THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2023 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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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

FINANCIAL REPORTING

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, NOVEMBER 14, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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

Akamata Nigeria Limited is a manufacturing company. Its finished products are stored in a nearby warehouse until ordered by the customers. Akamata Nigeria Limited has performed very well in the past, but has been in financial difficulties in recent months due to removal of petroleum subsidies and floating of exchange rate by the Federal Government of Nigeria. The company has been re-organising the business to improve its performance.

The trial balance of Akamata Nigeria Limited at March 31, 2023 was as follows:

	₦'000	**₦'000**
Revenue		624,500
Cost of goods manufactured (excluding depreciation)	470,000	
Distribution costs	45,300	
Administrative expenses	80,100	
Restructuring costs	605	
Interest received		6,000
Loan notes interest paid	3,195	
Land and building (including land ₦100,000,000)	251,500	
Plant and equipment	18,600	
Accum. depreciation at March 31, 2022:		
Buildings		30,300
Plant and equipment		8,350
Investment properties (at market value)	120,000	
Inventories at March 31, 2022	24,260	
Trade receivables	46,650	
Cash and bank	5,950	
Ordinary share capital of ₦1 each (fully paid)		100,000
Share premium		2,150
Revaluation surplus		15,625
Retained earnings at March 31, 2022		140,385
Ordinary dividend paid	5,000	
7% loan notes (2027)		91,250
Trade payables		40,600
Proceeds of shares issued		12,000
	1,071,160	1,071,160

Additional information:

i. The property, plant and equipment are being depreciated as follow:
Building 5% per annum on straight line basis.
Plant and equipment 25% per annum on reducing balance basis.
Depreciation of buildings is considered as administrative cost while depreciation on plant and equipment should be treated as cost of sales.

ii. On March 31, 2023 the land was revalued to ₦120, 000,000.

iii. Income tax for the year to March 31, 2023 is estimated at ₦4, 880,000 (ignore deferred tax).

iv. The closing inventories at March 31, 2023 were ₦25,900,000. An inspection of the finished good showed that a production machine had been set up incorrectly and that several production batches, which had cost ₦250,000 to manufacture had wrong packaging. The goods cannot be sold in this condition but could be repacked at an additional cost of ₦100,000. They could then be sold for ₦275, 000. The wrongly packed goods were included in the closing inventories at their cost of ₦250,000.

v. The 7% loan notes are 10-year loan due for repayment by March 31, 2027. Interest on these loan notes need to be accrued for the six (6) months to March 31, 2023.

vi. The restructuring cost in the trial balance represents the cost of a major restructuring of the company to improve competitiveness and future profitability.

vii. No fair-value adjustments were necessary to the investment properties during the period.

viii. During the year, the company issued 10 million new ordinary shares for cash at ₦1.20 per share. The proceeds have been recorded as 'proceeds of share issue'.

You are required:

a. To prepare the statement of profit or loss and other comprehensive income and statement of changes in equity for the year ended March 31, 2023. (15 Marks)

b. To prepare statement of financial position as at March 31, 2023. (10 Marks)

c. You are the chief accountant of Akamata Nigeria Limited. A new managing director (MD) with strong domineering character has recently been appointed by your company.

The managing director has decided that Akamata Nigeria Limited should be listed on Nigerian Exchange Limited (NGX) in the next few months. The MD has demanded that you should revise the last financial statement prepared by you and also prepare a six-month forecast financial statement that will be very attractive and acceptable to the exchange, and where necessary you should play down on relevant accounting standards and Nigerian Exchange rules and regulations.

Required:
Identify the motivations of the managing director and actions that you should consider under this ethical pressure. (5 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

QUESTION 2

Chisom Plc experienced rapid growth in recent years through the acquisition and integration of other companies. Chisom Plc is interested in acquiring Oyowood Limited, a retailing company, which is one of several companies owned and managed by the same family.

The summarised financial statements of Oyowood Limited for the year ended December 31, 2022 are as follow:

	₦'000	₦'000
Revenue		70,000
Cost of sales		(45,000)
Gross profit		25,000
Operating cost	7,000	
Directors' salaries	1,000	(8,000)
Profit before tax		17,000
Income tax expense		(3,000)
Profit for the year		14,000

Statement of financial position	**₦'000**	**₦'000**
Non-current assets:		
Property, plant and equipment:		32,400
Current assets		
Inventories	7,500	
Bank	100	
		7,600
		40,000
Equity and liabilities:		
Equity		
Ordinary shares of ₦1.00 each		1,000
Retained earnings		18,700

		19,700
Non-current liabilities:		
Directors' loan account (interest free)		10,000
Current liabilities:		
Trade payables	7,500	
Current tax payables	2,800	
		10,300
Total equity and liabilities		40,000

From the above financial statements, Chisom Plc has calculated for Oyowood Limited the ratios below for the year ended December 31, 2022. It has also obtained the equivalent ratios for the retail sector average, which can be taken to represent Oyowood's sector.

	Oyowood	**Sector average**
Return on equity (ROE)		
(including directors' loan accounts)	47.1%	22.0%
Net asset turnover	2.36 times	1.67 times
Gross profit margin	35.7%	30.0%
Net profit margin	20.0%	12.0%

From enquiries, Chisom Plc has obtained the following information:

i. Oyowood Limited buys all of its inventories from other family companies at a price which is 10% less than the market price for such goods.
ii. After the acquisition, Chisom Plc would replace the existing board of directors and need to pay remunerations of ₦2.5 million per annum.
iii. The directors' loan accounts would be repaid by obtaining a loan of the same amount with interest at 10% per annum.
iv. Chisom Plc expects the purchase price of Oyowood Limited to be ₦30 million and net assets are equal to equity plus the loan.

Required:

a. As the financial analyst of Chisom Plc, recalculate the ratios for Oyowood Limited after making appropriate adjustments to the financial statements for notes (i) to (iv) above. (10 Marks)

b. Draft a memo for the consideration of the managing director of Chisom Plc commenting on the performance of Oyowood Limited. (10 Marks)

(Total 20 Marks)

QUESTION 3

a. If a property is transferred into or out of the category of property, plant and equipment (PPE), it might be reclassified as investment property or as no longer an investment property.
A transfer of investment property can only be made where there is a change of use of such property.

Required:
Identify **FOUR** circumstances that may lead to recognition or de-recognition of an investment property under IAS 40 and state the appropriate accounting treatments under each circumstance. (8 Marks)

b. Young Shall Grow Limited with year end of December 31 purchased an office building, with a useful life of 50 years for ₦55million on January 1, 2013. The amount attributable to land was negligible. The company used the building as its head office until December 31, 2017 when the entity moved its head office to a larger premises.

The building was reclassified as an investment property and leased out under a five year lease. However, owing to a change in circumstances, Young Shall Grow Limited took possession of the building five years later on December 31, 2022 to use it as its head office once more. At that date the remaining useful life of the buildings was confirmed as 40 years.

The fair value of the head office was as follows:
At December 31, 2017 ₦60million
At December 31, 2022 ₦75mllion

Required:

Discuss how the changes of use should be reflected in the financial statements of Young Shall Grow Limited.

i If the company uses the cost model for its investment properties.
ii If the company uses the fair value model for its investment properties.

(12 Marks)
(Total 20 Marks)

QUESTION 4

IAS 33 requires publicly-traded companies to calculate a diluted Earning Per Share (EPS) in addition to their basic EPS for the current year (with a comparative diluted EPS for the previous year), allowing for the effect of all dilutive potential ordinary shares.

Required:

a. Explain the purpose of the dilutive measures and discuss **THREE** types of dilution. (8 Marks)

b. The statement of financial position (extracts) for Ebonyi Limited for the year ended December 31, 2022 is as follows:

Equity and liabilities	
	₦'000
Ordinary shares (₦1 each)	12,000
Retained earnings	36,000
Equity	48,000
Non-current liabilities:	
5% convertible loan notes	4,000

Additional information:

i. As at December 31, 2022, there has been no new issue of shares or loan notes for several years.
ii. The loan notes are convertible into ordinary shares in year 2023 or year 2024 at the following rates.
iii. At 30 shares for every ₦100 of loan notes if converted at December 31, 2023.
iv. At 25 shares for every ₦100 of loan notes if converted at December 31, 2024.
v. Company income tax rate is 30% on profit.

Required:

Calculate the basic EPS and diluted EPS for year 2022. (8 Marks)

c. IAS 33 allows an entity to disclose an alternative measure of EPS in addition to the EPS calculated.

Required:

Identify and explain **TWO** conditions that are required in accordance with IAS 33 to be complied with where an alternative measure of EPS is shown in the financial statements of an entity. (4 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

QUESTION 5

a. Explain the following terms in accordance with IAS 12 – Income tax.
   i. Deferred tax
   ii. Permanent differences
   iii. Temporary differences

(3 Marks)

b. Shakara Limited was incorporated on January 1, 2022. During the year ended December 31, 2022, the company made a profit before taxation of ₦18,150,000.

The following capital expenditure were made during the year.

	₦'000
Plant and machinery	7,200
Motor vehicles	1,800

The depreciation charged for the year amounted to ₦1,650,000 and capital allowance granted by Federal Inland Revenue Services (FIRS) for the same period amounted to ₦2,250,000.

Company income tax rate is 30% and deferred tax liability brought forward was ₦1,200,000.

Required:

i Calculate the company income tax liability for the year ended December 31, 2022. (3 Marks)

ii Calculate the deferred tax balance that should be disclosed in the statement of financial position of Shakara Limited as at December 31, 2022. (3 Marks)

iii Prepare notes showing the movement of deferred tax charged to profit or loss for the year ended December 31, 2022. (3 Marks)

iv Prepare income tax expense notes that will accompany the statement of profit or loss of Shakara Limited for the year ended December 31, 2022. (3 Marks)

(Total 15 Marks)

QUESTION 6

a. The management of an entity experiencing decline in profits or poor cash flows may use various forms of creative accounting techniques to manipulate the views shown by the financial statements while complying with all applicable accounting standards and regulations.

Required:
Identify and discuss **FOUR** techniques of creative accounting. (8 Marks)

b. Businesses are increasingly accepting that they are not only accountable to investors and lenders, but also accountable to a much wider group of people or stakeholders to which non-financial information are useful in understanding and taking informed decision on financial statements of the entities.

Required:
State **THREE** of such useful non-financial information. (3 Marks)

c. Discuss **TWO** areas of financial reporting that could be enhanced by the use of technology. (4 Marks)

(Total 15 Marks)

QUESTION 7

a. Within the context of financial reporting and regulatory frameworks,
   i. Discuss the main sources of regulations. (3 Marks)
   ii. Discuss **TWO** reasons why financial reporting practice should be regulated. (2 Marks)

b. IAS 1- Presentation of Financial Statements provides a list of line items that as a minimum, must be shown on the face of statement of financial position.

Required:
   i. Give **FIVE** examples of minimum line items, to be shown on the face of statement of financial position. (5 Marks)
   ii. State **FIVE** items that should be accounted for in the statement of changes in equity. (5 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. **Akamata Nigeria Limited**

Statement of profit or loss and other comprehensive income for the year ended March 31, 2023

	Note	₦'000
Revenue		624,500
Cost of sales	1(b)	(470,998)
Gross profit		153,502
Administrative expenses	2	(87,675)
Distribution cost		(45,300)
Restructuring cost		(605)
Operating profit		19,922
Interest received		6,000
Interest expense	3	(6,388)
Profit before taxation		19,534
Income tax expense		(4,880)
Profit for the year		14,654
Other Comprehensive Income:		
Gain on revaluation of land (120,000 – 100,000)		20,000
Total comprehensive income		34,654

Akamata Nigeria Limited

Statement of changes in equity for the year ended March 31, 2023

	Ordinary share ₦'000	Share premium ₦'000	Revaluation surplus ₦'000	Retained earnings ₦'000	TOTAL ₦'000
Balance b/f	100,000	2,150	15,625	140,385	258,160
Profit for the year	-	-	-	14,654	14,654
Issue of shares	10,000	2,000	-	-	12,000
Gain on revaluation	-	-	20,000	-	20,000
Dividend paid				(5,000)	(5,000)
Balance to SOFP	110,000	4,150	35,625	150,039	299,814

Notes to the accounts

Wk1: (a) Valuation of closing inventories	**₦'000**	**₦'000**	**₦'000**
Balance b/f			25,900
Less: Written down:			
Cost		250	
Net realisable value:			
Expected selling price	275		
Further cost to enable sales	(100)	175	
Amount written down			75
Balance c/f (SOFP)			25,825

Wk1 (b): Cost of sales	**₦'000**
Opening inventories	24,260
Cost of goods manufactured	470,000
Closing inventories (WKI)	(25,825)
Depreciation on P/Equip (25% x 10,250,000)	2,563
SOPL	470,998

Wk 2: Administrative expenses	₦'000
Balance b/f	80,100
Depreciation on building	7,575
SOPL	87,675

Wk 3: Interest expense	₦'000
Balance b/f	3,195
Accrued interest (91,250,000 x 7% x 6/12)	
	3,194
SOPL	6,389

b. **Akamata Nigeria Limited**

Statement of financial position as at March 31, 2023

	Note	₦'000
Non-current assets:		
Property, plant and equipment (PPE)	4	241,313
Investment properties (at market value)		120,000
Total non-current assets		361,313
Current assets:		
Inventory	1(a)	25,825
Trade receivables		46,650
Cash and bank		5,950
Total current assets		78,425
Total assets		439,738
Equity and liabilities:		
Equity:		
Ordinary shares of ₦1 each		110,000
Share premium		4,150
Revaluation reserves on land		35,625
Retained earnings		150,039
Total equity		299,814
Non-current liabilities:		
7% Loan notes (repayable in 2027)		91,250
Current liabilities:		
Trade payables		40,600
Accrued interest expenses	3	3,194
Current tax payables		4,880
Total current liabilities		48,674
Total liabilities		139,924
Total equity and liabilities		439,738

Wk 4 **Schedule of movement in PPE for the year ended March 31, 2023**

	Land	Building	P/Equip	Total
Cost/valuation	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Balance b/f	100,000	151,500	18,600	270,100
Revaluation	20,000			20,000
Balance c/f	120,000	151,500	18,600	290,100
Acc. depreciation:				
Bal b/f	-	30,300	8,350	38,650
Current year charges	-	7,575	2,563	10,138
Balance c/f	-	37,875	10,913	48,788
Carrying amount:				
Balance c/f	120,000	113,625	7,688	241,313
Balance b/f	100,000	121,200	10,250	231,450

Wk 5 **Share issued;**

Since the proceeds were recorded separately in the trial balance. This requires a transfer to the appropriate accounts as follow;

	₦'000	₦'000
DR. Proceeds of shares	12,000	
CR. Share capital (₦10,000 x ₦1)		10,000
CR. Share premium (10,000 x ₦0.20)		2,000
	12,000	12,000

Motivating factors

The following are some of the factors that may motivate the managing director to act unethically:

- **The desire for personal gain:** The MD maybe motivated to try to impress the board of directors that, he is a performing director;
- **The pressure to meet certain goals or targets**: It is possible that during the interview for his employment by Akamata Nig. Ltd he has promised the panel that he will ensure, the company is registered with NGX within a short period of time;
- **A lack of awareness of the consequences of his actions;** and
- **Outright lack of ethical values**: The MD may be planning to acquire controlling interest at a price which is not at arm's length.

Actions to consider

i. The MD should be made aware of the issues involved, including the potential professional and legal issues. The requirement of the relevant accounting standards should also be explained to him.

ii. It may be appropriate to discuss and explain the situation with other members of the board of directors and seek their opinions. They may be able to add support to convince the MD that rules and regulations should not be bent to achieve the registration of the company with NGX.

iii. If the MD continues to dominate and exert influence to force his way through, then it would be appropriate to consider the ethical implications of such action.

iv. The MD could also be advised to do the right thing even if it involves extending or delaying the registration to ensure all the conditions are met without bending the rules and regulations.

v. The approach of the MD may also raise concern about his ethical approach to other business areas other than financial reporting. The ultimate domineering approach of the MD may even lead to conclusion by the accountant to look for other employment.

Examiner's report

The question tests candidates' knowledge of the preparation of statement of profit or loss and other comprehensive income as well as statement of changes in equity in part a, while parts b and c require preparation of statement of financial position and application of ethical issues respectively.

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

The common pitfalls include:

- Inability to correctly determine the value of closing inventory and calculate the cost of sales.

- Some candidates could not prepare the schedule of movement of property, plant and equipment.

- While others could not clearly state the motivating factors for the ethical pressure mounted by the MD of Akamata Nigeria Ltd. and actions to be considered as result of the pressure.

Candidates are advised to pay more attention to this area of the syllabus particularly as it relates to the application of relevant accounting standards required for the preparation of final accounts of limited liability companies. Efforts should also be made to get familiar with the principles and application of ethical issues in financial reporting.

Marking guide

		Marks	Marks
a.	**Presentation of statement of profit or loss and other comprehensive income:**		
	• Correct title of the statement	¼	
	• Stating the revenue	¼	
	• Determination of cost of sales	$2^3/_4$	
	• Stating the gross profit	¼	
	• Determination of admin expenses	1	
	• Determination of interest expense	$1^1/_2$	
	• Determination of profit before taxation	$1^1/_4$	
	• Stating income tax expense	¼	
	• Stating profit for the year	¼	
	• Determination of total Comprehensive income	1	
	Presentation of statement of changes in equity:		
	• Correct title of statement	¼	
	• Determination of ordinary share capital	1	
	• Determination of share premium	1	
	• Calculation of revaluation surplus	1	
	• Determination of retained earnings	$1^1/_4$	
	• Determination of total equity	$1^3/_4$	15
b.	**Presentation of statement of financial position**		
	• Correct title of the statement	¼	
	• Determination of non-current assets	$5^1/_2$	
	• Determination of current assets	1	
	• Stating total assets	¼	
	• Determination of equity	$1^1/_4$	
	• Stating non-current liabilities	¼	
	• Determination of current liabilities	1	
	• Determination of total equity and liabilities	½	10
c.	**Identification of motivating factors and actions to be considered for unethical pressure**		
	• Identifying any two motivating factors	2	
	• Stating any three correct actions to be considered	3	5
	Total		**30**

SOLUTION 2

Oyo wood's adjusted ratios:

On the assumption that after the purchase of Oyowood Ltd, the favourable effects of the transactions with other companies owned by the family would not occur, the following adjustments to the statement of profit or loss should be made:

		₦'000
Cost of sales (45,000 / 0.9)	(note 1)	50,000
Directors' remuneration	(note 2)	2,500
Loan interest (10,000 x 10%):	(note 3)	1,000

These adjustments would give rise to a revised Statement of Profit or Loss below:

Revenue	70,000
Cost of sales (note 1)	(50,000)
Gross profit	20,000
Operating cost	(7,000)
Directors' remunerations (note 2)	(2.500)
Loan interest (note 3)	(1,000)
Profit before tax	9,500
Income tax expense	(3,000)
Profit for the year	6.500

In the statement of financial position:	₦'000
Equity would be the purchase price of Oyowood (per question)	30,000
The commercial loan (replacing the directors' loan) would now be debt:	10,000

From these figures, the adjusted ratios are calculated as follows:

Return on equity: (6,500 ÷30,000) x 100%	21.7%
Net asset turnover: 70,000 ÷ (30,000 + 10,000)	1.75 times
Gross profit margin: (20,000 ÷ 70,000)x 100%	28.6%
Net profit margin: (6,500 ÷ 70,000)x 100%	9.30%

For Comparison:

	Oyowood Ltd adjusted	Oyowood Ltd as reported	Sector average
Return on equity (ROE)	21.7%	47.1%	22.0%
Net assets turnover	1.75 times	2.36 times	1.67 times
Gross profit margin	28.6%	35.7%	30.0%
Net profit margin	9.3%	20.0%	12.0%

Date: ....

From: Financial Analyst   To: Managing Director

Subject**: Comments on the performance of Oyowood Limited**

Dear Sir,

Further to the request to carry out performance scorecard of the above company using accounting ratios to access the viability of its acquisition, the following findings have been made:

i. **Profitability:**
Based on the financial statements provided, an analysis of Oyowood's ratios reveals strong positions in relation to profitability, when compared to other businesses in the retail sector.

ii. **Return on equity (ROE)**
Oyowood Ltd has a high ROE, which is a product of profit margins that are higher than average at both the gross and net profit levels.

iii. **Net asset turnover:**
Oyowood Ltd also has a significantly higher net asset turnover.

Therefore on the face of it, Oyowood Ltd achieved higher prices (or reduced cost of sales) hence:

- Oyowood Ltd has better control of overheads; and
- Oyowood Ltd is using its net assets more efficiently in terms of generating revenue.

iv. The positions however, changed when adjustments are made for the effect of Oyowood's favourable transactions with other companies owned by the family.

- **Gross profit margin:**
  With purchases made at market prices, reported gross profit margin fell from 35.7% to 28.6%, which is below the sector average of 30%.

- **Net profit margin:**
  With purchases made at market prices, reported net profit margin fell from 20.0% to 9.3% which is below sector average of 12%.

- **Return on equity (ROE):**
  It would seem the existing directors of Oyowood Ltd are not charging commercial rates for their remunerations. When Chisom Plc replaces the board of Oyowood Ltd, it will have to increase the directors' remunerations by ₦1.5million. Additionally, when the interest free directors' loans are replaced with a commercial loan with interest charged at 10% per annum, this would reduce net profit by a further ₦1 million. The accumulation of these adjustments means that the ROE, which Chisom Plc should expect would be 21.7% rather than the reported 47.1% which is almost exactly in line with the sector average of 22%.

v. **Net asset turnover:**
Net asset turnover falls from 2.36 times to 1.75 times, which is above, but much closer to the sector average of 1.67 times. This occurs when the asset turnover is calculated based on the equity purchase price and the commercial loan (equating to net assets).

Conclusion:
In summary, Oyowood's adjusted results would still be slightly ahead of the sector averages in most areas, and may well justify the anticipated purchase price of ₦30 million. However, Oyowood Ltd will be no where near the excellently performing company suggested by the reported figures. Chisom Plc needs to exercise a degree of caution in its negotiations.

Thanks
Signed
XYZ

Examiner's report
The question tests candidates' knowledge of computation of ratios from an adjusted financial statements and the application of the ratios for the purpose of taking decisions on acquisition of a company.

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

Majority of the candidates could not prepare the adjusted statement of profit or loss as well as the ratios required.

Candidates are advised to make use of the ICAN Pathfinder and practice relevant questions on ratio analysis for better performance in future examinations of the Institute.

Marking guide

		Marks	Marks
a.	**Adjustment of financial statements and recalculation of ratios**		
	Presentation of revised statement of profit or loss	5	
	Presentation of revised statement of financial position extracts	1	
	Calculation of four ratios	4	10
b.	**Memo to the managing director commenting on financial performance**		
	Use of memo format	1	
	Stating appropriate subject/title	1	

Comment on performance using relevant ratios	5	
Conclusion	1	
Recommendations	1	
Closing memo format	1	10
Total		**20**

SOLUTION 3

The circumstances that may lead to recognition or de-recognition of investment property under IAS 40 and its accounting entries is shown below:

S/N	**Circumstance**	**Recognition/De-recognition**	**Accounting Treatment**
i.	Commencement of owner occupied property	Transfer from investment property to owner-occupied property.	• Where the fair value model for investment property is used: Revalue the property per IAS 40 (taking the gain or loss to the SOPL) and then transfer to property, plant and equipment at fair value. • If the cost model is used for investment properties: The asset is transferred into property, plant and equipment at the current carrying amount and continues to be depreciated.
ii.	End of owner occupied property	Transfer from owner-occupied property to investment property	• Where the fair value model for investment property is used: The asset must be revalued as per IAS 16 (creating a revaluation reserve in equity) and then transferred into investment property at fair value. • If the cost model is used for investment Properties: The asset is transferred into investment properties at the current carrying amount and continues to be depreciated.

iii.	Commencement of development with the view to sale	Transfer from investment property to inventories	Fair value at the date of change of use becomes the deemed cost for future accounting purposes
iv.	Commencement of a lease to another property	Transfer from inventories to investment property	Fair value at the date of the transfer and any difference compared to transfer, previous carrying amount is recognised in profit or loss
v.	Development with a view to continue letting	Development of investment property to be treated as investment property	Continue to treat it as investment property

i. **If Young Shall Grow uses cost model for its investment properties:** When the building was owner-occupied, it was an item of property, plant and equipment.

From December 31, 2017, the property was held to earn rental income and for capital appreciation so it should be reclassified as investment property in line with IAS 40.

	₦'000
Cost	55,000
Accumulated Depreciation (₦55,000/50) x 5	(5,500)
Carrying amount as at December 31, 2017	49,500

According to IAS 40, if owner-occupied property becomes investment property that will be carried at cost, it is transferred into Investment Properties at the current carrying amount i.e. at December 31, 2017, and continues to be depreciated.

Carrying amount to be transferred is shown below:
The carrying amount of ₦49,500 transferred to investment property will be depreciated for 5 years before the change in use to owner-occupied property and depreciation of ₦5,500 (₦49,500/45yrs) x 5 will be recorded in the statement of profit or loss.

On December 31, 2022, there is another change in use by Young Shall Grow from investment property to owner-occupied property.

According to IAS 40, If the cost model is used for investment properties: The asset is transferred into owner-occupied property (PPE) at the current carrying amount and continues to be depreciated. Therefore, ₦44,000 (₦49,500- ₦5,500) will be transferred to owner-occupied property and will be depreciated for the remaining 40 years i.e. (₦44,000/40yrs) amounting to ₦1,100 annual depreciation recorded in the statement of profit or loss.

ii. **If Young Shall Grow uses fair value model for its investment properties:**

When the building was owner-occupied, it was an item of property, plant and equipment.

From December 31, 2017, the property was held to earn rental income and for capital appreciation so it should be reclassified as investment property in line with IAS 40.

According to IAS 40, if owner-occupied property becomes investment property that will be carried at fair value, the asset must be revalued as per IAS 16 (creating a revaluation reserve in equity) and then transferred into investment property at fair value.

This means that the building will be transferred at ₦60million as at December 31, 2017 and the gain of ₦10,500 (₦60,000 – ₦49,500) will be recorded in other comprehensive income and held in a revaluation reserve within equity. See working below.

Note: Investment properties held at fair value are not depreciated.

Also, Investment properties measured at fair value must be revalued each year end, with the gain or loss recorded in profit or loss.

	₦'000
Cost	55,000
Accumulated depreciation (N55,000/50) x 5	(5,500)
Carrying amount as at December 31, 2017	49,500
Revaluation surplus	10,500
Fair value as at December 31, 2017	60,000

On December 31, 2022, there is another change in use by Young Shall Grow from investment property to owner-occupied property.

According to IAS 40, if the fair value model for investment property is used, revalue the property as per IAS 40 (taking the gain or loss to the SOPL) and then transfer to owner-occupied property (property, plant and equipment) at fair value.

This means the building will be transferred to owner-occupied property at ₦75Million and the gain of ₦15million (₦75m-₦60m) will be recorded in the statement of profit or loss.

Examiner's report

The question tests candidate's knowledge of the principles and application of IAS 40 – Investment Property. Part (a) of the question requires candidates to state the circumstances that may lead to recognition and de-recognition of investment property as well as relevant accounting treatments. Part (b) of the question tests the application of the accounting treatments.

Few candidates attempted the question and performance was very poor.

Most of the candidates that attempted the questions could not identify the circumstances that may lead to recognition and de-recognition of investment property. Others could not also apply the principles of IAS 40 to determine how changes in use of the property should be reflected in financial statements.

Candidates should pay special attention to all relevant statement of accounting standards at this level of the Institute's Examinations for better performance in future.

Marking guide

		Marks	Marks
a.	**Four circumstances for recognition or de-recognition of investment property**		
	Identification of any four circumstance	2	
	Accounting treatments for the four circumstances identified	<u>6</u>	8
b.	**Discussion of how changes of use are treated in the financial statements in accordance with IAS 40**		
	Discussion based on cost model of valuing investment property and treatment of changes in use	6	
	Discussion based on fair value model of valuing investment property and treatment of changes in use	<u>6</u>	<u>12</u>
	Total		**<u>20</u>**

SOLUTION 4

a. **Purpose of dilutive measures**

- Diluted EPS act as warning sign for investors in that, it shows what EPS could become if all potential shares were actually in issue.
- The purpose of presenting diluted EPS is to reflect the maximum potential dilution of current basic EPS as if the dilution took place at the later of:
  - ➢ The beginning of the current period (for comparatives); and

- The date of issue of the potential ordinary shares (applicable only where potential ordinary shares have been issued in the current year of comparative year presented.

Types of dilution

There are effectively three (3) types of dilution:

i. **Convertible instruments**

Earnings are adjusted positively to reflect saving in interest or dividends incurred net of tax and shares as are adjusted positively to reflect additional number of shares as a result of the conversion.

Examples include convertible preference and convertible loan notes. The calculation entails adjusting basic earnings and the weighted average number of shares outstanding.

ii. **Options to acquire ordinary shares**

The issue of these incentives to directors, senior staff or occasionally other parties will entail adjustments to the weighted average number of shares outstanding only.

Earnings are not adjusted, shares are adjusted positively to reflect the number of shares that will be issued for no consideration as a result of being issued at below the market price.

iii. **Contingently issuable shares**

These are ordinary share issuable for little or no consideration, upon the satisfaction of certain condition pursuant to a contingent share. The contingent event could be, for example:

- The maintenance of a specified level of earnings;
- The future market place of ordinary shares; and or
- The opening of additional distribution of outlets

Contingently issuable shares are only included in the computation of diluted EPS if the condition are satisfied (that is the contingent events have occurred).

b. **Basic Earning Per Share (EPS) for the year ended December 31, 2022**

$$EPS = \frac{\text{Earnings}}{\text{No of ordinary shares}}$$

$$= \frac{36{,}000}{12{,}000}$$

₦3 per share

Diluted EPS for the year ended December 31, 2022

	No of Shares	Earnings	EPS
Basic EPS	12,000,000	36,000,000	₦3
Dilution			
4,000,000 x 30/100	1,200,000		
Add back interest:			
5% x ₦4,000,000		200,000	
Tax at 30%			
(200,000 x 30%)		(60,000)	
	13,200,000	36,140,000	₦2.74

Diluted EPS = $\frac{36,140,00}{13.2million}$ = ₦2.74 per share

Note:

The number of potential shares is calculated using the conversion rate of 30 shares for every ₦100 of loan notes, because this conversion rate produce more new shares than the other conversion rate of 25 shares for every 100 bonus.

c If an alternative EPS figure is presented. IAS 33 states that:

i. A reconciliation must be shown between the earnings figure used in the alternative measure and the amount shown in the statement of profit or loss;

ii. The alternative EPS must use the same weighted average number of shares as the IAS 33 calculations;

iii. Basic and diluted EPS should both be disclosed with equal prominence; and

iv. The alternative figure must only be shown in the notes and NOT on the face of the statement of profit or loss.

Examiner's report

The question tests the principles of accounting standards of IAS 33- Earnings Per Share (EPS) with particular emphasis on calculations of basic and diluted EPS. Candidates are also required to state the conditions under which alternative measures of EPS can be shown in the financial statements.

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

Some candidates could not correctly calculate the EPS, while others could not state the conditions under which the alternative measure of EPS should be disclosed in the financial statements.

Candidates are advised to pay more attention to all relevant accounting standards at this level of the Institute's Examinations.

Marking guide

	Marks	Marks
Explanation of purpose of dilutive measures and types of dilution:		
Stating two purpose of dilutive measures	2	
Stating three (3) types of dilution	3	
Explanation of three types of dilution	3	8
Calculation of Earnings Per Share (EPS)		
Calculations of Basic Earnings per share	$2^1/_2$	
Calculation of Diluted Earnings per share	$5^1/_2$	8
Conditions to be complied with when alternative measures of EPS is shown in the Financial statement		
Two conditions correctly stated		4
Total		**20**

SOLUTION 5

a. **Definition of terms in line with IAS 12:**

i. **Deferred tax:** This is the amount of tax payable or recoverable in future periods in respect of temporary differences, unused tax losses and unused tax credits. Deferred tax can either be deferred tax assets or deferred tax liabilities. It is not a tax levied by government that need to be paid.

ii. **Temporary differences**: These are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary differences may be either taxable temporary differences or deductible temporary differences. For example, temporary difference can arise as a result of differences in depreciation rate and capital allowance rate over the same period.

iii. **Permanent differences:** These are differences between taxable profit and accounting profit that originate in one period and do not reverse in subsequent periods. They are the differences between book tax expense and the actual tax owed, which is caused by an item that does not reverse over time. Examples include Interest income on tax-exempt securities, fines and penalties paid to governments for violation of the law, etc.

b. **Shakara Limited**

i. **Computation of tax payable for the year ended December 31, 2022**

	₦'000
Profit before taxation	18,150
Add: Depreciation	1,650
Less: Capital allowances	(2,250)
Taxable profit	17,550
Tax rate	30%
Income tax liability	5,265

ii. **Computation of deferred tax balance at at December 31, 2022**

	₦'000	₦'000
Carrying amount:		
Cost (₦7,200,000 + ₦1,800,000)	9,000	
Less: Depreciation	(1,650)	7,350
Tax base:		
Cost (₦7,200,000 + ₦1,800,000)	9,000	
Less: Capital allowances	(2,250)	6,750
Taxable temporary difference		600
Tax rate		30%
Deferred tax		180

iii. **Computation of movement in deferred tax balance for the year**

	₦'000
Opening balance	1,200
Movement in the year	180
Closing balance	1,380

iv. **Computation of income tax expenses for the year**

	₦'000
Current tax	5,265
Deferred tax	180
Income tax expense	5,445

Examiner's report

The question tests candidates' knowledge of basic terminologies on deferred tax in accordance with IAS 12 and application of the principles to compute deferred tax.

Most of the candidates attempted the question and their performance was average. Some candidates were unable to correctly explain the basic terminologies while others could not correctly compute the deferred tax as required by the examiner.

Candidates are advised to pay attention to all sections of the syllabus for better performance in future examinations.

Marking guide

			Marks	Marks
a.	**Explanation of terms**			
	Explanation of deferred tax		½	
	Example of deferred tax		½	
	Explanation of temporary difference		½	
	Examples of temporary difference		½	
	Explanation of permanent difference		½	
	Example of permanent difference		½	3
b.	i.	Correct calculation of company income tax liability for the year ended December 31, 2022	3	
	ii.	Correct calculation of deferred tax balance at December 31, 2022	3	
	iii.	Computation of movement in deferred tax balance charged to statement of profit or loss for year ended December 31, 2022	3	
	iv.	Presentation of notes to income tax expense in the statement of profit or loss for the year ended December 31, 2022	3	12
	Total			**15**

SOLUTION 6

a. **Creative accounting techniques that can be used by the management of an entity to manipulate the view given by the financial statements include:**

i. **Window dressing**

An entity enters into a transaction just before the year end and reverses the transaction just after the year end. For example, goods are sold on the understanding that they will be returned immediately after the year end. This appears to improve profits and liquidity. The only reason for the transaction is to artificially improve the view given by the financial statements;

ii. **Off statement of financial position finance**
Transactions are deliberately arranged so as to enable an entity to keep significant assets and particularly liabilities out of the statement of financial position. This improves gearing and return on capital employed. Examples include sale or repurchase agreements and some forms of leasing;

iii. **Changes in accounting policies or accounting estimates:**
An entity can revalue assets that is change from the cost model to the revaluation model) to improve gearing or change the way in which it depreciates assets in order to improve profits;

iv. **Profit smoothing:**
This involves manipulating reported profits by recognising artificial assets or liabilities and releasing them to profit or loss as required;

v. **Aggressive earnings management**
This is artificially improving earnings and profits by recognising sales revenue before it has been earned; and

vi. **Capitalising expenses**
This is by recognising assets which do not meet the definition in the IASB Conceptual Framework or the recognition criteria. Examples include human resources, advertising expenditure and internally generated brand names.

b. **Useful non-financial information would include the following:**
i. A description of the business, objectives and strategies of the entity;
ii. A narrative review of the performance of the business during the period;
iii. A description of the main risks and uncertainties facing the entity and the ways in which these risks are managed;
iv. Details of any significant factors or events that may have an impact on the entity's performance in future;
v. Details of any significant factors or events that may have an impact on the entity's cash flows in future;
vi. Information about key relationships with other entities and transactions with related parties, including management;
vii. A description of the entity's research and development activities and of any material intangible assets, including internally generated intangible assets that have not been recognised in the statement of financial position;
viii Additional explanations of amount included in the financial statements, where appropriate. For example, where these are based on estimates; and
ix. Information about the entity's policies in relation to environmental matters in relation to its employees and on social and community issues.

c. **Areas of financial reporting that could be enhanced by the use of technology include:**

i. **Data collection**

The starting point of the financial reporting process is identification and collection of data from multiple sources within and outside the entity.

Data identification and collation can actually be automated through the integration of the entity's accounting software with the various data sources. It is equally possible to convert the unstructured and dirty data into a format and structure ready for entry into the accounting system with the help of some advanced technology tools.

ii. **Data recording**

Once data is collated from various sources, the next course of action is to enter or record the data into the accounting system. Technology tool such as optical character recognition (OCR) has made it possible for organisations to capture and record data seamlessly with little or no human intervention.

The data in source documents customer orders; invoices and delivery notes are captured through scanners or mobile device cameras and posted into the appropriate ledgers within the accounting system;

iii. **Report preparation**

A well designed and automated accounting system will be able to aggregate all relevant information from individual ledger accounts to the general ledger which forms the basis of preparing the trial balance and ultimately, the financial statements and other products of financial reporting.

Modern technology can enhance this process efficiently by replacing mechanistic human processing transactions and transforming the various data into proper accounting and management information, which ultimately feeds into a company's annual reports;

iv. **Report distribution**

Traditionally, annual reports of companies are published several months after the financial year end and sent to shareholders and other stakeholders through the postal or courier services.

In recent times, many entities through the adoption of relevant technology tools have started hosting the annual reports on their websites or put them on CDS and sent to the stakeholders. Also there are instances where the soft copies of the annual reports are sent to each stakeholder's e-mail address for downloading.

In highly regulated sectors, such as the banking industry, the regulators could provide a web portal where each operator is required to submit the annual reports and other returns electronically; and

v. **Report consumption**

Once the various stakeholders and investors receive the annual reports of an entity, they attempt to analyse and make useful meaning from them. Most institutional investors are already using technology to enhance effectiveness of investment analysis by extracting meaning and value, not only from company's reporting, but from various sources of alternative data. Data analytic solutions can be used to perform detailed analysis of any company's information for deeper insight that will aid decision making by investors.

Examiner's report

The question tests candidates' knowledge of techniques of creative accounting, usefulness of non -financial information and areas of financial reporting that could be enhanced by the use of technology.

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

Most of them were able to identify and discuss the techniques of creative accounting and usefulness of non- financial information. However, they could not explain the areas of financial reporting that could be enhanced by use of technology.

Candidates are advised to read accounting and financial journals to further enhance their knowledge of contemporary financial reporting issues for better performance in future examinations of the institute.

Marking guide

		Marks	Marks
a.	**Identification and discussion of techniques of creative accounting**		
	Identification of any four techniques of creative accounting	4	
	Discussion on four identified techniques of creative accounting	4	**8**
b.	**Useful non-financial information**		
	Stating three (3) non-financial information		**3**
c.	**Discussions on areas of financial reporting enhanced by technology**		
	Identification of two (2) areas of financial reporting enhanced by technology	1	
	Discussions of two (2) areas of financial reporting enhanced by technology	3	**4**
	Total		**15**

SOLUTION 7

a. Financial reporting and regulatory frameworks

i. The main sources of regulations are:

- **Accounting standards:** Accounting standards are authoritative statements of how particular types of transactions and events are reflected in the financial statements. International Financial Reporting Standards (IFRS) are used in Nigeria.
- **Company law:** Company law varies from country to country, but typically it sets out rules for determining profits available for distribution, issuing and redeeming of share capital, the reserves that a company must have and the uses to which they can be put. These matters are not covered in accounting standards. The main company law statute in Nigeria is the Companies and Allied Matters Act 2020, as amended.
- **For listed companies, the listing rules of the relevant Stock Exchange:** Listing rules set out the information which entities must supply when their shares are traded on a major stock market. They must comply with these rules in order to maintain their listing. These rules include requirements relating to information, including financial reports that entities must prepare and provide to the stock market while they are listed.

ii. There are several reasons why financial reporting should be regulated. Some of the reasons include:

- An entity is free to adopt any accounting treatment if there are no regulations;
- It ensures that external users of financial statements are provided with information that is relevant to their decisions;
- It helps to ensure that entities adopt similar accounting treatments for similar items and account for similar transactions in the same way. This makes it possible to compare the financial statements of different entities and the entities performance for the current year with those of the previous years; and

  Without regulation, management would adopt whichever accounting treatment that presents its results and position in the best possible light.

b. In line with the provision of IAS 1 – Presentation of Financial Statements.

i. Minimum line items to be shown on the face of the statement of financial position are as follows:

Assets:
- Property, plant and equipment;
- Investment property;
- Intangible assets;
- Long-term financial assets, such as long-term holdings of shares in other companies;
- Investments accounted for using the equity method;
- Biological assets;
- Inventories;
- Trade and other receivables;
- Cash and cash equivalents;
- The total of assets classified as held for sale in accordance with IFRS 5;

Liabilities:
- Trade and other payables;
- Provisions;
- Financial liabilities;
- Liabilities (but possibly assets) for current tax, as required by IAS 12: Income Taxes;
- Deferred tax liabilities and deferred tax assets as defined in IAS 12;
- Liabilities included in disposal groups in accordance with IFRS 5;

Equity:
- Non-controlling interests presented within equity; and
- Issued capital and reserves attributable to the owners of the equity.

ii. Items that should be accounted for in the statement of changes in equity:
- Profit or loss for the period;
- Each item of other comprehensive income;
- New issues of shares;
- Payments of dividends;
- Repurchases and cancellation of its own shares by the company;
- Share premium;
- Revaluation reserve; and
- Fair value gain.

Examiner's report

The question tests candidates' knowledge of sources and reasons why financial reporting are regulated. It also requires candidates to highlight minimum line items in statement of financial position and components of statement of changes in equity.

Most candidates attempted the question and their performance was good. However, some candidates could not correctly state the reasons why financial reporting practice should be regulated.

Candidates are advised to cover all sections of the syllabus, particularly the areas on regulatory and financial framework for better performance in future examinations of the Institute.

Marking guide

		Marks	Marks
a.	i. **Main sources of regulations**		
	Identification of three (3) main sources of regulation	$1^1/_2$	
	Discussions of three (3) main sources of regulations	$1^1/_2$	
	ii. **Reasons for regulation of financial reporting**		
	Identification of any two reasons	2	**5**
b.	i **items to be presented on face of statement of financial position**		
	Stating five (5) line items to be disclosed on face of statement of financial position	5	
	ii. **items to be accounted for in the statement of changes in equity**		
	Stating five (5) items to be accounted for in statement of changes of equity	5	**10**
	Total		**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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, NOVEMBER 15, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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

NIGERIA WATER RESOURCES LIMITED

Nigeria Water Resources Limited (NWR) is a limited liability company floated by the Federal Government to control water related activities and resources. Its operations cover surface and under water activities. The company is about three years old.

As is the practice with entities having government interest, NWR wanted to change the company's auditors. It therefore, invited tenders for the audit assignment through a national newspaper.

In order to score an advantage over other bidders, the firm of John Ibrahim and Co. (Chartered Accountants) decided to quote a seemingly unrealistic fee level in order to get the job. The Managing Director (MD) of the company did not see anything wrong with the low professional fee level since it will save costs for the company, especially that despite the clean audit report of the previous years, fraud and financial misdemeanour went undetected. The MD believed the annual statutory audit is just to "fulfil all righteousness". John Ibrahim and Co. has been rated high since this firm has as its client, another company in the same line of trade.

Required:

If the firm, John Ibrahim & Co., wins the bid to audit NWR,

a. Explain the ethical matters the firm should consider before the client acceptance, at the point of engagement acceptance, and after accepting the appointment. (12 Marks)

b. Assess the remarks of the MD of NWR from the point of the expectation of the public as regards audit assignments. (8 Marks)

c. Explain the procedures the audit firm should undertake to avoid conflict of interests that could affect the judgment of the firm since John Ibrahim & Co. audits another client that is in direct competition with NWR. (6 Marks)

d. Explain the guidelines of the Institute's Code with respect to advertisement by members. (4 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

ISA 530 *Audit sampling* states that the objective of the auditor when using audit sampling is to provide a reasonable basis to draw conclusion about the population from which the sample is drawn.

Required:

a. In accordance with ISA 530, what are the requirements the auditor should consider in designing a sample size? (6 Marks)

b. Explain **FIVE** sampling methods that are available for the use of the auditor. (10 Marks)

c. State **FOUR** circumstances where sampling may not be appropriate for use by the auditor. (4 Marks)

(Total 20 Marks)

QUESTION 3

The following scenarios may threaten the compliance with fundamental principles in auditing:

(i) The audit supervisor is married to the daughter of the Managing Director of the client company;

(ii) The audit firm's Senior Partner holds shares in the client company;

(iii) The assurance firm also provides valuation services, internal audit services and taxation services to an assurance client;

(iv) The assurance firm earns more than 50% of her annual revenue from one assurance client; and

(v) The firm obtained motor vehicle financing from a client bank for its staff.

Required:

a. Explain why compliance with fundamental principles in auditing may be threatened in each of the above **FIVE** circumstances. (10 Marks)

b. Explain **FIVE** ethical requirements that would reduce or mitigate the threats to compliance with the fundamental principles in the above **FIVE** circumstances. (10 Marks)

(Total 20 Marks

QUESTION 4

Greater Tomorrow Foundation (GTF) was established with the aim of providing support to children from disadvantaged backgrounds who wish to take part in sports, such as tennis, athletics and football. It has really been of great benefit to the country, as some of the beneficiaries have represented the country in international competitions.

GTF has a constitution which explains how its income can be spent. The constitution also notes that administrative expenditure cannot exceed one-eighth of income in any year.

The GTF income is derived wholly from voluntary donations. Sources of donations include:

(i) Cash collected by volunteers asking the public for donation; and
(ii) Direct donations from generous individuals.

Some of these donations have specific clauses attached to them indicating that the initial amount donated cannot be spent and that the income generated (interest) from the donations must be spent on specific activities, for example, provision of sports equipment like football, boots, rackets, sports wears, etc.

Required:

a. Explain **FIVE** areas of inherent risk in Greater Tomorrow Foundation (GTF) and explain the effect of each risk on the audit approach. (10 Marks)

b. Explain **FIVE** reasons why the control environment may be weak in GTF. (10 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

The world-wide COVID 19 pandemic disrupted the operations of Divine Hope Limited, like it did to many other business concerns. Sequel to this, the management of Divine Hope Limited has now commissioned the development of a Contingency or Business Continuity Plan to ensure continuity of operations, even if such a pandemic or similar situation should re-occur.

Required:

a. Explain **SIX** steps to be taken in the information system audit of a Contingency or Business Continuity Plan. (9 Marks)

b. Explain why the audit of the Contingency or Business Continuity Plan is very necessary. (6 Marks)

(Total 15 Marks)

QUESTION 6

Your client, Picturescope Limited, intends to produce a motion picture titled **"Naíja Power"**. The development costs before presentation to investors for financing the production is estimated to be ₦15 million.

Required:

a. As the assurance provider, assess the situation to confirm that the amount spent so far can be recognised as development costs within the provisions of IAS 38 – Intangible Assets. (6 Marks)

b. Explain the audit tests that you would perform in respect of the development costs expended so far. (9 Marks)

(Total 15 Marks)

QUESTION 7

You witnessed a scene during the audit of Tiwani Cement Limited, an indigenous medium-sized cement manufacturing company.

Indigenes of the host town, situated in the southern part of the country, staged a peaceful protest at the premises of the company. Their grouse was the apparent nonchalant posture of the company in showing concern for the terrible impassable situation of the roads surrounding their factory – ostensibly damaged by the heavy equipment and heavy duty vehicles they operated.

The management appeased the anger and displeasure of the protesters – promising immediate consideration of their demand.

The Managing Director has now asked for your advice.

Required:

Advise the Managing Director of Tiwani Cement Limited on what the company could do in this type of situation. **(Total 15 Marks)**

SOLUTION 1

a. (i) **The ethical matters the firm (John Ibrahim & Co.) should consider before client acceptance include:**

- Threats to compliance with the fundamental principles. Before accepting a new client relationship, a Chartered Accountant in public practice should consider whether acceptance would create any threats to compliance with the fundamental principles;
- Potential threats to integrity or professional behaviour may be created from questionable issues associated with the client owners, management and activities. Client issues that, if known, could threaten compliance with the fundamental principles include, client's involvement in illegal activities (such as money laundering);
- Dishonesty or questionable financial reporting practices;
- Evaluation of the significance of any threats. If it is high, the firm should decline to enter into the client relationship;
- Consideration of safeguards that are available. If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level; and
- Communication with current (outgoing) auditor. The firm should as a matter of professional necessity communicate with the current auditors (if there are any) to establish if there are any matters that the firm should be aware of when deciding whether or not to accept the appointment.

(ii) **The ethical matters the firm (John Ibrahim & Co.) should consider at the point of acceptance of the new client include:**

- The firm should assure to provide only those services that it is certified and competent to perform;
- The firm should evaluate the significance of identified threats, and if they are other than clearly insignificant, safeguards should be applied as necessary to eliminate them or reduce them to an acceptable level. Where it is not possible to reduce the threats to an acceptable level, the firm should decline to accept the appointment; and
- When the firm intends to rely on the advice or work of an expert, it should evaluate whether such reliance is warranted, by considering factors such as reputation, expertise, resources available and applicable professional and ethical standards, information which may be gained from reference to prior association with the expert or from consulting others.

(iii) **The ethical matters the firm (John Ibrahim & Co.) should consider after the acceptance of the new client include:**

- It should ascertain that the current auditors have resigned from the audit in a proper manner, or has been removed from office in

accordance with any appropriate legislation or regulations;
- It should ensure that its appointment is valid in law and is properly documented; and
- It should prepare and submit an engagement letter to the board of the new client.

a. **The MD's remarks and users' expectations**

The MD's remarks are confirmation of the existence of users' expectation gap in an audit. The seemingly low fee quoted by John Ibrahim & Co. does not matter to him as his expectations from the auditors are not being met.

The audit expectation gap is the gap between the auditors' roles and the expectations of the users. The gap usually manifests through misinterpretation of the auditors' roles and duties.

In this case, the MD believes that the role of the auditors and indeed the primary objective of an audit is for the auditors to discover fraud and other misdemeanour. Whereas, this is the primary responsibility of the management and those charged with the governance of an entity.

But the statutory auditor in the course of his audit assignment would design his work in a way that would make possible the identification of risks of material misstatements due to fraud or detect frauds that would be uncovered by standard audit procedures.

b. **Procedures the audit firm should undertake to avoid conflict of interest while auditing competing clients include:**

i. Giving careful consideration to accept the appointment;
ii. Ensuring different members of staff and engagement partners are involved in the two engagements;
iii. Disclosing to the clients to manage potential conflicts of interest;
iv. Creating 'Chinese Walls' to ensure proper separate management of audit and client information;
v. Making use of confidentiality agreement;
vi. Regular reviewing of safeguards; and
vii. Advising one or both clients to seek additional independent advice.

c. **Guidelines of the Institute's Code as to advertisement include:**

i. Advertisement must not discredit the services offered by others (for example by claiming superiority);
ii. It must not be misleading;
iii. It must not fall short of any local regulations or legislation;
iv. The firm should not bring the profession into disrepute when marketing professional services;
v. The firm should be honest and truthful;
vi. It should not make exaggerated claims for services offered, qualifications possessed, or experience gained; and

vii. It should not make disparaging references to unsubstantiated comparisons to the work of another Chartered Accountant.

Examiner's report

The question tests the candidates' knowledge of ethical matters and fundamental principles of an audit engagement.

This being a compulsory question, about 100% of the candidates attempted it, but the performance was average.

The common pitfalls of the candidates were lumping of the different requirements of the question and transpositioning of solutions of ethical matters before, during and after engagement acceptance with one another and also, inability of the candidates to explain procedures to avoid conflicts of interest in auditing competing clients.

Candidates are advised to ensure their proper understanding of the requirements of composite parts of the question while attempting it.

Marking guide

			Marks	Marks
a.	i.	**Ethical matters John Ibrahim & Co. should consider before the client acceptance**		
		(1 mark each subject to a maximum of 4 points)	4	
	ii.	**Ethical matters John Ibrahim & Co. should consider at the point of engagement acceptance**		
		(2 marks each subject to a maximum of 2 points)	4	
	iii.	**Ethical matters John Ibrahim & Co. should consider after engagement acceptance**		
		(2 marks each subject to a maximum of 2 points)	4	
				12
b.		**The remarks of the MD and users' expectation**		
		(2 marks each subject to a maximum of 4 points)		8
c.		**Procedures to avoid conflict of interest while auditing competing clients**		
		(1 mark each subject to a maximum of 6 points)		6
		Guidelines of the Institute's code as to advertisement		
		(1 mark each subject to a maximum of 4 points)		4
		Total		**30**

SOLUTION 2

a. **When designing a sample size, ISA 530 requires the auditor to:**

i. Consider the purpose of the audit procedure and the population from which the sample will be drawn;
ii. Determine the sample size sufficient to reduce sampling risk to an acceptably low level;
iii. Select items for the sample in such a way that each sampling unit in the population has an equal chance of selection;
iv. Decide the sampling approach to be used;
iv. Understand the characteristics of the population from which the sample is to be drawn;
v. Select the sample method;
vi. Decide what constitutes a misstatement or deviation and set the 'tolerable' misstatement or rate of deviation; and
vii. Decide 'expected' misstatement or rate of deviation.

b. **The method of sampling selection available for the use of the auditor include:**

i. **Simple random selection**
This is a method of selection in which every item in a population has the same statistical probability of being selected as every other item. The sample will, therefore, be representative of the population as a whole. This involves selecting from a source of random numbers, either by use of computer programs which generate random numbers or to random number tables.

ii. **Value weighted selection**
This involves using the currency unit value rather than the items as the sampling population. Each individual currency unit (unit of) in the population is given an equal chance of selection. For example, one unit of currency is selected out of the first two thousand and thereafter, each two thousandth currency is selected. Since an individual currency unit cannot be examined, the item which includes that unit of currency is selected for examination, usually an invoice, payment or balance.

iii. **Systematic selection**
The auditor calculates a uniform interval by dividing the population size by the sample size. Having determined a starting point at random, every item that corresponds to the sampling interval is selected.

iv. **Block sampling**
This is not generally an appropriate method of selection because populations might be expected to be structured in such a way that items in a sequence have similar characteristics to each but different characteristics to items elsewhere in the population.

v. **Haphazard selection or judgemental sampling**
It is a selection process in which the auditor attempts to give all items in a population a chance of being selected by choosing items haphazardly. The auditor should avoid conscious bias and predictability in selecting items. An example is a tendency to favour items that appear to be 'easy', that is, items that appear to be simple and without complication.

vi. **Monetary unit sampling**
This is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

vii. **Stratified sampling**
Audit efficiency may be improved if an auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic.

c. **Sampling may not be appropriate for use by the auditor in the following circumstances:**

i. Where population is too small for a valid conclusion like sales in aerospace industries, ship building industries, heavy duty machinery manufacturers. It would be better to check all the transactions;
ii. Where there has been an indication of a high level of errors or system failures and availability of fraud risk factors (auditor is put on enquiry);
iii. Where legal or regulatory guidelines require full disclosure of the items in the financial statements, for example, loan loss provisioning;
iv. Where the population is not homogenous;
v. Where the internal control procedures are weak, and 100% audit testing is feasible;
vi. Where the transaction under review is one off or non-recurring in nature and is material;
vii. Where the items are unusual or extraordinary; and
viii. Where the items within the class of transactions, assets, liabilities and owner equity items are few and are individually material.

Examiner's report

The question tests the candidates' knowledge of sampling in auditing.

About 45% of the candidates attempted the question and performance was average.

The major pitfalls of the candidates were their inability to explain methods of sampling and designing a sample size.

Candidates are advised to avail themselves of the use of the Institute's Study Texts and ensure that they prepare well for subsequent examinations.

Marking guide

		Marks
a.	**Requirements of ISA 530 in respect of design of sample size**	
	(1 mark each subject to maximum of 6 points)	6
b.	**Sample selection methods available**	
	(2 points each subject to a maximum of 5 points)	10
c.	**Circumstances where sampling may not be appropriate**	
	(1 mark each subject to a maximum of 4 points)	4
	Total	**20**

SOLUTION 3

a. (i) **The threats that may arise from the marriage of the Audit Supervisor to the daughter of the MD include:**

- Intimidation threat – since the MD (as a father-in-law) could have influence on the Audit Supervisor;
- Familiarity threat – because of the relationship between the MD and his in-law; and
- Self-interest threat may develop later since the shareholding of the MD may devolve onto the daughter.

(ii) **The threat that may occur if the audit firm's Senior Partner is holding shares in client company is:**

- Self- interest threat - This would occur since the partner holds a direct financial interest or material indirect interest in the client company.

(iii) **The following threats may arise when the assurance firm is providing non-audit services:**

- Valuation services - self-review threat may arise especially where the matter is material to the financial statements and involves a significant degree of subjectivity;
- Internal audit services - A self review threat may arise as he may later be reviewing his own work and may therefore not be as critical as necessary; and
- Taxation services – these are not considered to threaten the fundamental principles.

(iv) **The threat that may be created when the assurance firm earns more than 50% of its annual turnover from a client**
It would create a self-interest threat since it is apparent she 'depends' solely on this client and the firm may have a grave concern about the possibility of losing the major client.

(v) **The threat to compliance with fundamental principles in the case of the firm obtaining a motor vehicle financing facility for its staff from a client bank**
There may not be a major threat here if the loan facility is made on normal business terms to the assurance firm and it is not material.

b. **The ethical requirements for reducing or mitigating the threats in the stated scenarios**

i. **Audit supervisor married to the daughter of the MD**
The safeguard is to remove the audit supervisor from the audit team.

ii. **The audit firm's Senior Partner holding shares in client company**
The safeguards are:

- The senior partner should dispose his holding in that particular client company;
- The financial interest holding could also be reduced to an inconsequential or immaterial level; and
- The firm should retire from the audit.

iii. **Provision of non-audit services**
These include:

- The firm should not engage in valuation services for the client;
- The firm could provide the internal audit services so far the personnel handling the internal audit are not responsible for the statutory audit; and
- There is no observed threat in the provision of taxation services.

iv. **Earning more than 50% of one's earnings from a particular client**
The assurance firm should take steps to reduce dependency on that particular client.

v. **The firm obtaining a motor vehicle financing facilities for its staff**
There is no observed threat for the vehicle loan financing from the client bank, especially if the facility is made on normal business terms and it is not material.

Examiner's report

This question tests candidates' knowledge of threats that may affect compliance with fundamental principles.

About 80% of the candidates attempted the question and their performance was good.

The major pitfall of the candidates was their inability to state the ethical requirements to reduce or mitigate the identified threats.

Candidates are advised to prepare well for future examinations.

Marking guide

		Marks
a.	**Threats to compliance with fundamental principles**	
	(2 marks each subject to maximum of 5 points)	10
b.	**Ethical requirements that would reduce or mitigate threats per above**	
	(2 marks each subject to a maximum of 5 points)	10
	Total	**20**

SOLUTION 4

a.	**Identification of inherent risk**	**Explanation of risk effect on audit approach**
i.	Income is from voluntary donations only. There is a risk that donations will reduce or may not be constant especially where donor's own income is limited by the economic downturn and other factors.	It is difficult to estimate that income in the future will be sufficient to meet the expenditure profile of the foundation. Audit of the going concern concept (as ensuring that the foundation can still operate) will therefore be quite difficult.
ii.	Completeness of income where there are no controls to ensure income is fully received, for example, receipts are not raised to obtained donations and donations could be stolen by staff or the volunteers.	Audit tests are unlikely to be effective to meet the assertion of completeness. The audit report may need to be modified or qualified to explain the lack of evidence stating that completeness of income cannot be confirmed.
iii.	Funds can only be spent in accordance with the objects of the foundation. There is a risk that funds are spent outside the objects of the foundation especially where there is limited supervision and control.	Careful review of expenditure will be necessary to ensure that expenditure is not 'ultra vires' the objectives of the foundation. The auditor will need to review the constitution of the foundation carefully in this respect.

iv.	Legal and regulatory rules relevant to GTF. There is a risk that the rules will be broken due to lack of correct and timely compliance.	The auditor will need to ensure that audit staff familiar with the legal and regulatory rules affecting the entity is available even in the audit team.
v.	Requirement to report expenditure in accordance with the constitution – administration expenditure cannot be more than one-eighth of total income. The risks include income being overstated to allow expenditure to be overstated.	The trustees may attempt to hide 'excessive' expenditure on administration under other expense headings. As the auditor has to report on the accuracy of income and expenditure, then audit procedures must focus on the accuracy of recording of expenditure.
vi.	Donations to the GTF for specific activities, for example, provision of sports equipment. There is a risk that donations are not spent in accordance with donors' instructions.	Documentation for any donation will need to be obtained and then expenditure confirmed to the terms of the documentation. Any discrepancies will have to be reported to management or those charged with governance.

b. **Reasons why control environment may be weak in GTF include:**

i. **Lack of segregation of duties/responsibilities**

There is normally a limited number of staff working in an organisation of this type and size, meaning that a full system of internal control, including segregation of duties cannot be implemented. Staff are likely to be unclear as to their exact responsibilities, as some are not formal 'employees' and are not part of the formal authority structure in the Foundation.

ii. **Volunteer staff**

Many functions are performed by volunteers and so will only work at the foundation on an occasional basis. Controls will be performed by different staff on different days and occasions making the system unreliable.

iii. **Lack of regular qualified staff**

GTF uses volunteers, who may not be subject to the internal controls or discipline.

iv. **Selection of staff is limited**
People tend to volunteer for work when they have time – and so they are unlikely to have adequate professional qualifications or experience to implement or maintain good control systems.

v. **No internal audit department**
Any control system will not be monitored effectively, mainly due to the lack of an internal audit department. The foundation will not have the funds or experience to establish internal audit department.

vi. **Lack of well-defined organisation structure**
Most NGOs of this stature, relying only on external donations for survival and volunteers to discharge some functions, would not usually have a well-defined organisation structure.

vii. **Attitude of the trustees**
It is not clear how the foundation trustees view risk. However, where trustees are not professionally trained or have little time to devote to the foundation, there may be an impression that controls are not important. The overall control environment may, therefore, be weak as other foundation workers do not see the importance of maintaining good controls.

Examiner's report
This question tests the candidates' knowledge of inherents risks and control environment.

About 50% of the candidates attempted the question but performance was poor.

The major pitfalls of the candidates were their inability to explain the risks and why the control environment may be weak in the given scenario.

Candidates are advised to prepare well for their examinations, making use of the Institute's Study Text and the Pathfinder. They are also advised to apply their knowledge to given scenarios.

Marking guide

		Marks	Marks
a.	**Areas of inherent risk in the not-for-profit organisation**		
	(1 mark each for stating the risks)	5	
	(1 mark each for the effects on the audit approach)	5	
			10
b.	**Reasons why control environment may be weak in the NGO**		
	(½ mark each subject to a maximum of 5 points)	2 ½	
	(1½ mark each for explanation of the reason subject to a maximum of 5 points)	7 ½	
			10
	Total		**20**

SOLUTION 5

a. **The audit steps to be taken in the information system audit of a Contingency or Business Continuity plan (BCP) include:**

i. **Completeness of Business Plan:** obtaining and reviewing a copy of the business plan to determine if it is complete and approved by management;
ii. **The audit plan:** preparing the audit plan outlining the scope, approach and schedule of the business continuity plan (BCP);
iii. **Organisational chart review:** reviewing the organisational chart and business process analysis;
iv. **Management knowledge:** enquiring from management to ascertain their level of involvement in and knowledge about the plan;
v. **Assumptions:** reviewing the assumptions made to determine if they are reasonable and consistent with the type of business;
vi. **Business impact analysis:** reviewing the business impact analysis and enquiring if the recovery time objectives and recovery point objectives have been identified;
vii. **Recovery strategies:** comparing the recovery strategies with the result of the business impact analysis to determine if they align;
viii. **Appointment of emergency coordinator:** enquiring from management to confirm if an emergency coordinator has been appointed and discuss with the emergency coordinator;
ix. **Critical role personnel:** identifying the personnel with critical roles to perform in the plan and discussing with them to confirm their levels of awareness and readiness;
x. **Third party links:** identifying third party links and test the viability of their contact;

xi. **Backups:** verifying the backup tapes with respect to backup logs and labelling of the tapes;
xii. **Logs:** verifying the maintenance and testing logs for all key equipment, such as power generators, fire control equipment, air conditioners, UPS;
xiii. **Testing the BCP:** verifying if the BCP has been tested;
xiv. **Review and update:** confirming that the BCP documentation has been reviewed and updated in recent times; and
xv. **Evaluation:** evaluating relevant employee preparedness and familiarity with procedures.

b. **The reasons the audit of the Contingency or Business Continuity Plan is necessary include:**

i. Uncoveri.ng any weakness or lapses in the plan that might not be revealed during the audit;
ii. Validating an organisation's Business Continuity Plan to ensure that all relevant parts are working correctly; and
iii. Ensuring disaster recovery processes meet organisational standards.

Examiner's report

This question tests the candidates' knowledge of the information system audit aspect of a Contingency or Business Continuity Plan.

About 60% of the candidates attempted the question but their performance was poor.

The common pitfall of the candidates was poor understanding of the requirements of the information system audit of a Contingency or Business Continuity Plan.

Candidates are advised to adequately cover the entire syllabus noting especially correct developments in auditing.

Marking guide

		Marks	Marks
a.	**Audit steps to be taken in the information system audit of a Contingency or Business Continuity plan (BCP)**		
	(½ mark each for stating with a maximum of 6 points)	3	
	(1 mark for explaining the points above subject to a maximum of 6 points)	6	9
b.	**Reasons for the audit of the BCP**		
	(2 marks each subject to maximum of 3 points)		6
	Total		**15**

SOLUTION 6

(a) **The criteria for recognising development costs as an intangible asset according to IAS 38 which the auditor must first confirm are the:**

i. Technical feasibility of completing the intangible asset so that it will be available for use or sale;
ii. Entity's intention to complete the intangible asset and use or sell it;
iii. Ability to use or sell the intangible asset;
iv. Intangible asset will generate probable future economic benefits, either through sale externally or through an internal use;
v. Availability of adequate technical, financial or other resources to complete the development and to use or sell the intangible asset; and
vi. Ability to measure reliably the expenditure attributable to the intangible asset during its development which in case of the movie production is the total sum needed to invest before the package will be presented for production finance.

(b) **The audit tests in respect of the development costs include:**

i. Discussing the development costs with stakeholders to assess feasibility of the project;
ii. Reviewing projection and forecasts for using resources and generating future economic benefits;
iii. Assessing product and marketing plan and whether a market really exists;
iv. Considering funding requirements to complete the project;
v. Ascertaining whether the entity will be able to actually use or sell the products;
vi. Discussing management intention for the completion of the asset - for use or sale;
vii. Inspecting development contracts and records supporting and safeguarding patents;
viii. Testing controls around the documentation and safeguarding of technical notes, discoveries and conclusions;
ix. Testing a sample of the development costs being capitalised; and
x. Obtaining written representation from management as to their commitment to complete the project and either use or sell the resulting assets.

Examiner's report

This question tests the candidates' knowledge of IAS 38 – *Intangible Assets,* and relevant audit tests.

About 60% of the candidates attempted the question, but the performance was poor.

The common pitfall of the candidates was their inability to state the criteria for recognising costs within the provisions of IAS 38 – *Intangible Assets.*

Candidates are advised to cover all sections of the syllabus adequately and make informed use of the Institute Study Text and other publications.

Marking guide

		Marks
a.	**Criteria for recognising development costs as an intangible asset according to 1AS 38**	
	(1½ marks each subject to maximum of 4 points)	6
b.	**Audit tests in respect of development costs**	
	(1½ marks each subject to a maximum of 6 points)	9
	Total	**15**

SOLUTION 7

The Managing Director of Tiwani Cement Limited should note, in this situation, that:

i. Companies and other relevant organisations are becoming conscious of their public profile and are being made aware of their responsibilities not only to their shareholders, suppliers, customers and staff but also to the communities and environment in which they operate;

ii. Societies now do not consider it acceptable for organisations to ignore the environment in which they operate and their social obligations;

iii. The company stands the risk of suffering reputational risk which may have dire consequences on the operations of the company. For instance, there may be boycott of products, damage to company facilities and damage to the reputation of the company's management;

iv. It is now trite sense for companies to have social and environmental policies that would reflect that they are responsible corporate citizens by relating to their communities;

v. The government itself flays organizations against environmental degradation, among other things;

vi. Companies are required to publish a social and environmental report – sometimes referred to sustainability report and this form part of the Annual Report of the companies;

vii. To avoid issues like boycott of goods, unnecessary disruption of operations due to protests and loss of goodwill, the company should make it a point of duty and obligation to, as good business practice, take care of their communities and environment;

viii. Not taking care of the environment even attracts sanctions by government; and

ix. The audit firm, as is the current practice, would evaluate the operations of the company against social and environmental issues and duly report on them.

Examiner's report

This question tests candidates' knowledge of corporate social responsibility and sustainability reporting in a given scenario.

About 60% of the candidates attempted the question, but the performance was only average.

The major pitfall of the candidates was their inability to apply their knowledge practically to the given scenario of Corporate Social Responsibility.

Candidates are advised to cultivate the habit of reading widely and applying their knowledge to given practical scenarios.

Marking guide

	Marks
Advice offered to the MD of TIWANI Cement LTD	
(3 marks each subject to a maximum of 5 points)	**15**

ICAN/232/Q/B4 **Examination No....................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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, NOVEMBER 15, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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

Oshimiri Nigeria Limited, a company based in Aba, produces two grades of industrial vanish. The selling price and associated unit variable costs for vanish Grade A and Grade B are shown below:

Particulars	**Grade A**	**Grade B**
	₦	**₦**
Selling Price	2,100	1,500
Material x - ₦240 per kg	480	240
Skilled Labour - ₦144 per Hour	720	288
Unskilled Labour - ₦60 per hour	120	180
Variable overhead - ₦84 per machine hour	168	336

The fixed overhead costs are ₦2,600,000 per month. The company plans to maximise profits.

The availability of resources for the following month is as follows:

Material X	25,000Kg
Skilled labour	48,000 hours
Unskilled labour	39,000 hours
Machine hours	50,000 hours

Required:

a. Identify the objective function and the constraints of the model to be used in determining the optimum production plan for the following month. (5 Marks)

b. Determine the optimum production plan for the month and the associated Profit. (5 Marks)

c. Explain the concept and significance of dual prices and slack variables in the context of the model used by the company in this scenario. (4 Marks)

d. Calculate the dual prices for constraints identified in this scenario. (10 Marks)

e. Suggest ways in which the management can overcome the capacity constraints identified above during the month and the cost implications.

(6 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

Ope-Olu Limited produces and sells household items. For a particular product, the marketing department has prepared the following quarterly expected demand for next year:

Quarter	Expected Demand (Units)
1	400,000
2	440,000
3	760,000
4	560,000

The existing production facility can only produce 540,000 units per quarter under regular time. However, it is possible to increase output by 40% if working overtime is introduced.

It is the policy of the company to manufacture units using a constant level of production system. This means that although the opening and closing levels of inventory for the year are zero units, there are increases and decreases in the quarterly inventory levels. Based on this policy, the unit selling price, variable production costs and contribution for next year are expected to be as follows:

	₦ per unit	₦ per unit
Selling price		450
Direct materials	150	
Direct labour	175	
Variable production overhead	50	(375)
Contribution		75

The following additional information is available:

- Overtime is paid at 150% of normal rate and the unit variable production overhead cost will increase by 25% for those units produced during overtime working.
- The company incurs a holding cost (based on average inventory) of ₦25 per unit per quarter for each item that is held in inventory.

- The company is considering whether it should change to a just-in-time (JIT) production system, but it is concerned that due to the fluctuating levels of its sales demand, this may not be financially beneficial.

Required:

a. Discuss generally, the key conditions that are necessary for the successful implementation of JIT manufacturing system. (7 Marks)

b. Calculate the cost of holding inventory for each of the quarters and the year in total under the current production system. (6 Marks)

c. Calculate the financial impact of changing to a JIT production system. (7 Marks)

(Total 20 Marks)

QUESTION 3

You are the management accountant of a large manufacturing company in Kaduna. A management retreat has been planned for next week to set agenda for the preparation for next year's budget.

Required:

a. Outline the key stages in the planning process that link long-term objectives and budgetary control. (8 Marks)

b. Explain the meaning of the terms 'fixed budget', 'rolling budget' and 'zero-based budget', and discuss the circumstances under which each budget might be used. (8 Marks)

c. Discuss whether time series analysis may be preferred to linear regression as a way of forecasting sales volume. (4 Marks)

(Total 20 Marks)

QUESTION 4

PK Limited manufactures two models of heavy-duty cooking rack suitable for use in restaurant kitchens and similar commercial environments. Both models use the same types of raw material and machine hour. No inventories are held. The sales budget for next year is as follows:

	Model A	**Model B**
Sales units	300,000	140,000
Selling prices	₦1,000	₦1,400

The following additional information is provided:

- Cost data:

	Model A	Model B
Material cost	₦400	₦500
Variable production conversion costs	₦100	₦300

- Fixed production overheads attributable to the manufacture of the two models amount to ₦40,500,000
- Each model is completed in the machining department. The production rate per hour in the department is:

Model A	12.5 units
Model B	10 units

- Availability of machine hours is limited to 30,000 hours.

Required:

a. Using marginal costing principles, calculate the mix (units) of each model which will maximise net profit and indicate the value of the net profit. (5 Marks)

b. Calculate the throughput accounting ratio for each of the two models and briefly discuss when it is worth producing a product where throughput accounting principles are in operation. Your answer should assume that the variable overhead cost amounting to ₦24 million incurred as a result of the chosen product mix in part (a) is fixed in the short-term. (7 Marks)

c. Using throughput accounting principles, advise management of the quantities of each model that should be manufactured which will maximise profit and prepare a projection of the net profit that would be earned by PK Limited next year. (5 Marks)

d. Explain two aspects in which the concepts of 'contribution' in throughput accounting differs from its use in marginal costing. (3 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Vena Plc. manufactures engineering equipment. The company has received an order from a new customer for 5 machines at ₦5,000,000 each. Vena Plc.'s terms of sale are 10 percent of the sales value payable with order. The deposit has been received from the new customer. The balance is payable 12 months after acceptance of the order by Vena Plc.

Vena Plc.'s past experience has been that only 60 percent of similar customers pay within 12 months.

Customers who do not pay within 12 months are referred to a debt collection agency to pursue the debt. The agency has in the past had a 50 percent success rate of obtaining immediate payment once they became involved. When they are unsuccessful, the debt is written off by Vena Plc. The agency's fee is ₦500,000 per order, payable by Vena Plc. with the request for service. This fee is not refundable if the debt is not recovered.

You are an accountant in Vena Plc.'s credit control department, and based on the company's past experience and on discussions with the sales and credit managers, you do not expect the pattern of payment and collection to change.

Incremental costs associated with the new customer's order are expected to be ₦3,600,000 per machine; 70 percent of these costs are for materials and are incurred shortly after the order has been accepted. The remaining 30 percent is for all other costs which you can assume are paid shortly before delivery that is, in 12 months' time. The company is not presently operating at full production capacity.

A credit bureau has offered to provide an error-free credit information about the new customer if the price is right.

Vena Plc.'s opportunity cost of capital is 16 percent. Ignore taxation.

Required:

Write a report to the Credit Control Manager which;

a. Evaluates, from a purely financial point of view, whether Vena Plc. should accept the order from the new customer on the basis of the above information. (12 Marks)

b. Comment on what other factors should be considered before a decision to grant credit is taken. (3 Marks)

(Total 15 Marks)

QUESTION 6

Omegboje and company is a medium scale outfit that specialises in rental business in Owerri and Isiekenesi towns. The company has a gigantic event center in each of the two cities. The rental business is tailored to supplying of chairs, tables and canopies to outdoor event centres and in some cases to indoor event centre owned by the company.

Each event centre is managed by a manager who is given some level of independence in the management of the affairs of the centre. Event centre managers and their staff are rewarded with performance bonus of 10% of sales if they earn more than the approved standard returns on capital employed which is 50%.

The following information is extracted from the accounts of the company as it relates to the centres for two years ended December 31, 2020 and 2019.

Particulars	Owerri Event Centre 2020 ₦'000	Owerri Event Centre 2019 ₦'000	Isiekenesi Event Centre 2020 ₦'000	Isiekenesi Event Centre 2019 ₦'000
Revenue	10,400	9,600	10,000	6,000
Rental and hiring expenses	2,100	1,800	2,000	1,000
Salaries and wages	2,580	2,300	2,230	2,120
Consumables	970	880	850	540
Other operating costs	1,450	1,150	950	700
Total non-current asset less depreciation	6,400	6,100	5,900	5,700
Total current asset less cash and bank	1,300	1,100	1,500	1,690
Cash and bank	1,000	900	1,000	1,200
Long term debts	1,400	1,500	1,300	1,100
Current liabilities	1,100	1,000	1,200	1,150
Interest expenses	250	250	250	220

Further information:

(1) Revenue is derived from rentals and other ancillary services to customers.
(2) Both centres have a cost of capital of 15%.
(3) Ignore taxation and inflation.

Required:

a. Discuss the relative performance of the two centres using the following basis:

i. Return on capital employed
ii. Residual income model
iii. Profit margin
iv. Current ratio
v. Quick ratio
vi. Gearing ratio
vii. Interest cover (7 Marks)

b. Compute the performance bonus of the centres (if any) and state your workings. (4 Marks)

c. Briefly state the role of a Management Accountant in Project management. (4 Marks)

(Total 15 Marks)

QUESTION 7

a. Define the following concepts:

i. Responsibility accounting
ii. An investment centre

iii. Return on Investment (ROI)

iv. Residual income (6 Marks)

b. Ngerige and Sons limited has four operating divisions which are spread in four cities in Nigeria: Lagos, Kano, Gombe and Enugu. These divisions are treated as investment centres for the purpose of performance reporting. The following information is available:

S/N	Particulars	Lagos	Kano	Gombe	Enugu
1.	Divisional investment	₦10,000,000	₦4,000,000	₦3,000,000	₦7,000,000
2.	Divisional sales	₦53,000,000	₦23,000,000	₦24,600,000	₦29,400,000
3.	Divisional variable costs	₦50,000,000	₦22,000,000	₦23,400,000	₦27,400,000
4.	Divisional fixed costs	₦1,500,000	₦750,000	₦600,000	₦800,000

The company's annual fixed cost is ₦1,300,000 which is apportioned to the divisions on the basis of sales.

The cost of capital for Ngerige and Sons limited is 7.5%
Ignore taxation.

Required:

i. Evaluate the performance of the divisions using:
ROI method. (3 Marks)

Residual Income Method. (3 Marks)

ii. Re-evaluate the residual income situation of the company given that the cost of capital is 10%. (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. $\dfrac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate

n = number of periods

Discount rate (r)

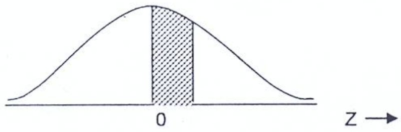
Periods

(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. Identify the objective function and the constraints of the model (linear programming model)

Contribution per unit

	A	B
Selling Price	**₦2,100**	**₦1,500**
Less Variable costs:		
Material X	480	240
Labour 1-Skilled	720	288
Labour 2-Unskilled	120	180
Variable overhead	168	336
Total variable cost	1,488	1,044
Unit contribution	**612**	**456**

Objective function = C = 612a + 456b

Constraints:'

Material will be $2a + b \leq 25,000$

Skilled labour will be $5a + 2b \leq 48,000$

Unskilled labour will be $2a + 3b \leq 39,000$

Machine hours will be $2a + 4b \leq 50,000$

Non negativity $a, b \geq 0$

In determining where the constraint equation lines cross a and b axes

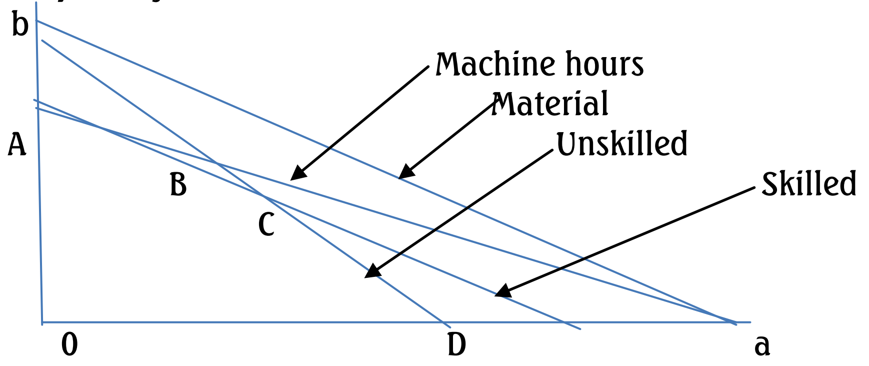
Material: 2a + b = 25000 Which is a = 12,500 b = 0; a = 0 b = 25,000

Skilled labour: 5a + 2b = 48000 Which is a = 9600 b = o; a = 0 b = 24,000

Unskilled labour: 2a + 3b = 39000 which is a = 19500 b = 0; a = 0 b = 13,000

Machine hours: 2a + 4b = 50000 which is a = 25000 b = 0; a = 0 b = 12,500

Graphically:



The binding constraints are skilled and unskilled labour.

From the Graph, the non-limiting factors are material and machine hours while the limiting factors are skilled labour and unskilled labour.

b. Determine the optimum production plan for the month and associated Profit
Hence the equations from the linear programme are:

Skilled Labour = $5a + 2b = 48,000$ .... Equation 1
Unskilled Labour = $2a + 3b = 39,000$ .... Equation 2
Multiply Equation 1 by 3 = $15a + 6b = 144,000$ .... Equation 3
Multiply Equation 2 by 2 = $4a + 6b = 78,000$ ....Equation 4
Subtract Equation 4 from Equation 3

$$11a = 66,000$$
$$a = 6000$$

Substitute for a in Equation 1

$$5a + 2b = 48000$$
$$5\,(6000) + 2b = 48000$$
$$30000 + 2b = 48,000$$
$$2b = 48000 - 30000$$
$$= 18000$$
$$b = 9000$$

Maximum contribution	= 612a + 456b
	= 612 x 6000 + 456 x 9000
	= ₦7,776,000
Less Fixed cost	₦2,600,000
Net Profit	₦5,176,000

c. Concept of dual prices and slack variables

The concept or model used in this situation of dual or double limiting factor decision tool is linear programming approach and it provides instrument for computing optimum solutions when dual constraints are identified. In this case, some constraints are not limiting while some are limiting. Skilled and unskilled labour hours are the relevant constraints. The **dual prices** are also known as shadow prices. The shadow or dual price of a constraint is the change in the objective function that is brought about if such constraint is changed by one unit.

Slack variables on the other hand refer to the amount of the available resources not used in the optimal solution. Only non limiting resources have slack variables. Limiting resources are fully utilised and therefore do not have slack values. In this case, the slack variables can be determined from material and machine hour resources.

d. Calculate the dual prices for constraints identified in this scenario

Dual price for Skilled Labour

Skilled Labour = $5a + 2b = 48,001$ ………………….. Equation 1

Unskilled Labour = $2a + 3b = 39,000$ ………………..…Equation 2

Multiply Equation 1 by 3 = $15a + 6b = 144,003$ …….. Equation 3

Multiply Equation 2 by 2 = $4a + 6b = 78,000$ ……..….Equation 4

Subtract Equation 4 from Equation 3

$$11a = 66,003$$

$$a = 6000.2727$$

Substitute for a in equation 1

$2a + 3b = 39,000$

$2(6,000.2727) + 3b = 39,000$

$12,000.545 + 3b = 39,000$

$$3b = 39,000 – 12,000.545 = 26,999.4545$$

$$b = 8,999.82$$

New Max. contribution

$= 612a + 456b = 612 \times 6,000.2727 + 456 \times 8,999.82 =$ ₦7,775,918.14

Old contribution = ₦7,776,000.00

Dual price for skilled labour = ₦81.86

Dual price for unskilled labour

Skilled Labour = $5a + 2b = 48,000$ ……………….Equation 1

Unskilled Labour = $2a + 3b = 39,001$ ……..…………Equation 2

Multiply Equation 1 by 3 = $15a + 6b = 144,000$ ………. Equation 3

Multiply Equation 2 by 2 = $4a + 6b = 78,002$ …………. Equation 4

Subtract Equation 4 from Equation 3

$$11a = 65,998$$

$$a = 5,999.82$$

Substitute for a in equation 1

$5a + 2b = 48,000$

$5(5,999.82) + 2b = 48,000$

$29,999.10 + 2b = 48,000$

$$2b = 48,000 – 29,999.10 = 18,000.90$$

$$b = 9,000.45$$

New maximum contribution

$= 612a + 456b = 612 \times 5,999.82 + 456 \times 9,000.45 =$ ₦7,776,095.04

Old contribution = ₦7,776,000.00

Dual price for unskilled labour = ₦95.04

e. Ways linear programming model can be used to overcome capacity constraints:

- Investigate alternative sources of materials, skilled labour and unskilled labour. Such sources may necessitate overtime hours and bonuses;
- Increase operating hours of machinery. Including maintenance cost or purchase cost;
- Increase output per machine hours which could lead to additional labour cost;
- Acquisition of machines requiring purchase and capital costs (Investment or capital outlay); and
- Subcontract some of the production to outsiders at higher purchase price which could be higher than the incremental costs.

Examiner's report

Question one is a compulsory question. This question tested candidates understanding of Linear Programming in capacity decision making and dual pricing in situation where there are limiting and non-limiting equations. Being a compulsory question, most candidates attempted this question. However performance was average.

Major Pitfall was candidates' inability to decipher limiting and non-limiting equations as well as computation of dual prices.

Candidates are encouraged to intensively use the ICAN study guide when preparing for future ICAN Examinations.

Marking guide

		Marks	**Marks**
a.	Identification of objective function and constraints of the model (30 ticks = 5 marks)		5
b.	Determine optimum plan and associated profit. (20 ticks = 5 marks)		5
c.	Explain the concept and significance of dual prices and slack variables.		
	Dual price: (Any 4 Points = 2 marks)	2	
	Slack variables: (Any 4 points = 2 marks)	2	4
d.	Calculate the dual prices for the constraints. (30 ticks = 10marks)		10
e.	Suggest the ways in which the model will be used to overcome capacity constraints. (3 points @ 2 marks each)		6
	Total		**30**

SOLUTION 2

(a) Set out below are the conditions that are necessary for the successful implementation of a JIT manufacturing system.

Suppliers

- **Quality raw materials/components**
  Stocks of raw materials/components, work in progress and finished goods are kept at near zero levels under a JIT system. Raw materials/components must therefore be of 100% quality, as defects stop the production line and, with no buffer stocks available, they could possibly result in failure to meet delivery dates to customers.

- **Delivery on time**
  As well as being responsible for the quality of raw materials/components, suppliers must also guarantee to deliver on time so that there are no production delays.

- **Small deliveries**
  Order sizes should be small to avoid the build up of stocks and the costs associated with this.

- **Close relationships**
  You must therefore establish long-term commitments with a limited number of suppliers with whom you should deal exclusively in their component areas. They guarantee to deliver material of 100% quality on time in return they are guaranteed demand for their products.

Production

- **Smooth production flow**
  The rate of production should be kept as smooth as possible as fluctuations can cause delays and lead to high levels of work in progress.

- **Pull system**
  Production in one process is only carried out when output of that process is needed by the next.

  Ultimately this means production is entirely based on customer demand for final output.

- **Set-ups**
  Because production runs are short, there are more of them, and set-ups need to be quick and inexpensive.

- **Machine maintenance**
  Routine preventative maintenance will avoid machine downtime.

Employees

- Flexible and multi-skilled workers

  Workers must be multi-skilled and flexible in order to be able to move between different production lines to maintain output.

- **Teamwork**
  Teamwork will ensure high levels of efficiency and the elimination of non-value added costs.

(b) Annual demand = 400,000 + 440,000 + 760,000 + 560,000 = 2,160,000 units
Annual capacity = 540,000 x 4 = 2,160,000 units

Thus, there is no need to work overtime under the existing policy of constant quarterly production.

Calculation of cost of holding inventory

Quarter	1	2	3	4	(₦'000) Total
Opening stock (units)	0	140,000	240,000	20,000	
Production (units)	540,000	540,000	540,000	540,000	
Sales (units)	(400,000)	(440,000)	(760,000)	(560,000)	
Closing stock (units)	140,000	240,000	20,000	0	
Average stock (Q)	70,000	190,000	130,000	10,000	
Holding cost = Q x ₦25	₦1,750,000	₦4,750,000	₦3,250,000	₦250,000	10,000

(c) **JIT Production system**
Sales demand for quarter 3 is above maximum capacity – including overtime capacity.

	Units
Demand	760,000
Maximum possible production: 540,000 x 1.40	756,000
Production shortfall	4,000

Contribution (4,000 units x ₦175 = ₦700,000) associated with the 4,000 units will be lost.

- **Quantity produced during overtime**
  Quarter 3 – maximum overtime capacity = 540,000 x 40% = 216,000 units
  Quarter 4: 560,000 – 540,000 = 20,000 units

- **Extra cost per unit during overtime working**

	₦		₦
Overtime premium:	175 x 50%	=	87.50
Variable production overhead:	50 x 25%	=	12.50
			100.00

- **Financial impact of JIT**

	₦000
Extra cost of overtime production:	
- 3rd quarter: 216,000 x ₦100	21,600
- 4th quarter: 20,000 x ₦100	2,000
	23,600
Lost contribution	700
	24,300
Existing cost (per (b) above)	(10,000)
Incremental cost	**14,300**

Examiner's report

This question tests candidates understanding of implementation of JIT, inventory management and control and financial impact of JIT manufacturing system.
The attempt on this question by candidates was very low.
The candidates recorded below average performance.

The Pitfall noticed was candidates' lack of understanding of the salient issues in inventory control and JIT implementation.
Candidates are encouraged to intensively use the ICAN study guide when preparing for future ICAN examinations.

Marking guide

		Marks	Marks
a.	Key conditions necessary for JIT Implementation. (Any 7 points @ 1 mark each)		7
b.	Cost of holding inventory for each quarter and the year. (30 ticks = 6 marks)		6
c.	Financial impact of changing to JIT system (21 ticks = 7 marks)		7
	Total		**20**

SOLUTION 3

a. The key stages in the planning process that links long-term objectives and budgetary control can be divided between long-term planning and the budgeting process. Long- term planning involves identifying objectives, and identifying, evaluating and selecting alternative courses of action. The budgeting process involves implementing the long-term plan in the annual budget, monitoring actual results and responding to divergences from plan. This can be stated thus:

Stage one: Identifying objectives

The planning process cannot take place unless organisational objectives are identified, since these determine what the organisation is seeking to accomplish through its operations and activities. These objectives will be long-term or strategic in nature and will give direction to the organisation's operational activities.

Stage two: Identifying alternative courses of action

Once organisational objectives have been identified, alternative courses of action that may lead to achieving those objectives can be identified. Strategic analysis of the organisation and its environment can indicate potential courses of action. For example, a company may look at its existing products and markets, its potential markets, the threat posed by its competitors, the impact of changes in technology on its products and production processes, and so on, and decide that a key objective is the development of new products to replace existing products in existing markets that are reaching the end of their product life cycle.

Stage three: Evaluating alternative courses of action

At this stage the various alternative courses of action are considered from the point of view of suitability, feasibility and acceptability. In order for this to be done, detailed information about each alternative course of action needs to be gathered and analysed.

Stage Four: Selecting alternative courses of action

Once the most appropriate alternative courses of action have been selected, long-term plans to implement them are formulated. Because these plans are long-term in nature, they will of necessity be less detailed than short-term plans, and will need to allow a degree of flexibility in responding to the changing organisational environment.

Stage Five: Preparing and implementing of long-term budget

Preparing and implementing the budget: A budget is a short-term plan formulated in financial terms and will show in detail the short-term actions the organisation will take in working towards its long-term objectives. Once the budget has been formulated, finalised and agreed it can be implemented.

Stage Six: Monitoring actual results

In order to achieve the long-term objectives that are reflected in the budget, the organisation must ensure that actual performance is proceeding according to plan. It will therefore need to monitor actual performance and results.

Stage Seven: Responding to divergences from plan

Divergences from planned activity, as measured by variances from budget, can lead to action if they are deemed to be significant. This action may be corrective in nature, in order to bring actual activity back into line with planned activity, or may entail revision of the budget if one of its underlying assumptions is seen as being in error.

b. A **fixed budget** is one prepared in advance of the relevant budget period which is not changed or amended as the budget period progresses. This budget represents a periodic approach to budgeting, since a new budget is prepared towards the end of the budget period for the subsequent budget period. In this way, an organisation may set a new budget on an annual basis.

A **rolling budget**, sometimes called a continuous budget, represents an Alternative approach to periodic budgeting. Here, a portion of the budget period is replaced on a regular basis so that the overall budget period remains unchanged. For example, with a budget period of one year, at the end of each quarter a new quarter could be added to the end of the budget period and the elapsed quarter could be deleted, so that the budget was always looking one year ahead. Continuous budgeting continues to increase in popularity.

A **zero-based budget** is a periodic budget which seeks to dispose of the incremental approach to budgeting. In the incremental approach, an increment is added to the relevant figure from last year's budget, for example to take account of inflation. In this way, inefficiency can become embedded in the annual budget and profitability may suffer as a result. With the zero-based approach, each element of planned activity is required to be justified in terms of its contribution towards achieving organisational objectives. This involves the formulation of decision packages, which describe particular activities in such a way that managers can compare them in terms of their competing claims on organisational resources, and then rank them from a cost-benefit point of view. In this way, zero-based budgeting looks at each budget period with a new perspective.

A fixed budget is likely to be useful in circumstances where the organisational environment is relatively stable and can be predicted with a reasonable degree of certainty.

A rolling budget is likely to be useful in circumstances where the future is less certain and more flexibility is needed in the organisational response to its changing environment. For this reason, rolling budgets are popular with new organisations. A cash budget is often a rolling budget because of the need to keep tight control over this aspect of financial management. A rolling budget is also supported by the availability of cheap and powerful information processing via personal computers and computer networks.

A zero-based budgeting approach tends to be most beneficial when used with services and with discretionary activities, and so is most widely used in the public sector.

c. **Linear regression** is a powerful way of analysing past information in order to derive linear relationships and so is ideally suited to deriving cost equations from past accounts. Sales volume, however, is unlikely to follow a linear relationship alone. Linear regression could be used to determine the overall trend being followed by sales volume on, for example, an annual basis, but inspection of historic sales volumes is likely to show variations about the trend. These could be due to seasonal variations, or longer-term cyclical variations.

Time-series analysis can extract these seasonal and cyclical variations and therefore produce forecasts of sales volumes that are likely to be more accurate in a given period than forecasts based on the underlying trend alone.

In forecasting future sales volumes, therefore, both quantitative methods have their place in increasing forecasting accuracy.

Examiner's report

This question tests candidates' knowledge of the planning process and budget types and when to use them. It also tests candidates' understanding of time series analysis and linear regression models for sales forecasting.

The attempt on the questions which were in three parts (a) to (c) by candidates was very low. The candidates recorded below average performance.

The Pitfall noticed was the inability of the candidates to comprehend the theoretical requirements of the questions.

Candidates are encouraged to intensively use the ICAN study guide when preparing for future ICAN Examinations.

Marking guide

		Marks	Marks
a.	Key Stages in Planning process linking Long term Objectives and Budgetary Control. (8 stages @ 1 mark/stage)		8
b.	• Meaning of Fixed Budget and when to use it (Explanation = 1%; When to use it = ½%)	1½	
	• Meaning of Rolling Budget and when to use it. (Explanation = 1%; When to use it = ½%)	1½	
	• Meaning of Zero-based Budget and when to use it. (Explanation = 2%; When to use it = 3%)	<u>5</u>	8
c.	Discuss whether time series analysis are preferred to linear regression analysis in sales forecasting. (2 points @ 1 point = 2 marks)		<u>4</u>
	Total		**20**

SOLUTION 4

a. The machine hours are insufficient to produce all the budgeted quantity:

Hours needed:

Model A	300,000/12.5	=	24,000	hours
Model B	140,000/10	=	14,000	hours
Total needed			38,000	hours
Total available			30,000	hours
Shortfall			8,000	hours

- **Calculation of contribution and ranking**

		Model A		Model B
Selling price per unit (₦)		1,000		1,400
Total variable cost per unit (₦)		500		800
Contribution per unit (₦)		500		600
Machine hour per unit	(1/12.5)	0.08	(1/10)	0.10
Contribution per machine hour	(₦500/0.08)	₦6,250	(₦600/0.10)	₦6,000
Ranking		1st		2nd

- **Calculation of optimal production plan**

Model A to be produced	300,000 units
Model B that can be produced: 140,000 – (8,000 ÷ 0.10)	60,000 units

The company should therefore produce 300,000 units of Model A and 60,000 units of Model B.

- **Calculation of projected profit**

		₦'000	₦'000
Contribution:			
Model A	300,000 x ₦500	150,000	
B	60,000 x ₦600	36,000	186,000
Fixed costs			(40,500)
Optimal profit			145,500

b. Throughput accounting ratio = return per factory hour/cost per factory hour

Return per factory hour = Sales – material costs/usage of bottleneck resource

		Model A		Model B
Selling price (₦)		1,000		1,400
Less material cost (₦)		400		500
Return per unit (throughput contribution)		600		900
Bottleneck resource (machine hours)		0.08		0.10
Return/machine hour	(₦600 ÷ 0.08)	₦7,500	(₦900 ÷ 0.10)	₦9,000

Cost per machine hour = Total factory cost/Total available machine hours

		₦000	₦000
• **Total factory cost**			
Variable overheads costs (fixed in short-term)			
- Model A: 300,000 x ₦100	=	30,000	
- Model B: 60,000 x ₦300	=	18,000	48,000
Conversion of variable cost to fixed cost			24,000
Unconverted Variable costs			24,000
Short term Fixed costs			24,000
Other Fixed overheads			40,500
Total factory costs			88,500
Available machine hours			30,000
Factory Cost per machine hour	=	₦88,500,000/30,000 =	₦2,950

- **Throughput accounting ratio (TAR)**

$$TAR = \frac{\text{Return per machine hour}}{\text{Cost per machine hour}}$$

Model A ₦7,500/₦2,950 = 2.54
B ₦9,000/₦2,950 = 3.05

In situations where throughput accounting principles are in application, a product will be worth producing provided that the throughput return per hour of bottleneck resource is greater than the cost per factory hour. This may be measured by the throughput accounting ratio. If throughput return outweighs the cost per factory hour, the ratio will be greater than 1.00. Management should focus attention upon increasing the throughput ratio. If they can do this, then higher levels of profit will be achieved.

c. Since Model B has a higher return per machine hour than Model A, PK Ltd should produce Model B until it has satisfied the total demand for 140,000 units. The production mix will therefore be as follows:

Model	**Qty.**	**Machine hour per unit**	**Total machine Hours**
B	140,000	1/10 = 0.10	14,000
A	200,000	1/12.5 = 0.08	16,000
			30,000

- **Calculation of projected profit**

		₦000	₦000
Throughput contribution:			
Model A 200,000 x ₦600	=	120,000	
B 140,000 x ₦900	=	126,000	/246,000
Less: Variable over-head costs			
(assumed fixed)		48,000	
Fixed overheads		40,500	88,500
Projected net profit			157,500

d. Throughput accounting and marginal costing both determine a contribution by calculating the difference between sales revenue and variable costs. However this contribution will be higher under throughput accounting since only material costs are recognised as being variable costs. Under marginal costing, direct labour costs and certain overhead expenses will also be deducted from sales revenue in order to calculate contribution. This is because such costs are variable in nature.

   Throughput accounting regards such costs as fixed and this is true insofar as they cannot be avoided in the 'immediate' sense. In marginal costing and throughput accounting the rate of contribution generated per unit of scarce resource can be used to determine the optimum production mix. However, different rankings can occur under each method of which the decision maker must be aware. Throughput accounting is only concerned about output that will affect sales revenues. Very much in sympathy with Just-in-time philosophy stocks are only considered desirables when they can enhance and increase throughput. In throughput accounting the cost of all materials purchased during a period is deducted from the sales revenue generated in that period irrespective of whether they have been consumed or remains in stock at the end of the period. This contrasts with marginal costing where only the costs of materials actually consumed during the period is deducted from sales revenue generated in period.

Examiner's report

This question tests candidates' knowledge of marginal costing technique as a tool for capacity decision vis a viz throughput accounting. It also tests computation of Throughout Accounting Ratio (TAR).

The attempt on the questions which were in four parts (a) to (d) by candidates was very low. The candidates recorded below average performance.
The Pitfall noticed was the inability of the candidates to comprehend the concept of throughput accounting.

Candidates are encouraged to intensively use the ICAN study guide when preparing for future ICAN examinations.

Marking guide

		Marks	Marks
a.	Using marginal costing to compute optimal mix and net Profit. (25 ticks = 5 marks)		5
b.	Calculate Throughput Accounting Ratio (TAR) (20 ticks = 5 marks)	5	
	Discussion of TAR	2	7
c.	Using throughput accounting to compute optimal mix and net Profit (10 ticks = 5 marks)		5

d. Differences between throughput contribution and marginal costing contribution.
(Any 2 points @ 1½ marks per point) 3
Total **20**

SOLUTION 5

a. **From:** **Finance Manager**
To: **Credit Control Manager, V Plc.**
Date: **15 May 2019**
Subject: **Order from new customer**

As required, I have looked into the above. There are three possible outcomes:

i) all goes well and we receive the balance due from the customer (probability 60%);
ii) we have to pay a ₦500,000 collection fee, as a result of which the balance is received (probability 20%);
iii) we pay the ₦500,000, but the balance is not forthcoming (probability 20%).

These can be evaluated, and a statistically "expected" figure calculated, as follows:

		Possible Outcome		
		(i)	**(ii)**	**(iii)**
		₦000	**₦000**	**₦000**
Now	Receive 10% of ₦25m	2,500	2,500	2,500
	(Pay) 70% of ₦18m	(12,600)	(12,600)	(12,600)
	Net (k)	**(10,100)**	**(10,100)**	**(10,100)**
Year 1	(Pay) 30% of ₦18m	(5,400)	(5,400)	(5,400)
	(Pay) collection fee	-	(500)	(500)
	Receive balance	**22,500**	**22,500**	-
	Net receipt/(payment)	17,100	16,600	(5,900)
	Present value at 16% p.a (T)	14,740	14,310	(5,086)
	Net present value (K+T)	4,640	4,210	(15,186)
	Probability	60%	20%	20%
	Expected value	**2,784 + 842 - 3,037**		**= ₦589**

The expected value being positive, the order is financially viable.

b. Other factors worthy of consideration include the following:

- Although the expected value is positive, there are only three possible outcomes:
  ₦4,640,000 positive, ₦4,210,000 positive and ₦15,186,000 negative;

  Depending on your aversion to risk, the size of the negative outcome may dissuade you from accepting the order;
- The possibility of insuring against default;
- The possibility of using other forms of payment, e.g. bills of exchange or different terms (discount for early payment);
- The likelihood of getting further orders as a consequence of accepting this (e.g. repeat or recommendation).
- The possibility of recovering some of the balance at a later date (e.g., on the insolvency of the buyer).
- Opportunity cost, e.g. penalties/layoffs if order is not accepted; and
- The question of whether the 16% already includes a component to reflect uncertainty/risk aversion - if so, what

Please let me know if you wish to elaborate on any of the above or take any aspect further.

Signed: **Credit control Accountant**

Examiner's report

The question tests candidates' understanding of credit control analysis and investment analysis. The question was poorly attempted by candidates.
The candidates recorded below average performance.

The Pitfalls noticed were the inability of the candidates to compute the customers outstanding based on credit terms and associated bad debts, incremental costs and the investment appraisal on cash receipts and payments.

Candidates are encouraged to intensively use the ICAN study guide when preparing for future ICAN examinations.

Marking guide

		Marks	Marks
a.	Evaluate the financial implication of whether to accept or reject the order. (36 ticks = 12 marks)		12
b.	Factors for Credit control decisions. (Any 3 points @ 1mark each)		3
	Total		**15**

SOLUTION 6

a. Relative performance of the two profit centres

S/N	Ratios	Owerri event centre ₦'000 2020	2019	Isiekenesi Event Centre ₦'000 2020	2019
	Capital employed:				
	Total non – current asset	6400	6100	5900	5700
	Current asset less cash/bank	1300	1100	1500	1690
	Cash and bank	1000	900	1000	1200
	Total asset	8700	8100	8400	8590
	Less: current liabilities	1100	900	1200	1150
	Capital employed	7600	7200	7200	7440
	Sales (Revenue)	10,400	9,600	10,000	7,000
	Less: Operating expenses:				
	Rental and hiring expenses	2100	1800	2000	1000
	Salaries and wages	2580	2300	2230	2120
	Consumables	970	880	850	540
	Other operating expenses	1450	1150	950	700
	Total expenses	7100	6130	6030	4360
	Operating profit before interest and tax	3300	3470	3970	2640
i.	Returned on capital employed = Profit/capital employed	0.434	0.482	0.551	0.355
ii.	Operating profit	3300	3470	3970	2640
	Imputed cost = 15% of capital employed	1140	1080	1080	1116
	Residual income = Profit – imputed cost	2160	2390	2890	1524
iii.	Operating profit before interest and tax	3300	3470	3970	2640
	Sales (Revenue)	10400	9600	10000	7000
	Profit margin = Profit /sales	0.317	0.362	0.397	0.377
iv.	Current asset	2300	2000	2500	2890
	Current liabilities	1100	900	1200	1150
	Current ratio= current Asset/current liability	2.091	2.222	2.083	2.513
v.	Current asset less inventory	2300	2000	2500	2890
	Current liability	1100	900	1200	1150
	Quick ratio = Current asset less Inventory/Current liability	2.091	2.222	2.083	2.513

vi.	Long term debts	1400	1500	1300	1100
	Capital employed	7600	7200	7200	7440
	Gearing ratio = Long term debt /Capital employed	0.184	0.208	0.181	0.148
vii.	Interest charge	250	250	250	220
	Profit before interest/tax	3300	3470	3970	2640
	Interest cover = (PBIT/Interest charge)	13.2 times	13.88 times	15.88 times	12.00 times

Explanations of the computed ratios:

Returns on capital employed (ROCE)

The ROCE sometimes called Return on Investment (ROI) is the profit of the division as a percentage of the capital employed. Isiekenesi event centre has a better ROCE than Owerri in 2020 while Owerri had a better ROCE than Isiekenesi event centre in 2019.

Residual income

Residual income is another way of appraising a company or division which shows the absolute profit after deducting imputed cost or notional cost of capital from operating profit. The Isiekenesi event centre shows better residual income than Owerri event centre in 2020 but Owerri event centre shows better residual income than Isiekenesi in 2019.

Profit margin

This is the profit as a percentage of sales/revenue (Profit achieved per ₦1 of sales. Isiekenesi event centre makes higher profit margin than Owerri event centre.

Current ratio

The current ratio is the liquidity ratio that specifies the relationship between current asset and current liabilities. The ideal current ratio is 2:1 or 2.0. that means the company has enough liquid asset to meet the demand of short term of current liabilities. Owerri event centre have better liquidity in 2020 while Isiekenesi event centre have a better liquidity in 2019.

Quick ratio

The quick ratio is a more effective liquidity ratio that shows the relationship between Current asset less inventory and current liability. In some cases it is current asset less only inventory. But in this very situation the inventory are not specified. Owerri event centre have better liquidity in 2020 while Isiekenesi event centre have a better liquidity in 2019.

Gearing ratio

The gearing ratio otherwise referred to as leverage ratio shows the relationship between Long term debt and capital employed. A company is said to be highly geared or leveraged when its debt capital exceeds its equity interest. It is low geared if the debt capital is lower than equity. All the two centres are low geared even though in 2019 and 2020 the Owerri centre was slightly higher.

Interest cover
This measures the ability of the company to meet its obligations to pay interest. An interest cover of 3 is considered low and shows that the company may be at risk from too much debt in relation with the amount of profit the centre makes. All the centres are comfortable even though Owerri centre is better than Isikenesi event centre.

b. **Computation of Performance bonus**

Particulars	**Owerri event centre**		**Isiekenesi event centre**	
	2019	**2020**	**2019**	**2020**
Actual ROCE	0.434	0.482	0.551	0.355
Standard ROCE	0.50	0.50	0.50	0.50
Qualifies for bonus	Not qualified	Not Qualified	Qualified	Not Qualified
Performance Bonus = 10% of Sales		-	₦1,000	-

c. Role of Management Accountant in Project Management

- Understanding the economics of different options and decisions
- Ability to forecast cost and profits
- Generate accurate networks analysis and Gantt chart
- Use spread sheets effectively
- Considers external factors and internal factors.

Examiner's report

The question tests candidates' ability to determine performance measure of company using ROCE, residual income, profit margin, current ratio, gearing ratio and interest cover. The question tests candidates' understanding of role of management accountant in project management. The attempt on this question by candidates was very high.

The candidates recorded average performance.
The Pitfall noticed was candidates' inability to discuss the theoretical aspect that dwell on project management.

Candidates are encouraged to intensively use the study guide when preparing for future ICAN examinations.

Marking guide

		Marks	Marks
a.	Compute performance ratios:		
	i. ROCE	1	
	ii. Residual income	1	
	iii. Profit Margin	1	
	iv. Current Ratio	1	
	v. Quick ratio	1	
	vi. Gearing ratio	1	
	vii. Interest cover	1	7
b.	Computation of performance bonus (16 ticks = 4 marks)		4
c.	Role of management accountant in project management. (Any 4 points @ 1 mark each)		4
	Total		**15**

SOLUTION 7

i) Definition of Terms

Responsibility Accounting

This is the structuring of performance report for individual manager in a way that identifies the factors that are controllable by them and for which they are responsible. Responsibility accounting reports may be prepared for cost centres, revenue centres, profit centres, or investment centres.

ii) **An Investment Centre**

It is an operating division within an organisation whose manager has the responsibility for both the profit and investments of the division.

iii) **Return on Investment (ROI) for a division**

It is the divisional profit divided by the capital employed in that division.

iv) **Residual Income (RI) for a division**

Divisional income less a notional or imputed interest charge on the investment in capital employed.

b. (i) Evaluate the performance of the divisions using ROI and residual income method.

Returns on capital employed (ROI)

Particular	Lagos	Kano	Gombe	Enugu	Total
	₦'000	₦'000	₦'000	₦'000	₦'000
Sales	53,000	23,000	24,600	29,400	130,000
Variable Cost	50,000	22,000	23,400	27,400	122,800
Contribution	3,000	1,000	1,200	2,000	7,200
Fixed Cost					
Specific	1,500	750	600	800	3,650
General	530	230	246	294	1,300
	2,030	980	846	1,094	4,950
Net Profit	**970**	**20**	**354**	**906**	**2,250**
ROI =	970,000 / 10,000,000	20,000 / 4,000,000	354,000 / 3,000,000	906,000 / 7,000,000	2,250,000 / 24,000,000
=	0.097	0.005	0.118	0.1294	0.09375

Using ROI, Enugu division is more profitable than the other three Divisions

Residual Income: At cost of capital of 7½%

Particular	Lagos	Kano	Gombe	Enugu	Total
Profit	970,000	20,000	354,000	906,000	2,250,000
Less: Imputed cost:					
7.5% of investment	750,000	300,000	225,000	525,000	1,800,000
Residual income	220,000	(280,000)	129,000	381,000	450,000

Appraising the divisions using residual income method with an imputed interest of 7.50%, Enugu is more profitable.

Residual income at cost of capital of 10%

Particular	Lagos	Kano	Gombe	Enugu	Total
Profit	970,000	20,000	354,000	906,000	2,250,000
Less: Imputed cost	1,000,000	400,000	300,000	700,000	2,400,000
Residual income/					
(Negative income)	(30,000)	(380,000)	54,000	206,000	(150,000)

In appraising the divisions with a imputed interest of 10%, Enugu is still profitable.

Examiner's report

The question tests candidates understanding of certain definitions like responsibility accounting, investment centres, ROI and residual income. Many candidates attempted the question.

The candidates recorded above average performance.
The Pitfall noticed was candidates' inability to compute the new performance ratio arising from 10% cost of capital.

Candidates are encouraged to intensively use the study guide when preparing for future ICAN examinations.

Marking guide

		Marks	Marks
a.	**Definition of Terms:**		
	i. Responsibility accounting	1½	
	ii. An investment centre	1½	
	iii. Return on investment (ROI)	1½	
	iv. Residual income	1½	6
b.	i. Evaluation of performance of Divisions		
	• ROI method (30 ticks = 3 marks)	3	
	• Residual income method (15 ticks = 3 marks)	3	
	ii. Re-evaluate the residual income situation of company if cost of capital is 10% (15 ticks = 3 marks)	3	9
	Total		**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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, NOVEMBER 16, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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

Housing-for-all Corporation is an entity established by Kazua State to engage in building construction. The corporation is partly financed with subvention from the State and also from the proceeds from its operations. It applied for a bid to construct twenty (20) classroom buildings in the riverine area of the state. After all the initial procurement processes on bid-opening were carried out, the corporation won the contract in June 2018. The contract price was ₦220m. The building construction contract was billed for completion in two years. The company uses stages of completion on the basis of value of work completed. The following financial data were available in respect of the contract as at December 31, 2019:

	₦'000
Total contract price	220,000
Total expected costs	180,000
Costs incurred to date	120,000
Value of work certified as complete	140,000
Amount billed to client (Kazua State)	130,000
Progress payment received from client (Kazua State)	100,000

The contract was duly completed in June 2020

Required:

In line with IPSAS 11- Construction Contracts,

a. Determine the expected profit of the contract, stage of completion in percentage as well as the amount to be recognised in Housing-for-all Corporation's income statement at December 31, 2019. (11 Marks)

b. Calculate the amount to be recognised as gross amount due to or from the client, Kazua State, the amount of trade receivable and prepare extracts of financial statements in respect of the construction contracts at December 31, 2019. (13 Marks)

c. Identify what constitutes the composition of contract costs as contained in IPSAS 11. (6 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

a. Enumerate **FOUR** of the documents that must accompany the appropriation bill when the President is making submission to the National Assembly. (8 Marks)

b. Briefly discuss the **THREE** types of audit responsibility of the Auditor-General for the Federation in line with Financial Regulation (2009 Edition). (12 Marks)

(Total 20 Marks)

QUESTION 3

a. Describe the procurement process for each of the following three items as specified in the Procurement Act, 2007 and the subsequent guidelines issued by the Bureau of Public Procurement (BPP), given that appropriations were made in the current budget of Federal Government of Azare.

   i. Consultancy services worth ₦99 million. (3 Marks)

   ii. Procurement and installation of sundry items for virtual library in federal government secondary schools including the construction of the building facilities worth ₦958 million. (3 Marks)

   iii. Supply of branded envelopes, files and letter-heads worth ₦4.2 million. (3 Marks)

b. Based on the budget of Azare Federal Ministry of Health and Wellbeing (AFMHW), a contract to construct 5 units of Primary Healthcare Centres (PHC) in each of the six (6) geo-political zones to address malaria, infant deaths and years of neglect in prioritising primary healthcare and well-being of the citizens was signed with Alaafia Construction Company. This contract was at the cost of ₦12,250,200 per unit, with a 2-year contract duration and no variation clause.

A valuation certificate was submitted at the end of year one, which showed that over 60% of the contract has been executed, while ₦294,004,800 has been estimated to have been spent on the project since inception. There were also indications that office of AFMHW has paid the contractor a total sum of ₦244,100,000.

Required:

Prepare journal entries to record the above transactions. (4 Marks)

c. i. Identify **TWO** provisions of Financial Regulations which guide against the delay in contract payments. (3 Marks)

   ii. Enumerate **TWO** punishments each that can be meted out to a government official and a legal person in case of delay in payment of contracts executed. (4 Marks)

(Total 20 Marks)

QUESTION 4

Fakafiki Federal Transport Agency (FFTA) introduced a new rail coach, Luxury DV, to its range last year. The coach used to transport passengers with serious bottleneck in the transportation process, meaning that a maximum of 5,000 passengers per annum can be transported.

The Luxury DV product has been a huge success and as a result, all passengers showing interest were transported. The marketing department has prepared the following demand forecast for future years as a result of feedback from high networth customers.

Year	1	2	3	4
Demand (Number of passengers)	7,000	9,000	11,000	4,000

The Directors of FFTA are now considering investing in a second coach that will allow the company to satisfy the increasing demand. The following information relating to this investment proposal has now been prepared:

Initial investment	₦350,000
Maximum additional perssengers	5,000 passengers
Current fare	₦450 per passenger
Variable cost of operation	₦200 per passenger
Fixed operating costs	₦175,000

If tickets issued remained at 5,000, the current fare would be expected to continue throughout the remainder of the life of the coach. However, if passenger traffic is increased, it is expected that the fare will fall to ₦400 per passenger for all tickets sold. Again, this will last for the remaining life of the coach.

No terminal value or coach scrap value is expected at the end of four years, when passengers on Luxury DV is planned to end. For investment appraisal purposes, FFTA uses a nominal discount rate of 10% per year and a target return on capital employed of 20% per year. Ignore taxation.

Required: Using an incremental approach, calculate the following values for the investment proposal of the second coach.

a. Net present value. (10 Marks)
b. Internal rate of return. (4 Marks)
c. Return on capital employed (accounting rate of return) based on initial investment. (6 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Fiscal federalism deals with the division of tax and expenditure functions among the various levels of government in a federation. A federal system of administration allows both centralised and decentralised collective choices to be made by each tier of government.

Required:

a. Explain **TWO** arguments each in favour of decentralisation and centralisation of fiscal responsibilities. (6 Marks)

b. Explain **THREE** fiscal and monetary strategies that government takes to address the impact of the economic downturn. (9 Marks)

(Total 15 Marks)

QUESTION 6

The merits and demerits of debt and tax finance for deficit financing are often debated. The choice of one method depends on the objective and overall long-term implications for the economy.

Required:

a. Explain the following:

i. Debt refinancing. (1 Mark)

ii. Why debt refinancing may be of interest to a federal authority. (4 Marks)

iii. Project financing. (2 Marks)

b. Explain **FOUR** forms of debt refinancing. (8 Marks)

(Total 15 Marks)

QUESTION 7

Public, Private Partnership (PPP) involves a private entity financing, constructing or managing a project in return for a promised stream of payments directly or indirectly from government.

Required:

Explain **THREE** merits and **TWO** demerits of private finance initiatives.

(15 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

Housing-for-all Corporation

a. **Calculation of expected profit of the contract at December 31, 2019**

	₦'000
Total contract revenue	220,000
Total expected contract costs (based on stage of completion method)	180,000
Expected profit of the contract	40,000

Calculation of stage of completion method (in percentage)

$$\text{Formular:} = \frac{\text{Value of work certified as complted}}{\text{Total contract price}} \text{ X } \frac{100}{1}$$

$$\frac{140,000}{220,000} \text{ X } \frac{100}{1} = 63.64\%$$

Determination of the amount to be recognised in Housing-for-all Corporation's income statement

	₦'000
Revenue (value of work certified)	140,000
Profit taken (₦40,000,000 x 63.64%)	(25,456)
Costs	**114,544**

b. **Calculation of amount to be recognised in the statement of financial position for gross amount due to or from client, Kazua State and accounts receivable**

	₦'000
Trade receivable (Amount billed)	130,000
Amount received	(100,000)
Account receivable	30,000
Gross amount due from client, Kazua State	(25,456)
Cost incurred	120,000
	145,456
Amount billed	(130,000)
Gross amount due from client (Kazua State)	**15,456**

Housing-for-all Corporation
Income statement extracts for the year ended December 31, 2019

	₦'000
Revenue	140,000
Costs	(114,544)
Profit	25,456

Housing-for-all Corporation
Statement of financial position extracts as at December 31, 2019

Current assets:	**₦'000**
Trade receivable	30,000
Gross amount due from client (Kazua State)	15,456

c. **Composition of major contract costs as contained in IPSAS 11**

i. Site labour costs, including site supervision.
ii. Cost of materials used in construction.
iii. Depreciation of plant and equipment used on the contract.
iv. Cost of moving plant, equipment and materials to and from contract site.
v. Cost of hiring plant and equipment.
vi. Costs of design and technical assistance that are directly related to the contract.
vii. The estimated costs of rectification and guarantee work including expected warranty costs.
viii. Claims from third parties.
ix. Costs that are attributable to contract activity in general and can be allocated to the contract on a systematic and rational basis.
x. Such other costs as are specifically chargeable to the customer under the terms of the contract.

Examiner's report

Part (a) of the question tests candidates' knowledge on the determination of the expected outcome of the contract, stage of completion in percentage and amount to be recognised in the income statement. Part (b) requires the candidates to calculate the amount to be recognised as gross amount due to or from their client, amount of trade receivable and to prepare extracts of financial statements, while part (c) requires the candidates to identify what constitutes the composition of contract costs as contained in IPSAS 11.

As a compulsory question, all the candidates attempted the question but their performance was below average.

The common pitfalls were the inability of the candidates to determine the expected outcome of the contract, stage of completion in percentage and amount to be recognised in the income statement. Also, candidates were unable to calculate the amount to be recognised as gross amount due to or from their client and the amount of trade receivable.

Candidates are advised to have adequate knowledge of the relevant provisions of International Public Sector Accounting Standards (IPSAS) and to make use of the Pathfinder and Study Text of the Institute for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a.	Title	1	
	Calculation of expected outcome of the contract at December 31, 2019	4	
	Calculation of stage of completion method (in percentage)	3	
	Determination of the amount to be recognised in income statement	3	11
b.	**Calculation of amount to be recognised in the statement of financial position**		
	Amount to be recognised in the statement of financial position for gross amount due to or from client	8	
	Preparation of financial statements extracts		
	Income statement extracts for the year ended December 31, 2019	3	
	Statement of financial position extracts as at December 31, 2019	2	13
c.	**Composition of major contract costs as contained in IPSAS 11**		
	Any six (6) points stated		6
	Total		**30**

SECTION B

SOLUTION 2

Documents that must accompany the Appropriation Bill

a. The annual budget must be accompanied by:

   i. A copy of the underlying revenue and expenditure profile for the next two years;
   ii. A report setting out actual and budgeted revenue and expenditure, with a detailed analysis of the performance of the budget for the 18 months up to June of the preceding financial year;
   iii. A fiscal target broken down into monthly collection targets;

iv. Measures of cost, cost control and evaluation of result of programmes financed with budgetary resources;

v. A fiscal target document derived from the underlying Medium - Term Expenditure Framework (MTEF) setting out the following targets for the relevant financial year;
   - Target inflation rate
   - Target fiscal account balances; and
   - Any other development target deemed appropriate; and

vi. A fiscal risk document, evaluating the fiscal and other related risks to the annual budget and specifies measures to be taken to offset the occurrence of such risks.

b. **Types of statutory audit responsibility that the Auditor-General for the Federation must carry out in line with Section 109 of Financial Regulations (2009 Edition).**

i. **Financial audit** - Financial audit is determining whether an entity's financial information is presented in accordance with an applicable financial reporting and regulatory frameworks. While doing financial audit, auditors should look for misstatements and errors that can have material impact on the information presented in the financial statements. Misstatements or errors are considered material if they impact the decisions of the intended users of the financial statements.

ii. **Appropriation audit** - This is to ensure that funds are expended as appropriated by the National Assembly. The definition of appropriation or compliance audit builds on the definition of public sector audit with a specific focus on assessing compliance with criteria derived from authorities. Authorities are the parliamentary decisions, laws, legislative acts, established codes or norms and agreed-upon terms that a public sector entity is expected to comply with in the execution of its roles and responsibilities. The main objective of compliance audit is to provide the intended user(s) with information on whether the audited public entities follow parliamentary decisions, laws, legislative acts, policy, established codes and agreed upon-terms.

iii. **Financial control audit** – It is an audit process in which all the transactions of the public sector entities are reviewed. The core objective of this procedure is to find out the financial health of the public sector entities and to make certain that all the information provided by the government is accurate. It is to ensure that the laid down procedures are being observed in tendering, contracts and storekeeping with a view to preventing waste, pilferage and extravagance.

iv. **Value-for-Money or performance audit** - To ascertain the level of economy, efficiency and effectiveness derived from government projects and programmes.

Performance audit is an independent, objective and reliable examination of whether the government undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvements. Performance audit seeks to provide new information, analysis or insights and where appropriate, recommendations for improvement.

'Value for Money' (VFM) means using resources in the best way in order to achieve intended objectives. There are three aspects to achieving value for money, often known as the '3Es'.

- **Economy** - This means spending money carefully, and not paying more than necessary for resources such as, materials, labour and other expenses.
- **Efficiency** - Efficiency means using resources in such a way that they produce the greatest possible amount of output. It means getting more from the use of available resources. For example, efficiency in the use of an employee means getting a high rate of output for every hour or day worked.

- **Effectiveness** - Effectiveness means using resources in such a way as to achieve the desired objectives. Efficiency is of little value unless the output from the system is what the entity wishes to achieve.

The purpose of a VFM engagement is to investigate a particular aspect of an entity's operations and reach a conclusion about whether the entity is obtaining value for money.

Examiner's report

Part (a) of the question requires the candidates to enumerate the documents that must accompany the appropriation bill to the National Assembly while part (b) requires the candidates to discuss types of audit responsibility of the Auditor-General for the Federation in line with Financial Regulations (2009 Edition).

Majority of the candidates attempted the question but their performance was below average.

The commonest pitfall was the inability of the candidates to enumerate the documents that must accompany the appropriation bill to the National Assembly

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

Marking guide

		Marks	Marks
a.	**Documents that must accompany the Appropriation Bill**		
	Any four (4) documents		8
b.	**Types of statutory audit responsibility of the Auditor-General for the Federation**		
	Identification of three types of audits	3	
	Explanation of types of audits identified	9	12
	Total		**20**

SOLUTION 3

a. **Description of the procurement process**

A description of the procurement process for the following items:

i. Procurement process for consultancy services worth ₦99 million.
- **Approval -** Requires approval of ministerial board, that is ministries have authority to award contract of between ₦5 million and ₦99 million.
- **Bidding process-** The procurement methods and thresholds of application involve national competitive bidding.
- Prequalification is not applicable.

ii. Procurement process for procurement and installation of sundry items for virtual library in federal government secondary schools including the construction of the building facilities worth ₦958 million.

Approval - It requires Federal Executive Council's (FEC's) approval.
- **Bidding process**- Bidding must be made open to both international and national competitive bidder. The procurement methods and thresholds of application involve national competitive bidding.
- There is need to obtain certificate of no objection to award from Bureau of Public Procurement (BPP).

iii. Procurement process for supply of branded envelopes, files and letter-heads worth ₦4.2 million.

- **Approval**- It requires the Accounting Officer or Permanent Secretary's approval.
- **Bidding process -** Bidding must be nationally competitive.
- Consultant qualification is not applicable.
- Direct contracting is not possible.

b. **Preparation of the journal entries**

Journal entries

	Dr. ₦	Cr. ₦	Narration
Account receivables	220,503,600		To recognise revenue based on
Contract revenue		220,503,600	valuation certificate submitted
Bank	244,100,000		Upon receipt of cash from Federal
Account receivables		244,100,000	Ministry of Housing
Contact expenses	294,004,800		To recognise contract expenses to
Account payables		294,004,800	date
Account payables	294,004,800		Upon payment of cash to
Bank		294,004,800	suppliers

Workings

i. Account receivables: ₦12,250,200 × 5 × 6 × 60% = ₦220,503,600.

ii. Payment made to the contractor: ₦ 244,100,000.

iii. Estimated costs expended: ₦294,004,800.

c. i. **Provision of financial regulation on delayed contract payment**

There shall be a provision of interest payment to contractors for delayed payments by ministries or extra ministerial departments. Such payment should be made:

- At the interest rate specified in the contract agreement; and
- If there is delay in the settlement of the claim for more than 60 days, from the date of submission of the contractor's invoice or valuation certificate and the confirmation or authentication by the relevant ministry.

ii. **Punishment for government official**

An officer of the BPP or the procuring entity who, while performing his procurement duties, contravenes any of the offences under the Act shall be liable on conviction by the Federal High Court to a cumulative punishment of:

- A term of imprisonment of not less than 5 calendar years without any option of fine; and

- Summary dismissal from government service

Punishment for legal person

Any legal person who contravenes any provision of the Act is deemed to have committed an offence and shall be liable on conviction to a cumulative penalty of:

- Debarment from all public procurements for a period of not less than 5 calendar years; and
- A fine equivalent to 25% of the value of the procurement in issue.

Examiner's report

Part (a) of the question requires candidates to describe the procurement process for consultancy services, installation of sundry virtual library items and supply of branded envelopes etc. as specify in the Procurement Act. 2007 while part (b) of the question requires the candidates to prepare journal entries to record contract financial transactions.

Part (c) requires candidates to identify provisions of Financial Regulations (2009 Edition), which guides against delay in contract payments and to enumerate punishments that can be meted out to a government official and legal person in case of delay in payment of contracts executed.

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

The common pitfalls were the inability of the candidates to describe the procurement process for each of the items in the question as specified in the Procurement Act. 2007. Candidates were unable to identify the provisions and punishments which guide against and meted out to a government official and legal person in case of delay in payment of contracts executed respectively.

Candidates are advised to read widely and ensure they have adequate knowledge of relevant provisions of Financial Regulations (2009 Edition) and other extant regulations. Pathfinder and Study Text of the Institute are relevant learning materials on this aspect of the syllabus for better performance in future examinations.

Marking guide

		Marks	Marks
a.	**Description of the procurement process**		
i.	**Procurement process for consultancy services**		
	Any two points on approval and bidding process.	3	
ii.	**Procurement process for procurement and installation of sundry items**		
	Any two points on approval and bidding process.	3	
iii.	**Procurement process for supply of branded envelopes, files and letter-heads**		
	Any two points on approval and bidding process.	3	9
b.	**Journal entries**		
	Details of four journal entries.		4
c.	**Provision of financial regulation on delayed contract payment**		
i.	Any two (2) points		3
ii.	**Punishment for government official**		
	Any two (2) points	2	
	Punishment for legal person		
	Any two (2) points	2	4
	Total		**20**

SOLUTION 4

Fakafiki Federal Transport Agency (FFTA)

a. **Computation of NPV**

Year	**0**	**1**	**2**	**3**	**4**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Investment	(350)				
Income (Note 1)	0	550	1,350	1,750	(200)
Operating costs/year (Note 2)	0	(575)	(975)	(1,175)	(175)
Net relevant cash flow	(350)	(25)	375	575	(375)
Discount factor (10%)	1	0.909	0.826	0.751	0.683
Present value	(350)	(22.73)	309.75	431.83	(256.13)

Net present value = **₦112,720**

Decision: Since NPV is positive the project should be accepted.

Workings:

Note 1

Computation of incremental income base on new fare of ₦400

Year		**1**	**2**	**3**	**4**
Estimated demand (No. of passengers)	**A**	7,000	9,000	11,000*	4,000
Old demand (No of passengers)	**B**	5,000	5,000	5,000	4,000
Increase in demand		2,000	4,000	5000*	Nil
Demand with new fare of ₦400		**₦'000**	**₦'000**	**₦'000**	**₦'000**
Demand (**A** X ₦ 400)		2,800	3,600	4,000	1,600
Current revenue (**B** X ₦ 450)		2,250	2,250	2,250	1,800
Increase (Decrease)		**550**	**1,350**	**1,750**	**(200)**

*Restriction to 10,000 passengers' capacity. In year 3, even if the passengers are there, the coach cannot accommodate them because the two coaches can only accommodate 5,000 passengers each. In year 4 the old coach is more than sufficient for the passengers.

Note 2

Computation of operating costs

Year	**1**	**2**	**3**	**4**
Additional passengers	2,000	4,000	5,000	0
	₦'000	**₦'000**	**₦'000**	**₦'000**
Variable cost at ₦200 per passenger	400	800	1,000	0
Fixed cost	175	175	175	175
Operating cost per year	**575**	**975**	**1,175**	**175**

b. **Computation of IRR**

Year	**0**	**1**	**2**	**3**	**4**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Net relevant cash flow	(350)	(25)	375	575	(375)
Discount factor at 30%	0	0.769	0.591	0.455	0.350
Present value	(350)	(19.225)	221.625	261.625	(131.25)

Net Present value = **(₦17,225)**

$$IRR \approx a + \left(\left(\frac{NPV_a}{NPV_a - NPV_b}\right)(b-a)\right)\%$$

$$IRR = 10 + \frac{112,720}{112,720 - (17,225)} \text{ X } (30 - 10)$$

$$= 10 + \frac{112,720}{129,945} \times 20$$

IRR = **27.35.%**

Decision: Cost of capital must not be higher than 27.35% for the project to still be acceptable.

c. **Computation of Return on Capital Employed (ROCE)**

$$\frac{\textit{Average accounting profit}}{\text{Initial capital invested}} \times \frac{100\%}{1}$$

Total cash inflows (₦'000) = (25) + 375 + 575 + (375) = 550

Total depreciation and initial investment are the same, since there is no scrap value that is, ₦350

Total accounting profit (₦'000) = 550 – 350 = 200

Average Annual Accounting Profit (₦'000) = 200/4 = 50

Initial investment (₦'000) = 350

ROCE = (50/350) × 100%

ROCE = 14.29%

Decision: If there is no alternative investment which yields a higher return over and above the 14.29%, the project can be embarked upon.

Examiner's report

Parts (a) and (b) of the question require the candidates to calculate the Net Present Value (NPV) and Internal Rate of Return (IRR) under investment appraisal while part (c) of the question requires the candidates to calculate the Return on Capital Employed (ROCE) based on initial investment.

Most of the candidates attempted the question and performance was very poor.

The common pitfalls were the inability of the candidates to calculate Internal Rate of Return (IRR) and Return on Capital Employed (ROCE).

Candidates are advised to read widely and ensure they have adequate knowledge of relevant methods used under investment appraisal and other regulations relating to public sector accounting for better performance in the Institute's future examinations. The Pathfinder and Study Text of the Institute are relevant learning materials on this aspect of the syllabus.

Marking guide

		Marks	Marks
a.	**Computation of Net Present Value**		
	Calculation of NPV	6	
	Computation of incremental income	2	
	Calculation of operating costs	2	10
b.	**Computation of IRR**		
	IRR formula	½	
	Calculation of PV using higher discounting rate	1¼	
	NPV figure	¼	
	Interpolation	1	
	Calculation of IRR	½	
	Correct decision	½	4
c.	**Computation of ROCE**		
	Formula for ROCE	1	
	Calculation of total cash inflows	1	
	Calculation of total accounting profit	1	
	Calculation of Average Annual Accounting Profit	1	
	Calculation of ROCE	1	
	Correct decision	1	6
	Total		**20**

SECTION C

SOLUTION 5

a. **Arguments in favour of decentralisation of fiscal responsibilities.**

Decentralisation is a form of organisational structure that functions by delegating decision making capabilities to multiple teams across levels of management.

i. **Closeness to local residents:** Local governments have better understanding of the concerns of local residents being the closest to the people.

ii. **Removal of bureaucratic leadership:** Local decision making is responsive to the people for whom the services are intended, thus encouraging fiscal responsibility and efficiency, especially if financing of services is also decentralised.

iii. Unnecessary layers of jurisdiction are eliminated.

iv. Inter-jurisdictional competition and innovation are enhanced.

v. **Democratic institution for the people:** Offers a democratic environment where people can have a say in the governance.

vi. **Promotion of leadership skills:** It enables those at the grassroots to gain leadership skills, which can contribute to the growth of the local governance in the long-run.

Arguments in favour of centralisation of fiscal responsibilities

Centralisation is a form of organisational structure where the decision-making capability rests with the top management. The top management members are saddled with the responsibilities of creating strategies, determine goals and objectives based on which an organisation will function.

i. **Focused vision:** Communicating and delivering the governments vision and agenda are through clear lines of authority. This is consistent and therefore communication of government's vision to all sectors of engagement is prompt and undivided.
ii. **Quick implementation of programmes:** A centralised structure of governance allows for faster decision making from the top, since decisions are made by a small group of people and communicated to lower levels of governance.
iii. **Reduced administrative and compliance costs.** Centralised administration generally leads to lower administrative costs associated with financing public services.
iv. **Economies of scale.** Certain services require areas larger than a local jurisdiction for cost-effective provision, for example, public transportation and sewage in metropolitan areas
v. **Spatial externalities.** Spatial externalities arise when the benefits and costs of public services are realised by non-residents. In the case of benefit spill-outs, the jurisdiction providing the service does not consider the proportion of benefits of a public service accruing to non-residents and therefore under-provides such a service. The reverse result is obtained in the case of cost spill-outs, where the public service could not be financed by exporting taxes to other jurisdictions. There are also public services whose benefits are considered national in scope, such as defence and foreign affairs. These services would be best provided by the federal government.

b. **Explanation of fiscal and monetary strategies during economic downturn**

i. **Fiscal policy**: It is a collective term for the taxing and spending actions of governments. It is the policy concerning the use of state treasury or government finances to achieve the macro-economic goals. The policies are as follows:

- **Deficit financing policy:** Deficit financing refers to financing the budget deficit. Budget deficit means excess of government expenditure over government income or taking loan from CBN by government to meet the budgetary deficit. CBN gives loans by issuing new currency notes and an increase in money supply will lead to fall in the value of money. Fall in value of money will in turn leads to increase in price level which must be kept low in order to avoid price rise in the economy. Thus, due to deficit financing, necessary funds are made available for economic growth while managing the consequent level of inflation, which could be on the rise in the country;

- **Public expenditure:** Public expenditure influences the economic activities of a country which may be of two kinds that is, developmental and non-developmental. Expenditure on developmental activities requires huge amount of capital which cannot be made available by private sector alone. Public expenditure may be in form of' development of state enterprises; support to private sector; development of infrastructure; and social welfare. Unemployment benefits should be encouraged as well;
- **Taxation policy:** Taxes are main source of government revenue, which are both direct and indirect. Direct taxes are those which are directly paid by the taxpayers to the government, that is, company income tax, etc., while indirect taxes are paid indirectly by the public to the government, that is, custom duties, stamp duties, etc. The main objectives of taxation policy are: mobilisation of resources; to promote savings; and to bring equality of income and wealth. In situations of reviving the economy during downturn, temporary tax deferrals and tax cuts is carried out. Tariffs are reduced; and
- **Public debt:** Government needs lot of funds for economic development of the country which cannot be mobilised from taxes alone. Therefore, it becomes inevitable for the government to mobilise resources by resorting to public debt which can be internal debt and external debt. Restructuring and refinancing of debt is a vital option to encourage or reduce debt burden.

ii. **Monetary policy: It** refers to the use of instruments under the control of the Central Bank of Nigeria (CBN) to regulate the availability, cost and use of money and credit. It is the policy CBN uses to control the supply of money in circulation, which are:

- **Bank rate or discount rate:** It is the rate at which CBN lends to commercial banks or rediscount their bills. If the CBN rate is increased, then commercial banks also charge higher rate of interest on loans given by banks to public because commercial banks get funds from CBN at higher rate of interest. Higher rate of interest will contract credit in the economy, that is, public will take lesser loans because of higher rate of interest. In the case of downturn, CBN should encourage investments by reducing bank rates so as to reduce interest rates to investors.

- **Cash reserve ratio (CRR):** It is a certain percentage of bank deposits which banks are required to keep with CBN in the form of reserves or balances. The higher the CRR with CBN, the lower will be the liquidity in the system and vice-versa. The CBN in downturn is expected to reduce the CRR so as to increase liquidity in the system.
- **Statutory liquidity ratio (SLR):** It is a certain percentage of deposits that should be kept by banks in form of liquid assets. It is kept by banks themselves and they include; government securities; treasury bills; and other securities notified by CBN. If SLR is more, then banks have to keep more part of deposits in specified securities and banks will have fewer surplus funds for granting loans. SLR should be reduced during economic downturn or depression.
- **CBN lending rate and reverse CBN lending rate:** It is the rate at which CBN lends to commercial banks generally against government securities while reverse lending rate is the rate at which CBN borrows money from commercial banks. Reduction in lending rate helps the commercial banks to get money at a cheaper rate and an increase in lending rate discourages the commercial banks to get money as the rate increases and becomes expensive. As the rates are high, the availability of credit and demand decreases resulting to decrease in inflation. This decrease in lending rate and reverse lending rate is a symbol of tightening of driving monetary policy. However, during economic downturn, it is expected that the government through the CBN will boost the economy rather than tighten monetary policy.
- **Open market operations (OMO):** It means that the banks control the flow of credits through the sale and purchase of securities in the open market. When securities are purchased by CBN, then CBN makes payment to commercial banks and public, thereby resulting in the public and commercial banks having more money with them, which will expand credit facilities in the economy. Purchase of securities by CBN should be encouraged during downturn of an economy so as to boost the economy and increase aggregate demand.

Examiner's report

Part (a) of the question requires the candidates to explain arguments in favour of decentralisation and centralisation of fiscal responsibilities, while part (b) requires the candidates to explain fiscal and monetary strategies that government at both federal and state level are taking to address their impact of economic downturn.

Few candidates attempted the question and their performance was poor.

The common pitfalls were the inability of the candidates to explain fiscal and monetary strategies that governments are taking to address the impact of the economic downturn.

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

Marking guide

		Marks	Marks
a.	**Arguments in favour of centralisation and decentralisation**		
	Explanation of two arguments to support decentralisation	3	
	Explanation of two arguments to support centralisation	3	6
b.	**Explanation of fiscal and monetary strategies during economic downturn**		
	Identification of any three fiscal strategies	$1^1/_2$	
	Explanation of the three fiscal strategies identified	3	
	Identification of any three monetary strategies	$1^1/_2$	
	Explanation of the three monetary strategies identified	3	9
	Total		**15**

SOLUTION 6

a. i) Debt refinancing is the replacement of an existing debt by means of another debt with terms and or conditions that are more favourable. In other words, debt refinancing refers to the replacement of existing debt with new debt.

ii) Debt refinancing can be of interest to a federal authority because of the following reasons:

- To take advantage of better interest rate;
- To reduce the monthly repayment amount by entering into new debt with longer terms;
- Under certain circumstances like war and other emergencies, when there is need for large pool of funds and additional tax revenue cannot be raised, debt refinancing becomes inevitable;
- Where actual tax receipts are falling much below the anticipated volume, while expenditure is not showing a corresponding reduction;
- In the case of a project tied; such projects are expected to benefit certain areas or certain sections of the people who can be expected to bear the cost of the project out of the benefit they would receive; and
- To switch from a variable-rate debt to a fixed-rate debt.

iii) Project financing is the funding of long-term infrastructure, industrial projects, and public services using a non-resource or limited resource. The debt and equity used to finance the project are paid back from the cash flow generated by the project. Project financing is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights and interest held as collateral.

b. **Forms of refinancing debt are:**

Rate-and-term refinance loans

The rate-and term refinance loans are the most popular refinancing of loan. It is used to pay off the original mortgage, which is then replaced with a new loan.

Fixed-rate refinancing

It sets a monthly payment during the time of the loan. The monthly principal and interest payment are typically higher than a long-term loan. It is also protected from increasing interest rates.

Adjustable-rate refinancing

An adjustable-rate refinance has a fixed interest rate for about 5-7 years. After that period, its rate adjusts based on the conditions of the market. This loan often includes an interest rate cap, limiting how high the interest rate can increase. It gives some flexibility, especially if there is plan to refinance again in a few-years' time.

Cash-out refinance loans

A cash-out refinance loan works best if there is need for some extra cash. It is only used when homes are worth more than what is owed on the existing loan. This type of loan replaces the mortgage by paying it off. It then refinances the current mortgage and allows to keeping the difference of the two mortgages in cash.

Cash-in refinance loan

In a cash-in refinance loan, the debtor brings in cash to lower the mortgage balance and future interest payments. A cash-in refinance loan improves loan-to-value (LTV) ratio. This makes it easier for future approval. Cash-in refinance loan also allows one to reach the 20% equity threshold, saving thousands of future funds on insurance payments.

Consolidation refinancing

It combines federal loans in a single new loan amount and the decision to refinance or consolidate depends on the goal and whether there is need to maintain federal loan benefits. It is advisable to consolidate if: the new loan reduces the total interest charges to be paid on all the loans; saves money even after payment of lender's fees; and can comfortably afford the monthly payments.

Examiner's report

Parts (ai) and (aii) of the question require candidates to explain the terms "Debt refinancing" and why debt refinancing may be of interest to a federal authority, while part (aiii) asks the candidates to explain "Project finance". Part (b) requires the candidates to explain forms of debt refinancing.

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

The commonest pitfalls were the inability of the candidates to explain why debt refinancing may be of interest to a federal authority and identify and explain the forms of debt refinancing.

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

Marking guide

		Marks	Marks
a.			
i.	Definition of debt refinancing	1	
ii.	Any two (2) reasons for interest of debt refinancing	4	
iii.	Definition of project financing	<u>2</u>	7
b.	**Explanation of forms of debt refinancing**		
	Identification of any four (4) forms	4	
	Explanation of forms identified	<u>4</u>	<u>8</u>
	Total		<u>**15**</u>

SOLUTION 7

Merits of private finance initiatives (PFI):

i. **Efficiency:** There is the belief that the private sector is better at managing investment projects and achieving overall cost efficiencies than the public sector, which is bedeviled with unnecessary bureaucracies.

ii. **Extra investment:** Extra funding can kick-start more projects thereby bringing about economic and social benefits. The private finance initiatives (PFI) provide private sector funds for projects that might prove difficult for government to finance through higher borrowing and taxes. Projects supporting health or education will improve productive capacity, increase economic growth and can therefore be funded out of future incomes that the projects help to generate.

iii. **Timely delivery:** The private sector is not paid until the asset has been delivered, which encourages timely delivery. PFI construction contracts are fixed price contracts with financial consequences for contractors, if delivered late.

iv. **Dynamic efficiency:** Private sector is better placed to bring innovation and good design to projects, higher quality of delivery and lowering of maintenance costs. The bidding process for PFI projects creates competition at the point of tendering.

Demerits of private finance initiatives

i. **Debt costs:** Private finance has always been more expensive than government borrowing, but since the financial crisis, the difference between the costs has widened significantly. The difference in finance costs means that PFI projects are significantly more expensive to fund over the life of a project. This represents a significant cost to taxpayers.

ii. **Inflexibility and poor value for money**: Long service contracts may be difficult or costly to change, especially when the management of a project seems to have gone wrong. There have been many stories of flawed projects, for example, private firms contracted out to provide car parking, cleaning and other services in hospitals built and run as part of a PFI. Infrastructure may not be designed to last more than the length of the contract and will need replacing or maintenance at high costs.

iii. **Risk:** The ultimate risk with a project lies with the public sector (government). Private finance agreements are complicated to organise and there is no guarantee that the private sector will make a better cost- benefit analysis of a project than the public sector.

Examiner's report

The question asks the candidates to explain the merits and demerits of private finance initiatives.

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

The common pitfalls were the inability of few candidates to explain the merits and demerits of private finance initiatives.

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

Marking guide

	Marks	Marks
Merits of private finance initiatives:		
Identification of three (3) merits	3	
Explanation of the merits identified	6	9
Demerits of private finance initiatives		
Identification of two (2) demerits	2	
Explanation of the demerits identified	4	6
Total		**15**

ICAN/232/Q/B6 Examination No.........................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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 handsets, electronic storage devices, 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 found with any prohibited item.

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, NOVEMBER 16, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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)

Adeoye Oladejo was an exceptionally brilliant student. He graduated from the Department of Wildlife and Ecotourism in the Second-Class Upper Division. He was fortunate to undertake his youth service in Lagos with Dovic International Travel Agency (DITA), which apart from sales of tickets and hotel reservations, is reputed for organising tours for individuals and groups to different parts of the world. By dint of hard work and impressive results in attracting clients to the travel agency, Adeoye, was made a sales manager immediately he concluded his service year. He held this position for two years, after which he was made a senior operations manager, a position he held before becoming the CEO.

The motto of the company is "service optimised", and the company is very clear about its primary strategic goal, which is to optimise profit, in the short, medium, and long terms. Hence, Adeoye, as the company CEO, undertook a specialised MBA course in International Business Management. He also wrote a book titled, Optimising Profit in International Tourism. In addition, he employed a business manager and an operations manager with very strong backgrounds in financial planning and strategic thinking respectively, apart from the vast experiences they have acquired in the field of international tourism.

To ensure that DITA remains highly competitive in the global tourism arena, the company has different tourism packages for its clients from all parts of the world. These include cheap airfares, highly rated hotels at unbelievably low prices, amazing tourists' attractions, and the inclusion of rated artistes (musicians, comedians, etc) for the pleasure of their clients. What is quite significant is the fact that DITA has been able to establish excellent working relationships with airlines, hotels and various service providers in the tourism industry that enable it to provide world-class services at unbelievably cheap rates that its competitors find difficult to match.

Of course, the services that DITA offer are similar to those of its competitors in the tourism industry, but DITA has been able to introduce special flavours into its packages that render them more attractive than those of its competitors. These include free massages, horse-riding, scuba diving, exquisite dinners, welcome parties, limousine airport shuttles and much more.

However, the business strategies by DITA have their trade-offs, which in the short, medium, and long terms offer it some competitive advantage. For instance, it does not offer services to large groups of people exceeding 50 at a time. Thus, it does not offer pilgrimage services. Nonetheless, DITA has become very popular among rated organisations, family groups, groups of friends and other relatively small teams that are interested in organised tours to special places anywhere in the world. Another trade-off of DITA strategies is that it does not sell travel tickets to individuals. It does only group tours.

Over a period of two years, the CEO of DITA, in conjunction with the business and operations managers, have successfully established a synergy of all the elements of their business such that they are all intricately and seamlessly linked together, resulting in great success and high return on investment for DITA.

To ensure continuity of its strategic direction, DITA organises periodic training retreats for its staff and sends them on specialised training to enhance their productivity and commitment to the vision, strategic goals and core values of the company. By so doing, it is systematically creating an impressive organisational culture that is key to its success. Overall, DITA has become a huge success story and a remarkable leader in the international tourism industry.

Required:

a. Discuss how the operations of DITA is consistent with Porter's six principles of strategic positioning and how individual firms can achieve sustainable competitive advantage. (24 Marks)

b. A business entity can be classified as any one of the **FOUR** types in terms of strategic position.

   i. Identify and briefly explain each of these. (3 Marks)

   ii. To which of these does DITA belong?. (3 Marks)

(Total 30 Marks)

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

You have been appointed as a consultant to a company manufacturing microchips in Nigeria. The company's management and board of directors want to implement a sustainable development agenda. You have been asked to develop a blueprint of financial and environmental reporting that captures the influence of the company's activities on the physical and social environment.

Required:

a. Define the term 'Sustainable Development'. (1 Mark)

b. Suggest frameworks for environmental and social reporting using the following:
   i. Triple Bottomline (4 Marks)
   ii. Balanced Scorecard (BSC) (4 Marks)
   iii. Sustainability Assessment Model (SAM) (4 Marks)

c. What are the steps involved in implementing the SAM approach to measure a product performance over its entire life-cycle? (7 Marks)

(Total 20 Marks)

QUESTION 3

Professor Akinlabi has been teaching physics at a frontline public university in Nigeria for 30 years. He made quite some money from research grants and has over the years saved about 75 million naira, which he has been keeping in a fixed deposit facility. He complained to his friend, Dr Albert, who is a professional accountant and expert in risk management, about the low interest rate on fixed deposit and how the high inflation rate in the country is fast eroding the real value of his savings. He is thinking of investing his savings in a poultry farm, but he is quite averse to risks.

Having tried to get some information on the diverse dimensions and dynamics of risks involved in business, he asked Dr Albert to offer some clarifications. As Dr Albert, you are required to offer clarifications on the following:

a. Exposure to risk and the nature of qualitative risks (5 Marks)

b. Residual risk (3 Marks)

c. The dynamic nature of risk assessment (7 Marks)

d. Risk-based approach to business (5 Marks)

(Total 20 Marks)

QUESTION 4

There are different models of relationship between a professional accountant and his/her clients. In the context of the above:

a. Explain the different models of relationship between a professional accountant and his/her clients. (16 Marks)

b. Which of the models in (a) above would you recommend, and which do you consider to be the least recommended?

   (Provide justification for your choices). (4 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Prepare a presentation on social skills, detailing the following:

a. Definition and importance of social thinking (3 Marks)
b. Key concepts in social thinking (8 Marks)
c. Social thinking interventions (4 Marks)

(Total 15 Marks)

QUESTION 6

Today's business environment is often described by many experts as Volatile, Uncertain, Complex, and Ambiguous (VUCA). Some of the driving force of the VUCA environment include COVID-19 pandemic, the war in Europe, global warming, and a rapidly changing technological environment.

The impact of the VUCA environment on the global economy includes inflation, dwindling consumers' purchasing power, rising energy costs, among others, leading to an increase in a sense of turbulence, danger and unpredictability. With the volatility in the business environment also comes frequent changes in laws and regulations affecting businesses, a factor that adds instability to an already unstable business environment.

You have been asked by a start-up company in consumer goods retailing business to provide advice on risk management as it concerns the global economy. The company is planning to launch an online retail store with a focus on the global consumer goods market.

Required:
Using the Turnbull Report and drawing from the given scenario, identify and explain to your client, the types of risk that are inherent in the VUCA business environment.
(15 Marks)

QUESTION 7

An Information Technology start-up located in Lagos is planning to establish a robust risk management system that covers all its activities. You have been engaged as a consultant to advise it on how an effective risk management framework can be incorporated into the company's processes to ensure that all risks that could impair the achievement of organisational goals are effectively managed.

Required:

a. Suggest to your client, risk management framework that the management can adopt by using the following:
   - i. Enterprise Risk Management (6 Marks)
   - ii. ISO31000 frameworks (3 Marks)

b. Draft an enterprise risk management strategy for the firm, using ALARP. (5 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

Porter's six principles of strategic positioning

Principle 1

- The strategic goal for a company should be to achieve a superior long-term return on investment.
- A company should not select as its strategic goal any other objective, such as maximising sales volume or maximising market share, on the assumption that high profits will result from this.
- Maximising sales or market share does not necessarily provide a superior return on investment.

Application

- In the case of DITA, while its motto is "service optimised", the company is very clear about its primary strategic goal which is to optimise profit, in the short, medium, and long terms.
- It has also put mechanisms in place to ensure that this goal is achieved.
  - ➢ For instance Adeoye as the company CEO, undertook a specialised MBA course in International Business Management.
  - ➢ He even wrote a book on Optimising Profit in International Tourism.
- He employed a business manager and an operations manager with very strong background in financial planning and strategic thinking respectively.

Principle 2

- The strategy must offer a unique value proposition for the customer.
- This is a combination of price and benefits that competitors do not (and cannot) offer.
- The value proposition might be for customers in the entire market, or for customers in a segment or niche of the market.

Application

- To ensure that DITA remains highly competitive in the global arena of tourism, the company has tourism packages for its clients from all parts of the world.

- These include cheap airfares, highly rated hotels at unbelievably low prices, amazing tourists' attractions, and the inclusion of rated artists (musicians, comedians, etc) for the pleasure of their clients.
- DITA has been able to establish excellent working relationships with airlines, hotels and various service providers in the tourism industry that enable it to provide world-class services at unbelievably cheap rates that its competitors find difficult to match.

Principle 3

- There should be a distinctive value chain.
- A company should perform similar activities to competitors, but in a different way that offers customers more value.

Application

- The services that DITA offers are similar to those of its competitors in the tourism industry, but DITA has been able to introduce special flavours into its packages that render them more attractive than those of competitors.
- These include free massages, horse riding, scuba diving, exquisite dinners, welcome parties, limousine airport shuttles and much more.

Principle 4

- The selected strategy will involve some trade-offs.

OR

- This means that by selecting one set of strategic options, a company inevitably chooses not to select alternative options.
- For example, there has to be a trade-off between the selling price of the product and the benefits that it offers. By offering one set of benefits, the firm is choosing not to offer others. (If a company could alter its product or value chain without having to make trade-offs, it cannot be achieving any sustainable competitive advantage, and competitors will be able to copy what the company is doing.)

Application

- It does not offer services to large groups of people exceeding 50 at a time.
- It does not offer pilgrimage services.
- It does not sell travel tickets to individuals. It does only group tours.

Principle 5

- All the different elements in the strategy and in the value chain should link together and reinforce each other.

Application

- Over a period of two years, the CEO of DITA, in conjunction with the business and operations managers have successfully established a synergy of all the elements of their business such that they are all intricately and seamlessly linked together resulting in great success and return on investment for DITA.

Principle 6

- There should be continuity of strategic direction.
- Having chosen its strategies and the direction it wants to take its business, a company should apply the strategy consistently.

OR

- It should avoid changing strategy every time a new threat emerges.

Application

- To ensure continuity of strategic direction, DITA organises periodic retreat for its staff and sends them on specialised training to enhance their capacity to be in tune with the vision, strategic goals, and core values of the company.
- By so doing, it is systematically creating an impressive organisational culture that is key to its success.

b. (i)

i. The **leader** is the entity that sells most products in the market. Examples are Microsoft for PC operating software and Coca-Cola for cola drinks.

ii. A **challenger** is an entity that is not the market leader, but wants to take over as the market leader.

iii. A **follower** is an entity that does not have any ambition to be the market leader, and so follows the strategic lead provided by the market leader (or challenger). A follower will try to differentiate its product.

iv. A **nicher** is an entity that targets a particular market segment or market niche for its product and does not have any strategic ambition to gain a position in the larger market.

(ii) DITA is either a nicher or leader.

Examiner's report

This compulsory strategic management question in part (a) tests Porter's six principles of strategic positioning and how individual firms achieve sustainable competitive advantage, while part (b) tests classification of strategic position.

Virtually all the candidates attempted this question.

Performance was poor, as more than 70% of the candidates scored less than 50% of the marks.

Commonest pitfall was inability of most candidates to relate the principles to the scenario. Also many candidates could not explain Porter's six principles of strategic positioning, while some other candidates could not explain how individual firms achieve sustainable competitive advantage.

Candidates are enjoined to hone their skills to apply principles to specific situations.

Marking guide

S/N	Description	Marks	Total
a.	Identification of Porter's principles (2 marks for each of 6 points)	12	
	Relation of principles to scenario (2 marks for each of 6 points)	12	24
b. i.	Types of strategic position		
	Identification: ½ mark for each of 4 points	2	
	Explanation: ½ mark for each of 4 points	2	4
ii.	Identification of category to which DITA belongs		2
	Total		**30**

SOLUTION 2

a. Sustainable development may be defined as 'a dynamic process which enables all people to realise their potential and improve their quality of life in a way which simultaneously protect and enhance the earth's life support system'.

OR

Sustainable development may be defined as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

b. Frameworks for environmental and social reporting are:

(i) **Triple Bottom-line** is a reporting framework that aims to encourage companies to recognise economic, social and environmental issues in their business models and reporting systems.

OR

Triple Bottom-line: is a reporting framework that encourages companies to recognise profit, people and the planet in their reporting systems.

This framework requires companies to report their performance in three dimensions:

Economic indicators: These include measurements relating to:

- Sales revenue
- Profit earnings and earnings per share
- Dividend per share
- Global market share
- Unit of sales (for some specific industries like car manufacturing)

Environmental indicators:

- Reducing the 'intensity' of materials in products and services
- Reducing energy intensity
- Minimising the release of toxic materials/pollutants
- Improving the ability to recycle materials
- Minimising the use of renewable resources
- Extending the life of a product

Social Indicators:

- Impact on community
- Diversity and inclusivity
- Employees satisfaction

ii. **Balanced Scorecard (BSC)**: is a 'strategy map' divided into the following elements or perspectives:

- a financial perspective;
- a customer perspective;
- an internal perspective (operations);
- an innovation and learning perspective; and
- Non-market perspective

- For each perspective, goals, targets and tasks are established, with indicators of performance for comparing actual results against the target.

- The purpose of a balanced scorecard is to prevent management from directing all their attention to short-term financial considerations.
- The four perspectives give suitable importance to short-term profitability, but also provide for non-financial and longer-term strategic issues.

iii. **Sustainability Assessment Model (SAM):**

- Sustainability Assessment Model (SAM) measures the impacts on sustainability of a product over its full life cycle, from raw material extraction through the production process to its final consumption.

- The impacts measured are:
    - the direct economic cost of the product; but also
    - the direct impact of the company's operations on society and the environment; and also
    - the broader social costs and benefits.

- The total impacts are measured as a cost, known as full cost.
- The measurement system supporting the Sustainability Assessment Model is called full-cost accounting or FCA, because it includes environmental and social costs as well as economic costs.
- The SAM is also used to measure the performance of a company on an index of sustainability (SAM). This measures the percentage distance that the company is from achieving sustainability.

c. **Step 1**. A SAM exercise is established. The object of the exercise is to identify that which will be subjected to evaluation. This might be a product, a process, a part of an entity's operations or the whole of its operations.

Step 2. The boundaries of the SAM evaluation are defined. All the costs and benefits to be included, including environmental and social costs or benefits, are identified over the full life cycle of the product (or other object of the exercise).

Step 3. The impacts of the product are measured under four headings:
- Economic;
- Resource use;
- Environmental; and
- Social.

Step 4. These non-monetary measures are converted into a common basis of measurement: money. This total money measurement provides the full cost analysis of the product, process or operation.

Examiner's report

This is a sustainability reporting question which tests knowledge of environmental and social reporting frameworks using triple bottom-line, balanced scorecard and sustainability assessment model (SAM), and steps involved in implementing the SAM approach to measuring a product's performance over its entire life cycle. About 75% of the candidates attempted this question.

Most candidates did not have a good grasp of the tested environmental and social reporting frameworks. Some others did not understand the steps involved in implementing the SAM approach.

Performance was poor, as more than 70% of the candidates scored below 50% of the available marks.

Recommendation: Sustainability has become a very topical issue globally, hence candidates must pay adequate attention to it.

Marking guide

S/N	Description	Marks	Total
a.	Sustainable development		
	Definition – 1 mark for any one definition		1
b. i	Framework – Triple bottom line		
	Definition	1	
	Identification of dimensions – ½ mark for each of any 3 points	1½	
	Explanation of dimensions - ½ mark for each of any 3 dimensions	1½	
			4
ii.	Framework – Balanced scorecard (BSC)		
	Elements or Perspectives: ¼ marks for each of any 4 points	1	
	Components: 1 mark for each of any 3 points	3	
			4
iii.	Framework - Sustainability Assessment Model (SAM)		
	Impacts: 1 mark for each of any 2 points	2	
	Components: ½ mark for each of any 4 points	2	
			4
c.	Steps for implementing SAM		
	Identification of each of steps 1, 2 & 4: ½ mark for each of the steps	1½	
	Explanation of each of steps 1,2 & 4: 1mark for each of the steps	3	
	Identification of step 3: ½ mark	½	
	Explanation of impacts in step 3: ½ mark for each of any 4 impacts	2	
			7
	Total		**20**

SOLUTION 3

a. **Exposure to risk**

- When a company is exposed to risk, this means that it will suffer a loss if there are unfavourable changes in conditions in the future or unfavourable events occur.
- An exposure is not necessarily the amount that the company will expect to lose if events or conditions turn out unfavourable.

Qualitative risk

- Qualitative risks are those risks which cannot be measured.
- Qualitative risks are assessed based management's judgment, experience or opinion, or experts' opinion or evaluation.
- Examples of qualitative risks include reputation risk, cultural risk, and business probity risk.

b. **Residual risk**

- Controls cannot eliminate risks completely, and even after taking suitable control measures to mitigate a risk, there is some remaining risk exposure.
- The remaining exposure to a risk after control measures have been taken is called **residual risk**.
- If a residual risk is too high for a company to accept, it should implement additional control measures to reduce the residual risk to an acceptable level.

The dynamic nature of risk assessment

- Organisations differ in how exposed they are to changes in internal and external risks.
- The internal and external factors that affect an organisation might be very changeable. This means that the risks faced by a company do not remain static but change over time and in different situations.
- In some situations, environmental factors change relatively little, but in other environments, risk factors can change a great deal. The latter are sometimes called 'turbulent' environments.
- The extent of possible exposure to risk due to environmental change can be represented as a scale or continuum between two theoretical extremes that would not be found in practice.
- At one end of the scale there is never any change in the external or internal environment of an organisation. This does not mean that there are no risks but, rather that the risks faced do not change. Clearly this cannot exist in practice. All organisations will face a changing risk profile.
- At the other extreme, the external or internal environment of an organisation changes constantly with the results that all risks are changing all the time. Such a situation does not exist in reality but situations close to it do exist.

Static → **Dynamic**

Increasing environmental change and turbulence

A risk-based approach

- The term 'risk-based approach' is often used to describe risk management processes.

- It is an approach to decision-making based on a detailed evaluation of risks and exposures, and policy guidelines on the level of risk that is acceptable (risk appetite).

- The risk-based approach takes the view that some risk must be accepted, but risk exposures should be kept within acceptable limits.

- Decisions should therefore be based on a consideration of both expected benefit and the risk.

- Any appropriate example.

Examiner's report

This question tests the following areas of risk:

- Exposure to risk and nature of qualitative risk;
- Residual risk;
- Nature of risk assessment; and
- Risk-based approach to business.

About 90% of candidates attempted this question.

Performance was poor, considering that this was a very popular question and this area had frequently been tested in past examinations. Less than 30% of the candidates scored up to 50% of the allocated marks.

Many of the candidates were not able to discuss the dynamic nature of risk and risk-based approach to business.

Recommendation: Candidates are admonished to fully study all areas of the syllabus in their preparation for the examination.

Marking guide

S/N	Description	Marks	Total
a.	Exposure and nature of qualitative risks		
	Explanation of exposure to risk – 1 mark for each of any 2 points	2	
	Explan/ation of qualitative risk: 1 mark for each of any 3 points	3	
			5
b.	Residual risk		
	Components of residual risk: 1 mark each for any 3 points		3
c.	Dynamic nature of risk		
	Explanation/components: 1 mark each for any of 5 points	5	
	Diagram: ½ mark for box	½	
	Labelling of diagram: ½ mark for each of 3 annotations	1½	
			7
d.	Risk-based approach to business		
	Components: 1 mark for each of any 5 points		5
	Total		**20**

SOLUTION 4

a. **Agency relationship**

- In an agency relationship, the client has most of the authority and responsibility for decision-making.
- The professional is an expert acting on behalf of a client, but under instructions from the client.
- The client knows what is wanted and instructs the professional to do it.
- For an agency relationship to exist between a professional accountant and a client, the client must have a reasonable amount of technical knowledge and must understand what the accountant is being asked to do.
- The accountant carries out the client's instructions, and provides information and possibly advice, but the client makes the decisions.
- An agency relationship exist when the accountant is not independent but is acting on the client's instructions and on behalf of the client.

b. **Contractual relationship**

- In a contractual relationship, the client and professional are 'equals' in terms of authority and responsibility for decisions.
- There is a contract between them, in which the client arranges for the accountant to carry out some work, and the accountant undertakes to do the work.

- This kind of relationship will exist when the accountant has some expertise or technical knowledge that the client does not have, and the client hires the accountant to provide it.
- The accountant provides the technical advice and the client acts on the advice given.

c. **Paternalism**

- Paternalism is modeled on the relationship between parents and their children. Parents have much more knowledge and experience than their children, and they act and make decisions on behalf of their children that are in the children's best interests.

- A comparable situation may exist between a professional accountant and a client. For this situation to exist, the professional accountant must have experience and knowledge, and the client should be inexperienced and without much knowledge of the matters that the accountant deals with.

- In a paternalistic relationship, the accountant has most of the decision-making authority and responsibility and can make decisions without the client's knowledge or consent.

- The accountant exercises his or her judgment in what are the client's best interests.

- Paternalistic relationships between a professional and a client can be the relationship model that causes greatest concern because the professional will be virtually taking over the client's affairs.

d. **Fiduciary relationship**

- In a fiduciary relationship between a professional and a client, the professional (as a 'fiduciary') has an obligation to act in the best interests of the client.

- The professional has superior technical knowledge and greater expertise than the client.

- In a fiduciary relationship the client retains significant authority and responsibility for making decisions.

- Both parties in the relationship have responsibilities and the judgments of both carry weight.

- The client depends on the accountant for much information and advice, but the client's consent is needed for any decision, and in many instances the client is involved in reaching decisions and makes the final decision.

- However, for some issues, the client may recognise the technical knowledge of the accountant and allow the accountant to make the decisions. However, this is not the norm. (4 marks for each of the four models identified and discussed).

Recommended
A combination of the agency, contractual and fiduciary models is recommended. This will provide a balanced and comprehensive template for the professional-client relationship by incorporating the important elements that should be in the relationship between a professional accountant and his/her client.

OR

Any of the agency, contractual or fiduciary models chosen and justified.

Least Recommended
This is the paternalistic model. The professional accountant does not have a right to completely take over the affairs of the client. There are important decisions client themselves must take.

Examiner's report
This question tests knowledge of models of relationship between a professional accountant and his/her clients. Part (b) of this question requires exercise of judgement by candidates. 80% of the candidates attempted this question.

Performance was just average as about half the number of candidates who attempted the question scored 50% of the available marks.
Many candidates could not exercise professional judgement as required in part (b) of the question.

Recommendation: Candidates are admonished to cultivate judgement skills in dealing with principles.

Marking guide

S/N	**Description**	**Marks**	**Total**
4.	Relationship between professional accountant and clients		
a.	Models of relationship		
	Identification: 1 mark for each of any 4 points	4	
	Components: 1 mark for each of any 12 points	12	
			16
b.	Recommended model: 2 marks for model recommended	2	
	Identification and justification of the least appropriate model	2	
			4
	Total		**20**

SOLUTION 5

a. **Social thinking** is a mental process people go through to make sense of their own and others' thoughts, feelings, and intentions in context, whether co-existing, actively interacting, or figuring out what is happening from a distance (e.g., through media, literature, etc.).

OR

Social thinking is the process by which we interpret the thoughts, beliefs, intentions, emotions, knowledge and actions of another person along with the context of the situation to understand that person's experience.

Importance of social thinking includes the following:

i. Using appropriate social skills tend to make people feel comfortable around us which helps us better co-exist and interact with those we share space with;
ii. Most of us want to make connections and make friends with our family, peers, boss or colleagues; and
iii. The core concepts of social thinking help us develop insights and socially based critical thinking in the workplace. Individuals deploy their social thinking capabilities anytime they are asked to for example by work in a group, solve a problem, write an email, express their ideas, answer questions, understand a video clip,and critically think about an issue, he/she is using his social thinking mind.

b. **Key concepts of social thinking** are:

i. **Think with your eyes:** means use eye contact. This means that eyes are not just for looking at another person during an interaction. The eyes are powerful tools to be used for gaining information in almost any situation. The concept of "thinking with your eyes" is also relevant in problem solving and perspective taking;

ii. **Expected/unexpected behaviour:** Social and communicative expectations are contextually sensitive. In fact, for every situation there are a set of expected and unexpected behaviours that generate different types of thoughts. When a behaviour is expected for a situation, it encourages us to have good or normal thoughts and feelings; when a behaviour is unexpected, we tend to have uncomfortable or weird thoughts and related feelings. How we think about someone over time affects our "social memory" of them;

iii. **Smart guess/wacky guess:** This concept has to do with "reading the situation" before deciding what actions to take based on the situation. Social inferencing is at the heart of determining what to say or do and this occurs at a rapid-fire pace in everyday social communication as well as when comprehending text. The process of inferencing involves becoming aware of words and nonverbal cues to "take what you (think, know, see and hear) to make a guess"; and

iv. **Social Fake**: This is a concept about how we feel in reality as we engage in a social interaction with others. Most of the time, we are interested in getting to know one another, even though we are not always interested by exactly what they say. We simply tolerate other's conversational topic in order to maintain the social-emotional connection. How we make each other feel is more important than the exact words used to sustain the relationship.

c. **Social thinking interventions** include the following:

i. Social stories: describes a context, skill, achievement, or concept according to 10 defining criteria;
ii. Hidden curriculum: is a concept that describes the often unarticulated and unacknowledged things students are taught in school and that may affect their learning experience;
iii. 5-point scale: visual system that can help to organise a person's thinking when working through difficult moments, particularly those that require social understanding:

For example:

- Self-regulation: This is control or supervision from within instead of by an external authority.
- Executive functioning: Executive function is a set of mental skills that include working memory, flexible thinking, and self-control. They are used for learning, working, and daily living.
- Central coherence issues: Central coherence is seeing how many component parts fit together to make a coherent whole. Central coherence difficulties could be related to attention, visual processing, or rigidity.
- Shifting attention: Regarding attention, a child may have difficulty shifting attention, that is, the ability to shift focus back and forth between stimuli.
- Perspective-taking: Perspective-taking is the act of perceiving a situation or understanding a concept from an alternative point of view, such as that of another individual.

Examiner's comment

This question on social skills tests importance, concepts and interventions of social thinking.

Only about 50% of the candidates attempted this question.

Performance was poor, as less than 40% of the candidates who attempted this question allocated scored 50% of the marks allocated to the question.

Many candidates were unable to discuss the interventions of social thinking.
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

S/N	Description	Marks	Total
5.	Presentation on social skills		
a.	Definition of social thinking: 1 mark for either of the 2 definitions	1	
	Importance: 1 mark each for any 2 points	2	
			3
b.	Key concepts		
	Identification: 1 mark for each of any 4 points	4	
	Explanation: 1 mark for each of any 4 points	4	
			8
c.	Social thinking interventions		
	Identification: ½ mark for each of any 4 points	2	
	Explanation: ½ mark for each of any 4 points	2	
			4
	Total		**15**

SOLUTION 6

The Turnbull report highlighted the various types of risks that a firm may face these include:

a. **Market risk**: Changes in market of commodities. The VUCA environment is characterised by inflation. As such market risk is high because higher prices could lead to lower purchases of commodities sold by the online store. This will, in turn, lead to lower profit;

b. **Credit Risk**: Risk of loss from bad debt or delay in customers settling their debt. If the business in the given scenario decides to sell on credit, it will expose itself to this risk;

c. **Liquidity risk**: Risk that the company will be unable to make payments to settle liabilities when payment is due. It can occur when a company has no money in the bank, is unable to borrow more money quickly, and has no assets that it can sell quickly in the market to obtain cash;

   The firm in the given scenario could be exposed to liquidity risk due to the volatility of prices.

d. **Technology risk**: Risk that could arise from changes in technology (or inadequacy of technological systems in use). When a major technological change occurs, companies might have to make a decision about whether or not to adopt the new technology;

e. From the given scenario, the VUCA environment is also characterised by rapid technology changes. An online store is technology **driven. As such, such a firm** will be exposed to technology risk;

f. **Legal risk**: the risk of losses arising from failure to comply with laws and regulations, and also the risk of losses from legal actions and lawsuits;

   The scenario describes an unstable legal environment which heightens legal risk; and

g. **Health, Safety, and Environment Risk**: Risks to the health and safety of employees, customers and the general public. Environment risks are risks of losses arising, in the short term or long term, from damage to the environment - such as pollution or the destruction of non-renewable raw materials.

   The VUCA environment described in the scenario is partly driven by the spread of COVID 19 which can expose employees at the workplace to risk of infection. Hence, the HSE risk is high.

Examiner's report

This question tests the use of Turnbull report to explain types of risk inherent in the VUCA business environment.

80% of the candidates attempted this question, but performance was poor.

Common pitfall was that many of the candidates did not display a detailed knowledge of Turnbull report on types of risk inherent in business. Some wasted time deliberating on VUCA, which was not a requirement of the question.

Recommendations: Candidates at this level should endeavour to study the contents of the syllabus well enough to apply them to situations and take pains to understand the requirements of a question before proceeding to provide responses.

Marking guide

S/N	Description	Marks	Total
6.	Turnbull's report on types of risk inherent in VUCA business environment		
	Identification of risk: 1 mark for each of any 6 points	6	
	Explanation of risk:: 1 mark for each of any 6 points	6	
	Relation to the scenario: 1 mark for each of any 3 points	3	
	Total		**15**

SOLUTION 7

a. The following are risk management frameworks that the company in the scenario may adopt:
   i. Enterprise Risk Management (ERM): This framework suggests the application of risk management in three stages:

The first stage is the creation of a 'vision' for risk management and establish the approach to it. Approach includes

- a clear strategy for risk management,
- establishment of an organisation-wide risk management culture and
- design and implementation of a common framework for managing risks.

ii. The second stage is investing in risk management, and building risk capabilities. Investing in risk infrastructure involves;

- Creating an infrastructure for risk management;
- Ensuring that the company/group has the skills and capabilities to manage risk;
- Building risk management leadership and support;
- Establishment of risk management leadership/support; and
- Design of policies, procedures and guidelines.

Risk capabilities include:

- development of personal objectives and plans among all staff;
- training and education of staff on risk management; and
- setting up of early warning system.

iii. This stage involves the assessment, treatment, and monitoring of risk

Risk assessment involves:

- Risk identification;
- Risk profiling/measurement;
- Risk ownership/accountability;
  Risk treatment entails:
- Effective control to mitigate risk, periodic review of controls to ensure effectiveness, testing of effectiveness of risk for critical risks and understanding and monitoring of residual risks to ensure that they are within acceptable levels.

Risk monitoring involves:
Monitoring done by managers responsible for the risks.

a.(ii.) ISO31000 is an International Standards Organisation (ISO) issued framework for implementation of risk management systems.
It is a risk management framework that is useable in any sector. Its purpose is to promote a uniform quality standard in risk management.

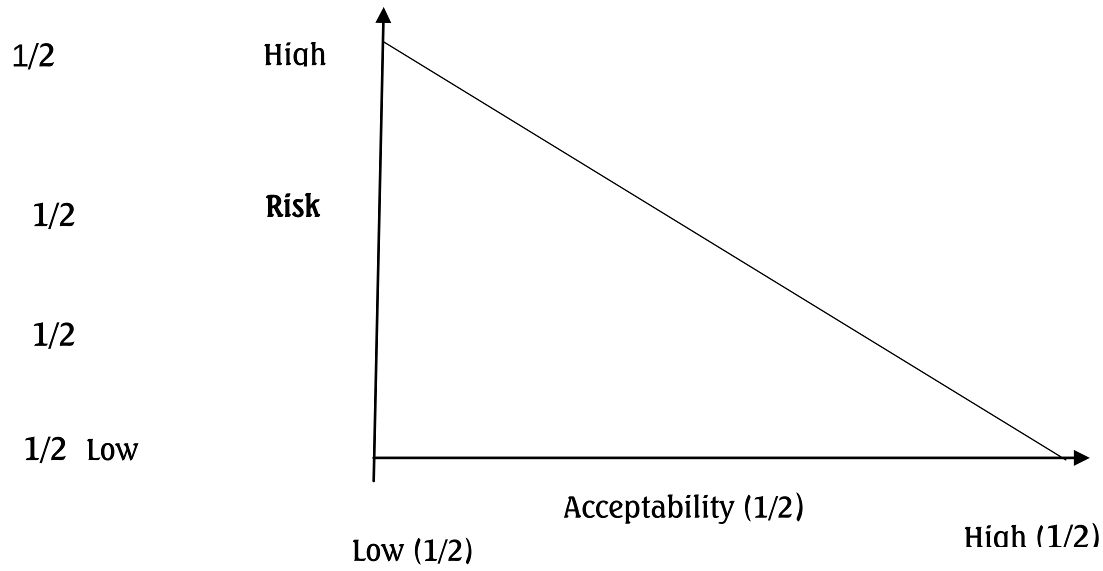
The ISO31000 is made up of three main elements"

i. **Risk architecture**: It consists of risk management roles and responsibilities within the organisation and risk reporting structures.

ii. **Risk Strategy**: In addition to defining the risk strategy, the board should also specify its risk appetite.

iii. **Risk Protocol**: Are rules and procedures for implementing risk management and risk management methodologies that should be applied.

b. ALARP is the acronym for As Low as Reasonably Practicable. The principle of ALARP is that it is usually impossible to eliminate all risks but that any residual risk should be as low as reasonably practicable. A risk is said to be ALARP when the cost involved in reducing it further outweighs the benefit. Since there exists an inverse relationship between risk and acceptability as shown in the diagram below, then, it is only common sense that entities should keep their risks ALARP.



Examiner's report

This question tests application of risk management frameworks of enterprise risk management and ISO 31000, and deployment of ALARP as a risk management strategy.

This question was very popular amongst candidates as more than 90% of them attempted the question.

Performance was below average, as less than 40% of the candidates scored up to 50% of the marks on offer.

Common pitfalls were inadequate understanding of enterprise risk management and components of ISO 31000. Surprisingly, some candidates could not present the graphical representation of the ALARP principle.

Recommendation: Candidates are enjoined to master principles and concepts well enough to apply them to situations.

Marking guide

S/N	Description	Marks	Total
7.			
a.	Risk management framework		
i.	Enterprise risk management		
	Identification: 1 mark for each of any 3 points	3	
	Explanation: 1 mark for each of any 3 points	3	
			6
ii.	ISO 31000 Framework		
	Identification of elements: 1 mark for each of any 3 points	3	
	Explanation: 1 mark for each of any 3 points	3	
			6
b.	Risk management strategy of ALARP		
	Definition: 1½ marks	1½	
	Diagram: ¼ mark for each of the 6 annotations on the diagram	1½	
			3
	Total		**15**

ICAN/232/Q/B3 Examination No...................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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, NOVEMBER 14, 2023

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2023

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

Alhaji Nura Imam, having spent over 20 years as an employee of Apex Limited, retired on November 1, 2020.

On January 2, 2021, he registered a business under the name of Nura Imam Enterprises. The profit or loss account of the enterprise for the year ended December 31, 2021, is as follows:

	₦	₦
Revenue:		
Gross profit		35,000,000
Profit on sale of property, plant and equipment (PPE)		925,000
Rental income received (gross)		750,000
Dividend received (gross)		624,800
		37,299,800
Expenses:		
Salaries and wages	7,200,600	
Rent and rates	600,000	
Transport and traveling	285,000	
Printing, photocopying and stationery	71,300	
Newspapers and periodicals	42,500	
Postages and communications	96,800	
Legal expenses	1,800,000	
Repairs and maintenance	124,000	
Security charges	120,000	
General expenses	2,840,000	
Allowance for doubtful debts	311,000	
Bad debts	28,000	
Bank charges	275,000	
Depreciation	1,650,000	(15,444,200)
Net profit for the year		21,855,600

You were provided with the following additional information:

		₦
(i)	**Salaries and wages include:**	
	Allowance paid to the proprietor's cousin who is a student at Olympia University	720,000
	Salary paid to the domestic staff of the proprietor	600,000
	Salaries of other employees	5,880,600
		7,200,600
(ii)	**Rent and rates consist of:**	₦
	Rent paid for space occupied as the private residence of the proprietor	180,000
	Rent paid for space used for business purposes	420,000
		600,000
(iii)	**Legal expenses comprise:**	₦
	Cost of renewing a long lease	240,000
	Cost of defending traffic offence	180,000
	Cost of defending a tax appeal	320,000
	General legal advisory services	1,060,000
		1,800,000
(iv)	**General expenses include:**	₦
	Audit fees	1,000,000
	Donation to proprietor's church	350,000
	Medical expenses on the proprietor's sister	220,000
	Amount misappropriated by the Chief Accountant	1,270,000
		2,840,000

(v) Agreed capital allowance on qualifying capital expenditure was ₦1,240,000.
(vi) Alhaji Imam received a gratuity of ₦4,000,000 during the year.
(vii) Alhaji Imam is blessed with five children, all within the ranges of 10 to 21 years.
(viii) The proprietor has a life assurance policy on which he pays a premium of ₦1,200,000 annually.

Required:

Compute the personal income tax payable by Alhaji Nura Imam for the relevant assessment year. **(30 Marks)**

SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 2

Forward Nigeria Limited is a company incorporated in Nigeria for the manufacture of electronic items. The company has been in business for a long time and makes up accounts to June 30, every year.

The company decided to change its accounting year end to September 30, every year. The adjusted profits for the following periods are as follows:

	₦
Year ended June 30, 2014	2,700,000
Year ended June 30, 2015	3,300,000
Period ended September 30, 2015	1,500,000
Year ended September 30, 2016	4,200,000
Year ended September 30, 2017	3,600,000

You are given the following additional information:

(i) Incomes were overstated as follows:

- June 30, 2015 ₦250,000
- September 30, 2016 ₦280,000

(ii) Expenditures were understated as follows:

- June 30, 2014 ₦160,000
- September 30, 2017 ₦150,000

Required:

a. What is the provision of the law when a business decides to change it's accounting year end? (5 Marks)

b. What is the practice of the Revenue in relation to the provisions of the law? (3 Marks)

c. Compute the assessable profits for all relevant years of assessment affected by the change of accounting date rules, taking into consideration the provisions of the law and the practice of the Revenue. (12 Marks)

(Total 20 Marks)

QUESTION 3

a. Tax administration in Nigeria involves the practical interpretations and application of the tax laws. The bodies charged with the administration of tax in Nigeria are the Federal, State and Local Governments. The tax authorities of these tiers of governments derive their power from Federal laws.

The tax laws allow all tiers of government to establish their own authorities. The administration of taxation in Nigeria is, therefore, vested in various tax authorities depending on the type of tax under consideration.

You are required to:

i. State the composition of the Joint Tax Board (3 Marks)

ii. Outline **FOUR** functions of the State Board of Internal Revenue (3 Marks)

iii. State **FIVE** levies and taxes collectible by Local Government Revenue Committee. (5 Marks)

b. In line with the provisions of the revised National Tax Policy (NTP) in 2017, explain the roles and responsibilities of the following stakeholders:

i. The government (3 Marks)
ii. The taxpayers (3 Marks)
iii. Revenue agencies (3 Marks)

(Total 20 Marks)

QUESTION 4

The records of the two trustees of Olalomi Children Settlement created in favour of the three children - Olami, Olambe and Olaide, revealed the following as at December 31, 2020:

	₦
Rental income (gross)	398,900
Trading income	210,000
Dividend (gross)	196,000
Profit on sale of non-current assets	600,000

The following additional information were made available:

(i) The interest received was from the Gbogbo-Ero Commercial Bank Limited.
(ii) Other allowable expenses amounted to ₦23,000.
(iii) Each beneficiary was entitled to a quarter of the net distributable income.
(iv) Fixed annuity to the beneficiaries was ₦42,000 (gross) to be shared equally.
(v) Trustee's remuneration per trust deed was fixed - ₦25,000 each and 2.5% of total computed income.
(vi) The trustees made discretionary payments to: Olami - ₦10,000; Olambe - ₦34,000 and Olaide - ₦29,000.
(vii) The agreed capital allowance was ₦87,600.
(viii) Administrative and other expenses amounted to ₦106,000.

You are required to compute:

a. The net income assessable in the hands of the trustee (14 Marks)

b. Assessable income in the hands of each beneficiary (6 Marks)

(Total 20 Marks)

SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)

INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION

QUESTION 5

Stamp duties are duties basically on instruments (defined to include written document). Stamp duties are governed by Stamp Duties Act Cap. S8 LFN 2004 (as amended), which provides for the levying of duties on certain matters specified in the Act, effective April 1, 1993.

Required:

In relation to the Act and other relevant circulars issued, explain the following:

a. **THREE** instruments exempted from stamp duties (3 Marks)

b. When electronic documents are regarded as received in Nigeria (3 Marks)

c. Duty on contracts (3 Marks)

d. Electronic money transfer levy (6 Marks)

(Total 15 Marks)

QUESTION 6

a. The Nigeria Customs Service (NCS) is one of the major revenue generating agencies for the Federal Government of Nigeria.

The establishment of the Nigerian Customs Service Board, which is under the control of the Federal Ministry of Finance, is contained in section 1 of the Nigerian Customs Service Board Act Cap.C45 LFN 2004 (as amended). The Board shall be responsible for the administration of the Customs and Excise Management Act.

Required:

Explain the functions and powers of the Board. (5 Marks)

b. It is expected that a schedule of Withholding Tax (WHT) payable should be prepared by applying the correct WHT rate on each transaction/payment made during the month. Thereafter, a cheque for the amount due to the Federal Inland Revenue Service is raised and forwarded together with the WHT schedule to one of the approved collecting banks for processing.

Required:

Explain **FIVE** contents of a WHT returns/payment schedule. (10 Marks)

(Total 15 Marks)

QUESTION 7

Raposa Nigeria Limited, a company located in Sambisa Forest, Kutunwegi State of Nigeria, commenced operations on November 1, 2017. The accounting year end was September 30.

As a result of stiff government policy on the importation of rice which the company deals with, the going concerns of the business became threatened and the Board of Directors decided to cease operations on December 31, 2022.

The adjusted profits for the relevant periods are as follows:

	₦
Period to September 30, 2019	2,100,000
Year ended September 30, 2020	2,400,000
Year ended September 30, 2021	3,640,000
Year ended September 30, 2022	6,300,000
Period to December 31, 2022	500,000

You are provided with the following additional information:

(i) Bad debt in the sum of ₦120,000 which was written off in 2020 assessment year, was recovered in October, 2021.

(ii) A sum of ₦20,000 was spent to recover the debt.

(iii) An expenditure of ₦350,000 incurred in assessment year 2020, though considered in the statement of profit or loss was not paid until August, 2022.

On cessation, the revenue authority intended to conduct a back-duty investigation and the taxpayer was duly informed. As a tax consultant, you have been invited to ascertain the assessable profits for the periods covered from the commencement of trade to cessation of business.

You are required to:

a. State **THREE** reasons why a business may cease trading. (3 Marks)

b. Compute net terminal adjusted profit. (6 Marks)

c. Compute assessable profits for all the relevant years of assessment. (6 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)

SOLUTION 1

Nura Imam Enterprises
Computation of income tax liability
For assessment year 2022

	₦	₦
Net profit per accounts		21,855,600
Add: Disallowable expenses:		
Allowance paid to the proprietor's cousin	720,000	
Salary paid to the domestic staff of the proprietor	600,000	
Rent paid for space occupied as the private residence of the proprietor	180,000	
Cost of renewing a long lease	240,000	
Cost of defending traffic offence	180,000	
Cost of defending a tax appeal	320,000	
Donation to proprietor's church	350,000	
Medical expenses on the proprietor's sister	220,000	
Amount misappropriated by the Chief Accountant	1,270,000	
Allowance for doubtful debts	311,000	
Depreciation	1,650,000	6,041,000
		27,896,600
Deduct: Non-taxable income		
Profit on sale of property, plant and equipment (PPE)	925,000	
Dividend (gross)	624,800	1,549,800
Adjusted profit		26,346,800
Deduct: Capital allowances		1,240,000
Income from trade		25,106,800
Gratuity		4,000,000
Total income		29,106,800
Tax exempt items:		
Life assurance premium	1,200,000	
Gratuity	4,000,000	(5,200,000)
Gross income		23,906,800
Consolidated relief allowance: (₦200,000 or 1% of ₦23,906,800, whichever is higher, plus 20% of ₦23,906,800)		(5,020,428)
Chargeable income		18,886,372

Tax payable

	₦ K
First ₦300,000 @ 7%	21,000.00
Next ₦300,000 @ 11%	33,000.00
Next ₦500,000 @ 15%	75,000.00
Next ₦500,000 @ 19%	95,000.00
Next ₦1,600,000 @ 21%	336,000.00
Next ₦15,686,372 @ 24%	3,764,729.28
₦18,886,372	
Tax payable	4,324,729.28

NOTE:
The rental income was received gross which means no withholding tax was suffered at source, hence, no set off is available on the rental income in accordance with section 79 of CITA (as amended)

Examiner's Report
The question tests the candidates' knowledge of the computation of personal income tax.

This being a compulsory question, about 100% of the candidates attempted the question. The performance of the candidates was good.
The commonest pitfall of the candidates was their inability to compute the consolidated relief allowance.

Candidates are advised to read widely and be conversant with the provisions of the Personal Income Tax Act Cap. P8 LFN 2004 (as amended) before sitting for subsequent examinations to enhance better performance.

Marking guide

			Marks	Marks
Heading	-	Name of enterprise		1
	-	Computation of income tax liability		1
	-	Assessment year 2022		1
Net profit per accounts				1
Disallowable expenses:				
(1 mark for each correct expense)				11
Non – taxable income:				
(1 mark for each correct income)				2
Capital allowances				1
Gratuity				1
Tax exempt items:				
(1 mark for each correct item)				2
Consolidated relief allowance:				
	-	₦200,000 or 1% of ₦23,906,800	1	

	- 20% of ₦23,906,800	1	
	- Correct amount (₦5,020,428)	1	3
Tax payable:			
(1 mark for each correct answer)			6
Total			30

SOLUTION 2

a. **Rules on a change of accounting date**

Whenever a company fails to make up its accounts to its normal year-end, the assessable profits of the company for the year of assessment in which that failure occurs as well as the following two years shall be computed on such basis as the Service in its discretion may determine.

b. The manner in which the FIRS exercises its discretion, in practice, is as follows:

i. Determine the year of assessment in which the company failed to make up accounts to its normal year-end;

ii. Identify the two (2) years of assessment next following (i) above;

iii. Compute the assessable profits for the three (3) years of assessment in (i) and (ii) above using the existing accounting dates, that is, the old accounting dates;

iv. Compute the assessable profits for the three (3) years of assessment in (i) and (ii) above using the new accounting dates;

v. Obtain the sum of the assessable profits for the three (3) years for each of the computations in (iii) and (iv) above; and

vi. Choose the higher of the assessable profits for the 3 years in (v) above.

Note:

The provision in Section 29(2) CITA confers on FIRS the discretion to determine the basis of assessment on a change of accounting date. In exercising this discretion, the FIRS may assess the year of change and the two following assessment years on actual basis instead of preceding year basis. This, it will do, if using the basis, produces a higher assessable profits of the three (3) years put together.

c. **Forward Nigeria Limited**
Computation of the assessable profits
For the relevant assessment years

Accounting year	2014	2015	2016	2017
	₦	₦	₦	₦
Adjusted profit	2,700,000	3,300,000	4,200,000	3,600,000
Deduct:				
Income overstated	0	(250,000)	(280,000)	0
Expenditure understated	(160,000)			(150,000)
Revised adjusted profit	2,540,000	3,050,000	3,920,000	3,450,000

Computation based on old accounting date

Year of assessment	Basis period	Assessable profit
		₦
2016	1/7/14 - 30/6/15	3,050,0000
2017	1/7/15 - 30/6/16	
	1,500,000 + ($^9/_{12}$ × ₦3,920,000)	4,440,000
2018	1/7/16 – 30/6/17	
	($^3/_{12}$×₦3,920,000)+($^9/_{12}$×₦3,450,000)	
	(₦980,000 + ₦2,587,500)	3,567,500
		11,057,500

Computation based on new accounting date

Year of assessment	Basis period	Assessable profit
		₦
2016	1/10/14 - 30/9/15	
	($^9/_{12}$ × ₦3,050,000) + ₦1,500,000	3,787,500
2017	1/10/15 - 30/9/16	3,920,000
2018	1/10/16 – 30/9/17	3,450,000
		11,157,500

The tax authority will assess 2016 to 2018 assessment years using the new accounting date as the computed total of assessable profits which amounted to ₦11,157,500 is higher than that based on old accounting basis (₦11,057,500).

Examiner's report

The question tests the candidates' knowledge of the rules of change in accounting date, practice of the Revenue, and computation of the relevant assessments based on change in accounting date.

About 60% of the candidates attempted the question but the performance was average.

The common pitfalls of the candidates were their inability to explain the practice of the Revenue when a taxpayer changes his accounting date. Some of the candidates could not compute the assessable profits for all the relevant assessment years based on the rules of change in accounting date.

Candidates are advised to read relevant texts on taxation, ICAN Pathfinders and Study Text.

Marking guide

		Marks	Marks
a.	Provision of the law when a business changes its accounting date		
	- year of assessment in which the failure occurs	2	
	- As well as the following two Years	2	
	- Computation of assessable profits on such basis as the Board in its discretion may determine	1	5
b.	**Practice of the Revenue**		
	(½ mark for each of the correct six points)		3
c.	**Computation of assessable profits for all the relevant years of assessment**		
	Heading	$^1/_4$	
	Computation of the revised adjusted profits	$^1/_4$	
	Adjusted profit (½ mark for each correct figure)	2	
	Income overstated (½ mark for each correct figure)	1	
	Expenditure understated (½ mark for each correct amount	1	
	Computation based on old accounting date:		
	Year of assessment ($^1/_4$ mark for each correct year)	¾	
	Basis period (½ mark for each correct year)	1½	
	Assessable profit (½ mark for each correct year)	1½	
	Computation based on new accounting date:		
	Year of assessment ($^1/_4$ mark for each correct year)	¾	
	Basis period (½ mark for each correct year)	1½	
	Assessable profit (½ mark for each correct year)	1½	12
	Total		**20**

SOLUTION 3

a. i. **Composition of Joint Tax Board (JTB)**

The JTB consists of:

- Executive Chairman of the Federal Inland Revenue Service as Chairman;
- A representative from states of the federation with experience in tax;
- The Secretary, who shall be ex-officio appointed by the Federal civil service
- Commission; and
- The Legal Adviser of the FIRS who acts as the Legal Adviser to the JTB.

ii. **Functions of State Board of Internal Revenue (SBIR)**

The functions of SBIR are as follows:

- Ensuring the effectiveness and optimum collection of all taxes and penalties due to the government under relevant laws;
- Making recommendations where appropriate to the JTB on tax policy, tax reform, tax legislation, tax treaties and exemptions as may be required from time to time;
- Appointing, promoting, transferring and discipline of employees of the State Internal Revenue Service (SIRS);
- Doing all such things as may be deemed necessary and expedient, for the assessment and collection of the tax and shall account for all sums so collected, in a manner to be prescribed by the Commissioner; and
- Generally controlling the management of the State Service on matters of policy, subject to the provisions of the law setting up the State Internal Revenue Service.

iii. **Taxes and levies to be collected by Local Governments**

These include:

- Shops and kiosks rates;
- Tenement rates;
- On and off liquor license fees;
- Slaughter slab fees;
- Marriage, birth and death registration fees;
- Naming of street registration fee, excluding any street in the State Capital;
- Right of occupancy fees on lands in rural areas, excluding those collectible by the Federal and State Governments;
- Market taxes and levies excluding any market where State Finance is involved;
- Motor park levies;
- Domestic animal license fees;
- Bicycle, truck, canoe, wheelbarrow and cart fees, other than a
- mechanically propelled truck;
- Cattle tax payable by cattle farmers only;
- Road closure levy;

- Radio and television license fees (other than radio and television transmitter);
- Radio license fee (to be imposed by the local government of the State in which the car is registered);
- Illegal parking fees;
- Public convenience, sewage and refuse disposal fees;
- Customary burial ground permit fees;
- Religious places establishment permit fees;
- Signboard and advertisement permit fees; and
- Wharf landing charge, where applicable.

b. **The roles and responsibilities of the following stakeholders in the revised National Tax Policy (NTP), 2017 are as follows:**

i. **The government**

All levels and arms of government, ministries, extra-ministerial departments and agencies where applicable shall:

- Implement and regularly review of tax policies and laws;
- Provide information on all revenue collected on a quarterly basis;
- Ensure adequate funding, administrative and operational autonomy of tax authorities; and
- Ensure a reasonable transition period of between three and six months before implementation of a new tax.

ii. **The taxpayers**

A taxpayer is a person, group of persons or an entity that pays or is liable to tax. The taxpayer is the most critical stakeholder and primary focus of the tax system. The taxpayer shall consider tax responsibilities as a civic obligation and constant duty that must be discharged as and when due. The taxpayer shall be entitled to:

- Relevant information for the discharge of tax obligations;
- Receive prompt, courteous and professional assistance in dealing with tax authorities;
- Raise objections to decisions and assessments and receive response within a reasonable time;
- A fair and impartial appeal; and
- Self-representation or by any agent of choice, provided an agent acting for financial reward shall be an accredited tax practitioner.

iii. **Revenue agencies**

Any agencies responsible for the collection and administration of revenue shall:

- Treat the taxpayer as a customer;
- Ensure efficient implementation of tax policies, laws and international treaties;
- Facilitate inter-agency co-operation and exchange of information;

- Undertake timely audits and investigations;
- Undertake tax awareness and taxpayers' education; and
- Establish a robust process to prevent, detect and punish corrupt tax officials

Examiner's report

The question tests candidates' knowledge of the composition and functions of the organs of tax administration with emphases on Joint Tax Board, State Board of Internal Revenue, and Local Government Revenue Committee. Additionally, candidates are expected to explain the roles and responsibilities of the government, taxpayers, and revenue agencies under the revised National tax policy (NTP), 2017. About 70% of the candidates attempted the question but the performance was average.

The commonest pitfall of the candidates was their inability to explain the roles and responsibilities of the government, taxpayers, and Revenue agencies under the revised National tax policy (NTP), 2017.
Candidates are advised to read widely and make use of the Institute's Pathfinder and Study Text in their preparations for subsequent examinations.

Marking guide

		Marks	Marks
a.(i)	**Composition of the Joint Tax Board** (1 mark for each member subject to a maximum of 3 members)	3	
(ii)	**Functions of the State Board of Internal Revenue** (1 mark for each function subject to a maximum of 3 functions)	3	
(iii)	**Levies and taxes collectible by Local Government Revenue Committee** (1 mark for each levy subject to a maximum of 5 levies)	5	11
b.	**Roles and responsibilities of stakeholders in National Tax Policy (NTP)**		
	(i) **The government** (1 mark for each role subject to a maximum of 3 roles)	3	
	(ii) **The taxpayers** (1 mark for each role subject to a maximum of 3 roles)	3	
	(iii) **Revenue agencies** (1 mark for each role subject to a maximum of 3 roles)	3	9
	Total		**20**

SOLUTION 4

a. **Olalomi Children Settlement**

Computation of net income assessable in the hands of the trustees

	₦	₦
Income:		
Rental Income (gross)		398,900
Dividend (gross)		196,000
Profit on sale of non-current assets		600,000
Trading income	210,000	
Capital allowance	(87,600)	122,400
Total income		**1,317,300**
Less authorised payments:		
Administrative expenses	106,000	
Fixed annuity	42,000	
Other allowable expenses	23,000	
Trustee's remuneration		
- Fixed (2 trustees)	50,000	
- Variable (2.5/102.5 × (₦1,317,300 – ₦221,000)	26,739	247,739
Computed income		**1,069,561**
Discretionary payments:		
- Olami	10,000	
- Olambe	34,000	
- Olaide	29,000	(73,000)
Net computed income		**996,561**
Distribution to beneficiaries:		
- Olami ($^1/_4$ ×₦996,561)	249,140.25	
- Olambe ($^1/_4$ ×₦996,561)	249,140.25	
- Olaide ($^1/_4$ ×₦996,561)	249,140.25	(747,420.75)
		249,140.25
Less Franked investment income:		
Dividend		(196,000.00)
Amount taxable in the hands of trustees		**53,140.25**

b. **Computation of assessable income of each beneficiary**

	Olami	**Olambe**	**Olaide**
	₦	**₦**	**₦**
Fixed annuity	14,000	14,000	14,000
Discretionary payment	10,000	34,000	29,000
Share of distributable Income	249,140.25	249,140.25	249,140.25
Assessable income	**273,140.25**	**297,140.25**	**292,140.25**

Examiner's report

The question tests the candidates' knowledge of the taxation of trustees and beneficiaries in a settlement. About 70% of the candidates attempted the question but performance was fair.

The common pitfalls of the candidates were their inability to compute the variable remuneration of the trustees and instead of computing the fixed remuneration for two trustees as stated in the question, they computed for one trustee.

Candidates are advised to read ICAN Study Text and Pathfinders as this topic is adequately covered in them.

Marking guide

		Marks	Marks
a.	Net income assessable in the hands of the trustees		
	- Name of company	½	
	- Computation of net income assessable in the hands of the trustee	½	
	- Rental income	½	
	- Dividend (gross)	½	
	- Profit on sale of non-current assets	½	
	- Trading income	½	
	- Capital allowance	½	
	Authorised payments:		
	Administrative expenses	1	
	Fixed annuity	1	
	Other allowable expenses	1	
	Trustees' remuneration – Fixed	1	
	- Variable	1½	
	Discretionary payments:		
	- Olami	½	
	- Olambe	½	
	- Olaide	½	
	Distribution to beneficiaries:		
	- Olami	½	
	- Olambe	½	
	- Olaide	½	
	Dividend	1	
	Amount taxable in the hands of the trustee	1	14
b.	**Assessable income in the hands of each beneficiary**		
	Names: Olami	½	
	Olambe	½	
	Olaide	½	
	Fixed annuity (½ mark for each correct amount)	1½	
	Discretionary payment (½ mark for each correct amount)	1½	
	Share of distributable income (½ mark for each correct amount)	1½	6
	Total		**20**

SOLUTION 5

a. **Instruments exempted from stamp duties**

Instruments that are specifically exempted are as follows:

(i) Those relating to agreements between the Federal Government and other foreign governments;

(ii) Instruments relating to reconstruction and amalgamation, subject to specified condition under section 104(1) of the Act;

(iii) Transactions and sales of properties of a company under liquidation arising from a compulsory winding up by a court or creditors' voluntary winding up;

(iv) Based on Central Bank circular number CBN/GEN/DMB/02/006 dated January 15, 2016, titled *"Currency and Remittance of Statutory Charges or Receipts to Nigerian Postal Service under the Stamp Duties Act"*, the following transactions are exempted from stamp duties:

- Transactions relating to savings accounts holders, salary accounts or students savings accounts;
- Payments and deposits for self to self-transactions whether inter or intra-bank; and
- Payments for goods supplied or services rendered if the amount is under ₦1,000, payment of salaries or wages, pensions, gratuities, etc;

(v) Section 56 of the Finance Act, 2019, exempts the following "exempt receipts" and "general exemptions" from stamp duties;

- Exempt receipts:
  Receipts given by any person in a regulated securities lending transaction carried out under regulation issued by the Securities and Exchange Commission
- General exemptions which include the following:
  - Shares, stocks or securities transferred by a lender to its approved agent or a borrower in furtherance of a regulated securities lending transaction;
  - Shares, stocks or securities returned to a lender or its approved agent by a borrower in pursuant to a regulated securities lending transaction; and
  - All documents relating to a regulated securities lending transactions carried out under regulations issued by the Securities and Exchange Commission; and

(vi) Share transfer based on FIRS information circular on "clarifications on the provisions of the Stamp Duties Act" No: 2020/05 dated April 29, 2020.

b. **When Electronic documents are regarded as received in Nigeria**

Documents, receipts or instruments executed outside Nigeria but received in Nigeria must be presented for stamping in accordance with sections 7(3)(a), 23(3) and 47 of the SDA, within:

(i) 10days in the case of charter parties;

(ii) 30days in the case of instruments subject of ad valorem stamp duties; or

(iii) 21days in any other instance.

For an electronic document, receipt or instrument executed outside Nigeria to be regarded as received in Nigeria, it must be:

(i) Retrieved or accessed in or from Nigeria;

(ii) Stored or an electronic copy of it is also stored on a device (including a computer, magnetic storage, etc) and brought into Nigeria; or

(iii) Stored or an electronic copy of it is also stored on a device or computer in Nigeria

c. **Duty on contracts**

It is the responsibility of any corporate body or Ministry, department or agency (MDA) to charge stamp duty at a rate of 1% of the contract value excluding value added tax (VAT) on all contracts issued to third party vendors. Thereafter, the stamp duties collected should be remitted to the Service.

d. **Electronic money transfer levy**

Section 89A of the Stamp Duties Act (as amended) states that:

"There is imposed a levy, to be referred to as the Electronic Money Transfer Levy, on electronic receipts or electronic transfer for money deposited in any deposit money bank or financial institution, on any type of account to be accounted for and expressed to be received by the person to whom the transfer or deposit is made;

(i) The levy shall be imposed as a singular and one-off charge of ₦50 on electronic receipts or electronic transfers of money in the sum of ₦10,000 or more;

(ii) The Minister of Finance shall, subject to the approval of the National Assembly, make regulations for the imposition, administration, collection and remittance of the levy, including regulations relating to the auditing, accounting, allocation and distribution of arrears of the relevant stamp duties and Electronic Money Transfer Levies collected between 2015 and 2019 fiscal years within 30 days of the date when this Act becomes effective.

Provided that Electronic Money Transfer Levies subsequently collected shall be distributed within 30 days following the month of collection.

(iii) Notwithstanding any formula that may be prescribed by any other law, the revenue accruing by virtue of the operation of this section, shall, on the basis of derivation, be distributed as follows:
- 15% to the Federal Government and the Federal Capital Territory, Abuja; and
- 85% to state governments.

Examiner's report

The question tests the candidates' knowledge of the provisions of Stamp Duties Act Cap. S8 LFN 2004 (as amended) in relation to exempted instruments, when electronic documents are regarded as received in Nigeria, duty on contracts, and electronic money transfer levy.

About 50% of the candidates attempted the question and performance was fair.
Many of the candidates could not explain when electronic documents are regarded as received in Nigeria.

Candidates are advised to read the Stamp Duties Act 2004 (as amended), the Institute's Pathfinder and ICAN Study Text when preparing for the Institute's examinations.

Marking guide

		Marks	Marks
a.	**Three instruments exempted from stamp duties** (1 mark each for any instrument exempted subject to a maximum of 3 instruments)		3
b.	**When electronic documents are regarded as received in Nigeria** (1 mark each for any condition subject to a maximum of 3 conditions)		3
c.	**Duty on Contracts**		
	- Responsibility of any corporate body or ministry, department or agency to charge stamp duty	1	
	- Stamp duty to be calculated at 1% of the contract value excluding VAT	1	
	- Stamp duties collected should be remitted to the Service	1	3
d.	**Electronic money transfer levy** (3 marks each for any point subject to a maximum of 2 points)		6
	Total		**15**

SOLUTION 6

a. **Functions of the Nigeria Customs Service Board**

The Board shall be responsible for:

(i) Formulating the general policy guidelines for the Nigeria Customs Service; and

(ii) Administering the Customs and Excise Management Act and accordingly, the Board shall-

- Subject to the general control of the Minister, control and manage the administration of the customs and excise laws; and

- Collect the revenues of customs and excise and account for them in such manner as the Minister shall from time to time, direct.

Powers of the Board

The Board shall have power:

(i) To appoint persons to hold or act in all the offices in the Service, including power to make appointments on promotion or transfer and to confirm appointments; and

(ii) To dismiss and exercise other disciplinary control over persons appointed pursuant to (i) above.

b. **Contents of WHT returns/payment schedule**

Each withholding tax cheque, being paid to the Revenue must be accompanied with a payment schedule, which is a list of those who suffered the deductions that make up the cheque. The payment schedule must contain the following particulars:

(i) Name of the taxpayers who suffered the deductions;

(ii) Their addresses;

(iii) The nature of their activities/services and period covered;

(iv) Their tax file numbers [now Tax Identification Number (TIN)];

(v) The total amount payable;

(vi) The rate of tax applied;

(vii) The amount of tax withheld;

(viii) The balance paid to the taxpayer;

(ix) The tax contract for which returns were being made;

(x) The date of payment;

(xi) The cheque number and date;

(xii) The name of the bank through which remittance was effected; and

(xiii) The period covered.

Examiner's report

The question tests the candidates' knowledge of the functions and powers of Nigeria Customs Service Board and contents of a withholding tax (WHT) returns / payment schedule.

Over 80% of the candidates attempted the question and performance was above average.

The commonest pitfall was the candidates' inability to explain the functions and powers of the Nigeria Customs Service Board.

Candidates are advised to read relevant study materials and The Nigeria Customs Service Act, 2023, in order to enhance performance in future examinations.

Marking guide

		Marks
a.	**Functions and powers of the Board**	
	(1 mark for each correct answer)	5
b.	**Contents of a WHT returns/payment schedule**	
	(2 marks for each correct point subject to a maximum of five points)	10
	Total	**15**

SOLUTION 7

a. **Possible reasons why a business could cease business include:**

i. Government legislation – the Federal Government may declare the activities of a business illegal and thus this may lead to the end of such business;
ii. Permanent dearth or inability of sourcing raw materials;
iii. Loss of major market due to stiff competitors or economic prices;
iv. Inability to settle the debt owed by the company;
v. Loss of key personnel with technical know-how;
vi. Agreement by the management of the company;
vii. Liquidity problem;
viii. Mismanagement of fund;
ix. Complying with the order of the court through an application of creditors or debenture holders of the company;
x. Failing objectives – continuous decline in profits;
xi. Natural disaster, for example, fire, earthquake or flood disaster;
xii. Death of all shareholders; e.t.c.

b. **Raposa Nigeria Limited**
Computation of net terminal adjusted profit

	₦
The net terminal adjusted profit was	500,000

NOTE:

(i) Bad debts recovered in October 2021 must have been captured in the relevant accounting year.

(ii) Amount spent in recovering the debt must also have been captured in the same accounting year.

(iii) The expenditure of ₦350,000 was actually passed through the books before the year of cessation.

Given the fact that the transactions occurred before the date of cessation, informed the decision to ignore same in the computation of the net terminal adjusted profit.

c. **Raposa Nigeria Limited**
Computation of assessable Profit
For the relevant assessment years

		₦
2017	1/11/17 – 31/12/17 (2 months) ($^{2}/_{23}$ × ₦2,100,000)	182,609
2018	1/11/17 – 30/10/18 ($^{12}/_{23}$ × ₦2,100,000)	1,095,652
2019	1/11/17 – 30/9/18 ($^{12}/_{23}$ × ₦2,100,000)	1,095,652
2020	1/10/18 – 30/9/19 ($^{12}/_{23}$ × ₦2,100,000)	1,095,652
2021	1/10/19 – 30/9/20	2,400,000
2022	1/10/20 – 30/9/21	3,640,000
2023	1/10/21 – 30/9/22	6,300,000
2023	1/10/22 – 31/12/22	500,000

Examiner's report

The question tests the candidates' knowledge of the possible reasons why a business could cease business, computations of net terminal adjusted profit, and assessable profits for the relevant assessment years on cessation of business.

About 70% of the candidates attempted the question but the performance was below average.

The common pitfall was that the candidates adjusted the terminal adjusted profit with pre – date of cessation transactions which would have been reflected in the relevant accounting years. Additionally, they could not compute assessable profits for all the relevant years of assessment.

Candidates are advised to pay attention to this particular aspect of the syllabus when preparing for future examinations.

Marking guide

		Marks	Marks
a.	**Reasons why a business may cease trading**		
	(1 mark for each reason subject to a maximum of 3 reasons)		3
b.	**Computation of net terminal adjusted profit**		
	- Net terminal adjusted profit (₦500,000)	2	
	Treatments:		
	Bad debts	1	
	Cost of recovery of bad debts	1	
	Expenditure of ₦350,000	1	
	Transactions before the date of cessation	1	6
c.	**Computation of assessable profits for all the relevant years of assessment**		
	Assessment year ($^1/_4$ mark for each correct assessment year)	2	
	Basis period ($^1/_4$ mark for each correct basis period)	2	
	Assessable profit ($^1/_4$ mark for each correct amount)	2	6
	Total		**15**