THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2014 SKILLS EXAMINATION

Question Papers
Suggested Solutions
Plus
Examiners’ Reports

SKILLS EXAMINATION – NOVEMBER 2014
FOREWORD

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

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

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

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

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

The answers provided in this publication do not exhaust all possible alternative approaches to solving these questions. Efforts had been made to use the methods, which will save much of the scarce examination time. Also, in order to facilitate teaching, questions may be 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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QUESTION 1

The Trial Balance of Excellent Plc. as at 30 June 2014 is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries &amp; wages</td>
<td>80,000</td>
</tr>
<tr>
<td>Plant and machinery maintenance cost</td>
<td>44,800</td>
</tr>
<tr>
<td>Irrecoverable debt</td>
<td>14,700</td>
</tr>
<tr>
<td>Plant and machinery at cost</td>
<td>75,500</td>
</tr>
<tr>
<td>Provision for receivables</td>
<td>21,220</td>
</tr>
<tr>
<td>Provision for depreciation:</td>
<td></td>
</tr>
<tr>
<td>- Plant and machinery</td>
<td>41,150</td>
</tr>
<tr>
<td>- Furniture</td>
<td>37,000</td>
</tr>
<tr>
<td>Delivery van at cost</td>
<td>49,000</td>
</tr>
<tr>
<td>Provision for depreciation:</td>
<td></td>
</tr>
<tr>
<td>- Delivery Van</td>
<td>12,000</td>
</tr>
<tr>
<td>Delivery van expenses</td>
<td>11,970</td>
</tr>
<tr>
<td>Purchases/Revenue</td>
<td>195,000</td>
</tr>
<tr>
<td>10% Loan Notes</td>
<td>100,000</td>
</tr>
<tr>
<td>Bank balance</td>
<td>20,900</td>
</tr>
<tr>
<td>Furniture at cost</td>
<td>64,000</td>
</tr>
<tr>
<td>Sundry expenses</td>
<td>39,500</td>
</tr>
<tr>
<td>Trade receivables/payables</td>
<td>48,000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>45,000</td>
</tr>
<tr>
<td>Inventories: 30/6/2013</td>
<td>16,000</td>
</tr>
<tr>
<td>Dividend paid to ordinary shareholders</td>
<td>15,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td></td>
</tr>
<tr>
<td>Ordinary shares of N1 each</td>
<td>100,000</td>
</tr>
<tr>
<td>Revaluation surplus (Furniture)</td>
<td>8,000</td>
</tr>
<tr>
<td>Freehold land</td>
<td>600,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,319,370</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,319,370</td>
</tr>
</tbody>
</table>

Total: 1,319,370
The following notes are relevant:

i. Inventories as at 30/6/2013:

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Units '000</th>
<th>Unit Price (₦)</th>
<th>Cost '000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commodity 1</td>
<td>300</td>
<td>20</td>
<td>6,000</td>
</tr>
<tr>
<td>Commodity 2</td>
<td>350</td>
<td>15</td>
<td>5,250</td>
</tr>
<tr>
<td>Commodity 3</td>
<td>475</td>
<td>10</td>
<td>4,750</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>16,000</strong></td>
</tr>
</tbody>
</table>

The net realisable values of these commodities per unit are as follows:

<table>
<thead>
<tr>
<th>Commodity 1</th>
<th>Commodity 2</th>
<th>Commodity 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Realisable Value per unit</td>
<td>₦15</td>
<td>₦20</td>
</tr>
</tbody>
</table>

Any increase or decrease in the value of opening inventories is to be adjusted to cost of sales.

ii. Inventories on 30 June 2014 amounted to ₦9,000,000

iii. Prepaid salaries and wages were ₦10,000,000

iv. Included in the plant and machinery maintenance cost was depreciation of ₦14,800,000.

v. The allowances for receivables are no longer required. The outstanding 10% loan notes interest was paid on 30 June 2014 and this has not been accounted for. The fair value of goods is ₦40,000,000 at the end of the year.

vi. The value in use of delivery van for the year 30 June 2014 is ₦31,000,000. The prevailing market interest rate is 21% per annum and the Discounting Factor for this year is 0.8264.

vii. The fair value of delivery van at an arm’s length transaction as at 30 June 2014 was ₦28,000,000 and the cost to sell was ₦2,000,000. All non-current assets were depreciated at 10% per annum on reducing balance basis.

viii. Current tax provision for the year is ₦165,000,000.
Required:

a. Identify any **FOUR** of the cost items that are EXCLUDED in the valuation of inventories under IAS 2. (4 Marks)

b. Calculate the following:

   (i) Value of opening inventories to be included in the Statement of Profit or Loss and Other Comprehensive Income. (2 Marks)
   (ii) The present value in the use of delivery van (1 Mark)
   (iii) The fair value and recoverable amount of delivery van (2 Marks)
   (iv) The carrying amount and impairment if any on delivery van (2 Marks)

c. Prepare the Statement of Profit or Loss and Other Comprehensive Income (OCI) and Statement of Changes in Equity for the year ended 30 June 2014. (11 Marks)

d. Prepare the Statement of Financial Position as at 30 June 2014. (8 Marks) Show all relevant workings (Total 30 Marks)

SECTION B: ATTEMPT TWO QUESTIONS FROM THIS SECTION (40 MARKS)

**QUESTION 2**

a. A non-accountant friend of yours attended a seminar for non-accounting executives on interpretation of financial statements.

   Though, he enjoyed the seminar especially the aspect on the uses of accounting ratios, he strongly believes that they have their limitations. State and explain the limitations of ratios for the purpose of interpreting financial statements. (5 Marks)

b. You are provided with the following set of amended published Financial Statements of HAMMED Plc for the year ended 31 December 2013: Consolidated Statement of Profit or Loss and Other Comprehensive Income
### Consolidated Statement of Financial Position

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦’000</td>
<td>₦’000</td>
</tr>
<tr>
<td><strong>Non-current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant &amp; equipment (PPE)</td>
<td>69,864</td>
<td>74,630</td>
</tr>
<tr>
<td>Motor Vehicles</td>
<td>11,554</td>
<td>11,200</td>
</tr>
<tr>
<td></td>
<td>81,418</td>
<td>85,830</td>
</tr>
<tr>
<td><strong>Current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>16,548</td>
<td>18,344</td>
</tr>
<tr>
<td>Trade and other receivables</td>
<td>59,092</td>
<td>41,982</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>62,824</td>
<td>69,916</td>
</tr>
<tr>
<td>Assets classified as held for sale</td>
<td>1,874</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>140,338</td>
<td>130,242</td>
</tr>
<tr>
<td><strong>Total assets:</strong></td>
<td>221,756</td>
<td>216,072</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>48,090</td>
<td>49,432</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>43,778</td>
<td>45,276</td>
</tr>
</tbody>
</table>

**Capital and Reserves Attributable to equity shareholders:**
Additional information

i. The issued share capital of the company consists of 50k ordinary shares.

ii. The market price of the ordinary shares was ₦17 at 31 December 2012 and ₦19.16 at 31 December 2013.

iii. There were no preference shares and no loan notes.

iv. The cost of purchases plus production cost was ₦124,966,000 in 2012 and ₦125,000,000 in 2013.

v. Other opening and closing balances:

<table>
<thead>
<tr>
<th></th>
<th>Closing 2013</th>
<th>Closing 2012</th>
<th>Opening 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
</tr>
<tr>
<td>PPE accumulated depreciation</td>
<td>37,046</td>
<td>129,540</td>
<td>122,288</td>
</tr>
<tr>
<td>Inventories</td>
<td>16,548</td>
<td>18,344</td>
<td>20,836</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>40,486</td>
<td>37,160</td>
<td>35,678</td>
</tr>
<tr>
<td>Trade payables</td>
<td>9,604</td>
<td>12,882</td>
<td>11,412</td>
</tr>
<tr>
<td>Other taxes and social security</td>
<td>3,822</td>
<td>3,640</td>
<td>3,818</td>
</tr>
<tr>
<td>Accruals</td>
<td>30,740</td>
<td>27,810</td>
<td>27,680</td>
</tr>
<tr>
<td>Equity</td>
<td>129,888</td>
<td>121,364</td>
<td>106,274</td>
</tr>
</tbody>
</table>

Required:

i. Calculate performance (efficiency) and investment ratios for each of the two years as far as the available information permits. (10 Marks)

ii. Comment on the company’s financial performance for the year ended 31 December 2013 based on the ratios. (5 Marks)

(Total 20 Marks)
QUESTION 3

USMAN Plc.
Statement of Profit or Loss and Other Comprehensive Income
for the year ended 31 December 2013

N'000

Revenue 1,600,000
Interest income 10,000
Gain on sale of plant 8,000

1,618,000

Expenses:
Cost of sales 960,000
Wages and salaries expenses 240,000
Depreciation on plant and equipment 50,000
Interest expense 8,000
Other expenses 152,000 (1,410,000)

Profit before tax 208,000
Income tax expense (60,000)
Profit for the year 148,000

Other comprehensive income:
Gain on available for sale Investment 4,000
Income tax (1,200) 2,800

Total comprehensive income for the year 150,800

USMAN Plc.
Comparative Statements of Financial Position as at:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N'000</td>
<td>N'000</td>
<td>N'000</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>113,100</td>
<td>120,000</td>
<td>(6,900)</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>158,000</td>
<td>140,000</td>
<td>18,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>140,000</td>
<td>130,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Prepayments</td>
<td>19,000</td>
<td>16,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>200</td>
<td>300</td>
<td>(100)</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>330,000</td>
<td>300,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Investment (Available for sale)</td>
<td>28,000</td>
<td>24,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>30,000</td>
<td>-</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>818,300</td>
<td>730,300</td>
<td>88,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>90,000</td>
<td>84,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Wages and salaries payable</td>
<td>10,000</td>
<td>8,000</td>
<td>2,000</td>
</tr>
</tbody>
</table>

SKILLS EXAMINATION – NOVEMBER 2014
Accrued interests 400 - 400
Other expenses payable 3,600 6,000 (2,400)
Current tax payable 32,000 28,000 4,000
Deferred tax liability 17,200 10,000 7,200
Long-term borrowings 140,000 120,000 20,000
Share capital 400,000 400,000 -
Retained earnings 122,300 74,300 48,000
Available for sale reserve 2,800 - 2,800
818,300 730,300 88,000

Additional information extracted from the company's records are:

(i) Plant which had a carrying amount of ₦20,000,000 was sold for ₦28,000,000 cash and new equipment was purchased for ₦100million.
(ii) Intangibles valued at ₦30,000,000 were acquired for cash.
(iii) Borrowings of ₦20,000,000 were made during the year and received in cash.
(iv) Dividends paid in cash amounted to ₦100,000,000.

Required:

Prepare Statement of Cash Flows for USMAN Plc for the year ended 31 December 2013 in accordance with IAS7 using direct method. (20 Marks)

QUESTION 4

a. International Financial Reporting Standards (IFRS) through the International Accounting Standard Board (IASB) sets out the definition and essential characteristics of assets and liabilities in the presentation of financial statements which users of the statements are likely to rely on when making major economic decisions.

Required:

Identify the essential characteristics of assets and comment on the features of liabilities in accordance with provisions of IAS1 on presentation of financial statements. (10 Marks)

b. Island Plc is an international airline which operates in Nigeria. The entity plans to enter into a lease agreement with KLM Leasing Limited for the use of a
Boeing 747 aircraft. This agreement should not involve sale and lease back transactions.

The contract terms include the following:

- Lease period - 5 years
- Quarterly lease rental payments - ₦150 million.
- Cost of buying Boeing 747 Aircraft - ₦500 million.
- Economic useful life - 20 years
- Scrap value after 20 years - nil
- KLM Limited maintains the aeroplane

**Required:**

i. Recommend the type of lease arrangement that Island Plc should enter into giving reasons for your choice. (2 Marks)

ii. Illustrate, in tabular form, the basic differences between the type of lease recommended in b(i) above and any other type of lease arrangements under IAS 17. (5 Marks)

c. Based on the information supplied in the question, calculate the following:

i. Total lease rental over the lease period. (1 Mark)

ii. Finance charge. (2 Marks)

(Total 20 Marks)

**SECTION C: ATTEMPT TWO QUESTIONS FROM THIS SECTION (30 MARKS)**

**QUESTION 5**

In accordance with IAS 23, Borrowing Costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset while other borrowing costs are recognised as an expense.

**Required:**

a. State the conditions wherein capitalisation of borrowing costs:

   i. Commence
ii. Should not be suspended

iii. Should cease (6 Marks)

b. VITAMAX Plc. is constructing a factory that will take about 18 months to complete. The company commenced construction on 2 January 2013. The following payments were made during the year:

<table>
<thead>
<tr>
<th>Date</th>
<th>Payment (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 January</td>
<td>40,000</td>
</tr>
<tr>
<td>31 March</td>
<td>90,000</td>
</tr>
<tr>
<td>30 June</td>
<td>20,000</td>
</tr>
<tr>
<td>31 October</td>
<td>40,000</td>
</tr>
<tr>
<td>30 November</td>
<td>50,000</td>
</tr>
</tbody>
</table>

The first payment on 31 January was funded from the company’s pool of debts. However, the company succeeded in raising Medium-Term Loan Notes for an amount of ₦160,000,000 on 31 March 2013 at a simple interest rate of 9 percent per year, calculated and payable monthly in arrears. These funds were specifically used for the construction. Excess funds were temporarily invested at 6 percent monthly in arrears and payable in cash. The pool of debts were again used for a ₦40,000,000 payment on 30 November 2013 which could not be funded from the Medium-Term Loan Notes.

The construction project was temporarily halted for three weeks in May 2013 when substantial technical and administrative work was carried out.

The following amounts of debts were outstanding at the reporting date of 31 December 2013:

<table>
<thead>
<tr>
<th>Debt</th>
<th>Amount (₦’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium-Term Loan Notes</td>
<td>160,000</td>
</tr>
<tr>
<td>Bank overdraft</td>
<td>240,000</td>
</tr>
<tr>
<td>10% 7-year Notes 1 October 2018 with simple interest payable annually at 31 December</td>
<td>1,800,000</td>
</tr>
</tbody>
</table>

For the bank overdraft, the weighted average amount outstanding during the year was ₦150,000,000 and the total interest charged by the bank amounted to ₦6,760,000 for the year.
Required:

Calculate the total amount of interest to be capitalised. (9 Marks)

Note: All workings should be to the nearest thousand naira. (Total 15 Marks)

QUESTION 6

Skelewu Nigeria Limited owns the following Property, Plant and Equipment as at 31 December 2011.

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Cost N’000</th>
<th>Accumulated Depreciation N’000</th>
<th>Carrying Amount N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant &amp; Machinery</td>
<td>45,000</td>
<td>9,000</td>
<td>36,000</td>
</tr>
<tr>
<td>Land</td>
<td>25,000</td>
<td>-</td>
<td>25,000</td>
</tr>
<tr>
<td>Office Buildings</td>
<td>75,000</td>
<td>15,000</td>
<td>60,000</td>
</tr>
</tbody>
</table>

Additional pieces of information are:

(i) Plant and Machinery are depreciated on a straight-line basis over 5 years. The plant & machinery was acquired on 1 January 2011.
(ii) Land is not depreciated
(iii) Buildings are depreciated on a straight-line basis over 25 years.
(iv) Depreciation on office building is not deductible for tax purposes but for the plant and machinery; tax deductible is granted over a period of 3 years in the ratio 50:30:20 percent of cost consecutively.
(v) The accounting profit before tax amounted to N’15,000,000 for the 2012 financial year and N’20,000,000 for year 2013. These figures include non-taxable revenue of N’4,000,000 in year 2012 and N’5,000,000 in year 2013.
(vi) Skelewu Nig. Ltd had a tax loss on 31 December 2011 of N’12,500,000. The tax rate for year 2011 was 35% and 30% for each of years 2012 and 2013.

Required:

a. In accordance with IAS 12 on Income Taxes, differentiate between Current Tax and Deferred Tax. (2 Marks)
b. Prepare the Deferred Tax Account for the year ended 31 December 2013. (10 Marks)
c. Advise the Directors of Skelewu Nigeria Limited on the reasons why it is necessary to recognise or make provision for Deferred Tax in the company’s Financial Statements. (3 Marks) (Total 15 Marks)

QUESTION 7

a. IAS 16 covers all aspects of accounting for Property, Plant and Equipment (PPE) including its measurement and qualification for recognition as an asset. The standard also described the elements of cost, stating that some costs are directly attributable costs of PPE while some other costs failed to qualify as costs of an item of PPE.

Required:

In the context of IAS 16, identify the elements of cost of an item of Property, Plant and Equipment, giving SIX examples of directly attributable costs. (5 Marks)

b. The following details are extracted from the non-current assets register of Kwali Nigeria Plc at the year ended 30 September 2013:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freehold property at cost</td>
<td>N’000 586,700</td>
</tr>
<tr>
<td>Leasehold property at valuation 30 Sept. 2012</td>
<td>229,500</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>355,800</td>
</tr>
<tr>
<td>Plant and equipment at cost</td>
<td>198,600</td>
</tr>
<tr>
<td>Plant and equipment (Leased) at cost</td>
<td>85,200</td>
</tr>
<tr>
<td>Accumulated depreciation 30 Sept. 2012:</td>
<td></td>
</tr>
<tr>
<td>Freehold property</td>
<td>264,015</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>86,888</td>
</tr>
<tr>
<td>Plant and equipment (Leased)</td>
<td>21,300</td>
</tr>
</tbody>
</table>

Additional information:

(i) During the year ended 30 September 2013, the company incurred the sum of N106,000,000 on the construction work in progress and this resulted in the completion of a warehouse costing N325,000,000. The warehouse was put to use on 1 June, 2013. The freehold property is depreciated at a flat rate of 15% per annum on a straight-line basis.
(ii) The leasehold property was acquired on 1 October 2011 on 15 years lease at a cost of ₦300,000,000. The company's policy is to revalue the property at market value at each year end. At 30 September 2013, the property was valued at ₦204,600,000.

(iii) Plant acquired is depreciated at 25% per annum using the reducing balance method while the leased plant is also depreciated at 25% using the straight-line method.

(iv) One item of plant acquired for ₦48,000,000 on 1 October 2010 was disposed on 30 September, 2013 for ₦36,000,000 while a new plant with a higher capacity was acquired as a replacement for ₦65,000,000 on the same date.

(v) All the additional pieces of information above are yet to be adjusted for in the books of Kwali Nigeria Plc.

Required:

Prepare a statement of changes in Property, Plant and Equipment for inclusion in the Financial Statements for the year ended 30 September 2013. (10 Marks) (Total 15 Marks)

SOLUTION 1

(a) Excluded costs in IAS 2 on inventories include the following:

- Abnormal amount of wasted materials, labour or other production cost.
- Storage costs, unless those costs that are necessary in the production process before a further production stage.
- Administrative overheads that do not contribute to bringing inventories to their present location or condition.
- Selling costs.
- Interest cost/charges that may arise when inventory is bought on terms that allow for settlements at a later date.
• Foreign exchange differences that may arise when inventory bought is payable to agent for arranging imported inventories.

• After sales warranty costs.
• Borrowing costs not qualified for capitalization under IAS 23.

ii. The Present Value in use remains at N31,000,000

iii. Fair value of delivery van = N28,000,000
Recoverable amount is N31million being the higher of

Fair value less cost to sell (N28million – N2million) 26,000
Value in use (PV of future CF) 31,000

iv. The carrying amount as at 30/6/2014

<table>
<thead>
<tr>
<th>Commodity</th>
<th>(a) Units</th>
<th>Unit cost N</th>
<th>(b) Inventory Value (lower of a or b)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N’000 ‘000</td>
<td>N’000</td>
<td>N’000</td>
</tr>
<tr>
<td>1</td>
<td>6,000 300</td>
<td>15</td>
<td>4,500 4,500</td>
</tr>
<tr>
<td>2</td>
<td>5,250 350</td>
<td>15</td>
<td>7,000 5,250</td>
</tr>
<tr>
<td>3</td>
<td>4,750 475</td>
<td>8</td>
<td>3,800 3,800</td>
</tr>
<tr>
<td></td>
<td>16,000</td>
<td></td>
<td>15,300 13,550</td>
</tr>
</tbody>
</table>

Impairment loss (2,300)

Carrying amount after impairment as at 30/6/2014

Impairment loss is excess of:

Carrying amount (before possible impairment) as at 30/6/2014 33,300
Recoverable amount 31,000 2,300
c.

EXCELLENT PLC
Statement of Profit or Loss and Other Comprehensive Income for the year ended
30 June 2014

<table>
<thead>
<tr>
<th></th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>940,000</td>
</tr>
<tr>
<td>Cost of sale (w1)</td>
<td>(199,550)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>740,450</td>
</tr>
<tr>
<td>Personnel cost (₦80million - ₦10million prepayments)</td>
<td>(70,000)</td>
</tr>
<tr>
<td>Depreciation, amortization &amp; impairment charges (w2)</td>
<td>(23,500)</td>
</tr>
<tr>
<td>Admin. and other operating expenses (w3)</td>
<td>(74,950)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>572,000</td>
</tr>
<tr>
<td>Finance costs</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Profit Before Tax (PBT)</td>
<td>562,000</td>
</tr>
<tr>
<td>Income tax expenses</td>
<td>(165,000)</td>
</tr>
<tr>
<td></td>
<td>397,000</td>
</tr>
</tbody>
</table>

EXCELLENT PLC
Statement of Changes in Equity for the year ended 30 June 2014

<table>
<thead>
<tr>
<th></th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary Share</td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>₦'000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>₦'000</td>
</tr>
<tr>
<td>Revaluation Surplus</td>
<td>₦'000</td>
</tr>
<tr>
<td>Total</td>
<td>₦'000</td>
</tr>
<tr>
<td>B/fwd</td>
<td>100,000</td>
</tr>
<tr>
<td>Prior year Adjustment</td>
<td>(2,450)</td>
</tr>
<tr>
<td>Restated B/fwd</td>
<td>100,000</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>397,000</td>
</tr>
<tr>
<td>Dividend paid</td>
<td>(15,000)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>517,550</td>
</tr>
</tbody>
</table>

WORKINGS:

1. Cost of sales:
   - Opening inventories as adjusted | ₦13,550
   - Purchases                      | ₦195,000
   - Cost of goods available for sale | ₦208,550
   - Closing inventories            | (₦9,000)
   - Cost of sales                   | ₦199,550

2. Depreciation, Amortisation & Impairment Charges
   - Depreciation: Plant & Machinery | ₦14,800
   - Delivery van                    | ₦3,700
Furniture (10% x (₦64m – ₦37m)) 2,700
Impairment charge for delivery van 2,300

Admin Expenses/Other operating:

3. Maintenance Cost-Plant (₦44,800 – ₦14,800) 30,000
Irrecoverable debts 14,700
Reversal of impairments on receivables (21,220)
Delivery van expenses 11,970
Sundry expenses 39,500
          74,950

EXCELLENT PLC.
Statement of Financial Position as at 30 June 2014

<table>
<thead>
<tr>
<th>ASSET</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non -Current Assets:</td>
<td></td>
</tr>
<tr>
<td>Property Plant &amp; Equipment (W1)</td>
<td>689,650</td>
</tr>
<tr>
<td>Intangible Asset: Goodwill</td>
<td>45,000</td>
</tr>
<tr>
<td></td>
<td>734,650</td>
</tr>
<tr>
<td>Current Assets:</td>
<td></td>
</tr>
<tr>
<td>Inventories (lower of ₦9m and ₦40m)</td>
<td>9,000</td>
</tr>
<tr>
<td>Trade and other receivables</td>
<td>48,000</td>
</tr>
<tr>
<td>Cash &amp; Cash equivalents (₦20.9m-₦10m)</td>
<td>10,900</td>
</tr>
<tr>
<td>Other Assets (i.e prepaid salary)</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>77,900</td>
</tr>
<tr>
<td>Total Assets</td>
<td>812,550</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EQUITY &amp; LIABILITIES</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital &amp; Reserves:</td>
<td></td>
</tr>
<tr>
<td>Ordinary Share Capital (₦1 per share)</td>
<td>100,000</td>
</tr>
<tr>
<td>Retained Earnings (₦30 million - ₦2.45m- ₦15m + ₦397m)</td>
<td>409,550</td>
</tr>
<tr>
<td>Revaluation Reserve</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Non -Current Liabilities:</td>
<td></td>
</tr>
<tr>
<td>10% Loan notes</td>
<td>100,000</td>
</tr>
<tr>
<td>Current Liabilities:</td>
<td></td>
</tr>
<tr>
<td>Trade and other payables</td>
<td>30,000</td>
</tr>
<tr>
<td>Current Tax payable</td>
<td>165,000</td>
</tr>
<tr>
<td></td>
<td>195,000</td>
</tr>
<tr>
<td>Total Equity and Liabilities</td>
<td>812,550</td>
</tr>
</tbody>
</table>
WORKINGS:

1. Statement of Changes in Property, Plant and Equipment

<table>
<thead>
<tr>
<th></th>
<th>Cost '000</th>
<th>Acc Depr. '000</th>
<th>Acc Impair. '000</th>
<th>Carrying Amount '000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freehold Land</td>
<td>600,000</td>
<td>0</td>
<td>0</td>
<td>600,000</td>
</tr>
<tr>
<td>Plant &amp; Machinery</td>
<td>75,500</td>
<td>(41,150)</td>
<td>0</td>
<td>34,350</td>
</tr>
<tr>
<td>Furniture</td>
<td>64,000</td>
<td>(39,700)</td>
<td>0</td>
<td>24,300</td>
</tr>
<tr>
<td>Delivery van</td>
<td>49,000</td>
<td>(15,700)</td>
<td>(2,300)</td>
<td>31,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>788,500</td>
<td>(96,550)</td>
<td>(2,300)</td>
<td>689,650</td>
</tr>
</tbody>
</table>

EXAMINER’S REPORT

The question tests candidates’ understanding of the provisions of IAS2 on inventory, IAS 36 on impairment of assets and their application to the preparation and presentation of published financial statements. It specifically requires candidates to value the opening inventory, determine impairment, if any, on the delivery van and to prepare the Statement of Profit or Loss and Other Comprehensive Income, Statement of Changes in Equity and Statement of Financial Position.

The candidates’ performance was very poor as only about 10% of the candidates obtained up to 40% of the allocated marks.

The candidates’ commonest pitfalls were their lack of understanding of the provisions of the relevant accounting standards tested and their inability to present the required financial statements in IFRS prescribed format.

Candidates are advised to study all aspects of the preparation of published financial statements of companies including groups. They should also acquaint themselves with all the accounting standards stated in syllabus for the Financial Reporting paper.
SOLUTION 2

The limitations of accounting ratios include the following:

(i) **Heterogeneity or Homogeneity:**
A company may have various divisions operating in many different industries. This can make it difficult to find comparative industry ratios to use for comparison purposes.

(ii) **Need to determine whether the results of the ratio analyses are consistent:**
One set of ratios may indicate a problem, whereas another set may indicate that the potential problem is only short-term in nature.

(iii) **Need to use judgment:**
Although financial ratios are used to help assess the growth, political and risk profile of a company, they cannot be used alone; the entire operation of the company must be examined, and the external economic and industry setting in which it is operating must be considered when interpreting financial ratios.

(iv) **The use of alternative accounting methods:**
Companies frequently have latitude when choosing certain accounting methods. Ratios obtained from financial statements that employ different accounting choices may not be comparable unless adjustments are made.

(v) **Management Assumptions, Basis of Estimation and Judgment:**
IFRS is principles-based; it requires significant judgement from management of entities, this could result in material differences in the financial statements of the entities. It can also further limit the financial analyses of financial statements with accounting ratios unless further adjustments are made to the accounts.

(vi) **Differences in Accounting Policies:**
IFRS as a principles-based financial reporting system, allows alternative treatments of transactions via accounting policy choice, which invariably makes comparison of company’s performance via accounting ratios more difficult and less meaningful unless alignment of the accounting policies of the entities are considered.
(vii) **Use of Historical Cost Data:**

Decisions about future expectations are based on historical data, which in some cases, make it difficult and insensitive to reaching economic decision that are likely to take into consideration changes in underlying variables that determine company’s performance.

(viii) **Inflation can distort the financial statements:**

Inflation can distort the financial statements (particularly the statement of financial position). Any problem in the financials caused by inflation can be passed on to ratios.

(ix) **Difference in ratio definitions may make it difficult to compare ratios from different sources:**

Differences in ratio definitions make it difficult to compare ratios from different sources. There can be many different ways to compute the same ratio. This can cause confusion or different answers.

(x) **Use of Industrial average:**

Comparison against industry average may not be subjected to factors that are not common in the industry.

(xi) **Lack of comparative figure for a new entity:**

In the company’s first year of trading, there will be no comparative figures, hence no indicator to compare with.

(i) **EFFICIENCY RATIOS**

<table>
<thead>
<tr>
<th>S/N</th>
<th>RATIOS</th>
<th>FORMULAE</th>
<th>YEAR 2013</th>
<th>YEAR 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Gross Profit %</td>
<td>( \frac{\text{gross profit}}{\text{sales}} \times 100 )</td>
<td>110,724</td>
<td>126,458</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>257,520</td>
<td>254,444</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>50.76%</td>
<td>49.70%</td>
</tr>
<tr>
<td>(ii)</td>
<td>OPERATING PROFIT MARGIN</td>
<td>( \frac{\text{profit before interest &amp; tax}}{\text{sales}} )</td>
<td>32,814</td>
<td>31,258</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>257,520</td>
<td>254,444</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>12.74%</td>
<td>12.28%</td>
</tr>
<tr>
<td></td>
<td>Formula</td>
<td>Year 2013</td>
<td>Year 2012</td>
<td></td>
</tr>
<tr>
<td>-------</td>
<td>---------</td>
<td>-----------</td>
<td>-----------</td>
<td></td>
</tr>
<tr>
<td>(iii)</td>
<td><strong>NET PROFIT MARGIN</strong></td>
<td>$\frac{\text{Profit after Tax}}{\text{Sales}}$</td>
<td>9.52%</td>
<td>9.20%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>24,506/257,520</td>
<td>23,404/254,444</td>
<td></td>
</tr>
<tr>
<td>(iv)</td>
<td><strong>INVENTORY TURNOVER</strong></td>
<td>$\frac{\text{Cost of goods sold}}{\text{Average Inventory}}$</td>
<td>7.27%</td>
<td>6.51%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>126,796/17,446</td>
<td>127,458/19,590</td>
<td></td>
</tr>
<tr>
<td>(v)</td>
<td><strong>AVERAGE COLLECTION PERIOD</strong></td>
<td>$\frac{\text{Average Receivables days x 365}}{\text{Credit Sales}}$</td>
<td>55 days</td>
<td>52 days</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$\frac{(40,486 + 37,160)}{257,520}$ x 365</td>
<td>55 days</td>
<td>$\frac{(37,160 + 35,678)}{254,444}$ x 365</td>
</tr>
<tr>
<td>(vi)</td>
<td><strong>AVERAGE PAYMENT PERIOD</strong></td>
<td>$\frac{\text{Average payables days x 365}}{\text{Credit Purchases}}$</td>
<td>33 days</td>
<td>35 days</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$\frac{(9,604 + 12,882)}{125,000}$ x 365</td>
<td>33 days</td>
<td>$\frac{(12,882 + 11,412)}{124,966}$ x 365</td>
</tr>
<tr>
<td>(vii)</td>
<td><strong>RETURN CAPITAL ON EMPLOYED</strong></td>
<td>$\frac{\text{Profit before Interest and Tax}}{\text{Capital Employed}}$ x 100</td>
<td>25.26%</td>
<td>25.76%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$\frac{32,814}{129,888}$</td>
<td>31.258/121,364</td>
<td></td>
</tr>
<tr>
<td>(viii)</td>
<td><strong>ASSET TURNOVER</strong></td>
<td>$\frac{\text{Revenue}}{\text{Capital Employed}}$</td>
<td>1.98</td>
<td>2.10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>257,520/129,888</td>
<td>254,444/121,364</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>INVESTMENT RATIOS FORMULAE</strong></td>
<td>YEAR 2013</td>
<td>YEAR 2012</td>
<td></td>
</tr>
<tr>
<td>(i)</td>
<td><strong>EARNINGS YIELD (%)</strong></td>
<td>$\frac{\text{Earnings per share (EPS)}}{\text{Market Price per Share (MPS)}}$</td>
<td>1.2522</td>
<td>7.37%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1.302/19.1600</td>
<td>1.2522/19.1600</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1.98</td>
<td>2.10</td>
<td></td>
</tr>
<tr>
<td>(ii)</td>
<td><strong>DIVIDEND YIELD %</strong></td>
<td>$\frac{\text{Dividend per share (DPS)}}{\text{Market Price per Share (MPS)}}$ x 100</td>
<td>2.3%</td>
<td>2.29%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$\frac{0.4400}{19.1600}$ x 100</td>
<td>2.3%</td>
<td>$\frac{0.3900}{17.000}$ x 100</td>
</tr>
<tr>
<td>(iii)</td>
<td><strong>PRICE EARNINGS RATIO</strong></td>
<td>$\frac{\text{Market Price per share (MPS)}}{\text{Earnings per share (EPS)}}$</td>
<td>14.72%</td>
<td>13.58%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$\frac{19.16000}{1.3012}$</td>
<td>14.72%</td>
<td>$\frac{17.0000}{1.2522}$</td>
</tr>
<tr>
<td>(iv)</td>
<td><strong>DIVIDEND PAYOUT</strong></td>
<td>$\frac{\text{Dividend per share (DPS)}}{\text{Earnings per share (EPS)}}$</td>
<td>33.81%</td>
<td>31.15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$\frac{0.4400}{1.3012}$</td>
<td>33.81%</td>
<td>$\frac{0.3900}{1.2522}$</td>
</tr>
</tbody>
</table>
ANALYSIS AND REVIEW OF THE ACCOUNTING RATIOS

PERFORMANCE (EFFICIENCY) RATIOS

The analysis of performance via the “profitability Ratio” revealed that the performance of 2013 is marginally better than the performance observed for the preceding period (2012) as every profitability measures/ratios showed an enhanced performance, which include:

Gross Profit Margin of 51% in 2013 as against 50% in 2012, operating profit margin of 13% in 2013 from 12% in 2012, and Net Income Margin of 10% in 2013 from 9% in 2012.

All indications with respect to profitability in 2013 are clear evidence of management efficiency with respect to efficient utilisation of its assets to generate economic benefits and enhanced returns (even though marginal).

The analysis of performance via the “working Capital Efficiency” revealed increase in inventory turnover from 6.51 times to 7.27 times. Furthermore, there was insignificant difference/variation with respect to average payment period to vendors/suppliers with 2 days shortened payment period observed with respect to the management of the entity’s working capital, there exists consistency in its short term solvency and liquidity position based on slight improvement. The performance of the entity via its liquidity, has continued to demonstrate the original decrease, is recorded in the return on capital employed and net asset turnover. The return on capital employed decreased from 25.76% in 2012 to 25.26% in 2013 while the assets turnover decreased from 2.10 times in 2012 to 1.98 times in 2013.

INVESTMENT RATIOS

The analysis of investment ratios equally demonstrated the applaudable performance of the company with respect to meeting investors’ expectations as regards its enhanced returns as shown by the increase in Price Earnings from 13.58 in 2012) to
14.72 in 2013. Increase in dividend yield (2.30% in 2013 as compared with 2.29% in 2012), dividend payout of 34% in 2013 from 31% in 2012. There was slight exception in performance with respect to drop in earnings from 7.37% in 2012 to 6.79% in 2013, likewise was a further drop in dividend cover from 3.21 times to 2.96 times. Overall, it is perceived that on an average basis, the market expectations of the investors may have been satisfied based on the analysis and review of the company’s performance for 2013.

EXAMINER’S REPORT

The question tests candidates’ knowledge of accounting ratios and the limitations of using accounting ratios in the analysis and interpretation of Financial Statements.

Candidates are required to compute performance (efficiency) and investment ratios and to comment on the performance of the entity based on the computed ratios.

Candidates’ performance was fair as over 40% of the candidates who attempted the question obtained up to 50% of the marks allocated.

Candidates’ commonest pitfall was their inability to identify the relevant accounting ratios which measure performance and investments of an entity. Some candidates in addition, had problem with stating the correct formulae for computing the ratios. Candidates are therefore advised to study all aspects of accounting ratios including its limitations.

SOLUTION 3

USMAN PLC.

STATEMENT OF CASHFLOW FOR THE YEAR ENDED 31 DECEMBER 2013

<table>
<thead>
<tr>
<th>NOTES</th>
<th>N’000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASHFLOW FROM OPERATING ACTIVITIES:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Receipts from customers</td>
<td>(1)</td>
<td>1,582,000</td>
</tr>
<tr>
<td>Cash paid to supplier and employers</td>
<td>(2)</td>
<td>(1,359,400)</td>
</tr>
<tr>
<td>Cash generated from operations</td>
<td></td>
<td>222,600</td>
</tr>
<tr>
<td>Interest Received</td>
<td>(3)</td>
<td>10,100</td>
</tr>
<tr>
<td>Interest paid</td>
<td>(4)</td>
<td>(7,600)</td>
</tr>
<tr>
<td>Income Tax paid</td>
<td>(5)</td>
<td>(50,000)</td>
</tr>
<tr>
<td>Net cash from operating activities</td>
<td></td>
<td>175,100</td>
</tr>
</tbody>
</table>
Cash flow from investing activities:
Purchase of intangibles (30,000)
Purchase of plant (100,000)
Proceeds from sale of plant 28,000
Net cash used in Investing Activities (102,000)

Cash flow from Financing Activities:
Proceeds from borrowing 20,000
Dividends paid (100,000)
Net cash used in Financing Activities (80,000)
Net Decrease in cash and Equivalents (6,900)
Cash and Cash equivalent at the beginning of the year 120,000
Cash and cash equivalent at the end of the year 113,100

Notes:

1. Cash Receipts from customers:

\[
\begin{array}{lcl}
\text{Revenue} & 1,600,000 \\
\text{Beginning account receivable} & 140,000 \\
\hline
\text{Total} & 1,740,000 \\
\text{Ending account receivable} & (158,000) \\
\text{Cash receipts from customer} & 1,582,000 \\
\end{array}
\]

OR

-account receivables

\[
\begin{array}{lcl}
\text{Opening bal} & 140,000 \\
\text{Cash receipts} & 1,582,000 \\
\hline
\text{Sales Revenue} & 1,600,000 \\
\text{Closing bal} & 158,000 \\
\text{Total} & 1,740,000 \\
\text{Closing bal} & 1,740,000 \\
\end{array}
\]

2(a) Payment to suppliers for Purchases:

\[
\begin{array}{lcl}
\text{Cost of sales} & 960,000 \\
\text{Increase in inventory} & 10,000 \\
\hline
\text{Total} & 970,000 \\
\end{array}
\]
Increase in account payables  \( (6,000) \)
Payment for purchases  \( 964,000 \)

(b) Payment for other services
Other expenses  152,000
Increase in prepayments  3,000
Decrease in other expenses payable  2,400
\( \) 157,400

(c) Payment to employees
Wages and salaries expenses  240,000
Increase in wages and salaries payable  \( (2,000) \)
\( ) 238,000

(d) Summary of total payment to suppliers and employees:
For purchases  964,000
For services  157,400
For salaries and wages  238,000
\( ) 1,359,400

(3) Interest received:
Interest revenue – increase in interest receivable or decrease in interest receivable =  \( N10,000,000 + N100,000 = N10,100,000 \)

(4) Interest paid:
Interest expenses  8,000
Decrease in accrued interest  400
\( ) 7,600

(5) Income Tax paid:
Beginning balance  28,000
Income tax expenses  54,000
Income tax paid  \( (50,000) \)
Ending balance  32,000

(a) Deferred Tax
\( \)
\( N'000 \) \( N'000 \)
Balance c/d  17,200 Bal b/d  10,000
Tax on OCI  1,200
Income tax expenses  6,000
\( ) 17,200 \)

SKILLS EXAMINATION – NOVEMBER 2014


OCI = Other Comprehensive Income

(b) Income Tax expenses 60,000
Less: Deferred Tax (5a) 6,000
54,000

EXAMINER’S REPORT

The question tests candidates’ ability to prepare and present a statement of Cash Flows using the direct method.

Candidates’ performance was poor as about 20% of those who attempted the question obtained up to 40% of the marks allocated.

Candidates’ commonest pitfall was their inability to correctly classify the cash flows. Candidates are advised to study the different classification of cash flows against future examinations.

SOLUTION 4

(a) Essential characteristics of Assets.

IASB defines asset as a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

The characteristics of this definition are as follows:

- Emphasis on control rather than ownership of asset. It means ability to restrict other entity from using the asset.
- Also, it places emphasis on substance of the transactions rather than their legal form.
- When there is control of an asset, it is recognised in the statement of financial position e.g. Finance lease, contractual rights.
- The definition makes reference to past events, thereby excluding asset that may occur in future.
Essential characteristics of liabilities:

IASB defines liability as a present obligation of the entity arising from past event, the statement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

From this definition, the characteristics of a liability are as follows:

- It is opposite or mirror image of asset
- It is a present obligation
- The obligations are legally enforceable
- Such obligations may also arise on provisions, contingent liabilities, contingent assets e.g. replacing faulty assets, warranty.

4(bi)

Island Plc should enter into Operating Lease arrangement for the following reasons:

- The lease period of 5 years is less than 20 years of useful life.
- The lessor KLM Ltd. maintains the asset.
- The Company will be able to get maximum tax deduction via periodic expensing of the lease rentals

4(bii)

<table>
<thead>
<tr>
<th>OPERATING LEASE</th>
<th>FINANCE LEASE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership is not transferred at the end of the lease period</td>
<td>Ownership is transferred at the end of the lease period</td>
</tr>
<tr>
<td>No bargain purchase option in the contract</td>
<td>Bargain purchase option exists</td>
</tr>
<tr>
<td>The present value of the minimum lease does not equal the asset fair value</td>
<td>The present value of the minimum lease payment substantially equal to the asset fair value</td>
</tr>
<tr>
<td>The asset can be leased out again after the expiration of the initial lease period</td>
<td>The asset cannot be leased out again after the expiration of the initial lease period (the asset would have been used for substantial part of the useful life)</td>
</tr>
<tr>
<td>The lessor maintains and is responsible for the upkeep of the asset</td>
<td>The lessee maintains and up keeps the asset</td>
</tr>
</tbody>
</table>
Lease rentals is expensed | Lease Rental is used to reduce lease obligation while some portion is expensed as finance cost.

No value of asset is recognised in the books of the lease, and no depreciation nor impairment of the asset is charged | Value of asset is recognised in the books of the lessee as an asset, and depreciation and impairment of the asset are charged.

4(ci)

**TOTAL LEASE RENTAL OVER THE LEASE PERIOD**

| Lease Rental (quarterly) is | ₦150m |
| Lease period (in years) is | 5 |
| Number of payments is | 20 |
| Lease rental for 1 year is | ₦150m × 4 = ₦600m |

:. For Five years, the total lease rental = ₦600m × 5 = ₦3 billion.

4(cii)

**FINANCE CHARGE (TOTAL)**

| ₦’000 m |
| 3,000 |
| 500 |

| Total Lease rentals over the 5 years lease period = | 2,500 |

**EXAMINER’S REPORT**

The question tests candidates’ knowledge of IAS 17 on leasing and IAS 1 provision on essential characteristics of assets and the features of liabilities. Candidates are also required to differentiate between types of leases and to calculate the total lease rentals and finance charge.

The candidates’ performance was above average as over 70% of the candidates obtained up to 50% of the marks allocated. The candidates’ commonest pitfall was their inability to identify the essential characteristics of assets and the features of liabilities. Some candidates failed to properly distinguish between the types of leases.
Candidates are advised to pay special attention to accounting standards while preparing for examinations.

SOLUTION 5

a(i) Condition that must exist before capitalisation of borrowing costs can commence are as follows:

- Expenditure on qualifying asset are being incurred.
- Borrowing Costs are being incurred
- Activities necessary to prepare the assets for their intended sales or use are in progress

(ii) When Capitalisation of Borrowing Costs should not be suspended will be

- When all of the components required before any part of the asset can be sold or used though not yet completed.
- For brief interruptions in activities
- During the periods when substantial technical and administrative work is being carried out, or for delays that are inherent in the assets acquisition process.

(iii) Capitalisation of Borrowing Costs should Cease when

- the assets are materially ready for their intended use or sale, or
- Construction is complete in part and the completed part can be used independently.

BORROWING COSTS TO BE CAPITALISED

<table>
<thead>
<tr>
<th>SPECIFIC LOAN</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦160,000,000 × 9% × 9/12</td>
<td>10,800</td>
</tr>
</tbody>
</table>

Interest earned on unused portion of loan available during the year:-

- April 1 to June 30 (160,000,000 – 90,000,000) × 3/12 × 6% = (1,050)
- 1 July to 31 October (160,000,000 – 110,000,000) × 4/12 × 6% = (1,000)
- November 1 to November 30 (160,000,000 – 150,000,000) × 1/12 × 6% = (50)

Total = 8,700
GENERAL POOL OF FUND

Capitalisation rate is 9.58% (wi)
Paid 31 January (40,000,000 x 11/2 x 9.58%) 3,513
Paid 30 November (40,000,000 x ½ x 9.58%) 320

Total Amount to be capitalised 12,533

Workings:
1. Interest paid on borrowings :-
   Bank overdraft: 6,760
   7 year Note (1,800,000,000 x 10%) 180,000
   Total 186,760

Weight average of total borrowings:
Bank overdraft 150,000
7 year Note 1,800,000

Capitalisation Rate \( \frac{186,760}{1,950,000} = 0.0958 \)

2. Note
   Although no activities had been interrupted by technical
   administrative work during May 2013, Capitalisation is not
   suspended for this period according to IAS 23

EXAMINER’S REPORT

The question tests candidates’ knowledge of IAS 23 on borrowing costs. Candidates are required to state the conditions for capitalization of borrowing costs and to calculate the total amount of interest to be capitalized based on the information available.

Candidates’ performance was poor as only about 15% of those who attempted the question obtained up to 40% of the marks allocated.
The candidates' commonest pitfall was their inability to state correctly when capitalization of borrowing costs commences, should not be suspended and should cease. In addition, most of them could not calculate the amount of interest to be capitalized.

Candidates are advised to study relevant accounting standards stipulated in the new ICAN syllabus as testable in Financial Reporting.

SOLUTION 6

(a) **Difference Between Current Tax & Deferred Tax**

**Current Tax:** is the amount actually payable to the tax authorities in relation to the trading activities of the entity during the period.

**Deferred Tax** is the amount payable to or refundable by the tax authorities in respect of the current and previous periods on taxable profit. It is also considered as an accounting measure used to match the tax effect of transactions with their accounting impact and thereby produce less distorted results.

(b) **Deferred Tax Account as at 31 December 2013**

\[
\begin{array}{ccc}
\text{N'000} \\
1 \text{ January 2012 balance} & (4,725) \\
\text{Plant & Machinery (13,500,000 x 35%)} & \text{(4,725)} \\
\text{Tax less carried forward (12,000,000 x 35%)} & 4,375 \\
\text{Balance 1 January 2012} & (350) \\
\text{Rate of change (350,000 x 5/35)} & 50 \\
\text{Temporary difference: Plant & Machinery (w1)} & (1,350) \\
\text{Loss utilised (w2) 9,500,000 x 30%} & (2,850) \\
\text{Balance 31 December 2012} & (4,500) \\
\text{Temporary difference plant & Machinery (w1)} & - \\
\text{Loss utilised (2) N3,000,000 x 30%} & (900) \\
\text{Balance 31 December 2013} & (5,400) \\
\end{array}
\]

1. **Workings:**
   Plant
<table>
<thead>
<tr>
<th>Carrying Amount</th>
<th>Tax Base</th>
<th>Temporary difference</th>
<th>Deferred Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>N'000</td>
<td>N'000</td>
<td>N'000</td>
<td>N'000</td>
</tr>
<tr>
<td>1 Jan 2011 –cost</td>
<td>45,000</td>
<td>45,000</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation</td>
<td>(9,000)</td>
<td>(22,500)</td>
<td>13,500</td>
</tr>
<tr>
<td>31 Dec. 2011</td>
<td>36,000</td>
<td>22,500</td>
<td>4,725</td>
</tr>
<tr>
<td>Rate charge (5/35 x 4,725)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Depreciation</td>
<td>(9,000)</td>
<td>(13,500)</td>
<td>4,500</td>
</tr>
<tr>
<td>31 December 2012</td>
<td>27,000</td>
<td>9,000</td>
<td>5,400</td>
</tr>
<tr>
<td>Depreciation</td>
<td>(9,000)</td>
<td>(9,000)</td>
<td>-</td>
</tr>
<tr>
<td>31 Dec 2013</td>
<td>18,000</td>
<td>-</td>
<td>18,000</td>
</tr>
</tbody>
</table>

2. Income Tax Expense

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>N'000</td>
<td>N'000</td>
</tr>
<tr>
<td>Accounting profit before Tax</td>
<td>20,000</td>
</tr>
<tr>
<td>Tax effect of item not deductible</td>
<td></td>
</tr>
<tr>
<td>Non-taxable revenue</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Depreciation on building</td>
<td>3,000</td>
</tr>
<tr>
<td>18,000</td>
<td>14,000</td>
</tr>
<tr>
<td>Depreciation Accounting</td>
<td>9,000</td>
</tr>
<tr>
<td>Depreciation/allowable tax</td>
<td>(9,000)</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>18,000</td>
</tr>
<tr>
<td>Assessed loss b/fwd</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Taxable profit/Loss</td>
<td>15,000</td>
</tr>
<tr>
<td>Tax loss c/fwd</td>
<td>-</td>
</tr>
<tr>
<td>Tax payable/benefit at 30%</td>
<td>4,500</td>
</tr>
</tbody>
</table>

c. Reasons why deferred Tax should be recognised or provided for by Skelewu Nigeria Limited are as follows:

(i) Adjustment for deferred tax are made in accordance with the actual concept and in accordance with the definition of a liability in the conceptual framework i.e a past event has given rise to an obligation in the form of increased taxation which will be payable in the future. The amount can be reliably estimated.
(ii) If the future tax consequences of transaction are not recognised or provided for, profit can be overstated leading to overpayment of dividend and distortion of share price and Earnings Per Share (EPS).

EXAMINER’S REPORT

The question tests the candidates’ knowledge and understanding of IAS 12 on Income Taxes. Specifically, candidates are required to differentiate between Current Tax and Deferred Tax, prepare Deferred Tax Account and to profer reasons why it is necessary to make provision for deferred tax in Company’s Financial Statements.

Candidates’ performance was very poor as only about 10% of those who attempted the question obtained up to 30% of the marks allocated to it.

Candidates’ commonest pitfall was their inability to prepare Deferred Tax Account. Candidates are advised to study all the relevant Accounting Standards before presenting themselves for examinations.

SOLUTION 7

(a) Elements of Cost of an item, Property, Plant and Equipment (PPE) include the following.

(i) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discount and rebates.

(ii) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(iii) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs, either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
Examples of attributed costs include the following:

(i) Costs of employees’ benefits arising directly from the construction or acquisition of the item of Property, Plant and Equipment.
(ii) Costs of site preparation
(iii) Initial delivery and handling costs
(iv) Installation and assembly costs
(v) Cost of testing whether the asset is functioning properly, after deducting the net proceeds from selling any item produced while bringing the asset to that location and condition, such as samples produced when testing equipment
(vi) Professional fees
(vii) Borrowing costs (IAS 23)

(b) Kwali Nigeria Plc.
Schedule for Property, Plant and Equipment for the year ended 30 September 2013

<table>
<thead>
<tr>
<th>Cost/Valuations</th>
<th>Freehold property</th>
<th>Leasehold property</th>
<th>Plant &amp; Equipment</th>
<th>Leased Plant &amp; Equipment</th>
<th>Construction in progress</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
</tr>
<tr>
<td>Bal. at 1/10/2012</td>
<td>586,700</td>
<td>229,500</td>
<td>198,600</td>
<td>85,200</td>
<td>355,800</td>
<td>1,455,800</td>
</tr>
<tr>
<td>Additions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reclassifications</td>
<td>325,000</td>
<td>-</td>
<td>65,000</td>
<td>-</td>
<td>106,000</td>
<td>171,000</td>
</tr>
<tr>
<td>Disposals</td>
<td></td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>(8,507)</td>
</tr>
<tr>
<td>Bal. At 30/9/2013</td>
<td>911,700</td>
<td>229,500</td>
<td>215,600</td>
<td>85,200</td>
<td>136,800</td>
<td>1,578,800</td>
</tr>
<tr>
<td>Depreciation:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bal at 1/10/2012</td>
<td>264,015</td>
<td>-</td>
<td>86,888</td>
<td>21,300</td>
<td>-</td>
<td>372,203</td>
</tr>
<tr>
<td>Depreciation for the year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>On disposals</td>
<td>104,255</td>
<td>16,393</td>
<td>27,928</td>
<td>21,300</td>
<td>-</td>
<td>169,876</td>
</tr>
<tr>
<td>On revaluation</td>
<td>-</td>
<td>-</td>
<td>(27,750)</td>
<td>-</td>
<td>(27,750)</td>
<td>-</td>
</tr>
<tr>
<td>Bal. at 30/9/13</td>
<td>368,270</td>
<td>24,900</td>
<td>87,066</td>
<td>42,600</td>
<td>-</td>
<td>522,836</td>
</tr>
<tr>
<td>Carrying amount at 30/9/2013</td>
<td>543,430</td>
<td>204,600</td>
<td>128,534</td>
<td>42,600</td>
<td>136,800</td>
<td>1,055,964</td>
</tr>
</tbody>
</table>

Workings: Calculation of Depreciation

1. Freehold property: ₦586,700 x 15% = ₦88,050,000
   Warehouse: ₦325,000 x 15% x 4/12 = ₦16,250,000
   Total = ₦104,255,000
2. Property at Valuation 1/10/12
   Depreciation (14 yrs remaining)
   Carrying amount before valuation
   Valuation at 30/9/13
   Revaluation loss

   229,500,000
   (16,393,000)
   213,107,000
   (204,600,000)
   8,507,000

3. Plant and Equipment (₦198,600,000 - ₦86,888,000) x 25% = ₦27,928,000

4. Plant & Equipment:
   Accumulated Depreciation on disposal
   Cost @ 1/10/2010
   25% Depreciation 30/9/2011
   25% depreciation 30/9/2012
   25% depreciation 30/9/2013

   25% depreciation 30/9/2011
   36,000,000
   12,000,000
   27,000,000
   9,000,000
   6,750,000

   Accumulated Depreciation on Plant & Equipment disposed on 30/9/2013
   27,750,000

EXAMINER’S REPORT

The question tests the candidates’ knowledge and application of IAS 16 on Property, Plant and Equipment, thus they are required to prepare the statement of changes in Property Plant and Equipment and also to identify the elements of cost of an item of Property, Plant and Equipment.

Candidates’ performance was very poor as only about 12% of those who attempted the question obtained up to 30% of the marks allocated.

Candidates’ commonest pitfall was their inability to differentiate between elements of cost and attributable costs of PPE. They could also not prepare the schedule of Property, Plant and Equipment.

Candidates are therefore advised to familiarize themselves with all the relevant Accounting Standards stipulated in the ICAN Syllabus for Financial Reporting paper.
Chief Ozone, a versatile business personality who has been in business for many years, decided to set up a new family business.

He commenced the new business of publishing books on 1 July 2008, under the name Seye Ventures Limited. The accounting year-end is 31 December each year.

Extracts from the financial records are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Period to 31/12/08 (6 Months)</th>
<th>Year ended 31/12/09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>₦1,850,000</td>
<td>₦2,320,000</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>(₦500,000)</td>
<td>(₦900,000)</td>
</tr>
<tr>
<td>Gross Profit (A)</td>
<td>₦1,350,000</td>
<td>₦1,420,000</td>
</tr>
<tr>
<td>Deduct:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Newspapers</td>
<td>₦75,000</td>
<td>₦95,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>₦150,000</td>
<td>₦200,000</td>
</tr>
<tr>
<td>Salaries</td>
<td>₦45,000</td>
<td>₦55,000</td>
</tr>
<tr>
<td>Transport expenses</td>
<td>₦85,000</td>
<td>₦64,000</td>
</tr>
<tr>
<td>General provision for bad debts</td>
<td>₦50,000</td>
<td>₦46,000</td>
</tr>
<tr>
<td>Vehicle repairs</td>
<td>₦95,000</td>
<td>₦73,000</td>
</tr>
<tr>
<td>Formation expenses</td>
<td>₦35,000</td>
<td>-</td>
</tr>
<tr>
<td>Purchase of equipment</td>
<td>₦78,000</td>
<td>₦68,000</td>
</tr>
<tr>
<td>Donation to political party</td>
<td>₦25,000</td>
<td>₦42,000</td>
</tr>
<tr>
<td>Loss on sale of Non-Current Assets</td>
<td>-</td>
<td>₦60,000</td>
</tr>
<tr>
<td>Medical expenses</td>
<td>₦30,000</td>
<td>₦40,000</td>
</tr>
<tr>
<td>Total Cost (B)</td>
<td>₦668,000</td>
<td>₦743,000</td>
</tr>
</tbody>
</table>
Chief Ozone travelled from Benin to Abuja for a meeting between a team of businessmen and the Federal Minister of Trade. During the meeting, the Minister informed the delegates that for the operations of any business entity to be considered for approval, it must comply with taxation laws.

Some of the delegates at the meeting gave different interpretations to the provisions of the tax laws on the Change of Accounting Date. Chief Ozone was of the opinion that whether a company changes its accounting date or not, normal tax computations should apply. Mr. Jay, one of those who attended the meeting was of the opinion that the procedure for determining the Change of Accounting Date was not clear to him.

The meeting was postponed till another date since the issues raised remained unresolved.

**Required:**

a. Using the extracts provided, compute the Income and Tertiary Education taxes for 2009 and 2010 Years of Assessment.
   NOTE: Ignore the tax payer’s right of election.  
   (15 Marks)

b. Explain briefly the rules on Change of Accounting Date under the Companies Income Tax Act (CITA) that may resolve the issues of the pending delegates’ meeting.  
   (10 Marks)

c. State the procedure for determining Companies Income Tax Liability arising from a Change in Accounting Date.  
   (5 Marks)

Total (30 Marks)
SECTION B: ATTEMPT TWO OUT OF THREE QUESTIONS (40 Marks)

QUESTION 2

MESINOY Limited has been carrying on business in Nigeria for many years. The company makes up its accounts to 31 December of each year. The cost of doing business in the country has been on the increase, the direct result of which is decline in profitability.

The board of directors of the company decided to wind-up its business in Nigeria and transfer its activities to a more tax friendly country with effect from 31 May 2011.

Tax laws have specific provisions which must be complied with by any company winding up its business.

The company has unutilised Capital Allowances agreed with the tax authority amounting to ₦460,000.

The company applied for a claim for unutilized Capital Allowances to be carried back. This was granted by the tax authority.

Stated below are its Adjusted Profits:

<table>
<thead>
<tr>
<th>Year ended</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 December 2009</td>
<td>520,000</td>
</tr>
<tr>
<td>31 December 2010</td>
<td>450,000</td>
</tr>
<tr>
<td>31 May 2011</td>
<td>300,000</td>
</tr>
</tbody>
</table>

The company recovered a bad debt amounting to ₦58,000 on 30 November 2011.

Required:

a. Compute the Assessable Profits of the company for the relevant years of assessment. (5 Marks)

b. Calculate the agreed Capital Allowances to be rolled back to the relevant years. (5 Marks)

c. Compute the Total Profits of the relevant years of assessment. (5 Marks)

d. Explain briefly the term “Best of Judgement (BoJ)” Assessment. (5 Marks)

(Total 20 Marks)
QUESTION 3

Gab Pal Limited commenced business on 1 May 2008. The company makes up its accounts to 31 August each year.

The data stated below relate to the company’s trading activities:

<table>
<thead>
<tr>
<th>N’000</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Adjusted Profit/(loss) for:</td>
</tr>
<tr>
<td></td>
<td>Period ended 31 August 2009 (16 months)</td>
</tr>
<tr>
<td></td>
<td>Year ended 31 August 2010</td>
</tr>
<tr>
<td></td>
<td>Year ended 31 August 2011</td>
</tr>
</tbody>
</table>

Capital Allowances for the relevant assessment years are as follows:

<table>
<thead>
<tr>
<th>N’000</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
</tr>
<tr>
<td></td>
<td>2009</td>
</tr>
<tr>
<td></td>
<td>2010</td>
</tr>
<tr>
<td></td>
<td>2011</td>
</tr>
<tr>
<td></td>
<td>2012</td>
</tr>
</tbody>
</table>

Required:

a. Determine the basis periods and the tax liabilities for the relevant years. (Ignore the Taxpayer’s right of election) (10 Marks)

b. State the TWO types of Loss reliefs acceptable to the tax authority. (2 Marks)

c. State the conditions that must be satisfied by a taxpayer in order to enjoy the loss reliefs stated in (b) above. (5 Marks)

d. State the conditions for the grant of Capital Allowances to taxpayers. (3 Marks)

(Total 20 Marks)

QUESTION 4

Mr. David Olaleye retired from the employment of the Ministry of Water Resources, Ogun State of Nigeria on 31 December 2012. He was paid a gratuity of N4,000,000 on retirement.
He secured employment with OLAK Limited on 1 January 2013, as a Senior Marketing Manager, on a salary of ₦8,400,000 per annum. He is married with a wife and six children.

His records at the end of his first working year in the new employment revealed the following information:

i. He was given an official car with a market value of ₦2,500,000.
ii. The company pays ₦820,000 per annum on his official accommodation.
iii. He has a life assurance policy with Okonkwo Assurance Plc. The sum assured is ₦480,000, while the monthly premium payable is ₦4,200.
iv. He contributes ₦20,000 monthly to an approved pension scheme.
v. He spent ₦17,000 during the year for the upkeep of his two aged parents who have no source of income.
vi. He contributes the sum of ₦15,000 per month to National Health Insurance Fund, and ₦20,000 per month to the National Housing Fund.

Required:

a. Compute the annual and monthly tax liabilities of Mr. David Olaleye for the relevant tax year. (12 Marks)
b. What constitutes Gross emoluments, under the Personal Income Tax (Amendment) Act 2011? (3 Marks)
c. List the benefits of applying computer models in tax administration. (5 Marks)

(Total 20 Marks)

SECTION C: ATTEMPT TWO OUT OF THREE QUESTIONS (30 Marks)

QUESTION 5

KENKY Limited is an Austrian Company engaged in cable undertakings in Nigeria. The company has been a major player in the cable business in many African countries. The Revenue Authority in Nigeria did not agree with the returns of the financial statements prepared and sent for tax assessment, hence a Best of Judgement (BoJ) assessment was levied on the company.
The Cable Undertaking Company decided to appeal against the BoJ assessment levied on it. Presented below is the extract of the Income Statement of the Company for the Year Ended 30 September 2012:

<table>
<thead>
<tr>
<th>N’000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from cable messages terminating in Nigeria</td>
<td>380,000</td>
</tr>
<tr>
<td>Income from cable messages routed through other</td>
<td>260,000</td>
</tr>
<tr>
<td>Countries</td>
<td></td>
</tr>
<tr>
<td>Income from cable messages originating in Nigeria</td>
<td>230,000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td><strong>870,000</strong></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>210,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>150,000</td>
</tr>
<tr>
<td>Overhead expenses</td>
<td>130,000</td>
</tr>
<tr>
<td>Purchase of equipment</td>
<td>80,000</td>
</tr>
<tr>
<td><strong>Net profit</strong></td>
<td><strong>300,000</strong></td>
</tr>
</tbody>
</table>

**Notes**

i. Federal Inland Revenue Service obtained satisfactory evidence that the tax computed in Austria and Nigeria are in the specialised business category.

ii. Austrian authority has certified the Adjusted profit and depreciation allowance ratio.

iii. Donation to Jeje amounting to N’40,000,000 was included in overhead expenses.

**You are required to:**

a. Compute the company’s Adjusted Profit. (4 Marks)

b. Determine the Adjusted Profit Ratio and Depreciation Ratio. (4 Marks)

c. Compute the Total profits and Income Tax payable in Nigeria. (4 Marks)

d. What other business activities apart from cable messages are covered in the specialised business for taxation purposes? (3 Marks)

*(Total 15 Marks)*
**QUESTION 6**

Osondu Bako Company Limited has been in business for many years as a general business entrepreneur.

The Company prepares its accounts to 31 December of every year. The Company however submitted its audited Financial Statements for the year ended 31 December 2012 on 27 May 2013.

The Company applied for Tax Clearance Certificate on 26 August 2014, but the issuance of same was delayed by the Revenue. Instead of issuing the Tax Clearance Certificate, a Best of Judgement assessment of N3,450,000 was raised on the company.

The date on the Notice of Assessment was 30 May 2014, but was served on the company on 31 August 2014.

Stated below is information relating to the financial statements of the company for the year ended 31 December 2012:

<table>
<thead>
<tr>
<th>Description</th>
<th>N'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit per Accounts</td>
<td>3,400</td>
</tr>
<tr>
<td>Depreciation</td>
<td>380</td>
</tr>
<tr>
<td>Capital Allowances agreed with Revenue</td>
<td>590</td>
</tr>
<tr>
<td>Revenue</td>
<td>12,050</td>
</tr>
<tr>
<td>Net Assets</td>
<td>8,400</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>960</td>
</tr>
<tr>
<td>Share Capital</td>
<td>10,000</td>
</tr>
</tbody>
</table>

The company paid all the tax liabilities. This notwithstanding, the Chief Executive Officer of the company was surprised and also worried when he received a Notice of Best of Judgment Assessment from the tax authority. Consequently, you have been engaged by the company as Tax Consultant.

**You are required to:**

Write a Letter of Objection to the Tax office in respect of the Best of Judgement Assessment together with relevant workings. (15 Marks)
QUESTION 7

Zuba Construction Company Limited is an irrigation and building construction company. The company has been in the business for many years. The company appointed you as the tax representative to provide tax advisory services and deal with the VAT office on its behalf.

On commencement of your assignment, you discovered that there was a dispute on the determination of the amount of VAT payable to the Revenue by the Company. To assist you in the assignment, the following information was made available to you:

<table>
<thead>
<tr>
<th>Date</th>
<th>Details</th>
<th>Amount (₦)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/8/13</td>
<td>Bought a concrete mixer</td>
<td>700,000</td>
</tr>
<tr>
<td>2/8/13</td>
<td>Bought sand</td>
<td>40,000</td>
</tr>
<tr>
<td>3/8/13</td>
<td>Bought gravel</td>
<td>40,000</td>
</tr>
<tr>
<td>5/8/13</td>
<td>Bought scaffolding</td>
<td>1,800,000</td>
</tr>
<tr>
<td>5/8/13</td>
<td>Bought photocopier machine</td>
<td>50,000</td>
</tr>
<tr>
<td>7/8/13</td>
<td>Bought tables</td>
<td>15,000</td>
</tr>
<tr>
<td>14/8/13</td>
<td>Bought poker vibrator</td>
<td>300,000</td>
</tr>
<tr>
<td>14/8/13</td>
<td>Bought chairs</td>
<td>20,000</td>
</tr>
<tr>
<td>14/8/13</td>
<td>Progress payment received</td>
<td>2,000,000</td>
</tr>
<tr>
<td>24/8/13</td>
<td>Progress payment received</td>
<td>1,500,000</td>
</tr>
</tbody>
</table>

**Additional Note**

VAT was paid on all the company’s purchases.

**You are required to:**

a. Compute VAT payable (if any) for the month of August 2013. (8 Marks)
b. Advise your client on when and how VAT payment should be made. (4 Marks)
c. Itemise the contents of a Notice of Appeal against VAT Assessments. (3 Marks)

(Total 15 Marks)
SOLUTION 1

a.

SEYE VENTURES LIMITED

Computation of Adjusted Profits for 2009 and 2010 Years of Assessment

<table>
<thead>
<tr>
<th></th>
<th>6 Months ended</th>
<th>Accounting Year Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31 December 2008</td>
<td>31 December 2009</td>
</tr>
<tr>
<td>Net Profit</td>
<td>N 682,000</td>
<td>N 677,000</td>
</tr>
<tr>
<td><strong>Add: Disallowable expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>N 150,000</td>
<td>N 200,000</td>
</tr>
<tr>
<td>General provision for bad debt</td>
<td>N 50,000</td>
<td>N 46,000</td>
</tr>
<tr>
<td>Formation expenses</td>
<td>N 35,000</td>
<td>-</td>
</tr>
<tr>
<td>Purchase of equipment</td>
<td>N 78,000</td>
<td>N 68,000</td>
</tr>
<tr>
<td>Donation to political party</td>
<td>N 25,000</td>
<td>N 42,000</td>
</tr>
<tr>
<td>Loss on sale of Non current assets</td>
<td>-</td>
<td>N 60,000</td>
</tr>
<tr>
<td>Adjusted profit</td>
<td>N 1,020,000</td>
<td>N 1,093,000</td>
</tr>
</tbody>
</table>

SEYE VENTURES LIMITED

Computation of tax liabilities for 2009 Year of Assessment
(Basis period 1 July 2008 – 30 June 2009)

<table>
<thead>
<tr>
<th></th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted profit 1/7/08 – 31/12/08</td>
<td>N 1,020,000</td>
</tr>
<tr>
<td>1/1/09 – 30/6/09 = N 1,093,000/2</td>
<td>N 546,500</td>
</tr>
<tr>
<td>Total profit</td>
<td>N 1,326,500</td>
</tr>
</tbody>
</table>

Tax payable

<table>
<thead>
<tr>
<th></th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies income tax (30% x N 1,326,500)</td>
<td>397,950</td>
</tr>
<tr>
<td>Tertiary Education tax (2% x N 812,500)</td>
<td>31,330</td>
</tr>
<tr>
<td></td>
<td>N 429,280</td>
</tr>
</tbody>
</table>
Computation of Tax Liabilities for 2010 Year of Assessment
Basis period 1/1/2009 - 31/12/2009

Adjusted profit 1,093,000
Deduct: Agreed Capital Allowance (120,000)
Total profit 973,000

Tax payable

Companies Income Tax
(30% x ₦973,000) = 291,900
Tertiary Education tax
(2% of ₦1,093,000) = 21,860

313,760

(b) Where the Assessable Profits of a company have been computed by reference to accounts made up to a certain day and such company fails to make up an account to the corresponding day in the year following, the assessable profits of that company for the year of assessment in which such failure occurs and two subsequent years of assessment, shall be computed on such basis as the Board in its discretion may decide.

It is the practice of the Revenue to request tax payers to submit two sets of accounts. One based on the old accounting basis and the other on the new basis. The Revenue accepts the one that produces the higher income.

(c) Procedures for Change in Accounting Date

(i) Identify the year of change
(ii) Identify the two years immediately following the year of change in (i) above
(iii) Compute the Assessable Profits for the three relevant years in (i and ii above) based on preceding year basis (PYB) for the old accounting date.
(iv) Compute the Assessable Profits for the three relevant years in (i) and (ii) above on PYB, based on the new accounting date.
(v) Aggregate and compare the assessable profits under old and new accounting dates, and
(vi) The higher aggregate is the basis of assessment
EXAMINER’S REPORT

The question tests candidates’ understanding of the computation of Companies’ Income Tax and Tertiary Education Tax.

Most candidates understood the question and performance was good.

The commonest pitfalls were the inability of the candidates to present their solutions properly and poor knowledge of the principles of change in accounting date. Candidates are advised to pay attention to these areas in preparation for future examinations.

SOLUTION 2

MESINON LIMITED

a. Computation of Assessable Profits for the Relevant Assessment Years

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Workings</th>
<th>N</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>Adjusted profit (1/1/11 – 31/5/11)</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td></td>
<td>Adjusted profit</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td></td>
<td>Add bad debts recovered</td>
<td>58,000</td>
<td>58,000</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>358,000</strong></td>
<td><strong>358,000</strong></td>
</tr>
<tr>
<td>2010</td>
<td>1/1/10 – 31/12/10 (AYB)</td>
<td>450,000</td>
<td>450,000</td>
</tr>
<tr>
<td></td>
<td><strong>OR</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1/1/09 – 31/12/09 (PYB)</td>
<td>520,000</td>
<td>520,000</td>
</tr>
</tbody>
</table>

**NOTE:** The tax authority will choose the higher for the penultimate year, which is, N520,000

b. Capital Allowances to be Rolled back to the Relevant Years

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>N</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>Adjusted profit</td>
<td>358,000</td>
</tr>
<tr>
<td></td>
<td>Deduct: Capital Allowance</td>
<td>460,000</td>
</tr>
<tr>
<td></td>
<td>Restricted to 66 2/3 % of Gross Profit</td>
<td>(238,667) (238,667)</td>
</tr>
<tr>
<td></td>
<td>Unutilized Capital Allowance rolled back</td>
<td>221,333</td>
</tr>
<tr>
<td></td>
<td><strong>Total profit</strong></td>
<td><strong>119,333</strong></td>
</tr>
<tr>
<td>2010</td>
<td>(Penultimate year)</td>
<td>520,000</td>
</tr>
<tr>
<td></td>
<td>Assessable profit</td>
<td>520,000</td>
</tr>
</tbody>
</table>
Capital Allowance rolled back  (221,333)
Total profit  298,667

c. **Total Profits of the Relevant Years of Assessment**

<table>
<thead>
<tr>
<th>Year</th>
<th>Assessable Profit</th>
<th>Capital Allowance</th>
<th>But restricted to 66%/3 of Assessment Profit</th>
<th>Utilized Capital Allowances rolled back</th>
<th>Total Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>358,000</td>
<td>460,000</td>
<td>(238,667)</td>
<td>221,333</td>
<td>119,333</td>
</tr>
<tr>
<td>2010</td>
<td>520,000</td>
<td></td>
<td></td>
<td></td>
<td>298,667</td>
</tr>
</tbody>
</table>

d. **Best Of Judgement (Boj) Assessment**

When no returns/accounts have been submitted by a taxpayer, or when such returns/accounts submitted have been considered unreliable by the Revenue, assessments are made based on estimated profits. Such estimates made are said to be based on the Best of Judgment of the tax inspectors.

**EXAMINER’S REPORT**

The question tests candidates’ understanding of the computation of tax liability on cessation of business.

Performance was below average.

The commonest pitfall was the poor knowledge of the rules of cessation and unutilized capital allowances.

Candidates should pay attention to these areas when preparing for future examinations.
### SOLUTION 3

#### GAB PAL LIMITED

**a. Determination of Basis Period**

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Basis Period</th>
<th>$'000</th>
<th>$'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>1/5/08 - 31/12/08</td>
<td>8/16</td>
<td>(390,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(195,000)</td>
</tr>
<tr>
<td>2009</td>
<td>1/5/08 - 30/4/09</td>
<td>12/16</td>
<td>(390,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(292,500)</td>
</tr>
<tr>
<td>2010</td>
<td>1/9/08 - 31/8/09</td>
<td>12/16</td>
<td>(390,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(292,500)</td>
</tr>
<tr>
<td>2011</td>
<td>1/9/09 - 31/8/10</td>
<td></td>
<td>170,000</td>
</tr>
<tr>
<td>2012</td>
<td>1/9/10 - 31/8/11</td>
<td></td>
<td>150,000</td>
</tr>
</tbody>
</table>

#### Computation of Tax Liabilities for the relevant years

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Adjusted Profit/(Loss)</th>
<th>N'000</th>
<th>N'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>(195,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Loss relieved</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Unrelieved loss c/f</td>
<td></td>
<td>(195,000)</td>
</tr>
<tr>
<td></td>
<td>Capital Allowance</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Absorbed</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Unrelieved Capital Allowance c/f</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Companies Income Tax Liability</td>
<td>NIL</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tertiary Education Tax Liability</td>
<td>NIL</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>(292,500)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unrelieved loss b/f</td>
<td>(195,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unrelieved loss c/f</td>
<td>(487,500)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Loss c/f restricted to</td>
<td>(390,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Capital Allowance b/f</td>
<td>18,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unabsorbed Capital Allowance c/f</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>38,000</td>
<td></td>
</tr>
</tbody>
</table>
Companies Income Tax Liability  
NIL

Tertiary Education Tax Liability  
NIL

2010  
Adjusted Profit/(Loss)  
(292,500)
Unrelieved loss b/f  
(390,000)
Total loss  
(682,500)
Loss c/f restricted to  
(390,000)

Capital Allowance for year  
12,000
Capital Allowance b/f  
38,000
Unabsorbed Capital Allowance c/f  
50,000

Companies Income Tax Liability  
NIL

Tertiary Education Tax Liability  
NIL

2011  
Adjusted Profit  
170,000
Unrelieved loss b/f (as restricted)  
(390,000)
Unrelieved loss c/f  
(220,000)
Capital Allowance for year  
8,000
Unabsorbed Capital Allowance b/f  
50,000
Unabsorbed Capital Allowance c/f  
58,000

Companiess Income Tax Liability  
NIL

Tertiary Education Tax Liability  
NIL

2012  
Adjusted profit  
150,000
Unrelieved loss b/f  
(220,000)
Unrelieved loss c/f  
(70,000)
Capital Allowance for year  
5,000
Capital Allowance b/f  
58,000
Unabsorbed Capital Allowance c/f  
63,000

Companies Income Tax Liability  
NIL

Tertiary Education Tax Liability  
NIL

(b) **Two types of Loss Reliefs:**

(i) Current Year Loss Relief
(ii) Carried Forward Loss Relief

SKILLS EXAMINATION – NOVEMBER 2014
(c) **Conditions To Be Satisfied Before Enjoying Loss Reliefs**

i. **Current Year Loss Relief**: The following conditions must be satisfied to enjoy loss relief on current year basis:

   - The trade loss can be set off against the current year’s gains or profits from other sources of income.
   - Such losses can also be set off against the preceding year’s gains or profits, provided that it is claimed in writing within twelve months after the end of the year of assessment to which it relates.
   - Such relief covers only trade losses and does not cover those incurred in connection with any other sources of income.

ii. **Carried Forward Loss Relief**: The following conditions must be satisfied to enjoy loss relief on carried forward basis:

   - The relief is in respect of the loss brought forward from the preceding year of assessment.
   - This relief is automatically granted, hence no need for claiming it in writing as is the case under Current Year’s Loss Relief.
   - The relief is available only against the gains or profits of the same trade.
   - The aggregate deduction from assessable income in respect of any loss must not exceed the amount of such loss.
   - The amount to be relieved must not have been relieved under the Current Year’s Relief provision.
   - Losses incurred in Property letting can be relieved under the Carry Forward Loss Relief provision (and not under the Current Year Loss Relief).
   - Carried Forward Loss Relief can now be carried forward indefinitely by all companies except Insurance Companies.
(d) **Conditions for granting capital allowances**

Capital allowances are granted if the following conditions are satisfied:

(i) The Company must have incurred qualifying capital expenditure.

(ii) The claimant must remain the beneficial owner of the asset at the end of the basis period of the company.

(iii) The asset must be in use wholly, exclusively, necessarily and reasonably for the purpose of a trade or business carried on by the company at the end of its basis period.

(iv) Where the value of the qualifying capital expenditure is more than ₦500,000, an Acceptance Certificate must be obtained from the Industrial Inspectorate Division of the Federal Ministry of Industry, Trade and Investment.

**EXAMINER’S REPORT**

The question tests candidates’ knowledge of the treatment of losses, Capital Allowances and commencement of business rules.

Candidates displayed a good understanding of the question and performance was above average.

The commonest pitfall was lack of understanding of conditions to be satisfied before loss relief can be enjoyed.

Candidates’ are advised to pay attention to areas involving abnormal basis.

**SOLUTION 4**

Mr. David Olaleye  
Computation of Tax Liability for 2013 Tax Year

Gratuity $4,000,000
Salary 8,400,000
Benefits-in-kind
- Official car (₦2.5m x 5%) 125,000
- Company accommodation 820,000 945,000
Gross emoluments 9,345,000

**Less reliefs**
(i) Consolidated Relief Allowance
(₦200,000 + 20% x ₦9,345,000) = 2,069,000
(ii) Life Assurance Relief 50,400
(iii) Contribution to pension fund 240,000
(iv) National Health Insurance contribution 180,000
(v) National Housing Fund contribution 240,000

(2,779,400)
Chargeable Income 6,565,600

**Calculation of tax payable**

<table>
<thead>
<tr>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>300,000 x 7%</td>
<td>21,000</td>
</tr>
<tr>
<td>300,000 x 11%</td>
<td>33,000</td>
</tr>
<tr>
<td>500,000 x 15%</td>
<td>75,000</td>
</tr>
<tr>
<td>500,000 x 19%</td>
<td>95,000</td>
</tr>
<tr>
<td>1,600,000 x 21%</td>
<td>336,000</td>
</tr>
<tr>
<td>3,365,600 x 24%</td>
<td>807,774</td>
</tr>
</tbody>
</table>

6,565,600

Total tax payable 1,367,744

Monthly tax deduction = ₦ \frac{1,367,744}{12} = ₦113,978.67

(b) "Gross emoluments" means wages, salaries, allowances including benefits-in-kind (BIK), gratuities, superannuation and any other incomes derived solely by reason of employment.

(c) Benefits of applying computer models in tax administration include:

i. Speed and improved efficiency on the part of the administrators
ii. Accuracy of tax computations since all forms of manual computations will be eliminated.
iii. Reliability of data used, since the bulk of the information used in tax computations are generated using computers.
iv. Consistency in the information generated and provided for public consumption.
v. Improved productivity as less time is spent.

EXAMINER’S REPORT

The question tests candidates’ understanding of the computation of tax liability for individuals and what constitutes “gross emoluments”.

Most candidates understood the question and performance was average.

The commonest pitfall was the inability of the candidates to understand the procedure in PAYE computation and meaning of “gross emoluments”.

Candidates are advised to learn the principles of PAYE and the provisions of the Personal Income Tax (Amendment) Act 2011.

SOLUTION 5

KENKY LIMITED

a. Computation of Adjusted profit for 2013 Tax Year

<table>
<thead>
<tr>
<th></th>
<th>N’000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit per accounts</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Add:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>150,000</td>
<td></td>
</tr>
<tr>
<td>Purchase of equipment</td>
<td>80,000</td>
<td></td>
</tr>
<tr>
<td>Disallowed expenses</td>
<td>40,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>270,000</td>
<td></td>
</tr>
<tr>
<td>Adjusted profit</td>
<td>570,000</td>
<td></td>
</tr>
</tbody>
</table>

b. Determination of Adjusted Profit Ratio and Depreciation Ratio.

<table>
<thead>
<tr>
<th></th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Computation of Adjusted Profit Ratio = ( \frac{570,000}{870,000} \times 100% )</td>
<td>( 65.52% )</td>
</tr>
</tbody>
</table>
ii. Computation of Depreciation Ratio

\[
\text{Depreciation Ratio} = \frac{150,000}{870,000} \times 100\% \\
= 17.24\%
\]

c. Computation of Total Profit and Income tax payable in Nigeria

<table>
<thead>
<tr>
<th>Nigerian Income</th>
<th>230,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessable Profit</td>
<td>N230m x 65.52% =</td>
</tr>
<tr>
<td>Deduct: Capital Allowances N230m x 17.24%</td>
<td>(39,652)</td>
</tr>
<tr>
<td>Total profit</td>
<td>111,044</td>
</tr>
<tr>
<td>Companies Income Tax Payable (N111,044,000 x 30%)</td>
<td>N33,313.2</td>
</tr>
<tr>
<td>Minimum tax (2% x N230,000,000)</td>
<td>N4,600</td>
</tr>
</tbody>
</table>

d. Other business activities that are regarded as specialized businesses for taxation purposes are as follows:

- (i) Banks
- (i) Insurance
- (ii) Shipping
- (iii) Air transport
- (iv) Unit trust

EXAMINER’S REPORT

The question tests candidates’ understanding of the computation of tax liability relating to special businesses.

Candidates demonstrated fair understanding of the question and performance was below average.

The commonest pitfall was incorrect computation of ratios and the determination of income tax payable.

Candidates are advised to pay attention to special businesses tax assessments.
The Tax Controller  
Federal Inland Revenue Service  
Micro and Small Tax Office  
3, Energy Street  
Lagos

02 October 2014

Dear Sir,

OSONDU BAKO COMPANY LIMITED................ TIN NO.....................

RE: BEST OF JUDGEMENT ASSESSMENT NO INVOICE FOR ₦3,450,000 DATED 30 MAY 2014 BUT SERVED ON OUR CLIENT ON 31 AUGUST 2014

Your Notice of Assessment No ....... dated 30 May 2014, but served on our client on 31 August 2014, refers.

We object to the Best of Judgment Assessment on the following grounds:

(a) The Audited Financial Statements forwarded to you on 27 May 2013, were not considered in arriving at the Best of Judgment Assessment;

(b) The financial statements were filed within six months after the company’s accounting year-end; and

(c) The assessment is arbitrary and excessive,

We hereby appeal to you to kindly discharge the Best of Judgment Assessment and raise the assessments based on the Audited Accounts forwarded to you, that is, Companies income tax payable of ₦957,000 and Tertiary Education tax of ₦76,000.

Thanking you for your anticipated understanding, it is hoped that the above will meet your requirements.
Yours faithfully,
James Peters
(Tax Partner)
For: XYZ & Co

WORKINGS

(a) Osondu Bako Company Limited
Computation of Tax Liabilities

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit per accounts</td>
<td>3,400</td>
</tr>
<tr>
<td>Add depreciation</td>
<td>380</td>
</tr>
<tr>
<td>Adjusted profit</td>
<td>3,780</td>
</tr>
<tr>
<td>Capital allowances</td>
<td>(590)</td>
</tr>
<tr>
<td>Total profit</td>
<td>3,190</td>
</tr>
</tbody>
</table>

Companies Income tax payable
(30% of Total profit (30% x ₦3,190,000) ₦957,000)

Tertiary Education tax payable
(2% of Assessable profit) ₦75,600

(b) Minimum Tax computation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₦)</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. 0.5% of Gross profit</td>
<td>₦4,800</td>
</tr>
<tr>
<td>0.5% of Net assets</td>
<td>₦42,000</td>
</tr>
<tr>
<td>0.25% of Paid up Capital</td>
<td>₦25,000</td>
</tr>
<tr>
<td>0.25% of Revenue</td>
<td>₦1,250</td>
</tr>
<tr>
<td>ii. 0.125% of excess over ₦500,000</td>
<td>₦14,437.50</td>
</tr>
</tbody>
</table>

The highest of (i) plus (ii) 14,437.5 + 42,000 = 56,437.50

The minimum tax liability is ₦56,437.50
EXAMINER’S REPORT

The question tests candidates’ ability to resolve a Best of Judgment (BoJ) assessment. Candidates displayed fair understanding of the question and performance was fair.

The commonest pitfall was the inability of the candidates to write a letter of objection as required.

Candidates are advised to get used to report writing.

SOLUTION 7

(a) ZUBA CONSTRUCTION COMPANY LIMITED
Computation of Valued Added Tax Payable for the Month August 2013

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output VAT</td>
<td></td>
</tr>
<tr>
<td>VAT on Progress payment received:</td>
<td></td>
</tr>
<tr>
<td>( \frac{5}{105} \times ₦2,000,000 )</td>
<td>95,238.10</td>
</tr>
<tr>
<td>( \frac{5}{105} \times ₦1,500,000 )</td>
<td>71,428.57</td>
</tr>
<tr>
<td>Output VAT</td>
<td>166,666.67</td>
</tr>
<tr>
<td>Less: Input VAT</td>
<td></td>
</tr>
<tr>
<td>VAT on Sand – ( \frac{5}{105} \times ₦40,000 )</td>
<td>1,904.76 (3,809.52)</td>
</tr>
<tr>
<td>VAT on Gravel – ( \frac{5}{105} \times ₦40,000 )</td>
<td>1,904.76</td>
</tr>
<tr>
<td>VAT payable</td>
<td>162,857.15</td>
</tr>
</tbody>
</table>

(b) DUE DATE FOR PAYMENT OF AUGUST 2013 VAT

APEX CONSULTANTS
(CHARTERED ACCOUNTANTS AND CHATERED TAX PRACTITIONERS)
30, Orange Street, Lagos

The Managing Director
Zabu Construction Company Limited
Plot 15, Moonlight Estate
Dear Sir,

RE: DUE DATE AND MODE OF PAYMENT OF AUGUST 2013 VAT

We refer to your request on the above subject.

Please be informed that according to the provisions of the VAT Act, the due date for the payment of monthly VAT is on or before the 21\textsuperscript{st} day of the month following the month of the transaction for which VAT is due.

Therefore, the due date for payment of VAT for the month of August 2013 should not be later than the 21\textsuperscript{st} day of September 2013.

You are to remit the VAT to the FIRS through designated Banks. An electronic receipt i.e. e-receipt would be issued as soon as payment is made. The e-receipt and completed VAT form 002 shall be submitted at the FIRS office not later than the due date for submission of VAT returns i.e. 21\textsuperscript{st} day of the month following the month of the transaction.

Please note that failure to comply with the above date would result in the imposition of a penalty of ₦5,000 for every month the failure continues.

May we use this opportunity to enclose our bill in respect of the services rendered.

Thanking you for your continuous patronage.

Yours faithfully,

Okolo Richard
Managing Partner
For: Apex Consultants

(c) CONTENTS OF A NOTICE OF APPEAL AGAINST VAT

The contents of a Notice of Appeal against VAT are as follows:
EXAMINER’S REPORT

The question tests candidates’ ability to calculate net VAT payable to the FIRS and also knowledge of the contents of a Notice of Appeal.

Candidates demonstrated a fair understanding of the question and performance was also fair.

The commonest pitfall was the inability of the candidates to compute Net VAT remittable to FIRS.

Candidates are advised to pay attention to the provisions of VAT Act.
QUESTION 1

NAIJAX Group Limited has been in operation since 1980 playing a leading role in the automobile industry.

Division “X” which is part of the group manufactures only “265 by 16” Rim tyre which it sells to external customers and also to Division “Y” another member of the group. Naijx Group’s policy is that:

(i) Divisions have the freedom to set transfer prices and choose their suppliers.

(ii) It uses Residual Income (RI) for performance appraisals.

(iii) The group’s cost of capital is 12% per annum.

The two divisions’ operating data are as follows:

Division X

Budgeted information for the coming year is:

Maximum capacity 150,000 tyres
External sales 110,000 tyres
External selling price ₦35,000 per tyre
Variable cost  N22,000 per tyre
Fixed costs  N1,080,000,000
Capital employed  N3,200,000,000
Target residual income  N180,000,000

Division Y

Division Y has found two other companies willing to supply tyres:

Adex Limited could supply at N28,000 per tyre, but only for annual orders in excess of 50,000 tyres. Banaxa Limited could supply at N33,000 per tyre for any quantity ordered.

Required:

a. If Division Y provisionally requests a quotation for 60,000 tyres from Division X for the coming year;
   i. Determine the transfer price per tyre that Division X should quote in order to meet its residual income target. (9 Marks)
   ii. Calculate the TWO prices that Division X would have to quote to Division Y if it becomes the group’s policy to quote transfer prices based on opportunity costs. (2 Marks)

b. Evaluate the impact of the group’s current and proposed policies on the profits of Divisions X and Y and on group profit. (4 Marks)

c. Assume that Divisions X and Y are based in different countries and consequently pay taxes at different rates: Division X at 55% and Division Y at 25%. If Division X has now quoted a transfer price of N30,000 per tyre for 60,000 tyres, you are required to determine whether it is better for the group if Division Y purchases 60,000 tyres from Division X or from Adex Limited. (15 Marks)

(Total 30 Marks)

SECTION B ATTEMPT ANY TWO OUT OF THREE QUESTIONS (40 Marks)

QUESTION 2
Ibek Limited manufactures a standard product and operates a system of variance accounting using a fixed budget.

As a newly appointed Management Accountant, you are responsible for preparing the monthly operating statements.

Extracts from the budget for the standard product cost and actual data for the month ended 31 December, 2013 are given below:

**Budgeted and Standard Cost Data:**

Budgeted sales and production for the month: 20,000 units.
Standard cost for each unit of product:

**Budget**

- **Direct materials:**
  - A: 10kg at N\$2 per kg
  - B: 5kg at N\$10 per kg

- **Direct wages:** 5 hours at N\$6 per hour

Fixed production overhead is absorbed at 200% of direct wages.
Budgeted sales price has been calculated to give a margin of 20% of sales price.
Actual data for the month ended 31 December, 2013:

- **Production:** 19,000 units sold at a price of 15% higher than that budgeted.
- **Direct materials consumed:**
  - A: 192,000kg at N\$2.40 per kg
  - B: 96,000kg at N\$9.40 per kg

- **Direct wages incurred:** 92,000 hours at N\$6.40 per hour.
- **Fixed production overhead incurred:** N\$580,000.

You are required to prepare:

a. The operating statement for the month ended 31 December, 2013. (3 Marks)

b. i. Direct material cost variance (5 Marks)
ii. Direct labour variances (5 Marks)

iii. Overhead variances (3 Marks)

iv. Sales variances (4 Marks)

(Total 20 Marks)

QUESTION 3

Purity Nigeria Limited is a company that produces table water. The company’s board plans to restructure its operations with the aim of boosting its market share and profitability.

The financial results of Purity Nigeria Limited and Bench Mark Co. Limited, which is the leader in the industry, are as follows:

Operating Statements for the year ended 31 December, 2013

<table>
<thead>
<tr>
<th></th>
<th>Purity Nigeria Ltd</th>
<th>Bench Mark Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>₦5,600</td>
<td>₦9,430</td>
</tr>
<tr>
<td>Variable costs</td>
<td>₦3,500</td>
<td>₦5,100</td>
</tr>
<tr>
<td>Other costs</td>
<td>₦1,000</td>
<td>₦1,800</td>
</tr>
<tr>
<td>Net Profit</td>
<td>₦1,100</td>
<td>₦2,530</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th></th>
<th>Purity Nig Ltd</th>
<th>Bench Mark Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Current Assets:</td>
<td>₦000</td>
<td>₦000</td>
</tr>
<tr>
<td>Freehold land and buildings</td>
<td>₦1,800</td>
<td>₦4,100</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>₦1,560</td>
<td>₦1,800</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>₦1,300</td>
<td>₦1,600</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>500</td>
<td>700</td>
</tr>
<tr>
<td></td>
<td>₦5,160</td>
<td>₦8,200</td>
</tr>
</tbody>
</table>

Current Assets/Current Liabilities:

<table>
<thead>
<tr>
<th></th>
<th>Purity Nig Ltd</th>
<th>Bench Mark Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receivables</td>
<td>400</td>
<td>600</td>
</tr>
<tr>
<td>Cash</td>
<td>200</td>
<td>500</td>
</tr>
<tr>
<td>Inventory</td>
<td>400</td>
<td>300</td>
</tr>
<tr>
<td>Payables</td>
<td>(600)</td>
<td>(500)</td>
</tr>
<tr>
<td></td>
<td>400</td>
<td>900</td>
</tr>
</tbody>
</table>
Required:

a. Compute the following performance indices for both companies:
   i. Profit margin
   ii. Asset turnover
   iii. Returns On Capital Employed (ROCE)
   iv. Current ratio
   v. Debt-equity ratio (5 Marks)

b. Compare and analyse the performance of the two companies computed in (a) above and explain what the board of Purity Nigeria Limited needs to do to achieve their objectives. (10 Marks)

c. What other non-financial measures can influence the decision of the board of Purity Nigeria Limited? (5 Marks)

(Total 20 Marks)

QUESTION 4

Paly Limited, a cottage manufacturer of aluminium products, specialises in producing kettles and cooking pots with annual sales value of ₦960,000 and ₦1,440,000 respectively.

Given below are the cost data of each of the products:

<table>
<thead>
<tr>
<th></th>
<th>Kettle</th>
<th>Cooking pots</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct material</td>
<td>₦'000</td>
<td>₦'000</td>
</tr>
<tr>
<td>Direct material</td>
<td>200</td>
<td>240</td>
</tr>
<tr>
<td>Direct wages ₦80 per hour:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Department 1</td>
<td>160</td>
<td>240</td>
</tr>
<tr>
<td>Department 2</td>
<td>80</td>
<td>160</td>
</tr>
<tr>
<td>Department 3</td>
<td>240</td>
<td>-</td>
</tr>
</tbody>
</table>

SKILLS EXAMINATION – NOVEMBER 2014
Variable overhead

\[
\begin{array}{cc}
4 & 320 \\
120 & 40 \\
\end{array}
\]

The fixed overhead per annum is \(₦1,000,000\)

The company allows for annual 50 weeks of operation at 40 hours per week with the following employees currently engaged in each department as follows:

Department 1: 30
Department 2: 16
Department 3: 18

You are required to provide your assessment of the company, if only one product was to be made given the following circumstances:

a. Which product would give the maximum profit and what are the associated problems that could arise? (10 Marks)

b. Which product should be made and the amount of profit per annum, assuming that the product uses the same direct materials and that there is a shortage of the material with supply limited at a current price to a maximum of \(₦3,000,000\) per annum? (5 Marks)

c. Determine the product that should be made and the amount of profit per annum, assuming that there is a shortage of employees possessing the skills required in Department 2? (5 Marks)

(Total 20 Marks)

SECTION C: ATTEMPT ANY TWO OUT OF THREE QUESTIONS (30 Marks)

QUESTION 5

Colour-Effects Limited retails two products: Common and Executive travelling bags. The budgeted income statement for Year 2015 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>COMMON BAG</th>
<th>EXECUTIVE BAG</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units sold</td>
<td>300,000</td>
<td>100,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Revenue at (₦200) and (₦300) per unit</td>
<td>60,000,000</td>
<td>30,000,000</td>
<td>90,000,000</td>
</tr>
<tr>
<td>Variable costs at (₦140) and (₦180) per unit</td>
<td>42,000,000</td>
<td>18,000,000</td>
<td>60,000,000</td>
</tr>
</tbody>
</table>
Contribution margins at ₦60 and ₦120 per unit

<table>
<thead>
<tr>
<th>Margin</th>
<th>12,000,000</th>
<th>30,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦18,000,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Fixed costs:**

<table>
<thead>
<tr>
<th>Cost</th>
<th>₦12,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating profit</td>
<td>₦18,000,000</td>
</tr>
</tbody>
</table>

**Required:**

a. Calculate the break-even units, assuming that the planned revenue mix is maintained. (3 Marks)

b. Determine the break-even point in units if only Common bags are sold and if only the Executive bags are sold. (6 Marks)

c. Calculate the budgeted operating profit and break-even point if 200,000 units are sold but only 20,000 are Executive bags. (6 Marks)

**QUESTION 6**

GOODLAND Limited produces and sells a single product. The company adopts a standard absorption costing system and absorbs overheads on the basis of direct labour hours. Presented below are the standard cost details and selling price for a single unit of the product:

<table>
<thead>
<tr>
<th>Item</th>
<th>Per Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price</td>
<td>₦6,000</td>
</tr>
<tr>
<td>Direct material 30 litres @ ₦90</td>
<td>2,700</td>
</tr>
<tr>
<td>Director labour 10 hours @ ₦120 per hour</td>
<td>1,200</td>
</tr>
<tr>
<td>Variable production overhead 10 hours @ ₦60 per hour</td>
<td>600</td>
</tr>
<tr>
<td>Fixed production overhead 10 hours @ ₦30 per hour</td>
<td>300 (4,800)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>₦1,200</td>
</tr>
</tbody>
</table>

It has been estimated that the production and sales for the month would be 2,000 units. However, the estimated production for the month has been used as a basis for determining the fixed overhead absorption rate.

The actual results for the month are as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Quantity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production (units)</td>
<td>2,800</td>
</tr>
<tr>
<td>Sales (units)</td>
<td>2,400</td>
</tr>
<tr>
<td>Selling price</td>
<td>₦6,120</td>
</tr>
</tbody>
</table>
Direct material 88,000 litres @ ₦120 per litre  
Direct labour 21,000 hours @ ₦ 150 per hour  
Variable production overhead ₦ 660,000  
Fixed production overhead ₦ 360,000

Required:

Prepare a statement that reconciles the budgeted gross profit with the actual gross profit for the month with a detailed computation of all the variances involved.

(15 Marks)

QUESTION 7

Omola Industries Limited is introducing a new product. The original information, available to the company from its archive suggests that the product will sell for ₦190 per unit. Other information obtained from the initial source are as follows:

Variable cost per unit is ₦100  
Fixed cost is ₦20,000,000  
Annual production and sales information is 700,000 units.

The company’s board, knowing the importance of sourcing for credible information, inaugurated a market research team to carry out a good research on the product in the area of marketing variables like volume of sales, sales price and variable cost.

The result of the detailed research work is shown below:

(i) The selling price is not static as originally thought but will be in three regimes of ₦180, ₦190 and ₦200.

(ii) The following estimates of sales demand for each possible selling price is provided on the basis of pessimistic forecast, most likely forecast and optimistic forecast along with their subjective probabilities.

<table>
<thead>
<tr>
<th>Price</th>
<th>₦180</th>
<th>₦190</th>
<th>₦200</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pessimistic</td>
<td>800,000</td>
<td>700,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Most likely</td>
<td>900,000</td>
<td>800,000</td>
<td>600,000</td>
</tr>
<tr>
<td>Probability</td>
<td>0.3</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Probability</td>
<td>0.5</td>
<td>0.7</td>
<td>0.5</td>
</tr>
</tbody>
</table>
The unit variable cost is projected as follows:

<table>
<thead>
<tr>
<th>Variable Cost</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦100</td>
<td>0.60</td>
</tr>
<tr>
<td>₦90</td>
<td>0.40</td>
</tr>
</tbody>
</table>

In the light of the market research carried out, the company has committed itself to an annual contract cost of ₦5,000,000.

Required:

a. Compute the initial profit achievable by the company. (2 Marks)

b. Calculate the profit achievable by the company in the light of the credible information for the THREE price scenarios. (7 Marks)

c. What is the value of the new information? (3 Marks)

d. Identify THREE other sources of information available to an organisation. (3 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

NAIJAX GROUP LIMITED

(a) Calculation of transfer price per tyre that Division X should quote in order to meet its residual income target:

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total profit required by Division X</td>
<td>₦384,000,000</td>
</tr>
<tr>
<td>12% of capital employed (₦3,200,000,000 x 12%)</td>
<td>₦384,000,000</td>
</tr>
<tr>
<td>Residual Income required</td>
<td>₦180,000,000</td>
</tr>
<tr>
<td>Required profit</td>
<td>₦564,000,000</td>
</tr>
<tr>
<td>Add: Fixed costs</td>
<td>₦1,080,000,000</td>
</tr>
</tbody>
</table>
Total contribution required: 1,644,000,000
Less: External contribution (90,000 x 13,000): 1,170,000,000
Contribution needed for Internal Sales: 474,000,000

Additional contribution per tyre = \( \frac{474,000,000}{60,000 \text{ tyres}} = \text{₦}7,900 \)

Transfer price therefore:

Variable cost = 22,000
+ Additional Contribution = \( \frac{7,900}{29,900} \)

(aii) Selling price to division Y on an opportunity cost basis:

40,000 tyres at \( \text{₦}22,000 \) marginal cost and
20,000 tyres at \( \text{₦}35,000 \) external selling price

(b) Because of the present policy of judging performance on the single measure of
profitability, there is the possibility of sub-optimality.

Y could purchase tyres at \( \text{₦}28,000 \) from Adex Ltd instead of \( \text{₦}29,900 \) from
company X, and if X cannot sell the 40,000 tyres externally, the group’s profit
would fall.

To optimise group profit, goods should be transferred at marginal cost but
divisional performance assessment becomes meaningless and motivation would
fall.

(c)(i) Buying from company X Strategy A

<table>
<thead>
<tr>
<th></th>
<th>( \text{₦} )</th>
<th>( \text{₦} )</th>
</tr>
</thead>
<tbody>
<tr>
<td>External sales 90,000 x ( \text{₦}35,000 ) =</td>
<td>3,150,000,000</td>
<td>60,000 x ( \text{₦}35,000 ) =</td>
</tr>
<tr>
<td>Transferred sales 60,000 x ( \text{₦}30,000 ) =</td>
<td>1,800,000,000</td>
<td>( \text{-} )</td>
</tr>
<tr>
<td>Less Cost</td>
<td>( \text{₦} )</td>
<td>( \text{₦} )</td>
</tr>
<tr>
<td>Variable cost 150,000 x ( \text{₦}22,000 ) =</td>
<td>3,300,000,000</td>
<td>60,000 x ( \text{₦}30,000 ) =</td>
</tr>
<tr>
<td>Fixed Cost</td>
<td>1,800,000,000</td>
<td>( \text{-} )</td>
</tr>
<tr>
<td></td>
<td>4,380,000,000</td>
<td>1,800,000,000</td>
</tr>
</tbody>
</table>

Net Profit \( (4,950,000,000 - 4,380,000,000) = 570,000,000 \)

21,000,000,000 – 1,800,000,000) = 300,000,000
Tax at 55% \[ \text{Group Net Profit} = 570,000,000 + 300,000,000 = 870,000,000 \]
Less: Group Tax \[ = 313,500,000 + 75,000,000 = (388,500,000) \]
Group profit after tax \[ = 481,500,000 \]

(ii) Buying from Adex Ltd. – Strategy B

<table>
<thead>
<tr>
<th></th>
<th>X</th>
<th>Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>110,000 tyres x N 35,000</td>
<td>3,850,000,000</td>
<td>60,000 x N35,000  = 2,100,000,000</td>
</tr>
<tr>
<td>Less: Cost</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable cost 110,000 x N22,000</td>
<td>2,420,000,000</td>
<td>60,000 x N28,000  = 1,680,000,000</td>
</tr>
<tr>
<td>Fixed cost</td>
<td>1,080,000,000</td>
<td></td>
</tr>
<tr>
<td>Net profit (3,850,000,000 – 3,500,000,000)</td>
<td>3,500,000,000</td>
<td>2,100,000,000 – 1,680,000,000 = 420,000,000</td>
</tr>
<tr>
<td>Tax at 55%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>N192,500,000</td>
<td>N105,000,000</td>
</tr>
</tbody>
</table>

Group Net Profit = 350,000,000 + 420,000,000 = 770,000,000
Group Tax = 192,500,000 + 105,000,000 = (297,500,000)
Group profit after tax = 472,500,000

Decision
Division Y should buy from Division X in order to maximise the groups’ profit. N481,500,000 is higher than N472,500,000 as analysed above.

EXAMINER’S REPORT
The question tests the principles of Transfer Pricing between two divisions: Divisions X and Division Y. It also tests candidates’ understanding of the implication of Residual Income (RI) as a performance measure and the effect of taxation on transfer from divisions operating in different countries.
Candidates are expected to compute transfer price given a Target Residual Income.

They are also expected to assess the impact of the use of Residual Income as a measure of profitability and the implication on group profit of transfer to divisions operating in different tax regimes.

Over 95% of the candidates attempted the question but demonstrated a shallow knowledge of its requirements due to poor understanding of the basic principles of Transfer Pricing and application of tax in transfer pricing transactions.

Candidates are advised to pay greater attention both to the theory and application of Transfer Pricing.

**SECTION B**

**SOLUTION 2**

The actual profit for 31 December, 2013

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (19,000 units @ 230)</td>
<td>4,370,000</td>
</tr>
<tr>
<td>Direct Materials: A</td>
<td>460,800</td>
</tr>
<tr>
<td>B</td>
<td>902,400</td>
</tr>
<tr>
<td>Direct Wages</td>
<td>588,800</td>
</tr>
<tr>
<td>Fixed overhead</td>
<td>580,000</td>
</tr>
<tr>
<td>Actual Profit</td>
<td>1,838,000</td>
</tr>
</tbody>
</table>

Direct material cost variance:

\[
\left( \frac{\text{Standard Quantity}}{\times \text{Standard Price}} \right) - \left( \frac{\text{Actual Quantity}}{\times \text{Actual Price}} \right)
\]

A = (19,000 x 10kg x ₦2) - (₦192,000 x ₦2.40)

= ₦380,000 - 460,800

= ₦80,800 A

B = (19,000 x 5kg x ₦10) - (₦950,000 x ₦9.40)

= ₦950,000 - 902,400

= ₦47,600 F

TOTAL = ₦80,800A + ₦47,600F

= 33,200 A

**ALTERNATIVE APPROACH**

(Standard Price – Actual Price) x Actual Qty
\[ A = (N^2 - 2.4) \times 192,000 = N76,800 \]
\[ B = (10 - 9.40) \times 96,000 = N57,600 \]
\[ (\text{Std. Qty.} - \text{Act. Qty}) \times \text{Std. Price} \]
\[ A = (19,000 \times 10) - 192,000 \times \text{N}^2 = 4,000 \]
\[ B = (19,000 \times 5) - 96,000 \times \text{N}^{10} = 10,000 \]

The Actual Materials used are in standard proportion. Therefore, there is no MDC variance.

Direct Labour Cost:

\[ \text{Standard Labour Cost} - \text{Actual labour cost} \]
\[ (\text{Std. Hrs} \times \text{Std. Rate}) - (\text{AHs} \times \text{AR}) \]
\[ = (19,000 \times 5 \times \text{N}^6) - (\text{N}92,000 \times \text{N}^6.40) \]
\[ = 570,000 - 588,800 \]
\[ = N18,800 \]

Labour Rate Variance
\[ (\text{Standard Rate} - \text{Actual Rate}) \times \text{Actual Hours} \]
\[ = (\text{N}^6 - 6.40) \times 92,000 \]
\[ = N36,800 \]

Labour Efficiency Variance
\[ (\text{Std. Hrs} - \text{Actual Hrs}) \times \text{Std. Rate} \]
\[ 19,000 \times 5 = (95,000 - 92,000) \times \text{N}^6 = 18,000 \]

Fixed Overhead Cost Variance
\[ \left( \frac{\text{Standard fixed overhead}}{\text{Charged to production}} \right) - \left( \frac{\text{Actual fixed production}}{\text{Overhead cost incurred}} \right) \]
\[ = (5 \times 19,000 \times 12) - 580,000 \]
\[ = 1,140,000 - 580,000 \]
\[ = N560,000 \]

Split into:

Fixed Overhead Expenditure Variance
\[ \text{Budgeted fixed overhead} - \text{Actual Fixed Overhead} \]
\[ = (20,000 \times \text{N}60) - 580,000 \]
\[ = 1,200,000 - 580,000 \]
\[ = N620,000 \]
Fixed Overhead Volume Variance:

\[ \text{SFORph} \left( \text{AO} - \text{BO} \right) \]
\[ = 60 \left( 19,000 - 20,000 \right) = 60,000 \text{A} \]

**OR**

Volume Spilt Into

Volume Capacity Variance

\[ = \left( \text{Actual Hrs} - \text{Budgeted Hrs} \right) \times \text{Budg. F. O. rate per hr} \]
\[ = \left( 92,000 - (5 \times 20,000) \right) \times 12 \]
\[ = 96,000 \text{A} \]

Volume Efficiency Variance

\[ = \left( \text{Std. Hrs} - \text{Actual Hrs} \right) \times \text{FORph} \]
\[ = (19,000 \times 12) - 92,000 \times 12 \]
\[ = 36,000 \text{F} \]

Sales Margin Price Variance:

\[ = \left( \text{Actual Margin} - \text{Std. Margin} \right) \times \text{Actual Sales Volume} \]
\[ = (70 - 40) \times 19,000 = 570,000 \text{F} \]

Sales Margin Volume Variance:

\[ = \left( \text{Actual Sales Volume} - \text{Budgeted Sales Volume} \right) \times \text{sales margin} \]
\[ = (19,000 - 20,000) \times 40 \]
\[ = 40,000 \text{A} \]

**Workings:**

Std. product cost and selling price are calculated as follows:

- **Direct material:**
  - A: (10kg @ N2 per kg) = 20
  - B: (5kg @ N10 per kg) = 50

- **Direct Wages:**
  = 30

- **Fixed Overhead (5 hrs x 200% of N6):**
  = 60

- **Standard Cost:**
  = 160

- **Profit: 20% margin i.e. \( \frac{20}{(100 - 20)} \times N160 \):**
  = 200

- **Actual Selling Price = 115\% of 200 = N230**

**EXAMINER’S REPORT**

The question tests candidates’ knowledge of standard costing and variance analysis including preparation of performance report.
Candidates are expected to determine variances for materials, labour overhead and sales.

About 85% of the candidates attempted the question and about 50% of them obtained average marks allocated to the question.

About 30% of the candidates could not correctly compute the sales variances and fixed overhead variances.

Candidates are advised to ensure they sharpen their skill in the area of the principles of standard costing and variance analysis to improve performance. They should also improve on presentation of statements.

SOLUTION 3

Computation of performance measures for Purity Nig. Ltd. and Bench Mark Co. Ltd.

<table>
<thead>
<tr>
<th></th>
<th>Purity Nig. Ltd.</th>
<th>Bench Mark Co. Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>Profit Margin</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>= Profit x 100</strong></td>
<td><strong>1100 x 100 = 19.64%</strong></td>
<td><strong>2530 x 160 = 26.83%</strong></td>
</tr>
<tr>
<td>Sales</td>
<td>5600</td>
<td>9430</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>*2. <strong>Asset Turnover</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>= Turnover</strong></td>
<td>5600 = 1.007 times</td>
<td>9430 = 1.036 times</td>
</tr>
<tr>
<td>Net Total Asset</td>
<td>5560</td>
<td>9100</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>*3. <strong>Returns on Capital Employed</strong></td>
<td></td>
<td><strong>2530 = 27.80%</strong></td>
</tr>
<tr>
<td><strong>= Profit x 100</strong></td>
<td><strong>1100 x 100</strong></td>
<td>9100</td>
</tr>
<tr>
<td>Net Total Asset</td>
<td>5560</td>
<td>9100</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>= 19.78%</strong></td>
</tr>
<tr>
<td>4. <strong>Current Ratio</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>= Current Asset</strong></td>
<td><strong>1000 = 1.67:1</strong></td>
<td><strong>1400 = 2.8:1</strong></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>600</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. <strong>Debt-Equity Ratio</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>= Debt Capital x 100</strong></td>
<td><strong>1000 x 100 = 21.91%</strong></td>
<td><strong>4400 x 100 = 93.61%</strong></td>
</tr>
<tr>
<td>Equity Capital</td>
<td>4560</td>
<td>4700</td>
</tr>
</tbody>
</table>

3.(a) Computation of performance measures for Purity Nigeria Limited

i. **Profit Margin = Profit x 100**
This measure evaluates the profitability of the company

ii. Asset Turnover = \( \frac{\text{Turnover}}{\text{Total Asset less current liabilities}} \)

\[
= \frac{5600}{5560} = 1.007 \text{ times}
\]

The Asset turnover shows the number of times the asset will be used in building the sales. It shows how well the company has used its asset. It is a measure of productive capacity of company’s asset.

iii. Returns on Capital Employed (ROCE).

The Returns on Capital Employed (ROCE) measures the performance of a company as a whole in using all sources of long term finances. It is seen as a measure of management efficiency. It is computed thus:

\[
\text{ROCE} = \frac{\text{Profit}}{\text{Total Asset less current liabilities}} \times 100 = \frac{1100}{5560} = 19.78\%
\]

iv. Current Ratio

It is a measure of liquidity that represents the relationship between current assets and current liabilities. The normal ratio is 2:1. It is computed thus:

\[
\text{Current Ratio} = \frac{\text{Current Asset}}{\text{Current liabilities}} = \frac{1,000}{600} = 1.67:1
\]

v. Debt - Equity Ratio

It is gearing ratio that describes the mix of debt finance and equity finance in a company. It thus considers the relative proportion of long term debts and equity in the long term financing of the business. It is computed thus:

\[
\text{Debt-Equity Ratio} = \frac{\text{Debt Capital}}{\text{Equity Capital}} \times 100 = \frac{1000}{1} = 21.91\%
\]
The implication of the level of percentage of gearing is in the level of financial risk. Low gearing percentage indicates low exposure to financial risk as there will be little difficulty in meeting loan interest payment and repayment of principal. High gearing rate is the opposite.

b.(i) Profit Margin

The profit margin of Purity Nig. Ltd. is 19.64% while that of the Bench Mark Co. Ltd. is 26.83%. This measure evaluates the profitability of its operation. It shows that Bench Mark Co. Ltd. achieves higher profit margin than Purity Nig. Ltd. This can be achieved by the board through strategies that will enhance sales, improve the market share, sales promotion, advertising and cost reduction.

(ii) Asset Turnover

This measure shows how well the company uses its asset to increase its sales. The asset turnover ratio of Purity Nig. Ltd. is slightly lower than the ratio of Bench Mark Co. Ltd. The present Asset Turnover of Purity which is 1.007 times can be improved upon if the asset value in stock is reduced and sales improved through advertising and sales promotion strategies.

(iii) Return on Capital Employed:

This is a measure of company profitability and efficiency. The ratio is higher in the industry leader – Bench Mark Co. Ltd. with a ratio of 27.80% which is higher than the ratio of Purity Nigeria Limited whose ROCE ratio is 19.78%. This can be improved through increasing profitability and sales or reduction in current asset values receivables, inventories, etc.

(iv) Current Ratio:

This is a measure of liquidity. This shows the ability of the company to meet its short term debt commitment or obligation. Purity Nig. Ltd. ratio of 1.67:1 is lower than standard ratio which is 2:1 and lower than the industry leader’s current ratio which is...
2.81:1. Improvement can be achieved through reduction in payables’ value and increase in receivables.

(v) Debt-Equity Ratio

The Debt-Equity ratio for Purity Nig. Ltd. is lower than that of the industry leader. It has a low gearing ratio of 21.91% as against the industry leader’s ratio 93.61%.

c. The non-financial measures that will be used in furtherance of the Board’s decision are as follows:

i. Total quality measures
ii. Measures relating to customer service time and customer satisfaction.
iii. Productivity measures.
iv. Measures that show how individual goals remain consistent with organisation goals.
v. Number of defects and machine down times.
vi. Idle times
vii. Advertisements
viii. Bulk purchase discounts

Note: For the asterisked ratios, alternative formulae can be accepted.

EXAMINER’S REPORT

The question tests candidates’ skill in the computation of basic performance indicators on ratios.

Candidates are expected to determine the stated ratios, compare the results of the given companies and advise the boards on measures for improvement.

Candidates performed well in the computations but performed poorly on giving advice necessary for the needed improvement. About 60% of the candidates that attempted this question had this pitfall. Many could also not give workable non-financial measures.

Candidates are advised to study interpretation of ratios as they apply in practice.
SOLUTION 4

COOKING POTS & KETTLES

(a)

<table>
<thead>
<tr>
<th></th>
<th>Sales</th>
<th>£'000</th>
<th>£'000</th>
<th>£'000</th>
<th>£'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct cost:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Materials</td>
<td>200</td>
<td>240</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Wages</td>
<td>160</td>
<td>240</td>
<td>80</td>
<td>160</td>
<td></td>
</tr>
<tr>
<td></td>
<td>240</td>
<td></td>
<td>-</td>
<td>320</td>
<td></td>
</tr>
<tr>
<td>Variable Overhead</td>
<td>40</td>
<td>120</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pot Contribution</td>
<td>720</td>
<td>1080</td>
<td>240</td>
<td>360</td>
<td></td>
</tr>
</tbody>
</table>

that could arise are:

i. The department with the lower contribution may be shut down with the attendant severance cost.
ii. There will be need to employ more workers for Department 4.
iii. Labour hours required for cooking pot is higher and so sensitive to labour rate. Any increase in labour rate may result in loss.
iv. Direct material and variable overhead costs are sensitive to price change. Any slight change in the price of the costs may make its production not worthwhile.
v. Loss of goodwill.
vi. Loss of sale which may result to loss of profit.

(b)

<table>
<thead>
<tr>
<th></th>
<th>Kettle</th>
<th>Pot</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Materials</td>
<td>200,000</td>
<td>240,000</td>
</tr>
<tr>
<td>Total Contribution</td>
<td>240,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Contribution per £ of materials</td>
<td>£1.2</td>
<td>£1.50</td>
</tr>
<tr>
<td>Number of units</td>
<td>£3,000,000</td>
<td>12,500 units</td>
</tr>
<tr>
<td>Annual Contribution</td>
<td>12,500 x 360</td>
<td>£4,500,000</td>
</tr>
<tr>
<td>Less Fixed overhead</td>
<td>£1,000,000</td>
<td></td>
</tr>
<tr>
<td>Profit per annum</td>
<td>£3,500,000</td>
<td></td>
</tr>
</tbody>
</table>

Pot should be produced because it has a higher contribution margin per £ of materials.

(c)

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>960,000</td>
<td>1,440,000</td>
</tr>
</tbody>
</table>
Dept. 2

Labour hours required

\[ \frac{N\,80,000}{N\,80} = 1000 \text{ hours} \]
\[ \frac{N\,160,000}{N\,80} = 2000 \text{ hours} \]

Total Contribution

\[ N\,240,000 \]
\[ N\,360,000 \]

Contribution per hour

\[ N\,240 \]
\[ N\,180 \]

Kettle should be produced because it has a higher contribution per hour.

Computation of profit per year

\[ N'000 \]

Total contribution \( 240 \times 16 \times 40 \times 50 \)

Less fixed cost

\[ 1,000 \]

Profit per year

\[ 6,680 \]

EXAMINER’S REPORT

The question tests candidates’ knowledge on the application of Marginal Costing Techniques for decision making. It also tests the ability of the candidates in determining contribution per limiting factor to select the better alternative based on material and labour.

Candidates are expected to rank the products using contribution per limiting factor.

About 40% of the candidates attempted the question but performance was very poor as less than 10% of them obtained average score. Candidates inability to correctly determine the number of hours required to manufacture each product was their greatest pitfall.

Candidates are advised to adequately cover the entire syllabus.

SECTION C

SOLUTION 5
COLOUR EFFECTS LTD.

a. Let $Q = \text{Number of units of executive bags to break even.}$

$3Q = \text{Number of units of common bags to break even.}$

Revenues – variable costs – fixed costs = zero profit

$\text{N}\ 200(3Q) + \text{N}\ 300Q - \text{N}\ 140(3Q) - \text{N}\ 180Q - \text{N}\ 12,000,000 = 0}$

$\text{N}\ 600(3Q) + \text{N}\ 300Q - \text{N}\ 420Q - \text{N}\ 180Q = \text{N}\ 12,000,000}$

$\text{N}\ 900Q - \text{N}\ 600Q = \text{N}\ 12,000,000$

$\text{N}300Q = \text{N}12,000,000$

$Q = \text{N}40,000 \text{ units of executive bags}$

$3Q = \text{N}120,000 \text{ units of common bags}$

The breakeven point in units is 120,000 of common bags plus 40,000 units of Executive bags. Total of 160,000 units.

b. Unit contribution margins are:

Common bag: $\text{N}200 - \text{N}140 = \text{N}60$

Executive bag: $\text{N}300 - \text{N}180 = \text{N}120$

If only common bags were sold, the break-even point would be:

$\text{N}12,000,000$

$\text{N}60$

$= 200,000 \text{ units}$

If only executive bags were sold, the break-even point would be:

$\text{N}12,000,000$

$\text{N}120$

$= 100,000 \text{ units}$

c. Operating profit

$= 180,000 (\text{N}60) + 20,000 (\text{N}120) \text{N}12,000,000$

$= \text{N}10,800,000 + \text{N}2,400,000 - \text{N}12,000,000$

$= \text{N}13,200,000 - \text{N}12,000,000$

$= \text{N}1,200,000$

Let $Q = \text{Number of units of executive bags to break-even.}$

$9Q = \text{Number of units of common bags to break-even}$
\[ \text{N200}(9Q) + \text{N300}(Q) - \text{N140}(9Q) - \text{N180Q} - \text{N12,000,000} = 0 \]

\[ \text{N1,800} + \text{N300Q} - \text{N1,260Q} - \text{N180Q} - \text{N12,000,000} = 0 \]
\[ \text{N2,100Q} - \text{N1,440Q} - \text{N12,000,000} = 0 \]
\[ \text{N660Q} = \text{N12,000,000} \]

\[ Q = 18,182 \text{ units of Executive Bags} \]
\[ 9Q = 163,636 \text{ units of Common Bags} \]

Total = 181,648

**Alternative Solution**

a. Overall Contribution/Sales ratio approach

Total Contribution - N30,000,000
Total Revenue - N90,000,000

Therefore contribution/sales ratio (c/s)
\[ \frac{30,000,000}{90,000,000} = \frac{1}{3} \text{ or } 0.3333 \]

\[ \text{BEP (N)} = \frac{\text{Fixed Cost}}{\text{c/s}} = \frac{\text{N12,000,000}}{0.3333} = \text{N36,000,000} \]

For common bags

\[ \text{BEP (Units)} = \frac{\text{N60,000,000}}{90,000,000} \times \frac{\text{N36,000,000}}{90,000,000} = \text{N24,000,000} \]

Dividing by units sales price
\[ = \frac{\text{N24,000,000}}{200} = 120,000 \text{ units} \]

For Executive bags

\[ \text{BEP} = \frac{\text{N30,000,000}}{90,000,000} \times \frac{\text{N36,000,000}}{90,000,000} = \text{N12,000,000} \]

Dividing by unit sales price
\[ = \frac{\text{N12,000,000}}{300} = 40,000 \text{ units} \]

Total common + executive bags
\[ = 120,000 + 40,000 = 160,000 \text{ units} \]

(b) The same approach

(c)ii. Budgeted Operating Profit

<table>
<thead>
<tr>
<th></th>
<th>Common Bags</th>
<th>Executive Bags</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit sold</td>
<td>180,000</td>
<td>20,000</td>
<td>200,000</td>
</tr>
<tr>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
</tbody>
</table>
### EXAMINER’S REPORT

The question tests candidates’ knowledge of break-even analysis for decision making involving single and multi-products. It also tests the use of Marginal Costing Technique in determining budgeted operating profit and break-even in units and value.

Candidates are expected to calculate the break-even points in units and value for the given product mix, compute the break-even points from multi products for a given revenue mix and determine the operating profit for a given sales mix.

About 85% of the candidates attempted this question but performance was poor with over 70% obtaining less than half of the allocated marks. Their inability to understand the requirements of the question regarding the stated revenue mix was a major pitfall.

Candidates are advised to ensure adequate understanding of the requirement of questions before proffering solutions.
## RECONCILIATION OF ACTUAL AND BUDGETED PROFITS

### RECONCILIATION STATEMENT FOR THE MONTH

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Budgeted Gross Profit (2000 x N1200)</td>
<td></td>
<td>2,400,000</td>
</tr>
<tr>
<td>Sales Volume Variance (2,400 – 2,000) x N1,200</td>
<td></td>
<td>480,000F</td>
</tr>
<tr>
<td>Sales Price Variance 2,400 (N6,120 – N6,000)</td>
<td></td>
<td>288,000F</td>
</tr>
<tr>
<td>Direct Material Price Variance 88,000 (N90 – N120)</td>
<td></td>
<td>2,640,000A</td>
</tr>
<tr>
<td>Direct Material Usage Variance [(2,800 x 30) - (88,000)] x N90</td>
<td></td>
<td>360,000A</td>
</tr>
<tr>
<td>Direct Labour Rate Variance 21,000 x (120 – N150)</td>
<td></td>
<td>630,000A</td>
</tr>
<tr>
<td>Direct Labour Efficiency Variance [2,800 x 10] - (21,000) x N120</td>
<td></td>
<td>840,000F</td>
</tr>
<tr>
<td>Variable Overhead Expenditure Variance (21,000 x N60) – N660,000</td>
<td></td>
<td>600,000F</td>
</tr>
<tr>
<td>Variable Overhead Efficiency Variance (2,800 x 10) – 21,000 x N60</td>
<td></td>
<td>420,000F</td>
</tr>
<tr>
<td>Fixed Overhead Expenditure Variance (2,000 x 300) – N360,000</td>
<td></td>
<td>240,000</td>
</tr>
<tr>
<td>Fixed Overhead Volume Variance 2,800 – 2,000 x 10) x N30</td>
<td></td>
<td>240,000F</td>
</tr>
<tr>
<td><strong>ACTUAL GROSS PROFIT</strong></td>
<td></td>
<td>3,630,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5,508,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>1,878,000</strong></td>
</tr>
</tbody>
</table>
EXAMINER’S REPORT

The question tests candidates’ understanding of performance reporting using variance analysis and the reconciliation of actual profit with budgeted profit. Candidates are expected to compute the variances with breakdowns into their components and state the effects of the variances on profit.

About 75% of the candidates attempted the question but performance was poor. They could not accurately compute the variances which could have assisted in adequate reconciliation of the actual and budgeted profit. This is a confirmation of candidates’ weak foundation in Cost Accounting and inadequate preparation.

SOLUTION 7

OMOLA INDUSTRIES LTD

a. Original Profit Statement

\[
\begin{align*}
N/Unit & \\
Selling Price & 190 \\
Less: & \\
Variable cost & 100 \\
Contribution & 90 \\
\end{align*}
\]

Annual Production and Sales 700,000 units

\[
\begin{align*}
N'000 & \\
Contribution (N90 x 700,000) & 63,000 \\
Less: & \\
Fixed cost & 20,000 \\
Net Profit & 43,000 \\
\end{align*}
\]

b. Profit achievable by the company under the 3 selling prices scenarios

Selling Price Scenarios

\[
\begin{align*}
N180 & \\
N190 & \\
N200 & \\
\end{align*}
\]
Quantity expected to be sold (units) (wi) | 890,000 | 810,000 | 570,000
---|---|---|---
SP/Unit | 180 | 190 | 200
Less: Variable Cost/Per Unit wii | 96 | 96 | 96
Contribution/Unit | 84 | 94 | 104

Total Contribution (wiii) | 74,760 | 76,140 | 59,280
Less: Fixed Cost | 25,000 | 25,000 | 25,000
Net profit from new info | 49,760 | 51,140 | 34,280
c. Value of information from the market research team:

<table>
<thead>
<tr>
<th>Price</th>
<th>₦180</th>
<th>₦190</th>
<th>₦200</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit from credible information</td>
<td>49,760</td>
<td>51,140</td>
<td>34,280</td>
</tr>
<tr>
<td>Profit from original information source</td>
<td>43,000</td>
<td>43,000</td>
<td>43,000</td>
</tr>
</tbody>
</table>

Alternative solution

Average profit = ₦’000 \((49,760 + 51,140 + 34,280) / 3\)

₦45,060,000

Average profit | 45,060
Less: Initial profit | 43,000
Value of new information | 2,060
d. Other sources of information:

Primary sources – Questionnaire, observation, surveys

Secondary sources - Newspapers, business guides, journals, text books, trade organisations, professional bodies, library, reports of competitors, circulars, gazettes etc.

Workings

i. Computation of expected demand on each of the 3 price scenarios
### Pessimistic

<table>
<thead>
<tr>
<th>VC</th>
<th>Pr</th>
<th>X.Pr</th>
</tr>
</thead>
<tbody>
<tr>
<td>800,000</td>
<td>0.3</td>
<td>240,000</td>
</tr>
<tr>
<td>700,000</td>
<td>0.1</td>
<td>70,000</td>
</tr>
<tr>
<td>500,000</td>
<td>0.4</td>
<td>200,000</td>
</tr>
</tbody>
</table>

### Most likely

<table>
<thead>
<tr>
<th>VC</th>
<th>Pr</th>
<th>X.Pr</th>
</tr>
</thead>
<tbody>
<tr>
<td>900,000</td>
<td>0.5</td>
<td>450,000</td>
</tr>
<tr>
<td>800,000</td>
<td>0.7</td>
<td>560,000</td>
</tr>
<tr>
<td>600,000</td>
<td>0.5</td>
<td>300,000</td>
</tr>
</tbody>
</table>

### Optimistic

<table>
<thead>
<tr>
<th>VC</th>
<th>Pr</th>
<th>X.Pr</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,000,000</td>
<td>0.2</td>
<td>200,000</td>
</tr>
<tr>
<td>900,000</td>
<td>0.2</td>
<td>180,000</td>
</tr>
<tr>
<td>700,000</td>
<td>0.1</td>
<td>70,000</td>
</tr>
</tbody>
</table>

### Computation of expected variable cost

\[
\text{VC} \times \text{Pr} = X.\text{Pr}
\]

<table>
<thead>
<tr>
<th>VC</th>
<th>Pr</th>
<th>X.Pr</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>0.60</td>
<td>60</td>
</tr>
<tr>
<td>90</td>
<td>0.40</td>
<td>36</td>
</tr>
</tbody>
</table>

\[
\text{Total} = 96
\]

### Computation of the new fixed cost:

\[
\text{N’000}
\]

<table>
<thead>
<tr>
<th>Original fixed cost</th>
<th>Add: Annual contract cost</th>
<th>Total Fixed Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>20,000</td>
<td>5,000</td>
<td>25,000</td>
</tr>
</tbody>
</table>

### EXAMINER’S REPORT

The question tests candidates’ knowledge of planning with emphasis on forecasting incorporating the use of probabilities to determine demand at different prices. It also tests candidates’ knowledge of different sources of information available to organisations.

About 40% of the candidates attempted the question but performance was very poor. Many of the candidates applied the wrong probabilities thus deriving wrong expected demand and incorrect. Candidates attempt on the value and sources of information was also very poor.

Candidates are advised to ensure adequate preparation and coverage of the syllabus.
SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

Poles Apart Limited

You are the Principal Partner in charge of a four-partner firm of Chartered Accountants. Your firm has been invited to tender for the audit of Poles Apart Limited for the year ended 31 December 2013.

Poles Apart Limited was established two years ago, and provides mobile phone service for individuals and businesses. The system established by the company comprises:

(i) Small portable mobile phones, which allow subscribers to contact or be contacted by any other telephone.

(ii) The mobile phones can be used within the range of a local relay station which receives calls from and sends calls to the mobile phone.

(iii) The local relay stations are linked to a central computer which connects the calls to other users. Frequently, this is through a computer telephone network.

(iv) Currently, the local relay stations cover one large city with a population of about 1,000,000. Within the next one year the system will cover all other cities in Nigeria with a population of over 250,000 each. By 2017, the system will cover all motorways and cities with a population of over 100,000. Extending the coverage of the system will involve considerable capital expenditure on new relay stations and require additional borrowings.
(v) The cost of the relay stations and central computer are capitalised and written off over six years.

(vi) The mobile phones are manufactured by other companies and sold through retailers. Poles Apart Limited does not sell the phones, but it pays ₦2,000 to the retailer for each phone sold. This payment is capitalised in the financial statements of Poles Apart Limited and written off over four years.

(vii) Subscribers are invoiced monthly with a fixed line rental and a variable call charge. Other operators are charged for the time spent by their customers calling Poles Apart Limited subscribers. These charges are logged and calculated by the company’s main computer.

(viii) All the shares are owned by three wealthy individuals who are also non-executive directors. They will receive a fixed allowance. They do not plan to make any further investment in the company.

(ix) Establishing the network of relay stations and subscribers will result in the company making losses for at least three years. Current borrowings are about 20% of the shareholders’ funds. Because of the substantial capital expenditure and trading losses, it is expected that the company will be highly geared by 2016.

(x) As the company will not be immediately profitable, the non-executive directors have decided that executive directors should receive a basic salary and a bonus based on the number of subscribers to the system.

(xi) The owners plan to float the company on the local Stock Exchange in 2016. The flotation will involve:
    • issuing new shares to the general public to provide funds for the company; and
    • the three non-executive directors selling some of their shares.

You are aware that Poles Apart Limited has a number of very large competitors, each of which has a large number of subscribers and comprehensive coverage (i.e. over 90% of the population are within range of a relay station).

Required:

a. Consider the risks associated with the audit of Poles Apart Limited.  
   (12 Marks)

b. Describe the ethical matters you should consider in deciding whether your audit firm should accept the audit engagement. This should include
c. Advise on whether you should accept or decline the audit assignment, giving your principal reasons for coming to this decision. (6 Marks)

TOTAL 30 MARKS

SECTION B: ATTEMPT ANY TWO OUT OF THREE QUESTIONS (40 Marks)

QUESTION 2

Radcliffe Co.

ISA 500 Audit Evidence states that the objective of the auditor is to ‘design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion’.

Required:

a. List and explain the factors which will influence the auditors’ judgement concerning the sufficiency of audit evidence obtained. (4 Marks)

b. You are the audit senior in charge of the audit of Radcliffe Co, a company that has been trading for over 50 years. Radcliffe Co manufactures and sells tables and chairs directly to the public. The company's year-end is 31 December.

Current liabilities are shown on Radcliffe Co's statement of financial position as follows:

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade payables</td>
<td>884,824</td>
<td>816,817</td>
</tr>
<tr>
<td>Accruals</td>
<td>56,903</td>
<td>51,551</td>
</tr>
<tr>
<td>Provision for legal action</td>
<td>60,000</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>1,001,727</td>
<td>868,368</td>
</tr>
</tbody>
</table>

The provision for legal action relates to a claim from a customer who suffered an injury while assembling a chair supplied by Radcliffe Co. The directors of Radcliffe Co dispute the claim, although they are recommending an out of court settlement to avoid damaging publicity against Radcliffe Co.

Required:
List the substantive audit procedures that you should undertake in the audit of the current liabilities of Radcliffe Co for the year ended 31 December 2013. For each procedure, explain the purpose.

Marks are allocated as follows:

a. Trade payables (9 Marks)
b. Accruals (3 Marks)
c. The provision for legal action. (4 Marks)

(Total 20 Marks)

**QUESTION 3**

**Hurricane Limited**

You are the audit manager in charge of the audit of Hurricane Limited. The company’s year-end is 31 December, and Hurricane Limited has been a client for seven years. The company purchases and resells fittings for ships including anchors, compasses, rudders, sails etc. Clients vary in size from small businesses making yachts to large companies maintaining large luxury cruise ships. No manufacturing takes place in Hurricane Limited.

Information on the company’s financial performance is available as follows:

<table>
<thead>
<tr>
<th></th>
<th>2014 Forecast (₦'000)</th>
<th>2013 Actual (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>45,928</td>
<td>40,825</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(37,998)</td>
<td>(31,874)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>7,930</td>
<td>8,951</td>
</tr>
<tr>
<td>Administration costs</td>
<td>(4,994)</td>
<td>(4,758)</td>
</tr>
<tr>
<td>Distribution costs</td>
<td>(2,500)</td>
<td>(2,500)</td>
</tr>
<tr>
<td>Net profit</td>
<td>436</td>
<td>1,693</td>
</tr>
</tbody>
</table>
## Forecast and Actual Figures (₦'000)

<table>
<thead>
<tr>
<th></th>
<th>2014 Forecast</th>
<th>2013 Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-current assets (at net book value)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>₦'000</td>
<td>₦'000</td>
</tr>
<tr>
<td></td>
<td>3,600</td>
<td>4,500</td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>200</td>
<td>1,278</td>
</tr>
<tr>
<td>Receivables</td>
<td>6,000</td>
<td>4,052</td>
</tr>
<tr>
<td>Cash and bank</td>
<td>500</td>
<td>1,590</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>10,300</td>
<td>11,420</td>
</tr>
<tr>
<td><strong>Capital and reserves</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Accumulated profits</td>
<td>5,300</td>
<td>5,764</td>
</tr>
<tr>
<td><strong>Total shareholders’ funds</strong></td>
<td>6,300</td>
<td>6,764</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>1,000</td>
<td>2,058</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>3,000</td>
<td>2,598</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>10,300</td>
<td>11,420</td>
</tr>
</tbody>
</table>

### Other information

(i) The industry in which Hurricane Limited operates has seen moderate growth of 7% over the last year.

(ii) Non-current assets mainly relate to company premises for storing inventory. Ten delivery vehicles are owned with a net book value of ₦300,000.

(iii) One of the directors purchased a yacht during the year.

(iv) Inventory is stored in ten different locations across the country, with your firm again having offices close to seven of those locations.

(v) A computerised inventory control system was introduced in August 2013.

(vi) Inventory balances are now obtainable directly from the computer system. The client does not intend to count inventory at the year-end but rely instead on the computerised inventory control system.
Required:

a. ISA 300 Planning an Audit of Financial Statements, states that an auditor must plan the audit. Explain why it is important to plan an audit. (5 Marks)

b. Using the information provided above, prepare the audit strategy for Hurricane Limited for the year ending 31 December 2014. (15 Marks)

(Total 20 Marks)

QUESTION 4

Fraud and error present risks to an entity. Both internal and external auditors are required to deal with risks in an entity. However, the responsibilities of internal and external auditors in relation to the risk of fraud and error differ.

Required:

a. Explain how the internal audit function helps an entity with the risk of fraud and error. (7 Marks)

b. Explain the responsibilities of external auditors with respect to the risk of fraud and error in an audit of financial statements. (7 Marks)

c. Rock Holidays is an independent travel agency. It does not package holidays itself. It takes commission on holidays sold to customers through its chain of high street shops. Staff are partly paid on a commission basis. Well established tour operators run the holidays that Rock Holidays sells. The network reservations system through which holidays are booked and the computerised accounting system are both well-established systems used by many independent travel agencies.

Payments by customers, including deposits, are accepted in cash and by debit and credit cards. Rock Holidays is legally required to pay an amount of money (based on its total sales for the year) into a central fund maintained to compensate customers if the agency should cease operations.

Describe the nature of the risks arising from fraud and error to which Rock Holidays is subject. (6 Marks)

(Total 20 Marks)
SECTION C: ATTEMPT ANY TWO OUT OF THREE QUESTIONS (30 Marks)

QUESTION 5

Threats
The ICAN Professional Code of Conduct and Guide for Members gives a list of threats to auditors’ independence which may impair integrity, objectivity or the good reputation of the profession.

Required:

Explain the following threats and give TWO examples each of circumstances that may lead to the threats:

a. Self Interest (3 Marks)

b. Self Review (3 Marks)

c. Advocacy (3 Marks)

d. Familiarity (3 Marks)

e. Intimidation (3 Marks)

(Total 15 Marks)

QUESTION 6

Partnerships

The audit of the accounts of a partnership is not statutorily required, but it is clear that various benefits would accrue to the firm if its accounts are voluntarily audited.

Required:

a. State FOUR reasons which may necessitate the audit of the accounts of a partnership. (4 Marks)

b. State FIVE important issues that you, as an auditor, would look into while auditing the books of a partnership. (5 Marks)

c. Suggest SIX substantive procedures that might be performed on the receipts of a school owned by a partnership. (6 Marks)

(Total 15 Marks)
QUESTION 7

The audit process has evolved from vouching and systems based audits to risk-based auditing.

Required:

a. Give brief descriptions of each of the three types of audit stated above.  
   (9 Marks)

b. State the instances where vouching and systems audits are still applicable.  
   (6 Marks)
   (Total 15 Marks)
SECTION A:

SOLUTION 1

1. Poles Apart Limited

(a) **Risks associated with the audit**

There appear to be considerable risks associated with undertaking the audit. In particular, Poles Apart Limited appears to have very high inherent risks.

The risks involved include the following:

(i) The central computer is pivotal to the organisation, as it relays the calls and calculates the bills for subscribers. It is unlikely the computer and its software will be reliable. The consequences of a breakdown of the computer will be very serious. Ideally, there should be more than one computer running the system for the system to be able to monitor when one of the computers fails.

(ii) With the planned market expansion, it is probable that the available faculties will no longer be adequate. The cost of upgrading the computer may not have been included in the budget. The current software may not be able to process a large increase in subscribers.

(iii) The commission paid to retailers for the sale of the phones is not recoverable yet it is capitalised and amortised over four years.

(iv) In view of the planned high borrowings and future trading losses, there is a very serious risk the company may not be a going concern. This increases the risk of the firm being sued for negligence. Also, Poles Apart Limited will put severe pressure on the Auditors to give an unqualified audit report. This pressure will increase because my audit firm is small and Poles Apart Limited is a relatively large and rapidly growing company.

(v) As an alternative to the company not being a going concern, there is the risk that other investors may purchase more shares in the company (to provide additional equity finance) or purchase the company outright from the existing directors (or the administrator/liquidator). If this occurs, recent financial statements will be subject to close scrutiny. The standard of audit work will have to be high, and the
problems stated above (e.g. complex computer systems and depreciation rates which may be inaccurate) could lead to undetected material errors in the financial statements. Thus, there is a high risk that legal action for negligence could be taken against the audit firm following a take-over or purchase of shares.

(vi) Flotation of the company on the Stock Exchange is a further risk. Immediately prior to the flotation, the audit work carried out by the firm will be subject to close scrutiny, so the firm has to be very careful in its work which would increase the cost of the audit and reduce its profitability. Also, when the company becomes quoted on the Stock Exchange, it is probable the firm will be replaced as the auditor.

(vii) The firm should consider the reputation of the three major shareholders and the executive directors. If they have been directors of companies which have failed, or been involved in financial or other wrongdoings, this will increase the inherent risk. The reputation of the financial director and the quality of the accounting records are other factors which will have to be considered.

(viii) Risk of non-adherence to corporate governance: The wealthy non-executive directors can negatively influence the day-to-day activities of the company.

(b) Professional and ethical matters

(i) The size of the audit fee. ICAN’s Professional Code of Conduct and Guide for members says the fees for audit and other recurring work paid by one client should not normally exceed 25% of the gross practice income. If the planned audit fee is over 25% of the current practice income it could be argued that the firm should not accept the audit. However, the rate of expansion of Poles Apart Limited will probably be much greater than the increase in income of the audit practice, so the 25% rule may become a problem in the next few years.

In practice, it is undesirable for the audit fee to approach 25% of the practice income, as reliance on such a large audit fee could be seen to affect the firm’s independence.

(ii) The audit firm may be able to audit Poles Apart Limited at its current size. However, when the system covers all towns with a population of over 250,000, on occasions audit work will probably have to cover all
areas of the country, and it is most unlikely that the audit firm will have sufficient staff to perform this work.

(iii) Whether the firm is technically competent to perform the audit, and whether the size of the company being audited is too large for the experience of the practice. Mobile telephone companies are very complex and have specialised accounting procedures, both in terms of the accounting system and the ways matters are treated in the financial statements (e.g. the commission of ₦2,000 given on the sale of phones to new subscribers). The firm will probably not have experience in auditing the computerised accounting system which controls calls and generates bills for subscribers. This requires specialised computer auditing techniques. Also, the firm will be unfamiliar with many of the accounting treatments for non-current assets. This lack of experience will probably mean that the audit will be too high a risk for the firm.

(iv) The firm will consider whether it has adequate professional Indemnity Insurance (PII) cover.

(v) Partners of the audit firm have no family or personal relationships with the directors of Poles Apart Limited. These relationships also apply to any staff involved in the audit. Ideally, no member of the firm should have relationships with the directors of Poles Apart Limited.

(vi) No staff in the audit firm should own shares or any investments in Poles Apart Limited.

(vii) No staff in the audit firm should be a beneficiary or trustee of a trust which holds shares in Poles Apart Limited. ICAN Professional Code of Conduct and Guide for members does allow an employee of the audit firm to be a beneficiary of shares in an audit client, but that employee must not be assigned to the audit of that client.

(viii) Employees of the audit firm must not accept loan from audit client unless it is in normal banking situation and only as regards car loan, overdraft, mortgage loan and debit card financing.

(ix) The audit firm should not make a loan to or accept a loan from an audit client.

(x) When the audit firm is asked to accept the audit appointment, it must request client’s permission to communicate with the existing auditor.
If this permission is refused, the audit firm should decline the appointment.

(xi) The firm should write to the existing auditor requesting for the information which ought to be made available to decide whether or not to accept the audit appointment.

(xii) The audit firm should consider the reply from the existing auditor. If adverse comments are made by the existing auditor, it should consider whether to accept the audit appointment.

(xiii) If the existing auditor does not reply to the firm’s letter, a further letter should be sent giving notice (e.g. seven days) that if no reply is received within that time, it is understood that there are no professional or other reasons preventing the firm from accepting the audit appointment.

(xiv) Before finally accepting the audit, the firm should prepare a letter of engagement and ask the directors of Poles Apart Limited to sign it.

(c) **Recommendation**

The firm should not accept the audit based on the following reasons:

(i) Poles Apart Limited appears to be too large a company for the firm to audit, and it is likely to grow faster than the audit firm. The audit fee will probably exceed ICAN’s limit of 25% of the practice income, and if this is not exceeded now, it is likely to be exceeded in the next few years.

(ii) Poles Apart Limited is a specialised company with complex computer systems. It is probable the firm will not have the skills to perform this work.

(iii) The accounting conventions for Poles Apart Limited will probably be unfamiliar to the firm, particularly the treatment of the ₦2,000 given to new subscribers to purchase the phones and the useful lives of the non-current assets. The firm may not have the skills to consider whether these treatments are satisfactory, and this could lead to the firm not detecting material misstatements in the financial statements.

(iv) Poles Apart Limited appears to be undercapitalised. Currently, gearing is 20% but this will increase substantially with expansion of the network and losses in early years of trading. Thus, there is a serious
risk that Poles Apart Limited will fail or be taken over, which could result in the firm being sued for negligence.

(v) The large size of Poles Apart Limited and the small size of the audit firm could compromise the independence of the firm. Third parties (including shareholders) will perceive the firm is not independent (on the relative size criteria), and Poles Apart Limited could bring severe pressure on the firm which would be hard to resist (i.e. they will ask for an unqualified audit report to be given when the firm should either give a qualified opinion or a modified report with an explanatory paragraph which mentions going concern problems).

(vi) The potential listing of the company on a Stock Exchange increases the audit risk, as there will be greater scrutiny of the financial statements prior to listing, which could highlight problems in the financial statements.

(vii) Finally, because of the imminent large size of Poles Apart Limited and the attendant large audit fee, Poles Apart Limited may attempt to ‘squeeze’ the audit fee. The firm may have to accept this reduced audit fee (as it would be reluctant to lose such a large audit fee) and this could result in a reduction in the time to perform the audit and thus increase the risk of the firm not detecting material misstatements in the financial statements.

The firm should accept the work based on the following reasons:

(i) It is expected that a four partner firm, will have wide enough experience and adequate personnel to handle this kind of audit.

(ii) Where they realise that they lack technical competence they could request for assistance from other firms or the institute.

(iii) It is an advantage to the firm that after the audit exercise they would have grown in knowledge, experience and exposure. This will further enhance the profile of the firm.

(iv) It is likely that a four-partner firm would have other clients from which they get sizeable audit fee; therefore the 25% benchmark will not affect the firms.

EXAMINER’S REPORT

The question is compulsory and was attempted by all the candidates.
It tests candidates’ knowledge on risks associated with audit of a company in part (a) and candidates’ advice on whether to take up an audit assignment after considering the ethical matters peculiar to a particular company environment in parts (b) and (c).

Candidates exhibited poor understanding of this question hence performance was generally below average. Candidates are advised to study the requirements of new syllabus and prepare well for the examinations.

SECTION B:

SOLUTION 2

Radcliffe Co.

(a) **Factors affecting auditor’s judgment concerning sufficiency of evidence**

**Assessment of inherent risk**

As inherent risk increases, then more audit evidence will be required to reduce detection risk.

**Materiality of the item**

An increase in materiality means that more audit evidence will be required to ensure that no material error has occurred.

**Nature of the accounting and control systems**

Where the accounting and control systems are poor then more audit evidence is necessary as less reliance can be placed on those systems.

**Control risk**

Determine the extent to which the directors have implemented a sound system of internal control; poor internal controls increase control risk, decreasing reliance that can be placed on those controls.

**Experience from previous audits**

Good experience from previous audits will decrease the amount of evidence required as the auditor can place reliance on previous review of clients’ systems.

**Result of audit procedures**

Where the results of different audit procedures agree with each other, then less evidence is needed. Where the evidence is more persuasive; and results are in conflict, then more evidence is required.
**Quality of information available**

Some sources of audit evidence are more reliable than others - meaning less evidence is needed. When relying on those sources, for example, documentary evidence is more reliable than oral evidence.

**(b) Substantive procedures**

**(i) Trade payables**

<table>
<thead>
<tr>
<th>Audit procedure</th>
<th>Reason for procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cast the schedule of trade payables and agree the total payables control ledger account then to trial balance.</td>
<td>To confirm that the schedule is complete, is accurately stated in the control ledger and contains no unusual or reconciling items which must be investigated.</td>
</tr>
<tr>
<td>• Test, on a sample basis that payables on the schedule agree to the individual ledger balances and from the ledger to the schedule.</td>
<td>To confirm that the schedule agrees with the payables control ledger stated on the trial balance.</td>
</tr>
<tr>
<td>• Compare trade payables individually and in total to prior year’s balances and explain any unusual changes.</td>
<td>To explain changes in the balances. For example, the increase in payables could indicate cash flow problems and Radcliffe &amp; Co is delaying payment to suppliers in response to this.</td>
</tr>
<tr>
<td>• Select a sample of individual payables</td>
<td>Comparison may also indicate lack of completeness of the schedule where payables balances have been omitted.</td>
</tr>
<tr>
<td></td>
<td>Material balances should always be tested to ensure correctness and test a large</td>
</tr>
<tr>
<td>Audit procedure</td>
<td>Reason for procedure</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>accounts for testing, focusing on material balances, zero balances and a sample of other items.</td>
<td>amount of payables by value. Some zero balances are tested to ensure that invoices have not been omitted from one supplier.</td>
</tr>
<tr>
<td>• Select population from purchase invoices received after the year-end. Trace to evidence of goods receipt and where goods received prior to year-end, ensure invoices are included in purchases.</td>
<td>• Confirm completeness of recording of purchase invoices.</td>
</tr>
<tr>
<td>Audit procedure</td>
<td>Reason for procedure</td>
</tr>
<tr>
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</tr>
<tr>
<td>▪ Obtain year-end supplier statements, either from Radcliffe &amp; Co or direct from the individual suppliers through a circularisation letter. Agree the balance on the statements to the individual account in Radcliffe &amp; Co’s payables ledger. Where necessary, reconcile the balances taking into account cash and invoices in transit, and also payments after year-end.</td>
<td>▪ Agree the payables balance to independent third party evidence to confirm accuracy, completeness and existence of the ledger balance.</td>
</tr>
<tr>
<td>▪ Take a sample of purchase invoices recorded in the purchases day book (PDB) just prior to the year end and trace to goods received note (GRN), ensuring that the goods were received within the year.</td>
<td>▪ To ensure that liabilities recorded in the PDB are represented by goods received during that year, and recorded in the correct period (cut-off procedure).</td>
</tr>
<tr>
<td>▪ Take a sample of GRNs prior to the end of the year and trace to purchase</td>
<td>▪ To ensure completeness of recording of amounts payable.</td>
</tr>
</tbody>
</table>
(i) Audit procedure

<table>
<thead>
<tr>
<th>Audit procedure</th>
<th>Reason for procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>invoice or the ‘goods received not invoiced’ for accrual in the financial statements.</td>
</tr>
<tr>
<td></td>
<td>To ensure that the purchases figure is not under or overstated in this year’s financial statements.</td>
</tr>
<tr>
<td></td>
<td>List all debit balances and obtain an explanation from the client.</td>
</tr>
<tr>
<td></td>
<td>To confirm why the balances arose and consider re-classifying the amounts as receivables. Debit balances may indicate control weaknesses with additional implications for audit testing.</td>
</tr>
</tbody>
</table>

(ii) Accruals

<table>
<thead>
<tr>
<th>Audit procedure</th>
<th>Reason for procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cast the schedule of accruals and agree individual amounts to the general ledger accounts.</td>
<td>Confirm that the schedule is complete, the balances are accurately stated in the general ledger and contains no unusual or reconciling items which must be investigated.</td>
</tr>
<tr>
<td>Compare individual accruals with amount in the prior year’s accounts.</td>
<td>Compare individual accruals with amount in the prior year to account for unusual</td>
</tr>
<tr>
<td>Audit procedure</td>
<td>Reason for procedure</td>
</tr>
<tr>
<td>-----------------</td>
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</tr>
<tr>
<td>Agree accruals to payments made after the end of the year for example, amounts payable for tax deducted from wages &amp; salaries payments to remittances to the tax authority.</td>
<td>differences and identify omissions from the schedule this year.</td>
</tr>
<tr>
<td>Review payments after the year-end to determine whether any accruals are required. Where the need for an accrual is identified, ensure this is included in the accruals schedule.</td>
<td>To ensure the accuracy of the amounts paid and confirm that the accruals are genuine.</td>
</tr>
<tr>
<td>Check calculations of individual accruals to supporting documents/evidence for example, tax deductions from wages to the amount shown on the payroll as deducted from wages and salaries for the last month of the year.</td>
<td>To confirm completeness of the accruals listing.</td>
</tr>
<tr>
<td></td>
<td>To check that the accrual has been calculated correctly and therefore testing for over or understatement of each accrual.</td>
</tr>
</tbody>
</table>
(iii) **Provision for legal action**

<table>
<thead>
<tr>
<th>Audit procedure</th>
<th>Reason for procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discuss the provision with the directors.</td>
<td>To attempt to confirm whether the company is liable for the payment.</td>
</tr>
<tr>
<td>Obtain a letter from Radcliffe &amp; Co’s lawyers.</td>
<td>To provide evidence on whether Radcliffe may be liable for payment and check that the amount provided is adequate.</td>
</tr>
<tr>
<td>Review any correspondence with the customers. Suppliers and other parties that do business with the company.</td>
<td>To determine Radcliffe &amp; Co’s liability.</td>
</tr>
<tr>
<td>Obtain a letter of representation from the directors.</td>
<td>To ensure that all the assets and liabilities are stated in the accounts.</td>
</tr>
<tr>
<td>Review the payments made after year end to receipt from the suppliers.</td>
<td>To confirm the accuracy of the amount stated in accruals.</td>
</tr>
</tbody>
</table>

**EXAMINER’S REPORT**

The question tests candidates’ understanding on sufficiency of audit evidence in part (a) and substantive audit procedures in part (b).

More than 50% of the candidates attempted the question and performance was poor. The commonest pitfall is poor interpretation of the requirements of the question.
Candidates are advised to upgrade their knowledge in the light of current professional and regulatory developments.

SOLUTION 3

Hurricane Limited

(a) Importance of audit planning

According to ISA 300, the auditor should plan the audit work so that the engagement will be performed in an effective manner. Specifically, planning is required for the following reasons:

- develop a general strategy and detailed approach for the specific nature, timing and extent of the audit work. This will help to ensure that the audit is carried out in an efficient and timely manner.
- ensure attention is devoted to the important areas of the audit. Planning will also help to identify problem areas so they can be addressed in a timely fashion.
- determine the amount of work to be carried out and therefore assist in determining the number of staff required to perform the audit work.
- provide a document as a reference for an initial discussion of the approach to the audit with the company’s audit committee. The plan will also help ensure that audit work is co-ordinated with client staff: e.g. for production of specific documentation to assist the auditor.
- act as a basis for the production of the audit program.

(b) Audit strategy

Client: Hurricane Limited
Year ended: 31 December 2014
Prepared by: A Manager

Characteristics of entity

- Hurricane Limited requires a normal statutory audit.
- The financial reporting framework is the International Financial Reporting Standards and there are no industry specific reporting requirements.
Hurricane Limited buys and then resells all types of fixtures and fittings for ships from yachts through to large cruise ships. The company has ten warehouses, seven of which are located near to branches of our audit firm.

Key dates

Key dates in the audit timetable are:

- Interim audit
- Final audit
- Meeting with audit committee
- Financial statements approved by management

Specific dates are to be confirmed.

Overview of audit approach

The shipping supply industry has grown by 7% during the last year. Hurricane Limited sales increase is 12% indicating that the company continues to perform well within the industry.

There have been no changes to the accounting policies of Hurricane Limited during the year.

This is the first year that International Standards on Auditing (ISAs) are relevant to this company. A detailed check will be required to ensure that no changes are required to the audit plan.

The overall audit approach will be to use tests of control where possible. However, the fall in gross profit indicates that sales may be understated or cost of sales (COS) overstated, so additional substantive procedures may be required in this area.

Materiality determination

Materiality will initially be set at \( \frac{1}{2} \) to 1% of revenue as this figure appears to be more accurate than gross profit.

Materiality on the statement of financial position will be based on net asset values.

Performance materiality will be set for specific areas.

Identification of risk areas with a higher risk of misstatement

A review of the draft financial statements for the company shows the following risks:
Sales have increased by 12% but COS by 19%. There is a risk of COS being overstated.

Inventory on the statement of financial position is down significantly on last year indicating that there may be valuation or quantity errors.

Trade receivables have increased by about 50%, significantly more than the increase in sales. This indicates that the company may have debt collection problems. Additional testing may be required on after date cash collections to check for bad debts.

Non-current assets have fallen by ₦900,000, which is significant given that most non-current assets are land and buildings. The reason for sale must be ascertained.

Non-current liabilities have also fallen by ₦1 million. While not necessarily linked to the fall in non-current assets, there is a possibility that non-current assets have been sold to pay off the liabilities.

**Audit approach – extent of control testing**

Audit testing will focus on the use of tests of controls where possible. However, changes have been made to the inventory system during the year, limiting the extent of testing of controls. Client systems have changed in the year with a new computerised inventory control system. Unfortunately, the change was not identified until audit planning started. Three actions are necessary in respect of this system:

Audit initial installation of the system including transfer of balances. One of the reasons for the low inventory value could be omission of inventory balances on transfer.

Test count inventory at the year end and agree to the computerised inventory records (and vice versa) to test their accuracy. Note that the client may not be counting inventory at the year-end but relying on the computerised system.

Test check bookings into and out of inventory from the purchases and sales systems.

**Other risk areas**

The client appears to be a going concern, although the fall in gross profit must be investigated. Cash and profit forecasts for the next 12 months must also be obtained to confirm ongoing profitability and that the fall in cash balances will not continue.
There is the possibility of related party transactions. One of the directors purchased a yacht during the year. Checks to be made to determine whether company products were purchased, and if so whether these were in the normal course of business.

A new letter of engagement is required in ISA format.

Assistance may be required on the inventory count; three warehouses are located away from our offices.

EXAMINER’S REPORT

Part (a) of the question tests students understanding of planning an Audit of financial statements while part (b) requires the candidates to prepare the audit strategy based on given financial information on a company.

About 50% of the candidates attempted the question. Candidates demonstrated a good understanding of the requirements of part (a) but performed poorly in part (b) because they exhibited poor knowledge.

Candidates should prepare well for the exams, cover the syllabus well and understand the requirements of a question before answering.

QUESTION 4

Rock holidays

(a) Internal audit function: risk of fraud and error

(i) The internal audit function in any entity is part of the overall corporate governance function of the entity.

(ii) A large part of the management of risks, and the proper exercise of stewardship, involves the maintenance of proper controls over the business, which include the effective operation of an internal audit function.

(iii) Internal audit can help management manage risks in relation to fraud and error and exercise proper stewardship by:

• commenting on the process used by management to identify and classify the specific fraud and error risks to which the entity is
subject (and in some cases helping management develop and implement that process);

- commenting on the appropriateness and effectiveness of actions taken by management to deal with the risks identified and in some cases helping management to develop appropriate actions by making recommendations;

- periodically auditing or reviewing systems or operations to determine whether the risks of fraud and error are being effectively managed;

- monitoring the incidence of fraud and error, investigating serious cases and making recommendations for appropriate management responses.

(iv) In practice, the work of internal audit often focuses on the adequacy and effectiveness of internal control procedures for the prevention, detection and reporting of fraud and error. Routine internal controls reviews are relevant.

(v) It should be recognised however that many significant frauds bypass normal internal control systems and that in the case of management fraud in particular, much higher level controls (those relating to the high level governance of the entity) need to be reviewed by internal audit in order to establish the nature of the risks and to manage them effectively.

(b) **External auditors: fraud and error in an audit of financial statements**

(i) External auditors are required by ISA 240 *The auditor's responsibilities relating to fraud in an audit of financial statements* to consider the risks of material misstatements in the financial statements due to fraud. Their audit procedures will then be based on risk assessment. Regardless of the risk assessment, auditors are required to be alert to the possibility of fraud throughout the audit and maintain an attitude of professional scepticism, notwithstanding the auditors' past experience of the honesty and integrity of management and those charged with governance. Members of the engagement team should discuss the susceptibility of the entity's financial statements to material misstatements due to fraud.

(ii) Auditors should make enquiries of management regarding management's assessment of fraud risk, its process for dealing with
risk and its communications with those charged with governance and employees. They should enquire of those charged with governance about the oversight process.

(iii) Auditors should also enquire of management and those charged with governance about any suspected or actual instance of fraud.

(iv) Auditors should consider fraud risk factors, unusual or unexpected relationships and assess the risk of misstatements due to fraud and identifying any significant risks. Auditors should evaluate the design of relevant internal controls and determine whether they have been implemented.

(v) Auditors should determine an overall response to the assessed risk of material misstatements due to fraud and develop appropriate audit procedures, including testing certain journal entries, reviewing estimates for bias and obtaining an understanding of the business rationale of significant transactions outside the normal course of business. Appropriate written representations should be obtained.

(vi) Auditors are only concerned with risks that might cause material error in the financial statements. External auditors might therefore pay less attention than internal auditors to small frauds and errors, although they must always consider whether evidence of single instances of fraud or error are indicative of more systematic problems.

(vii) It is accepted that because of the hidden nature of fraud, an audit properly conducted in accordance with ISAs might not detect a material misstatement in the financial statements arising from fraud. In practice, routine errors are much easier to detect than frauds.

(viii) Where auditors encounter suspicious or actual instances of fraud (or error), they must consider the effect on the financial statements, which will usually involve further investigations. They should also consider the need to report to management and those charged with governance.

(ix) Where serious frauds (or errors) are encountered, auditors need also to consider the effect on the going concern status of the entity, and the possible need to report externally to third parties, either in the public interest, for national security reasons, or for regulatory reasons. For example many entities in the financial services sector are subject to
this type of regulatory reporting and many countries have legislation relating to the reporting of money laundering activities, for example.

(x) A properly executed audit program stands the chance of detecting material misstatements arising from fraud.

(c) **Nature of risks arising from fraud and error: Rock Holidays**

(i) Rock Holidays is subject to all of the risks of error arising from the use of computer systems. If programmed controls do not operate properly, for example, the information produced may be incomplete or incorrect. Inadequate controls also give rise to the risk of fraud by those who understand the system and are able to manipulate it in order to hide the misappropriation of assets such as receipts from customers.

(ii) All networked systems are also subject to the risks of errors because of the possibility of the loss or corruption of data in transit. They are also subject to the risk of fraud where the transmission of data is not securely encrypted.

(iii) All entities that employ staff who handle company assets (such as receipts from customers) are subject to the risk that staff may make mistakes (error) or that they may misappropriate those assets (fraud) and then seek to hide the error or fraud by falsifying the records.

(iv) Rock Holidays is subject to problems arising from the risk of fraud perpetrated by customers using stolen credit or debit cards or even cash. Whilst credit card companies may be liable for such frauds, attempts to use stolen cards can cause considerable inconvenience including loss of goodwill.

(v) There is a risk of fraud perpetrated by senior management who might seek to lower the amount of money payable to the central fund (and the company's tax liability) by falsifying the company's sales figures, particularly if a large proportion of holidays are paid for in cash.

(vi) There is a risk that staff may seek to maximise the commission they are paid by entering false transactions into the computer system that are then reversed after the commission has been paid.
EXAMINER’S REPORT

The question tests candidates’ knowledge on risks relating to fraud and error to an entity. Over 80% of the candidates attempted the question but performance was generally poor. The candidates exhibited shallow knowledge of this area of the new syllabus. Candidates are advised to cover the new syllabus more effectively.

SECTION C

SOLUTION 5

Threats

(a) **Self Interest threat**

This is a threat which occurs when a firm or a member of an audit firm could benefit from a financial interest or other self-interest benefits from the client organisation.

The circumstances include:

(i) A direct or indirect financial interest in the client organisation

(ii) A loan or guarantee to or from the client organisation or its directors or officers

(iii) Close business relationship with the client company.

(iv) Undue dependence on the fees received from a client organisation.

(v) Contingent fees in relation to an assurance engagement.

(b) **Self Review threat**

This is a threat which occurs when a product or judgement on an audit engagement needs to be re-evaluated in order to reach conclusions on the engagement.

Circumstances include:

(i) A member of the audit team having recently been a director or officer of the client organisation.

(ii) A member of the audit team performing services for the client that directly affect the audit assignment.

(iii) Preparation of financial statements to be audited by the audit firm.
(c) **Advocacy threat**

This occurs when a firm or members of an audit team promotes or are perceived to promote, the position or opinion of a client such that objectivity is perceived to be compromised.

The circumstances include:

(i) Dealing in or promoting shares or other securities of a client organisation.

(ii) Acting as an advocate on behalf of a client in litigation.

(iii) Acting as an advocate on behalf of a client in resolving disputes with third parties.

(d) **Familiarity threat**

This is a threat which occurs when there is a close relationship or the possibility of a close relationship between the firm or members of the audit team and the client organisation.

The circumstances include:

(i) A member of the audit team having a close family member who is a director, or officer of the client organisation.

(ii) A former partner of the audit firm being a director or officer of the client organisation.

(iii) Acceptance of gifts or hospitality from the client organisation, its directors, officers or employers except it is immaterial.

(iv) Having a long personal relationship with the client.

(e) **Intimidation threat**

This occurs when a firm or members of an audit team are prevented from carrying out their duty with objectivity and due professionalism as a result of threats actual or perceived from the directors, officers or employees of the client organisation.

The circumstances include:

(i) Threat of replacement of the auditor over disagreement on application of accounting principles.

(ii) Pressure to reduce inappropriately the extent of work to be done.

(iii) Threat of reduction of fees.
(iv) Threat arising out of family, business or personal relationship.

EXAMINER’S REPORT

The question tests candidates’ knowledge of threats to independence of auditors. More than 90% of the candidates attempted the question and their performance was good.

SOLUTION 6

Partnerships

(a) **Reasons for the audit of partnership accounts**

The audit of partnership accounts

(i) provides a convenient and reliable means of settling accounts among the partners.

(ii) reduces the possibility of dispute among partners.

(iii) constitutes a reliable evidence for computing the amount due from the firm to a retiring or deceased partner.

(iv) facilitates admission of a new partner if a set of past audited accounts is available for examination.

(v) enables the partnership accounts to be relied upon by banks for advancing facilities (loan & overdraft).

(vi) to be generally accepted by the tax authority for computing the assessable income of each partner.

(vii) facilitates negotiation for sale or conversion of the firm to a limited liability company.

(viii) serves as moral deterrent and checks on the partners against fraudulent practices.

(b) The issues that the auditor would look into while auditing the books of a partnership include:

(i) **Confirmation of scope of audit**

The scope of the audit must be confirmed.
(ii) **Examination of partnership deed/articles of partnership**

Partnership deed must be examined to ascertain capital contribution, profit sharing ratios, powers and responsibilities of each partner of the firm, among other issues.

(iii) **Examination of minutes book**

Examine the minutes book to check for the policy decisions taken by the partners.

(iv) **Ascertaining the business of the partnership**

Verify that the business in which the firm is engaged is duly authorized and legally allowed by the articles of partnership.

(v) **Compliance with the provisions of Partnership Act**

Ascertain that relevant provisions of the Partnership Act, as applicable, are complied with.

(vi) Ascertain that profits are shared in the agreed ratio.

(vii) Confirm if professional indemnity insurance policy is in place.

(c) **Substantive audit tests for receipts in a school owned by a Partnership**

(i) Check the fees received on account of admission and compare them with admission forms.

(ii) Check the names entered in the students’ attendance register to ascertain the total number of students enrolled. This should then be compared with students’ fee register to verify the amount of fees charged and received.

(iii) Ascertain the system of recovery of fines and penalty imposed on account of late payments, if applicable.

(iv) Confirm that all hostel dues have been paid by students.

(v) Vouch the rental income or interest/dividend income from investments held by the school.

(vi) Check grants received from government or donations received from donors, if any.

(vii) Check for other incomes received by the school.

(viii) Verify that the school operates a system of internal check which ensures that bills for fees are properly raised.
(ix) Check fees received by comparing it with the counterfoil of receipts and pay-in-slips through to the bank statements.

(x) Ensure that the person receiving cash is not responsible for entries in the cash book and other records.

(xi) Where payments are made directly into the bank, check the bank reconciliation statements prepared to ensure completeness in accounting for receipts.

(xii) Review the control systems on enrolment and recordings of tuition income.

(xiii) Confirm if fidelity insurance policy is in place.

EXAMINER’S REPORT

The question tests candidates’ knowledge on non-statutory audit. Over 90% of the candidates attempted the question and the performance was good.

SOLUTION 7

(a) The Audit Process

(i) **Vouching Audit** - This is an audit approach which involves complete examination of the transactions of the business together with the documentary evidence of sufficient validity to satisfy the auditor that the transactions are in order, properly authorized and accurately recorded. The auditor traces the transactions to their sources in order to ascertain their full origins and meanings.

(ii) **Systems-Based Audit** - This involves the evaluation of the systems of internal control in the organization. It is a system to determine what reliance can be placed on the established controls to ensure that resources are being managed effectively and financial information provided accurately especially for reporting purposes. Additionally, a system based audit is an audit of the internal controls in a system.

Two procedures may be adopted in a system audit:

- Compliance tests which seek evidence that a good and reliable system of control as established in the organization is being maintained.
- Substantive tests are designed to ensure that the system of controls that have been established continue to operate at all times confirming the validity, completeness and accuracy of recorded transactions.

The essence is to determine whether especially, because of the volume of transactions, the sample of the population selected for testing is representative of the whole population for the purpose of expression of opinion thereof.

iii. **Risk Based Audit** - This is a distinct development of audit techniques that are responsive to risk factors in an audit. The auditor determines, by applying judgment, what levels of risks pertain to different areas of the client systems and designs appropriate audit tests. Emphasis of the audit work is directed at areas in which the financial statements are mostly likely to be misstated materially. In effect, audit costs are likely reduced. The risk that the auditor will give inappropriate opinion is also reduced.

(b) Instances where vouching and systems audits are still applicable.

Vouching audit is useful in:

(i) Very small organizations with few transactions.

(ii) Organisations where the systems of internal control is weak or nonexistent.

(iii) Specialised audits which require investigations such as those of trust, estate, church, mosque, charity etc.

(iv) Checking of non-recurring, material, unusual and extraordinary items.

(v) When the auditor is put on enquiry.

Systems Audit is useful in the following areas:

(i) Tests seeking evidence that the internal controls are being applied as prescribed. These are called compliance tests.

(ii) Once the compliance tests have been completed, further tests may be required to substantiate the entries in the figures in accounts and the evaluation of financial information by a study of plausible relationship among both financial and non-financial data.

(iii) When an auditor investigates a system by identifying the control objectives of the system and evaluating the system’s internal control
on paper, the auditor should determine whether the internal controls that currently exist appear to be adequate.

EXAMINER’S REPORT

The question tests the evolution of the audit process. Less than 50% of the candidates attempted the question and performance was very poor. Candidates apparently did not prepare well for examinations and this was reflected in their answers.

The commonest pitfall was that candidates could not identify areas where vouching and systems audit are still applicable.

Candidates should read relevant literature, including study packs and ICAN pathfinders.
Eboda State is one of the 30 States in Olakoma Federation. The Federation has a population of 120 million people with 700 Local Government Councils and a Land Mass of 300,000 Sq kilometres.

Eboda State has a population of 12 million, 25 Local Government Councils and Land Mass of 30,000 Sq kilometres.

The following transactions took place in the Office of the Accountant-General of Olakoma Federation during the year ended 31 December, 2013.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil sale</td>
<td>₦350,000</td>
</tr>
<tr>
<td>Domestic oil receipts</td>
<td>₦445,000</td>
</tr>
<tr>
<td>Miscellaneous oil receipts</td>
<td>₦105,000</td>
</tr>
<tr>
<td>Royalty on crude oil</td>
<td>₦101,000</td>
</tr>
<tr>
<td>Royalty on gas</td>
<td>₦95,000</td>
</tr>
<tr>
<td>Rentals on oil field</td>
<td>₦87,000</td>
</tr>
<tr>
<td>Gas flared penalty</td>
<td>₦77,000</td>
</tr>
<tr>
<td>Petroleum profit tax</td>
<td>₦650,000</td>
</tr>
<tr>
<td>Companies income tax</td>
<td>₦500,000</td>
</tr>
<tr>
<td>Other non oil taxes</td>
<td>₦225,000</td>
</tr>
<tr>
<td>Import duties</td>
<td>₦255,000</td>
</tr>
<tr>
<td>Export duties</td>
<td>₦125,000</td>
</tr>
<tr>
<td>Excise duties</td>
<td>₦320,000</td>
</tr>
<tr>
<td>Custom penalty charge</td>
<td>₦115,000</td>
</tr>
<tr>
<td>Custom fees account</td>
<td>₦120,000</td>
</tr>
<tr>
<td>Common external tariff levy</td>
<td>₦100,000</td>
</tr>
<tr>
<td>Court fees</td>
<td>₦30,000</td>
</tr>
<tr>
<td>PAYE of armed forces</td>
<td>₦55,000</td>
</tr>
</tbody>
</table>
7% Port levy
Value Added Tax (VAT)

i. The Olakoma Customs Service is entitled to 7% cost of collection on all revenues collected while the Federal Inland Revenue Service is entitled to 4% of Non-oil revenue.

ii. The sharing formula for the Federation Account and VAT is stated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Federation Account</th>
<th>VAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal government</td>
<td>52.68%</td>
<td>15%</td>
</tr>
<tr>
<td>State governments</td>
<td>26.72%</td>
<td>50%</td>
</tr>
<tr>
<td>Local governments</td>
<td>20.60%</td>
<td>35%</td>
</tr>
</tbody>
</table>

iii. 13% Derivation is paid to Oil producing states and is based on oil and gas related income.

iv. The sharing ratio in (ii) above is based on the following criteria:

<table>
<thead>
<tr>
<th></th>
<th>State Government</th>
<th>Local Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>Population</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Land mass</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Internally generated revenue effort</td>
<td>10%</td>
<td>10%</td>
</tr>
</tbody>
</table>

v. The total internally generated revenue effort of the 30 States and 700 Local Government Councils amounted to N500 Billion and N300 Billion, respectively.

vi. The total internally generated revenue effort of the Eboda State and 25 Local Governments amounted to N50 billion and N20 billion, respectively Eboda State is not one of the oil producing States.

vii. All revenues due to all Local Governments in each State is paid to the State Joint Local Government Account. This account is entitled to 10% of the Internally Generated Revenue (IGR) of the State.

**Required:**

a. State the differences between **Federation** Account and **Consolidated** Revenue Account. (4 Marks)
b. **Calculate:**

i. Olakoma Custom Service cost of collection. (3 Marks)

ii. Federal Inland Revenue Service cost of collection. (2 Marks)

iii. 13% derivation paid to oil producing states. (3 Marks)

c. **Calculate the amount to be credited to:**

i. Consolidated Revenue Fund of Olakoma Federal Government. (6 Marks)

ii. Eboda State Consolidated Revenue Fund Account. (6 Marks)

iii. State Joint Local Government Account. (6 Marks)

*(Show workings)* (Total 30 Marks)

SECTION B: **ATTEMPT TWO OUT OF THREE QUESTIONS** (40 MARKS)

**QUESTION 2**

In all Government units, the executive arm prepares the budget and submits same to the legislative arm for review, modifications and approval. The approved budget serves as a basis for the activities of that government unit for the fiscal year under focus.

**Required:**

a. Explain any **TWO** main purposes which a government budget serves. (2 Marks)

b. Explain any **THREE** basic features of each of the following budget concepts.

i. Performance budgeting. (6 Marks)

ii. Zero-based budgeting. (6 Marks)

c. Nigeria is said to be low in budget implementation, Discuss any **THREE** key factors that negate efficient and effective budget implementation in the Nigerian public sector. (6 Marks)

*(Total 20 Marks)*
QUESTION 3

Fraud is described as an intentional act involving deception to obtain an unjust or illegal advantage. It involves the presentation of a statement or representation made recklessly or without the belief in the truth or suppression of facts.

The Economic and Financial Crime Commission (EFCC) is a criminal investigation organisation in charge of investigating financial crimes involving politicians, economic saboteurs and electoral fraudsters. EFCC’s “modus operandi” is such that any suspect or ‘accused’ must deposit all his money and other belongings with the exhibit section headed by Mr. Oripipe a cashier, who is expected to pay all cash receipts collected by him to the Banking officer. The banking officer issues a revenue receipt to the Cashier.

Mrs. Innocent who is the resident auditor in charge of the organisation conducted a physical cash survey and discovered that the total amount on the duplicate receipt book with the banking officer is N4,550,000 which does not agree with the actual cash paid in. It was therefore suspected that the organisation has been defrauded.

The following information relate to the deposits collected from January to December 2013:

i. Cash from Honourable Talaka. 12,500
ii. Cash from a container with five suite cases each containing. 250,000
iii. Cash recovered from Anine; a criminal that raided Ifako bank 4,000,000
iv. Cash sales of impounded lace. 425,000
v. FIVE boxes containing consumable items earlier disposed of for the sum of N16,000 was mistakenly kept in Mr. Oripipe’s drawer and was later discovered by the auditor.
vi. On thorough investigation, it was discovered that the banking officer was illegally removing the sum of N500 from every N2,500 paid to him by the cashier.

Required:

a. Explain briefly FOUR types of financial fraud. (4 Marks)

b. Prepare the correct statement of deposits from detainees, as it should be in

SKILLS EXAMINATION – NOVEMBER 2014
Mr. Oripipe’s records and identify the shortfall due to his negligence. (10 Marks)

c. Calculate the amount of cash lost by the government as a result of the fraud based on the Auditor’s findings. (3 Marks)

d. As the Chief Accountant, state THREE measures you would put in place to reduce or eliminate this type of financial fraud? (3 Marks)

(Total 20 Marks)

QUESTION 4

The General National Communication Commission (GNCC) is the sub-regulatory body in the Communications industry. It is mandatory for the Board of GNCC to submit its Report/Financial statements to the Ministry of Communication before publication in accordance with IPSAS 14 (Events after the reporting date). The events occurring after the reporting date could be favourable and /or unfavourable.

You are required to:

a. Distinguish between the reporting date and authorisation date of the financial statements giving examples. (4 Marks)

b. Explain briefly the differences between Adjusting and Non-Adjusting events after the reporting date giving TWO examples of each. (8 Marks)

c. Identify the events (occurring after the reporting date) in the following situations and explain briefly the treatment of each:

i. General National Communication Commission carries its inventories at the lower of cost and net realizable value. At 31 December 2013, the cost of inventory determined under the First in, First out (FIFO) method as reported in its financial statement for the year ended was ₦5million. Due to severe recession and the negative economic trends, the inventory could not be sold in January 2014. On 10 February GNCC entered into agreement to sell the entire inventory for ₦3 million. (2 Marks)

ii. The statutory audit of GNCC for the year ended 31 December 2012 was completed on 28 February, 2013. The Financial Statement was signed by the Chief Executive Officer on 8 March, 2013 and approved on 10 April, 2013. The following events have since occurred:
A special equipment costing ₦605,000 purchased on 1 September, 2012 was destroyed by fire on 31 December, 2012. GNCC had booked a receivable of ₦508,000 from the insurance company in respect of this claim. On completion of investigation by the insurance company, it was discovered that the fire broke out due to negligence on the part of a machine operator. Consequently, the insurance company repudiated liability. (4 Marks)

iii. A debtor owing ₦900,000 filed for bankruptcy on January 15, 2013. The financial statements had included an allowance for doubtful debts relating to this debtor for ₦60,000 only. (2 Marks)

(Total 20 Marks)

SECTION C: ATTEMPT TWO OUT OF THREE QUESTIONS (30 MARKS)

QUESTION 5

“The need for governmental intervention in the economy is justified on the basis of market failure and public goods provision”.

Required:

a. Explain the concept of market failure and public goods. (5 Marks)
b. What conclusions can you draw from the foregoing statement in the context of a developing nation like Nigeria? (10 Marks)

(Total 15 Marks)

QUESTION 6

Nigeria has contracted a number of debts obligations from both domestic and external sources.

a. What comparisons can you make between domestic and external public debts? (9 Marks)
b. Formulate a debt restructuring method as a strategy for debts management in Nigeria. (6 Marks)

(Total 15 Marks)
QUESTION 7

a. Mr. Make-No-Mistake has ₦200,000 which he decides to invest if he can secure an assurance that the investment will earn at least 10% p.a. He is considering three projects:

Project A: will earn ₦218,000 at the end of the 1st year.
Project B: will earn ₦250,000 at the end of the 2nd year and
Project C: will earn ₦140,000 at the end of 1st year and another ₦100,000 at the end of 2nd year.

If none of the projects is undertaken, Mr. Make-No-Mistake will invest his ₦200,000 in something else that will earn him 10% p.a.

You are required to assess and advise Mr. Make-No-Mistake on which of the projects he should undertake.  (12 Marks)

b. Identify THREE main features of Cost-Benefit-Analysis in public project appraisal.  (3 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. The Federation Account is one into which shall be paid all revenue collected by the Government of the federation, except the proceeds from PAYE of the personnel of the Armed Forces of the Federation, Olakoma Police Force, Foreign Service Officers and Residents of the Olakoma Federal Capital Territory. The Federation Account is a distributable pool account from which allocations are made to the Federal, State and Local Governments on such terms and in a manner prescribed by the law. Currently, the figure in the pool is distributed, using the revenue allocation formulas over the years.

The Consolidated Revenue Fund (CRF) was established by a Section of the Constitution of the Federal Republic of Olakoma. Except those revenue items which are specifically designated to other funds, all others shall be paid into the Consolidated Revenue Fund e.g. PAYE of the Officers of the Armed Forces, Police, Foreign Affairs, and Resident of Olakoma Federal Capital Territory.
### b. Olakoma Custom Service Cost of Collection

<table>
<thead>
<tr>
<th></th>
<th>₦’million</th>
<th>₦’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import Duties</td>
<td>255,000</td>
<td></td>
</tr>
<tr>
<td>Export Duties</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td>Excise Duties</td>
<td>320,000</td>
<td></td>
</tr>
<tr>
<td>Custom Penalty Charge</td>
<td>115,000</td>
<td></td>
</tr>
<tr>
<td>Common External Tariff Levy</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Custom Fees Account</td>
<td>120,000</td>
<td></td>
</tr>
<tr>
<td>Federation Revenue</td>
<td>1,035,000</td>
<td></td>
</tr>
<tr>
<td>7% Port Levy</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,060,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

\[
\text{7\%} \times \text{₦1,035,000m}\quad 72,450
\]
\[
\text{7\%} \times \text{₦25,000m}\quad 1,750
\]

**Total Cost of Collection** 74,200

### ii. Federal Inland Revenue Service Cost of Collection

<table>
<thead>
<tr>
<th></th>
<th>₦’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies Income Tax</td>
<td>500,000</td>
</tr>
<tr>
<td>Other Non-Oil Taxes</td>
<td>225,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>725,000</strong></td>
</tr>
<tr>
<td>Value Added Tax</td>
<td>700,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,425,000</strong></td>
</tr>
</tbody>
</table>

\[
4\% \times \text{₦725,000m}\quad 29,000
\]
\[
4\% \times \text{₦700,000m}\quad 28,000
\]

**Total Cost of Collection** 57,000

### iii. 13% Derivation paid to Oil Producing States

<table>
<thead>
<tr>
<th></th>
<th>₦’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude Oil Sales</td>
<td>350,000</td>
</tr>
<tr>
<td>Domestic Crude Oil Receipts</td>
<td>445,000</td>
</tr>
<tr>
<td>Miscellaneous Oil Receipts</td>
<td>105,000</td>
</tr>
<tr>
<td>Royalty on Crude Oil</td>
<td>101,000</td>
</tr>
<tr>
<td>Royalty on Gas</td>
<td>95,000</td>
</tr>
<tr>
<td>Rentals on Oil Field</td>
<td>87,000</td>
</tr>
<tr>
<td>Gas Flared Penalty</td>
<td>77,000</td>
</tr>
<tr>
<td>Petroleum Profit Tax</td>
<td>650,000</td>
</tr>
</tbody>
</table>
13% x N1,910,000m

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>248,300,000</td>
</tr>
</tbody>
</table>

c. Calculation of amount to be credited to:

i. Consolidated Revenue Fund of Okokoma Federal Government

<table>
<thead>
<tr>
<th></th>
<th>N‘million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federation Account (W1)</td>
<td>1,749,107.70</td>
</tr>
<tr>
<td>Value Added Tax Account (W2)</td>
<td>100,800.00</td>
</tr>
<tr>
<td>Court fees</td>
<td>30,000.00</td>
</tr>
<tr>
<td>PAYE of Armed forces</td>
<td>55,000.00</td>
</tr>
<tr>
<td>Total</td>
<td>1,934,907.70</td>
</tr>
</tbody>
</table>

Workings 1

Federation Account for the year ended 31 December 2013

<table>
<thead>
<tr>
<th></th>
<th>N‘million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>350,000</td>
</tr>
<tr>
<td>Crude Oil Sale</td>
<td>445,000</td>
</tr>
<tr>
<td>Domestic Crude Oil Receipts</td>
<td>105,000</td>
</tr>
<tr>
<td>Royalty on Crude Oil</td>
<td>101,000</td>
</tr>
<tr>
<td>Royalty on Gas</td>
<td>95,000</td>
</tr>
<tr>
<td>Rentals on Oil Field</td>
<td>87,000</td>
</tr>
<tr>
<td>Gas Flared Penalty</td>
<td>77,000</td>
</tr>
<tr>
<td>Petroleum Profit Tax</td>
<td>650,000</td>
</tr>
<tr>
<td>Companies Income Tax</td>
<td>500,000</td>
</tr>
<tr>
<td>Other Non Oil Taxes</td>
<td>225,000</td>
</tr>
<tr>
<td>Import Duties</td>
<td>255,000</td>
</tr>
<tr>
<td>Export Duties</td>
<td>125,000</td>
</tr>
<tr>
<td>Excise Duties</td>
<td>320,000</td>
</tr>
<tr>
<td>Custom Penalty Charge</td>
<td>115,000</td>
</tr>
<tr>
<td>Common External Tariff Levy</td>
<td>100,000</td>
</tr>
<tr>
<td>Custom Fee Account</td>
<td>120,000</td>
</tr>
<tr>
<td>Total</td>
<td>3,670,000</td>
</tr>
</tbody>
</table>
### Less:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Collection</td>
<td></td>
</tr>
<tr>
<td><strong>Nigeria Custom Service</strong></td>
<td>72,450</td>
</tr>
<tr>
<td><strong>Federal Inland Revenue Service</strong></td>
<td>29,000</td>
</tr>
<tr>
<td><strong>13% Derivation paid to Oil Producing States</strong></td>
<td>248,300</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>349,750</td>
</tr>
</tbody>
</table>

**Net Total for Distribution**: 3,320,250

### Sharing

<table>
<thead>
<tr>
<th>Description</th>
<th>%</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Government</td>
<td>52.68</td>
<td>1,749,107.70</td>
</tr>
<tr>
<td>State Governments</td>
<td>26.72</td>
<td>887,170.80</td>
</tr>
<tr>
<td>Local Government</td>
<td>20.60</td>
<td>683,971.50</td>
</tr>
<tr>
<td><strong>Total Distribution</strong></td>
<td></td>
<td>3,320,250.00</td>
</tr>
</tbody>
</table>

### Workings 2

**Value Added Tax Account for the year ended 31 December, 2013**

<table>
<thead>
<tr>
<th>Revenue</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value Added Tax Collected</td>
<td>700,000</td>
</tr>
<tr>
<td>Less: Cost of Collection (FIRS)</td>
<td>28,000</td>
</tr>
<tr>
<td>Net Total for Distribution</td>
<td>672,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sharing</th>
<th>%</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Government</td>
<td>15.00</td>
<td>100,800</td>
</tr>
<tr>
<td>State Governments</td>
<td>50.00</td>
<td>336,000</td>
</tr>
<tr>
<td>Local Government</td>
<td>35.00</td>
<td>235,200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>672,000</td>
</tr>
</tbody>
</table>

(ii) **Eboda State Consolidated Revenue Account**

<table>
<thead>
<tr>
<th>Sharing</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federation Account (W3)</td>
<td>65,059,192.00</td>
</tr>
<tr>
<td>Value Added Tax Account (W4)</td>
<td>24,640,000.00</td>
</tr>
<tr>
<td>Internal Generated Revenue</td>
<td>50,000,000.00</td>
</tr>
</tbody>
</table>
### Workings 3

<table>
<thead>
<tr>
<th>Federation Account</th>
<th>Eboda State</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equality</td>
<td>( \frac{40% \times N887,170,800}{30} )</td>
<td>11,828,944.00</td>
</tr>
<tr>
<td>Population</td>
<td>( \frac{30% \times N887,170,800 \times \left( \frac{12}{120} \right)}{30} )</td>
<td>26,615,124.00</td>
</tr>
<tr>
<td>Landmass</td>
<td>( \frac{20% \times N887,170,800 \times \left( \frac{30}{300} \right)}{30} )</td>
<td>17,743,416.00</td>
</tr>
<tr>
<td>Internally Generated Revenue</td>
<td>( \frac{10% \times N887,170,800 \times \left( \frac{50}{500} \right)}{30} )</td>
<td>8,871,708.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>65,059,192.00</strong></td>
</tr>
</tbody>
</table>

### Workings 4

<table>
<thead>
<tr>
<th>Value Added Tax</th>
<th>Eboda State</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equality</td>
<td>( \frac{40% \times N336,000,000}{30} )</td>
<td>4,480,000.00</td>
</tr>
<tr>
<td>Population</td>
<td>( \frac{30% \times N336,000,000 \times \left( \frac{12}{120} \right)}{30} )</td>
<td>10,080,000.00</td>
</tr>
<tr>
<td>Landmass</td>
<td>( \frac{20% \times N336,000,000 \times \left( \frac{30}{300} \right)}{30} )</td>
<td>6,720,000.00</td>
</tr>
<tr>
<td>Internally Generated Revenue</td>
<td>( \frac{10% \times N336,000,000 \times \left( \frac{50}{500} \right)}{30} )</td>
<td>3,360,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>24,640,000.00</strong></td>
</tr>
</tbody>
</table>

iii. **State Joint and Local Government Account**

<table>
<thead>
<tr>
<th></th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federation Account (W5)</td>
<td>39,149,225.86</td>
</tr>
<tr>
<td>Value Added Tax Account (W6)</td>
<td>13,462,400.00</td>
</tr>
<tr>
<td>Internally Generated Revenue (W7)</td>
<td>5,000,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53,611,625.86</strong></td>
</tr>
</tbody>
</table>

### Workings 5

<table>
<thead>
<tr>
<th>Federation Account</th>
<th>State Joint and Local Government Account</th>
<th>N’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equality</td>
<td>( \frac{40% \times N683,971,500}{700} )</td>
<td>390,840.86</td>
</tr>
<tr>
<td>Population</td>
<td>( \frac{30% \times N683,971,500 \times \left( \frac{12}{120} \right)}{700} )</td>
<td>20,519,145.00</td>
</tr>
<tr>
<td>Landmass</td>
<td>( \frac{20% \times N683,971,500 \times \left( \frac{30}{300} \right)}{700} )</td>
<td>13,679,430.00</td>
</tr>
<tr>
<td>Internally Generated Revenue</td>
<td>( \frac{10% \times N683,971,500 \times \left( \frac{50}{500} \right)}{700} )</td>
<td>4,559,810.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>39,149,225.86</strong></td>
</tr>
</tbody>
</table>
Working 6

<table>
<thead>
<tr>
<th>Value Added Tax Account</th>
<th>State Joint and Local Government Account</th>
<th>₦’million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equality</td>
<td>40% x ₦235,200,000/700</td>
<td>134,400.00</td>
</tr>
<tr>
<td>Population</td>
<td>30% x ₦235,200,000 x (12/120)</td>
<td>7,056,000.00</td>
</tr>
<tr>
<td>Landmass</td>
<td>20% x ₦235,200,000 x (30/300)</td>
<td>4,704,000.00</td>
</tr>
<tr>
<td>Internally Generated Revenue</td>
<td>10% x ₦235,200,000 x (20/300)</td>
<td>1,568,000.00</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td><strong>13,462,400.00</strong></td>
</tr>
</tbody>
</table>

Working 7

10% x ₦50,000,000,000 = ₦5,000,000,000

EXAMINER’S REPORT

The question tests candidates’ understanding of Federation Account and Consolidated Revenue Fund. Candidates are expected to recognize the sources of revenue that make up Federation Account, Consolidated Revenue Fund and also to calculate the cost of Revenue collection by Customs, Federal Inland Revenue Service as well as the amount of derivation to be shared by the oil producing states.

All the candidates attempted the question but performance was below average. The commonest pitfall was the inability of the candidates to differentiate the various components of Federation Account and Consolidate Revenue Fund.

Candidates are advised to have a sound knowledge of pure government account as it relates to Federation Account and Consolidated Revenue Fund.
SECTION B

SOLUTION 2

(a) The main purposes which a government budget serve include:

i. It highlights government’s policies which are designed to promote economic growth, full employment and enhance the quality of life of the citizenry.

ii. It is a useful guide for the allocation of available resources.

iii. The executive arm uses the budget as a means of accountability for the money earlier entrusted and the appropriation of money newly approved; through the legislature.

iv. The budget stands as the request of the Executive arm of government to the legislature to collect revenue and disburse it.

b. i. **Performance Budgeting:**

Performance budgeting is defined as a technique used for presenting public expenditure in form of functions or projects to be undertaken, highlighting the cost implications. The anticipated costs are compared with the expected income. The focus of the technique is on results and output achieved rather than how much has been expended. The essentials features of performance budgeting are:

- Classification of budgets in terms of performance and activities.
- Measurement of work done or output provided by each activity.
- Expression of budget in a way which allows direct comparison between a project cost and the anticipated income or benefits.
- Monitoring of actual cost and performance against the budgeted results or expectation.

ii. **Zero-Based Budgeting**

- This is a management effort which provides for systematic consideration of all activities and programmes.
- The technique requires every item of expenditure to be justified as if the particular activity or programme is taking off for the first time.
- It is the preparation of operating budgets from a “zero-base” of expenditure cost.

- Under the technique, resources are not necessarily allocated in accordance with the previous patterns.

- Each item of expenditure proposed has to be annually rejustified.

- Zero-based budgeting involves the use of decision package approach, based on the identification of activities which may be classified into the following five based events:

  - Identification of decision units and formulating operational plans. The entire Ministry or Parastatals is divided into smaller components called decision units.

  - Analysing the whole budget into decision packages; based on the “decision units”, to which costs are assigned and to the alternative ways of executing the same operation.

  - Ranking in priority the “decision packages” covering the activities, both new and existing in a competitive manner.

  - Determination of the “cut-off” point to choose the package, which can be included and those to be rejected.

  - Prioritisation of the packages to highlight the ones which fit in with the available resources.

c. The key factors which militate against efficient and effective budget implementation in the public sector are as follows:

   i. **Human Element:**

   Top Management members see budgeting as restraining and challenging. They tend to develop a lot of apathy towards its adoption and implementation.

   ii. **Uncertainties Underlying Data Inputs:**

   There is a lot of uncertainties in the data used for the budget preparation. Lack of efficient data base hamstrings reliable forecasts.
iii. **The type of project for which budget is prepared:**

How successful a project will be depend on the type of project to which it relates.

iv. **The problem of Inflation**

Inflation tends to reduce the purchasing power of money. When the value of money is falling, budget implementation may run into problems.

v. **Political, Social and Cultural Elements**

Each segment of the Nation has its own cultural beliefs and taboos which may take time to change. Introducing innovation may be met with stiff opposition.

vi. **Changing Government Policies**

To implement a budget, a lot depends on the policy of Government. For effective budget implementation, government policies have to be harmonised and consistent.

vii. **The problem of Debt Management and Optimal Use of Limited Resources**

There is the challenge of striking a balance between what proportion the nation’s resources should be used for servicing debts and the amount that should be utilised for economic development.

viii. **Fiscal Indiscipline**

Most spending officers are budget maximisers. Under the incremental budgeting system, they tend to expend the last Naira available in a year’s budget in order to justify the demand for increased allocation in the subsequent year, with little or nothing to show under the current dispensation.

ix. **External Factors**

Global economic outlook may affect effective budget implementation in Nigeria and in the cases of oil glut, war and unrest situation in other countries of the world.
Delay in Fund Release

The Federal Government’s budget is the lifeline of the economy. Delay in fund release will pose negative effect on Government spending on contractors, import bills, wages and allowances with delayed multiplier effects across the section.

EXAMINER’S REPORT

The question is all about budget, budget preparation and implementation. The requirements of the question involve explanation of the purposes of budgeting, approaches to budgeting and problems of budget implementation in Nigeria.

Majority of the candidates attempted the question while the general performance was below average. The candidates were able to identify and explain the purposes of government budget as well as the problems of budget implementation in Nigeria.

However, just a few of them demonstrated good understanding of the concepts: performance budgeting and zero-based budgeting, which accounted for 60% of the total marks and hence the poor performance in the question.

Candidates are advised to have a good grasp of the basic features of performance budgeting and zero-based budgeting. The Pathfinder and Study Pack of the Institute are relevant learning materials on this aspect of the syllabus.

SOLUTION 3

Types of fraud can be classified as follows:

(a)i. Stealing and pilfering of money or goods. Removing some notes out of a wrapper of money and keeping the rest as full packs. Taking government property home for personal use. It also includes diversion of Government supply to another area other than the store.

ii. Fictitious Transactions: Payment to fictitious creditors e.g. ghost workers or ghost suppliers. Issue of non-existent discounts.
iii. Subversion of facts e.g. failure to collect Government revenue, non-recovery of advances, non-posting of ledgers, keeping cash in transit for long period. Failure to prepare bank reconciliation, failure to retire an Advance, Contract Splitting to break expenditure limit.

iv. Teeming and Lading: This is a method by which the deficiencies of cash are concealed for some time. When cash is received from a debtor, the credit is delayed until cash is received from another debtor and now used to update the first debtor’s account.

v. Embezzlement: e.g. Diversion of Government fund into personal use, payment for jobs not executed.

vi. Inflation of prices e.g. supply of inferior materials, over-payment of salaries and allowances to staff, unauthorised variation of contracts or procurement costs.

vii. Mismanagement of funds e.g. use of virement without approval from National Assembly and execution of white elephant projects to the detriment of other viable and important projects.

(b) Revenue Collection Statement

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Cash from Honourable Talaka</td>
<td>12,500</td>
</tr>
<tr>
<td>ii. Cash from 5 Suitcases @ ₦250,000 each</td>
<td>1,250,000</td>
</tr>
<tr>
<td>iii. Cash recovered from Anine</td>
<td>4,000,000</td>
</tr>
<tr>
<td>iv. Cash-sales of impounded lace</td>
<td>425,000</td>
</tr>
<tr>
<td>v. Cash found in Accountant’s Drawer</td>
<td>16,000</td>
</tr>
<tr>
<td></td>
<td>5,703,500</td>
</tr>
<tr>
<td>Amount on Duplicate Rec Book</td>
<td>4,550,000</td>
</tr>
<tr>
<td>Shortage from collections</td>
<td>1,153,500</td>
</tr>
</tbody>
</table>

C. Cash Lost by Government

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Shortage from collections</td>
<td>1,153,500</td>
</tr>
<tr>
<td>ii. Pilfering by banking officer</td>
<td>4,550,000 x ₦500</td>
</tr>
</tbody>
</table>
d. Methods of reducing financial frauds:
   
i. Spot check by Internal Auditor
   
ii. Timely preparation of Bank Reconciliation Statement
   
iii. Periodic Audit
   
iv. Division of Key Duties
   
v. Job Rotation

EXAMINER’S REPORT

The question tests candidates’ understanding of internal control and its challenges. Candidates are expected to raise the following points: types of fraud and ability to discover them, and measures to curb such fraud and other irregularities.

Candidates demonstrated a fair understanding of the question and the performance was average. Candidates’ commonest pitfalls included inability to appreciate types of fraud from a wider perspective and how to curb them.

Candidates are advised to have indepth knowledge of types of fraud and types of internal control to be set up to curb them.

SOLUTION 4

a. Reporting date and Authorisation date of financial statement

The Reporting date is the last day of the reporting period to which the Financial Statements relate. The date of authorization for issue is the date on which the Financial Statements have received approval from the individual or body with the authority to finalise those statements for issue.

The audit opinion is provided on those Financial Statements.

It is to be noted that the process in preparing and authorising the Financial Statements for issue may vary for different types of entities within and across
jurisdiction. It can depend upon the nature of the entity, the governing body structure, the statutory requirements relating to that entity and the procedures followed in preparing and finalizing the Financial Statements.

For example, where the accounting period of an entity is January-December 31st and the preparation of Financial Statement was completed on March 19th of the following year. The date when the Board approved them and authorised them for issue is the authorization date.

b. **Differences between “Adjusting” and “Non-Adjusting” events after reporting date.**

In the period between the reporting date and date of authorization for issue, government officials may announce a government’s intentions in relation to certain matters. Whether or not these announced government intentions would require recognition as adjusting events, would depend upon whether they provide more information about the conditions existing at reporting date and whether there is sufficient evidence that they can and will be fulfilled. In most cases, the announcement of government intention will not lead to the recognition of adjusting event. Instead, they would generally qualify for disclosure.

An entity should adjust the amounts recognised in its Financial Statements to reflect adjusting events after the reporting date. But an entity should not adjust the amounts recognised in its Financial Statements to reflect non-adjusting events after the reporting date. However, where non-adjusting events after the reporting date are of such importance that no disclosure would affect the ability of the users of the Financial Statements to make proper evaluations and decisions, an entity would disclose the following information:

i. The nature of the event

ii. An estimate of its financial effect or a statement that such an estimate cannot be made.

Examples of Adjusting events include:

- The receipt of an information about impairment of an asset after the reporting date.
- The sale of inventories after the reporting date may give evidence about their net realizable value of the reporting date.
- The determination after the reporting date of performance bonus payments to be made to staff, if the entity had a present legal or construction obligation at the reporting date to make such payments as a results of events before that date.
- The determination after the reporting date of the amount of revenue collected during the reporting period to be shared with another government under a revenue sharing agreement in place.
- The resolution after the reporting date of a court case which, because it confirms that an entity already had a present obligation at the reporting date requires the entity to adjust a provision already recognised.
- The discovery of fraud or errors that show that Financial Statements were incorrect.

Examples of non-adjusting events after the reporting date that non-disclosure would affect the ability of the users of the Financial Statements to make proper evaluation and decisions include:

- An acquisition or disposal of a major controlled entity or the outsourcing of all or substantially all of the activities currently undertaken by an entity after the reporting date.
- The entity decides after the reporting date to provide/distribute substantial additional benefits in the future directly or indirectly to participants in community service programmes that it operates, and those additional benefits have a major impact on the entity.
- An unusually large decline in the value of property carried at fair value, where the decline is unrelated to the condition of the property at the reporting date but is due to circumstances that have arisen since reporting date:
  - The destruction of a major building by fire after the reporting date.
  - The introduction of legislation to forgive loans made to entities and individuals.
  - Major purchases and disposal of assets and abnormally large changes after the reporting date in asset prices due to foreign exchange rate fluctuation.
  - Changes in tax rates or tax laws enacted or announced after the reporting date.
c.(i) There was an economic recession which occurred during the reporting period that delayed the inventories sale to February 10, 2014. The inventories should be adjusted to ₦3 million in the report and the ₦2 million loss should be written-off in the financial year ended 31 December 2013.

ii. **Specialised equipment**

This is an adjusting event, because it relates to an asset that was recognised at the end of the reporting period. However, as the insurance company's liability is zero then the GNCC must adjust its receivables on the claim to zero. The GNCC should increase its allowance for doubtful debts to ₦508,000.00 because the debtor's bankruptcy is indicative of a financial condition that existed at the end of the reporting period as this is an adjusting event.

iii. The ₦900,000.00 will be treated as a bad debt in the current year and ₦60,000 as an adjusting event in the previous year Financial Statements.

**EXAMINER’S REPORT**

The question tests candidates’ ability to distinguish between reporting date and authorization date and also to distinguish between adjusting and non-adjusting events.

Candidates understood the question and many attempted it, but performance was below average. Candidates’ commonest pitfall was their inability to express themselves on paper and distinguish between reporting date and authorization date. Also evident was the candidates’ poor understanding of post balance sheet events and their treatment in the accounts.

Candidates are advised to have indepth knowledge of all International Public Sector Accounting Standards for future examinations.
SECTION C

SOLUTION 5

a. **Market Failure**

This is the concept used to describe the situation in which the market is no longer efficient in its allocation of resources.

**Public goods**

These are goods which are collectively consumed, non-rival in consumption and not subject to the exclusion principle. Examples include roads, national defence, street lights etc.

b. **Validity of the Statement**

i. A developing economy like Nigeria has a market structure that is grossly imperfect - a market structure that cannot guarantee optimal social allocation condition.

ii. There are many situations which lead to market failure in developing economies. These are collective consumption goods (public goods), externalities not taken into account by the market system, cases of imperfect knowledge and immobility of factors of production.

iii. Public goods, characteristically, give rise to some externalities; both positive and negative, which tend to undermine the efficiency of the market mechanism and thus, provide justification for governmental intervention. Such externalities include noise, litter, or pollution which are negative. On the positive side are the spillover effects of education, health expenditure, road construction projects, etc

iv. Income distribution obtained via the market is in many cases, unequal, especially in developing nations, including Nigeria. Governmental action is therefore required to redress the gaps between incomes.

All the foregoing points border on market failure and public goods provision which largely underscore the economic rationale for the intervention of the government in the economy.
EXAMINER’S REPORT

The question tests candidates’ understanding of the economic bases for governmental intervention in the economy. The requirements of the question involve the explanation of “market failure” and “public goods”. Also, the two concepts and the claim in the statement of the question are to be examined in the context of a developing nation like Nigeria.

Few candidates attempted the question and the general performance was poor. There was apparent lack of understanding of the question and hence the inappropriate responses to the requirements of the question.

The concepts of “market failure” and “public goods” require specialised knowledge in the area of Public Finance. Hence, it is needful for candidates to be familiar with these concepts and be able to use them to justify governmental intervention.

Standard textbooks on Public Finance and the Institute’s Study Pack should be consulted for requisite information and understanding of this aspect of the syllabus.

SOLUTION 6

(a) Public debt, which refers to the total outstanding debt obligation or accumulated borrowing of the Federal Government. It is usually categorized into domestic and external public debts.

Domestic public debt refers to the total money owed by the Federal Government to its local obligatees.

The sources of Nigeria’s domestic public debt include the Central Bank of Nigeria (CBN), commercial banks (or deposit money banks), and non-bank public such as insurance companies, saving institutions, state and local governments and individuals.

Domestic debt is procured through instruments such as Treasury Bills, Treasury Certificates as well as Government Development Stocks.

External Public Debt on the other hand, refers to the money owed by the government to overseas governments, institutions and residents.
The external sources of Nigerian’s public debt has been identified as Paris Club of Creditors, London Club of Creditors, Multilateral creditors, Promissory Note Creditors, and Bilateral and private sector creditors.

The external public debt of Nigeria has been classified into four types:

Trade arrears, balance of payments support loan, project-tied loans and loans for socio-economic needs.

(b) Debt Restructuring is a mechanism for reducing a country’s debt burden through such strategies as:

i. Debt refinancing arrangement - procuring a new loan on more concessional terms to repay an existing loan.
ii. Debt rescheduling - changing the maturity structure of a loan.
iii. Debt buy-back offering a substantial discount to pay off an existing debt.
iv. Debt conversion e.g. debt for equity swap etc.

EXAMINER’S REPORT

The question tests candidates’ understanding of debt obligations of a nation in terms of the two broad sources: domestic and external public debts. Candidates are also expected to provide proposals on a debt restructuring method as a strategy for debt management in Nigeria.

Virtually all the candidates attempted the question while the pass rate was below average. Candidates’ responses to the question were inadequate and lacking in depth. The focus of the second aspect of the question is specific on a “debt restructuring method” which many of the candidates failed to recognize. Rather their answers were somehow general with debt proposals that have nothing to do with debt restructuring.

Candidates are advised to have an in-depth understanding of sources of debt obligations and the specific elements and proposals on debt restructuring method.
To have familiarity with this type of debt management strategy, candidates are advised to consult Central Bank of Nigeria (CBN) publications and the Study Pack of the Institute.

**SOLUTION 7**

<table>
<thead>
<tr>
<th>Year</th>
<th>D/F</th>
<th>Project A</th>
<th>Project B</th>
<th>Project C</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>100%</td>
<td>Cash Flow</td>
<td>Cash Flow</td>
<td>Cash Flow</td>
</tr>
<tr>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>0</td>
<td>1</td>
<td>(200,000)</td>
<td>(200,000)</td>
<td>(200,000)</td>
</tr>
<tr>
<td>1</td>
<td>0.9091</td>
<td>218,000</td>
<td>198,184</td>
<td>-</td>
</tr>
<tr>
<td>2</td>
<td>0.8264</td>
<td>-</td>
<td>250,000</td>
<td>206,600</td>
</tr>
<tr>
<td>NPV</td>
<td>(1,818)</td>
<td>6,600</td>
<td>9,914</td>
<td></td>
</tr>
</tbody>
</table>

**Project A** - The negative NPV indicates that the project would fail to make the expected return of 10%.

**Project B** - The positive NPV indicates that the project will earn more than the required rate of return of 10%.

**Project C**: The positive NPV indicates that the project will earn more than the required rate of return of 10%.

**Conclusion**: Project B has an NPV of N6,600 while project C has NPV of N9,914 both positive. Project C should be undertaken because it has a higher positive NPV.

b. The main features of cost-benefits analysis in Public Project Appraisal include:
   i. It is a methodology or rational choice involving public programme decisions.
   ii. It is an analytical tool in decision-making requiring a systematic identification and comparison of the possible benefits and costs associated with a project.
   iii. It is a monetary valuation exercise requiring the estimation in money terms, the cost of undertaking a project and the value and benefits that could accrue from the operation of such projects.
iv. It is a methodology that involves discounting of costs and benefits of public projects that usually have longer life spans.

v. For a public project appraisal, the methodology of Cost-Benefit Analysis (CBA) requires the use of a social discount rate as opposed to private discount rate in the process of valuing time preference of streams of benefits and related costs of a project of public concern.

EXAMINER’S REPORT

The question tests candidates’ understanding of project appraisal and selection based on the criterion of the Net Present Value (NPV) concepts. Candidates are also expected to demonstrate their understanding of the features of Cost-Benefit Analysis (CBA) in public project appraisal.

Many candidates attempted the question and the performance was average. Many of the candidates lost marks for neglecting the discounting factor in the appraisal of the three projects. Also, their knowledge of the methodology of CBA in project appraisal lacks depth.

Candidates are advised to have a deep understanding of the technique of CBA in project selection and the essence of discounting factor in the exercise. The Pathfinders and Study Pack of the Institute contain relevant information on the subject matter of CBA from which candidates could learn.
SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

ROC Company Plc. manufactures aluminium (stainless) household equipment. Its plant is located by Alobe river, which is the source of water for the community. The company currently has the largest share of the market on the West African Coast and plans to expand its operations to East African and South African markets.

At the 26th Annual General Meeting (AGM), shareholders approved the appointment of Adeola & Partners as External Auditors to the company. The Managing Partner of Adeola & Partners, Sir Segun Adeola, is a nephew of the Managing Director of ROC Company Plc. The appointment of Adeola & Partners as External Auditors to ROC Company was facilitated by the Managing Director, who did not disclose his relationship with Sir Segun Adeola to the company’s board.

At a recent board meeting, the Managing Director of ROC expressed concern that so much resources were expended towards satisfying the interest of the community at the expense of the company’s shareholders. According to him, shareholders are the primary stakeholders of the company and their interest should be given the highest priority. He further opined that although other stakeholders are important to the company but only to the extent that ROC needs them. Consequently, the board resolved that henceforth, the company should not spend more than 0.5% of its Profit After Tax (PAT) on other stakeholders.

At the peak of the company’s production cycle, one of its underground waste tanks ruptured, and a large quantity of chemical waste leaked into Alobe river. This led to the destruction of aquatic life and contamination of neighbouring farmlands. This catastrophic event devastated the community as many farmers and fishermen lost their sources of livelihood. The community’s major source of drinking water was also contaminated.
The leadership of Alobe River Community Association approached the management of ROC Company Plc; and requested them to pay huge sums as compensation to the affected people and also to construct ten bore holes for the community. The management, however, informed the community leaders that based on the resolution of their board, expenditure on the issue would be limited to only 0.5% of profit after tax at the end of the year which was projected to be far less than the amount of compensation demanded by the community. As a result, all discussions with the leadership of the community broke down.

The youths of the community responded with a sit-in protest, leading to a blockade of the company’s gate and disruption of its operations. The board of the company is now seeking immediate and amicable resolution of this problem.

While this was going on, the company suffered a major fire outbreak in its second factory, destroying its main furnace, machines and large quantity of its finished goods. Some of the workers were severely burnt, while attempting to put out the fire at the factory’s major warehouse. This event culminated in production shut down at the second factory and temporary disengagement of several skilled workers as well as some casual staff. Fortunately, the company is covered by comprehensive fire and workers compensation insurance policies with Nagode Risk and Life Assurance Plc.

**Required:**

a. As a Strategic Risk Consultant of ROC Company Plc. you are to evaluate the adequacy of the risk management processes, including its information and communication systems. (8 Marks)

b. Evaluate the company’s residual risks in contrast to the management’s risk appetite. (7 Marks)

c. Using the stakeholders theory, evaluate the Managing Director’s position. Are there other stakeholders important to the company? (9 Marks)

d. Identify and discuss the ethical issues involved in the scenario described above. (6 Marks)

(Total 30 Marks)
SECTION B: ATTEMPT ANY TWO OUT OF THREE QUESTIONS (40 Marks)

QUESTION 2

In January 2014, Mr. Uzodike Okoh, the Managing Director of DEF Oil Mills Limited, constituted a Strategic Planning Committee to coordinate the development of a five-year strategic plan for the company. This is the first time a formal strategic plan is being attempted in the company.

After several meetings of the Strategic Planning Committee, Mr. Ibrahim Edoro, the Chairman of the Strategic Planning Committee, presented what he described as a roadmap to actualize the objectives of the company. Several sub-committees were constituted to work on different aspects of the strategic plan.

Mrs. Edwards is the Chairperson of the sub-committee assigned to articulate and draw up the mission statement of the company. The Chairman of the Strategic Planning Committee took particular interest in the work of this sub-committee because, according to him, an appropriate mission statement would set the tone of the strategic plan, galvanise energies of the entire workforce and set a clear direction for the company.

At the first meeting of the mission statement’s sub-committee, Mrs. Edwards distributed working papers, which included the history of the company. Speeches delivered by the pioneer Managing Director on different occasions and mission statements of similar companies were also provided.

The next meeting of the sub-committee was a brainstorming session in which participants were asked to identify the key elements that should be incorporated into the mission statement of the company.

Required:

As a member of the sub-committee on mission statement, identify and explain any FIVE elements which may be incorporated into the mission statement of the company. (20 Marks)
QUESTION 3

Universal Food Processing Company Plc. is a company in Nigeria engaged in the production of food products and confectioneries. Some of the products are cocoa beverages, candy, food seasoning and biscuits. Since inception, the company sources most of its raw materials locally and from a West African country. It currently produces 10 different products from different production facilities. The company is also structured along functional lines.

As part of its corporate strategy to consolidate and improve on its competitive position, the Board of Directors has resolved to integrate backwards. This, according to Board members, has become necessary due to current challenges encountered with its suppliers of cocoa, the most important raw material that the company uses. Due to the Ebola outbreak, supplies from other West African sources have become erratic.

This situation, coupled with activities of competitors, has drastically reduced the volume of supplies of cocoa from local suppliers. In order to address this issue, the company decided to set up cocoa plantations and a cocoa processing plant in Western Nigeria.

To effectively implement this strategy, the management of the company also decided to redesign its organisational structure to support the backward integration strategy and improve organisational effectiveness.

**Required:**

a. Identify and explain the types of organisational structures that Universal Food Processing Company Plc. can adopt. (10 Marks)

b. Advise the company on which of the organisational structures identified will best suit its new strategy, giving reasons for your advice. (10 Marks)

(Total 20 Marks)
QUESTION 4

Orgamed Mining Company is located close to Erin river in Owode town and it has over 4,000 workers on its payroll, 1,250 of whom come from the town. Since the company started its operations 5 years ago, the town has witnessed considerable development in infrastructure such as hospitals, schools and electricity. Before commencement of operations of Orgamed Mining Company, Erin river had served as the main source of livelihood for the natives, most of whom are fishermen. A thriving fish market and small scale industries had emerged from the fishing activities. A few neighbouring towns also depend on water from Erin river for domestic activities.

Lately, chemical pollution from the company's mining activities has become a threat to the survival of fish in the river. Marine experts have pointed out that within the next three years, all the fish and other living organisms in Erin river would be dead as waste water from the mining operations containing sulphuric acid, iron and sulphate particles are lethal to most organisms living within the aquatic environment. There is also a record of health hazards in the neighbouring towns which have been traced to the water from Erin river finding its way into these towns' water supplies.

When delegates from Owode town and the affected neighbouring towns met with the management of Orgamed Mining Company to discuss this problem of water pollution, it became evident that the costs of controlling the pollution will have significant consequences on the operations of the company. One of these is that there would be a reduction of over 50% of the work force, and to put Erin river back to its normal state, would require closing down the mines.

Required:

a. Explain the forms of accounting that would be applicable to the situation described above. (6 Marks)

b. How would you advise the management of Orgamed to minimise its social costs and liabilities? (8 Marks)

c. Using the idea of retributive justice and the utilitarian approach, explain why Orgamed Mining Company should bear the costs of the water pollution. (6 Marks)

(Total 20 Marks)
SECTION C: ATTEMPT ANY TWO OUT OF THREE QUESTIONS (30 MARKS)

QUESTION 5

Hi-tech Industries Limited is a leading manufacturer of computers and mobile phones in the country. The company is considering the implementation of low-costs differentiation and innovation strategies aimed at sustaining and improving its competitive position. Hi-tech plans to make its flagship product, Zeta Phone, the mobile phone of choice, offering innovative and cutting-edge technology to its consumers.

For the company to transform into an innovative organisation as the business strategy requires, it must employ staff workgroups with highly skilled, innovative and energetic people who can bring life to new ideas quickly and inject same into the organisation.

A skills audit recently conducted by the company showed that the company does not have enough staff that possess those qualities. In order to address this deficit, the management decided to train existing staff, employ and retain the best candidates that the labour market can offer.

Required:

Formulate strategies that Hi-Tech Industries may adopt in its policy for employment and retention of human resources.

(15 Marks)

QUESTION 6

Gloria Okeke is the Chairman and Chief Executive Officer of Magi and Magi Pharmaceuticals, which produces drugs for the Lagoona region of the country. Gloria is convinced that the company is doing quite well and the management is following due process in terms of structure and governance. She believes that this is the reason for the company’s steady growth in terms of revenue, profit and earnings.

In 2013, Magi and Magi Pharmaceuticals made a profit of 70% over and above the 2012 results. Mr. Joeb, the Chief Accountant, is quite impressed and is of the opinion that the company should make full disclosure of its profits in the Financial Statements, thinking this would engender greater confidence and attract additional investment in the company.
However, Gloria, claiming to be the boss, instructed Joeb to increase her compensation and inflate the cost of production of Pharmaceutical drugs with a view to reducing the disclosed profit of the company.

Joeb outrightly disagreed with Gloria’s instruction, giving her a long talk about his duty to comply with his Institute’s professional rules of conduct. However, Gloria cut short the meeting saying that she did not wish to entertain any further discussion about her decision. She advised Joeb, in his own interest, to implement her instructions.

Required:

a. As a chartered accountant, specify any THREE categories of stakeholders that Joeb should consider in taking any professional decision or action with regard to the instruction stated above and give reasons for your choice. (7½ Marks)

b. Discuss the basic principles of ethics that Joeb, as a chartered accountant, should comply with in the course of carrying out his professional responsibilities. (7½ Marks)

(Total 15 Marks)

QUESTION 7

EXPEE CONSTRUCTION PLC.

Expee Construction Plc. has been awarded a contract to construct a 50 kilometer feeder road from Abekoko to Idi Magoro by Adatan State. Unfortunately, the company’s earth moving machine (bulldozer) suffered a major mechanical fault, making it impossible to mobilize to site for execution of the contract.

Similar machines are not available for sale in the open market. Management is therefore considering the option of either importing a new machine from Japan or leasing one from Odogunyan Machines Limited located in Eko-Akete. The lease may be a finance or operating lease; either option would release the machine to the lessee for immediate use. Management decision on this choice is dependent on its willingness to either retain or transfer the risks involved in the usage of the machine.
You are required to:

a. Evaluate the risk exposure of the company in adopting the import option. (5 Marks)

b. Identify and formulate strategies that might be used by the company in managing:

i. The finance lease option (5 Marks)

ii. The operating lease option (5 Marks)

(Total 15 Marks)

SECTION A:

SOLUTION 1

(a) ROC Company Plc; provisions against risk include:

i. Provision of 0.5% of its PAT for other stakeholders; and

ii. Comprehensive fire and workers compensation insurance policies. All these provisions are considered highly inadequate to mitigate risk/loss exposures experienced by the company.

Inspite of the above provisions against risks, ROC Company Plc. was still exposed to the following risks:

Leakage of chemical waste into the river;

- Pollution of community’s source of drinking water;
- Destruction of aquatic life; and
- Contamination of farmlands.

Fire outbreak which led to:

- Destruction of main furnace, machines and finished goods;
- Production shutdown;
- Burns suffered by employees; and
- Temporary disengagement of several skilled workers and some casual Staff.
The following suggested risk management processes would render the risk management system of ROC Company Plc. more adequate:

- Improved risk awareness in the company by all managers and employees, and the need to understand the company’s risk appetite while not losing focus of the main objective of higher profits;

- The need to put in place a systematic, planned and comprehensive processes of risk identification, assessment and measurement; and

- Identified risks should be prioritised with preventive and curative measures for controlling risks installed. These may include:
  - Introduction of staff to safety awareness and safety consciousness principles;
  - Provision of training and re-training for personnel on safety and safety procedures;
  - Regular monitoring and maintenance of fire fighting equipments;
  - Installation of fire fighting equipment such as automatic sprinkler system that promptly extinguishes fire and the maintenance of a mini-fire station;
  - Location of the warehouse far apart from the factory;
  - Regular physical inspection and maintenance of the underground waste tank in order to detect fault on time;
  - Installation of waste and sewage disposal system; and
  - Timely and regular communication between the community and the company. Dialogue should be encouraged in order to avoid conflict which may invariably lead to production shut down.

iii. Efficient system of communication of information about risks and their management to employees managers, and board of directors;

i. Generation and evaluation of alternative risk management strategies in order to ascertain their costs/ benefits;

ii. Selection and implementation of risk management strategies that would allow the enterprise to achieve their set-out objectives such as higher profits, market share, corporate social responsibility, employee’s welfare and growth; and
iii. Monitoring of risk management strategies and risks with a view to attaining strategic objectives within acceptable level of risks. ROC Company Plc., should put in place a procedure to monitor its strategic objectives.

b. The company’s residual risk is the remaining exposure to risk after control measures have been taken. The residual risks are too high for the company and these include:

   i. Production shutdown;
   ii. Physical injury of employees;
   iii. Temporary disengagement of employees;
   iv. Destruction of farmlands and aquatic life;
   v. Pollution of community’s source of drinking water;
   vi. Demand for compensation by the community;
   vii. Disruption of operations by the youths of the community; and
   viii. Loss of means of livelihood by farmers and fishermen

Management’s risk appetite, as approved by the board, is 0.5% of ROC Company Plc.’ profit after tax.

Since the amount of compensation demanded by the community is higher than the company’s limits, it means that the company’s risk appetite is far below what is needed in the type of business it is engaged in.

c. The stakeholder’s theory identifies and models the groups constituting the stakeholders of a company. It also describes and recommends methods by which management may give due regard to the interests of these groups. In a corporate context, a stakeholder is therefore a person who affects or can be affected by the company’s actions.

In this context, the MD/CEO’s comments with regard to the interest of stakeholders are incorrect. This is because the operations of ROC Company Plc. do not affect shareholders only, but also other stakeholders. The company needs to identify all stakeholders and seek to balance their interests in making its decision. No stakeholder interest should be ignored.
The company’s strategy should incorporate a robust risk appetite that supports the achievement of its objectives as well as the avoidance or reduction of loss exposures.

Other key stakeholders of the company apart from its shareholders are:

- Government
- Regulators
- Customers
- Suppliers
- Local Community
- Taxpayers
- Employees
- Competitors
- Wholesalers/retailers
- Bankers
- Trade Unions

(d). Ethical issues involved in the scenario described above are:

i. **Familiarity Threat**: The appointment of Adeola & Partners as External Auditors is capable of generating familiarity threat because Sir Segun Adeola is a nephew of the Managing Director of ROC Company Plc.

ii. **Self-Interest Threat**: The relationship between the Managing Director and the External Auditors raises the issue of self-interest threat as the Managing Director may enjoy privileged information that he would use for his own personal advantage.

iii. **Auditors’ Independence Impairment**: The relationship between the MD/CEO and Sir Adeola compromises the independence of the auditors. The expected financial transparency, accountability and observance of a good corporate governance by management may be compromised at the detriment of the shareholders.

iv. **Corporate Governance**: Though at the 26th Annual General Meeting (AGM), shareholders approved the appointment of Adeola & Partners as External Auditors to the company, the Managing Director failed to disclose his relationship with the External Auditors. This is against the standards of good corporate governance.

v. **Corporate Responsibility**: Predetermined limit of 0.5% of its Profit After Tax (PAT) for other stakeholders is considered too low for Corporate Social Responsibility in order to avoid exposure of the company to various risks and conflicts.
EXAMINER’S REPORT

The question tests candidates’ skill of assessing risk management systems and processes in terms of their efficacy, ethical implications and impact on stakeholders. Being a compulsory question, all candidates attempted it but their performance was very poor. This was largely due to their inadequate understanding of core concepts in risk management systems and inability to carry out a proper evaluation of the risk management processes as required by the examiner.

Candidates are advised to have a detailed understanding of all issues and concepts relating to risk management systems. They should also develop the practical skill of evaluating these systems in order to identify their strengths and weaknesses and the alternative systems that are more viable.

SECTION B:

SOLUTION 2

The mission statement should include the following elements:

i. **Customer:** The organisation’s belief that its products would satisfy the needs of its customers;

ii. **Product:** The organisation’s belief that its products will be of high quality to meet the taste of its customers;

iii. **Market:** The organisation’s belief that it will meet the needs of the market better than its competitors;

iv. **Competitors:** The organisation’s belief that it will be a key player in the industry and a worldwide competitor in the business;

v. **Technology:** The organisation’s belief that the technology to be used in production will provide a product or service that is cost effective and quality competitive;

vi. **Concern for Survival:** In this respect, the company will conduct its operations prudently and profitably to ensure its survival and growth;
vii. **Philosophy:** That the organisation will operate the business ethically and with high moral values to achieve favourable public image;

viii. **Concern for Employees:** The organisation’s belief that employees are valuable assets of the organisation, that they should be treated fairly, given meaningful compensation and growth opportunities.

ix. **Concern for Shareholders:** The organisation’s belief that shareholders will be provided with adequate returns on their investment; and

x. **Concern for Public Image:** The company will be a responsible entity to the communities in which it operates and to the world at large.

**EXAMINER’S REPORT**

The question tests candidates’ ability to draw up the mission statement of a company. Most candidates attempted the question but performance was very poor. Their major pitfall was the inability to identify and explain the elements that are essential for a company’s mission statement to be adequate. The communication skill of many candidates was also found to be very poor.

Candidates are advised to pay attention to all aspects of the syllabus and sharpen their skills of applying basic theories and principles to practical situations. They should also endeavour to improve their communication skills.

**SOLUTION 3**

(a) Organisational structures describe the ways an organisation’s activities may be divided, grouped and coordinated. This would include the communication links between managers and employees, managers and managers. The following are various organisational structures from which Universal Food Processing Plc. can choose:

i. **Functional Organisation:** In this arrangement, individuals engaged in each functional activity such as production, marketing or finance are grouped together into one unit;
ii. **Divisional Structure**: This arrangement brings together in one work unit all those involved in the production and marketing of a product, a related group of products; all those in a particular line of activities or all those dealing with a certain type of customers or market segment; and

iii. **Matrix Organisation**: This is a hybrid system which combines the benefits of functional and divisional structures in two chains of command; vertical chain present with functional organisation structure and horizontal overlay as with product/market/divisional structure.

(b) From the given scenario, the most appropriate organisational structure for Universal Plc. is divisional structure. This is due to the following reasons:

i. As a multi-product manufacturing company with production facilities for 10 products, it will be more economical to operate a divisional structure with beverages and confectionaries as separate divisions. Similar production operations should be administered as a division. Each division will have finance and human resources units; and

ii. Backward Integration Strategy: It requires the adoption of divisional organisational structure. This will enable the plantation of Universal Plc. to be managed as a separate division.
EXAMINER’S REPORT

The question tests candidates’ knowledge of the different forms of organisational structures and their ability to identify the one that most suitable for the company in the given case.

Many of the candidates did not attempt the question and the performance of those who did was very poor. A major pitfall was their inability to identify and explain the existing types of organisational structure. They were also unable to identify the type of structure suitable for the company in the given case.

Candidates are advised to prepare very well for future examinations by reading all aspects of the syllabus and ensure that they develop appropriate practical skills. This would ensure better performance in future examinations.

SOLUTION 4

(a) Environmental Accounting: This is a field that identifies resource use, measures and communicates costs of a company’s or national economic impact on the environment. The two major forms of environmental accounting that are relevant to the scenario are: Environmental Management Accounting and Environmental Cost Accounting.

i. Environmental Management Accounting: This is the generation, analysis and use of financial and related non-financial information to support the management within a company or business. The production analysis and appropriate application of costing, financial and statistical data collected to assist an organisation or company proactively in managing its environmental issues diligently.

ii. Environmental Cost Accounting: This dimension of accounting states that costs should be accounted for by their specific causes. The technique directly allocates every environmental cost to its immediate cause or source such as pollution and refuse dump. Environmental Cost Accounting is to eliminate or at least reduce the arbitrary allocation of environmental overhead, so that the true cost of products or services may be ascertained.
(b) Social costs and liabilities can be minimised in the following ways:

i. Introduction and consolidation of the principles and practice of good corporate governance which carries with it great social responsibility and maximisation of stakeholders’ interests;

ii. Optimisation of production capacity in order to minimise environmental costs;

iii. Multi-disciplinary teams should have clear distribution of tasks and functions in order to provide a basis for determining environmental impacts and related costs;

iv. The nature of environmental costs should determine the capital investment assessment method;

v. The company should not violate laws on environmental management;

vi. The company should collaborate with government and non-government agencies on environmental matters; and

vii. Waste and effluent discharges should be minimised.

(c) i. Utilitarianism is an ethical theory which holds that an action is right if it produces or tends to produce the greatest amount of good for the greatest number of people affected by the action. Otherwise, the action is wrong.

If a firm pollutes the environment, its shareholders benefit because their firm does not have to absorb the external costs of pollution. The external costs of pollution are borne largely by the poor who are in the majority as we have in the scenario above.

Utilitarianism suggests that internalising the costs would rectify matters by removing the burdens of external costs from this large number of people and placing them in the hands of the company’s shareholders and customers.

The utilitarian claim that the external costs of pollution be internalized or borne by the firm is consistent with the requirements of retributive justice.
ii. Retributive justice requires that those who are responsible for, and benefit from, an injury should bear the burdens of rectifying the injury. This implies that the costs of pollution control in Owode town and its neighbourhoods should be borne by Orgamed that is responsible for the water pollution.

EXAMINER’S REPORT

The question examines candidates’ understanding of environmental accounting and its cognate ethical issues.

Many candidates attempted the question, but their performance was poor. A major problem was that candidates’ level of understanding of environmental accounting and relevant ethical issues was low. They were also unable to apply basic concepts and theories to real life situations.

Apart from paying attention to the demands of environmental accounting, candidates should also ensure that they develop the skills of applying their theoretical knowledge in practical contexts.

SECTION C:

SOLUTION 5

(a) EMPLOYMENT STRATEGIES

(i) Recruitment Strategy: Recruitment strategies are based on the organisation’s Human Resources Plan. Thus, there should be a well articulated plan stemming from the organisation’s mission. These include:

- Vision and Objectives: Hitech Industries Limited should, therefore, have a well articulated HR plan, detailing the objectives and projected HR need and how these needs would be met;
- Job Analysis: Job specification and job description of identified vacant positions at Hi-tech Industries Ltd. should be articulated;
- A statement should be made on whether to outsource recruitment and selection or carry out the recruitment process internally;
- Placing of recruitment advertisement in media that would reach candidates with needed qualities. They can use the internet, job boards, adverts in journals/publications of professional bodies, depending on candidates to be reached;

- For certain categories of workers, ‘head hunting’ might be required; and

- In the advertisements, project the image of the organisation as a company that promotes career progress, good working environment, competitive remuneration and welfare packages. This would attract the attention of the right people in the labour market.

(ii) **Selection**: The organisation should put in place selection strategies that will sift out the best candidates from others. Hi-tech should clearly spell out its selection criteria in terms of qualifications, competencies, analytical skills, creativity, experience and track record.

(b) **RETENTION STRATEGY**

The company may adopt the following strategies:

i. **Training and Development**: Periodic training and development programmes that would provide requisite knowledge, skills and attitudes for current and future tasks should be put in place;

ii. **Job Design**: Jobs should be designed so that they are interesting, meaningful, challenging and provide opportunity to use a variety of skills;

iii. **Employee Involvement**: Employees should be encouraged to be creative and innovative, to challenge existing ways of doing things and offer better alternatives by submitting new ideas for new products or businesses. Progressive companies work hard at creating an environment in which ideas and suggestions come up from below rather than proceed from the top down. Employees are made to feel that their opinions count;
iv. **Reward System**: The executive should endeavour to attract and retain high-potential, high-performing employees with attractive salary packages, performance bonuses, stock options, equity ownership and other long-term incentives;

v. **Coaching**: Average performers should be coached to improve their skills and capabilities weeded out; under-performers and benchwarmers;

vi. **Work Environment**: A stimulating and engaging work environment should be fostered such that employees would consider the company a great place to work;

vii. **Employee Support**: This involves giving people the tools and equipment to get the job done; and

viii. **Career Plan**: Hi-tech Industries Limited should provide a system whereby career progress can be achieved by workers. The organisation should ensure that through an effective career progression strategy, employees can achieve their career goals while working for Hi-tech Industries Limited.

**EXAMINER’S REPORT**

The question tests candidates’ understanding of basic employment and retention strategies.

About half of the candidates attempted the question but performance was poor. Many candidates showed a lack of understanding of the question and of basic concepts in human resource management.

Candidates should ensure that they cover the syllabus adequately. They should also do their best to understand the demands of questions attempted.
(a) The categories of stakeholders that Joeb should consider in taking any professional decisions or actions cut across all the parties which are affected by the company’s operations. These include:

i. **The Board of Directors of the organisation**: They are the obvious key stakeholders. They provide the direction in which the organisation progresses;

ii. **The employees**: They who carry out the day-to-day activities of the company. If the company progresses in terms of profit, they would enjoy more benefits and a good working environment;

iii. **The shareholders**: These are the stakeholders who have invested their money in the company. The higher the profit declared by the company the higher the dividend they expect to receive;

iv. **Government**: Government is also a stakeholder in the sense that the more the profit declared by the company, the more the tax revenue accruable to government;

v. **Community/Society**: The community consists of the city/town/village in which the company is located. The community is directly affected when the company is profitable because the company is able to employ more people and provide amenities for the community. The general society also experiences prosperity, arising from the profitability of the company;

vi. **Creditors Group**: The group includes trade creditors, short and long term loan providers. They are primarily interested in the profitability, continuous liquidity and viability of the business before investing their resources; and

vii. **Analyst/Adviser Group**: The group is a collection of experts who advise stakeholders. Such as trade unions, government statisticians and others on the performance of various establishments.

Conclusion: It would be unethical to sideline any of these groups of people at the expense of just one person, Gloria Okeke.

(b) The basic principles of ethics that Mr. Joeb should abide by in carrying out his professional responsibilities are:
i. **Integrity:** A chartered accountant should be straightforward and honest in all professional and business relationships. Integrity is about honesty; hence Joeb should not be involved in the manipulation the financial statements as suggested by Gloria Okeke in order to ensure fair dealing and truthfulness;

ii. **Objectivity:** Mr. Joeb should be in a state of mind that does not allow undue influence by Okeke to change the financial statements of the company;

iii. **Professional Competence and Due Care:** As a chartered accountant, Mr. Joeb has a duty to maintain professional knowledge and skill at the level required. He should act diligently and in accordance with all applicable technical and professional standards; and

iv. **Professional Behaviour:** A chartered accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession. Manipulating the books will amount to an action that discredits the accounting profession.

**EXAMINER'S REPORT**

The question tests candidates’ understanding of the core ethical issues and principles that accountants should adhere to in taking professional decisions.

Most of the candidates attempted the question and performance was average. A major problem was that many of the candidates misinterpreted the demands of the question. They were also unable to identify and discuss relevant principles of ethics.

Candidates are advised to read questions carefully. They should also endeavour to understand the various ethical issues and principles that underpin the accounting profession.
EXPEE CONSTRUCTION PLC

(a) When an organisation is operating in more than one country, it is exposed to systemic risk. This is different from a company that is just importing an input for use in the organisation operating locally. Nevertheless, it is exposed to business risks which include the following:

Input Price Risk: This could also be described as economic risk. Expee Construction Plc. is faced with this risk, if there is a change in the price of the earth moving machine between the time the need is expressed, all necessary formalities are completed and the order for the machine is placed. There can also be a change in the tariff, thus increasing its cost to the company;

Credit Risk: There is the potential risk that Expee management may not be able to obtain funds required for the purchase of the machine;

Liquidity Risk: This is the risk that the company may not be able to raise enough cash to purchase the equipment, since it is a mechanical fault that the company is not prepared for;

Currency Risk: Currency risk is otherwise referred to as exchange rate risk arising from the possibility of movements in foreign exchange rates, thus changing the value of one currency in relation to another; and

Technical Risk: The company may be faced with non-availability of expertise to maintain and repair the machine.

Since all the risks discussed above are unsystematic in nature, it is not controllable by management. Therefore they can be avoided.

The risk-control technique required for dealing with such business decision is avoidance.

Avoidance means that a loss exposure is never acquired, hence Expee Construction Plc. can avoid these accompanying risks by deciding to lease rather than import or purchase from abroad.
(b) **Lease:** A lease is a contract between a lessor and a lessee for the use of specific assets. In a lease agreement, the lessor retains ownership of the asset but conveys the right to the use of the asset to the lessee for an agreed period of time in return for the payment of specified rentals.

i. **FINANCE LEASE:**

In finance lease, the lessee is responsible for the upkeep, maintenance, servicing and insurance of the leased asset. All the risks and the reward incident to ownership are substantially transferred to the lessee and the title may or may not eventually be transferred at the end of the lease agreement. The substance of the transaction is the purchase of the asset by the lessee financed by a loan from the lessor.

A Finance-type leasing is a non-insurance transfer risk loss exposure management strategy. Expee Construction Plc. management need be concerned with maintenance, repairs or any damage/loss to the plant throughout its useful life. Equally, providing insurance cover for the machine is the responsibility of the lessor.

Strategies that may be used in finance lease option include the following:

- The machine is retained by the Expee Construction Plc at the end of the lease period;
- The lease period is substantially the same as the useful life of the machine;
- The risk and reward is that of the Lessee (Expee Construction Plc.); and
- The lessee is ready to use the machine immediately without any major modification.

ii. **OPERATING LEASE:** Unlike finance lease, operating lease is a lease agreement whereby the lessor is responsible for the upkeep, maintenance, servicing and insurance of the leased asset i.e. all risks and rewards incident to ownership are passed to the lessor.

In other words, operating lease embeds operating risk with usage of the plant. The assets is passed to the lessor at the end of its useful life. From the lessees’ perspective, it confers the merit of providing for cancellation of the contract at short-notice, perhaps, when the lessee’s liquidity has
improved to necessitate the purchase of a new one, or a change in its operation necessitating relinquishing the asset.

Strategies that may be used in operating lease option:

- risk and reward relating to the machine rest with the lessor;
- This is appropriate in a situation where Expee Construction Plc. does not want the machine to appear as an asset in its books;
- Where the machine is to be temporarily used by the company; and
- Ownership of the machine is not expected to be transferred at the end of the lease period.

EXAMINER’S REPORT

The question examines candidates’ practical understanding of the concept of risk exposure and some of the lease options that may be adopted in managing business risks.

Many candidates attempted the question and their general performance was poor. Their commonest pitfall was the inability to discuss the strategies for both finance and operating leases.

Apart from having a good understanding of the concepts of risk exposure and lease options, candidates should also ensure that they improve on their skills for evaluating and formulating risk management strategies.