit is a primary concern as it directly impacts dividends, stock prices, and returns on investment. Focusing on profit aligns with the interests of these key stakeholders and can drive investment and support.

8. **Resource Allocation:** Profitability indicates how efficiently a company is using its resources. It helps management identify which areas of the business are most productive and which may require improvement or divestment, thus guiding strategic decisions on resource allocation.

9. **Incentive Alignment:** Profit as a performance measure can be a powerful motivator for management and employees. Profit-linked incentives and bonuses can drive behaviors that enhance overall business performance, encouraging efficiency, innovation, and cost control.

b. **Financial perspective**

1. Meeting a key financial target such as Economic Value Added is regarded by some as one of the best overall measures of performance.

2. Sales growth. Insurance companies are concerned with market share and would like to see strong sales growth.

Customer perspective

1. Customer retention. This is the proportion of customers who renew their policies from one year to the next. If the proportion is high, then it would imply that the insurance company is keeping its customers happy; if low, it would seem that the company is doing something wrong.

2. **Number of complaints.** This measure could be used for just about any organisation. A high level of complaints would indicate that the company's customers are not pleased with the service that they are receiving.

Learning and growth perspective or innovation and learning perspective

1. Labour turnover. Labour measures come within this perspective. A high labour turnover would indicate that the workforce is not happy, which may then lead to problems with their performance. It also means that those workers who leave will have to be replaced and that their replacements will need training, leading to extra cost and possibly initially poor performance.

2. The number of new types of policies issued each year. This would be a good indication of innovation.

Internal business process perspective

1. The percentage of policies issued or claims processed with the target time. This is an indication of how well the company performs its core functions.
2. Unit cost. The cost per policy issued, or per claim processed, would be an indication of how well the business is performing its internal functions. Care must be taken that if the cost is reducing so then the service to the customer is not getting worse.

Examiner's report

The question dwells on the importance of profitability measurement vis- a-viz other non-financial measures. It also discusses the importance of the balance scorecard in an insurance company.

The question was well attempted.

The Performance was above average.

The major pitfall observed was the candidates' inability to mention critical examples of the 4 perspectives.

It is advised that candidates use the ICAN Study Text on Performance Management when preparing for future Institute's examination.

Marking guide

Section	Description	Marks	Marks	Total
a.	Importance of Profit as a performance measure (Any 2 points @ 2½ marks = 5 marks)		5	
b.	Explanation and examples of 4 Perspectives of Balance scored card: 4 perspectives : (Any 4 points @1½ marks = 6 marks)	6		
	Explanations: (Any 4 explanations point@ 1 mark = 4 marks)	4	10	15

SOLUTION 7

a. Optimal Production Plan (Optimum Quantity) for Jumbo tailor
Computation of machine utilisation hours:

Machine hours required:

Products	Workings/Calculations	Machine 1 Hours	Machine 2 Hours
Trousers	Machine 1 = 2 x 2500	5,000	
	Machine 2 = 3 x 2500		7,500
Jackets	Machine 1 = 4 x 2600	10,400	
	Machine 2 = 6 x 2600		15,600
Skirts	Machine 1= 6 x 4200	25,200	
	Machine 2= 2 x 4200		8400
	Total machine hours required	40600	31500
	Total Machine hours available	39200	36000
	Deficit /Surplus	(1400)	4500

From the above analysis, Machine 1 is the Limiting factor.
Quantity Produced and Sold:
Trouser = Sales /Selling Price = ₦8,250,000/₦3300 = 2,500 units
Jackets = Sales /Selling Price = ₦9,880,000/ ₦3800 = 2,600 units
Skirts = Sales / Selling Price = ₦12,390,000 / ₦2950 = 4200 units

Contribution analysis and ranking

Particulars	**Trousers**		**Jacket**		**Skirts**
	₦		₦		₦
Selling Price			3800		2950
	3300				
Variable costs:					
Direct Material	1000		900		700
Direct Labour	500		450		350
Variable overhead	800	1600	2950	1000	2050
	2300				
Contribution per			850		900
unit	1000				
Machine 1 hours	2		4		6
Contribution / machine 1 hours	₦500		₦212.50		₦150
Ranking	1^{st}		2^{nd}		3^{rd}

Determination of production plan

Trouser	=	5000 hours	= 2500 units
Jacket	=	10400 hours	= 2600 units
Skirts (Balance)	=	23800 hours	= 23800/6 = 3967 units
Total Available		39200 hours	

b. Total profit from production plan

Particulars	**Trousers**	**Jackets**	**Skirts**	**Total**
Units Produced /Sales	2500	2600	3967	
Unit contribution	1000	850	900	
Less Product fixed Cost	250	500	400	
Net Profit	750	350	500	
Total Gross Profit	1,875,000	910,000	1,983,500	**4,768,500**
Fixed cost Block A				(1,960,000)
Fixed cost Block B				(1,500,000)
Fixed cost Block C				(740,000)
Total Company fixed cost				**(4,200,000)**
Total Profit				₦568,500

Note: where the attribute fixed cost is not regarded as fixed cost and therefore treated as relevant costs.

ALTERNATIVELY

Calculation of total profit

Product	Trouser	Jacket	Skirt	Total
Contribution /Unit(₦)	1000	850	900	
Units Produced	2500 units	2600 units	3,967 units	
Total contribution (₦)	₦2500000	₦2,210,000	₦3,570,300	₦8,280,300
Fixed costs:				
Block A				
₦1,960,000				
Block B				
₦1,500,000				
Block C ₦ 740,000				₦4,200,000
Net Profit				₦4,080,300

Note: The attributable product fixed cost is regarded as sunk cost and not relevant in view of the fact that it can be dropped in view of current output plan is different.

Examiner's report

This question is a popular question that tests candidates' knowledge of determination of company's machine utilisation rate for each machine and establishing the machine that is the bottleneck and limiting factor in part (a). The part (b) of the question tests conventional marginal and contribution analysis to determine the profit maximising output and finally the computation of the total profit after considering the attributable fixed cost of each product (relevant costs) and the company fixed overheads as deduced from the three blocks housing the machines.
The question was well attempted.

However, performance was average.

The major pitfall observed was candidates' inability to treat the attributable product fixed costs based on quantity produced and total company fixed cost appropriately and separately.

It is hereby recommended that candidates use the ICAN Study Text on Performance Management when preparing for future Institute's examination.

Marking guide

Section	Description	Marks	Marks	Total
a.	Machine utilisation Rate (12 ticks @ ½ mark = 6 marks)	6		
	Profit maximisation quantity using Marginal and contribution analysis Optimal Production Plan 12 ticks @ ½ mark = 6 marks)	6	12	
b.	Computation of total Profit (6 ticks @ ½ mark = 3 marks)		3	15
				15

ICAN/241/Q/B5 **Examination No....................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

PUBLIC SECTOR ACCOUNTING & FINANCE

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

THURSDAY, MAY 16, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

The University of Okoko Consultancy Unit (Uniko Consult) provides training courses for staff, public and private individuals. The consultancy unit is currently collating information for its budget for the six months ending December 31, 2021. The following information is available:

(i) **Provisional bookings for courses**

	July	Aug.	Sept.	Oct.	Nov.	Dec.
Number of courses	0	2	4	3	4	4
Average number of attendees per course	0	16	8	16	8	12

No courses are run during the month of July. Uniko Consult requires intending participants to confirm their attendance in the week prior to the course, giving their credit card number (first and last 4 digits) as a guarantee. On average, 75% of provisional bookings are confirmed and therefore result in fee payment.

(ii) **Course prices**

Each course lasts for three days, running from Friday to Sunday and the fee for each course is ₦120,000 per attendee. All courses have to be paid for in full on the first day of the course. Any returning participant will be given a 25% discount on the fee. One in three of confirmed bookings is from a returning participant.

(iii) **Personnel costs**

Experienced team of Professors led by Emeritus Professor Omopinleola deliver Uniko Consult's courses. He is not a member of staff at Uniko Consult, but rather an outsourced facilitator. Emeritus Professor Omopinleola charges Uniko Consult ₦300,000 for each course and is supported by his assistant, Dr. Chukwuma. Emeritus Professor Omopinleola pays his assistant a wage of ₦50,000 per course. Uniko Consult has several part-time support staff. Wages costs for July are only ₦100,000 per month, but every month thereafter amounts to ₦400,000. However, the Consult is planning to increase wages by 5% from September. All staff are paid at the end of each month.

(iv) **Property costs**

The University owns a Researchers' Lodge, which includes an office, a large kitchen and two conference rooms. Uniko Consult rents the Researchers' Lodge at a rental cost of ₦2,400,000 per annum, with rents being paid quarterly in advance on March 31, June 30, September 30 and December 31. However, the Consultancy Unit has just received a notice from the Bursar of the University, stating that, with effect from December 31, 2021, annual rental payments will increase by 5%.

(v) **Food costs (Tea break and lunch)**

All food items purchased by the Researchers' Lodge is organic and delivered weekly by Uniko Farms. On the 5th day of each month, Uniko Consult pays the bill for the previous month's food deliveries. However, in December, Uniko Consult is also required to settle its bill for December's food requirements due to the two-week holiday taken by Uniko Farm in January. In recent months, the cost for food on each training course has been ₦5,000 per attendee. However, due to lower availability of organic produce, inflation of 2% per month is expected to occur from September onwards. Food costs for June 2021 are expected to be ₦110,000.

(vi) **General overheads**

The running cost of Uniko Consult is ₦835,000 per annum, paid in ten equal instalments from April to January each year. The consult's fuel cost of ₦420,000 per annum is paid through equal monthly direct debits. However, it has just come to the fuel supplier's attention that the direct debits from January to April failed, due to systems error. Therefore, the direct debit payment for July will include these outstandings.

(vii) **Capital expenditure**

Uniko Consult needs to replace its three air conditioners in one of the conference rooms by August. The price is ₦180,000 each but Uniko Consult's Managing Director is confident that he can obtain a 10% discount on this price. The supplier is also allowing Uniko Consult to pay for the air conditioners in two instalments – one in August and the other in October.

(viii) **Bank account**

The balance on the Consultancy's bank account is expected to be zero on June 30, 2021; it currently has a sufficient overdraft facility to cover any cash deficit arising.

(ix) **Remittances**

The Consultancy Unit is expected to remit 50% of its cash balance to the University's account on half-yearly basis.

Required:

a. Prepare a cash budget for each of the six months period ending December 31, 2021.
Note: All workings should be rounded to the nearest ₦000 (20 Marks)

b. Enumerate the steps involved in Planning, Programming and Budgeting System (PPBS). (7 Marks)

c. State and explain **THREE** characteristics of performance budgeting system. (3 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

a. IPSAS 36 - Investments in Associates and Joint Ventures is a replacement of IPSAS 7 on Accounting for Investments in Associates.

You are required to:
Identify and briefly explain **FOUR** disclosures that should be made in the accounts on investments in associates. (8 Marks)

b. Interpretation of public sector financial statements is necessary in order to take decisive action in the public sector activities.

You are required to:
Identify and briefly explain **THREE** ways through which comparison of figures in respect of two or more years can be derived. (12 Marks)

(Total 20 Marks)

QUESTION 3

a. Differentiate between unapplied mandate and uncredited cheques. (5 Marks)

b. The Account Officer of University of Igbokuenu, Abia, supplied the following information for Asejere Bank for the month ended March 31, 2020. On the same date, the balance as per the bank statement was a credit balance of ₦26,229,000,while, the cash book showed a debit balance of ₦12,063,000.

The investigation carried out by the accounts officer revealed the following:

- There was a bank charge amounting to ₦15,000 for administrative fee, which had been deducted by the bank but no entry was made in the cash book.
- A commission on turnover (COT) of ₦30,000 for the month of February had not been recorded in the cash book.

- Interest of 2% was paid on an endowment fund of ₦127,500,000, which was maintained in a fixed deposit account in Kazua Bank. This was paid directly to Asejere Bank PLC, but has not been recorded in the cash book, while an investment income amounting to ₦60,000 was also received directly by the bank but has no entry in the cash book.
- A cheque of ₦24,000 was received from B-Engineering services as registration fee on March 31, 2020 and was duly entered into the cash book and taken to the bank same day but had not been credited as at the time the bank statement was collected.
- Cheques amounting to ₦3,300,000, previously credited by the bank were dishonoured.
- A sum of ₦10,200,000 which was paid directly to the bank was received from the Abuja Alumni of the University in form of aid which the accountant has not been recorded in the cash book while additional ₦4,500,000 aid was received from USAID but not recorded in the cash book.
- Mandate numbers, which were issued by the University to the bank for payments to beneficiaries in March 2020 were yet to be applied with details as follows:

Mandate No.	**Beneficiary**	**Amount (₦)**
0671420	SolarTech	90,000
0002418	GreenLaud	120,000
0021462	S-Publishers	15,000

Required:

i. Prepare a bank reconciliation statement for the period ended March 31, 2020 (10 Marks)

ii. Identify and explain **FIVE** challenges of bank reconciliation under the e-payment system. (5 Marks)

(Total 20 Marks)

QUESTION 4

National Chart of Accounts (NCOA) shows the complete list of budget and accounting items for General Purpose Financial Reporting (GPFS) and budgeting.

a. State **FOUR** characteristics of National Chart of Accounts. (4 Marks)

b. Discuss the **SIX** structures of the National Chart of Accounts for budgeting. (12 Marks)

c. Identify and briefly explain **FOUR** steps for budgeting with National Chart of Accounts. (4 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

In Nigeria, public revenue belongs to its citizenry and allocated to them through the National Revenue Mobilisation, Allocation and Fiscal Commission.

a. State and explain **FIVE** principles that guide revenue allocation in Nigeria. (7½ Marks)

b. Explain **FIVE** factors that led to the controversies surrounding revenue sharing in Nigeria. (7½ Marks)

(Total 15 Marks)

QUESTION 6

a. Oyigbo Local Government is set to improve its internally generated revenue by venturing into construction of an animal feedmill, which will cost ₦15million. The mill, when constructed is projected to generate a net cash inflow of ₦3.8 million annually and the useful life is 6 years. The cost of borrowing from a commercial bank for this purpose is 12%.

Required:

Advise the Chairman of Oyigbo Local Government whether or not to undertake the project using the Profitability Index (PI) technique of investment appraisal.

The cumulative discount factor formula to use is:

$$\left(\frac{1-\ (1+r)^{-n}}{r}\right)$$

where, r = discount rate
n = number of years (10 Marks)

b. Identify **THREE** advantages and **TWO** disadvantages of profitability index as a technique for project appraisal. (5 Marks)

(Total 15 Marks)

QUESTION 7

Public finance is concerned with the income and expenditure of public authorities and with the adjustment of one to the other. Also it opined that the subject matter of public finance looks into the financial problems and policies of the government at different levels and also studies the inter-governmental financial relations.

Required:

a. Identify and explain **FIVE** categories of public finance (7½ Marks)

b. Discuss **FIVE** rationale for public sector in the economy (7½ Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. **The University of Okoko Consultancy Unit**

Cash budget for the six months period ended December 31, 2021.

	July ₦'000	Aug ₦'000	Sept ₦'000	Oct ₦'000	Nov. ₦'000	Dec ₦'000
Cash inflows (Wk.i – iii)						
Course fees:						
- New attendees	-	1,920	1,920	2,880	1,920	2,880
- Returning attendees	-	720	720	1,080	720	1,080
Total cash inflows (A)	**-**	**2,640**	**2,640**	**3,960**	**2,640**	**3,960**
Cash out flows						
Tutor costs (Wk.iv)	-	600	1,200	900	1,200	1,200
Staff costs (Wk.v)	100	400	420	420	420	420
Property costs (Wk.vi)			600			630
Food costs (W VII)	110	-	120	122.4	187.2	321.6
General overheads (Wk. viii)	258.5	118.5	118.5	118.5	118.5	118.5
Capital expenditure (Wk. ix)		243		243		
Total cash outflows (B)	**468.5**	**1,361.5**	**2458.5**	**1,803.9**	**1,925.7**	**2,690.1**
Net cash flows (A-B)	(468.5)	1,278.5	181.5	2,156.1	714.3	1,269.9
Cash b/f	-	(468.5)	810	991.5	3,147.6	3,861.9
Cash balance before remittance	(468.5)	810	991.5	3.147.6	3,861.9	5,131.8
Remittance (Wk. x)	-	-	-	-	-	(2,565.9)
Cash c/f	**(468.5)**	**810**	**991.5**	**3.147.6**	**3,861.9**	**2,565.9**

Working notes

i) **Budgeted attendees**

	July	Aug	Sept	Oct	Nov	Dec
Number of courses (A)	-	2	4	3	4	4
Provisional attendees(B)	-	16	8	16	8	12
Budgeted confirmed attendees per course (C)	-	12	6	12	6	9
Budgeted total attendees per month (A multiply by C)	**-**	**24**	**24**	**36**	**24**	**36**

ii) **Budgeted fees from fully paid attendees**

	July ₦'000	Aug ₦'000	Sept ₦'000	Oct ₦'000	Nov. ₦'000	Dec ₦'000
Standard fees (A)	-	120	120	120	120	120
No. of attendees for month paying standard fee ($^2/_3$ budgeted of total attendees per month) (B)	-	16	16	24	16	24
Total fully paid fees (A X B)	**-**	**1,920**	**1,920**	**2,880**	**1,920**	**2,880**

iii) **Budgeted fees from returning attendees**

	July ₦'000	Aug ₦'000	Sept ₦'000	Oct ₦'000	Nov. ₦'000	Dec ₦'000
Standard fees (A)	-	90	90	90	90	90
No. of attendees for month paying standard fee (1/3 of budgeted total attendees per month) (B)	-	8	8	12	8	12
Total fully paid fees (A X B)	-	**720**	**720**	**1,080**	**720**	**1,080**

iv) **Total tutor costs**

	July	Aug	Sept	Oct	Nov.	Dec
No. of courses (A)	-	2	4	3	4	4
Cost per course (₦'000) (B)	-	300	300	300	300	300
Total cost per month (₦'000) (A X B)	-	**600**	**1,200**	**900**	**1,200**	**1,200**

Note: Cost of assistant paid by Emeritus Professor Omopinleola is irrelevant because he pays his assistant directly from his own course fee.

v) **Staff costs**

	July ₦'000	Aug ₦'000	Sept ₦'000	Oct ₦'000	Nov. ₦'000	Dec ₦'000
Increase in wages by 5% from September	100	400	420	420	420	420

vi) **Rental payments**

Current quarterly payments = ₦2,400,000/4 = ₦600,000 per annum.
Annual rental payment from December = ₦2,400,000 x 1·05 = ₦2,520,000.
Therefore, quarterly rent is ₦2,520,000/4 = ₦630,000

vii) **Food costs (Tea break and lunch)**

	July	Aug	Sept	Oct	Nov.	Dec
Budgeted attendees (Wk.i) (A)	-	24	24	36	24	36
Food cost per head (₦'000} (B)	-	5	5.1	5.2	5.3	5.4
Total food cost per month (₦'000) (A X B)	-	**120**	**122.4**	**187.2**	**127.2**	**194.4**

viii) **General overheads**

Business rates = ₦835,000/10 = ₦ 83,500 per month.

Fuel = ₦420,000/12 = ₦35,000 per month.

Therefore, in July fuel cost = ₦35,000 + (4 x ₦ 35,000) = ₦175,000.

Total = ₦258,500 for July and ₦118,500 for each month of August to December.

ix) **Capital expenditure**
Total cost = 3 X (180,000 x 90%) = ₦486,000
Therefore amount payable in August and October = ₦486,000/2 = ₦243,000

x) **Remittance**

	₦
Balance b/f as at December 31, 2024	3,861,900.00
December net cash flows	1,2690,100.00
Total	5,131,800.00
Payable in December (₦5,131,800/2)	2,565,900.00

b. **Steps in Planning, Programming and Budgeting Systems (PPBS)**
Steps in PPBS are as follows:

(i) Identification and enumeration of goals and objectives of the organisation;
(ii) Defining the total system in detail, including objectives, environment, available resources, the programmes and their objectives, etc;
(iii) Planning and analysis involve continuous process of developing, comparing and analysing alternative programmes, so as to evolve the most appropriate package for the organisation;
(iv) Development of the appropriate measures of performance for the programmes of the organisation;
(v) The agreed package of "programmes" complete with resource requirements and expected results are expressed in the form of "programmed budgets";
(vi) In reporting and controlling; planning, programming and budgeting system requires sophisticated information service, which is able to monitor the progress made towards meeting the organisational objectives. Performance evaluation, therefore, emphasises the attainment or non-attainment of the desired objectives, rather than the amount spent, which is the focus in traditional budgeting system; and
(vii) The budgeting system requires development in each year, of a multi-year programme and financial plan.

c. **Characteristics of performance budgeting systems**
The characteristics of performance budgeting are as follows:

(i) Classification of budgets in terms of functions and activities;
(ii) Measurement of work done or output provided by each activity;
(iii) Expression of the budget in a way which allows direct comparison between a project's cost and the anticipated income or benefit; an

(iv) Monitoring of actual cost and performance against the budgeted results or expectations.

Examiner's report

The question is in three parts. Part (a) of the question tests candidates' knowledge on the preparation of cash budget. Part (b) requires the candidates to enumerate the steps in Planning, Programming and Budgeting System (PPBS), while part (c) requires the candidates to identify characteristics of performance budgeting system.

All the candidates attempted the question and their performance was below average.

The common pitfalls were the inability of the candidates to enumerate the steps in Planning, Programming and Budgeting System (PPBS), Also, some candidates were unable to calculate the 50% cash balance to be remitted to the University's account in December, 31, 2021.

Candidates are advised to have adequate knowledge of the relevant provisions of the syllabus and to make use of Pathfinder and the Study Text of the Institute for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	**Preparation of cash budget:**		
	Calculation of total cash inflows	3¾	
	Calculation of total cash outflows	8	
	Calculation of net cashflows	1½	
	Calculation of cash balance carried forward	4¼	
	Workings:		
	Calculation of total fully paid fees by attendees	1¼	
	Calculation of fully paid from returning attendees	1¼	20
b.	**Steps involved in PPBS.**		
	Each of the 7 steps at 1 mark each		7
c.	**Characteristics of performance budgeting**		
	Any three (3) features at 1 mark each		3
	Total		**30**

SECTION B

SOLUTION 2

a. **Disclosure requirements for investment in associates**

Disclosures that should be made in the accounts of investments in associate are as follows:

(i) The fair value of investment in associate for which there are published price quotations;

(ii) Summarised financial information of associates;

(iii) The reasons why investor holds less than 20% of voting power in investee but concludes that it has significant influence;

(iv) The reasons why investor holds more than 20% of voting power in investee but concludes that it does not have significant influence;

(v) The reporting date of the financial statements of an associate, which such financial statements are used in applying the equity method and are as of a reporting date, or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;

(vi) The nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or similar distributions, or repayment of loans or advances;

(vii) The unrecognised share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;

(viii) The fact that an associate is not accounted for using the equity method; and

(ix) Summarised financial information of associates, either individually or in groups that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and surplus or deficits.

b. **Ways of comparison of figures in respect of two or more years**

(i) **Straight forward criticism or analytical review**

Figures in respect of two or more years may be compared and percentage differences obtained. Comparison of figures may be undertaken in any of the following ways:

- Previous years' figures with those of the current year;
- The statistics of a period this year with those of a similar period last year;

- Figures within the year's 1st quarter with those of the fourth quarter of the same year; and
- It may be percentage representation within the year. For example, salary expenses may be expressed as a ratio of total expenses.

The above stated methods are popular with public sector organisations. Other ways of analysing financial statements under this method are:

- Share of capital expenditure as a percentage of non-debt expenditure;
- Share of capital expenditure as a percentage of total expenditure;
- Share of recurrent expenditure as a percentage of total expenditure;
- Share of statutory allocation as a percentage of total revenue; and
- Share of internally generated revenue as a percentage of total revenue.

(ii) **Performance reports as per IPSAS 24**

According to IPSAS 24, entities are required to present a comparison of the budgeted amount for which it is held publicly accountable and actual amount, either as a separate additional financial statement or as an additional budget column in the financial statements currently presented in accordance with IPSASs. The comparison of budgeted and actual amounts shall be presented separately for each level of legislative oversight:

- The original and final budget amounts;
- The actual amounts on a comparable basis; and
- By way of the note disclosure, an explanation of material differences (variances) between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements and a cross reference to those documents is made in the notes.

(iii) **Cash flow statements**

Neither the statement of profit or loss account not statement of financial position gives a satisfactory explanation of how a business obtains and uses its cash. The cash flow statement is very revealing of the core operations of a Government, Parastatal or Board on the affordability or otherwise of adequate liquid resources.

This is the statement that shows the amount of cash generated by an organisation and the utilisation of such cash for that period.
The major sources of cash inflows and outflows into the public sector according to IPSAS 2 are:

- Operating activities;
- Investing activities; and
- Financing activities

(iv) **Ratio analysis**

Financial ratio analysis is the process of calculating financial ratios, which are mathematical indicators calculated by comparing key financial information appearing in financial statements of a public sector entity and analysing them to find out reasons behind the entity's current financial position and its recent financial performance and develop expectation about its future outlook.

Ratio analysis involves expressing one figure as a ratio or percentage of another, to bring out the weakness or strength in an organisation's affairs.

Examiner's report

The question is in two parts. Part (a) of the question requires the candidates to identify and explain disclosures that should be made in the accounts on investments in associates, while part (b) requires the candidates to identify and explain ways through which comparison of figures in respect of two or more years can be derived.

Few candidates attempted the question and their performance was below average.

The commonest pitfall was the inability of the candidates to properly identify and explain ways through which comparison of figures in respect of two or more years can be derived

Candidates are advised to make use of ICAN Pathfinders and the Study Text for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	**Disclosure requirements for investment in associates**		
	Any four disclosures at 2 marks each		8
b.	**Ways of comparison figures in respect of two or more years:**		
	Identification of any three ways at 1 mark each	3	
	Explanation of any three ways identified at 3 marks each	9	12
	Total		20

SOLUTION 3

a. An unapplied mandate is when a payment is made through a mandate to a bank which is reflected in the credit side of a cash book as being paid out but not reflected in the bank statement as a result of the following reasons:

   i) Delay arising from the failure of e-payment network put in place to facilitate payment;
   ii) Delay from the bank in posting the mandate; and

iii) Failure of the bank to post according to the mandate instructions.

Whereas uncredited cheque is a cheque paid into the bank but has not been cleared as at the date of the bank balance. Since the cheque has not been cleared, the bank does not add the value of the cheque to the balance in the account. However, in the cash book of the business the deposit would have been included as part of the cash in the bank.

b. (i)

University of Igbokuwenu, Abia
Bank reconciliation statement for the month ended March 31, 2020

	₦	₦
Cash book balance for the month ended March 31, 2020		12,063,000
Add:		
Unpresented/unapplied mandates (Wk1)	225,000	
Receipts in bank but not in cash book (Wk 2)	17,310,000	17,535,000
Less:		
Receipts in cash book but not in bank (Wk 3)	3,324,000	
Debits in bank not yet in cash book (Wk 4)	45,000	3,369,000
Balance as per bank statement		**26,229,000**

Workings notes:

i) **Unpresented/unapplied mandates**

Mandate No.	Beneficiary	₦	₦
0671420	Solar Tech	90,000	
0002428	Green Laud	120,000	
0021462	S-Publishers	15,000	225,000

ii) **Receipts in bank but not in cash book**

	₦	₦
2% Interest on an endowment fund of ₦127,500,000	2,550,000	
Investment income	60,000	
Aid received by the alumni of the university	10,200,000	
USAID donations	4,500,000	17,310,000

iii) **Receipts in cash book but not in bank**

	₦	₦
B-Engineering services registration fees	24,000	
Dishonoured cheque	3,300,000	3,324,000

iv) **Debits in bank not yet in cash book**

	₦	₦
Bank charges	15,000	
Commission on turnover (COT)	30,000	45,000

(ii) **Challenges of bank reconciliation statement under e-payment system.**

The following are the challenges of bank reconciliation under the e-payment system:

- Network failure which slows down the pace of reconciliation process;
- The mandate numbers in the cash book can be posted differently from the ones of the bank statements resulting in difficulty in matching items in the cash book with the ones in the bank statements;
- Splitting of items on a mandate by the banks. For example, a mandate for a total payment of ₦150,000 to three individuals equally, can be split by the bank as three different payments of ₦50,000 each in the bank;
- Absence or inadequate description of transactions in the bank statement;
- Delay in obtaining bank statements from the banks;
- Posting errors on the part of the banks; and
- Posting errors from the schedule officers of the MDAs.

Examiner's report

The question is in two parts. Part (a) of the question requires candidates to differentiate between unapplied mandate and uncredited cheques. Part (bi) of the question requires the candidates to prepare bank reconciliation statement of a university, while part (bii) requires candidates to identify and explain the challenges of bank reconciliation statement under the e-payment system.

Most of the candidates attempted the question and their performance was below average.

The common pitfalls were the inability of the candidates to differentiate between unapplied mandate and uncredited cheques. They were also unable to identify and explain the challenges of bank reconciliation statement under the e-payment system.

Candidates are advised to read widely and ensure they have adequate knowledge of the relevant sections of the syllabus. They should also make use of Pathfinders and the Study Text of the Institute and other relevant learning materials on this aspect of the syllabus for better performance in future examinations.

Marking guide

		Marks	Marks
a.	**Difference between unapplied mandate and uncredited cheque:**		
	Explanation of unapplied mandate	2½	
	Explanation of uncredited cheque	2½	5
b.i.	**Preparation of bank reconciliation statement**		
	Correctly stating the title.	½	
	Calculation of balance as per bank statement.	4	
	Calculation of unpresented or unapplied mandates.	1½	
	Calculation of receipts in bank not in the cash book.	2	
	Calculation of receipts in the cash book not in the bank.	1	
	Calculation of debits in the bank but not in the cash book.	1	10
ii.	**Challenges of bank reconciliation under e-payment**		
	Any five (5) challenges at 1 mark each		5
	Total		20

SOLUTION 4

a. **Characteristics of National Chart of Accounts (NCOA):**

The NCOA is based on the following key characteristics:

(i) The NCOA was designed after due consultations with all the Local Government Councils, States and Federal Government of Nigeria in consideration with their peculiar needs;
(ii) It is expandable and flexible;
(iii) Each item has a unique code;
(iv) It is used for both budgeting and accounting;
(v) It is in compliance with IPSAS cash and accrual bases;
(vi) It is in compliance with Government Financial Statistics(GFS) 2001; and
(vii) It is incompliance with Classification by Functions of Government (COFOG).

b. **Structure of National Chart of Accounts (NCOA)**

(i) **Administrative segment:** The Administrative segment assigns responsibility for each transaction whether revenue centre (receipt) or cost centre (payment).
(ii) **Economic segment:** Every receipt must be from a particular source for example, contractor's registration fee. Likewise, every expense must be on a particular item or object for example, purchase of drugs and medical supplies. It answers "What" question of every transaction.
(iii) **Functional segment:** Functional classification categorizes expenditure according to the purposes and objectives for which they are intended. Functional Classification or Classification by Functions of Government (COFOG) is defined as a detailed classification of the functions, or socio-

economic objectives, that general government units aim to achieve through various kinds of outlays. Functional classification organises government activities according to their broad objectives or purposes (for example, education, social security, housing, etc.). Government expenditure is measured according to internationally recognised functional categories. A functional classification is especially useful in analysing the allocation of resources among sectors. Functions and sub-functions will be assigned at the point of budget and planning for every transaction or initial set up.

(iv) **Programme segment:** The programme classification identifies various set of activities to meet specific policy objectives of the government for example, pre-primary education, poverty alleviation and food security.

(v) **Funds segment:** The fund segment addresses the "Financed by" element of a transaction. Fund refers to the various pools of resources for financing government activities. It will fast track the implementation of IPSAS particularly with respect to the full disclosure of government revenue including external assistance.

(vi) **Geographic segmen**t: It addresses the "Where" (location/station) element of every transaction. It is for location or physical existence of transaction so that an analysis of government budget and expenditure along the various geopolitical zones, states, and local government councils in the country can be done. The use of geographic codes will make it easier for agencies with over sight function like monitoring and evaluation (M&E) mandates to locate projects across the country.

d. The steps for budgeting with National Chart of Accounts (NCOA)

All the six segments of the chart of accounts must be completed on the budget entries, even if the value for a given segment is in active. Onynumeric values can be budgeted. Meanwhile, the following steps should be taken to ensure completeness of using the Chart of Accounts for budgeting:

(i) Identify the government institution(cost and revenue centre) from the hierarchy of administrative andcodes provided in the chart of accounts;
(ii) Identify the economic items that would be executed during the fiscal year;
(iii) Identify the functions intended to be performed by government institutions (revenue and cost centre);
(iv) Identify the programmes intended to be carried out by the government institution;
(v) Determine the sources of financing the budgeted amount for each budget line; and
(vi) Identify the planned location for the economic transactions or government institution.

Examiner's report

The question is in two parts. Parts (a) and (b) of the question require the candidates to state the characteristics of National Chart of Accounts (NCOA) and its structures for budgeting. while part (c) of the question requires the candidates to identify and explain four steps for budgeting with National Chart of Accounts.

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

The common pitfalls were the inability of the candidates to state the characteristics of National Chart of Accounts (NCOA) and its structures for budgeting, while in part (c), the candidates were unable to identify and explain four steps for budgeting with National Chart of Accounts.

Candidates are advised to read widely and ensure they have adequate knowledge of relevant regulations relating to public sector accounting for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	**Characteristics of National Chart of Accounts (NCOA):**		
	Stating any four characteristics of NCCOA at 1 mark each		4
b.	**Structure of National Chart of Accounts:**		
	Identification of the six structures at ½ mark each	3	
	Explanation of the six structures at 1½ marks each	<u>9</u>	12
c.	**The steps for budgeting with National Chartof Accounts:**		
	Explanation of any four steps at 1mark each		<u>4</u>
	Total		**<u>20</u>**

SECTION C

SOLUTION 5

a. **Principles of revenue allocation.**

(i) **Derivation:** This principle was originally applied to the proceeds of export taxes on agricultural produce. The principle asserts that the state from which the bulk of the revenue is obtained should receive extra share over and above what other states receive.

(ii) **Even development:** The objective of government is that the Federation itself should grow and develop at an optimum rate and that each of the constituent states should grow and develop at the optimum (not necessarily equal) rate. The principle requires that growth and development should be spread so that serious inequalities or imbalances are reduced in the Federation. These may be achieved by sacrificing efficiency in the form of a reduced overall growth.

(iii) **Need:** The rate of growth and development a state is able to achieve depends on the revenue the state is able to generate. It requires financial as well as other resources not only to maintain its existing facilities but also to develop additional capacities. Given a set of these other resources, a state requires funds to enable it realise its potential. When the need of a state is compared with the need of others, it may be necessary to transfer financial resources from one state to another in the interest of efficiency.

(iv) **National interest:** This principle is used residually by the highest level of government to intervene and transfer funds to lower levels or units in the lower levels to serve various considerations. It lies therefore in the sphere of discretionary grants to be administered by the highest tier, that is, government of the Federation.

(v) **Independent revenue:** The principle is of the view that each level of government should be able to raise and keep some revenue for its use. The bulk of the revenue of the state revenue comes from what is raised and collected by the Federal government. The main sources left to the state governments are those on personal income taxes, capital gains tax and stamp duties, which should be exploited.

(vi) **Continuity of government services:** The principle suggests that each level of government has a certain minimum responsibility and that the level of services provided should not be allowed to fall below a certain standard. Where a state is unable to function effectively due to lack of funds, such a state should be assisted with federally collected revenue.

(vii) **Equality of state:** All men are created equal but are endowed differently. Similarly, states are created equally but they arrive, at creation and through passages of time with different endowments of economic, financial and political power. The principle asserts that revenue sharing among the states should be done on equal basis.

(viii) **Equality of access to development opportunities:** This was introduced to correct unequal endowments of the states. The principle asserts that preferential treatment should be given to those states which by some measures of development lag behind others or fall below a certain norm.

(ix) **Absorptive capacity:** It represents the capacity of the state to make proper use of funds. It is on exceptional and efficiency grounds, that is, funds should go to those states that are best able to utilise them.

(x) **Population:** This principle asserts that since government is about people, that development is also about people and that the essence of government should be the welfare of the people. Therefore, states with larger populations should receive extra share above others with smaller populations.

(xi) **Tax effort**: The principle, which applies in most federation, is designed to encourage states to exploit their tax capacities. The realisation of a state's potential in respect of tax revenues will widen its development possibilities.

(xii) **Fiscal efficiency:** This principle asserts that states should minimise the cost of fiscal administration or obtain maximum revenue from a given cost. Fiscal efficiency reflects not only on the ability to raise taxes and collect them, but it reflects also the structure of the tax base itself as well as the overall administrative machinery of government.

b. **Factors responsible for revenue sharing problems**

(i) **Over-dependence on oil revenue.** The advent of oil in Nigeria and its high yielding revenue generation tendency has continued to undermine the development of the hitherto buoyant agricultural and other viable sectors such as industry, mining and human capital development. Consequently, oil revenue has become the major source on which the country critically depends on thereby becoming a mono-product economy. The current revenue sharing formula encourages laziness and idleness as states rely heavily on the federal allocation- a situation that makes most states, with the exception of Lagos parasitic in nature feeding voraciously on Federation Account.

(ii) **Politics of revenue sharing formular.** Revenue sharing among the component units of Nigerian federation has been, from the inception, replete with agitations, controversies and outright rejections due to the nature of the politics that is involved in it. The process of revenue sharing is inundated with conflicting criteria that were, often times, rejected by majority of the states. The determining factor in revenue allocation strongly revolved around political rather than economic criteria, thereby making the revenue allocation issue in Nigeria contentious and thorny.

(iii) **Agitation for resource control.** The historical facts of the use of the principle of derivation (emphasised earlier and de-emphasised later) have been a source of inter-regional or states conflict, rivalry and antagonism. The major fall out of the down play of the principle of derivation, which stipulates that the component units of a system should be able to control some of its own resources as they desire, is the agitation for resource control that has taken criminal dimensions in most of the oil producing communities and states of the Niger Delta. There have been multifarious cases of kidnapping, vandalism of oil pipes and installations, desperations and high scale violence.

(iv) **Increasing fiscal units.** The rapid changes in the number of fiscal units that is not necessitated by guided economic and political philosophy led to creation of states that are fiscally unviable and consequently increased demand for increased share of "national cake". Many states in Nigeria will blame their inactivity and ineffectiveness on low or lack of allocation from the federation account rather than become inventive and innovative in ideas that will cause increase in their revenue generation. The increase in the number of fiscal units in Nigeria from 3 to 4, 12, 19, 21, 30 and 36 within a period of three and a half decades is contrary to what obtains in older and other federations.

(v) **Unstable constitutional framework**. The absence of a permanent and generally acceptable legal structure in the form constitution may result in chaotic tendencies. For instance, the last constitutional conference in the United States of America was in 1787 and only 27 amendments have been made as at 1999 as opposed to Nigeria in which several constitutional conferences had taken place since independence without general acceptability. In addition, states in Nigeria do not really have the statutory power to raise taxes and collect the proceeds and as such the problem had centred not on who should raise but how the proceeds should be shared. Therefore, expenditure and tax/revenue assignment is inundated with ambiguity and inefficiency. A good example is the case of Lagos State Ministry of Transportation (MOT), which became a legal tussle between the government and some activists.

(vi) **Lack of will.** The absence of sincere desire on the part of the public office holders to address the challenges of revenue sharing is aptly reflected in the refusal to convoke a conference of leaders of various groups and ethnic nationalities that may lead to design of acceptable resource allocation scheme. Even where such conferences have been convoked in the past, the will to implement suddenly disappears from the initiators.

Examiner's report

The question is in two parts. Part (a) of the question requires the candidates to state and explain principles that guide revenue allocation in Nigeria, while part (b) requires the candidates to explain factors that led to the controversies surrounding revenue sharing in Nigeria.

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

The common pitfalls were the inability of the candidates to state and explain principles that guide revenue allocation in Nigeria, while in part (b) few of the candidates could not satisfactorily explain factors that led to the controversies surrounding revenue sharing in Nigeria.

Candidates are advised to make use of Pathfinders and the Study Text of the Institute for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	**Principles of revenue allocation:**		
	Identification of any five principles at ½ mark each	2½	
	Explanation of the five principles identified at 1mark each	<u>5</u>	7½
b.	**Factors responsible for revenue sharing:**		
	Identification of any five factors at ½ mark each	2½	
	Explanation of the five factors identified at 1mark each	<u>5</u>	<u>7½</u>
	Total		**<u>15</u>**

SOLUTION 6

a. **Investment appraisal under Profitability Index (PI)**

Cash outflow = ₦15,000,000.
Annual cash inflows =₦3,800,000
r = discount rate (Cost of borrowing) = 12%
n = number of years = 6 years

$$\text{Cumulative discount factor formular} = \frac{1-(1+r)^{-n}}{r}$$

$$= \frac{1-(1+0.12)^{-6}}{0.12}$$

$$= 4.11$$

Years	Cash flow ₦	DF (12%)	Present value ₦
0	(15,000,000)	1.0	(15,000,000)
1 - 6	3,800,000	4.11	15,618,000

$$\text{Profitability Index (PI)} = \frac{\text{Future cash inflows}}{\text{Cash outflow in year 0}}$$

$$\text{Profitability Index (PI)} = \frac{15{,}618{,}000}{15{,}000{,}000}$$

$$= 1.041$$

Decision: Based on the above computation, the project should be accepted because the PI is greater than one.

b. **Profitability index (PI)**

Advantages of profitability index

(i) It recognises time value of money.

(ii) It is a variant of the NPV method. It therefore requires the similar computation as in NPV method.

(iii) It is a relative measure of a project's profitability since the present value of cash inflows is divided by the present value of cash outflows.

(iv) It is generally consistent with the wealth maximisation principle.

Disadvantages of Profitability index (PI)

(i) It can only be used to choose projects under simple, one period, capital constraint situation.

(ii) It does not work with mutually exclusive projects as only dependent projects are being considered.

(iii) The technique is not popular in public sector project appraisal.

Examiner's report

The question is in two parts. Part (a) of the question requires candidates to calculate and advice the Chairman of a Local Government whether or not to undertake a project using Profitability Index (PI) technique of investment appraisal, while part (b) asks the candidates to identify the advantages and disadvantages of profitability index as a technique for project appraisal.

Majority of the candidates attempted the question and their performance was below average.

The common pitfalls were the inability of the candidates to calculate and give advice whether or not to undertake a project using Profitability Index (PI) technique of investment appraisal. Some candidates could not correctly state the advantages and disadvantages of profitability index technique.

Candidates are advised to make use of Pathfinders and the Study Text of the Institute for better performance in the future examinations.

Marking guide

		Marks	Marks
a.	**Investment appraisal under Profitability Index (PI)**		
	Calculation of present value of cash outflow in year '0'	1½	
	Calculation of present value of future cash inflows using correct formular	4	
	Calculation of Profitability Index (PI) using correct formular	2½	
	Decision	2	10
b.	**Advantages and disadvantages of Profitability Index:**		
	Identification of any three advantages at 1 mark each	3	
	Identification of any two disadvantages at 1 mark each	2	5
	Total		**15**

SOLUTION 7

a. **Categories of public finance**

(i) **Public revenue:** This deals with the various sources of revenue that is available to the government, the comparative advantages and disadvantages of each of the source of revenue as well as the principles that govern them. Among the sources of revenue to the government are taxation, non-tax revenue and others. Of all the sources of revenue, taxation is the most important and deserves special treatment.

(ii) **Public expenditure:** This is an important tool in the hands of the policy makers as it can be used to achieve various economic objectives of the government such as allocation of resources, redistribution of income and wealth, stabilisation of prices and employment as well as achieving optimum growth rate. It is through public expenditure that government contributes to the financial flows of the economy, regulates the patterns of demand and supply, as well as implement welfare programmes.

(iii) **Financial administration.** This involves the budget, its formulation and execution of the various objectives specified in the budget. It also includes the government accounting, auditing as well as the other financial operations of the public authorities.

(iv) **Economic growth and stabilisation.** The objective of economic growth and stabilisation is usually the major focus of government policies. To that extent, it is the concern of public finance that there should be prudent utilisation of scarce resources to ensure the achievement of these objectives.

(v) **Federal finance.** The practice of fiscal federalism necessitates the assignment of expenditure and revenue responsibilities among the multi-levels or tiers of government and the attendant challenges and possible solutions of inter-governmental financial flows.

(vi) **Public debt management:** This involves the borrowing, repayment and management of government debt to finance budget deficits and fund public investments. Governments issue debt securities (e.g. treasury bills, bonds, notes) to raise funds from domestic and international capital markets.

b. **Rationale for public sector in the economy**
Government involvement in the economy can be explained by any or combinations of these factors.

(i) **Political and social ideologies:** The need for government can be explained by the existence of political and social ideologies which is different from the principle of consumer's behaviour guided by utility satisfaction. More importantly, market forces left alone cannot perform all economic functions. Therefore, there is need to guide, regulate and supplement market forces under certain circumstances.

(ii) **Allocation of resources:** The claim that market mechanism leads to efficient allocation of resources is based on the conditions of perfect competition which presupposes the existence of free entry and exit, perfect knowledge of the market, mobility of factors, lack of preferential treatment among other factors. Government regulations and other measures are required to ensure the presence of these conditions as market on its own will not guarantee their existence.

(iii) **Healthy competition:** It is the role of government to ensure that competition exists in the production of goods and services. It is therefore expected to improve quality and increase quantity of output. However, in the absence of regulation, competition may become inefficient or at best reduced to decreasing cost.

(iv) **Legal structure:** An important factor for effective and efficient market system is the legal structure that guarantees punishment for violators of rules and regulations. It is the responsibility of government to ensure strict adherence to rules and regulations otherwise abuse becomes an albatross to economic growth and development.

(v) **Externalities:** The case of externalities may be a potent factor to explain the rationale for government intervention. Even if the legal structure is provided and all barriers removed, certain goods and services cannot be provided through the market system due to the presence of externalities that cause distortion between private and public appraisal of projects. Externalities can only be tackled through public policy.

(vi) **Economic objectives:** The economic objectives of full employment, general price stability, optimum growth rate, equitable distribution of income as well as soundness of foreign account cannot be brought about automatically, even in the most highly developed financial economy. Therefore, government policies and other measures are required to achieve these objectives.

Examiner's report

The question is in two parts. Part (a) of the question requires candidates to identify and explain categories of public finance, while part (b) of the question asks the candidates to discuss rationale for public sector in the economy.

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

The commonest pitfall was the inability of few candidates to identify and explain categories of public finance.

Candidates are advised to make use of Pathfinders and the Study Text of the Institute for better performance in the Institute's future examination.

Marking guide

		Marks	Marks
a.	**Categories of public finance**		
	Identification of the five categories at ½ mark each	2½	
	Explanation of the five categories identified at 1mark each	5	7½
b.	**Rationale for public sector in the economy**		
	Identification of the five rationale at ½ mark each	2½	
	Explanation of the five rationale identified at 1 mark each	5	7½
	Total		**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

CORPORATE STRATEGIC MANAGEMENT & ETHICS

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wrist watches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

THURSDAY, MAY 16, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

CORPORATE STRATEGIC MANAGEMENT & ETHICS

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Bascon Foods Plc is a producer of fast-moving consumer goods in Nigeria. Since it commenced business in 1960, the company has been providing Nigerians with high quality food products, such as cereals, cocoa beverages, confectionaries, and soaps, all at competitive prices. The following product brands had consistently commanded 10% of the market share in their respective segments: Bascon Cornflakes, Bascovite chocolate beverage, Rave cream soap, and Bascon digestive biscuits; all of which have grown to become household names among Nigerian consumers.

In 2021, the company launched Rave Ice-cream. This was done as part of its growth strategy through diversification and in response to the growing demand for ice-cream. Unfortunately, one year after the launch of Rave Ice-cream, sales have been very low with Bascon Foods Plc., thereby, struggling to break-even on this product line. The ice-cream market is said to be growing at the rate of 5%, but the market share of Rave ice-cream has been less than 0.5%.

In addition, Bascon Cornflakes, the company's flagship product experienced a sharp decline in total annual sales by 5% per annum between 2019 and 2021. Investigations show that this is partially attributable to the intense competition in the market, which resulted from the entry of a major global brand; Nekloggs to the Nigerian market. The market share of Bascon Cornflakes currently stands at 2% in a market that is growing at 16%. On the other hand, annual sales growth of Bascovite chocolate beverage has consistently risen by 6% per annum between 2016 and 2021. The market for chocolate beverages is believed to be growing at the rate of 8% per annum. Also, the market shares of Rave cream soap and Bascon digestive biscuits have been fairly stable in the last 7 years at 5%. Market growth rate for cream soap and digestive biscuit market is 7%. Profits made from Bascovite Chocolate beverage, Bascon digestive biscuits, and Rave cream soap have been high and stable. Despite the challenges faced by the company in each business unit, all product brands enjoy dominant positions in their respective markets, except Rave Ice-cream, whose market share is currently negligible. Also, all of the company's products are in fast growing markets.

As a strategy to reduce costs and thus, increase profits across all its product lines, the Board of Directors of Bascon Foods Plc is also planning to outsource a number of its non-core activities. It is hoped that within a short period of time, after the proposed outsourcing strategy has been implemented, Bascon will become a low-cost producer of household food items.

Required:
You have been engaged as a consultant to Bascon Foods Plc. To this end, advise the company's management on:

a. The position of each of Bascon Food Plc's products in the product lifecycle. (10 Marks)
b. The suitable strategy to adopt for each of Bascon Foods Plc's product brands, using the life-cycle portfolio matrix. (5 Marks)
c. Classification of all of Bascon Food Plc's products, using the Boston Consulting Group (BCG) model. (10 Marks)
d. Strategy for each of Bascon Food Plc's products, using the BCG framework. (5 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

An oil exploration company is planning to overhaul its risk management infrastructure. Prior to this time, there has been an upsurge in the number of oil spillages and fire outbreaks at its production facilities. Preliminary investigation narrowed the cause of these incidents to inadequate and ineffective risk identification system. You have been appointed to head the newly constituted risk committee, saddled with the responsibility of strengthening the company's risk identification system.

Required:
Prepare a report detailing the following:

a. Meaning, purpose, and importance of risk identification. (7 Marks)
b. The risk management process. (8 Marks)
c. Responsibilities of a risk committee. (5 Marks)

(Total 20 Marks)

QUESTION 3

ZAAN Pharmaceuticals, is a public limited liability company currently confronted by a severe crisis between the shareholders and the Board of Directors over how the company is being managed.

Required:
As an expert in corporate governance,

a. Explain how the separation of ownership from the control of a company can create problems. (2 Marks)

b. Discuss **TWO** circumstances in which problems may arise with corporate governance. (2 Marks)

c. What constitutes weak or poor corporate governance? (2 Marks)

d. Discuss the key issues covered by codes of corporate governance. (14 Marks)

(Total 20 Marks)

QUESTION 4

You work at a company that produces table water and you know that a colleague in connivance with one of the company's drivers, steals packs of water from the store and sells to customers. You are not sure if you should turn a blind eye to the ongoing theft or report to your boss?

Required:

a. Identify the technical term for your current situation in the scenario and briefly explain the term. (3 Marks)

b. Explain the consequential and non-consequential theories of ethics and specify how these can be applied in decision making within the context of the brief scenario presented above. (6 Marks)

c. What is the technical term for the decision to inform your boss about the theft and what considerations should you take before making this decision, going by the theory underpinning the technical term? (11 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

The Governing Council of Zeebeedee University reviewed the school's curriculum with a view to making acquisition of 'Soft Skills' a pre-requisite for graduation. This was as a result of the feedback from various employers of their alumni across the globe, pertaining to their graduates' weakness in this area.

Required:

a. Identify **EIGHT** importance of soft skills in the current global job market. (12 Marks)

b. Highlight **SIX** of the top 'soft skills' that relate to any employment. (3 Marks)

(Total 15 Marks)

QUESTION 6

The cultural web within an organisation shapes its corporate ethics, Edgar Schein believed that organisations take time to develop a culture as employees go through various changes and adapt to the external environment and solve organisational problems.

Required:

a. Present Edgar Scheins' view about corporate culture. (6 Marks)

b. Identify and explain succinctly Edgar Scheins' **THREE** levels of culture. (9 Marks)

(Total 15 Marks)

QUESTION 7

At an in-house seminar for the top management staff of your organisation, you have been appointed to present a report on the significant risks that have negatively affected the profitability of the two lines of business as presented in the Annual Report and Accounts of an insurance company with branches both within and outside Nigeria.

Required:

Present a report to the Management as a consultant, detailing the 'risks inherent in an insurance company'. **(15 Marks)**

SECTION A

SOLUTION 1

a. Bascon Food Plc, as indicated in the scenario has a total of five (5) products. The positions of these products in the Product Life Cycle (PLC) are as follows:

PRODUCT S/No.	PRODUCT BRAND NAME	POSITION IN PLC
1	Bascon Cornflakes	***GROWTH, or *MATURITY, or *DECLINE**
2	Bascovite Chocolate Beverage	**GROWTH**
3	Rave Cream Soap	**MATURITY**
4	Bascon Digestive Biscuits	**MATURITY**
5	Rave Ice Cream	**INTRODUCTION**

***NOTE:**

- In the case of Product Brand Bascon Cornflakes, given the nature of the data and information presented in the question's scenario, a candidate may choose amongst GROWTH, MATURITY or DECLINE positions in the life cycle.
- Any of the positions is correct, as long as the candidate is able to properly justify the choice accordingly.

PRODUCT POSITION AND JUSTIFICATION OF BASCON FOODS PRODUCT BRANDS IN THE PRODUCT LIFE CYCLE (PLC)

1. **Rave ice cream** is at the introduction stage of the PLC
   Introduction Stage – This is characterised by:
   - low sales;
   - high running costs; and
   - the products are not yet profitable.

2. **Bascon cornflakes** could be at the growth stage of the PLC because it has the following characteristics:
   - relatively fast sales growth;
   - company begins to make profit; and
   - due to increased prospect of making profits, new entrants are attracted into the market.

   OR

   Maturity stage with the following characteristics
   - Stable annual sales;
   - Opportunity for sales growth no longer exists; and
   - Stable profits.

   OR

   Decline Stage – because it has the following characteristics:

- Sales begin to decline;
- Profit also declines; and
- Companies gradually leave the market.

3. **Bascon Chocolate Beverage:** This product is at the growth stage because it has the following characteristics:
   - relatively faster sales growth;
   - company begins to make profit; and
   - and due to increased prospect of making profits, new entrants are attracted into the market.

4. **Rave Cream Soap:** This product is at the maturity stage because it has the following characteristics:
   - Stable annual sales;
   - Opportunity for sales growth no longer exists; and
   - Stable profits.

5. **Bascon Digestive:** This product is also at the maturity stage because it possesses the following characteristics:
   - Stable annual sales;
   - Opportunity for sales growth no longer exists; and
   - Stable profits.

b. The table below provides insight into the appropriate strategies for each product in the Product Life Cycle portfolio matrix.

PRODUCT BRAND NAME	POSITION IN PLC	STRATEGIES
Bascon Cornflakes	*Growth	• Cost leadership • Differentiation • Product quality improvement • Product refinement • Defend position • Renew
	*Maturity	• Cost leadership • Differentiation • Defend position • Fast growth • Product modification
	*Decline	• Defend position • Focus niche • Renew • Product innovation • Harvest • Divest

Bascovite Chocolate Beverage	Growth	• Cost leadership • Differentiation • Product quality improvement • Product refinement • Defend position
Rave Cream Soap	Maturity	• Cost leadership • Differentiation • Defend position • Fast growth • Product modification
Bascon Digestive Biscuits	Maturity	• Cost leadership • Differentiation • Defend position • Fast growth • Product modification
Rave Ice Cream	Introduction	• Niche • Catch-Up • Grow with the Industry • Market penetration Advertising and Sales Promotion

c. The BCG model classifies products in the following way: Question Marks, Stars, Cash Cows, and Dogs. The table below indicates the various categories into which Bascon Product brands can be classified:

d.

PRODUCT BRAND	**BCG CLASSIFICATION**	**CHARACTERISTICS**
Bascon Cornflakes	**Star (1 mark)OR**	(High market growth, High market share)
	Question Mark	(High market growth, Low market share)
Bascovite Chocolate Beverage	**Star**	(High market growth, High market share)
Rave Cream Soap	**Cash Cow**	(Low market growth, High market share)
Bascon Digestive Biscuits	**Cash Cow**	(Low market growth, High market share)
Rave Ice Cream	**Dog**	(Low market growth, low Market share)

Please note that this may be presented in tabular or prose/narrative format. Justification for each appropriate BCG matrix positioning of the products

Star: This is a product that has a relative high market share in a high growth market with the following features:

➢ Bascon chocolate is a star because it has:

- a high market share increasing by 6% p.a. in a market growing at 8%

OR

➢ Bascon Cornflake also shares characteristics that qualify the product to be classified as a star

Cash cow: This is a product with a high relative market share in a market where market growth is low. It has the following features:

➢ The rave cream soap and Bascon digestive biscuit are cash cows with stable market share and market growth rate of 7%.

Question mark [problem child: This is a product with a relatively low market share in a high growth market. It has the following features:

➢ Bascon cornflakes is a question mark product because it has a low market share of 2% in a market that has 16% growth rate.

Dog: This is a product with a low relative market share in a low-growth market. It has the following features:

➢ From the scenario, Rave Ice-cream is a dog product, that is, the market growth rate is low and the market share of Rave Ice-cream is very low at 5% and 0.5%, respectively.

d. Strategies suggested by BCG analysis, based on product features are as follows:

PRODUCT BRAND	BCG CLASSIFICATION	STRATEGY
Bascon Cornflakes	Star	• Aggressive marketing to maintain and increase market share • Invest in R&D • Innovation • Capacity expansion
	Question Mark	• Invest in product refinement • product modification • divest from product brand
Bascovite Chocolate Beverage	Star	• Aggressive marketing to maintain and increase market share • Invest in R&D • Innovation • Capacity expansion
Rave Cream Soap	Cash Cow	• Defend and maintain market share • Reduce Spending on R&D • Maximise profits and use surplus to fund other product lines

			• spin-off new businesses
Bascon Biscuits	Digestive	Cash Cow	• Defend and maintain market share • Reduce spending on R&D • Maximise profits and use surplus to fund other product lines • spin-off new businesses
Rave Ice Cream		Dog	• Divest • Reposition brand by investment in production and marketing initiatives to expand marketshare

Examiner's report

This compulsory strategic management question tests candidates' ability to apply product life cycle and relevant strategies to a given scenario, and product classification using the Boston Consulting Group (BCG) model and determining appropriate strategies for the products.

Virtually all the candidates attempted this compulsory question.

Performance was about average, as about 50% of the candidates scored more than half of the marks allotted to the question.

Commonest pitfall: This is very practical question. It did not require candidates to reproduce the diagram of the product life cycle or the BCG model quadrant, but placement of the products on the product life cycle and the BCG model quadrant.

Candidates who performed poorly in this question did not demonstrate detailed knowledge of the characteristics of the products and the markets at each stage. This knowledge is required to place the products in their appropriate stages.

Recommendations: Candidates are once more admonished to develop the skills required for application of knowledge to simple scenarios, as this is distinction between the Foundation and skills levels of the examination.

Marking guide

Section		Number of Points	Marks Per point	Total
a.	Identification of market position for each product in the Product Life Cycle	5	1	5
	Justification for the position	5	1	5

b.	Mentioning of appropriate strategy for each position mentioned	5	1	5
c.	Identification of classification of each product in the BCG model	5	1	5
	Justification for each classification	5	1	5
d.	Mentioning of appropriate strategy for each classification mentioned	5	1	5
	Total			**30**

SOLUTION 2

a. Risk identification is the process of recognising, assessing and managing risks to the achievement of organisational goals. It is the process where organisations recognise the nature and extent of risks to its corporate goals.

- The purpose of risk identification is to recognise and catalogue a list of potential risks that could negatively impact the organisation's ability to achieve its objectives.
- Importance of risk identification are:
    - It provides the foundation for all the other steps in the risk management process;
    - It provides information that is used in risk assessment to determine the likelihood and impact of risks;
    - It helps to prioritise risks for further analysis and action; and
    - It provides information that can be used to develop risk response plans.

b. The risk management process consists of the following steps:

i. **Risk identification**: this involves recognising and drawing up a list of potential risks to the operations and achievement of the goals of the entity. Such list must be drawn while recognising the dynamic nature of risks.

ii. **Risk analysis (assessment)**: in this step, the following questions are answered:

- What is the likelihood of these risks occurring?
- What will be the consequences of these risks to the organisation?

In the process of conducting risk analysis, probability of occurrence of each risk is assessed with a view to prioritising them.

iii. **Risk evaluation**: At this stage, risks are prioritised in order of significance in terms of severity of damage and probability of occurrence.

iv. **Risk mitigation treatment**. At this stage, steps are taken to mitigate the occurrence. Activities here include, risk avoidance, risk reduction, risk sharing or transfer and risk acceptance.

v. **Risk implementation**: At this stage, all the necessary activities are taken to put the risk treatment plans into action. Such activities for this purpose, include allocating resources, assigning responsibilities, and making sure appropriate risk control mechanisms are in place.

vi. **Risk monitoring and review**: This involves regular risk reviews, tracking risk indicators and updating risk management plans.

vii. **Risk documentation, reporting and communication**: This involves comprehensive plans to document risk management outcomes and to communicate the results to all stakeholders of the firm.

c. **Responsibilities of the Risk Committee are:**

i. Where the Risk Committee is a committee of the board, its responsibilities will include the fulfilment of corporate governance obligations of the board to review the effectiveness of the system of risk management.

ii. Where the Risk Committee is an inter-departmental committee, its responsibilities will include identification and monitoring of specific risks associated with each department and those involving multiple departments.

iii. Risk identification.

iv. Risk monitoring.

v. Reporting of effectiveness of risk management to the board or senior management.

vi. Oversight of the risk management infrastructure.

vii. Addressing risk management and strategy review and development process of the firm.

viii. Collaborating with the Audit Committee for effective and efficient risk management and internal controls.

ix. Review of the effectiveness of risk management and controls, at least annually.

x. A risk management committee should be a source of information and advice or recommendations for the board.

Examiner's report

This question tests risk identification, risk management process and responsibilities of a risk committee.

About 80% of the candidates attempted this question.

Performance was above average as more than half of the candidates that attempted this question scored more than half of the marks allotted to the question.

Common pitfalls: Candidates who performed poorly in this question, lacked understanding of the risk management process and the responsibilities of a risk management committee.

Recommendation: This is a simple risk management question which should not give a serious candidate any challenge. Candidates are therefore admonished to cover the syllabus fully, when preparing for future examinations.

Marking guide

		Number of Points	Marks per Point	Total
a.	Definition of risk identification	1	2	2
	Purpose of risk identification	1	2	2
	Importance of risk identification	3	1	3
b.	Steps involved in risk management process	4	2	8
c.	Responsibilities of risk committee	5	1	5
	Total			**20**

SOLUTION 3

a. **Problems arising from the separation of ownership from control of an organisation**

The separation of ownership from control creates problems for good corporate governance, because:

i. The directors of a company might manage and run the company in a way that is not in the best interests of the shareholders, leading to conflict of interests;

ii. Shareholders might not be able to prevent the directors from not running the company in the best interest of shareholders, because the directors have most of the powers to control what the company does;

iii. A breach in corporate governance codes and thresholds e.g. transparency, accountability, integrity, openness and withholding of requisite disclosures;

iv. Prevalence of unethical managerial practices, like embezzlement, fraud, violation of the organisation's codes, values, mission and philosophy, and other corporate misconducts;

v. Managers may resist changes and alterations to their management approach, which threaten their positions in the organisation;

vi. Managers may focus on short-term goals and objectives, rather than long-term goals and objectives, in a bid to promote their own management interests;

vii. Managers may increase the principal-agent costs, as a result of costs incurred in the process of mitigating principal-agency problems; and

viii. Managers may withhold strategic information, which makes it difficult for shareholders to make informed decisions in their own interest and interest of other stakeholders of the company, thus leading to information asymmetry problems.

b. **Problems with corporate governance generally arise:**

i. When a company has many different shareholders, and there is no majority shareholder. In these companies, the board of directors has extensive powers for controlling the company, but the shareholders are relatively weak;

ii. Directors ought to be accountable to shareholders for the way they are running the company. However, in practice the shareholders might have little or no influence and do not have the ability to prevent directors from running the company in the way that the directors themselves consider to be best;

iii. When in large companies, shareholders continually buy and sell their shares, so that many shareholders are not long-term investors in the company;

iv. When there are germane issues with board composition, like lack of diversity, which can limit perspectives of the board of certain issues;

v. Insufficient number of independent directors who are needed to provide oversight functions and challenge decision of managers with little or no bias;

vi. Insider dominance, which leads to conflict of interests and reduced objectivity of the dominant few;

vii. Corporate misconducts, perpetrated by managers with unethical practices and behaviour that affect the organisation's reputation; and

viii. Inadequate risk management, regulatory and management information systems for monitoring and ensuring compliance with extant laws, regulations, policies, procedures and ethics.

c. **Bad governance occurs:**

i. When an entity is governed in a way that is inconsistent with corporate governance principles, concepts and practices;

ii. Often, bad governance means that a company is governed in the interests of its directors personally, rather than in the best interests of its owners (or other important interest groups);

iii. Lack of fairness principle. Corporate governance will be poor or weak where all shareholders are not treated equitably;

iv. Lack of directors' independence. Directors must have independence in making their judgments and opinions;

v. Lack of transparency and openness;

vi. Lack of honesty and integrity; and

vii. Lack of accountability and responsibility.

d. **Key issues in Corporate Governance Code**
Below are the main areas covered by codes of corporate governance.

i. **The role and responsibilities of the board of directors**

- The board of directors should have a clear understanding of its responsibilities and it should fulfil these responsibilities and provide suitable leadership to the company.
- Governance is concerned with establishing what the responsibilities of the board should be, and ensuring that these are carried out properly.

ii. **The composition and balance of the board of directors**

The board should not be dominated by a powerful chief executive and/or chairman. It is therefore important that the board should have a suitable balance, and consist of individuals with a range of backgrounds and experience.

iii. **Financial reporting, narrative reporting and auditing**.

To make a board properly accountable, high standards of financial reporting and narrative reporting, and external auditing must be undertaken.

iv. **Directors' remuneration**

To encourage their commitment to achieving the objectives of their company, directors should be given suitable incentives. Linking remuneration to performance is considered essential for successful corporate governance.

v. **Risk management and internal control**

The directors should ensure that their company operates within acceptable levels of risk, and should ensure through a system of internal control that the resources of the company are properly used and its assets are protected.

vi. **Shareholders' rights**

Another aspect of corporate governance is encouraging the involvement of shareholders in the companies in which they invest, through more dialogue with the directors and through greater use of shareholder powers, such as voting powers at general meetings of the company.

vii. **Corporate social responsibility**

Corporate social responsibility is a business model by which companies make concerted efforts to operate in ways that enhance rather than degrade society and the environment.

viii. **Business ethics**

Business ethics refers to implementation of corporate business policies and practices with regards to controversial issues, such as corporate governance, insider trading, social responsibility, and fiduciary responsibilities.

Examiner's report

This question on corporate governance tests the following:

- How separation of ownership from the control of a company can create problems;
- Circumstances in which problems may arise in with corporate governance;
- Weak or poor corporate governance; and
- Key issues covered by corporate governance codes.

About 90% of candidates attempted this question.

Performance was below average, as less than 40% of the candidates who attempted this question scored up to 50% of the marks allotted.

Common pitfalls

A number of the candidates who provided poor responses to this question had inadequate to address the various parts of the question, especially the effects of separation of ownership from management of a company and contents of codes of corporate governance.

Recommendation: To perform well in the examination, candidates need to effectively cover the syllabus.

Marking guide

		Number of points	Marks per point	Total
a.	Problems arising from separation of ownership from control	2	1	2
b.	Problems with corporate governance	2	1	2
c.	When bad governance occurs	2	1	2
d.	Key issues in corporate governance	7	Mentioning 1 Explanation 1	14
	Total			**20**

SOLUTION 4

a. The Ethical term for the scenario described is Ethical /moral dilemma. Ethical (Moral) dilemma involves a conflict between two moral principles, whereby it can be argued that both perspectives are fair and reasonable.

Ethical or moral dilemmas typically arise in situation where a particular action is likely to benefit one stakeholder while harming another.

b. i. **Consequential theories of ethics** are also known as teleological theories or results-based theory. The theory in all its ramifications claim that, of all the decisions that a person might take at any given moment, the morally right decision is a decision with the best overall outcomes or consequences.

ii. According to this view, no action or decision taken would be inherently 'wrong', it all depends on the outcomes or consequences.

iii. Faced with the scenario, either you decide to tell or not to tell your boss about the theft because of the consequence of your choice, then you have applied the consequential theory of ethics.

iv. Whatever decision taken on the scenario above, based on the consequential theory would undermine (compromise) the principle of integrity either to your colleague or the company.

v. **Non-consequential or deontological theories of ethics** are theories based on the view that what is right or wrong does not depend at all on the consequences of the action or decision. This approach to ethics is a duty-based approach.

vi. The duty-based approach emphasises that we should always do the right thing. Do the right thing because it is right, regardless of the consequences.

From the scenario, if your decision is to tell your boss about the theft because you believed it is the right thing to do, irrespective of the consequences of doing so, you have adopted the non-consequential approach to ethics.

c. **Whistle blowing** is the technical term

The considerations that should be made before 'blowing the whistle' include:

i. Are all the facts correct? Could you have misinterpreted something or mistakenly drawn the wrong conclusion?

ii. Is there sufficient evidence to justify blowing the whistle?

iii. You should double-check that you have thought about the situation objectively and with neutral emotion (rather than, say, at a time of anger).

iv. Consider discussing events in confidence with an independent confidential third party e.g. a professional helpline or legal advisor.

v. Think about the impact that blowing the whistle may have on the whistleblower's career.

vi. Is the risk of being victimised and bullied outweighed by the benefits of proceeding with blowing the whistle?

vii. Double-check company policy and whistle blowing procedures in the staff handbook. The whistleblower must ensure they follow company procedures at all times.

viii. Establish whether there is scope to discuss events confidentially with the human resources department.

ix. Is there an internal audit department who could be made aware of relevant events and take ownership of reporting the issue?

x. Consider if there is a legal obligation to report – for example in many countries there is a legal obligation to report the discovery of money-laundering or terrorism activities

Examiner's report

This ethics question tests candidates' ability to

- Identify ethical (moral) threat/dilemma;
- Application of consequential and non-consequential theories of ethics; and
- Whistle-blowing considerations.

Attempt: More than half of the candidates attempted this question, but performance was poor.

Common pitfall was the candidates' lack of understanding of the considerations for whistle-blowing.

Recommendation: Skills level candidates are admonished to master application of knowledge to practical scenarios. This is akey requirement for this level of the examination.

Marking guide

		No. of points	Marks per point	Total
a.	Identification of term	1	1	1
	Explanation of term	1	2	2
b.	Consequential and non-consequential theories	6	1	6
c.	Identification of technical term	1	2	2
	Consideration that must be given before blowing whistle	6	$1^1/_2$	9
	Total			**20**

SOLUTION 5

a. Importance of soft skills in the current global job market
It helps in:

i) Solving organisational problems and demonstrate positive work ethics;
ii) Handling interpersonal relations;
iii) Taking appropriate decisions;
iv) Effective communication;
v) Encouraging good impression and impacting professional development;
vi) Building stronger customer relationship;
vii) Building more cohesive and creative teams;
viii) Building greater organisational productivity and effectiveness;
ix) Building more engaged and motivated employees;
x) Building deeper commitment to shared goals; and
xi) Facilitating the growth of the employees and employer.

b. Top soft skills that relate to any employment are:

i) Communication;
ii) Self–motivation;
iii) Leadership;
iv) Responsibility;
v) Teamwork;
vi) Problem-solving;
vii) Decisiveness;
viii) Ability to work under pressure;
ix) Time management;
x) Flexibility;
xi) Critical thinking;
xii) Leadership;
xiii) Digital literacy;
xiv) Negotiation;
xv) Conflict management and resolution;
xvi) Networking;
xvii) Self-management;
xviii) Self-awareness;
xix) Diversity awareness;

xx) Global mindset;
xxi) Active listening;
xxii) Collaboration;
xxiii) Ability to build positive relationships;
xxiv) Agility;
xxv) Resilience;
xxvi) Open-mindedness;
xxvii) Coping strategies;
xxviii) Empathy;
xxix) Work-Life balance; and
xxx) Emotional intelligence.

Examiner's report

This question tests importance of soft skills and identification of top soft skills in employment.

More than 90% of the candidates attempted this question, and the general performance was above average.

Pitfall: Those candidates who did not perform well in this question were unable to state the importance of soft skills.

Recommendation: Soft skills have assumed great importance in management and the future of work, hence candidates are advised to pay particular attention to them.

Marking guide

		No. of points	Marks per point	Total
a.	Importance of soft skills	8	$1\frac{1}{2}$	12
b.	Top soft skills that relates to any employment	6	½	3
	Total			**15**

SOLUTION 6

a. Edgar Schein' view about Corporate Culture
He suggested that employees working within a company have:

i) Shared values, beliefs and ways of thinking;

ii) Interact with the policies, organisation's structure and politics of the company's management system to create a corporate culture;

iii) That organisational/corporate culture is strong because it is regarded as something that helps the company to succeed;

iv) He sees the organisation's culture as a set of assumptions that a group of people working together have invented or discovered by learning how to deal with problems that the organisation faces, internally and externally;

v) Assumptions underlying organisational/corporate culture are valid, and should be taught to individuals who join the organisation;

vi) New employees should learn the culture of the organisation and become part of that culture;

vii) Organisational/corporate culture provides a mechanism for social control in an organisation;

viii) Organisational/corporate culture helps to strengthen organisational identity across the firm;

ix) Organisational/corporate culture helps members of a firm to make sense of their social, work and business environments, and thus equips them with stability and meaning; and

x) Organisational/corporate culture requires commitment of leadership and strategic steps to be altered due to its deep-rooted nature in the organisation's psyche.

b. **Edgar Schien's three levels of culture**

i. **Outer skin/Artefacts**

- Outer skin can also be referred as Artefacts.
- This is the first level where the culture of an organisation is visible and tangible.
- but which do not fully explain the cultural dynamics across the firm.
- They can be easily seen, heard, and perceived by individuals inside and outside an organisation.

Examples: Physical environment, language, communication, rituals, ceremonies, decoration, employees' dress code, logos, symbols, etc.

ii. **Inner layer/Espoused values:**

- Inner layer can also be referred to as espoused values of a firm's corporate culture.
- The inner layer is the explicitly stated values, norms, beliefs and attitudes that are preferred by the organisation, and which guide the members of the organisation on expected patterns of behaviour, and on what is important to the organisation.
- Company presents an outlook that it provides service to the community and the best quality of service to customers.

Examples: Mission statement, vision statement, values statement, patterns of strategy, dominant logic, philosophy of the firm, code of conduct, policies and procedures, etc.

iii **The Heart / Basic underlying assumptions:**

- The heart which also refers to the basic underlying assumptions of a firm's corporate culture is the deeply embedded, unconscious beliefs, perception, thoughts and feelings that are the ultimate source of values and actions within the organisation.
- The heart (basic underlying assumptions) provides the foundation for how members of a firm perceive, think, and feel about their works and organisation.
- The heart or shared assumptions is concerned with what really matter, that are taken for granted and rarely discussed. These affect the way that the organisation sees itself and the environment in which it operates.

Examples: Beliefs about human nature, work ethics, interpersonal relationships, approach to change etc.

Examiner's report

This question tests candidates' understanding of Edgar Schein's views on corporate culture and the three levels of the model.

About 60% of the candidates attempted the question, but performance was below average, as less than 40% of the candidates who attempted the question scored up to 50% of the marks allotted to it.

Many of the candidates who performed poorly displayed lack of understanding of Edgar Schein's views on corporate culture, while some others could not identify the three levels of the Schein model.

Recommendations: Candidates should endeavour to fully understand the components of the various models in the syllabus.

Marking guide

		No. of points	Marks per point	Total
a.	Edgar Schein's view of corporate culture	3	2	6
b.	Identification of three levels of culture	1	1	3
	Two Explanation/ examples for each level	2x3=6	1	6
	Total			**15**

SOLUTION 7

From: The Consultant
To: Management
Date:

Subject: Presentation on Risk Inherent in Insurance Companies

The above subject matter refers;

The risk inherent in insurance companies includes but is not limited to the following:

i) **Strategy risk**: This risk of choosing strategies that do not maximise shareholders value;

ii) **Product/Service risk**: The risk of developing products or services for customers that do not meet customers' requirements and are worse than the products or services offered by competitors;

iii) **Credit risk**: A risk of default on a debt that may arise from a borrower failing to make required payments. It includes default on payment of premium due;

iv) **Market risk**: The risk from variation in interest rates (or interest rate risk and currency exchange risk (currency risk) and the risk of changes in market prices of financial products like shares and stocks. This is important an insurance company as it would usually invest a significant part of the premium collected;

v) **Operational risks**: Risks of losses due to human error or fraud, failures in systems, like IT systems.

vi) **Security risks**: Is a risk that involves the potential for loss or damage to an organisation's assets, data or reputation due to malicious activities. For example, unforeseen external events like terrorism and natural disasters;

vii) **Human capital risk** or **People capability risk**: The risk of failing to attract the best people to work for the company;

viii) **Liquidity risk**: Risk of inadequate liquidity;

ix) **Legal/Regulatory risk**: Risk that a change in laws and regulations will significantly impact an Institution;

x) **Technology risk**: Risk that could result from technology related events which could have adverse effects on a firm. For example, cyber-attacks, data breaches, inadequate technology management practices, etc.;

xi) **Business probity risk**: This is the risk resulting from failure to act in an honest way. This can include unethical practices, lack of integrity, and other sharp practices. This is accentuated in an insurance company, as insurance is based on ultimate good faith;

xii) **Reputation risk**: This is risk resulting from events which damage the reputation of a firm and consequently lead to a loss of trust and confidence on the part of customers, clients and other stakeholders;

xiii) **Currency risk (Financial risk)**: This is a kind of risk that could occur as a result of a drop in the valuation of one currency via-a-vis its exchange rate with other major global currencies. It is sometimes associated with 'hedging risk'. This is important in this case as the company is said to engage in foreign operations, which will involve foreign exchange; and

xiv) **Derivative risk**: this refers to the financial, hedging and operational risks pertaining to the use of derivatives, which are financial contracts whose value is derived from the performance of assets like stocks, bonds, interest rates, currencies, commodities, futures, options, and swaps.

Examiner's report

This question tests candidates' understanding of risks inherent in an insurance company.

More than 80% of the candidates attempted this question, but performance was poor.

The common pitfall was the inability of most the candidates to relate the concept of inherent risk to an insurance company.

Recommendation: Skills level candidates should appreciate the need to develop the skill of applying concepts and theories to simple scenarios as stated in the syllabus.

Marking guide

	No. of Points	Marks per point	Total
Risks inherent in insurance companies Presentation format	3	½	1½
Risks inherent in insurance companies – mentioning	9	½	4½
Risks inherent in insurance companies – explanation	9	1	9
Total			**15**

ICAN/241/Q/B3 Examination No...................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

TAXATION

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.

2. Write your **EXAMINATION NUMBER** in the space provided above.

3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.

4. Do **NOT** write anything on your docket.

5. Read all instructions in each section of the question paper carefully before answering the questions.

6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.

7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

8. Tax and Capital Allowances rates are provided with this examination paper.

TUESDAY, MAY 14, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2024

TAXATION

Time Allowed: $3^1/_4$ hours (including 15 minutes reading time)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

1. Mr. Ola Alao works as the manager of XYZ Limited which has its office located at Ikeja, Lagos. He lived with his family in Ibafo, Ogun State, and he provided the following information in respect of his 2021 assessment year:

   (i) He was paid a gross monthly income of ₦ 204,000;

   (ii) In addition to his salary, he was paid the following bonuses;

Date of payment	Date of Entitlement	Amount
		₦
May 29, 2021	April 4, 2021	92,000
September 24, 2021	August 7, 2021	162,000
May 7, 2022	May 19, 2021	58,000

   (iii) He attended a workshop outside his station for a period of ten days and was paid a daily allowance of ₦45,000, to cover hotel expenses, transportation and other incidental expenses;

   (iv) As a senior sales staff of the establishment, he was given non – assignable luncheon vouchers to the tune of ₦120,000 in year 2021;

   (v) He was assigned an official vehicle for his exclusive use which was purchased at the cost of ₦8,000,000 by the company;

   (vi) He enjoyed the services of a night guard and a domestic staff fully paid for by the company. Domestic servant (staff of the company) was paid ₦360,000 per annum and the night guard received ₦480,000 per annum but was hired from a company offering security services;

   (vii) He was transferred to the Port-Harcourt office on November 1, 2021 and was paid the sum of ₦2,000,000 for the purpose of relocating to his new station;

(viii) He lived in a rented apartment fully paid for by company for ₦600,000 per annum;

(ix) He contributes to an approved pension scheme at the rate of 8% of his salary and has a life insurance policy with a capital sum assured of ₦5,000,000, paying a premium of ₦20,000 per month;

(x) He subscribed to National health insurance and National housing fund schemes making contributions of ₦35,000 and ₦40,000, respectively on a monthly basis.

Required:

a. For the relevant assessment year,
   i. Identify the relevant tax authority of Mr. Ola Alao (2 Marks)
   ii. Compute the chargeable income of Mr. Alao (19 Marks)
   iii. Compute income tax payable by Mr. Alao (5 Marks)

b. Differentiate between a contract of employment and contract for employment. (4 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Adidas Nigeria Limited has been in business for so many years. The company is into supply of furniture, fixtures and fittings.

Since the date of commencement of business to the accounting year ended October 31, 2018, it had posted reasonable profits. In year 2019, a competitor, ABC Limited, was able to introduce a new brand of furniture into the market, which boosted the sales of the company. Unfortunately, this had an adverse effect on the gross turnover of Adidas Nigeria Limited. Despite concerted efforts made by Adidas Nigeria Limited to compete favourably with ABC Limited, its fortunes continued to dwindle.

To allow for capital injection, the directors of Adidas Nigeria Limited, decided on February 1, 2020, to change its accounting date to be in line with one of its foreign partners. The board, therefore, decided that the accounting year-end be changed to December 31, every year.

You are provided with the following additional information:

		₦
(i)	**Adjusted profits**	
	Year ended October 31, 2019	24,500,000
	Period ended December 31, 2020 (14 months)	38,200,000
	Year ended December 31, 2021	44,100.000
(ii)	**Gross turnover**	
	Year ended October 31, 2019	49,100,200
	Period ended December 31, 2020	75,200,500
	Year ended December 31, 2021	101,300,000
(iii)	**Capital allowances**	
	Assessment year 2020	850,000
	Assessment year 2021	720,000
	Assessment year 2022	600,000

Required:

For the relevant assessment years:

a. Compute the assessable profits (14 Marks)

b. Compute the company's income tax liabilities (6 Marks)
(Ignore minimum tax computation) **(Total 20 Marks)**

QUESTION 3

a. Section 6 (6A) of Personal Income Tax Act Cap P8 LFN 2004 as amended by Finance Act 2020, states that the Minister by Order can determine what constitutes the significant economic presence of a non-resident, executor or trustee.

Required:

In relation to what constitutes a significant economic presence, discuss:

i. Digital transactions (4 Marks)

ii. Services (4 Marks)

b. Alhaji Yanko Abdulahi was a successful businessman in Kano before he died. He is survived by two children, namely: Yahaya and Binta.

A trust was created for the benefit of his two children. The records of the trustee for the year ended December 31, 2021, revealed the following information:

	₦
Rental income (gross)	2,400,000
Profit from trading activities	32,160,800
Interest received (gross)	840,000
Other income	630,500

Additional information provided

(i) Yahaya is entitled to a fixed annuity of ₦148,000 per annum.
(ii) Allowance for expenses of the trustee amounted to ₦62,000.
(iii) Capital allowance agreed with the Revenue amounted to ₦1,260,000.
(iv) Trustee remuneration per trust deed:
Fixed – ₦25,000 per annum
Variable – 2% of computed income.
(v) The trust has made provision for the payment of ₦150,000 as discretionary payments to each of the children.
(vi) 60% of the distributable income is to be shared between Yahaya and Binta in the ratio 55:45, respectively.

Required:

Compute the income of the trust assessable to tax in the hands of the trustee.

(12 Marks)

(Total 20 Marks)

QUESTION 4

Pkikan Nigeria Limited has been in business for several years preparing accounts to December 31 annually.

You are given the following information about the company's activities for the year ended December 31, 2021.

	₦'000
Turnover	1,300
Cost of sales	(400)
Gross profit	900
Less: Total expenses	(1,100)
Net loss for the year	(200)

Additional information provided:

(i) Total expenses included:

		₦
-	Cost of stamping documents	50,000
-	Depreciation charges	20,000
-	Withholding tax paid on rental income	30,000
-	General and administrative expenses	550,000
-	Refurbishing of equipment	60,000
-	Repainting of premises	80,000
-	Pre-incorporation expenses written off	10,000
-	Acquisition of plant	100,000
-	Transfer to capital redemption reserve fund For the future development of the business	200,000
		1,100,000

You were informed that:

(ii) After the review of the company's accounting records, ₦400,000 meant for the Managing Director of the company was erroneously included in the turnover for the year.

(iii) The issued share capital of the business was ₦1.8 million, out of which, the shareholders representing ₦300,000 are yet to pay the final call.

(iv) The net assets of the company was ₦850,000.

(v) There was a loss brought forward of ₦210,000 relating to the previous year of assessment and the agreed capital allowance with the Revenue was ₦385,000.

You are required to:

a. Compute the minimum tax liability for the relevant year of assessment. (14 Marks)

b. State the reasons behind the computation of minimum tax liability. (3 Marks)

c. State the companies exempted from the computation of minimum tax liability. (3 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Havillah Manufacturing Limited is a company that is engaged in the manufacture of different kinds of perfume, body lotions and other cosmetic products.

The statement of profit or loss of the company for the year ended September 30, 2021, is as follows:

	₦'000	**₦'000**
Turnover		206,250
Less cost of sales		(112,750)
Gross profit		93,500
Other income		34,375
		127,875
Less operating costs:		
Operating expenses	62,975	
Interest and similar charges	3,520	(66,495)
Profit before tax		61,380
Taxation		(6,875)
Profit after tax		54,505
Dividend		(42,350)
Retained profit for the year		12,155

You are provided with the following additional information:

(i) Turnover is made up of ₦64,350,000 export sales and ₦141,900,000 local sales.

(ii) Cost of sales comprises:

	₦'000
Opening inventory (VAT inclusive)	24,915
Closing inventory (VAT inclusive)	40,865
Purchase of raw materials	94,600
Freight charges	20,570
Other direct materials	13,530

(iii) The company purchased plant and machinery which cost ₦24,750,000. This amount was included in opening inventory, VAT inclusive.

(iv) Value added tax and withholding tax remitted during the year amounted to ₦2,173,180 and ₦1,787,500, respectively.

You are required to:

a. Compute the net VAT payable by Havillah Manufacturing Limited for the year. (10 Marks)

b. State **FIVE** VAT exempt goods. (2½ Marks)

c. State **FIVE** VAT exempt services (2½ Marks)

(Total 15 Marks)

QUESTION 6

Mr. Abiodun James returned to Nigeria after a long sojourn in America. In 2018, he incorporated James and Sons Nigeria Limited.

At the company's board meeting held in August 2021, the accountant of the company presented the tax query letter received from the Federal Inland Revenue Service (FIRS) for the consideration of the directors. Some of the directors thought that having engaged the services of external auditors, the FIRS should rely on the technical competence of the auditors in ascertaining the correctness of the audited financial statements submitted to them for their review.

The Managing Director explained to the other directors that the administration of taxation on the profits of incorporated companies is vested in the FIRS whose management board is known as Federal Inland Revenue Service Board (FIRSB).

The Federal Inland Revenue Services (Establishment) Act, 2007 (as amended) is relevant.

Required:

a. State **FIVE** members of the Federal Inland Revenue Service Board. (5 Marks)

b. State and briefly explain **FIVE** duties and functions of the Federal Inland Revenue Service. (5 Marks)

c. State the basis for tax dispute that may arise with the Revenue. (5 Marks)

(Total 15 Marks)

QUESTION 7

Kanbus Nigeria Plc is a company incorporated to manufacture and distribute food products that are widely accepted in many homes in Nigeria. It has operated for over 15 years since taking over the business of JHN Nigeria Limited. The main business of JHN Nigeria Limited was distribution of food items and other agricultural produce in the South-West geographical zone of Nigeria.

The Chief Executive Officer (CEO) of Kanbus Nigeria Plc, Mr. Babadada, was a former staff of Collinson India Limited for several years and thus brought into Kanbus Nigeria Plc a wealth of experience. Earlier in his working career, Mr. Babadada, had worked with Kong Manufacturing Limited, a Chinese company, where he imbibed the culture of collaboration with staff in the decision making process. Mr. Babadada, is assisted by a formidable team of managers recruited from major food and beverage companies in the country.

The management of Kanbus Nigeria Plc. engaged different consultants to handle professional issues, including consultancy matters in respect of law, medical, finance, tax, accounting, etc. which were outsourced to different, well-known and competent hands.

Your firm, Kassman and Co. (Chartered Accountants), were engaged to handle both corporate and personal income tax matters.

Required:
As the consultant, you have been requested by the Managing Partner, Kassman and Associate, to explain to the Chief Executive Officer of Kanbus Nigeria Plc., the following:

a. Professional issues that can be handled by your firm (5 Marks)
b. **FIVE** main sources of Nigerian tax laws (5 Marks)
c. **FIVE** allowable expenses in the ascertainment of assessable profits of companies (5 Marks)

(Total 15 Marks)

NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

	Initial %	Annual %
Building Expenditure	15	10
Industrial Building Expenditure	15	10
Mining Expenditure	95	Nil
Plant Expenditure (excluding Furniture & Fittings)	50	25
Manufacturing Industrial Plant Expenditure	50	25
Construction Plant expenditure (excluding Furniture and Fittings)	50	Nil
Public Transportation Motor Vehicle	95	Nil
Ranching and Plantation Expenditure	30	50
Plantation Equipment Expenditure	95	Nil
Research and Development Expenditure	95	Nil
Housing Estate Expenditure	50	25
Motor Vehicle Expenditure	50	25
Agricultural Plant Expenditure	95	Nil
Furniture and Fittings Expenditure	25	20

2. INVESTMENT ALLOWANCE Up to August 31, 2023 (10%); and Finance Act 2023 (NIL)

3. RATES OF PERSONAL INCOME TAX

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

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

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

4. COMPANIES INCOME TAX RATE: Finance Act 2019 specifies:

   30% (Large Company)

   20% (Medium-Sized Company)

   0% (Small Company)

5. TERTIARY EDUCATION TAX: 2% of assessable profit (up to December 31, 2021) 2.5% of assessable profit (with effect from January 1, 2022) and 3% of assessable profit, with effect from September 1, 2023 (Finance Act 2023)

6. CAPITAL GAINS TAX 10%

7. VALUE ADDED TAX 7.5%

8. HYDROCARBON TAX 15% (Petroleum prospecting Licence and Marginal Fields Companies)

   30% (Petroleum Mining Lease Companies)

SECTION A

SOLUTION 1

a. (i) The relevant tax authority of Mr. Ola Alao is Ogun State Internal Revenue Service.

(ii) **MR. OLA ALAO**

INCOME TAX COMPUTATION
FOR ASSESSMENT YEAR 2021

	₦	₦
Gross salary		2,448,000
Bonuses - May 29, 2021	92,000	
- September 24, 2021	162,000	254,000
Add benefits in kind:		
Cost of using car (₦8,000,000 x 5%)	400,000	
Night guard	480,000	
Rent paid for Alao	600,000	**1,480,000**
Total earned income		4,182,000
Tax exempt items:		
Pension contribution (₦8% of 2,448,000)	195,840	
Life assurance premium	240,000	
National insurance health contribution	420.000	
National housing fund contribution	480,000	(1,335,840)
Gross income		2,846,160
Consolidated relief allowance (₦200,000 + 20% of ₦2,846,160)		(769,232)
Chargeable income		**2,076,928**

(iii) **Tax payable**

	₦ : K
First ₦300,000 at 7%	21,000.00
Next ₦300,000 at 11%	33,000.00
Next ₦500,000 at 15%	75,000.00
Next ₦500,000 at 19%	95,000.00
Next ₦476,928 at 21%	100,154.88
2,076,928	
Tax payable	324,154.88

b. The Personal Income Tax Act CAP P8 LFN 2004 (as amended) defines employment to include any appointment or office whether public or otherwise for which remuneration is payable, and “employee” and employer” shall be construed accordingly.

However, the Labour Act 1994, defines a contract of employment as any agreement whether written or verbal, expressed or implied, whereby one person agrees to serve the employer as a worker”.

A contract for employment is an agreement whereby a person is engaged as an independent contractor, such as a self-employed person or vendor engaged for a fee to carry out an assignment or a project for the company. In a contract for employment, there is no employer-employee relationship in the contract and the self-employed person is not covered by the Labour Act.

An individual under a contract of employment is commonly referred to as an employee, while an individual under a contract for employment is referred to as an independent contractor or self-employed person. The following distinctions can be drawn between a contract of employment and a contract for employment:

(i) An individual under a contract of employment earns remuneration (that is, salary) while an individual under a contract for employment earns profit;

(ii) An individual under a contract of employment is assessed to tax on actual year basis, while an individual under a contract for employment is assessed to tax on preceding year basis;

(iii) A self-employed person is required to register for value added tax, while an employee is not required to do so; and

(iv) An employee has the right not to be unlawfully dismissed and to receive redundancy payment and other employment rights, while a self-employed person does not have such rights.

Examiner’s report

The question tests the candidates’ knowledge of the identification of the relevant tax authority, computation of personal income tax, and differentiation between contract of employment and contract for employment.

This being a compulsory question, about 100% of the candidates attempted the question and their performance was above average.

The common pitfalls of the candidates were their inability to:

i) State the correct relevant tax authority of the taxpayer based on his residence as some even referred to FIRS as the relevant tax authority of the individual;

ii) Annualise the tax exempt items;

iii) Take into consideration the date of payment in the determination of each of the bonuses to be treated as part of income; and

iv) Differentiate between "contract of employment" and "contract for employment".

Candidates are advised to read widely and be conversant with the provisions of the Personal Income Tax Act Cap. P8 LFN 2004 (as amended) and other tax laws before sitting for subsequent examinations to enhance better performance.

Marking guide

		Marks	Marks
a.	**Identification of the relevant tax authority**		
(i)	Ogun State Internal Revenue Service		2
(ii)	**Computation of the chargeable income of Mr. Alao**		
	Name	1	
	Income tax computation	½	
	For assessment year 2019	½	
	Total earned Income:		
	Gross salary	1	
	Bonuses - May 29, 2021	1	
	- September 24, 2021	1	
	Add: benefits-in-kind:		
	Cost of using car	1	
	Night guard	1	
	Rent for Alao	1	
	Tax exempt items:		
	Approved pension scheme contribution	2	
	Life assurance premium	2	
	National and insurance health contribution	2	
	National housing fund contribution	2	
	Consolidated relief allowance:		
	₦200,000	1	
	₦2,146,160	1	
	Chargeable income	1	19
(iii)	**Computation of income tax payable by Mr. Alao**		
	First ₦300,000 @ 7% - ₦21,000	1	
	Next ₦300,000 @ 11% - ₦33,000	1	
	Next ₦500,000 @ 15% - ₦75,000	1	
	Next ₦500,000 @ 19% - ₦95,000	1	
	Next ₦676,928 @ 21% - ₦142,154.88	1	5

b. **Differentiation between a contract of employment and contract for employment**

(i)	Definition of employment	1	
(ii)	Definition for employment	1	
(iii)	1 mark each for any distinction subject to a maximum of 2 points	2	4
Total			**30**

SOLUTION 2

a. **Adidas Nigeria Limited**
Computation of assessable profits
For assessment years 2020, 2021 and 2022

	Old basis		New basis	
Assessment year	**Basis period**	**Assessable profit**	**Basis period**	**Assessable profit**
		₦		**₦**
2020	1/11/2018 – 31/10/2019	24,500,000	1/1/2019 – 31/12/2019	25,873,810
2021	1/11/2019 –31/10/2020 (wi)	32,742,857	1/1//2020 – 31/12/2020	32,742,857
2022	1/11/2020 – 31/10/2021 (wii)	42,207,143	1/1/2021 – 31/12/2021	44,100,000
		99,450,000		102,716,667

Based on the foregoing, the Revenue would assess on the new basis, since this would produce higher assessable profits for 2020 – 2022 assessment years. Consequently, final assessable profits will be as follows:

Assessment year	**Basis period**	**Assessable Profits**
		₦
2020	1/1/19 – 31/12/19	25,873,810
2021	1/1/20 – 31/12/20	32,742,857
2022	1/1/21 – 31/12/21	44,100,000
		102,716,667

Workings:

Old basis			**Assessable profits**	
i) **2021 assessment year**			**₦**	**₦**
- 1/11/2019 – 31/10/2020	=	$^{12}/_{14}$ x ₦38,200,000		32,742,857
ii) **2022 assessment year**				
- 1/11/2020 – 31/12/2021	=	$^{2}/_{14}$ x ₦38,200,000	5,457,143	
- 1/11/2021 – 31/10/2021	=	$^{10}/_{12}$ x ₦44,100,00	36,750,000	42,207,143
				74,950,000

New basis

iii) **2020 assessment year**

1/1/2019 – 31/10/2019	=	$^{10}/_{12}$ x ₦24,500,000	20,416,667	
1/11/2019 – 31/12/2019	=	$^{2}/_{14}$ x ₦38,200,000	5,457,143	25,873,810

iv) **2021 assessment year**

1/1/2020 – 31/12/2020	=	$^{12}/_{14}$ x ₦38,200,000		32,742,857
				58,616,667

b. **Adidas Nigeria Limited**
Computation of tax liabilities
For assessment years 2020, 2021 and 2022

Assessment year 2020	**₦**
Assessable profit	25,873,810
Capital allowances	(850,000)
Total profit	25,023,810

Companies income tax payable (20% of total profit) ₦5,004,762.00

Tertiary education tax payable (2% of assessable profit) ₦517,476.20

Assessment year 2021	**₦**
Assessable profit	32,742,857
Capital allowances	(720,000)
Total profit	32,022,857

Companies income tax payable (20% of total profit) ₦ 6,404,571.40

Tertiary education tax payable (2% of assessable profit) ₦654,857.14

Assessment year 2022	**₦**
Assessable profit	44,100,000
Capital allowances	(600,000)
Total profit	43,500,000

Companies income tax payable (30% of total profit) ₦13,050,000.00

Tertiary education tax payable (2.5% of assessable profit)
₦1,102,500.00

Note

The Finance Act, 2021, became effective on January 1, 2022, but based on the circular issued by the Federal Inland Revenue Service, all audited financial statements with accounting years ended from July 1, 2021 to December 31, 2021, should reflect the provisions of the Act, hence the application of tertiary education tax rate of 2½% for A.Y. 2022.

Examiner's report

The question tests the candidates' knowledge of the computation of assessable profits and income tax liabilities of companies based on change in accounting date.

About 70% of the candidates attempted the question but the performance was average.

The common pitfalls of the candidates were their inability to ascertain the relevant assessment years based on the rules of change in accounting date. In addition to the foregoing, some of the candidates could not compute the assessable profits and apply the correct rates of tax, taking into consideration the turnover, in the determination of companies income tax liabilities for all the relevant assessment years.

Candidates are advised to read relevant texts on taxation, ICAN Pathfinders and Study Text.

Marking guide

		Marks	Marks
a.	**Computation of assessable profits**		
	Heading - Name of enterprise	1	
	- Computation of assessable profit	½	
	- Assessment years	½	
	Assessment years (correct identification of the assessment years)		
	(½ mark for each assessment year)	1½	
	Basis periods		
	(¼ mark for each correct basis period)	1½	
	Assessable profits:		
	Old basis – (1 mark for each correct profit)	3	
	New basis – (1 mark for each correct profit)	3	
	Final assessable profits:		
	(1 mark for each correct profit)	3	14
b.	**Computation of tax liabilities**		
	Assessment year 2020		
	Assessable profit	½	
	Capital allowances	½	
	CIT payable	½	
	TET payable	½	
	Assessment year 2021		
	Assessable profit	½	
	Capital allowances	½	
	CIT payable	½	
	TET payable	½	

Assessment year 2022		
Assessable profit	½	
Capital allowances	½	
CIT payable	½	
TET payable	½	6
Total		20

SOLUTION 3

a. (i) **Digital transactions**

Section 6 (6A) of PITA as amended by Finance Act, 2020, states that the Minister by Order can determine what constitutes the significant economic presence of a non-resident individual, executor or trustee.

For the purpose of section 13(2)(c) of CITA, a company, other than a Nigerian company, shall have a significant economic presence in Nigeria in any accounting year, where it derives gross turnover, or income of more than ₦25 million or its equivalent in other currencies, in that year, from any or combination of the following:

- Streaming or downloading services of digital contents, including but not limited to movies, videos, music, applications, games and e-books to any person in Nigeria;
- Transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface, including website or mobile applications;
- Provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria;
- Provision of goods or services directly or through a digital platform;
- Uses Nigeria domain name (ng) or registers a website address in Nigeria; or
- Has a purposeful and sustained interaction with persons in Nigeria by customising its digital page or platform to target persons in Nigeria, including reflecting the prices of its products or services in Nigerian currency or providing options for billing or payment in Nigerian currency.

The activities carried out by connected persons shall be aggregated in determining the ₦25 million threshold, where necessary.

Any company, other than a Nigerian company, covered under a multilateral agreement to address the tax challenges arising from the digitalisation of the economy, to which Nigeria is a party, shall be treated in accordance with that agreement or arrangement.

(ii) **Services**

A company other than a Nigerian company (foreign entity), carrying on a trade or business comprising the furnishing of services of technical, professional, management or consultancy nature, shall have a significant economic presence in Nigeria in any accounting year, where it earns any income or receives any payment from:

- A person resident in Nigeria; or
- A fixed based or agent of a company, other than a Nigeria company (foreign entity).

Services of a technical nature means any services of a specialised nature (including advertising services, training or the provision of personnel) that are not professional, management or consultancy services.

It should be noted, however, that a company shall not have a significant economic presence in Nigeria in relation to a payment, where the payment is made:

- To an employee of the person making the payment under a contract of employment; or
- For teaching in an educational institution or for teaching by an educational institution; or
- By a foreign fixed base of a Nigerian company.

In addition to the above, where an individual, executor, or trustee outside Nigeria carries on a trade or business that includes the furnishing of technical, management, consultancy or professional services to a person resident in Nigeria, the gains or profits of the trade or business shall be deemed to be derived from and taxable in Nigeria to the extent that the individual, executor or trustee has significant economic presence in Nigeria.

b. **The trust of Alhaji Yanko Abdulahi**
Computation of income assessable to tax in the hands of the trustee
For assessment year 2022

	₦	₦
Rental income (gross)		2,400,000
Profit from trading activities	32,160,800	
Capital allowances	(1,260,000)	30,900,800
Interest received (gross)		840,000
Other income		630,500
Total income		34,771,300
Deduct: Allowable expenses:		
Yahaya's fixed annuity	148,000	
Allowable expenses	62,000	
Trustee's remuneration:		
Fixed	25,000	
Variable ($^{2}/_{102}$ of ₦34,771,300 – ₦148,000 – ₦62,000 – ₦25,000)	677,182	912,182
Computed income		33,859,118
Less: discretionary payments		300,000
Distributable income		33,559,118
Deduct: 60% of the distributable income between Yahaya and Binta in the ratio of 3:2, respectively		20,135,471
Amount assessable to tax in the hands of the trustee		13,423,647

Examiner's report

The question tests candidates' knowledge of what constitutes a significant economic presence in respect of digital transactions and services, and the computation of the income of a trust that is assessable to tax in the hands of a trustee.

About 50% of the candidates attempted the question but the performance was poor.

The commonest pitfall of the candidates was their inability to explain what constitutes a significant economic presence in relation to digital transactions and services.

Candidates are advised to read Finance Acts, make use of the Institute's Pathfinders, and Study Text in their preparations for subsequent examinations.

Marking guide

		Marks	Marks
a.	**What constitutes a significant economic presence**		
	(i) Digital transactions		
	(1 mark for each correct answer)	4	
	(ii) Services		
	(1 mark for each correct answer)	4	8
b.	**Computation of the income of the trust assessable to tax in the hands of the trustee**		
	Heading - Name	½	
	- Computation of income assessable to tax	½	
	Profit from trading activities	1	
	Capital allowances	1	
	Interest received gross	1	
	Other Income	1	
	Allowable expenses:		
	(1 mark for each correct answer)	4	
	Discretionary payments	1	
	Share of the beneficiaries	1	
	Amount assessable to tax in the hands of the trustee	1	12
	Total		**20**

SOLUTION 4

a. **Pkikan Nigeria Limited**

Computation of minimum tax liability
For assessment year 2022

	₦
Gross turnover	1,300,000
Managing Director	(400,000)
Net turnover	900,000

Minimum tax liability is 0.5% of turnover.
Therefore, the minimum tax liability is 0.5% of ₦900,000 = ₦4,500

b. The main reason that has informed the computation of minimum tax liability of a company in any relevant assessment year is to ensure that no company escapes the payment of tax except those specifically exempted.

The computation of minimum tax liability could arise when a company:

i) Makes loss or no total profit;
ii) Has a total profit which results in no tax payable;
iii) Has a tax payable that is less than the minimum tax payable; and
iv) Makes a turnover of ₦25 million and above.

c. **The companies exempted from the computation of minimum tax liability are:**

- A company in agricultural trade or business;
- Any company that has not been in business up to four (4) calendar years; and
- A company that earns a gross turnover of less than ₦25 million in the relevant year of assessment.

Examiner's report

The question tests the candidates' knowledge of the computation of minimum tax liability, reasons that informed the computation, and companies that are exempted from this computation.

About 50% of the candidates attempted the question and performance was fair.

Most of the candidates computed minimum tax liability using the old method and displayed poor knowledge of the reasons behind the computation of minimum tax liability.

Candidates are advised to read Finance Acts, ICAN Study Text and Pathfinders as this topic is adequately covered in them.

Marking guide

		Marks	Marks
a.	**Computation of minimum tax liability**		
	Heading - Income	1	
	- Computation of minimum tax liability	1	
	- For assessment year 2022	1	
	Gross turnover	2	
	Managing Director	2	
	Net turnover	2	
	Computation of minimum tax liability		
	0.5%	1	
	₦900,000	2	
	₦4,500	2	14
b.	**Reasons behind the computation of minimum tax liability**		
	1 mark for the main reason	1	
	1 mark each for any correct reason subject to a maximum of 2 reasons	2	3
c.	**Companies exempted from the computation of minimum tax liability**		
	1 mark each for any correct answer		3
	Total		**20**

SOLUTION 5

a. **Havillah Manufacturing Limited**
Computation of net VAT payable to FIRS
For the year ended September 30, 2021

	₦	₦
Output VAT		
Local sales (₦141,900,000 @ 7.5%)		10,642,500
Input VAT		
Opening inventory		
(₦24,915,000 - ₦24,750,000) x 100/107.5	153,488	
Purchase of raw materials	94,600,000	
Freight charges	20,570,000	
Other direct materials	13,530,000	
	128,853,488	
Closing inventory (₦40,865,000 x 100/107.5)	(38,013,953)	
Cost of goods	90,839,535	
Input VAT (₦90,839,535 @ 7.5%)		(6,812,965)
VAT payable		3,829,535
VAT remitted		(2,173,180)
Net VAT payable		1,656,355

NOTE – The export sales were excluded from the computation because export sales are VAT exempt items.

b. **VAT exempt goods include:**

i. All medical and pharmaceutical products;
ii. Basic food items;
iii. Books and educational materials;
iv. Baby products;
v. Plant, machinery and goods imported for use in the Export Processing Zone or Free Trade Zone; provided that 100% production of such company is for export, otherwise tax shall accrue proportionately or the profits of the company;
vi. Plant, machinery and equipment purchased for utilisation of gas in downstream petroleum operations;
vii. Tractors, ploughs and agricultural equipment and implements purchased for agricultural purposes;
viii. Oil export wrongly written as all exports;
ix. Fertilizers locally produced, agricultural and veterinary medicine, farming machinery and farming transportation equipment;
x. Vegetable oil;
xi. Motorcycle (CKD)/Bicycle (SKDs) and their spare parts;
xii. Life insurance;

xiii. Locally manufactured sanitary towels, pads or tampoons;
xiv. Commercial aircrafts, commercial aircraft engines and commercial aircraft spare parts;
xv. Residential rent; and
xvi. Petroleum products, including aviation and motor spirit, kerosene, natural gas, other liquid petroleum gases and gaseous hydrocarbons.

c. **VAT exempt services include:**

i. Medical services;
ii. Services rendered by micro-finance banks and mortgage institutions;
iii. Tuition relating to nursery, primary, secondary and tertiary education;
iv. Airline transportation tickets issued and sold by commercial airlines registered in Nigeria;
v. Hire, rental or lease of tractors, ploughs and other agricultural equipment for agricultural purpose;
vi. Plays and performances conducted by educational institutions as part of learning;
vii. All exported services;
viii. Shared passenger transport service which is made available for public use but this does not include hired or rented vehicles;
ix. Training and education organised by not-for-profit or public educational institutions;
x. Interest on loans, advances, overdrafts. and savings;
xi. Interest on bank deposits; and
xii. Renewable energy.

Examiner's report

The question tests the candidates' knowledge of the computation of net VAT payable to FIRS, goods and services that are VAT exempt.

About 50% of the candidates attempted the question and performance was fair.

Many candidates could not ascertain the VAT included in opening and closing inventories and considered the input VAT on capital expenditure as part of allowable input VAT instead of adjusting for it, hence their inability to compute correctly the net VAT payable by the company.

Candidates are advised to be conversant with the provisions of Value Added Tax Act Cap. V1 LFN 2004 (as amended), and other relevant Finance Acts.

Marking guide

		Marks	Marks
a.	**Computation of net VAT payable by Havillah manufacturing Limited**		
	Heading - Name	½	
	- Computation of net VAT payable to FIRS	½	
	- For the year ended September 30, 2021	½	
	Local rates	1	
	Opening inventory	1	
	Workings of opening inventory:		
	₦24,915,000	½	
	₦24,750,000	½	
	100/107.5	½	
	Purchase of raw materials	½	
	Freight charges	½	
	Other direct materials	½	
	Closing inventory	1	
	Input VAT	1	
	VAT remitted	1	
	Net VAT payable	½	10
b.	**Identification of VAT exempt goods** (½ mark each for any correct answer subject to a maximum of 5 (five) points)		2½
c.	**Identification of VAT exempt goods** (½ mark each for any correct answer subject to a maximum of 5 (five) points)		2½
	Total		**15**

SOLUTION 6

a. **The Federal Inland Revenue Service Board comprises:**

(i) Executive Chairman, who shall be a person experienced in taxation, to be appointed by the President and subject to the confirmation of the Senate;

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

(iii) A representative of the Attorney General of the Federation;

(iv) The Governor of the Central Bank of Nigeria or his representative;

(v) The representative of the Minister of Finance not below the rank of a Director;

(vi) The Chairman of the Revenue Mobilisation Allocation and Fiscal Commission or his representative who shall be any of the Commissioners representing the 36 states of the Federation;

(vii) The Group Managing Director of the NNPC or his representative who shall not be below the rank of a Group Executive Director of the corporation or its equivalent;

(viii) The Comptroller-General of the Nigeria Customs Service or his representative, not below the rank of Deputy Comptroller-General;

(ix) Registrar-General of the Corporate Affairs Commission or his representative not below the rank of a Director; and

(x) The Chief Executive Officer of the National Planning Commission or his representative not below the rank of a Director.

b. **The Federal Inland Revenue Service shall:**

(i) Assess persons, including companies, enterprises chargeable with tax;

(ii) Assess, collect, account and enforce payment of taxes as may be due to the government or any of its agencies;

(iii) Collect, recover and pay to the designated account any tax under any provision of this act or any other enactment or law;

(iv) In collaboration with the relevant ministries and agencies, review the tax regimes and promote the application of tax revenue to stimulate economic activities and development;

(v) In collaboration with the relevant law enforcement agencies, carry out the examination and investigation with a view to enforcing compliance with the provisions of the Act;

(vi) Make from time to time, a determination of the extent of financial loss and such other losses by government arising from tax fraud, evasion and such other losses (or revenue forgone) arising from tax waivers and other related matters;

(vii) Adopt measures to identify, trace, freeze, confiscate or seize proceeds derived from tax fraud or evasion;

(viii) Adopt measures which include compliance and regulatory actions, introduction and maintenance of investigation and control techniques on the detection and prevention of non-compliance;

(ix) Collaborate and facilitate rapid exchange of information with relevant national or international agencies or bodies on tax matters;

(x) Undertake exchange of personnel or other expert with complementary agencies for purposes of comparative experience and capacity building;

(xi) Establish and maintain a system for monitoring international dynamics of taxation in order to identify suspicious transactions and the perpetrators and other persons involved;

(xii) Provide and maintain access up-to-date and adequate data and information on all taxable persons, individuals, corporate bodies or all agencies of government involved in the collection of revenue for the purposes of efficient, effective and correct tax administration and to prevent tax evasion or fraud;

(xiii) Maintain database, statistics, records and reports on persons, organisations, proceeds, properties, documents or other items or assets relating to tax administration including matters relating to waivers, fraud or evasion;

(xiv) Undertake and support research on similar measures with a view to stimulating economic development and determine the manifestation, extent, magnitude and effects of tax fraud, evasion and other matters that affect effective tax administration and make recommendations to the Government on appropriate intervention and prevention measures;

(xv) Collate and continually review all policies of the Federal Government relating to taxation and revenue generation and undertake a systematic and progressive implementation of such policies;

(xvi) Liaise with the office of the Attorney-General of the Federation, all government security and law enforcement agencies and such other financial supervisory institutions in the enforcement and eradication of tax related offences;

(xvii) Issue taxpayer identification number to every taxable person in Nigeria in collaboration with State Boards of Internal Revenue and Local Government Councils;

(xviii) Carry out and sustain rigorous public awareness and enlightenment campaign on the benefits of tax compliance within and outside Nigeria;

(xix) Carry out oversight functions over all taxes and levies accruable to the Government of the Federation and as may be required, query, subpoena, sanction and reward any activities pertaining to the assessment, collection of and accounting for revenues accruable to the Federation;

(xx) Provide assistance in the collection of revenue claims or any other administrative assistance in tax matters with respect to any agreement or arrangement made between the Government of the Federal Republic of Nigeria and the Government of any country or other persons or bodies as may be deemed necessary in that regard; and

(xxi) Carry out such other activities as are necessary or expedient for the full discharge of all or any of the functions under this Act.

c. **The following could result in tax disputes with the Revenue**:

(i) Taxpayer's inability to submit acceptance certificate relating to property, plant and equipment;
(ii) Inadequate documentation of allowable expenses for tax purposes;
(iii) Understatement or splitting of income;
(iv) Non/late filing of tax returns;
(v) Inability of the taxpayers to submit documents relating to Output and Input VAT;
(vi) Non remittance of withholding tax deducted at source;

(vii) Delay in the payment of refunds relating to excess withholding tax deducted at source;
(viii) Non-recognition of allowable expenses by the tax officials; and
(ix) Inability of the relevant tax authority to grant tax exempt items, etc.

Examiner's report

The question tests the candidates' knowledge of the composition, duties and functions of the Federal Inland Revenue Service, and the explanation of the basis for tax dispute that may arise with the Revenue.

About 80% of the candidates attempted the question but performance was average.

The commonest pitfall was the candidates' inability to explain the composition, functions and duties of the Federal Inland Revenue Service (FIRS).

Candidates are advised to be conversant with the provisions of the Federal Inland Revenue Service (Establishment) Act, 2007 (as amended).

Marking guide

		Marks
a.	**Composition of the Federal Inland Revenue Service Board** (1 mark each for any correct member subject to a maximum of 5 (five) members)	5
b.	**Duties and functions of the Federal Inland Revenue Service** (1 mark each for any correct answer subject to a maximum of 5 (five) points)	5
c.	**Basis of tax dispute with the Revenue** (1 mark each for any correct answer subject to a maximum of 5 points)	5
	Total	**15**

SOLUTION 7

a. Professional issues that can be handled by a firm of Chartered Accountants include:

(i) Filing of tax returns;
(ii) Tax planning and management;
(iii) Ensuring compliance with the tax laws;
(iv) Tax dispute resolution;
(v) Registration of a company with both FIRS and SIRS;
(vi) Computation of taxes according to the relevant tax laws;
(vii) Computation of personal income tax liability for a taxpayer;
(viii) Tax advisory services;
(ix) Obtaining tax clearance certificates for employees and companies;
(x) Attending to tax queries, audit and investigation;
(xi) Obtaining acceptance certificates in respect of capital expenditure;

(xii) Internal audit risk and compliance services;
(xiii) Forensic audit;
(xiv) Accounting advisory services;
(xv) Financial risk management;
(xvi) IT assurance;
(xvii) Cyber investigation;
(xviii) Assets verification services;
(xix) Training and capacity building;
(xx) Management consultancy;
(xxi) Receivership and bankruptcy;
(xxii) Registration of businesses and incorporation of companies;
(xxiii) Provision of company secretarial services;
(xxiv) Statutory audits and assurance;
(xxv) Consultancy services relating to offer for sale;
(xxvi) Mergers and acquisitions;
(xxvii) Corporate financing;
(xxviii) IT consulting services;
(xxix) Business advisory; and
(xxx) Audit advisory services.

b. **Sources of Nigerian tax laws**

The tax system in Nigeria is administered through statutes rather than common law. The sources of Nigerian tax laws are:

(i) **Customary laws**

These are the native laws and customs, governing the taxation of incomes, goods and properties of persons or communities within an ethnic group. Included under this heading, is the Islamic law, which is the basis of moslem laws that are usually applicable in the Northern part of Nigeria.

Examples of taxes collected under the customary laws are:

- Ishakole: Payable in Yoruba land, to titular heads of communities or obas on the produce from farmland;
- Osusu-nkwu: Applicable in the Eastern part of Nigeria;
- Zakkat tax payable by adherents of the Islamic faith, on their wealth, which has been in their possession for a full year. Such wealth includes money, properties, etc.

The Islamic law provides the basis for determining the amount of tax payable and to whom payable.

(ii) **Statute laws**

These are tax legislations passed by Acts of the National and State assemblies and bye-laws by local government authorities in a democratic government or decrees or edicts under a military government. These legislations confer necessary powers on the taxing authorities to impose taxes on the citizens that is, individuals, companies, trusts, settlements, etc.

Examples of such tax legislations are:
Personal Income Tax Act P8 LFN 2004 (as amended);
Companies Income Tax Act Cap C21 LFN 2004 (as amended);
Value Added Tax Act Cap VI LFN 2004 (as amended);
Petroleum Industry Act, 2021; and Various Finance Acts.

(iii) **Case laws**

This is the doctrine of stare decisis, that is, judicial precedents. Under this doctrine, judgements pronounced by superior courts of records, namely: High Courts, Appeal Courts, and the Supreme Court, on principles of tax laws and their interpretations of the provisions of tax statutes, are binding on the lower courts.

In view of the fact that Nigerian tax laws had their origin from the English tax laws, it would not be out of place to state that the principles of English common law pronounced upon by the judges in England and interpreted by them, also form another source of Nigerian tax laws.

This position is buttressed by the decision in the case of Aderawos Timbers Trading Co. Limited v Federal Inland Revenue Service Board (1966) LL.R 195, (1969) ALL NLR 247.

In this case, it was held that the decisions of English courts can be invoked for the purpose of interpreting Nigerian tax statutes where the expression and terms used are similar and substantially the same as those used in English Statutes.

(iv) Circulars issued by and practices of the Inland Revenue.
(v) Opinions of tax experts and authors insofar as the courts take judicial notice of them.
(vi) Budget and pronouncement of relevant ministries.
(vii) The Constitution of the Federal Republic.

c. **Allowable expenses**

The allowable expenses in the ascertainment of assessable profits of companies include:

i. A sum payable by way of interest on money borrowed and employed as capital in acquiring the income;

ii. Interest on loan for developing an owner occupier residential house;

iii. Rents payable in respect of land and buildings occupied for the purpose of acquiring the income;

iv. Expenses for repairs of premises, plant, machinery or fixtures employed in acquiring the income, or for the renewal, repair, or alteration of any implement, utensil or article so employed:

Provided that, if the premises, plant, machinery, fixtures, implement, utensils or articles are used in part for domestic or private purposes, so much of the expenses as relates to such use shall not be so deducted;

v. Bad debts incurred in any trade, business, profession or vocation, proved to have become bad during the period for which the income is being ascertained and doubtful debts to the extent that they have become bad during the said period and notwithstanding that such bad or doubtful debt were due and payable prior to the commencement of such period:

Provided that:
All sums recovered during the said period on account of amounts previously written off or allowed in respect of bad or doubtful debts shall for the purpose of this Act be deemed to be income of the trade, business, profession or vocation of that period;

vi. A contributory pension or an abatement deducted from the salary or pension of a public officer under the Pension Act or any approved scheme within the meaning of the Act, and any contribution, other than penalty, made under the provisions of any Act establishing a National Provident Fund or other retirement benefit schemes for employees throughout Nigeria;

vii. Contributions to approved pension, provident or other retirement benefits, funds under the Pension Reform Act 2004. (now Pension Reform Act 2014);

viii. In the case of income from trade, business, profession or vocation, any expenses or part thereon, incurred for that period wholly and exclusively for the purpose of trade, business, profession or vocation;

ix. Any expense which is proved to the satisfaction of the relevant tax authority, to have been incurred by the individual on research, for the period, including the amount of levy paid by him to the National Science and Technology Fund;

x. Where the income is chargeable, only by reason of it being brought into or received in Nigeria, nothing in this section shall confer a right to any deduction from the amount of that income so brought into or received in Nigeria.

xi. Legal expenses relating to:
- General legal advisory services;
- Retainer's fees;
- Renewal of short-term lease; and
- Any legal cost incurred in protecting or defending the business.

xii. Specific allowance for bad and doubtful debts; and

xiii. Donations to accredited bodies, taking the relevant restrictions into consideration.

Examiner's report

The question tests the candidates' knowledge of tax and other professional issues that are handled by firms of chartered accountants, main sources of Nigerian tax laws, and allowable expenses in the ascertainment of assessable profits of companies.

About 90% of the candidates attempted the question but the performance was average.

Many of the candidates could not state professional issues that are handled by a firm of chartered accountants whilst some could not explain the sources of Nigerian tax laws.

Candidates are advised to adequately cover the syllabus and read the Institute's Pathfinders and Study Texts when preparing for future examinations.

Marking guide

		Marks
a.	**Stating professional issues that can be handled by a firm of Chartered Accountants** (1 mark each for any correct point subject to a maximum of 5 (five) points)	5
b.	**Stating main sources of Nigerian tax laws** (1 mark each for any correct point subject to a maximum of 5 (five) points)	5
c.	**Stating allowable expenses in the ascertainment of assessable profits of companies** (1 mark each for any correct allowable expense subject to a maximum of 5 (five) expenses)	5
	Total	**15**